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on significant distortions in the economy of the Russian Federation for the purposes of trade defence investigations

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1 INTRODUCTION

This report has been prepared by the Commission Services[1] for the purposes of point (c) of Article 2 (6a) of Regulation (EU) 2016/1036 of the European Parliament and the Council of 8 June 2016 on protection against dumped imports from countries not members of the European Union, ('Basic Regulation' or 'Regulation').

Point (c) stipulates:

> *(c) Where the Commission has well-founded indications of the possible existence of significant distortions as referred to in point (b) in a certain country or a certain sector in that country, and where appropriate for the effective application of this Regulation, the Commission shall produce, make public and regularly update a report describing the market circumstances referred to in point (b) in that country or sector. Such reports and the evidence on which they are based shall be placed on the file of any investigation relating to that country or sector. Interested parties shall have ample opportunity to rebut, supplement, comment or rely on the report and the evidence on which it is based in each investigation in which such report or evidence is used. In assessing the existence of significant distortions, the Commission shall take into account all the relevant evidence that is on the investigation file.*

The Basic Regulation defines in point (b) of Article 2(6a) significant distortions as follows:

> *(b) Significant distortions are those distortions which occur when reported prices or costs, including the costs of raw materials and energy, are not the result of free market forces because they are affected by substantial government intervention. In assessing the existence of significant distortions regard shall be had, inter alia, to the potential impact of one or more of the following elements:*
>
> - *The market in question being served to a significant extent by enterprises which operate under the ownership, control or policy supervision or guidance of the authorities of the exporting country;*
> - *State presence in firms allowing the State to interfere with respect to prices or costs;*
> - *Public policies or measures discriminating in favour of domestic suppliers or otherwise influencing free market forces;*
> - *The lack, discriminatory application or inadequate enforcement of bankruptcy, corporate or property laws;*

[1] On the basis of research and analysis carried out by a consortium of the following institutions: CASE - Center for Social and Economic Research (https://www.case-research.eu/en), Norwegian Institute of International Affairs (https://www.nupi.no/en) and LSE Consulting (http://www.lse.ac.uk/business-and-consultancy/consulting).

- *Wage costs being distorted;*
- *Access to finance granted by institutions which implement public policy objectives or otherwise not acting independently of the State.*

This report examines the existence of significant distortions in the Russian Federation ('Russia') that are relevant under the Basic Regulation. It comprehensively approaches this topic from three different angles.

The first part (Chapters 2 to 7) analyses the core features that give the Russian economy its current shape and structure and determine the way of its functioning. Chapter 2 examines formal and informal role of the Government with respect to resource allocation based on country's Constitution, basic economic legislation, Government strategies and plans and practice of their implementation. This overview is followed by in-depth analyses of financial sector (Chapter 3), state-owned enterprises (Chapter 4), public procurement (Chapter 5), Russia's trade arrangements and export-import regime (Chapter 6) and investment restrictions (Chapter 7).

The second part (Chapters 8 to 13) covers the various factors of production. It looks in detail into the functioning of the markets for land (including implementation of environmental standards - Chapter 8), capital (Chapter 9), energy (Chapter 10), transportation services (Chapter 11), raw materials and other material inputs (Chapter 12), as well as into labour (Chapter 13).

The third part of the report (Chapters 14 to 16) examines in-depth three selected sectors, namely steel (Chapter 14), aluminium (Chapter 15) and chemicals, including fertilisers (Chapter 16).

2 FORMAL AND INFORMAL ROLE OF GOVERNMENT WITH RESPECT TO RESOURCE ALLOCATION

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2.1 LEGAL FRAMEWORK

The Russian legal framework consists of:

- The Constitution [2] which is the supreme law throughout the territory of Russia (′Constitution′);
- International treaties to which Russia is a party;
- Federal Constitutional Laws (′FCL′), which are exclusively adopted on issues that are envisaged in the Constitution;[3]
- Codes which consolidate legislation in a particular area;
- Federal laws on the federal and joint competences;
- Decrees[4] and orders of the President;
- Decrees, resolutions and other acts[5] of the Government and other executive authorities of the State, implementing the Constitution and different laws;
- Regional laws and regulations, adopted by the subjects of the Federation (regions);
- Court decisions are not regarded as a source of law but those of the Constitutional Court are considered quasi-sources.[6]

The legal framework reflects historical developments after the dissolution of the Soviet Union and particularly the conflict between the executive and legislature branches, the set-up of the first stage of privatisation, as well as the balance of powers between the central and regional levels of government.[7] The main characteristics of the legal framework can be summarized as weak legal institutions with strong presidential power, high level of ownership concentration,

[2] The Constitution of the Russian Federation, adopted by popular vote 12 December 1993, (Конституция Российской Федерации, Принята всенародным голосованием 12 декабря 1993 г.), available at: http://www.ksrf.ru/en/INFO/LEGALBASES/CONSTITUTIONRF/Pages/default.aspx, accessed on 9 October 2019. Translation by Yuridicheskaya literatura publishing company. Note: Laws and other legal acts adopted in Russia may not contradict the Constitution.

[3] No official English translation of the Federal Constitutional Laws as well as of the codes is available.

[4] *Rus*. ука́з

[5] The difference between decree (*rus.* постановление) and resolution (*rus.* распоряжение) in Russian practice is that decrees have a wide scope of application and are not limited to time frames, the range of subjects are not strictly defined, therefore the effect of the decree applies to all residents of Russia, unless otherwise specified. Resolutions are always personalized and limited by a time frame and subject to immediate execution by persons or the Government bodies to which they pertain.

[6] Popova, A. V., Solovyev, L.S., Arnautovich, A. A. (2017), *UPDATE: A Guide to Legal Research in Russia*, *Hauser Global Law School Program*, New York University School of Law, Previously updated in by Popova, A. and Soloviev, L. S. in Aug. 2008; and by Popova, A. V. and Arnautovich, A. A. in Dec. 2013, Dec. 2014, and Mar. 2016, available at: http://www.nyulawglobal.org/globalex/Russia_Legal_Research1.html, accessed on 14 October 2019.

[7] See in particular two handbooks on the Russian legal and political system, published in 2013, identify the following Gill, G. J. and Young, J. (2013), *Routledge Handbook of Russian Politics and Society*, Routledge Ltd, available at: https://www.dawsonera.com:443/abstract/9780203804490, accessed on 14 October 2019; Alexeev, M., Weber, S. (2013), *The Oxford Handbook of the Russian Economy*, Oxford University Press, available at: https://doi.org/10.1093/oxfordhb/9780199759927.001.0001, accessed on 14 October 2019.

substantial state ownership of major companies (see Chapter 4), as well as expansion of the definition of strategic sectors (see Chapter 7).[8]

2.1.1 THE CONSTITUTION

The Constitution was adopted on 12 December 1993 after a national referendum, replacing the Soviet-era constitution of 1978 and reflecting the dissolution of the Soviet Union. According to Article 1 of the Constitution, Russia is a democratic federal state with a republican form of government, comprised of eighty-five[9] subjects – republics, territories, regions, cities of federal importance, autonomous region and autonomous areas (Article 5(1)).[10]

According to Articles 71-73 of the Constitution, the federal competencies include, among others: basic legal principles for the single market; financial, currency, credit and customs regulation; federal budget, federal taxes and levies, federal funds of regional development; power-engineering systems and nuclear power, foreign policy and foreign economic relations, defence and security, as well as the judiciary. Joint competences between the federal Government and the subjects are: minority rights, use of natural resources, protection of the environment and provisions for ecological safety, coordination of health care issues, as well as general issues of upbringing, education, science, culture, physical education and sport. Finally, regional competences include those areas not mentioned under federal or joint competence, such as local government and regional transport (Article71). While the Constitution provides for a federal structure and joint competences, secondary legislation,[11] most recently amended in 2018, has undermined the role of the subjects in relation to the federal level (see Section 2.2.1).

The Constitution sets out also the balance of powers between the different state authorities, which comprise:

- The President;
- The legislative branch: the Federal Assembly (consisting of the State Duma, the Lower Chamber,[12] and the Council of the Federation, the Upper Chamber);
- The executive branch: the Government and relevant executive authorities; and
- The judicial branch: the courts.

The Constitution established Russia as a Presidential Republic (Chapter 4, Article 80-93). The position of the President is rather unique, reflecting the historical development of state

[8] Enikolopov, R., Stepanov, S., (2013), Corporate Governance in Russia, *The Oxford Handbook of the Russian Economy*, available at: https://doi.org/10.1093/oxfordhb/9780199759927.013.0003, accessed on 14 October 2019.

[9] This number includes the illegally annexed subjects of Crimea and Sevastopol.

[10] All subjects listed are in Chapter 3, Art. 65 of the Constitution.

[11] *On the general principles of the organization of legislative (representative) and executive bodies of state power of the constituent entities of the Russian Federation (as amended on 27 December 2018) (revised from 8 January 2019)* (*Об общих принципах организации законодательных (представительных) и исполнительных органов государственной власти субъектов Российской Федерации (с изменениями на 3 августа 2018 года), Федеральный закон от 06 октября 1999 года №184-ФЗ'* (2018)), available at: http://docs.cntd.ru/document/901744603, accessed on 14 October 2019. Unofficial English translation: 2018.

[12] Consisting of 450 elected deputies.

governance in Russia. Thus, it is important to outline the different aspects of presidential power, i.e. those competences and prerogatives which are formally enshrined in the Constitution, as well as their modifications on the basis of various constitutional amendments.[13]

As a result of amendments to the Constitution in 2008, the President is elected for six years but cannot be elected for more than two terms (Article 81). The Constitution provides for a directly elected President, who appoints the prime minister after her/his confirmation by the State Duma. It should be noted that in January 2020, the Federal Assembly approved in a first reading the constitutional amendments put forward by the President which would result in weakening somewhat the powers of the President, while introducing further changes to various areas of the constitutional order.[14] Subsequently, in March 2020, the Federal Assembly approved an additional amendment to the Constitution which would allow the current President to run for another two terms.[15] The constitutional changes have been formally approved by the constitutional court in March 2020.[16] A national referendum foreseen originally for April 2020 was postponed due to the global pandemic crisis. The public vote eventually took place between 25 June and 1 July 2020 and, according to the official results, 77.92% of the voters supported the constitutional changes while 21.27% were against.[17] However, widespread irregularities of the public vote were reported,[18] with the Russian political opposition calling the voting not fair and the results not reflecting reality.[19] Nevertheless, the constitutional amendments entered into force on 4 July 2020.

The President also appoints the chairman of the Central Bank of Russia (Article 83). The President nominates the judges of the Supreme Court, based on the proposal of the chief justice of the Supreme Court,[20] as well as a candidate for the post of the prosecutor-general. Judges of the Constitutional Court and the Supreme Court are appointed by the Council of the Federation, upon the proposals of the President. Judges of other federal courts are appointed by the President (Article 128).

The President, both houses of the Federal Assembly, the Government, and the legislative organs of the subjects of the Federation can initiate legislation. The Constitutional Court and Supreme Court are also empowered with legislative initiative in their respective jurisdictions. According

[13] Burkhardt, F., (2017), The Institutionalization of Relative Advantage: Formal Institutions, Subconstitutional Presidential Powers, and the Rise of Authoritarian Politics in Russia, 1994–2012, *Post-Soviet Affairs* 33, no. 6: 472–95, available at: https://doi.org/10.1080/1060586X.2017.1388471, accessed on 14 October 2019.

[14] Granting additional competences to the Council of the Federations, guaranteeing miminum wages above the subsistence level etc. For more details, see for instance: https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/646168/EPRS_ATA(2020)646168_EN.pdf, accessed on 2 March 2020.

[15] For more details, see for instance: https://www.axios.com/vladimir-putin-russia-president-2036-constitutional-reform-0c43e800-3ac6-45e2-a87e-3835149e1280.html, accessed on 12 March 2019.

[16] See for instance: https://www.bloomberg.com/news/articles/2020-03-16/putin-s-play-to-stay-in-power-approved-by-constitutional-court, accessed on 24 April 2020.

[17] See for instance: https://tass.com/politics/1174507, accessed on 14 July 2020.

[18] See for instance: https://www.bbc.com/news/world-europe-53255964, accessed on 14 July 2020,

[19] See for instance: https://www.dw.com/en/russias-putin-wins-referendum-on-constitutional-reforms/a-54018337, accessed on 14 July 2020

[20] Law No. 3132-1 of 26 June 1992 "*on the Status of Judges*"; Supreme Court of the Russian Federation, available at: https://vsrf.ru/en/judicial_system/law_status_judges/, accessed on 20 March 2019.

to Articles 84 and 90, the President has unrestricted authority to issue decrees, edicts, and directives and to call referenda. These decrees are binding and have force of law unless they are specifically rescinded by the Federal Assembly or nullified by the Constitutional Court. Both chambers of the Federal Assembly also have the power to issue decrees within their respective policy areas. Additionally, the Constitution also gives the Government the power to issue decrees, resolutions and other acts on issues related to policy implementation. This results in multiple levels of complexity in terms of the legislative process and the arbitration of disputes between the executive and legislative branches of the State.

Article 7 of the Constitution establishes that Russia shall be a '*social state*' providing social security guarantees to its citizens. At the same time, the Constitution also has a number of elements highlighting Russia's break with Soviet-style policies and some provisions of the Constitution reject socialist economic norms. Indeed, Article 13(2) explicitly prohibits the adoption of a state ideology and the principles of a functioning market economy are set out in Articles 8 and 9:

> *Article 8*
> *1. In the Russian Federation guarantees shall be provided for the integrity of economic space, a free flow of goods, services and financial resources, support for competition, and the freedom of economic activity.*
> *2. In the Russian Federation recognition and equal protection shall be given to the private, state, municipal and other forms of ownership.*
>
> *Article 9*
> *1. Land and other natural resources shall be utilized and protected in the Russian Federation as the basis of life and activity of the people living in corresponding territories.*
> *2. Land and other natural resources may be subject to private, state, municipal and other forms of ownership.*

Article 8 explicitly provides for the free flow of goods, services, and capital, as well as support for competition, while Article 9(2) establishes the right to private ownership of land, but also allowing for the ownership of land and other natural resources by state and municipal authorities. The right of ownership is further confirmed in Chapter 2 of the Constitution, in particular in Articles 34 and 35 which uphold the rights to engage in entrepreneurial activity and to possess private property:

> *Article 34*
> *1. Everyone shall have the right to use freely his (her) abilities and property for entrepreneurial and other economic activity not prohibited by law.*
> *2. Economic activity aimed at monopolization and unfair competition shall not be permitted.*
>
> *Article 35*

1. The right of private property shall be protected by law.
2. Everyone shall have the right to have property, possess, use and dispose of it both personally and jointly with other people.
3. No one may be deprived of property otherwise than by a court decision. Forced confiscation of property for state needs may be carried out only on the proviso of preliminary and complete compensation.
4. The right of inheritance shall be guaranteed.

The Constitution thus provides for a democratic federal State with a republican form of government with key elements promoting a free market economy, rule of law, and division of power.

The Constitution has been amended several times since its adoption in 1993:

- The term of office of the President was increased from 4 to 6 years, and the term of office of the members of the State Duma from 4 to 5 years on 30 December 2008;[21]
- The judicial system was changed on 5 February 2014, where the Supreme Arbitrage Court[22] was abolished;[23]
- An amendment of 21 July 2014 gave the President the right to appoint up to 17 personal representatives (to regions or to federal branches of power) directly;
- As of 6 August 2014, the Supreme Court became the highest court for civil (including commercial), criminal, administrative, military, and other cases;
- Other amendments relate to changes in Russia's territorial composition. Most important amongst these was the amendment on 21 March 2014 to include the illegally annexed Republic of Crimea and City of federal importance Sevastopol in the Federation.[24]

From a comparative perspective, these changes can be seen as small in number and reflect somewhat the difficulties in amending the Constitution.[25] Instead, most changes in Russia's

[21] Constitution of the Russian Federation of 25 December 1993, with Amendments of 30 December 2008 (*Конституция Российской Федерации от 25 декабря 1993 года, с изменениями от 30 декабря 2008 года*), Federal Constitutional Laws N.º 6-7 of 30 December 2008), ROSSIISKAIA GAZETA, 21 January 2009, available at: http://www.rg.ru/2009/01/21/konstitucia-dok.html, accessed on 14 October 2019.

[22] Commercial disputes in Russia are resolved by a system of commercial ('*arbitrage*') courts, consisting of the federal arbitrage courts located in each subject of the Federation; 21 arbitrage appellate courts and 10 federal district arbitrage courts. In 2013, the Court for Intellectual Property Rights was set up within this system, focusing on disputes relating to intellectual property (including copyright, trademarks, and patents). With the dissolution of the Supreme Arbitrage Court in 2014, the Supreme Court of the Russian Federation became the top court for commercial disputes.

[23] Federal Constitutional Law No. 1 of 31 December 1996 "*on the Judicial System of the Russian Federation*", as amended (Федеральный Конституционный Закон От 31 Декабря 1996 г. N 1-ФКЗ "О Судебной Системе Российской Федерации" (с Изменениями и Дополнениями)), available at http://www.arbitr.ru/law/docs/10035300/10035300-001.htm, accessed on 14 October 2019.

[24] For all changes of the Constitution since 1991 see: Petersen, F., Levin, I (2016), The Russian Federation, in Fruhstorfer, A., Hein, M. (eds.) *Constitutional Politics in Central and Eastern Europe: From Post-Socialist Transition to the Reform of Political Systems*, pp.519–45, Vergleichende Politikwissenschaft, Wiesbaden, Springer Fachmedien Wiesbaden, available at: https://doi.org/10.1007/978-3-658-13762-5_21, accessed on 14 October 2019.

[25] Chapter 9 of the Constitution sets out the procedures for its amendment. In a historical context the multiple constitutional changes in 1992 and 1993 led the drafters to favour a more restrictive amendment procedure.

institutional framework and the expansion of Presidential power occur through subconstitutional means – such as federal law, Presidential decrees, and the rulings of the Constitutional Court.

Finally, the Federal Law on Political Parties[26] setting out the system how political parties are organized was amended several times. As a result of these amendments in 2001, 2003 and 2013, the Federal Law on Political Parties requires that parties: '*shall have regional branches in more than a half of the subjects of the Russian Federation*' and '*shall have at least five hundred party members*' (Article 3(2) and Article 23(6)). The requirement that a party shall have a branch in more than half of the subjects de facto abolished regional parties and thus strengthened national parties.[27] The changes have proved beneficial to creating a single dominant political party – United Russia.[28] Moreover, United Russia is defined by high centralisation and dominance at both federal and regional level, consolidating power centrally.

2.1.2 LAWS, STRATEGIES AND PLANS

2.1.2.1 RUSSIA'S CIVIL CODE

The central piece of legislation governing the essential rights of natural and legal persons, including the ownership rights and contractual obligations, is the Civil Code. [29,30] Article 1 sets out the overall framework governing the rights and responsibilities of citizens and legal entities and relations among legal entities on the territory of Russia:

> *Article 1. Chief Principles of the Civil Legislation*
> *1. The civil legislation shall be based on recognizing the equality of participants in the relationships regulated by it, the inviolability of property, the freedom of agreement, the inadmissibly of anybody's arbitrary interference into the private affairs, the necessity to freely exercise the civil rights, the guarantee of the*

Amendments to Chapter 1, Chapter 2, and Chapter 9 require a three-fifths vote of members of the Federation Council and the State Duma. As Smith explains (2013, p.75): "*A Constitutional Assembly is then convened and may amend the Constitution with a two-thirds vote or, alternatively, the amendment may be ratified by a national referendum. In the case of a referendum, the amendment requires that a majority of voters support the amendment and that more than half of all eligible voters participate in the referendum. Amendments to Chapters 3–8 require ratification by the legislative organs of at least two-thirds of the subjects of the Russian Federation*." Smith, G. B. (2013), The Russian Constitution, in Graeme J. Gill, G. J., Young, J. (eds.), *Routledge Handbook of Russian Politics and Society*, 75, Routledge Ltd, available at: https://www.dawsonera.com:443/abstract/9780203804490, accesed on14 October 2019.

[26] Federal Law N.º 95 of 11 July 2001, "*on Political Parties*", available at: http://host.uniroma3.it/progetti/cedir/cedir/Lex-doc/Ru_l_2001.pdf, accessed on 15 January 2020.

[27] Smyth, R., (2013), *Political Parties*, in Gill, G. J., and Young, J.(eds.), *Routledge Handbook of Russian Politics and Society*, 115, Routledge Ltd, available at: https://www.dawsonera.com:443/abstract/9780203804490, accessed on 14 October 2019.

[28] Remington, T. F. (2015), *Politics in Russia*, (7th Edition), New York: Routledge, available at: https://www.taylorfrancis.com/books/9781317345411, accessed on 14 October 2019.

[29] Unofficial English translation of the Civil Code. The website is maintained by the World Intellectual Property Organisation (WIPO), available at: www.wipo.int/wipolex/en/text.jsp?file_id=385284, accessed on 14 October 2019.

[30] According to the translation of the earlier version, available at: http://www.russian-civil-code.com/, accessed on 14 October 2019.

reinstatement of the civil rights in case of their violation, and their protection in the court.

2. The citizens (natural persons) and the legal entities shall acquire and exercise their civil rights of their own free will and in their own interest. They shall be free to establish their rights and duties on the basis of an agreement and to define any terms of the agreement, which are not in contradiction with legislation.

The civil rights may be restricted on the basis of the Federal Law and only to the extent, to which it shall be necessary for the purposes of protecting the foundations of the constitutional system, morality, the health, the rights and the lawful interests of other persons, of providing for the defence of the country and for the state security.

3. The commodities, services and financial means shall move unhindered throughout the entire territory of the Russian Federation. Restrictions on the movement of commodities and services shall be imposed in conformity with the Federal Law, if this is necessary to provide for security, and to protect the human life and health, the environment and the cultural benefits.

It is not necessary to examine the entirety of the Civil Code for the purposes of this report. However, individual chapters of this Report provide an analysis of the following elements of the Civil Code:

- Legislation relating to right of ownership and the other rights of estate in Chapter 8;
- Legislation relating to state-owned enterprises ('SOEs') is covered in Chapter 4;
- Legislation relating to investment and strategic sectors is covered in Chapter 7.

2.1.2.2 STRATEGIES AND PLANS

With the transition from command economy and the Soviet system, Russia has tried to improve its attractiveness for investment, focusing on reforms to simplify and clarify rules, set clear objectives, and promote administrative efficiency through Government plans and initiatives. Sector-specific strategies are addressed in the relevant chapters of this Report (see Chapter 7 on Investment and Chapter 10 on Energy). This chapter only lists those which define strategic sectors, new policy initiatives and/or those which triggered wider reforms.

In the early 2000s, the Government policy started shifting toward re-nationalization and state control of strategic sectors, as well as limiting the scope of the private sector, starting in 2003 by series of executive orders. Notably, the Presidential Decree No. 1009 established a list of enterprises and joint-stock companies deemed to be of strategic value and henceforth prohibited from being privatized.[31] These entities operated predominantly in the domains of natural resources, finance, defence, and technology. The Government also put in place special measures in the case of a possible bankruptcy in strategic enterprises.[32]

[31] Unofficial translation: Presidential Decree N.º 1009 of 4 August 2004 "*on Approval of the List of Strategic Enterprises and Strategic Joint Stock Companies*", as amended.

[32] *Ibidem*.

This was coupled with a series of initiatives directed at the promotion of inbound foreign direct investment. For example, the Agency for Strategic Initiatives ('ASI'), created in 2011, was entrusted with identifying and solving problems hindering the development of domestic and foreign-owned businesses in Russia.[33] Beyond the ASI's original mission,[34] annual meetings, predominantly chaired by the President, outline different initiatives, such as to strengthen the business environment in regions (e.g. meeting of 7 March 2018), to strengthen regional development overall (e.g. meeting of 26 July 2017[35]) or to create a roadmap for the development of competition (meeting of 22 November 2012). Additionally, a *100 step* program was launched in 2012 intended to improve business and investment conditions and followed by a series of roadmaps '*aimed at reducing barriers to the acquisition of construction permits by businesses, improving customs regulations, promoting exports from Russia, and providing more attractive investment climates for business in the Russian regions*'.[36] However, academic sources indicate that this proliferation of policy initiatives has not led to a more open and transparent governance.[37]

As part of a broader anti-crisis plan, the Government took a series of steps to move towards promotion of import substitution as well as industrial policy focusing on key sectors. The 2014 Federal Law on industrial policy[38] establishes a priority for industrial products produced in Russia when state-owned enterprises make their procurement decisions and gives the Government the right to require in purchasing contracts the development of production of industrial products in Russia.[39] Incentives provided under the industrial policy take different forms, including direct grants to infrastructure, tax breaks, and preferences in government procurement contracts. This is part of a series of laws, directed at Russia's import substitution policy (see Section 6.4 for more details).

[33] Kremlin (2012), *Meeting of the Agency for Strategic Initiatives Supervisory Board*, President of Russia, available at: http://en.kremlin.ru/events/president/transcripts/deliberations/16871/photos, accessed on 14 October 2019.

[34] *Agency for Strategic Initiatives*, (*Агентство стратегических инициатив)*, available at: https://asi.ru/eng/, accessed on 12 December 2018.

[35] Kremlin (2017), *Meeting of the Agency of Strategic Initiatives Supervisory Board*, President of Russia, available at: http://en.kremlin.ru/events/president/news/55132, accessed on 12 December 2019; Kremlin (2018), *ASI Supervisory Board Meeting*, President of Russia, available at: http://en.kremlin.ru/events/president/news/57008, accessed on 12 December 2019.

[36] Yukhanaev, A. et al., (2016), *Russian Institutional Development: Challenges to Inbound Investments and Implications for Government Policymakers*, 13, available at: https://www.researchgate.net/publication/293651881_Russian_institutional_development_challenges_to_inbound_investments_and_implications_for_government_policymakers, accessed on 15 January 2020; Yakovlev, A. A., (2011), *State-Business Relations in Russia in the 2000s: From the Capture Model to a Variety of Exchange Models?', SSRN Scholarly Paper*, Rochester, NY, Social Science Research Network, avaliable at: https://papers.ssrn.com/abstract=1868811, accessed on 14 October 2019.

[37] Yukhanaev et al., *Russian Institutional Development*, 13.

[38] Federal Law N.º 488-FZ of 31 December 2014, "*on Industrial Policy in the Russian Federation*".

[39] World Trade Organisation (2018), *Russian Federation – Measures Implementing Russia's Import Substitution Policy Questions from the United States for the Russian Federation Regarding the Rules for a Product to Qualify as "Made In Russia" for the Purposes of Purchases by an Entity Covered by Law N.º 223-Fz, Law N.º 249-Fz and/or Law N.º 488-Fz, 1*.

Most recently, in May 2018, the President's Executive Order on National Goals and Strategic Objectives of the Russian Federation through to 2024 ('National Goals') called for the development of a detailed plan aimed to: *'achieve a real breakthrough in the economy, infrastructure, technology, science and social matters – mainly, to ensure prosperity and a new quality of life for Russian citizens, an abundance of opportunities to fulfill one's potential for every person, and to generally strengthen the country's competitiveness and achieve leadership in the fields that will, without a doubt, define the future of Russia and the entire world'.* [40]

The relevance of the National Goals is that they set out requirements for the involvement of private enterprises in Government development plans. According to a meeting report of the Council for Strategic Development and National Projects [41] of 24 October 2018, it is '*mandatory*' for private companies to participate in '*state-owned companies' development projects*', considering that the '*the private sector [*is*] the most important partner of the State and society in the implementation of development plans'*.[42] In relation to this, the President has declared an expectation that the '*managers of VEB, Gazprom, Rostec, Rostelecom, Rosneft, Rosatom, and other corporations co-owned by the State to submit proposals on financial, technological, scientific and personnel contributions to breakthrough programmes and projects'*.[43]

2.2 Basic Features of the Russian Institutional Framework

2.2.1 Russian Federal and Regional Governement

Going beyond the legal framework, any analysis of the role of the Government with respect to resource allocation must consider the role of the institutional framework in which the Government and private actors operate. This is not only because, by definition, institutions are the fundamental determinants of resource allocation but also because the divergence of Russian institutions from the legal framework described above is a pervasive feature of the country's institutional landscape. While Russia has improved its rankings in recent years according to internationally recognized standings on the state of its economy, the reality on the ground in terms of overall investment climate, Government intervention, and institutional functioning

[40] Kremlin (2018), *Meeting of Council for Strategic Development and National Projects*, President of Russia, available at: http://en.kremlin.ru/events/president/news/58894, accessed on 12 December 2019.

[41] According to the website of the President, the "*Council for Strategic Development and National Projects is a Presidential advisory body that was established to facilitate cooperation between government bodies at the federal, regional and local levels, and public associations, scientific and other organisations in discussing issues pertaining to the strategic development of the Russian Federation and the implementation of national projects and programmes in the main areas of strategic development of the Russian Federation*", the meeting was attended by the President, Prime Minister, Deputy Prime Minister and Finance Minister, President of the Russian Academy of Sciences, Central Bank Governor and Accounts Chamber Chairman, as well as Russian companies.

[42] Kremlin (2018), *Meeting of Council for Strategic Development and National Projects*, President of Russia, available at: http://en.kremlin.ru/events/president/news/58894**,** accessed 2 December 2019.

[43] *Ibidem*.

tells a more nuanced story. In 2018 and 2019 World Bank's Doing Business index[44] ranked Russia 76.76/100 and 77.37/100, respectively, on the ease of doing business score.[45] It further ranked Moscow and Saint Petersburg separately, Moscow ranking 77.05 and 77.59 while Saint Petersburg 76.1 and 76.85 in 2018 and 2019, respectively.[46]

The institutional environment – and subsequently the extent of Russian governmental involvement in the economy – is conditioned by Russia's political institutions, both formal and informal. In terms of formal political institutions, the Federal Government is often both the starting and ending point for understanding overall state involvement in the economy, due to the extreme centralization of decision-making which occurred in the early to mid-2000s. The administrative reforms of 2004 in particular, while formally aimed at streamlining competencies and making decision-making clearer, have led to a growth in the number of ministries and competencies taken on by the central Government, with a corresponding increase in the costs and needs of the State, as well as more power to reach into the economy. Administrative reforms since 2004 have been done in a haphazard yet expansive manner, uncoordinated by any central body and further reinforcing the silo mentality across ministries (which was a holdover from Soviet and pre-Soviet times). In this sense, changes in the state's involvement in the economy have either been done piecemeal on the initiative of specific ministries (and without coordination across Government) or as a centralized directive from the Kremlin.[47]

This approach has been further hampered by the reality that bureaucratic quality across the Russian government has remained low: according to the International Country Risk Guide ('ICRG')[48] indicator of '*bureaucratic quality*', at the national level, Russia has scored only 1 out of 4 (the lowest score possible) since August 1997 (prior to this, it scored a 2). Finally, certain key ministries driving Russia's institutional development have been steadily growing in power within the governmental apparatus and, subsequently, increasing their ability to intervene in the economy. The Federal Security Service ('FSB'), the Ministry of Defence, the

[44] The World Bank (2018), *Doing Business 2019 : Training for Reform - Russian Federation*, 4, available at: http://documents.worldbank.org/curated/en/488861542035207773/Doing-Business-2019-Training-for-Reform-Russian-Federation, accessed 14 October 2019.

[45] According to the WB guidance, the ease of doing business score reflects "the gap of each economy from the best regulatory performance observed on each of the indicators across all economies in the sample since 2005. An economy's ease of doing business score is reflected on a scale from 0 to 100, where 0 represents the lowest and 100 represents the best performance. The ease of doing business ranking ranges from 1 to 190." World Bank (2019), *Doing Business 2019. Economy Profile: Russian Federation*.

[46] The World Bank (2019), *Score-Ranking*, available at: http://www.doingbusiness.org/en/data/doing-business-score, accessed 25 March 2019.

[47] For a Russian perspective on these reforms, see Osipov, V. S., Skryl, T. V., Blinova, E. A., Kosov, M. E., Zeldner, A. G., & Alekseev, A. N. (2017), *Institutional Analysis of Public Administration System*, *International Journal of Applied Business and Economic Research*, 15(15), p. 193-203. In terms of the numbers, central Government debt in Russia has skyrocketed to 14.15% of GDP in 2016 (latest year available) from a low of 6.5% of GDP in 2008 (according to the World Bank). While Government expenditure was 18% of GDP in 2017, roughly on par with the level it had in 2013, absolute levels of Government spending tripled from 2003 to 2017, according to the Federal State Statistics Service.

[48] The PRS Group (2019), *International Country Risk Guide Annual Publication*. All variable definitions available at: https://epub.prsgroup.com/list-of-all-variable-definitions, accessed 14 October 2019.

Ministry of Extraordinary Situations (also known as the ′Ministry of Emergency Situations′), The Ministry of Industry and Trade (referred to sometimes as ′MinPromTorg′) and the Justice Ministry have played a disproportionate role in Russian governance over the past decade, adapting the traditions of the '*uniformed services*' towards both public administration and management of the economy.[49] By contrast, the main economic policymaking Ministries (the Ministry of Finance, the Ministry of Economic Development) and the Central Bank of the Russian Federation (′CBRF′) have been relegated towards more technocratic roles in ensuring macroeconomic stability.

Finally, public procurement policies have had a great impact on resource allocation (see Chapter 5). Access to state funding being seemingly limited to only those with excellent political connections has resulted in many entrepreneurs abstaining from entering the sector. This in turn reinforced the dominance of incumbent major players.[50] Major capital investment and mega-projects such as the Sochi Olympics or the 2018 football World Cup have been tightly controlled by the executive branch, with small and medium enterprises (′SMEs') unable to compete. The shift towards mega-projects over the past decade has also determined to a large extent the allocation of infrastructure resources within the Russian economy, diverting funding towards flagship events rather than day-to-day needs.

Regional governments also play a role in the allocation of resources, but they have lost importance since the 2004 reforms. A 2013 study by the University of Gothenburg Quality of Governance project on Russian regions found that there was considerable variation across regions in terms of quality, with some regions exhibiting meritocratic hiring and subsequently impartial procedures, while others having heavily influenced procurement and discriminatory practices against specific individuals and businesses.[51] These differences in bureaucratic quality have been reflected in differences in overall institutional quality, and also are correlated with both state interference in the economy at the regional level and the presence of extra-legal means of business (including violent attacks on businesspeople).[52] The variation across regions does mean that there are bright spots and some regions have been noted for their innovative approach to business and the economy in general. Kaluga and Tatarstan, for example, have been recognized for reforms to the business environment and attempts to involve SMEs in the regional economy, creating local solutions to national problems.[53] Nevertheless, such positive development in selected regions is to be attributed to the progressive approach of individual

[49] Huskey, E. (2010), *Elite recruitment and state-society relations in technocratic authoritarian regimes: The Russian case. Communist and post-communist studies*, 43(4), p. 363-372.

[50] Nistotskaya, M., & Cingolani, L. (2015), *Bureaucratic structure, regulatory quality, and entrepreneurship in a comparative perspective: Cross-sectional and panel data evidence*, Journal of Public Administration Research and Theory, 26(3), p. 519-534.

[51] Nistotskaya, M., Khakhunova, A. and Dahlström, C. (2015), *The Quality of Government in Russia's regions Expert Survey Report*, *The QoG Working Paper Series 2015:16*, Gothenburg:

[52] Baranov, A., Malkov, E., Polishchuk, L., Rochlitz, M., & Syunyaev, G. (2015), *How (not) to measure Russian regional institutions*. *Russian Journal of Economics, 1(2)*, p. 154-181.

[53] World Economic Forum (2014), *Russia's Regions Drivers of Growth: 4x4. Davos: World Economic Forum*, available at: http://www3.weforum.org/docs/GAC/2014/WEF_GAC_Russia_DriversGrowth_Report_2014.pdf, accessed on 14 October 2019.

governors rather than the systemic nature of governance in Russia. However, in general, economic policies emanating from the centre have played a larger role in determining allocation of resources, a fact which has been noted down even in relation to the allocation of labour within various regional cities.[54]

2.2.2 RULE OF LAW

Overall, the rule of law is perceived as being very low within Russia. This reality has been consistent in post-communist Russia, following directly from the lower levels of bureaucratic quality noted in Section 2.2.1. It has been claimed that the relative dearth of bureaucratic quality has led to freelancing by state officials, lack of initiative (waiting for a superior to rule before making a decision, thus inducing bottlenecks), and uneven application of regulations depending upon one's political connections or economic abilities. In this environment, '*the law is highly consequential and important, but its use tends to be arbitrary, expedient, and instrumental, rather than predictable and principled*'.[55]

As with governance in general, the enforcement of law is in principle directed from Moscow, with the executive branch liberally using Presidential decrees as a quasi-judicial form of rule delivery (and using Presidential envoys (*polpredy*) as the implementers of such decrees).[56] These decrees, a legacy from tsarist times, have often directly focused on the economy, such as the decrees of May 2012 which set targets on productivity and wages for all of Russia, based on previous trends pre-global financial crisis.[57] However, the use of such decrees without working through the formal governance structure have had the result of creating confusion, while also diverting efforts of ministries without necessarily marshalling resources to solve the underlying problems.[58]

Concerns have also been expressed in relation to so-called '*telephone laws*', where '*orders issued over the phone by those with political power rather than through the application of law*' have been instrumental in deciding courses already before various courts (the key example of this "law" being the Yukos case).[59] The application of such telephone laws has led to Russia scoring poorly in most international rankings of the rule of law. For example, the World Justice Project's Rule of Law Index, rating countries on eight sub-categories including constraints on

[54] Khmeleva, G., Tyukavkin, N., Bulavko, O., Prosvetova, A., & Egorova, K. (2017), *The Regional Allocation of Labor Resources in the Context of Economic Restructuring and Renewal: Using a Case from Russia. Problems and Perspectives in Management*, 15(3), p. 377-393.

[55] Popova, M. (2017), *Putin-Style "Rule of Law" & the Prospects for Change*, Daedalus, 146(2), p. 64-75 (quote on p. 64).

[56] Kahn, J. (2002), *Federalism, democratization, and the rule of law in Russia*. *Oxford*, Oxford University Press.

[57] Hanson, P. (2016), Russia's Global Strategy: Is It Economically Sustainable? in Ferrari, A. (ed.), *Putin's Russia: Really Back?*, Milan, ISPI, available at: https://www.ispionline.it/it/EBook/Russia2016/Putins-Russia-Cap.1.pdf, accessed on 14 October 2019.

[58] "*Discussions on the May decrees between the ONF [All-Russia People's Front] and the government are reminiscent of light trolling*." (unofficial translation) ("*Дискуссии на тему майских указов между ОНФ и правительством напоминают легкий троллинг*"), Kommersant, 11.5.2015, available at: https://www.kommersant.ru/doc/2724322, retrieved 14 October 2019. Unofficial translation:

[59] Hendley, K. (2009). *'Telephone law' and the 'rule of law': The Russian Case*. Hague Journal on the Rule of Law, 1(2), 241-262.

government powers and fundamental rights on a scale from 0 to 1, puts Russia overall at 0.47 (on par with the Philippines and Lebanon and below Iran and Bosnia) but with a score of only 0.12 on the sub-category '*criminal system is free of improper government influence*'.[60] Similarly, the World Bank's World Governance Indicators put Russia's score in 2017 at -0.8 (on a scale from -2.5 to 2.5), a percentile ranking of only 22.1 percent.[61]

Several studies from both the economics and political science perspective have questioned why, as Russia's business class has expanded, the rule of law has also not improved: part of the explanation may be that successful businesspeople are little interested in broader property rights once their own rights are secure[62] and that the access of Russians to institutions with a better law enforcement track-record in the West (as in the UK) may also lead to less reform at home.[63] In any event, arbitrary rule of law continues to plague economic decision-making at the firm level and makes it more difficult for efficient resource allocation within the Russian economy.

2.2.3 CORRUPTION

In some ways the flip side of the rule of law, corruption refers to both officials using their positions of power for private gain and/or the workings of a system (beyond individuals) designed to extract rents from productive sectors. In both areas, Russia has not fared well. Petty corruption in Russia, defined as corruption at the level of the individual bureaucrat, has been shown to be a function of the relatively low wages paid to civil servants, the quality of local law enforcement, opportunity costs in the labour market, and the average education level of the population.[64] However, while corruption has been a constant in Russia's political economy, the face of corruption shifted in the 2000s to become more a function of the system's incentive structure (even though individuals and petty corruption still abounds); in particular, '*corruption has played an ever larger role in the regime's stability […*serving*…] as a force to co-opt and control the political elite and to replace formal institutions with something more flexible and more amenable*'.[65]

This reality has led Russia to score low on internationally-recognized rankings for corruption, including coming in 135th out of 180 countries in the Transparency International Corruptions

[60] World Justice Project Rule of Law Index, 2017-2018, available at https://worldjusticeproject.org/our-work/wjp-rule-law-index/wjp-rule-law-index-2017%E2%80%932018, retrieved 14 October 2019.

[61] Based on data from the World Bank World Governance Indicators dataset, available at: http://databank.worldbank.org/data/source/worldwide-governance-indicators, accessed on 14 October 2019.

[62] Sonin, K. (2003). *Why the rich may favor poor protection of property rights. Journal of Comparative Economics*, 31(4), 715-731. No research was available examining whether the importance of better property rights protection in Russia may have increased more recently for wealthy Russians.

[63] Sharafutdinova, G., & Dawisha, K. (2017). The Escape from Institution-Building in a Globalized World: Lessons from Russia. Perspectives on Politics, 15(2), 361-378.

[64] Schulze, G. G., Sjahrir, B. S., & Zakharov, N. (2016). Corruption in Russia. The Journal of Law and Economics, 59(1), 135-171.

[65] Buckley, N. (2018). *Corruption and Power in Russia*. Philadelphia: Foreign Policy Research Institute, available at: https://www.fpri.org/article/2018/04/corruption-and-power-in-russia/, accessed on 14 October 2019.

Perception Index in 2017.[66] While the Heritage Foundation is slightly more charitable, ranking Russia's '*government integrity*' at its highest level in 2017 and 2018 since the post-communist transition, Russia's score of 38.1 percent in 2018 is underpinned by a '*growing lack of accountability*' for bureaucrats.[67]

Corruption has manifested itself in several political institutions within the Government. Public procurement represents an area where political-connections are needed to tap the state funding stream, and reforms undertaken in 2005-6 to overhaul the system resulted in no real changes in access.[68] Moreover, the failings of the judicial system also have massive implications for resource allocation, as there is a widespread perception of corruption, including bribery, fabrication or falsification of evidence, and the aforementioned '*telephone laws*' which prejudice judges in favour of a particular, politically-determined outcome.[69] The judiciary being weak and prone to corruption has been cited in numerous studies as a hindrance to the economic development of the country.[70] With no effective methods to fight corruption, businesses have to treat it as another cost of operating in Russia.[71]

2.3 CHAPTER SUMMARY

This chapter has explored the overarching legislative framework in Russia and touched upon some of the policies which have impact on the economy and resource allocation.

In terms of the existing legislative framework, the chapter identifies certain basic dynamics: presence of weak legal institutions with strong Presidential power, use of sub-constitutional means to affect the balance of power in favour of the central level of governance versus the subjects of the Federation, and use of centralised powers to define the remits of strategic sectors.

The Constitution includes all the relevant elements to support the sharing of competences between central, federal and local levels of government, as well as to allow for free flow of goods, services, and capital, and to support competition. However, the Constitution also

[66] Transparency International (2018). *Corruption perception index 2017*, available at: https://www.transparency.org/news/feature/corruption_perceptions_index_2017, accessed on 14 October 2019.

[67] Heritage Index of Economic Freedom fact sheet for Russia, available at: https://www.heritage.org/index/country/russia, accessed on 14 October 2019.

[68] Yakovlev, A., & Demidova, O. (2012). *Access of firms to public procurement in Russia in the 2000s: before and after radical reform of regulation. International Journal of Economic Policy in Emerging Economies*, 5(2), 140-157.

[69] GAN Business Anti-Corruption Portal Survey of Russia (2017), available at: https://www.business-anti-corruption.com/country-profiles/russia/, accessed on 14 October 2019.

[70] See in particular Aidis, R., Estrin, S., & Mickiewicz, T. (2008). *Institutions and entrepreneurship development in Russia: A comparative perspective. Journal of Business Venturing*, 23(6), 656-672. For a Russian perspective, focused on the regional level, see Арсланова, Х. Д. (2012). Коррупция как сдерживающий фактор развития экономики региона. Региональные проблемы преобразования экономики, 4, available at: https://cyberleninka.ru/article/n/korruptsiya-kak-sderzhivayuschiy-faktor-razvitiya-ekonomiki-regiona, accessed on 14 October 2019, English translation: Arslanova, H.D. (2012). Corruption as a restraining factor of economic development of the region. Regional problems of economic transformation, 4.

[71] Безуглова М. Н., Зыбинская О. А., Исаева Т. В. (2016). *Влияние коррупции на экономику России. Вопросы экономики и управления.* 4, 4-6, available at: https://moluch.ru/th/5/archive/38/921/, accessed on 14 October 2019. Unofficial translation: The impact of corruption on the Russian economy.

provides for strong Presidential powers in the issuing of decrees, appointing and nominating key roles in the judicial and legislative systems. The distribution of competences and the corresponding balance of powers among the main constitutional actors (the President, the Parliament, as well as the Government) is, however, likely to be affected by the amendments to the Constitution which, as of writing of this report, are in the process of being adopted. In addition, the informal arrangements such as the '*telephone laws*' have resulted in a prerogative of political power over the application of the law. Another dimension of the formal and informal institutional setting, explored in depth in Chapter 4, is the parallel expansion of state ownership of major companies as well as the expansion of the definition of strategic sectors. Since the early to mid-2000s but particularly with Presidential Decree No. 1009, the State expanded the list of enterprises and joint stock companies which are deemed strategic and cannot be privatised.

With regard to the key features of governance in Russia, the state's efforts to improve the institutional framework, especially in the areas of mitigating crises, improving growth, or attracting foreign investment, have had a mixed record. This can be seen most clearly in the limited administrative reforms resulting in a perception of low bureaucratic quality, albeit one which varies across regions. Moreover, existing studies have highlighted that bureaucratic quality is also correlated with both state interference in the economy at the regional level and the presence of extra-legal means of governance/business activity. Similarly, international rankings underline Russia's weak performance in tackling corruption, which is particularly important in relation to public procurement and the functioning of the judicial system.

3 **FINANCIAL SYSTEM**

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This chapter describes the general characteristics of the Russian financial system and its major components (banks, insurance companies, and other non-bank financial institutions), and the role of the State and of private (including foreign) economic operators. While this chapter analyses the individual components of the Russian financial system, it should be noted that facts presented need to be considered in the wider context of factors which have an impact on the financial system's performance and the the corresponding Government policies. Such factors entail, for instance, the oil and gas prices in view of the importance of raw materials for the Russian economy (see Chapter 10), the EU and US sanctions, in particular in response to the illegal annexation of Crimea (see Chapter 6), as well as other critical elements for the Russian economy, such as the historical and recent developments of the rouble exchange rate, inflation or yield on the sovereign debt.

3.1 SECTOR OVERVIEW

Table 3.1 gives an overview of the relative and absolute weight of the various categories of actors in the Russian financial sector. There are three observations, which can be drawn from Table 3.1:

1. Similarly to many other economies, the Russian financial sector is dominated by banks. Other subsectors play a less important role;
2. The number of financial sector subjects is decreasing in all its segments which reflects the ongoing process of consolidation in this sector;
3. The overall size of financial intermediation was stagnating in 2018 which is illustrated by the share of financial assets in relation to GDP.

Table 3.1: Main subjects of financial sector in Russia (number of organisations and assets in % of GDP)

Subjects of financial sector	Number of organisations		Assets in % of GDP	
	2017	2018	2017	2018
Credit organisations (banks)	561	484	92.5	90.6
Non-governmental pension funds	66	52	4.1	3.9
Mutual investment funds	1 497	1 440	3.2	3.2
Insurance entities (incl. mutual insurance companies and insurance brokers)	309	275	2.6	2.8
Professional participants in the securities market, incl. banks	614	537	0.8	1.1

Source: CBRF (2019)[72]

[72] CBRF, *Annual Report 2018* (*Годовой отчет 2018)*, Moscow, pp. 55-56, available at: https://www.cbr.ru/Collection/Collection/File/19699/ar_2018.pdf, accessed on 18 May 2019.

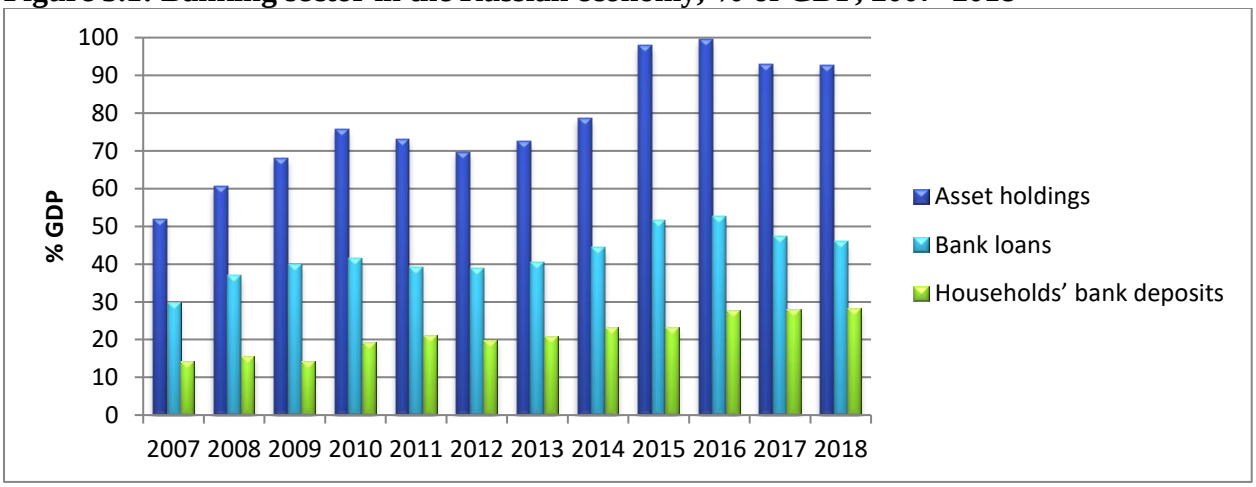
The subsequent subsections provide an analysis of the major subsectors – banks, insurance companies and other non-bank financial institutions.

3.2 BANKING SECTOR

The Federal Law No. 395-1[73] of 2 December 1990 on Banks and Banking Activities is the main legal basis for the operation of commercial banks in Russia.

Despite its dominance in the entire financial sector, the Russian banking subsector is relatively underdeveloped (as compared to other European economies) in terms of its size relative to GDP. At the end of 2017, the ratio of the sector's total assets to GDP amounted to 92.5% (growth of 32 p.p. since the end of 2007), and the ratio of own-capital-to-GDP – to 10.2% (growth of 2.2 p.p.). Deposits are also fairly limited; household deposits amounted to 28.2% of GDP in 2017 (growth of 12.7 p.p.), and deposits of non-financial enterprises and organisations to 27% (an increase of 7 p.p.) (Figure 3.1).

Figure 3.1: Banking sector in the Russian economy, % of GDP, 2007–2018



Note: All data are for 1 January of the corresponding year
Source: CBRF, *Reports on the development of the banking sector, 2010–2017* (*Отчеты о развитии банковского сектора за 2010–2017 гг.*)

3.2.1 BANKING SECTOR CONCENTRATION AND THE ROLE OF STATE OWNERSHIP

The Russian banking system is concentrated to some extent. As of the end of 2017, the cluster of the five largest banks, dominated by Sberbank, controlled, according to the official data of

[73] Federal Law N.º 395-1 of 2 December 1990 "*on Banks and Banking Activities*", as amended, available at: http://www.cbr.ru/content/document/file/37344/law_banks_e.pdf, accessed on 18 May 2019.

the CBRF, 55.8% of the sector's assets (60.4% by end-2018)[74] and 65.2% of households' deposits.[75]

The degree of banking system oligopolisation is growing. The gap between the largest state-controlled banks ('SCBs') that constitute the top five and the remaining banks is rapidly increasing (see Table 3.2).[76] This is particularly evident when the top five banks are compared to middle-size banks which rank from 21st to 50th position by the size of assets controlled. The ratio between the assets of the two groups was close to 3.5 at the end of 2008 (i.e. assets controlled by the top five equalled 350% of the combined assets controlled by the 21st–50th group of banks). By the end of 2013 this ratio grew to 4.5 and reached 5.2 at the end of 2017.[77]

Table 3.2: Russian state-controlled banks and banking groups ranking among top 20 RF banks* (by the size of assets controlled, as of 1 October 2018)

Rank	**Banking group (parent bank)**	**Banking group members**	**Bank assets, RUB bn**	**Banking group assets, RUB bn**	**Shareholders/Relation to Government**
1	**Sberbank**	Sberbank	26 414.6	26 549.4	CBRF owns 50% of nominal capital + one voting share; over 40% belongs to foreign investors.
		Setelem Bank	134.8		Sberbank owns 79.2% of shares, 20.8% belong to BNP Paribas S.A.

[74] *CBRF, Review of the banking sector in the Russian Federation (Internet version)*, Express Issue (2019), N°. 196, Table 7 (*Обзор банковского сектора Российской Федерации (Интернет-версия). Экспресс-выпуск*, № 196, available at: https://www.cbr.ru/Collection/Collection/File/14239/obs_196.pdf), accessed on 15 October 2019.

[75] CBRF, *Report on the development of banking sector and banking supervision in 2017* (2018) (*Отчет о развитии банковского сектора и банковского надзора в 2017 году)*, Moscow, p. 36, available at: https://www.cbr.ru/Content/Document/File/48160/bsr_2017.pdf, accessed on 21 October 2019.

[76] For the purpose of this report, state-controlled banks are defined as those credit organizations where over 50% of equity belongs either to a) State executive bodies of all levels or CBRF, or to b) state-owned or state-controlled financial and non-financial companies, or State corporations. See also Vernikov A. V., *Government banking in Russia: Magnitude and new features*. IWH Discussion Papers. Halle Institute for Economic Research, 2011; Glushkova E., Vernikov A. (2019), *How big is the visible hand of the state in the Russian banking industry?*, MPRA Paper N°. 15563, Munich Univ. Library, available at: http://mpra.ub.uni-muenchen.de/15563/1/MPRA_paper_15563.pdf, accessed on 29 May 2019.

[77] Institute of Complex Strategic Studies, 2018, *On current trends in the development of banking system* (Институт комплексных стратегических исследований (ИКСИ), (*О текущих тенденциях развития банковской системы)*, available at: http://www.banki.ru/news/research/?id=10279546, accessed on 15 October 2019.

2	**VTB**	VTB	13 268.3	14 494.2	The State (represented by Federal Property Management Agency) owns 60.93% of equity, 1.91% belongs to state controlled Rosselkhozbank. 2.95% of equity is controlled by the State Petroleum Fund of Azerbaijan, 3.50% by Alpha Bank, 2.47% by Credit Suisse.
		BM-Bank	632.9		Until May 2016 – Bank of Moscow. 100% controlled by VTB.
		Pochta Bank [Post Bank]	327.1		VTB and Federal Unitary Enterprise 'Post of Russia' each control 49.99% of equity.
		Vozrozhdenie [Renaissance]	265.9		Since 2 October 2018, 81.10% of equity belongs to VTB. 2.39% is controlled by Promsvyazbank. The rest of equity is controlled by private individuals.
3	**Gazprombank**	Gazprombank	6 091.1	6 123.7	Gazprom Group owns 46.02% of equity, Gazfond Group — 41.58% of equity, VEB — 8.53%.

		Credit Ural Bank	32.6		100% owned by Gazprombank
4	**VEB**	Vnesheconomban k	3 475**	3 993	State development corporation has no banking licence, functions on the basis of a special law. 100% owned by the State.
		Svyaz-Bank	284.9		99.77% controlled by VEB.
		Globex	116.3		99.99% controlled by VEB.
		Roseximbank	116.8		60.97% of equity belongs to AO 'ESCAR', 39.03% to AO 'Russian Export Centre', both 100% VEB subsidiaries.
5	**Otkrytie FC**	Otkrytie FC	1 812.3	3 297.2	Since 11 December 2017, over 99.9% of equity belongs to CBRF.
		Trust Bank	1 391.6		Since 14 May 2018, over 99.9% of equity belongs to CBRF.
		Rosgosstrakh Bank	93.3		Otkrytie FC (directly and through Rosgosstrakh insurance company) controls 93.77% of equity.

7	**Rosselkhozbank**	Rosselkhozbank	3 185	3 185	The State (represented by Federal Property Management Agency) owns 100% of equity.
9	**Promsvyazbank**	Promsvyazbank	1 521.1	1 521.1	Since March 2018, 99.99% of equity is owned by Deposit Insurance Agency. Selected as a base bank for implementation of State defence orders.
15	**All-Russian Bank of Regional Development (VBRR)**	VBRR	647.5	963.5	100% controlled by Rosneft Oil Company and its subsidiaries.
		Peresvet	316.0		100% of equity is controlled by VBRR.
17	**Binbank**	Binbank	723.9	749.5	Since March 2018, CBRF owns over 99.9% of equity.
		Binbank Digital	25.6		100% owned by Binbank
	Total SCBs		**60 876.6**	**60 876.6**	
	Total Top 20		**74 605.5**	**74 605.5**	
	% of SCBs			**81.6**	

* The table does not include banks controlled by private entities. Of these, banks controlled by Russian residents rank 6th (Alpha Bank), 8th (Moscow Credit Bank), 12th (Sovcombank Group), 14th (SMP Bank Group), 16th (Rossiya Bank Group), 18th (St. Petersburg Bank) and 20th (Uralsib). Banks controlled by non-residents rank 10th (Rosbank, controlled by Societé Generale), 11th (Unicredit), and 13th (Raiffeisen Bank).

** As of 1 July 2018 (https://veb.ru/investoram).

Sources: calculation based on data from https://www.banki.ru/banks/ratings/?LANG=en.

Most of the small banks are insignificant for the sector as a whole and operate as enterprises' pocket banks. One essential exception is a host of small regional banks that are important because they are often the only providers of banking services in their regions.

A significant degree of state ownership presence was characteristic for the Russian banking system at all stages of its evolution, beginning from an absolute monopoly of state banks in the Soviet Union command economy. It was given a renewed boost by a policy of raising '*national champions*' pursued by the Government in the course of transition.[78]

Between the early 1990s and 1998 (the year in which Russia experienced dramatic financial turmoil involving public debt, currency and banking crises), the degree of state control in the banking sector declined. However, since 1999, the process of a continuous increase of the share of SCBs and raising the new generation of their leaders has started.[79] It accelerated in the course of the next financial crises in 2008–2009, and particularly in 2014 (Figure 3.2). SCBs were growing rapidly and actively participated in the acquisition of other banks.

The preponderance of SCBs in the Russian banking sector can be attributed to the long-term impact of several factors:

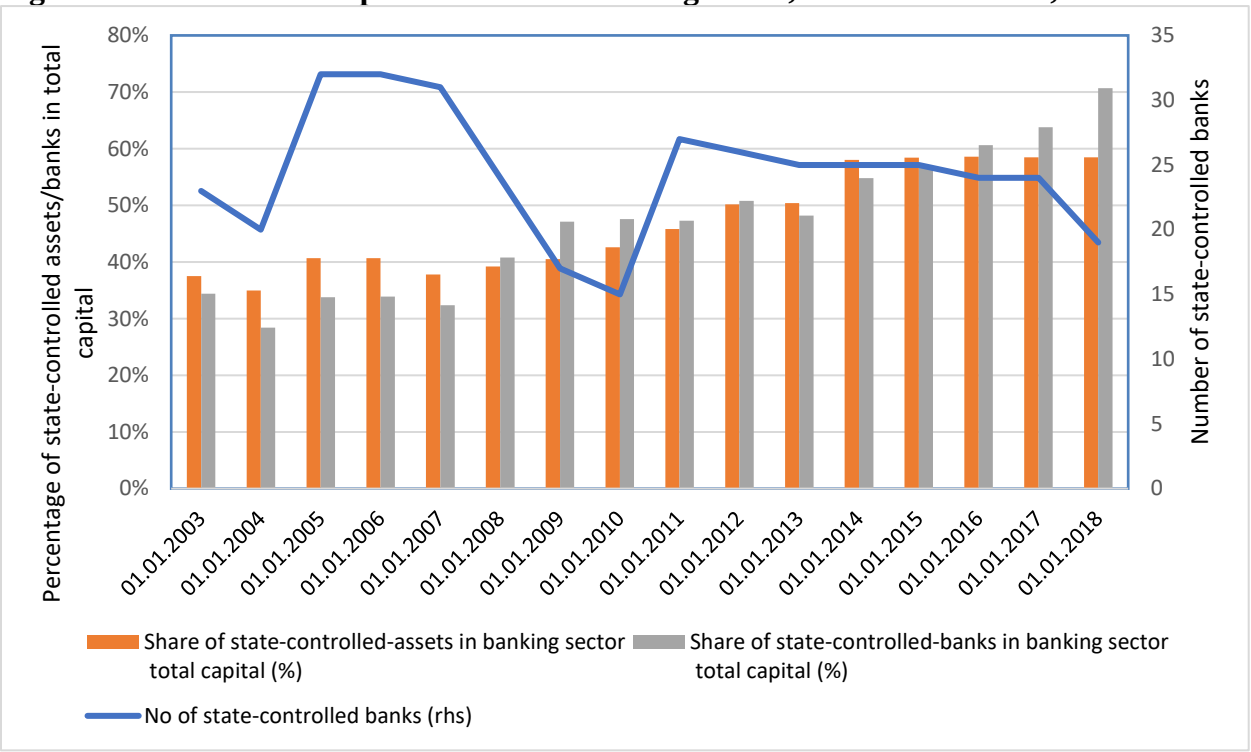
- The inherited infrastructure of Soviet industry sectoral banks;
- Servicing the ever-growing financial needs of the Government (including the use of budget resources at various levels of government), of state-owned corporations and companies with state participation;
- The economy of scale which enabled SCBs to become leaders in profitability, reduce costs and raise low-interest loans in international markets;
- The administrative support from various levels of government combined with the reputation of the islands of stability;
- The concentration of financial resources provided by the CBRF, primarily in SCBs.[80]

[78] Vernikov A. *'National champions' in the structure of Russian market for banking services, 2013, Voprosy ekonomiki*, No 3., p. 94-108 (*Верников А. В. "Национальные чемпионы" в структуре российского рынка банковских услуг) Вопросы экономики*.

[79] *Ibidem*.

[80] Vedev A., Drobyshevskiy C., Sinelnikov-Murylev C., Khromov M (2014), *Pressing concerns of the banking system development in the Russian Federation,* Economic Policy, No. 2 *(Ведев А., Дробышевский С., Синельников-Мурылев С., Хромов М. Актуальные проблемы развития банковской системы в Российской Федерации, Экономическая политика*.

Figure 3.2: State ownership in the Russian banking sector, various indicators, 2002–2017



Source: CBRF official data (see also Chapter 9).

According to the CBRF data, the share of state ownership in the total capital of the Russian banking sector amounted to ca. 70% at the end of 2017, an increase of 9 p.p. since 2016 and by approximately 20 p.p. since the end of 2012 (Figure 3.2). The share of SCBs in the total assets of the Russian banking sector is lower but still dominant – 58.5% at the end of 2017.

In reality, however, the extent of state ownership in the sector is even higher. In 2017, the CBRF used a specific presentation approach in its analysis of banks' ownership structure. It created a separate category of banks under emergency external management[81] that did not exist in previous years and was not counted as being state-controlled. If these distressed banks, primarily Otkrytie FC, Promsvyazbank, and Binbank are added to the SCBs category, the share of SCBs in the total assets of the Russian banking sector would rise to 70.7%, the highest in Russia's post-Soviet history. Note that on 1 January 2019, the CBRF completed the merger procedure of the above-mentioned two large banks previously under resolution – Otkrytie FC and Binbank – that led to the emergence of a new large state-owned bank operating under the Otkrytie brand.

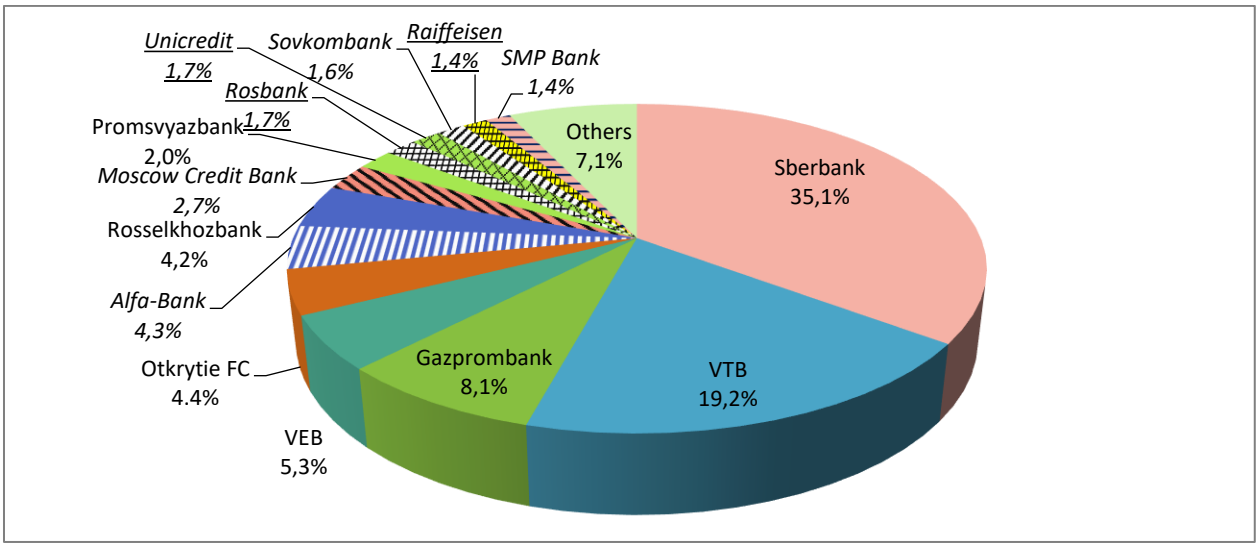
By the end of 2017, the SCBs, including the distressed ones under external management of the CBRF or the Deposit Insurance Agency ('DIA'), held almost 55% of private deposits and issued 78% of all loans to companies outside the banking sector, as well as 72% of loans to individuals. Among large countries, such levels are only seen in China and India, where the banking systems are state-dominated by design. This was not intended to be the case in Russia where economic

[81] As of 1 January 2018, 29 banks in this category were under control of either the CBRF or (DIA) and accounted for 12.2% of the sector asset holdings.

reforms conducted in the 1990s and early 2000s aimed to foster competition (also in the financial sector) and to allow the broad participation of foreign and private banks.[82]

Indeed, the Strategy of banking sector development until 2015[83] published by the Government and CBRF in 2011 envisaged a gradual privatisation of SCBs' equity while maintaining a limited Government presence only in Sberbank, VTB and Rosselkhozbank. Since then, however, not a single SCB has been privatised, and even banks which fell under the rescue state management in 2008–2009 (e.g. the former Bank of Moscow and Globex) are still fully controlled by the Government. After the 2014 currency crisis, the CBRF stated repeatedly that it did not pursue the policy of banking sector nationalisation and entered the banks' ownership only temporarily, with the aim of restructuring them and improving business models, while planning their sale to private investors at a later stage.

Figure 3.3: Top 20 Russian banks and banking groups (by assets controlled), as of 1 October 2018



Note: Private-owned banks/groups are emphasised by hatching/italics, and foreign-owned banks by cross-hatching/underlined italics.
Source: Internal calculation based on data from https://www.banki.ru/banks/ratings/?LANG=en.

Currently, banks with federal outreach, directly or indirectly controlled by the State, constitute the nucleus of the banking sector (Figure 3.3, Table 3.2). Out of the top 20 Russian banks and banking groups,[84] nine banks/groups are fully controlled either by the Government or state-

[82] Bershidsky L. (2018), *Putin's Creeping Nationalisation of Banks*. Bloomberg Opinion, available at: https://www.bloomberg.com/opinion/articles/2018-06-07/putin-s-under-the-radar-nationalization-of-russia-s-private-banks, accessed on 21 October 2019.

[83] Statement by the Government of the Russian Federation 1472п-П13, The Central Bank of the Russian Federation N.º 01-001/1280 of 5 April 2011 "*on the strategy of banking sector development in the Russian Federation until 2015*" (Заявление Правительства Российской Федерации № 1472п-П13, Центрального банка Российской Федерации № 01-001/1280 от 05.04.2011 "О стратегии развития банковского сектора Российской Федерации на период до 2015 года"), available at: http://www.cbr.ru/Content/Document/File/16176/strategy.pdf, accessed on 21 October 2019.

[84] CBRF publishes official figures for separate banks only, regardless of their affiliation, which distorts the ownership picture. Meanwhile, e.g. the VTB and VEB groups include four banks each, Otkrytie FC and Rosbank groups are comprised of three banks, etc. (see Table 3.2).

owned companies like Gazprom or Rosneft, or CBRF, or DIA. These nine banks/groups account for 81.6% of the top 20 banks/groups combined assets and for 68.3% of the total sector assets. In addition, the owners of the two relatively large private banks (SMP Bank and Rossiya, ranking 14th and 16th accordingly) are known for their allegedly close personal relations with President Putin.[85] An even stronger dominance of SCBs is observed in profits. For instance, the three biggest SCBs (Sberbank, VTB group and Gazprombank) made a profit of RUB 902.8 billion in 2017, which exceeds the entire banking sector's profit for the same period by 14.3%, reflecting their leading position in the market.[86] Thus, by accumulating a great deal of financial resources, these banks represent a larger development potential than private banks. Low profitability of private banks discourages their owners from increasing equity, thus further reinforcing their subordinate position to the state-owned segment of the banking sector.[87]

The top 20 group includes only four banks/groups controlled by non-residents, which represent 5.6% of the top 20 banks/groups assets. Since 2013, foreign banks are not permitted to have branch offices in Russia.[88] In order to be present in the market, foreign banks have to establish subsidiaries (which are inherently Russian banks) under Russian law.[89] The maximum permitted share of foreign capital in the Russian banking sector's total capital was set in 2015 at 50%[90] but the actual share is much lower and is likely to decrease. As of 1 October 2018, it amounted to 14.5% only.[91]

[85] In SMP Bank, the controlling interest is held by brothers Arkady (49.995%) and Boris (43.223%) Rotenberg, available at: https://www.banki.ru/banks/bank/smpbank/, accessed on 15 October 2019. The major beneficiaries of Rossiya Bank are Yuri Kovalchuk (42.28%), Gennady Timchenko (10.42%), and Nikolai Shamalov (10.25%), available at: https://www.banki.ru/banks/bank/rossiya/), accessed on 15 October 2019. In 2014, both SMP and Rossiya banks were included into US international sanctions lists, prohibiting transactions with these banks in US territory or with US citizens.

[86] Internal calculations based on Sberbank, VTB, GPB and CBRF annual reports for 2017.

[87] Gaidar Institute for Economic Policy (2018), *Russian Economy in 2017 Trends and Outlooks*, Moscow, Gaidar Institute Publishers, p. 157.

[88] Federal Law N.º 29-FZ of 14 March 2013 "*on introduction of amendments into certain legislative acts of the Russian Federation*" (Федеральный закон от 14.03.2013 г. № 29-ФЗ. О внесении изменений в отдельные законодательные акты Российской Федерации), available at: http://kremlin.ru/acts/bank/36874, accessed on 15 October 2019. These changes were motivated by the fact that foreign banks' branches could not be fully inspected and controlled by the CBRF, and had no obligation to comply with the standards established for contributions to compulsory reserve funds. That, in turn, could result in the deterioration of the Russian banks' competitiveness, for more information on this, see: https://www.rbc.ru/economics/15/03/2013/570404f79a7947fcbd446b9f (15 March 2013), accessed on 15 October 2019.

[89] Given that incorporation of a Russian bank is a legally complicated process taking significant time and effort, international banks have usually opted for the establishment of a presence in Russia through the acquisition of shares in an existing Russian bank that already holds the relevant licenses. However, prior approval of the CBRF is required in order to purchase 10% or more of a bank's shares, see: https://www.nortonrosefulbright.com/en/knowledge/resources-and-tools/banking-reform/supervision/russia, accessed on 15 October 2019.

[90] Federal Law N.º 395-1 of 2 December 1990 "*on Banks and Banking Activities*", Article 18. The CBRF could cease to issue banking licences to credit institutions with foreign investments if the set quota reaches 50%.

[91] CBRF. Information on acting credit organisations with the share of non-residents on 1 October 2018 (ЦБРФ. Информация о действующих кредитных организациях с участием нерезидентов на 1 октября 2018 года), available at: https://www.cbr.ru/Collection/Collection/File/10434/PUB_181001.pdf, accessed on 3 February 2019.

3.2.2 STATE SUPPORT FOR THE BANKING SYSTEM

Strong financial support for the financial system both through liquidity injections (loans) and, to a lesser extent, through the purchase of equity instruments[92] became the core element of the Government policies aimed at mitigation of the 2008–2009 crisis and stabilizing the sector. Initially, the Government allocated RUB 75 billion for the increase of authorized capital of VEB which was supposed to be used for buying up troubled banks.[93] In October 2008, Federal Law No. 173-FZ was adopted which enabled the CBRF to extend a RUB 500 billion subordinated loan to Sberbank at 8% p.a. for the period until 31 December 2019.[94] In accordance with this law, other banks were also permitted to borrow unsecured subordinated loans from VEB refinanced by the Sovereign Wealth Fund, which placed respective assets into deposit accounts at VEB. In return, shareholders were obliged to participate in the banks' recapitalisation and banks were obliged to lend to the real economy. To limit the number of potential recipients of the state support, only banks whose own capital exceeded RUB 3.5 billion could qualify. At that time, this limitation was justified as providing a stimulus for the consolidation of small banks.[95] Overall, during the period from 16 October 2008 to 17 December 2009, the VEB issued subordinated loans at 8% p.a. to 17 banks totalling RUB 404 billion with a pay-back period until 31 December 2019. The largest borrowers were the three biggest SCBs (apart from Sberbank) – VTB (RUB 200 billion), Gazprombank – GPB (RUB 90 billion), and Rosselkhozbank – RSHB (RUB 25 billion), as well as Alpha Bank (RUB 40 billion).[96] By the end of 2009, the programme of bank recapitalisation through subordinated loans was terminated, since the allocated funds were depleted and there was also no more the need for this kind of financial support (i.e. the interbank rates were back to normal).

[92] According to Eurostat rules, governments' interventions in support of the financial system are divided into the following forms: a) recapitalization (acquisition of financial instruments issued by banks): b) lending (granting loans to financial institutions); c) guarantees (on deposits and on borrowing), and d) purchase or exchange of "toxic" assets. See Eurostat Guidance Note, *The statistical recording of public interventions to support financial institutions and financial markets during the financial crisis*, available at: https://ec.europa.eu/eurostat/documents/1015035/2041357/Eurostat-guidance-note-FT-10-September-2009.pdf/eae8874d-3e2e-401d-b3cf-50063473bb0b, accessed on 2 December 2019.

[93] Federal Law 23 October 2008 "*on Introduction of Amendments into Federal Law"* "*on Federal Budget for 2008 and for the Target Period of 2009 and 2010*", Article 1(2) (Федеральный закон "О внесении изменений в Федеральный закон" "О федеральном бюджете на 2008 год и на плановый период 2009 и 2010 годов"), available at: http://docs.cntd.ru/document/902127079, accessed on 15 October 2019.

[94] Federal Law N.º 173-FZ of 13 October 2008 "*on Additional Measures to Support the RF Financial System*" (Федеральный закон от 13.10.2008 № 173–ФЗ "О дополнительных мерах по поддержке финансовой системы Российской Федерации"), available at: http://www.consultant.ru/document/cons_doc_LAW_80622/, accessed on 15 October 2019.

[95] Osipova T.I., Shashkina M.E., *Capital provision to Russian banks as a means of raising their competitiveness* (Осипова Т.И., Шашкина М.Е., Увеличение капитала российских банков как фактор повышения их конкурентоспособности), *Bulletin of Nizhniy Novgorod University, Economic sciences*, 2010, N.º 3 (2), p. 554. (Экономические науки. Вестник Нижегородского университета им. Н.И. Лобачевского).

[96] Poletaeva V.M., Smulov A.M, *Role of governmental programmes of Russian banks support in their credit–and-investment activity development* (Полетаева В.М., Смулов А.М. Роль государственных программ поддержки российских банков в развитии их кредитно-инвестиционной активности), *Academic Journal of Belgorod State University. Economics and informatic*s, 2018. N.º 2, volume 45, p. 231. (Научные ведомости БелГУ. Серия Экономика. Информатика), available at https://cyberleninka.ru/article/n/rol-gosudarstvennyh-programm-podderzhki-rossiyskih-bankov-v-razvitii-ih-kreditno-investitsionnoy-aktivnosti, accessed on 25 January 2020.

Further, amendments to the Law on CBRF adopted in October 2008[97] granted the CBRF a right to extend unsecured loans for a period up to six months to the Russian banks with a rating exceeding a certain level. Under this law, the CBRF, during a short period from 20 October to 10 November 2008, issued loans with terms from 33 to 91 days for a total amount of RUB 690.8 billion at an average rate of 9.89 to 10.53% p.a.[98]

In January 2009, due to rapidly declining banks' capitalisation, the CBRF took unprecedented measures to liberalise conditions for increasing their capital. In accordance with the revised clause 2.1.12.4 of Regulation N.º 215-P,[99] banks were allowed to form up to 15% of Tier 1 capital through subordinated loans, since, in accordance with the CBRF regulations, many banks could no longer draw loans into additional capital. This measure provided assistance primarily to SCBs, since only a few shareholders of private banks were able to raise capital on a par with SCBs.[100] In July 2009, Federal Law N.º 181-FZ[101] entered into force, providing for a procedure of recapitalisation through the exchange of preferred shares of banks to federal bonds ('OFZ'). Again, only banks with assets exceeding RUB 30 billion could take advantage of this type of capital support, which was aimed, in fact, at clearing the system of small and unstable banks.

The decisions to lower mandatory reserve requirements and raise the guarantees for household deposits from RUB 100 000 to RUB 700 000 at a given bank also contributed to improving bank stability.[102]

[97] Federal Law N.º 171-FZ of 13 October 2008 "*on introducing amendments to Article 46 of the Federal Law "on the Central Bank of the Russian Federation (Bank of Russia)*" (Федеральный закон № 171-ФЗ от 13.10.2008 "*О внесении изменения в статью 46 Федерального закона "О Центральном банке Российской Федерации (Банке России)*"), available at http://www.consultant.ru/document/cons_doc_LAW_80620/, accessed on 15 October 2019.

[98] Poletaeva, Smulov, *Op. cit.* For reference, in Q4 2008 the credit rates at interbank market ranged from 14.4 to 19.5%, see: CBRF, 2008, *Quarterly review Inflation: IV quarter 2008* (Kvartal'nyy obzor inflyatsii: IV kvartal 2008 god), available at: https://www.cbr.ru/Queries/XsltBlock/File/48361/8432, accessed on 15 October 2019. According to Bloomberg data, in Q4 2008 the three month interbank rate in Russia ranged between 10% (on 3 October 2008) and 62.6% (on 27 October 2008). However, from 1 to 2 Decenber 2008, the rate went down from 55 to 17.5% and then it staid at that level.

[99] CBRF Regulation N.º 215-P of 10 February 2003 "*on the Methodology for Determining Equity (Own Capital) of Credit Institutions*" (Положение Банка России от 10 февраля 2003 г. N 215-П "*О методике определения собственных средств (капитала) кредитных организаций*"), available at: http://base.garant.ru/12130229/, accessed on 15 October 2019.

[100] Osipova, Shashkina, *Op.cit.*, p. 554.

[101] Federal Law N.º 181-FZ of 18 July 2009 "*on the Use of the Government Securities of the Russian Federation to Increase the Capitalisation of Banks*" (Федеральный закон от 18.07.2009 № 181–ФЗ "*Об использовании государственных ценных бумаг Российской Федерации для повышения капитализации банков*"), available at: http://base.garant.ru/12168372/, accessed on 15 October 2019.

[102] In 2014, the amount of guaranteed compensation for household deposits was again raised to RUB 1.4 million to prevent bank panic.

Overall, from October 2008 to February 2009 the State Duma passed ten federal laws regulating banking activities and banks supervision. These were complemented by about two hundred instructions and other acts issued by the CBRF.[103]

Intervention by the Government and CBRF has prevented a systemic banking crisis. However, the state support was aimed at supporting only the largest banks, mostly SCBs. Moreover, state support for the banking system has not led to the resumption of lending to the real sector. The funds received from the Government and CBRF were either placed in accounts with the CBRF, or (mostly) channelled to the forex market, thus endangering the stability of the national currency. As a result, the CBRF devalued the rouble by 40% over four months, while spending a significant part of its reserves.[104] According to the then head of the Audit Chamber, a large part of the state support was funnelled out by banks and accumulated in offshore accounts.[105] The reason was that Federal Law N.º 173-FZ established only the procedure for issuing subordinated loans to key banks, without regulating the procedures of their use and without defining responsibility for their inappropriate use. In order to prevent a further transfer of the budget support abroad, the legislator adopted, in the shortest time possible, a new law enabling the CBRF to appoint its representatives in the banks that received state support.[106]

Estimates of the total amount of state support received by Russian banks during that period vary widely due to a multiplicity of support instruments, insufficient transparency of information on the implementation of the aid decisions etc. The total amount of crisis mitigation measures financed from the state budget and aimed at supporting the Russian financial sector in 2008–2009 reached up to RUB 2.33 trillion, or USD 75 billion.[107] In 2009 alone, the total amount of state support for recapitalisation of the banking sector and the recovery of distressed banks was

[103] Ruchkina G.F., Ruchkin O. Yu., Glinka V.I, *State Impact on Entrepreneurial Activities: Current Problems of Legal Regulation*. Chapter III (Ручкина Г.Ф., Ручкин О.Ю., Глинка В.И, *Государственное воздействие на предпринимательскую деятельность: современные проблемы правового регулирования*, Глава III.) М.: НОУ ВПО "МГТА", 2012. – 148 с., available at: https://pravoforyou.ru/statiy/gos-podderzka-credit-org.html, accessed on 15 October 2019.

[104] *Ibidem*.

[105] Lokshina Yu. *Audit Chamber threatens banks with licence revocatio*n, Kommersant, 20 October 2009, p. 8 (Локшина Ю. Счетная палата грозит банкам отзывом лицензий, Коммерсант), available at: https://veles-capital.ru/ru/company/media/21-10-2009-1, accessed on 15 October 2019.

[106] Federal Law N.º 317-FZ of 30 December 2008 "*on Amendments to Articles 46 and 76 of the Federal Law "on the Central Bank of the Russian Federation (Bank of Russia)*" (Федеральный закон от 30 декабря 2008 № 317-ФЗ "*О внесении изменений в статьи 46 и 76 Федерального закона "О Центральном банке Российской Федерации (Банке России)*"), available at: http://www.pravo.gov.ru/proxy/ips/?doc_itself=&backlink=1&nd=102126844&page=1&rdk=0#I0, accessed on 15 October 2019.

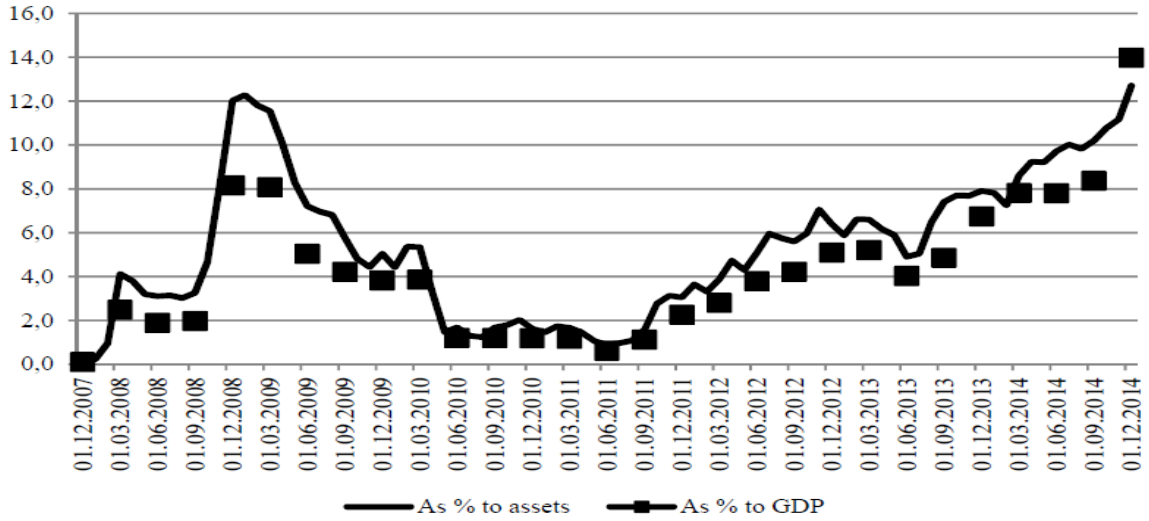
[107] *Rising Storm – Russian banks face serious troubles*, in: Economist, 9 May 2009, available at: https://www.economist.com/news/2009/05/08/rising-storm, accessed on 20 January 2020. See also: World Bank, *Russian Economic Report N.º20*, November 2009, p. 12, available at: https://siteresources.worldbank.org/INTRUSSIANFEDERATION/Resources/305499-1245838520910/rer20fulltext_eng.pdf, accessed on 20 January 2020.

estimated at over 4% of GDP. Importantly, over 80% of Government support was targeted to the four largest federal SCBs – Sberbank, VTB, GPB and RSHB.[108]

The financial crisis hit the Russian economy again at the end of 2014, when the rouble depreciated valued almost twice against the USD (see in this respect also Section 6.6 on the impact of EU and US santion on the economy of Russia). In 2014, the funds provided by the CBRF and the Ministry of Finance accounted for 40% of the increase in the total liabilities of the banking sector, while other two traditional sources of growth of banks' resources - households' deposits and foreign credits - were declining.[109]

The dependence of the banking sector on the CBRF and Government liquidity support grew to a maximum of 12% of GDP (on a monthly basis), compared to a maximum of 8% during the 2009 crisis (Figure 3.4). In 2014, the banks' debts to monetary authorities more than doubled, growing by RUB 5.3 trillion, to reach RUB 9.9 trillion (USD 257 billion). This represented 12% of the total assets of the banks, having almost reached the maximum observed during the 2009 crisis (12.3%).

Figure 3.4: Government and CBRF support to the banking sector relative to banks' total assets and GDP, 2007–2014



Source: Russian Economy in 2014. Trends and Outlooks. (Issue 36). Moscow: Gaidar Institute Publishers, 2015, p. 168.

The detailed sequence of support given by the State more recently to the banking sector is as follows: first, in December 2014, the DIA received RUB 1 000 billion[110] from the federal

[108] Aliev I. *Competitive environment in the Russian banking system*, ETAP, 2017, N.º5 *(*Алиев И.А (2017), *Конкурентная среда в российской банковской системе*, ЭТАП), available at: https://cyberleninka.ru/article/n/konkurentnaya-sreda-v-rossiyskoy-bankovskoy-sisteme, accessed on 15 October 2019.

[109] *Russian Economy in 2014 - Trends and Outlooks* (2015), Issue 36. M.: Gaidar Institute Publishers, p. 164.

[110] Federal Law № 448-FZ of 26 December 2014 "*on introduction of amendments into Article 23 of the Federal Law "on Federal Budget for 2014 and for the Target Period of 2015 and 2016*" (Федеральный закон от 26.12.2014 № 448-ФЗ "*О внесении изменения в статью 23 Федерального закона "О федеральном*

budget and began to implement the programme of banks' recapitalisation through OFZ. To qualify, the banks with equity over RUB 25 billion had to undertake to increase the portfolio of loans issued to real economy by at least 1% monthly. The initial list of the programme participants included 27 federal banks,[111] and the total volume of applications amounted to RUB 821.5 billion. In practice, the support under this programme was channelled primarily to systemically important banks ('SIBs')[112] defined as the largest banks of the country, the financial stability of which affects the banking system as a whole. In return for tighter prudential regulation by the CBRF, they could rely on a priority central bank's support in the case of liquidity shortages or crisis situations. As a rule, instead of revoking their licences and closing down their activities, the CBRF implemented rescue measures. Overall, about two-thirds of the total support amount under the OFZ programme (RUB 838 billion) was apportioned between three of the largest SCBs: VTB Group (RUB 307 billion), GPB (RUB 126 billion), and RSHB (RUB 69 billion).[113]

Second, several amendments were made to Federal Law No. 173-FZ[114] that provided for an option of extension until 2023 (instead of 2019) of subordinated loans issued by VEB to VTB, GPB and RSHB in 2008–09. Also, these amendments provided for an extension option of the RUB 500 billion subordinated unsecured loan disbursed by the CBRF to Sberbank in 2008 (at a reduced interest rate of 6.5% p.a. instead of 8% initially) for 50 years with a subsequent extension of no more than once every 50 years without agreement with the lender. According to expert estimates, these revisions, combined with amendments introduced to CBRF Instruction No. 395-P[115] that allowed the recording of the subordinated loans issued under the revised law as the bank's capital, enabled Sberbank to increase its capital after 1 April 2015 by at least RUB 215 billion.[116] The above amendments to Law No. 173-FZ also provided for an

бюджете на 2014 год и на плановый период 2015 и 2016 годов"), available at: http://base.garant.ru/70830548/, accessed on 15 October 2019.

111 Available at: asv.org.ru/for_banks/capitalization/002.pdf, accessed on 15 October 2019.

112 In January 2014, the CBRF issued the Instruction N.º 3174-У "*on Defining the List of Systemically Important Credit Organisations*", available at: http://www.garant.ru/products/ipo/prime/doc/70475610/#ixzz5eNpv2hAT, accessed on 15 October 2019, and published the first version of this list in July 2015. As of the end of 2018, the list of SIBs consisted of 11 banks, including the six largest SCBs, three foreign-controlled banks, and the two largest private domestic banks (Alpha Bank and Moscow Credit Bank).

113 Aliev I. *Op. cit.*

114 Federal Law N.º 275-FZ of 21 July 2014 "*on Introduction of Amendments into Articles 4 and 5 of the Federal Law" "on Additional Measures to Support the Financial System of the Russian Federation*" (Федеральный закон от 21.07.2014 N 275-ФЗ "О внесении изменений в статьи 4 и 5 Федерального закона "*О дополнительных мерах по поддержке финансовой системы Российской Федерации*"), available at: http://www.consultant.ru/document/cons_doc_LAW_165921/, accessed on 15 October 2019.

115 CBRF Instruction N.º 3450 of 20 November 2014 "*on Introduction of Amendments into Regulation by the Bank of Russia",* N.º 395-P of 28 December 2012 *"on Methods for Determining the Amount of Equity (Capital) of Credit Institutions ("Basel III")*" (ЦБРФ. Указание от 20 ноября 2014 года N 3450-У "О внесении изменений в Положение Банка России от 28 декабря 2012 года N 395-П "О методике определения величины собственных средств (капитала) кредитных организаций ("Базель III")"), available at: http://docs.cntd.ru/document/420236946, accessed on 15 October 2019.

116 Khromov M., 2016, *State support to the banking system*, Russian Economic Developments, Volume 23, N.º 3, pp. 44-47 *(Хромов М., Государственная поддержка банковской системы),* Экономическое развитие

option of converting subordinated loans issued to Sberbank and other banks into non-voting preferred shares with limited rights, without fixed dividend rate. By 2016, the total sum of loans converted into preferred shares of VTB, GPB and RSHB amounted to RUB 279 billion. Besides, VTB and GPB received new subordinated loans from the Sovereign Wealth Fund for a total of RUB 164 billion (VTB – RUB 126 billion and GPB – RUB 38 billion). Thus, the amendments adopted in July 2014 enabled the four largest SCBs to increase their capital by RUB 779 billion.[117]

Third, at the end of 2014 and the beginning of 2015, the CBRF, using repo Forex auctions, provided credit organisations with foreign currency. These operations started on 10 September 2014, with loans for a period of minimum 1 week and up to 28 days, and from 17 November 2014 for a period of 12 months as well. In December 2014, a net inflow of foreign currency into the banking system through this instrument reached almost USD 20 billion.[118]

Fourth, since 2014, CBRF funds were increasingly used for bailing out the distressed banks. Until June 2017, bank resolutions had basically been financed by the CBRF, involving the DIA and investing banks that were interested in bailing out a given bank. Quite often, however, investing banks used the funds allotted for bank resolution for their own business development purposes. The DIA's own funds were exhausted as early as summer 2015, and the deficit of the deposit insurance system was covered by loans from the CBRF, the credit limit for which was regularly updated. By 1 March 2019, the resources used by the DIA for financing bank resolutions amounted to RUB 1 164 billion, of which the CBRF contributed RUB 1 085 billion (93%).[119]

In June 2017, new regulations providing for an alternative mechanism for the solvency recovery of banks entered into force.[120] The CBRF established an entity, the Fund for Banking Sector Consolidation (′FBSC′), and set up an FBSC management company which it fully controlled. The updated mechanism has been officially designed primarily for curtailing bank resolution costs and for increasing control over the spending of appropriated resources. By removing the DIA and the investing bank from the chain of financial aid for rescued banks and replacing them with the management company, the new mechanism should prevent asset stripping prior to selling the rescued bank.[121]

In 2017, and as explained above in Section 3.2.1, the CBRF became an investor of two large private banks, having bought out Otkrytie FC as part of an additional capital issue of RUB 456.2

России, available at: http://www.iep.ru/files/RePEc/gai/ruserr/579Khromov.pdf, accessed on 15 October 2019.

[117] *Ibidem.*

[118] Ruchkina G.F. et al. Op. cit., 2015, *Battle for liquidity* (Ручкина Г.Ф. и др. Указ. соч., *Битва за ликвидность)*, available at: http://www.banki.ru/news/daytheme/?id=7774875, accessed on 15 October 2019.

[119] Available at: http://www.asv.org.ru/sanation/, accessed on 15 October 2019.

[120] Federal Law N.º 84-FZ of 1 May 2017 "*on Introduction of Amendments into Certain Legislative Acts of the Russian Federation*" (Федеральный закон от 01.05.2017 N 84-ФЗ "*О внесении изменений в отдельные законодательные акты Российской Федерации*"), available at: http://www.consultant.ru/document/cons_doc_LAW_216065/, accessed on 15 October 2019.

[121] Gaidar Institute for Economic Policy, 2017, *op. cit*., p. 151.

billion and plugging a hole in the capital of the Binbank to the amount of RUB 36.3 billion (see Section 3.1.1, Table 3.1).[122] These two banks became the first cases where the new bank resolution mechanism was applied shortly after the CBRF's new regulations came into effect.

The overall cost to taxpayers of the banking system support is estimated to have amounted to about RUB 2.7 trillion (USD 46.3 billion at the 2017 exchange rate) between 2013 and 1 September 2017,[123] of which RUB 260 billion were injections into banks' authorised capital from the Sovereign Wealth Fund.

In addition to SCBs, '*privileged*' private banks (SMP Bank and Bank Rossiya, see Section 3.2.1) also received considerable support from the Government. For example, these banks were allowed to keep idle funds of federal budget and state corporations, and the reserves of the Federal Social Insurance Fund in their deposits.[124] After being placed under international sanctions in 2014, these two banks were the only private banks which were allowed in 2016 to operate with federal budget resources.[125]

According to the FAS, there are currently at least 57 regulatory acts in Russia that provide competitive advantages to the largest banks, including SCBs, by means of establishing requirements for the size of equity capital and the form of ownership in order to participate in Government programmes and to gain access to federal budget funds. Additional requirements could be state participation in equity capital or signing a contract with the DIA for recapitalisation. The trend towards regulatory tightening is evident: since 2016, over 30 federal regulatory acts of this character were adopted.[126] For instance, only 21 banks (as of 1 March 2019) with equity capital over RUB 30 billion are allowed to keep federal budget funds in their

[122] Solodkov V., Belousova V., 2018, *The end of competition: How the growing state influence changes Russian banks*, Forbes.Ru (*Солодков В., Белоусова В. Конец конкуренции: как рост влияния государства меняет российские банки*), available at: http://www.forbes.ru/finansy-i-investicii/357027-konec-konkurencii-kak-rost-vliyaniya-gosudarstva-menyaet-rossiyskie, accessed on 15 October 2019.

[123] Sedlova Yu., Sedlov D. Recovery procedures, *Central Bank is the regulator of the year according to Forbes*, 2017, Forbes.Ru (Седлова Ю. Седлов Д. Оздоровительные процедуры. Центробанк — регулятор года по версии Forbes), available at: http://www.forbes.ru/finansy-i-investicii/354807-ozdorovitelnye-procedury-centrobank-regulyator-goda-po-versii-forbes, accessed on 15 October 2019.

[124] Stulov M., *Rotenbergs "SMP Bank" received new support*, Vedomosti, 19 August 2018 (Стулов М. *"СМП банк" Ротенбергов получил новую поддержку*, Ведомости)

[125] See: https://www.rbc.ru/economics/01/04/2016/56fe92989a7947340040e8af (1 April 2016), accessed on 15 October 2019.

[126] Kashevarov A. Deputy head, FAS of Russia, *Competition and regulation at the market of banking services*, presentation, Moscow, 5 March 2018 (Кашеваров А., заместитель руководителя ФАС России. Конкуренция и регулирование на рынке банковских услуг. Презентация. Москва, 05.03.2018), available at: https://fas.gov.ru/system/presentations/attachments/2018/03/5/original/Конкуренция_и_регулирование_на_рынке_банковских_услуг.pdf, accessed on 15 October 2019.

deposits.[127] Similarly, participation in Government programmes of subsidised credit is allowed for only ten banks with a minimal capital of RUB 100 billion, etc.[128]

3.2.3 COMPETITION WITHIN THE RUSSIAN BANKING SECTOR

Due to high market concentration, a high share of state ownership and privileged state support, SCBs operate in a more favourable competitive environment than all other financial institutions. SCBs also enjoy additional non-market competitive advantages due to the ability to use both financial and administrative resources of the State, i.e. they benefit from implicit Government guarantees on their obligations and, as a result, cheaper funding.[129] The cost of the capital of SCBs is reduced by the public perception that the State will always stand behind them, an implicit guarantee, which backs household banking deposits. For example, the average cost of raising funds from private and corporate clients in Sberbank in 2015 was 5.6% and 5.2%, respectively, while on average for private banks the cost of such funding was 7.1% and 6.2 % respectively.[130] Furthermore, Sberbank and VTB are the only two banks with a fully developed branch network. This gives them a near-monopoly position in handling services like pensions, housing and utilities payments, which provide them with large volumes of low-cost funds.

According to some Russian experts, preferences received by SCBs in the form of privileged access to CBRF funds and making use of additional rent obtained because of market power and 'soft budget constraints' result in *monopolistic competition* in the Russian banking sector.[131] These preferences enable the largest banks (primarily SCBs) to considerably reduce interest rates on household deposits while maintaining relatively high interest rates on loans, thus affecting the general market conditions in the banking sector.[132] As a result, SCBs have the highest profitability in the banking system (2.1% return on assets, 16.1% return on capital as of

[127] Government Degree N.º 1121 of 24 December 2011 "*on the Order of Allocation of Federal Budget Funds in Bank Deposits*" (Постановление Правительства Российской Федерации от 24.12.2011 № 1121 "*О порядке размещения средств федерального бюджета на банковских депозитах*", available at: http://www.consultant.ru/document/cons_doc_LAW_124396/5aa1c41fe76e1bd6548012cdd63fd03268da59c7/, accessed on 15 October 2019; *List of credit organisations meeting the requirements of the Government Decree N.º 1121 of 24 December 2011 "on the order of allocation of Federal budget funds in bank deposits*" ("*Перечень кредитных организаций, соответствующих требованиям постановления Правительства Российской Федерации от 24.12.2011 № 1121 "О порядке размещения средств федерального бюджета на банковских депозитах*"), available at: https://www.cbr.ru/vfs/credit/fzlist/fz1121list-20190301.xls, accessed on 15 October 2019.

[128] Kashevarov A., *op. cit.*

[129] Berezin V., *Large banks controlled by the state are in a privileged competitive position* (Березин В. Крупные банки, контролируемые государством, находятся в более предпочтительных конкурентных условиях, — эксперт), available at: http://sberex.ru/5201.html, accessed on 28 November 2019.

[130] Solodkov & Belousova, *op. cit*.

[131] Soldatenkova I., *Revisiting the issue of state dominance in the Russian banking sector* (Солдатенкова И.В. К вопросу об огосударствлении российского банковского сектора), Proceedings of Tula State University. Economics and legal sciences, N.º 4-1, 2017 (Известия ТулГУ. Экономические и юридические науки), available at: https://cyberleninka.ru/article/n/k-voprosu-ob-ogosudarstvlenii-rossiyskogo-bankovskogo-sektora, accessed on 15 October 2019.

[132] Kashevarov A., *op. cit.*

1 January 2018), while in private banks with capital of less than RUB 1 billion these figures were -0.01 and -0.1% respectively.[133]

The privileged position of SCBs puts the rest of the market participants in an impaired position, in particular constraining the interests of small and regional banks. From 1 January 2013 to 1 January 2017, the number of regional banks[134] decreased by 31%, the aggregate positions of regional banks in the deposits and corporate loans markets suffered a more than three times decrease. A similar decline in the position of regional banks occurred in respect to banking services for households.[135]

As a result, the dominant position of SCBs in the regions has strengthened: according to the FAS, the number of regional markets where SCBs play leading roles, increased from between 9 and 27 (depending on the market segment) in 2011 to between 18 and 53 in the first half of 2017.[136] In 14 regions of Russia,[137] only one regional bank remained by mid-2017, and regions with developed competition in the banking sphere were virtually absent. This system encourages regional authorities to create advantages for SCBs: in some cases, the authorities recommended to public servants to shift their accounts from private regional banks to SCBs.[138]

The Government granted additional implicit competitive advantages to SCBs through the system of deposit insurance. Since this system did not guarantee business deposits (as distinct from household deposits), a massive banking system clean-up initiated by the CBRF in 2014–2018 caused a large-scale outflow of capital from middle-sized banks to the largest SCBs, whose position was additionally strengthened by their inclusion in a list of SIBs.[139] According to Moody's, the standing of small and middle-sized banks relative to SCBs is further undermined by a new mechanism of bank recovery introduced by the CBRF in May 2017 under which the FBSC set up by the CBRF was designed primarily to curtail bank resolution costs and to increase control over the spending of appropriated resources (see Section 3.2.2). As result, under this new mechanism the CBRF almost exclusively supported the largest banks, rejecting requests for assistance from smaller banks, thus intensifying the flow of clients to the leaders in the banking market.[140]

The use of non-market competitive advantages by SCBs entailed a number of consequences. After the crisis of 2008–2009, exploiting implicit guarantees of Government support, several

[133] CBRF (2018), *op. cit.*, p. 29.
[134] According to CBRF classification, regional banks are those banks which are registered beyond the Moscow Region (Moscow and oblast).
[135] CBRF, 2017, *Report on the development of banking sector and banking supervision in 2016* (*ЦБРФ, Отчет о развитии банковского сектора и банковского надзора в 2016 году*), Moscow, available at: http://www.cbr.ru/Content/Document/File/48161/bsr_2016.pdf, accessed on 15 October 2019.
[136] Kashevarov A. *Op. cit*.
[137] In Vladimir, Voronezh, Kaliningrad, Lipetsk, Penza, Tambov, Tomsk, Ulyanovsk oblasts, Republics of Altai, Komi, Karelia, Tywa, Northern Ossetia, as well as in the Khabarovsk Territory.
[138] Kashevarov A. *Op. cit*.
[139] Aliev I. *Op. cit.*
[140] Sedlova & Sedlov. *Op. cit.*

large banks (the Bank of Moscow, Rosselkhozbank) became involved in risky operations.[141] Despite the fact that the CBRF applied an equal approach to all credit institutions from the point of view of prudential norms, de facto, softer requirements appear to have been were imposed on the largest banks. Repeatedly, the CBRF looked leniently at the violation of the capital adequacy ratio by the Gazprombank and did not take into account potential threats coming from other major banks, such as Mezhprombank and Bank of Moscow. In some cases, regional CBRF branch offices raised the quality categories of loans for large banks without other apparent reasons than to reduce the pressure on their own capital due to a growth of reserves for possible losses.[142]

Another potential source of distortions in the Russian banking system is the fact that the CBRF continues to hold the State's controlling stake at Sberbank, in accordance with the amended Law on the Central Bank of Russian Federation.[143] This presents a number of conflicts of interest since the CBRF is at the same time the state authority responsible for monetary policy, the banking sector's regulator, its largest single creditor and the owner of its biggest bank.[144] This means the central bank has its own subsidiary retail bank, and at the same time carries out prudential supervision over the rest of the banks, regulates them and applies sanctions. To conclude, the growing state interventionism in the banking sector gradually leads to aggravating the crisis of confidence by economic agents caused by a massive revocation of banks' licences, the withdrawal of funds from private banks and the flow of resources into SCBs, which further increases their oligopolistic power.

The competitive advantages of SCBs in key segments of the banking market, created in explicit or implicit form by the Government and CBRF, distort the competitive environment and may lead to an increase in moral hazard – the risk of abuse of their privileged market position.[145] The scope of state intervention in the Russian banking system, according to domestic experts, is approaching the degree when there may appear to be a threat to the financial market's competitive environment and hence to the sustainability of the market-oriented institutional structure.[146]

3.3 INSURANCE SECTOR

[141] Vedev et al. *Op. cit.*

[142] *Ibidem*.

[143] The CBRF cannot reduce, sell or transfer its capital share in Sberbank (of 50% plus one voting share) without the adoption of a special federal law. See Article 8 of Federal Law N.º 86-FZ of 10 July 2002 "*on the Central Bank of the Russian Federation (Bank of Russia)*", as amended, (Федеральный закон от 10.07.2002 N.º 86-ФЗ (ред. от 27.12.2018) "О Центральном банке Российской Федерации (Банке России)". Статья 8), available at: http://www.consultant.ru/document/cons_doc_LAW_37570/, accessed on 15 October 2019.

[144] OECD. (Sept. 2004) *OECD Economic Surveys 2004: Russian Federation*. Vol. 204/11, p. 220.

[145] Aliev I. *Op. cit*.

[146] Afanasyeva O., 2016, N.º 4, pp. 35-37, *Trends of Russian banking system institutional transformation,* Banking Business (Афанасьева О.Н. Направления институциональной трансформации российской банковской системы, №4. С. 35-37, Банковское дело). Quoted after Soldatenkova, 2017, op. cit., p. 196.

Commercial insurance activity is regulated by the Federal Law No. 4015-1 of 27 November 1992.[147] Since 2013, it is supervised (like other financial market activities) by the CBRF, performing the role of mega-regulator.

The insurance subsector of the Russian financial sector is much smaller compared to the banking subsector. The share of its assets in GDP amounted to 2.8% in 2018 (see Table 3.1). Similarly to banks, it is highly concentrated with a tendency to increase the market share of the top ten companies (by the size of gross insurance premiums) – see Figure 3.5 and Table 3.3.[148] The top ten companies increased their market share from 64% in 2014 to 75% in 2017, of which the largest five companies accounted for 51% of the entire market in 2017. In the same period of time, the share of the next ten largest companies (occupying positions from 11 to 20) decreased from 13% to 10% and that of the remaining companies from 23% to 15%.

The mechanisms of concentration are also similar to those in the banking sector – revoking licences by the CBRF in respect to companies in financial troubles or those breaching legislation and regulatory norms, mergers and acquisition[149] and faster expansion of the largest companies, which exploit the benefits of scale and strong market position. As a result, the number of insurance companies operating in the Russian market decreased from 391 in 2014 to 217 in 2017 with the expectations of this process to continue.[150]

The role of state ownership in the insurance subsector is substantial and increasing but smaller than in the banking subsector. In most cases, state ownership control is performed indirectly via state-owned parent companies such as Gazprom and its subsidiaries, or state-owned banks such as Sberbank, VTB, and Otkrytie FC. In 2017, among the largest insurance groups reported in Table 3.3, SOGAZ, Sberbank Strakhovanie and VTB Strakhovanie could be considered as majority state-owned while the Rosgosstrakh was partly owned by the State (via Otkrytie FC).[151] That is, at least 40% of insurance premiums were collected by insurance companies fully or partly owned by the State.

[147] Federal Law N.º 4015-1 of 27 November 1992 "*on the organisation of the insurance business in the Russian Federation*", as amended, available at: https://www.cbr.ru/Content/Document/File/36947/482-FZ.pdf, accessed on 17 May 2019.

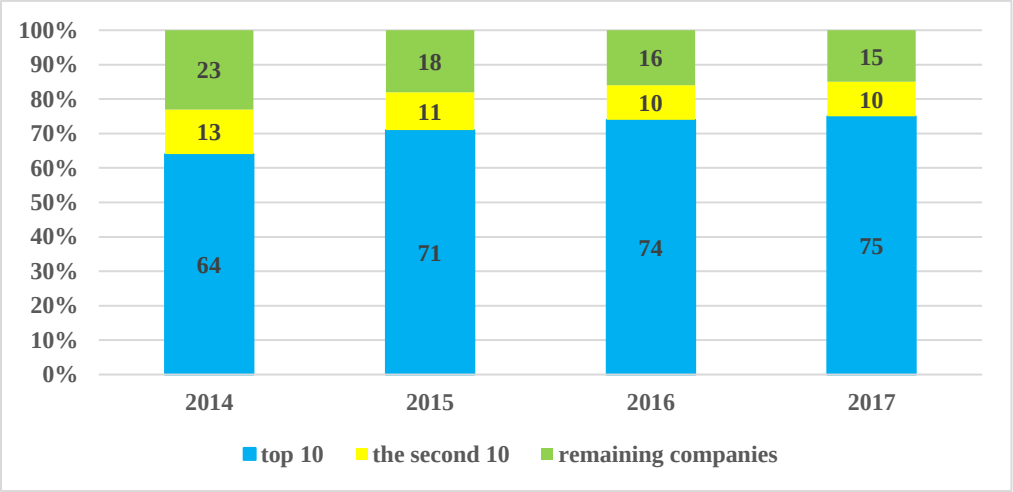
[148] Data of Figure 3.5 and Table 3.2 are not fully consistent because the former is based on individual companies' shares in the market while the latter presents the consolidated data of insurance groups (life and non-life insurance together).

[149] A particularly important transaction was the acquisition of VTB Strakhovanie (fifth largest company in 2017 accounting for 7.9% of market share) by SOGAZ (the largest company with market share of 13.3%) in November 2018. As a result, the largest insurance company will control more than 20% of the insurance market.

[150] KPMG, Russian insurance market survey 2018, 11 July 2018, (Обзор рынка страхования в России 2018), available at: https://assets.kpmg/content/dam/kpmg/ru/pdf/2018/07/ru-ru-insurance-survey-2018.pdf, accessed on 17 May 2019.

[151] Based on information available at: www.banki.ru, accessed on 7 November 2018.

Figure 3.5: The share of the first and second ten top insurance companies in total gross insurance premiums, in %, 2014–2015



Source: KPMG (2018), *Russian insurance market survey 2018* and KPMG (2017), *Russian insurance market survey 2017*, available at: https://assets.kpmg/content/dam/kpmg/ru/pdf/2017/07/ru-en-russian-insurance-market-survey-2017.pdf, accessed on 2 December 2019.

Table 3.3: Ten top insurance companies/groups of companies by share of total gross insurance premium, 2017

Company/Group	Share
SOGAZ	13.3
Rosgosstrakh	11.0
Alpha Strakhovanie	9.8
Sberbank Strakhovanie	8.9
VTB Strakhovanie	7.9
Ingosstrakh	7.3
RESO-Garantia	7.0
VSK	5.1
Renessans Strakhovanie	3.9
Soglasie	2.7

Source: KPMG (2018), *Russian insurance market survey 2018*.

According to Article 6(6) of Federal Law N.º 4015-1, foreign investors can perform insurance activities via subsidiaries incorporated in Russia for up to 50% of the overall authorised capital of this subsector (if this limit is exceeded, issuing new licences to foreign investors should be suspended). However, in practice, engagement of foreign investors is much smaller. On 1 January 2019, foreign capital accounted for 11.99% of the authorised capital of insurance

companies licensed as insurers.[152] Among the ten top insurance groups (Table 3.3) only Ingosstrakh and Renaissance Strakhovanie are partly owned by foreign investors.

Unlike banks, insurance companies did not enjoy state support programmes in the crisis periods of 2008–2009 and 2014–2015, at least in a direct form.

3.4 OTHER NON-BANK FINANCIAL INSTITUTIONS

Other non-bank financial institutions operating in the Russian financial market include, among others:

- Non-governmental pension funds;
- Mutual investment funds;
- Microcredit institutions;
- Professional participants of securities market.

The legal basis for their operation is provided by:

- Federal Law N.º 39-FZ;[153]
- Federal Law N.º 75-FZ;[154]
- Federal Law No. 208-FZ;[155]
- Federal Law No. 152-FZ;[156]
- Federal Law No. 151-FZ;[157]
- Federal Law N.º 156-FZ;[158]
- Federal Law N.º 46-FZ;[159]
- Federal Law N.º 414-FZ.[160]

Although important for specific activities and subsectors, non-banking financial institutions play a secondary role in financing the Russian economy. As seen in Table 3.1, their combined

[152] See The Central Bank of the Russian Federation. 28 February 2019. *Bank of Russia estimates share of foreign capital in aggregate authorised capital of insurance companies*, CBRF Press Service, available at: http://www.cbr.ru/eng/press/event/?id=2461, accessed on 17 May 2019.

[153] Federal Law N.º 39-FZ of 22 April 1996 "*on the Securities Market*", available at: https://www.cbr.ru/Content/Document/File/36165/39-FZ.pdf, accessed on 15 May 2019.

[154] Federal Law N.º 75-FZ of 7 May 1998 "*on Non-Governmental Pension Funds*", available at: https://www.cbr.ru/Content/Document/File/35781/75-FZ.pdf, accessed on 15 May 2019.

[155] Federal Law N.º 208-FZ of 26 December 1995 "*on Joint-Stock Companies*", available at: https://www.cbr.ru/Content/Document/File/33657/208-FZ.pdf, accessed on 15 May 2019.

[156] Federal Law N.º 152-FZ of 11 November 2003 "*on Mortgage Securities*", available at: https://www.cbr.ru/Content/Document/File/33656/152-FZ.pdf, accessed on 15 May 2019.

[157] Federal Law N.º 151-FZ of 2 July 2010 "*on Microfinance Activities and Microfinance Organisations*", available at: https://www.cbr.ru/Content/Document/File/33655/151-FZ.pdf, accessed on 16 May 2019.

[158] Federal Law N.º 156-FZ of 29 November 2001 "*on Investment Funds*", available at: https://www.cbr.ru/Content/Document/File/29898/156-FZ.pdf, accessed on 16 May 2019.

[159] Federal Law N.º 46-FZ of 5 March 1999 "*on Protecting Investors' Rights and Lawful Interests in the Securities Market*", available at: https://www.cbr.ru/Content/Document/File/29896/46-FZ.pdf, accessed on 15 May 2019.

[160] Federal Law N.º 414-FZ of 7 December 2011 "*on the Central Depository*", available at: https://www.cbr.ru/Content/Document/File/27590/414-FZ.pdf, accessed on 17 May 2019.

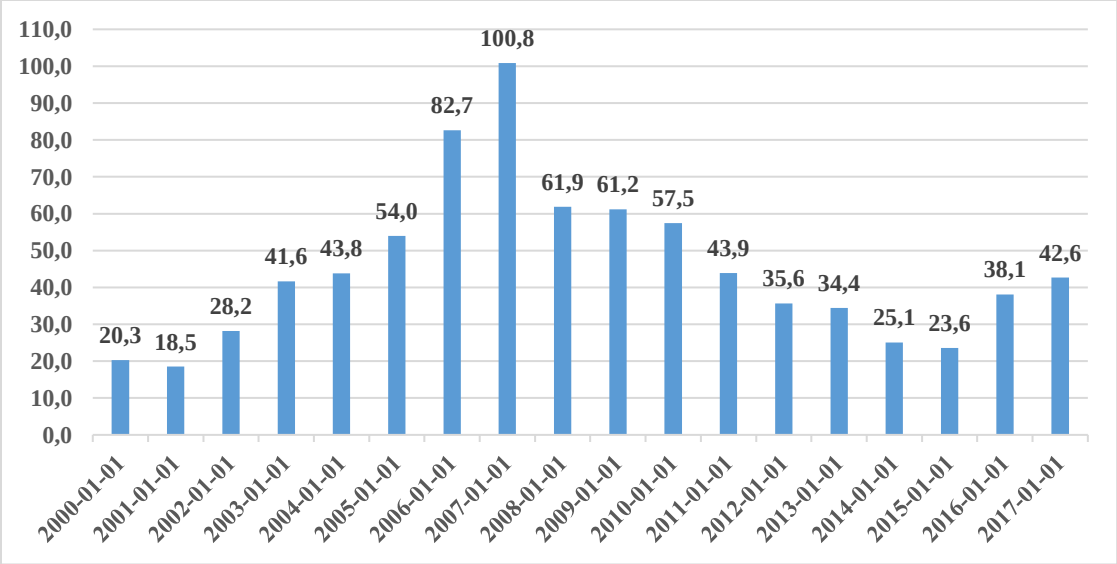
assets amounted to ca. 8% of GDP in 2018 (11% of GDP if insurance entities are added), that is, 11 or 8 times less than total banks' assets, respectively.

3.5 STOCK AND BOND MARKET

Figure 3.6 presents capitalisation of the Russian stock market and Figure 3.7 volumes of stocks traded, both in relation to GDP. The peak of both, over 100% of GDP in the case of capitalisation and slightly less than 100% of GDP for stocks traded, was achieved in the pre-crisis year 2007. Then the two financial crises (2008–2009 and 2014–2015) brought down capitalisation to less than 25% of GDP. Since 2015, it started to recover but at the end of 2016 it only reached a level of 42.6% of GDP. The volume of stocks transactions suffered even more, staying at a level of around 10% of GDP or below since 2013. This means the stock market in Russia remains illiquid.

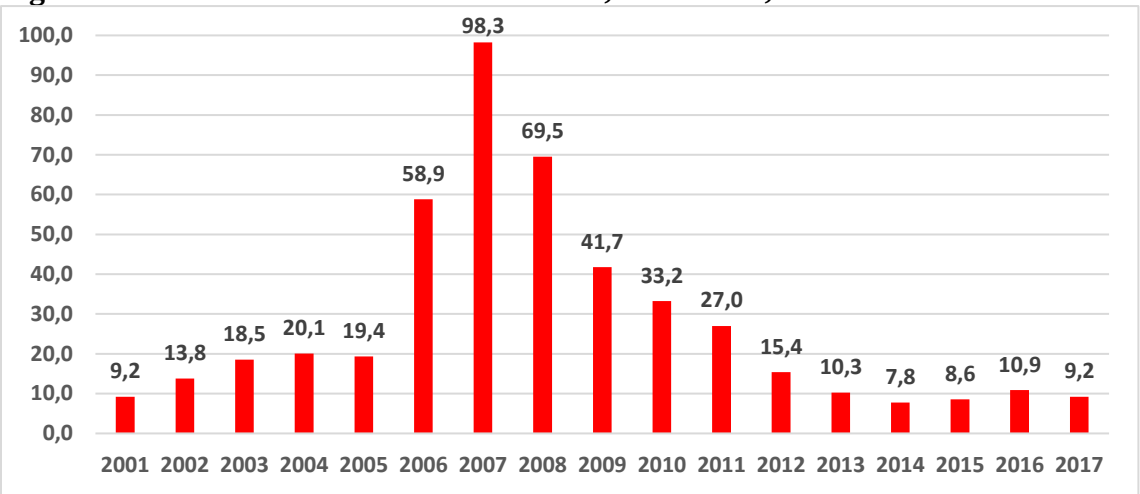
There are several factors that can explain the decreasing role of the stock market in Russia (as compared with the mid-2000s). Apart from the depressing impact of the financial crises in 2008–2009 and 2014–2015, these are the practical stopping of the privatisation process, and the increasing share of state ownership in several key sectors of the Russian economy (see Chapter 4), including the financial sector (see Sections 3.2 and 3.3), continuing restrictions on foreign investment (see Chapter 7) and frequent use of foreign stock markets by the largest Russian companies.

Figure 3.6: Russia: stock market capitalisation, 1999–2016, % of GDP



Source: Federal Reserve Bank of St. Louis, available at: https://fred.stlouisfed.org/series/DDDM01RUA156NWDB, accessed on 18 May 2019.

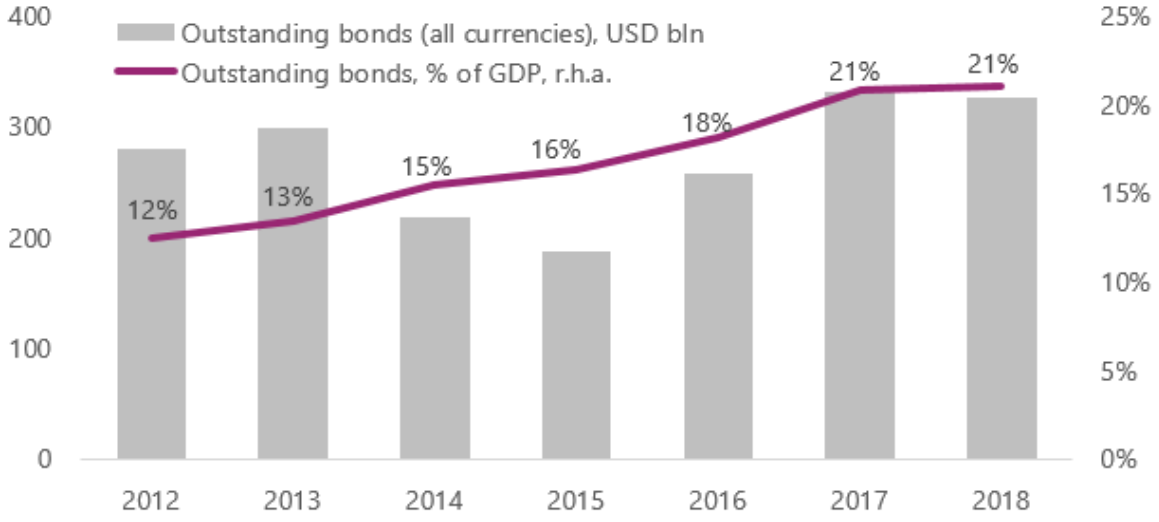
Figure 3.7: Russia: volumes of stocks traded, 2001–2017, % of GDP



Source: World Bank's World Development Indicators, available at: https://databank.worldbank.org/data/source/world-development-indicators, accessed on 18 May 2019.

Contrary to the stock market, the bond market in Russia represents a growing trend in the 2010s but from a relatively low initial level (Figure 3.8). At the end of 2018, its total outstanding volume amounted to 21% of Russian GDP and 0.5% of the total global volume of bond transactions.[161]

Figure 3.8: Russia: volume of the bond market, 2012–2018, end of the year, USD billion and % of GDP



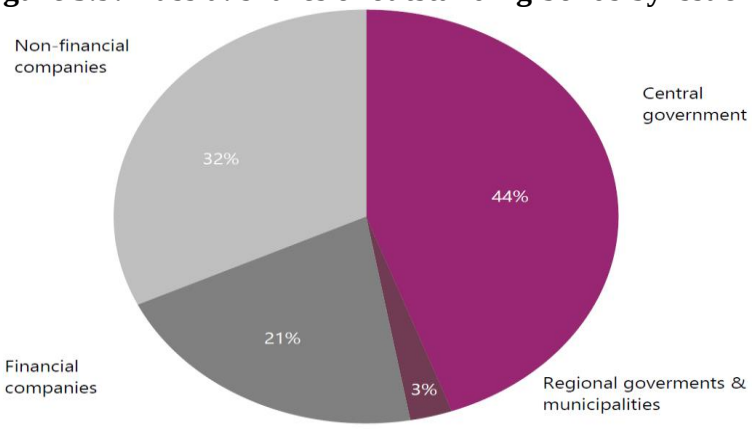
Source: Analytical Credit Rating Agency (ACRA) (2019), A *Brief introduction to the Russian bond market. Structure, history, and possible ways of evolution*, available at: https://www.acra-ratings.com/documents/1119, accessed on 15 October 2019.

Figure 3.9 demonstrates that federal government bonds accounted for 44%, bonds issues by regional and municipal governments for 3% and corporate bonds for the remaining 53% of the total outstanding volume of bonds on 30 November 2018. Within the corporate bonds category,

[161] Analytical Credit Rating Agency (ACRA) (2019), *A Brief introduction to the Russian bond market. Structure, history, and possible ways of evolution*, available at: https://www.acra-ratings.com/documents/1119, accessed on 15 October 2019.

21% of the total was issued by financial institutions and 32% by non-financial companies, mainly representing the oil, gas and other mining industries, construction and real estate.[162]

Figure 3.9: Russia: shares of outstanding bonds by issuers, % of total, 30 November 2018



Source: Analytical Credit Rating Agency (ACRA) (2019), *A Brief introduction to the Russian bond market. Structure, history, and possible ways of evolution*.

There are few stock exchanges in Russia, but the Moscow Exchange is the largest and most important platform for non-bank financial transactions. Its main shareholders are the CBRF (11.8% of shares), Sberbank (10.0%), VEB (8.4%), European Bank for Reconstruction and Development (6.1%) and the Russian Fund of Direct Investments 'Investment Management – 6' (5.0%).[163] The first three are state-owned institutions/companies. However, 57.6% of shares are dispersed and free floating on the stock market.[164]

3.6 CHAPTER SUMMARY

The Russian financial sector is dominated by banks that account for close to 90% of its total assets. Since the 2008–2009 financial crisis, the banking sector went through an intensive consolidation process driven by rescue operations of banks in financial trouble (provided by Government agencies such as the DIA, the CBFR as the financial mega-regulator and existing state-owned banks), mergers and acquisitions, and tighter prudential regulations. The 2014–2015 financial crisis accelerated this process. As a result, the number of operating banks decreased, the share of state ownership in their capital increased significantly and the market share of the largest, state-controlled banks also increased. In October 2018, 72.1% of banking assets were controlled by five SCBs. This poses a potentially serious challenge to the competitiveness of the banking sector and the effective allocation of capital (see Chapter 9).

[162] *Ibidem.*
[163] Available at: https://www.moex.com/s1343, accessed on 18 May 2019.
[164] The Moscow Exchange conducts a broad spectrum of financial transactions. It trades shares, bonds, derivatives, foreign exchange, and commodities. See also: Moscow Exchange (2019), *Investor Presentation*, available at: http://fs.moex.com/files/18873/, accessed on 17 May 2019.

Similar tendencies have been observed in the insurance sector, although to a smaller degree. The role of other subsectors such as investment funds, non-governmental pension funds, microfinance institutions or brokerage firms remains rather marginal.

The performance of the Russian stock market, which experienced rapid growth in the 1990s and the first half of the 2000s remains limited since the 2008–2009 crisis, both in terms of market capitalisation and, even more, in terms of the volume of trade stocks. Contrary to the stock market, the bond market represents a growing trend although.

4 STATE-OWNED ENTERPRISES

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4.1 INTRODUCTION

Based on available statistics and policy information related to SOEs,[165] this chapter assesses to what extent such enterprises may be influencing the functioning of markets in Russia. This depends not only on the size and distribution of the state sector but also on the legislation and practice pertaining to their governance, the markets in which they operate and the type and size of advantages the Government extends to and through SOEs. It is in this context that this chapter is structured to provide: (*i*) a brief overview of privatisation and renationalisation trends in the Russian economy since the beginning of its transition from a centrally-planned economy to a market-based one; (*ii*) a discussion of main legal forms of SOEs; (*iii*) assessment of the size of state ownership in the entire economy and in individual sectors/industries; (*iv*) an assessment of the general standards of their corporate governance and their management taking the Organisation for Economic Co-operation and Development ('OECD') Guidelines for Corporate Governance of SOEs as an internationally accepted reference; (*v*) an assessment of some more specific issues related to the behaviour of Russia's SOEs in the market place; and (*vi*) overall conclusions.

4.2 HISTORICAL BACKGROUND

4.2.1 PRIVATISATION IN THE 1990S

In the former Soviet Union, Russia's economy was almost totally dominated by state ownership. After the collapse of the Soviet Union, a mass-scale privatisation programme was implemented in the first half of the 1990s. The first regulatory act relating to privatisation in Russia was the Law on the Privatisation of State and Municipal Enterprises in the RSFSR, adopted on 3 July 1991, which defined the list and competences of state bodies authorised to conduct privatisation and regulated the procedure and methods for privatising state and municipal enterprises. The first stage of privatisation (1992–1994), called '*voucher'* or '*check*' privatisation, began in mid-1992. Each resident received a voucher (a check) with a nominal value of RUB 10 000, and with it the right to either exchange it during a private subscription for shares of the company he or she worked at, participate in a direct check auction where shares of state enterprises could be bought exclusively with privatisation checks, buy shares of intermediary organisations, called check investment funds[166] (′CIFs′), or just sell the voucher. However, the legislation at the time did not allow CIFs to acquire controlling stakes in enterprises with high growth potential such as natural monopolies and other important enterprises of the basic sectors of the economy, as these were kept out of the voucher privatisation process. Also, because of these restrictions, privatisation checks were often used

[165] This chapter interchangeably uses the terms ′SOEs′ and ′state enterprises′, reflecting the fact that ownership is not the only relevant criterion when analysing market-distorting practices (see e.g. Kowalski and Rabaioli, 2017, concerning the use of the term ′state enterprises′). Where relevant, a specific kinds of enterprises is indicated.

[166] CIFs are specialised funds created in Russia during the voucher privatisation period of the early 1990s, with the aim of assisting the public in investing privatisation vouchers and ensuring professional asset management of these funds.

to purchase shares of economically inefficient enterprises. As a result, many of the CIFs went bankrupt and were liquidated.

The transition to the second, so-called '*monetary*', stage of privatisation was approved in 1994.[167] Large enterprises of the basic sectors of the economy, which were kept out of the voucher privatisation process in the first stage, were privatised slowly on a case-by-case basis through auctions. The latter were reported to be largely rigged in the sense that the winners were determined mainly by their political connections. The most notorious examples were, allegedly, the loan-for-shares deals in which assets were sold far below their market value to a number of important businessmen in exchange for their support during Boris Yeltsin's presidential re-election campaign in 1995.[168]

The third stage of privatisation, initiated in 1997, supported by an important regulatory act in 2001,[169] and technically continuing until now,[170] has been referred to as '*point privatisation*' and has been carried out on a planned basis. Under current law, privatisation planning is within the competence of the Government, which annually approves the forecast plan (programme) of privatisation and, also annually, submits a report on its implementation to the Parliament. According to this system, it is for the President to formulate and approve a list of enterprises strategically important for national security and determine the possibility of their privatisation.

Overall, it has been estimated that during the first ten years of privatisation, in the period 1993–2003, the Russian Treasury received USD 9.7 billion from the sale of 145 000 SOEs, around USD 67 000 per enterprise. At the same time, Russia is estimated to have become a predominantly privately-owned economy with the share of the private sector in GDP estimated by the European Bank for Reconstruction and Development (′EBRD′) to be at a level of 70% in the early 2000s.[171] However, this share has fallen again in the following years due to various renationalisation initiatives, particularly as far as the larger enterprise segment is concerned. While the EBRD estimates are approximate, they do indicate that Russia was, in the early 2000s, roughly on par with its privatisation and market reforms with other post-communist economies in the region, but also that it has gone back with respect to the best performing ones since then.

[167] Presidential Decree of 22 July 22 1994 "*on the main Provisions of the State Privatisation Programme of State and Municipal Enterprises in the Russian Federation after 1 July 1994*".

[168] Enikolopov, R., and S. Stepanov (2013), *Corporate governance in Russia*, *in* M. Alexeev and S. Weber (eds.), *The Oxford Handbook of the Russian Economy*, p. 224.

[169] The phase was initiated by the Federal Law N.º 123-FZ of 21 July 1997 "*on the Privatisation of State Property and the Basics of Privatisation of Municipal Property of the Russian Federation*" (in force until 2002). The main regulatory act regulating privatisation, which is *nota bene* still in force now, is the Federal Law N.º 187-FZ of 21 December 2001 "*on the Privatisation of State and Municipal Property*".

[170] In July 2017, the 2001 Act underwent amendments resulting in significant tightening of privatisation regulations. For example, the selection procedure for entities scheduled for privatisation has been extended and made more cumbersome [see Gaidar Institute (2017), *Russian Economy in 2016*, pp. 378–386, available at: https://www.iep.ru/files/text/trends/2016-eng/Book.pdf, accessed on 21 October 2019].

[171] For the source of EBRD data, see: http://www.ebrd.com/downloads/research/economics/macrodata/sci.xls, accessed on 21 October 2019.

4.2.2 RENATIONALISATION SINCE 2005

The turning point in privatisation came in 2003 with the crackdown on the largest Russian private company, Yukos, when its assets were taken over by the state-owned Rosneft. In the following years, this trend of state takeovers continued, especially in the oil and gas industry.[172] Unlike privatisation, this wave of renationalisation in Russia was carried out haphazardly and was not publicly announced or discussed: it was not declared as part of Government policy, there were not any laws or programmes concerning nationalisation. This is the main reason why it was called a '*quiet*' or '*creeping*' renationalisation.[173]

December 2004 is often considered as the official start of the renationalisation – at that time Yuganskneftegaz, Yukos' main production unit, was sold to the state-owned oil company Rosneft to settle a tax debt for alleged tax evasion. Notably, the acquisition was arranged through the opaque shell company, Baikalfinansgroup.[174] However, even earlier, starting in 2002, Gazprom was tasked with the reacquisition of formerly state-owned assets. Through the efforts of management, SIBUR, Stroytransgaz and the main gas producing enterprises ITERA were bought back by the state monopoly. At the same time, Gazprom had transferred its non-core assets into private hands: Gazprom sold its shares in the Oskol Electrometallurgical Combine and Lebedinsky GOK, and it also sold the NRB Bank. Moreover, the oil company ONAKO was privatized, and at the end of 2002 the same happened to Slavneft.

Over the next four years, the Government directly, or through SOEs, acquired control over a number of large independent companies and whole business groups in different sectors of the economy. [175] For example, in 2005 alone, the Government and government-controlled companies consolidated control over companies such as Sibneft (oil), United Heavy Machineries (engineering), Power Machines (engineering), AvtoVAZ (automobiles) and several major aircraft and helicopter plants. The Government stake in the gas monopolist, Gazprom, has also increased from 38% to 50% plus one share. In subsequent years, the Government gradually acquired majority and blocking minority stakes in a number of other large companies in different industries including metallurgy, power-generation equipment and banking.[176]

During the financial crisis of 2008–2009, unlike other countries in which companies and financial institutions were nationalised in the bailout process, in Russia the bailouts were organised in the form of loans issued by the state-controlled banks. In some cases, however, the result of these loans was the transfer of control over such companies to state-controlled banks

[172] Sprenger, C. (2010), *State ownership in the Russian economy: Its magnitude, structure and governance problems*, *The Journal of the Institute of Public Enterprise*, 33(1–2), p. 14.

[173] Chernykh, L. (2011), *Profit or politics? Understanding renationalisations in Russia*, *Journal of Corporate Finance*, 17, no. 5 (2011): 1237-1253, p. 1241.

[174] *Ibidem*, p. 1240.

[175] Enikolopov, R., and S. Stepanov (2013), *Corporate governance in Russia*, *in* M. Alexeev and S. Weber (eds.), *The Oxford Handbook of the Russian Economy*, p. 229.

[176] Chernykh, L. (2011), Profit or politics? Understanding renationalizations in Russia, *Journal of Corporate Finance*, 17, no. 5 (2011): 1237-1253, p. 1240.

as a part of debt restructuring. Examples are the VTB's purchases of controlling stakes of the property developers Donstroy Invest and Sistema-Hals for as little as RUB 500[177] and RUB 60[178] respectively.[179] One of the sectors particularly affected was the banking sector which was recapitalised, directly or indirectly (through takeovers of the already state-owned banks) by the State. Although SOEs bought several private companies, the overall share of SOEs among the largest companies remained virtually unchanged in the period 2008–10.[180]

Still, by the mid-2010s, Russia's economy was overall not very significantly more state-dominated than some of the other post-communist economies in Central and Eastern Europe. The trend of renationalisation continued nevertheless, including during the period of the next macroeconomic and financial crisis of 2014–2016 caused by, among others, the collapse of oil prices, as well as sanctions imposed by the European Union (′EU′) and United States (′US′) against Russia and Russian counter-sanctions against its western partners.[181] One of the main cases was that of Bashneft in 2014[182] and the Central Bank's steady attempts at banking sector recovery and elimination of non-viable and unscrupulous banks including through the introduction of external state management in banks close to bankruptcy. As a result, the government-controlled share of banking assets is estimated to be as high as two thirds[183] or 70.7% in 2017.[184]

[177] Reuters (2009), *Russia's VTB to take control of developer Don Story*, available at: https://www.reuters.com/article/us-vtb-donstroy/russias-vtb-to-take-control-of-developer-don-stroy-idUSTRE57P1HI20090826, accessed on 21 October 2019.

[178] According to the company's published consolidated financial results for 2009, available at: https://en.hals-development.ru/upload/documents/5a3/5a3e962c35d4059c18dd5e3f5e928f36.pdf, accessed on 22 January 2020.

[179] Such low prices of controlling stakes can be explained by the fact that the heavily indebted Russian construction sector suffered greatly from the global credit crunch and the deep recession of the Russian economy.

[180] Standard & Poor's and Centre for Economic and Financial Research, (2010), *Transparency and Disclosure by Russian Companies 2010: Moderate Improvement in Transparency Led by Power Utilitie*, Moscow, Standard & Poor's, p. 5.

[181] See Dąbrowski, M. (2015), *The systemic roots of Russia's recession*, Bruegel Policy Contribution, Issue 2015/15, October 16, available at: http://bruegel.org/wp-content/uploads/2015/10/pc_2015_15.pdf, accessed on 20 February 2020. To be noted that on the Russian side, in August 2014, the Government imposed restrictions on imports of certain goods from the US, the EU, Norway, Australia and Canada, in line with the mandate granted to it according to the Presidential Decree "*on imposing separate special economic measures ensuring security for the Russian Federation.*" Later the list of countries was expanded, and the list of goods was revised. Moreover, Federal Law No. 127-FZ of 4 June 2018 on countermeasures against unfriendly actions of the United States and other foreign countries empowered the Government to introduce on the basis of the President's decision various countermeasures, provided they do not apply to vital goods not manufactured in Russia and other countries (available at: https://tass.com/politics/1012859, accessed on 9 March 2020).

[182] On 30 October 2014, the Moscow Arbitration Court decided to withdraw from the accounts of Sistema JSFC and Sistema-Invest 71% of Bashneft's shares and transfer them to federal ownership. Despite the fact that later Bashneft was excluded from the list of strategic enterprises and included in the privatisation plan for 2016, in October 2016 Bashneft was bought by the State company Rosneft. The court recognized Sistema JSFC as a *bona fide* purchaser of Bashneft, but Sistema JSFC may try to recover these loses from Ural-Invest – the seller of the Bashneft shares.

[183] IMF (2018*), Russian Federation; Selected Issues*, IMF Country Report No. 18/276, p. 19.

[184] Bershidsky L. (2018), *Putin's Creeping Nationalisation of Banks*. Bloomberg Opinion, available at: https://www.bloomberg.com/opinion/articles/2018-06-07/putin-s-under-the-radar-nationalization-of-russia-s-private-banks, accessed on 21 October 2019.

4.3 LEGAL AND INSTITUTIONAL FRAMEWORK AND LEGAL FORMS OF SOES

4.3.1 OWNERSHIP FUNCTIONS OF STATE AGENCIES

The Federal Agency for State Property Management (′Rosimushchestvo′ or the ′Federal Property Agency′ or ′FPA′) is a federal executive body managing federal property (excluding cases when, in accordance with the Russian legislation, these powers are exercised by other federal executive bodies). The FPA also organises the sale of federal property to be privatised and federal property confiscated in favour of the State.[185] The Government, through the FPA, owns the majority of Russian state-owned enterprises, although often state ownership and control in Russia takes the form of indirect ownership or other links, through state-controlled pyramid-like ownership structures.[186]

Exceptions are the banking and insurance sector where the CBRF owns 50% of shares +1 share of Sberbank[187] and 100% of shares of the Russian National Reinsurance Company (′RNRC′).[188] Also, as a part of the process of reorganising credit organisations and banks, the CBRF invests in them through the Banking Sector Consolidation Fund (′BSCF′), receiving (temporarily and indirectly) a share in the capital of banks subject to financial recovery. The first such project in the summer of 2017 was the sanction of the public joint-stock company Otkrytie Financial Corporation:[189] the CBRF provided a RUB 380 billion (USD 6.5 billion) bailout loan to Otkrytie and obtained control of that bank through BSCF.

4.3.2 LEGAL FORMS OF SOES

The legal framework enshrined in the Civil Code and supporting legislation distinguishes three main legal forms for state ownership in Russia: 1) unitary enterprises; 2) joint-stock companies; and 3) state corporations. Each of these categories is governed by a different set of laws and, thus, subject to different requirements, including with respect to bankruptcy or auditing procedures. This, in turn, has implications for the corporate governance and competitiveness of the enterprises falling under each category (see Section 4.5).

Unitary enterprises are business entities engaging in commercial operations that have no ownership rights to the assets they use in their operations and are fully controlled by the Government at a corresponding level: federal (Federal State Unitary Enterprise, ′FSUE′), regional (State Unitary Enterprise), or municipal (Municipal Unitary Enterprise).[190] They are referred to as unitary enterprises, since their property is indivisible and cannot be distributed

[185] The Russian Government, *Federal Agency for State Property Management*, available at: http://government.ru/en/department/83/events/, accessed on 21 October 2019.

[186] Chernykh, L. (2008), Ultimate ownership and control in Russia, *Journal of Financial Economics*, 88, n.º 1, 169-192, p. 170.

[187] Sberbank (2017), *Shareholder Structure*, available at: https://www.sberbank.com/ru/investor-relations/share-profile/shareholders-structure , accessed on 21 October 2019.

[188] RNRC is the largest Russian reinsurance company. RNRC is n.º 1 in terms of the authorised share capital (RUB 71 billion) and n.º 2 in terms of paid-in capital (RUB 21.3 billion) on the domestic insurance market.

[189] Available at: http://www.cbr.ru/press/pr/?file=29082017_170003ik2017-08-29T16_54_35.htm, accessed on 21 October 2019.

[190] Russian acronyms are "FGUP" (Federal State Unitary Enterprise), "GUP" (State Unitary Enterprise), and "MUP" (Municipal Unitary Enterprise), respectively.

among deposits and shares. Only federal, regional and municipal enterprises can be created in this legal form.

The basic law regulating the operation of unitary enterprises is the Federal Law No. 161-FZ on State and Municipal Enterprises from 2002.[191] Since unitary enterprises have only limited rights regarding the use of their property, many types of transactions have to be approved by the corresponding Government agencies, e.g. by the FPA. Moreover, since they have no assets, these cannot be used in satisfying any potential creditors in the event of bankruptcy. Unitary enterprises have no right to set up subsidiaries, but, with the owning agency's consent, can open branches and representative offices. They are also generally not obliged to disclose financial information but are audited by the Audit Chamber[192] of the Russian Federation.

According to Federal Law No. 161-FZ, there are two types of unitary enterprise: *kazennoye* and *gosudarstvennoye* (a simple unitary enterprise).[193] *Kazennoye* enterprises are intended to engage in the production of products related to military needs, as well as products for the needs of federal and public organizations, ensuring the security of the country and its strategic interests. Their activities are combined with active commercial activities, although they have very limited rights to property that was transferred by the owner-founder (the State). A *kazennoye* enterprise carries out its activities on the basis of an estimate of income and expenses approved by the owner. This requires a strictly targeted, rather than independent, as in the case of a simple unitary enterprise, nature of the use of existing property. Orders of the owner must necessarily be fulfilled, it may be the supply of goods, the provision of various services or the performance of work that ensures the activities of state and municipal bodies. The founder is entitled to withdraw excess and unused property, and if it is used for other purposes.

Examples of the largest federal state unitary enterprises are Rosoboronexport (exporter of military equipment), the Post of Russia (postal services), and Rosspirtprom (holding of producers of alcoholic beverages), the Air Traffic Management Corporation and the All-Russia State Television and Radio Broadcasting Company. Examples of large non-federal unitary enterprises are Moscow Metro, Mosgortrans (surface Moscow public transport company) or Saint Petersburg Metro.

According to the Federal Antimonopoly Service of Russia (′FAS′), most of the SOEs in terms of numbers are unitary enterprises. However, an official policy of the Government is to reduce the number of unitary enterprises, either by incorporating them as joint-stock companies, by means of privatisation, liquidation, or by converting them into treasury enterprises. The latter category of enterprises works exclusively to satisfy Government orders, typically in the defence sector, and their number is relatively small.

Most state-owned joint-stock companies (′JSCs′) with either partial or full state ownership are incorporated as open joint-stock companies (Russian acronym 'OAO') which have the right to

[191] Federal Law N.º 161-FZ of 14 November 2002 "*on State and Municipal Unitary Enterprises*".
[192] *Schetnaya Palata.*
[193] Since in other countries there are no similar forms of state enterprises, an exact translation of the names of these types into English is impossible.

organise a public subscription for the shares issued by them and sell these shares on the open market. Other JSCs have the legal form of closed joint-stock companies (Russian acronym 'ZAO'). ZAOs have a maximum of 50 shareholders. Shareholders have a pre-emptive right to buy shares sold by other shareholders but shares of ZAOs cannot be publicly traded. Thus, the main differences between closed JSCs and open JSCs lie in limitations for ownership transfers to other parties, and in the lower disclosure requirements.

The basic law that governs the organisation of JSCs is the Federal Law No. 208-FZ on Joint-Stock Companies from 1995.[194] Open JSCs are obliged to publish quarterly and yearly financial reports, to be audited externally, and may go bankrupt if they do not fulfil their financial obligations. The legal form of the open joint-stock company provides flexibility for the participation of private investors and allows raising capital on the stock and bond markets.

Examples of open JSCs with 100% ownership by the Government are Russian Railways, Sheremetyevo International Airport, and United Shipbuilding Corporation. Examples of open JSCs with partial state ownership are Gazprom, Rosneft, Sberbank, VTB, Aeroflot and Transneft. These companies are listed on Russian and foreign stock exchanges.

The State can also hold shares in Limited Liability Companies ('LLCs' or 'OOOs' in Russian) which are the most flexible form of incorporation in Russia although they also can have a maximum of 50 shareholders.

The Law on Non-Commercial Entities introduced in 1999 so-called state corporations (*gosudarstvennaya korporatsiya* or *goskorporasii* in Russian) into the Russian legal order. These are non-membership, in principle non-commercial, organisations.[195] Each state corporation is created by a separate Russian federal law. According to the Federal Law No. 7 on Non-Commercial Entities, a state corporation is wholly owned by the Russian Federation directly, bypassing the FPA. The peculiarity of the Status of state corporations is significantly less control by state bodies, as well as weak requirements for disclosing information about their activities. A state corporation, unlike an open JSC with predominantly state participation, cannot be declared bankrupt, as the current legislation provides only for the bankruptcy of non-profit organisations operating in the form of a consumer cooperative, a charitable or other fund.[196]

Despite their officially declared non-commercial, non-profit nature, there are certain questions about their *de facto* character. First, their *de jure* status is unclear. It is not directly defined in the Civil Code, which specifies only three categories of ownership: public, private and municipal. While the general notion of a state corporation was laid down in the Law on non-commercial entities, specific regulations concerning individual companies are set out every time in the individual law establishing a given state corporation. This complicates their legal status and obscures formal requirements.

[194] Federal Law N.º 208-FZ of 26 December 1995 "*on Joint-Stock Companies*" (as amended).
[195] Federal Law N.º 7-FZ of 12 January 1996 (as amended) "*on Non-Commercial Entities*", Article 7.1.
[196] Available at: https://ria.ru/20090807/180096090.html, accessed on 15 November 2019.

Second, their *de facto* status is also nebulous. On one hand, the Government acts as the founder by transferring certain assets to the corporation but is not responsible for its financial obligations. On the other hand, the top management of the corporation, while outside of the Government, is accountable directly to the President and selected members of the Government. Third, there is little transparency regarding operations of state corporations as they are exempt from many requirements that are binding for both private and public companies in Russia, which may have implications for their competitiveness. For example, the Bankruptcy Law does not apply to state corporations, and they are not controlled by the Audit Chamber of the Russian Federation.

It has indeed been suggested in the literature that some state corporations use the legal non-profit organisation (′NPO′) status in order to advance a given public objective, including operations in commercial markets. For example, Vnesheconombank does not have a bank licence and is not a bank, but is a Sate corporation, i.e. a non-profit organisation.[197] However, it provides financing for projects which may have commercial or profit goals and it operates in principle in similar markets to commercial banks. Vneshecoconombank can best be described as a development bank.[198]

Other prominent state corporations include the DIA, the Fund of Housing and Communal Services Development Cooperation, SC Olympstroy (development and construction of Olympic venues), Rostec (a holding conglomerate specialising in defence and high-tech industries), Rosatom (nuclear energy) and Roscosmos (cosmonautics).

An additional form of state enterprise, *budget institutions*, are non-profit organisations created by the Russian Federation, which are constituent entities of the Russian Federation or a municipality to perform work and services in order to ensure the implementation of the powers stipulated by legislation, respectively, of state bodies or local governments in the fields of science, education, health, culture, social protection, employment, physical culture and sports, as well as in other areas.[199]

4.4 SOEs AND THEIR WEIGHT IN THE RUSSIAN ECONOMY

Assessing the extent of state ownership and its economic significance in Russia is complicated by the co-existence of the diverse legal forms of state enterprises as well as a range of different statistical definitions used by various Russian State agencies in reporting on activities of these enterprises. The range and detail of available data, even if sometimes inconsistent, is however

[197] Vnesheconombank, or 'VEB', is a Russian government-owned development bank, meant to provide funding for projects aimed at developing the Russian economy. It is not involved in retail banking activities.

[198] Another example is the Russian Corporation for Nanotechnologies which received USD 5.4 billion in order to allocate grants for advancing cutting-edge research and development. Thus, the rationale for state corporations could be seen as a vehicle for the State to invest excess revenues from oil exports to further the modernisation effort, bypassing bureaucratic Government structures. However, the unprecedented legal structure that was created and resulting lack of transparency have caused problems in its own right.

[199] Federal law N.º 7-FZ of 12 January 1996 (as amended) "*on Non-Commercial Entities*", Article 9(2).

quite extensive and allows light to be shed on the general importance and sectoral concentration of state enterprises in the country and, as well as their likely economic effects.

4.4.1 THE SIZE OF THE STATE SECTOR

The most comprehensive and recent account which provides detailed statistics on federal government-owned state enterprises and which distinguishes between their legal forms can be found in the report *Russian Economy in 2017 Trends and Outlooks.*[200] The report uses data collected in the new framework for federal property management adopted in 2015 and supplements it with data from the similar monitoring framework by the official Russian national statistics provided by the National Statistical Office of the Russian Federation (′Rosstat′).

Summing up the information contained in this source, at the beginning of 2017 the Russian Federation owned 1 108 FSUEs which was down from around 3 500 in 2010. It also held an interest in 1 416 JSCs and Limited Liability Companies, respectively. The latter figure also shows more than a 50% decline with respect to the year 2010 (from more than 3 000 JSCs with state-held shares then). The numbers of FSUEs and JCSs declined further in the course of 2017 to, respectively, 1 058 and 1 247 enterprises in July 2017. In the same period, there were 53 federal treasury enterprises (′FTEs′) and 16 244 federal Government agencies (′FGAs′) (Table 4.1). These figures show consistent reductions in the numbers of different state enterprises, depending on the type of enterprise, in the range of above 20% (FSUEs and JCSs) and 4% (FGAs) between 2016 and 2017. The number of enterprises in which the Government has a golden share in absence of equity participation has also been declining.

Table 4.1: Federally owned companies and organisations registered with the federal property register and performance measures framework for federal property management, 2010–2017

Date	Number of shareholding companies with federal equity participation		Number of other federal property owners		
	Equity participation / of which JSCs	golden share in absence of equity participation	FSUEs	FTEs	FGAs
As of January 1, 2010	3066/2950[b]		3517[b]		
As of January 1, 2013	2356/2337[b]		1800/1795[b]	72	20458
As of January 1, 2016	1557/1704[b]	88/64[c]	1488/1247[b]	48	16194
As of April 7, 2016[a]	1683/1620[d]		1236	48	16726
As of July 1, 2016	1571	82	1378	47	16990
As of January 1, 2017	1356/ 1416[e]	81	1245/1108[e]	48	16846
As of July 1, 2017	1247	78	1058	53	16244

Note: To be able to compare time trends across different SOE types, the presented data draws on different sources which sometimes use different enterprise definitions. The most important differences and precisions are indicated in the associated superscripts, where:

[a] golden share is not accounted for in the register but mentioned in Rosimushchestvo's documents as part of data on Government equity participation;

[200] Gaidar Institute (2018), *Russian Economy in 2017, Trends and Outlooks*, Moscow, available at: https://iep.ru/files/text/trends/2017-eng/Book.pdf, accessed on 21 October 2019.

[b] the number of JSCs and FSUEs according to data from privatisation programmes for 2010–2013, 2014–2016 and 2017–2019 (the latter contains data based on OKVED classification (Russian Classifier of Economic Activities) that refer to companies with an interest owned by the Government);

[c] according to data from the federal property register;

[d] the numerator shows total corporate entities including ZAOs and OOOs, the denominator shows equity participation (the difference is supposedly represented by the number of JSCs with a golden share which is not explicitly specified);

e according to data from the 2017 Report on Execution of the Forecast Plan (Programme) for Federal Property Privatisation for 2017–2019.

Source: Gaidar (2018), using: The Forecast Plan (Programme) for Federal Property Privatisation and Guidelines for Federal Property Privatisation for 2011–2013; The Forecast Plan (Programme) for Federal Property Privatisation and Guidelines for Federal Property Privatisation for 2014–2016; available at: www.economy.gov.ru, 23 April 2013; The Rosimushchestvo's Performance Report for 2015; The Forecast Plan (Programme) for Federal Property Privatisation and Guidelines for Federal Property Privatisation for 2017–2019; Statistical data on The performance measures the framework for federal property management, available at: www.gks.ru, 20 March 2016, 5 September 2016; 20 March 2017, 5 September 2017; The Report on Execution of the Forecast Plan (Programme) for Federal Property Privatisation 2017–2019 in 2017.

As pointed out in the same source, these statistics, however, also have to be further considered in the context of the falling share of JCSs in which the FPA can fully exercise shareholder rights, due to either zero or very small equity stakes, transfer of shareholder rights to other entities, enterprises being in bankruptcy proceedings or liquidation. It is reported that the share of JSCs in which the FPA's shareholders rights are significantly restricted increased from 48% in 2012 to 59% in 2017. It is also estimated that more than 50% of JSCs in which the FPA can fully exercise shareholder rights were covered by forecast privatisation plans.[201] This complements the picture of declining ownership and control of enterprises by the State.

Another source of official data, which allows time series and cross-sector comparisons, is the official Russian national statistics provided by Rosstat. Rosstat classifies all enterprises according to the All-Russia Classifier of Forms of Ownership[202] into the following five categories: (1) state;[203] (2) municipal;[204] (3) private;[205] (4) religious and other non-profit organisations; (5) other ownership forms, including domestic ownership of State corporations, foreign, and joint domestic and foreign. In addition, some Rosstat tables, such as for example the ones on enterprises and organisations by economic activity introduce another category: (6) 'mixed Russian'.[206] Rosstat does not provide in its sources the exact definitions and delineations

[201] Gaidar (2018).

[202] Russian name: *Obsherossiyskiy Klassifikator Form Sobstvennosti*, Rosstat (2016).

[203] State property is property owned by the right of ownership of the Russian Federation, and property owned by the right of ownership to subjects of the Russian Federation – republics, territories, regions, cities of federal significance, autonomous region, autonomous districts (Rosstat (2016), *Obsherossiyskiy Klassifikator Form Sobstvennosti*, available at: www.gks.ru/metod/okfs-tiz.doc , accessed on 15 November 2019).

[204] Municipal property is property owned by the right of ownership of urban and rural settlements, as well as other municipalities (Rosstat, 2016).

[205] Private property is property owned by citizens or legal entities, with the exception of certain types of property that, in accordance with the law, cannot belong to citizens or legal entities (Rosstat, 2016).

[206] According to Resolution of the State Standard of Russia N.º 97 of 30 March 1999 (as amended) "*on the Adoption and Implementation of the All-Russian Classifiers*" (which includes the All-Russia Classifier of Forms of Ownership), mixed Russian property is property owned by a Russian legal entity and based on combining property of various forms of Russian property. In particular, this form includes forms of ownership both with and without the presence of a share of state ownership. But a fully SOE must be categorised as category 1, 2 or 5 (state corporation property).

between these different types of enterprises.[207] For example, the precise criteria for the share of capital ownership required for the enterprise to be classified as state-owned, as opposed to private or enterprise of other forms of ownership, are not stated clearly in any of the sources or methodological notes in the Russian Statistical Yearbook, where statistics regarding these enterprises are provided annually.[208]

According to Rosstat's classification and the data it provides in the Russian Statistical Yearbook, the share of state and municipal enterprises in the overall number of enterprises declined from respectively 17 and 9% in 1994 to 2 and 4% in 2017. The reduction in the share of state enterprises has thus been more pronounced than that in municipal ones, although in 2017 there were still some 103 000 state and 196 000 municipal enterprises in the economy of Russia. In comparison, there were nearly four million private companies, and this is the category that clearly expanded its share the most, accounting in 2017 for over 86% of all enterprises (Table 4.2 and Figure 4.1). The trends shown also suggest that, after a small increase in the years 2006 and 2007, the share of federal state ownership in Russian enterprises continues to fall, at least when it comes to enterprise counts.

Table 4.2: Enterprises and organisations by type of ownership (thousands)

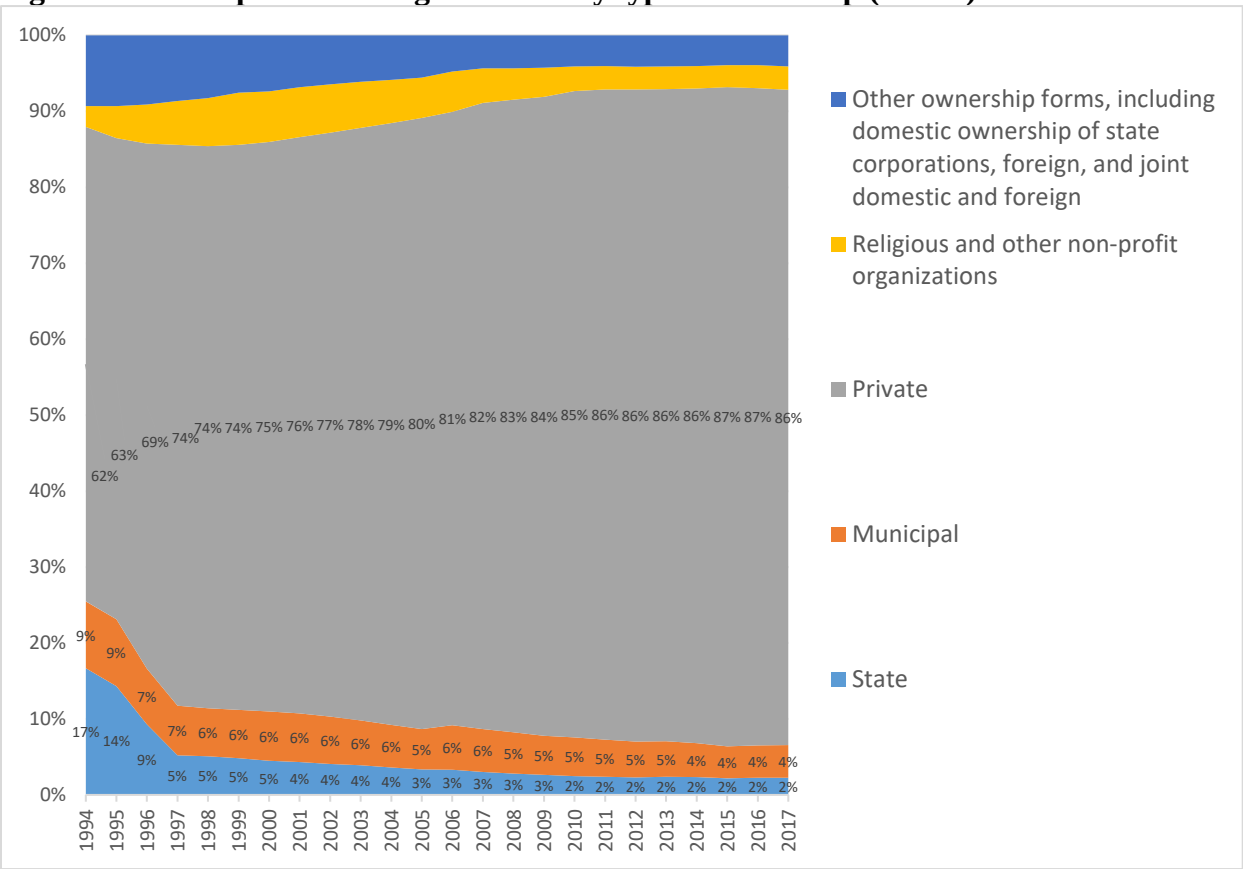
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total	1,946	2,250	2,505	2,727	2,901	3,106	3,346	3,594	3,845	4,150	4,417	4,767	4,507	4,675	4,772	4,908	4,823	4,867	4,886	4,843	4,886	5,044	4,764	4,562
State	325	322	233	143	148	150	151	155	157	161	159	160	149	142	135	130	119	116	113	116	114	111	108	103
Municipal	171	198	184	178	183	198	217	231	239	246	248	252	264	263	258	253	246	239	231	225	219	212	203	196
Private	1,216	1,426	1,730	2,014	2,147	2,312	2,510	2,726	2,957	3,238	3,499	3,838	3,639	3,855	3,976	4,128	4,104	4,165	4,195	4,160	4,212	4,378	4,122	3,936
Religious and other non-profit organizations	54	95	130	158	183	213	223	237	244	252	253	253	239	212	197	188	157	150	147	145	144	145	144	140
Other ownership forms (domestic ownership of state corporations, foreign, and joint domestic and foreign)	181	209	227	235	240	234	247	245	248	253	258	265	215	203	206	209	197	197	201	198	197	198	187	186

Source: Rosstat, Russian Statistical Yearbooks 1994–2018.

[207] At least, it was not possible to identify such definitions.

[208] The All-Russia Classifier is an institutional approach to the formation of macroeconomic indicators, which makes it possible to approach the studied processes not from the point of view of the process itself (such an approach is called functional), but from the point of view of the subjects implementing it. Another Russian classifier called the Institutional Unit Classifier divides the domestic economy into a number of groups of economic entities – residents of the country, which are homogeneous in terms of the functions they perform in the economic process, as well as the sources of financing their costs. Abramov et al. (2017), quoting the Institutional Unit Classifier, reports that state-owned companies include joint-stock companies where 50% (or more) of the authorised capital is owned by the State where this is calculated based on shareholdings (shares in the authorised capital) that are at the disposal of authorised Government agencies.

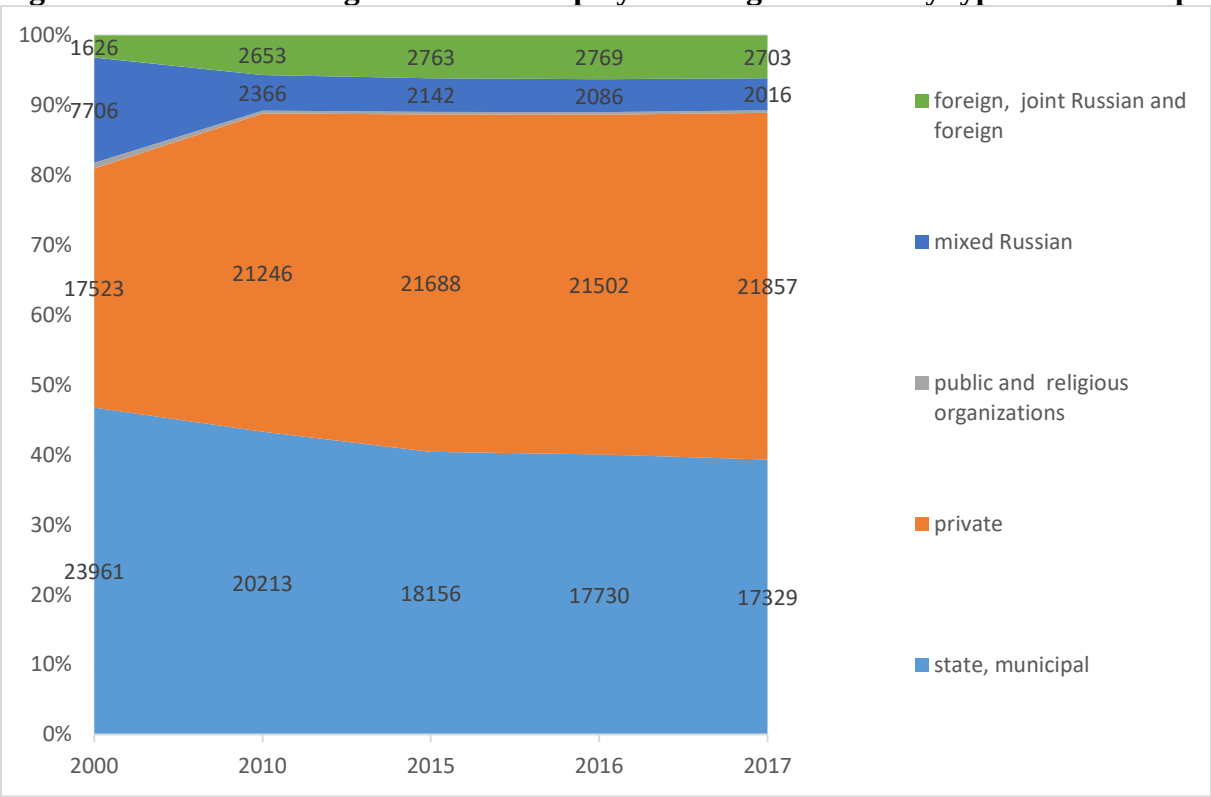
Figure 4.1: Enterprises and organisations by type of ownership (shares)



Source: Rosstat, Russian Statistical Yearbooks 1994–2018.

A similar enterprise categorisation in conjunction with Rosstat data can be used for assessing shares of state enterprises of employment, fixed assets, gross fixed capital investment and industrial production. Data for employment by enterprise category is only available since 2000 and shows that the share of state and municipal enterprises (categories 1 and 2) of overall employment has decreased from around 47% in 2000 to 39% in 2017 (Figure 4.2). The share of mixed state-private Russian enterprises (category 6) has declined significantly from over 15% in 2000 to just above 5% in 2010 and it stayed around that level up until 2017. Thus, altogether, in 2017 predominantly state and mixed state-private enterprises accounted for close to 45% of overall employment in Russia. In fact, the relatively high employment shares of state enterprises contrast with similarly constructed shares for other economic aggregates which are much lower, illustrating that the state involvement in the enterprise sector may be more important politically and socially than economically, if such a distinction can at all be made.

Figure 4.2: Annual average number of employees of organisations by type of ownership

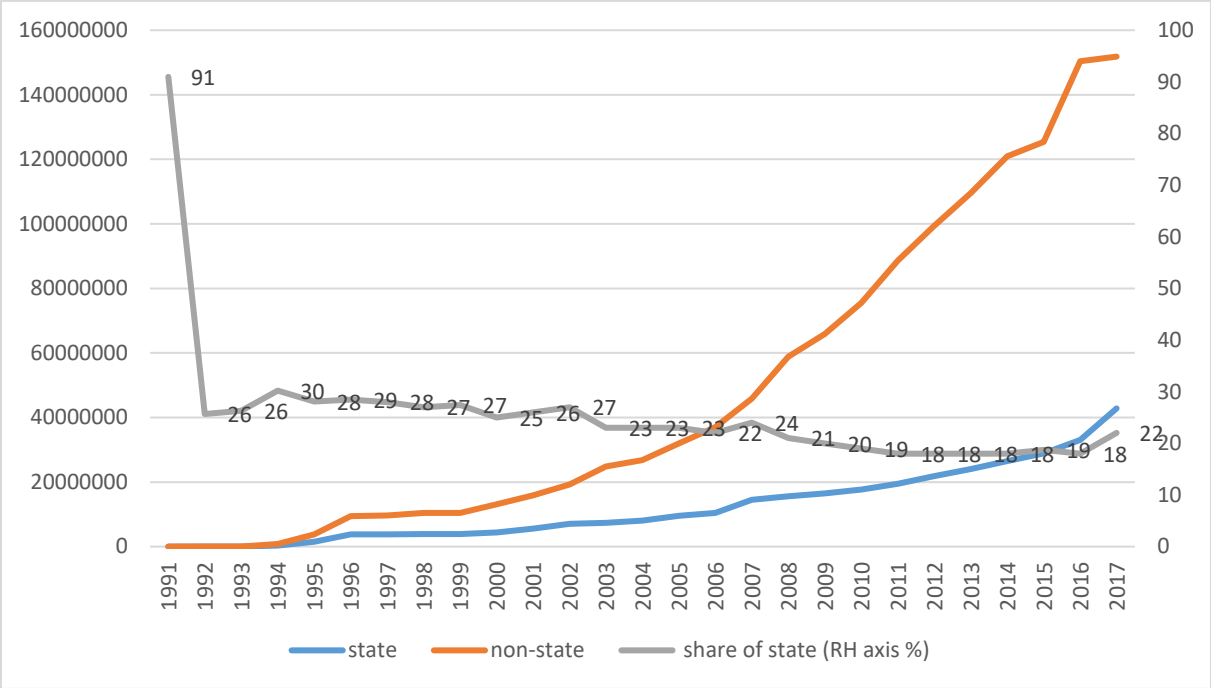


Note: the share for public and religious organizations is not visible due to small shares of these enterprises.
Source: Internal calculations based on Rosstat, Russian Statistical Yearbooks 2018, Chapter 5. Labour.

The share of state-owned [209] fixed assets in the overall value of assets declined most dramatically between 1991 and 1992 (from over 90% in 1991 to 26% in 1992 and 30% in 1994) and has since then been decreasing gradually (with a blip around the period of renationalisation around 2006) to reach 18% in 2015 and then increasing again to 22% in 2017 (Figure 4.3). A similar breakdown of statistics for investment in fixed capital, which is a corresponding '*flow*' statistic[210] for the value of fixed assets, and which is available broken down by enterprise type, shows that the share of state and municipal enterprises in fixed capital investment declined from 63% in 1993 to around 16% in 2017 (Figure 4.4). Investment by state enterprises accounted for the bulk of the latter figure (14%) with investment by municipal enterprises for the remaining 2%. These statistics also show interesting trends in the investment of mixed-ownership Russian enterprises, the share of which first dramatically increased (from around 22% in 1993 to close to 50% in 1996) then decreased to around 7% in 2017. Together with state enterprises, this gives around a 23% share of state ownership in investment, which is similar to the share of state ownership in the value of total fixed assets.

[209] Rosstat does not explain what is the ownership definition used for compiling these statistics.
[210] The value of fixed assets (stock of capital) is equal to the accumulated fixed capital formation (investment) less depreciation.

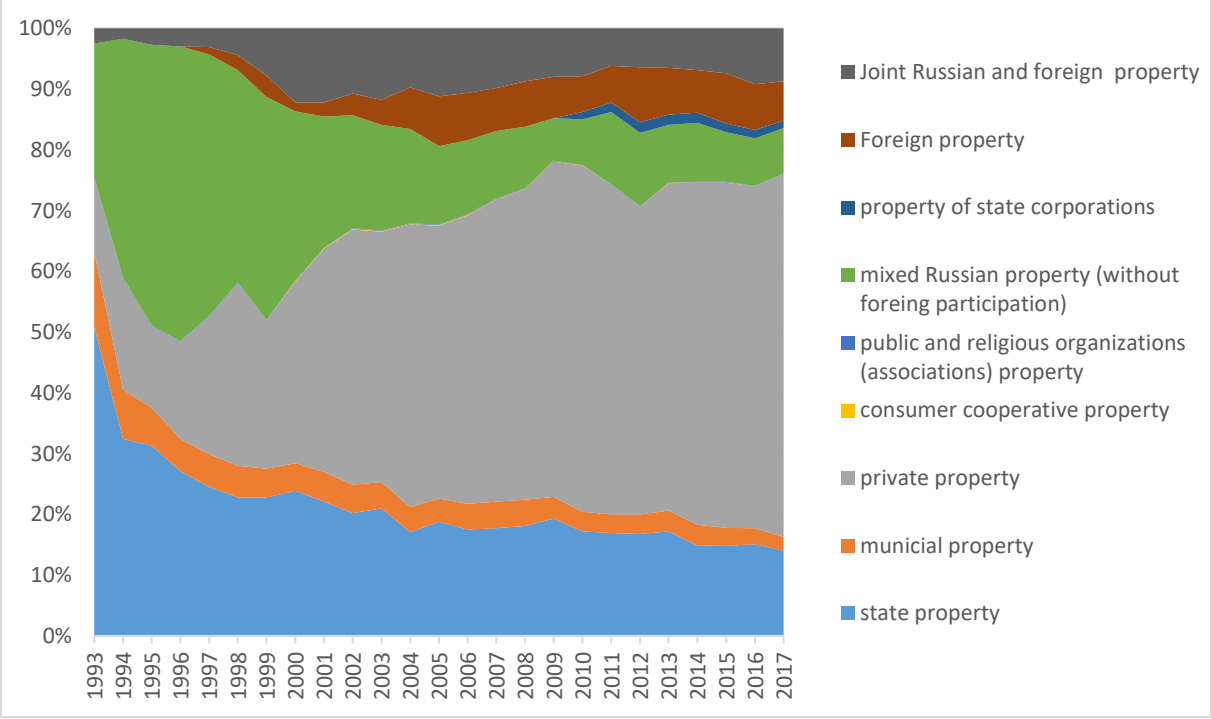
Figure 4.3: Fixed assets of state and non-state ownership at end of year by total book value, in million RUB and percentage share



Note: Fixed assets are estimated at acquisition cost, taking into account changes resulting from revaluations, completion, modernisation, additional equipment, reconstruction and partial liquidation that is, in mixed prices, determined by accounting data.

Source: Internal calculations based on Rosstat, Russian Statistical Yearbooks 1994–2018, Table 12. Fixed assets.

Figure 4.4: Structure of investments in fixed capital by ownership type



Source: Internal calculations based on Rosstat, Russian Statistical Yearbooks 1994–2018, Table 11. Investments.

The enterprise numbers, employment and investment statistics discussed thus far suggest that while the influence of state enterprises on the Russian economy seems non-negligible, it is not overwhelming (apart from relatively high employment shares) and is generally declining over time, despite temporary reversals in privatisation during times of economic and political crises.

Going beyond enterprise counts, a paper by the International Monetary Fund ('IMF')[211] tried to estimate the overall State's footprint in the Russian economy. The report used combined Rosstat data on the volume of industrial production and employment broken down by ownership and economic sector to estimate the shares of state enterprises in production by sector of economic activity. State ownership included: state and municipal enterprises and Government corporations (categories 1 and 2, as defined at the beginning of this section) and mixed-ownership Russian enterprises (category 6). However, in order to account for indirect state ownership, the study also included the subsidiaries of the largest 20 non-financial state conglomerates.[212] It then combined these shares with official data on the shares of these same sectors in the economy's overall value added (i.e. GDP) to come up with an overall estimate of the State's footprint in the Russian economy. The study concluded that the State's share in GDP increased moderately from 32% in 2012 to 33% in 2016 (Table 4.3).[213]

Table 4.3: IMF's estimates of the State's share in the Russian economy

2016

Economic Sector	Raw Sales Shares	Adjusted Sales Share	Assets Share	Labor Share	Total
Market Sectors					
Agriculture, Hunting, Forestry, Logging	2	2			
Fishing, hatcheries, and related services	2	2			
Mining and Extraction	4	**44**			
Manufacturing	19	**21**			
Electricity, gas, steam and hot water	36	**52**			
Construction	4	4			
Wholesale and retail trade; Repairs	4	9			
Hotels and Restaurants	3	5			
Transport and Communications	34	**48**			
Finances			**59**		
Real estate, renting and related services	9	9			
Non-Market Sectors					
Public Administration, Defense, Social Security				**99**	
Education				**92**	
Health and Social Work				**87**	
Other Communal and Personal Services				**48**	
Households with employed persons				0	
Gross Value Added					**33**

[211] IMF (2018), *Russian Federation; Selected Issues*, IMF Country Report No. 18/276, International Monetary Fund.

[212] These include: Gazprom, Rosneft, Transneft, Inter RAO, Rushydro, Rosseti, Rostelekom, Aeroflot, Tatneft, Alrosa, United Aircraft Corporation, Helicopters of Russia, United Engines, and United Shipbuilding Corporation.

[213] This work corrects some of the existing assessments which put the State's share of GDP at as high as 70%. As argued by the IMF authors, the overestimation stemmed from a dubious use of both earlier EBRD estimates of Russia's State size in 2005 and the ratio of public sector revenues to GDP in an earlier study by the IMF in 2014 (IMF (2014), *Russian Federation: 2014 Article IV Consultation-Staff Report*, Informational Annex, Press Release, IMF Country Report, No. 14/175, International Monetary Fund, Washington DC).

2012

Economic Sector	Raw Sales Shares	Adjusted Sales Share	Assets Share	Labor Share	Total
Market Sectors					
Agriculture, Hunting, Forestry, Logging	4	4			
Fishing, hatcheries, and related services	3	3			
Mining and Extraction	8	**34**			
Manufacturing	18	**20**			
Electricity, gas, steam and hot water	37	**57**			
Construction	5	6			
Wholesale and retail trade; Repairs	6	11			
Hotels and Restaurants	14	16			
Transport and Communications	38	**52**			
Finances			**50**		
Real estate, renting and related services	10	11			
Non-Market Sectors					
Public Administration, Defense, Social Security				**100**	
Education				**93**	
Health and Social Work				**90**	
Other Communal and Personal Services				**51**	
Households with employed persons				0	
Gross Value Added					**32**

Source: IMF (2018) based on Rosstat data.

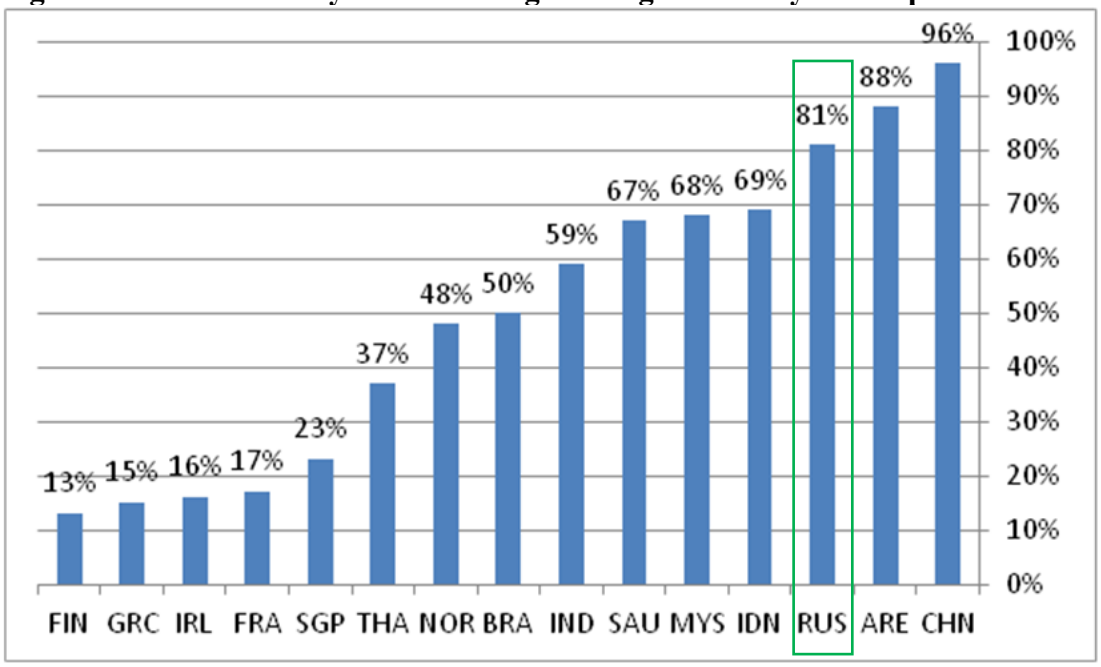
A picture that seems to be emerging from the reviewed recent literature is that:

- The size of the Russian State sector in the economy is much smaller than the not very well documented but nevertheless circulating in various commentaries estimate of 70%.[214] It is more likely to be in the range of 30–35%,[215] although there are also studies such as the one by the Centre for Strategic Research (′CSR′) which estimate the state share of GDP at 46% in 2016;[216]
- There has been no clear trend for the size of the Russian State to increase in the past few years even though the weight of the State has increased in certain sectors, such as banking and oil extraction.[217] CSR argues, however, that despite the fact that the number of state entities is declining, the State's direct and indirect participation in key sectors remains considerable and that the State's role in resource allocation is strengthening, including through stronger influence of SOEs and state development institutions as well as pseudo privatisation, and expansion of regulations;[218]
- The share of the State in the economy is relatively large by international standards.[219] In a study focused on international comparisons of the world's largest enterprises (i.e. those on the Forbes Global 2000 list), it was estimated that, in 2012, majority state-owned enterprises accounted for approximately 80% of the revenues of the largest Russian enterprises and that, by this metric, Russia was in third position on the list of countries with highest shares of SOEs, just after China (with a share of 96%) and the United Arab Emirates (88%), and before such economies as Indonesia (69%), Malaysia (68%) and Saudi Arabia (67%) (Figure

[214] IMF (2018), p. 3, provides a discussion.
[215] E.g. European Bank for Reconstruction and Development (EBRD) (2005), *Transition Report 2005: Business in Transition*.
[216] Center for Strategic Research (CSR) (2018), *Efficient State Property Management in 2018–24 and Through 2035*.
[217] IMF (2018).
[218] CSR (2018).
[219] IMF (2018).

4.5). [220] A similar ranking for the so-called state-invested enterprises in which the Government has a 10% or larger ownership stake is provided using a different methodology by the OECD and is reproduced in Figure 4.6.[221] Russia has shares lower than Norway or Saudi Arabia but higher than Brazil, India or Singapore. As described above (see Figure 4.2.), the employment data also show relatively high shares and a study by the IMF[222] confirms this in an international comparative context.[223] The same IMF study, however, also shows that the share of general Government expenditure in GDP in Russia is relatively moderate when compared with other countries.[224]

Figure 4.5: SOE country shares among the largest country's enterprises



Source: Kowalski et al. (2013), Data from Forbes Global 2000 are for the year 2011.

[220] Kowalski, P., Büge, M., Sztajerowska, M. and Egeland, M. (2013), *State-Owned Enterprises: Trade Effects and Policy Implications*, OECD Trade Policy Papers, No. 147, OECD Publishing, Paris.

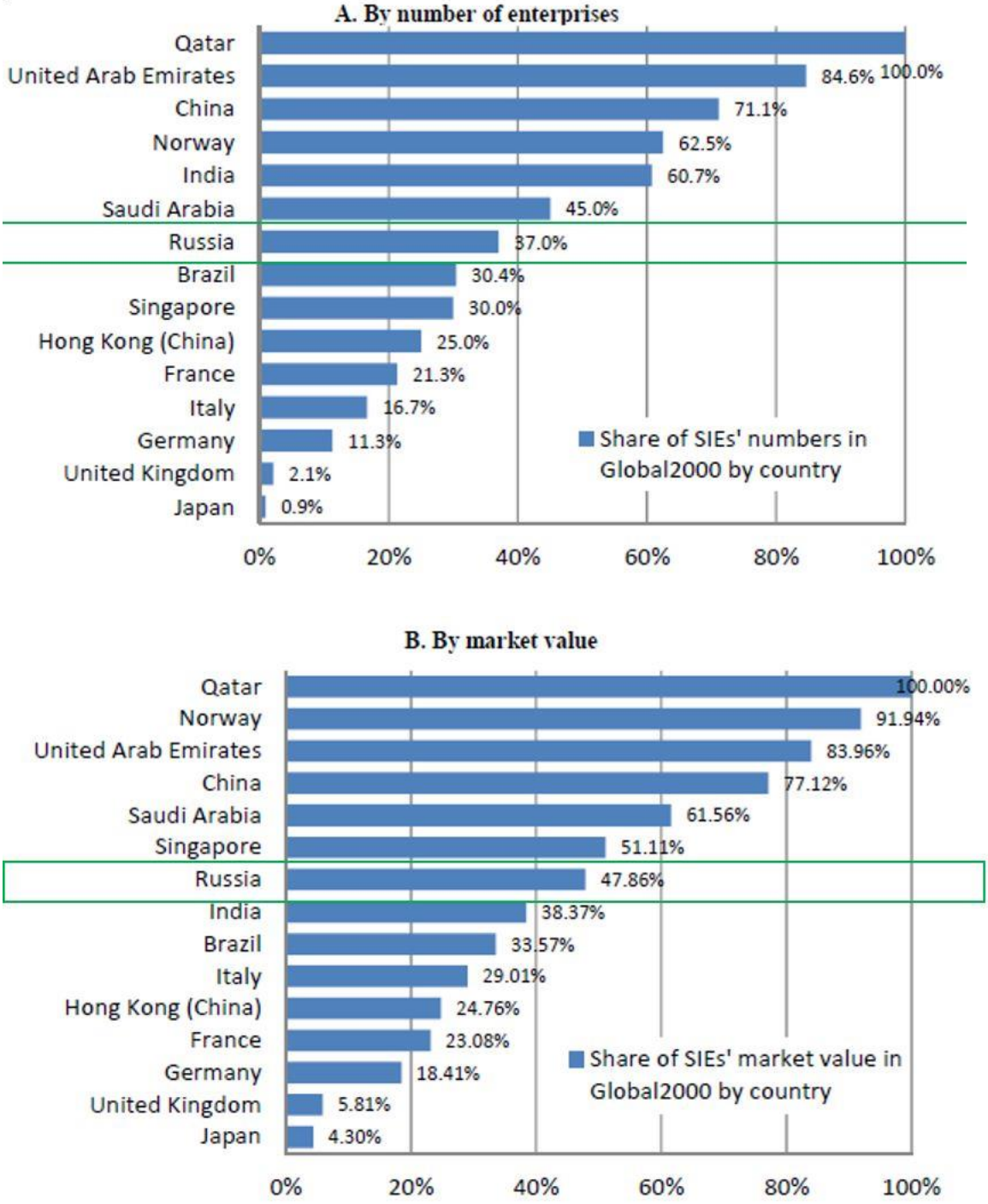
[221] OECD (2016), *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?* OECD Publishing, Paris.

[222] IMF (2018).

[223] For example, Russian shares of public sector employment in total employment are similar to those in Norway and Denmark. It should be noted, however, that employment in the public sector covers employment in many non-commercial institutions (e.g. public administration) and is, therefore, not necessarily relevant view for the specific task of assessing the relative importance in the economy of State enterprises.

[224] Again, Government expenditure covers items such as social transfers, which are generally higher in transition economies and can be largely unrelated to the extent of the state intervention in the enterprise sector.

Figure 4.6: Share of state-invested enterprises



Source: OECD (2016) based on Forbes Global-2000. Only countries whose state-invested sectors have a market value exceeding USD 100 billion are included.

4.4.2 SECTORAL CONCENTRATION

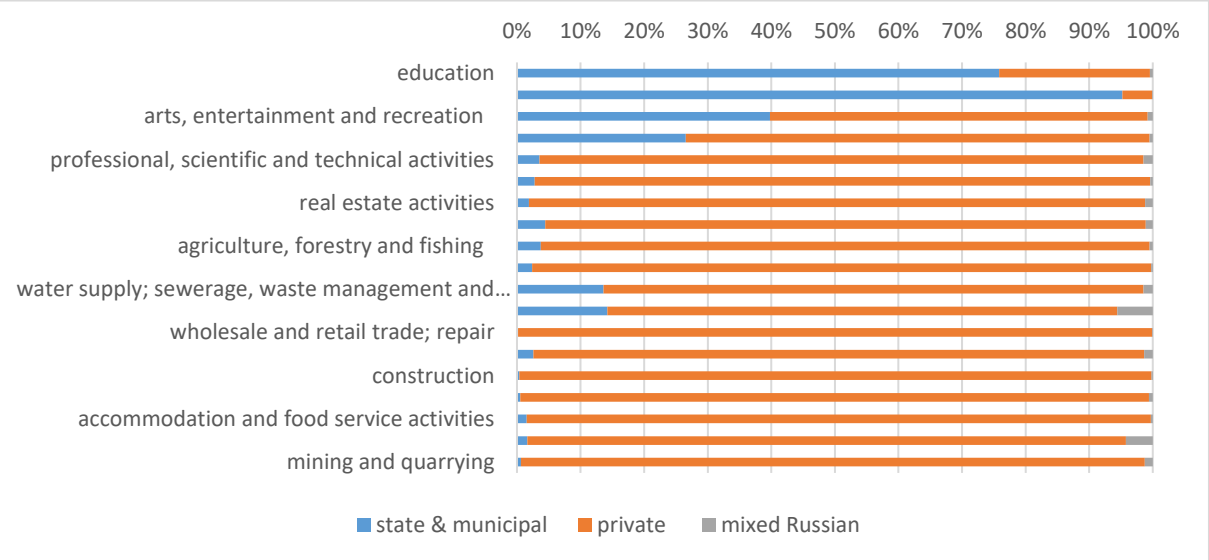
The incidence of state enterprises varies significantly across the economic sectors. Using the above-described approach (Section 4.2.1, Table 4.3), the IMF estimated the State's share in value added at 59% in finance; 52% in electricity, gas, steam and hot water; 48% in transport

and communications; 44% in mining and extraction; and 21% in manufacturing. Interestingly, finance, transport and communications and manufacturing were the only three sectors where the State's share has increased since 2012.

Using enterprise statistics from Rosstat, high shares of state enterprises are detected for sectors such as public administration and defence (around 95% of all enterprises in this sector are state enterprises) and education (75%), arts, entertainment and recreation (40%) and human health and social work (more than 25%). State enterprises are also relatively common in water supply, sewerage and waste management (more than 10%), electricity, gas, steam and air-conditioning supply (also more than 10%) and information and communication services (around 5%). Manufacturing has a negligible share of state enterprises in enterprise counts (Figure 4.7).

In addition, the pie charts showing the different distributions of enterprises of different ownership types across sectors (Figure 4.8) indicate that while majority state-owned enterprises are concentrated in rather less commercial sectors, quite different from those in which are concentrated private enterprises, mixed-ownership enterprises are heavily concentrated in some of the similar sectors to private enterprises, such as, for example, wholesale and retail trade; construction; professional and technical activities; real estate activities and manufacturing. All this suggests that while most of the many thousands of Russian State enterprises may be not competing head to head with their private peers in commercial activities, some definitely do.

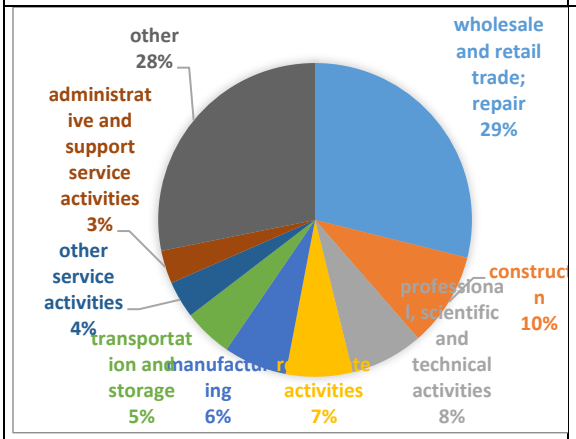
Figure 4.7: Enterprises and organisations by economic activity and type of ownership (2017)
Share in total number, sorted by activities with the largest number of state and municipal enterprises



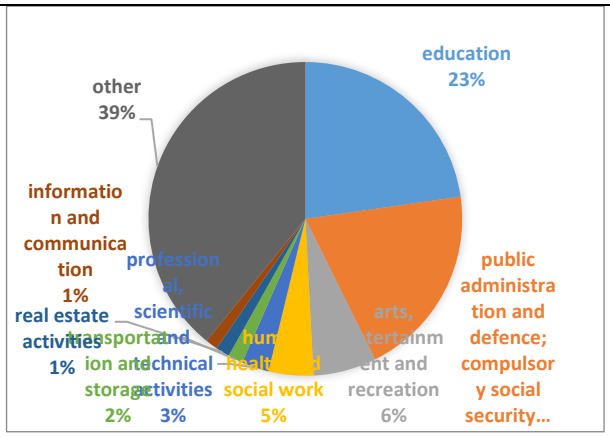
Source: Internal calculations based on Rosstat, Russian Statistical Yearbook 2018, Chapter 15. Enterprises and organisations by economic activity.

Figure 4.8: Distribution of number of enterprises by ownership type and sector of activity

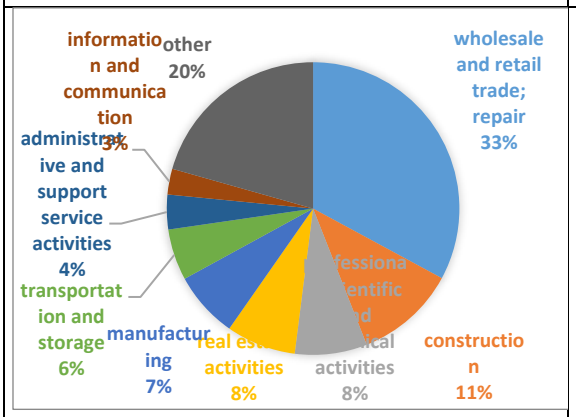
All enterprises



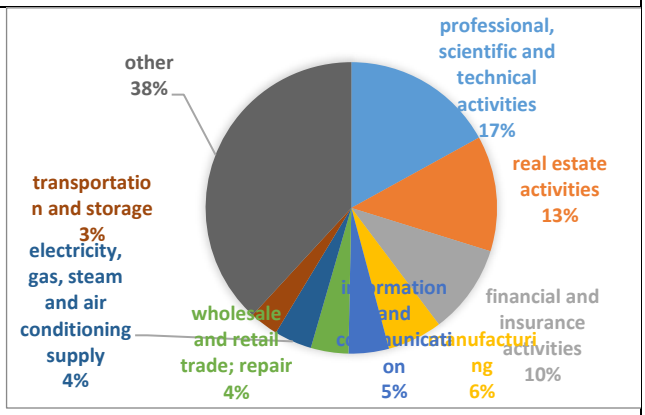
State and municipal



Private



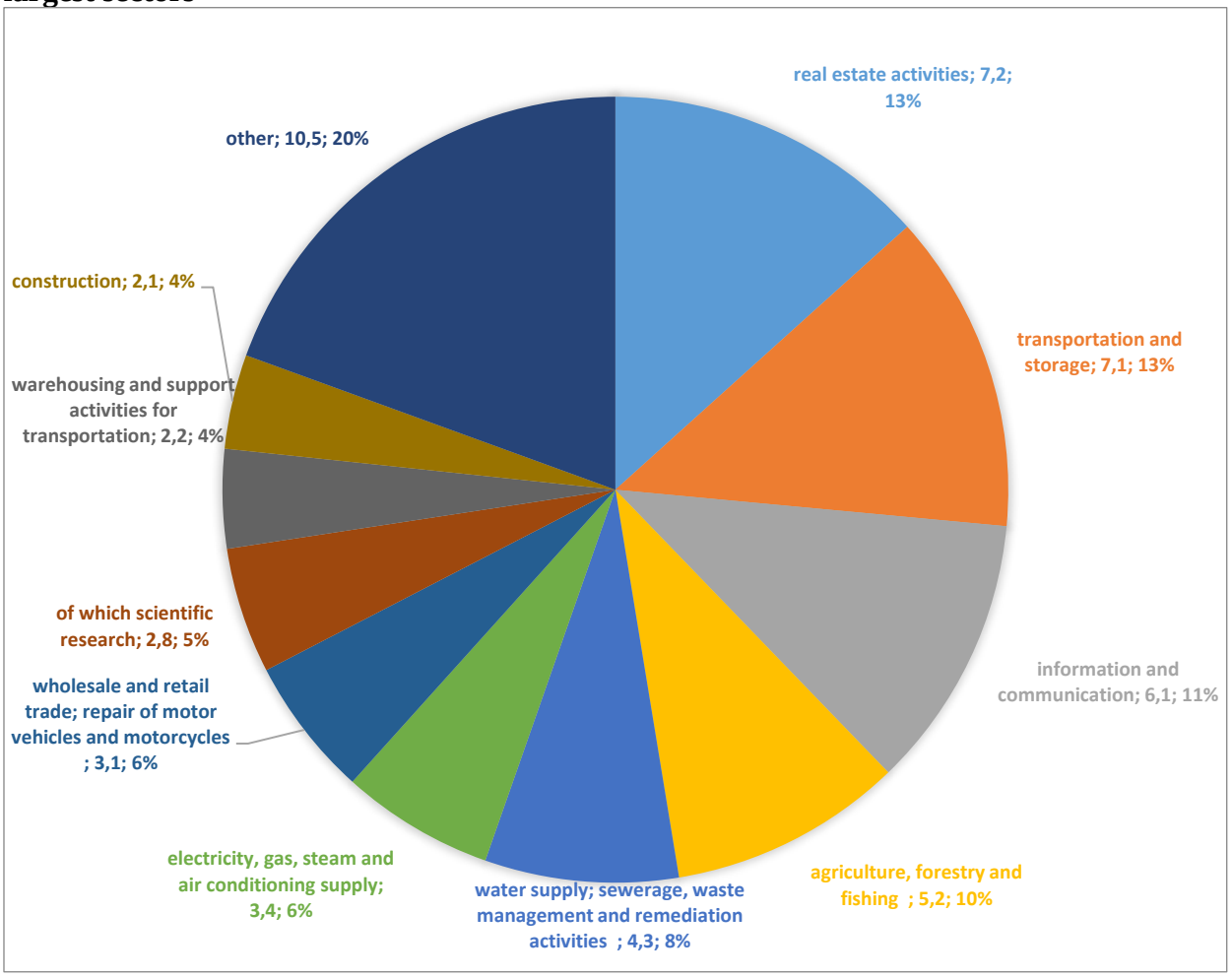
Mixed Russian



Source: Internal calculations based on Rosstat, Russian Statistical Yearbook 2018.

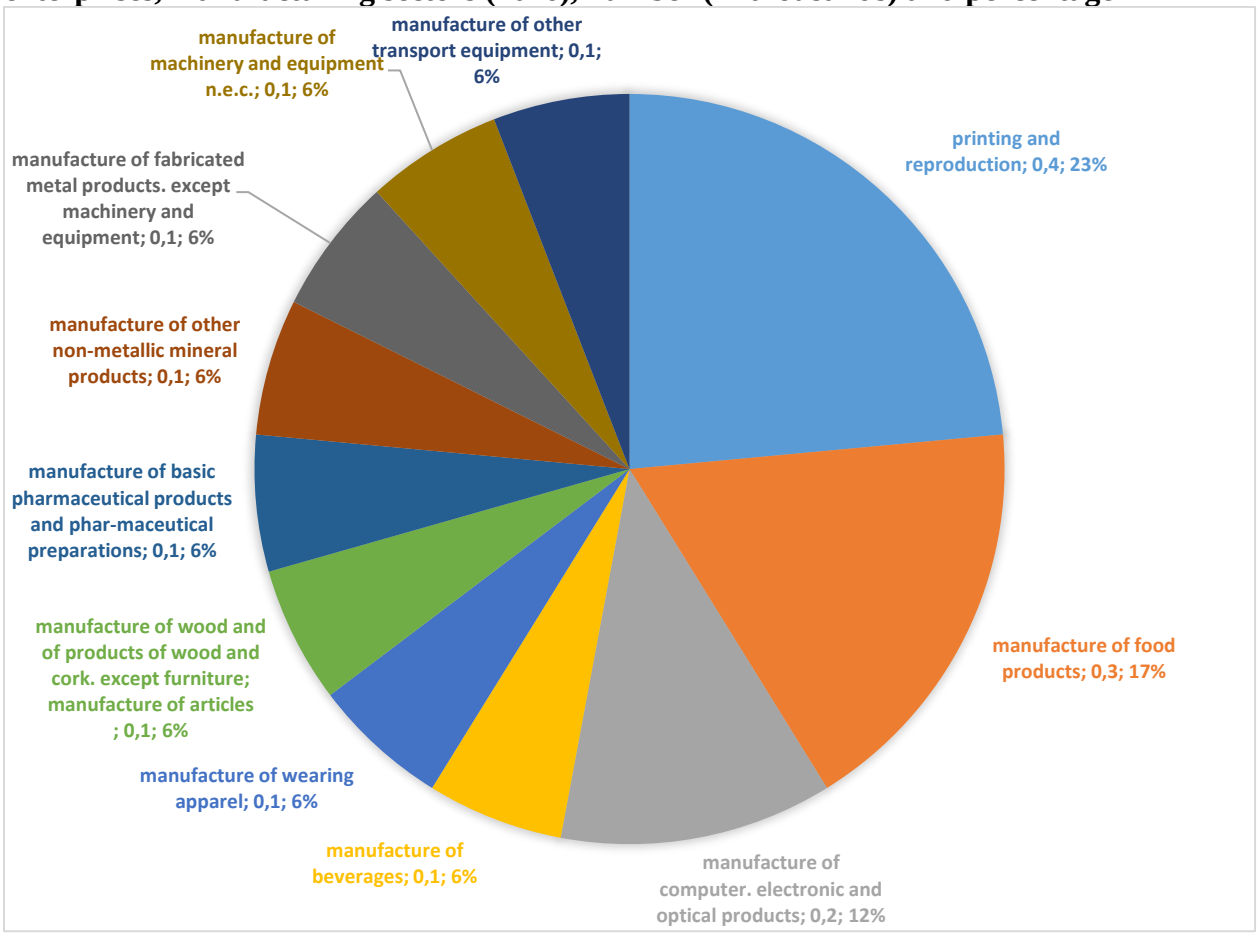
When public services such as public administration and defence, education, arts, entertainment and recreation are excluded from the sample, it is apparent that quite a number of the remaining state and municipal enterprises are concentrated in real estate activities, transportation and storage, as well as information and communication services or agriculture, forestry and fishing, but not in manufacturing (Figure 4.9). Isolating manufacturing as a stand-alone sector indicates a relatively high concentration of state enterprises in printing and reproduction, manufacturing of food and beverage products as well as manufacturing of computer, electronic and optical products (Figure 4.10).

Figure 4.9: Sectoral distribution of state and municipal enterprises by number of enterprises, excluding public services (2016), number (in thousands) and percentage, ten largest sectors



Source: Internal calculations based on Rosstat, Russian Statistical Yearbook 2018.

Figure 4.10: Sectoral distribution of state and municipal enterprises by number of enterprises, manufacturing sectors (2016), number (in thousands) and percentage

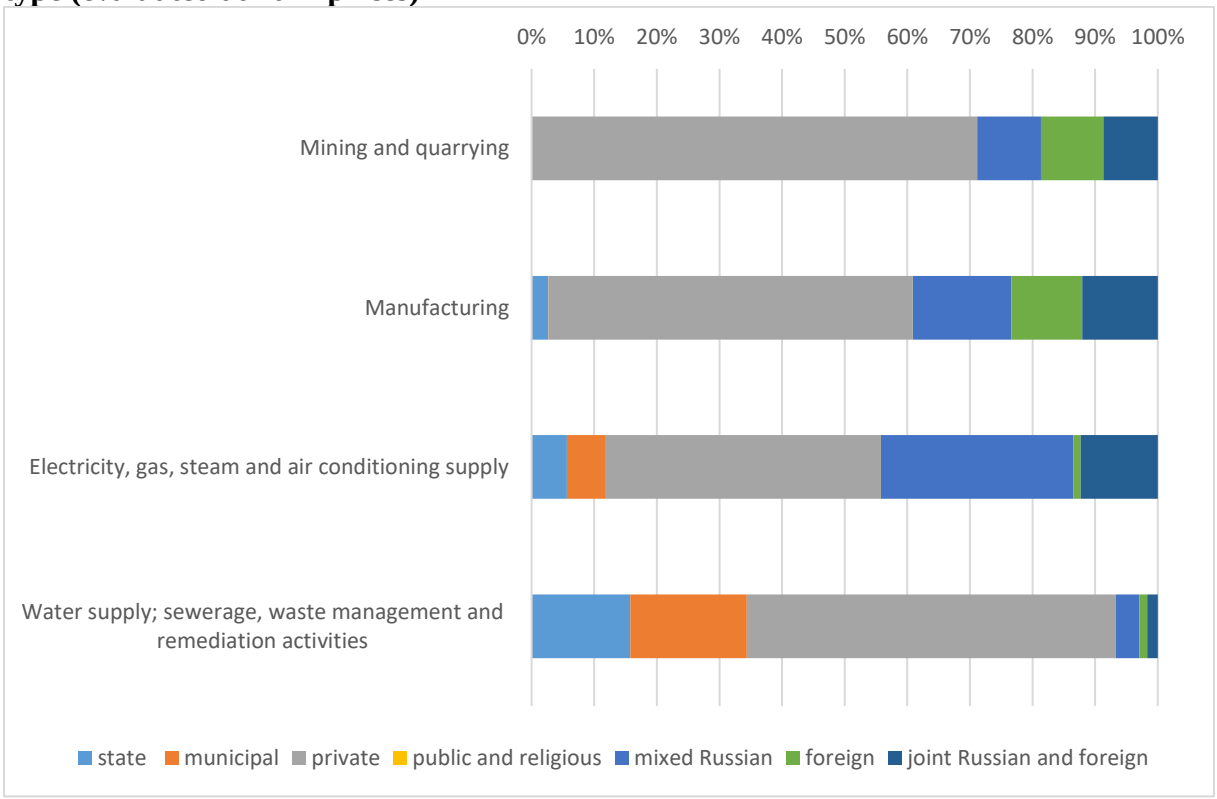


Source: Internal calculations based on Rosstat, Russian Statistical Yearbook 2018.

Using sales data, Figure 4.11 shows that in 2017 the share of state and municipal enterprises in sales was the highest in water supply, sewerage and waste management. If mixed-ownership enterprises are included in the calculation, electricity, gas, steam and air-conditioning supply, as well as manufacturing actually record quite high shares. Focusing solely on mining and quarrying shows that it is mostly the extraction of crude petroleum and natural gas and other mining and quarrying where mixed-ownership enterprises are mostly present and not in the mining of coal and lignite or mining support services activities (Figure 4.12). Focusing on manufacturing, the highest shares of state enterprises' sales are recorded in printing and reproduction of recorded media (15%), manufacturing of fabricated metal products (14%) and manufacturing of other transport equipment (12%) (Figure 4.13). Mixed-ownership shares are highest in the manufacturing of coke and refined petroleum products (36%), manufacturing of other transport equipment (34%), manufacturing of computer, electronic and optical products (30%), manufacturing of fabricated metal products (22%) and manufacturing of chemicals and chemical products (14%). In sum, these are quite significant shares of state involvement by global standards.[225]

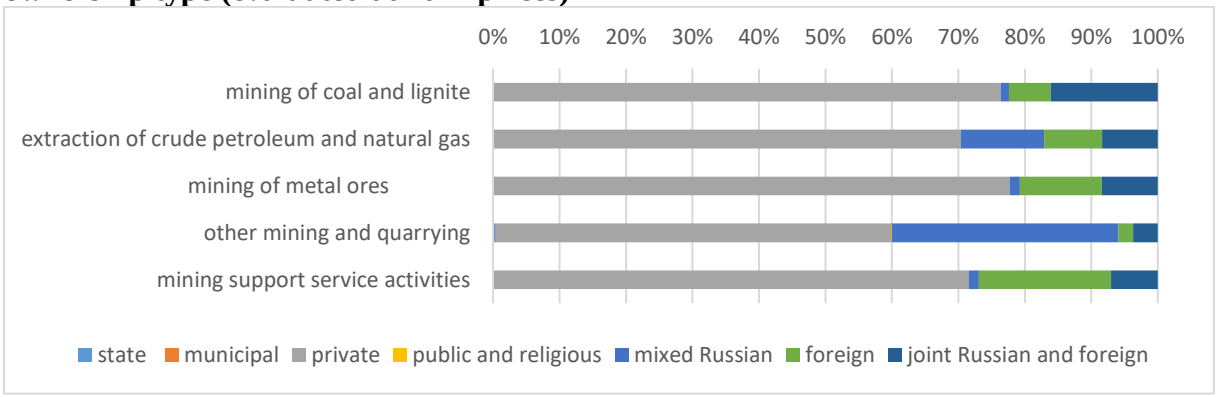
[225] Kowalski and Rabaioli (2017), for example, document the emerging literature on the extent of state ownership, which suggest that shares above 10% signal a higher than typical presence.

Figure 4.11: Shares in industrial production by broad sector of activity and ownership type (evaluated at 2017 prices)



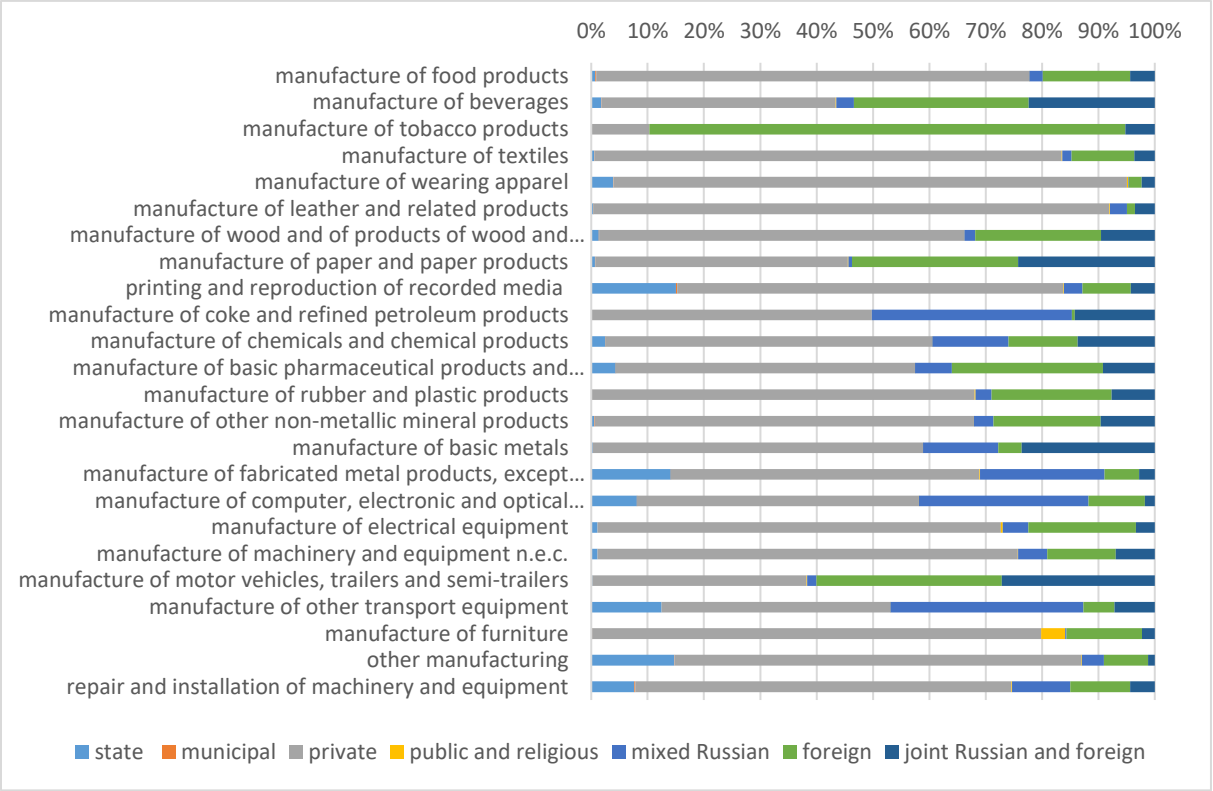
Source: Internal calculations based on Rosstat, Russian Statistical Yearbook 2018.

Figure 4.12: Shares in industrial production in the mining and quarrying sector by ownership type (evaluated at 2017 prices)



Source: Internal calculations based on Rosstat, Russian Statistical Yearbook 2018.

Figure 4.13: Shares in industrial production in the manufacturing sector by ownership type (evaluated at 2017 prices)



Source: Internal calculations based on Rosstat, Russian Statistical Yearbook 2018.

4.5 CORPORATE GOVERNANCE OF STATE ENTERPRISES IN RUSSIA

Even in countries where state enterprises account for a high share of economic activity, if these enterprises are designed and governed well, they can have positive, neutral, or only minimally-negative effects on the functioning of the rest of the economy, i.e. their impact could be small in terms of price levels, sales volumes and resource allocation. By contrast, improperly governed SOEs and those that receive state support can distort competition not only in domestic markets but they could also result in altered levels of international trade in goods and services and international investment. It is generally accepted, for example, that Norway, which for historical and geographical reasons has a relatively important state sector, follows corporate governance practices that minimise such distortions.[226]

As a standard reference, the OECD Guidelines on Corporate Governance of state-owned Enterprises (′OECD Guidelines′)[227] list and elaborate on a number of guiding principles in areas such as: legal and regulatory framework; principles of the State acting as an owner; state-owned

[226] This can be gathered from Norway's scores in the recent compendium on ownership and governance of state-owned enterprises presented in OECD (2018), *Ownership and Governance of State-Owned Enterprises*; *A Compendium of National Practices*, OECD Publishing, available at: http://www.oecd.org/daf/ca/ownership-and-governance-of-state-owned-enterprises-a-compendium-of-national-practices.htm, accessed on 21 October 2019. Norway is also relevant as a best practice comparison for Russia because of its rich natural resources.

[227] OECD (2015), *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, 2015 Edition, OECD Publishing, Paris, available at: http://dx.doi.org/10.1787/9789264244160-en, accessed on 21 October 2019.

enterprises in the marketplace; equitable treatment of shareholders; relations with stakeholders; transparency and disclosure; and the responsibilities of the boards of state-owned enterprises. This section provides an overview of some of the most important Russian regulations and practices in the area of corporate governance and management of state enterprises which are covered by the OECD Guidelines, such as the rationale for state ownership; the State's role as an owner (ownership models); treatment of shareholders and other investors; stakeholder relations and responsible business; disclosure and transparency; the responsibilities of the boards of state-owned enterprises; and the control by the Government of the corporate structure and boards of SOEs. Elements of SOE governance related to the presence of state-owned enterprises in the marketplace are addressed in Section 4.6.

4.5.1 RATIONALE FOR STATE OWNERSHIP

The above discussion (Section 4.3) of the ownership functions of state agencies and legal forms of SOEs in Russia provides evidence that the Russian model largely follows an explicit approach to formulating the rationale for state ownership: state ownership policies are set forth in specific legislation (Government decisions or decrees) or via Government policy statements. This has to do with Russia's past as a centrally planned economy and is consistent with the approaches taken in other post-communist countries in Central and Eastern Europe (such as e.g. in the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Slovenia). Moreover, many other countries such as Germany, Israel, Korea and Portugal also follow a similar approach.[228] In Russia, the explicit approach translated into specific laws being in place for unitary enterprises and JSCc. Regulation of state corporations is less clear-cut, however, and suggests an implicit approach[229] in this segment of state ownership (see Section 4.3.2 above).

Transparent reporting is an important element of communicating and monitoring the rationale of state ownership or control to the public.[230] In this area, Russia's practices seem to be in line with the OECD Guidelines for enterprises managed by the FPA (i.e. unitary and joint-stock ones) as the FPA prepares regular Reports, as well as Forecast Plans (Programmes) for Federal Property Privatisation and Guidelines for Federal Property Privatisation.[231] In the context of privatisation, the Government annually approves the forecast plan for privatisation and submits a report on its implementation to the Parliament.[232] The President formulates and approves a list of enterprises strategically important for the national security and determines the possibility of their privatisation. This is an explicit, even if not entirely inclusive, way of deciding and communicating about state ownership to the public and market participants.

[228] See OECD (2018).
[229] The objectives of state ownership have to be deduced from the overall legislative and policy framework, including from company and public administration law and sectorial policies, or from legislation establishing individual state enterprises.
[230] See OECD (2015), p. 19 and 25.
[231] These can be accessed at FAP's website, available at: https://rosim.ru/about/reports/performance, accessed on 21 October 2019.
[232] Materials relating to privatisation are available at: https://rosim.ru/activities/sales/info/plan, accessed on 21 October 2019.

4.5.2 THE STATE'S ROLE AS AN OWNER AND RELATED ELEMENTS OF CORPORATE GOVERNANCE OF STATE ENTERPRISES

In Russia, the structure of legal forms allowed for state enterprises is very heterogeneous with at least three different types (see Section 4.3.2) and three sets of associated regulations and reporting requirements.[233] Section 4.2 and some other chapters of this report (for example Chapter 10 or Chapter 14) contain information on instances of SOEs, particularly those functioning in strategic industries, acting on instruction of the authorities, rather than as autonomous operators. This suggests remaining challenges when it comes to the State acting as a transparent and informed owner.

Centralisation of ownership rights in a single ownership entity is another standard OECD recommendation.[234] The OECD has classified the Russian model of state ownership as '*centralised with exceptions*', putting the country in the same category with, for example, the Netherlands, Norway or Poland.[235] The following example shows this very well: the FPA has a prominent role as the manager of most of the State's corporate assets and prepares the State's position on the objectives of state enterprises, where SOE is of primary sector importance. By contrast, line ministries set the agenda, strategic priorities and develops instructions for the board, and the objectives to the extent FPA is not competent to do so. The status of state corporations of Russia, detailed in Section 4.3, together with the influence of line ministries could also lead some to classify the Russian model as '*dual*' or '*twin track*'. Even so, the dual or twin track model is followed by such countries as Belgium, Germany and Switzerland.

Russia also has procedures for the selection of board members in JSCs. The FPA prepares a list of candidates for nomination and election as members of governing and supervisory boards and monitors their statistics (e.g. the average number of civil servants on the boards of different JCSs). For example, in 2017, new regulations were introduced with respect to the selection of candidates for election as individual (collegiate) executive bodies (so-called 'I(C)EBs') on the boards of directors and audit committees of JSCs.[236] These new regulations include for instance provisions aiming at a stronger supervisory role of the FPA over candidate nominations for these roles submitted by federal ministries, organisations and natural persons. These new regulations have also tightened eligibility criteria for such an I(C)EB role. A person can now only be reappointed if he/she did not serve on the board during the last 12 years (previously, the cool off period lasted 5 years). The new regulations also give the FPA more supervisory and decision power, in the context of line ministries setting the agendas for and voting during

[233] Simplifying and standardising SOEs' legal forms and allowing autonomy of the operations of SOEs, ensuring independence of the boards of SOEs is recommended by the OECD Guidelines in this area (see OECD (2015), p. 33).

[234] OECD (2015), p. 35.

[235] OECD (2018).

[236] The relevant Government executive order is N.º 851 of 19 July 2017, which introduced major amendments to the *Provision on the management of federally-owned shares in joint-stock companies and the Russian Federation's golden share in joint-stock companies* introduced by the Government executive order N.º 738 of 3 December 2004, and the Government executive order N.º 1214 of 31 December 2010 "*Enhancing the governance of publicly traded companies with an interest owned by the federal government, and federal state unitary enterprises*".

annual general meetings of shareholders in some categories of JSCs. All this seems to be improving the ability of the State to act as an informed and active owner.

The FPA also monitors the statistics regarding approval of long-term development plans, key performance indicators and issues such as labour productivity growth policies, as well as other internal regulations by the boards and management of JCSs, particularly those listed on the list of strategically important companies and joint-stock companies. The FPA also monitors the discipline of annual meetings among all of its JSCs. In 2016, for example, all JSCs on the list of strategically important companies, as well as those not on the list but in which the State is the sole owner, held annual meetings. This was also the case in 91% of enterprises where the Government owned an interest of more than 2%.

The new regulations with respect to the selection of candidates for election to executive of JSCs excluded FSUEs established as a result of privatization that operate under the jurisdiction of the Ministry of Defence and subordinate to the Facilities and Property Management Office under the President.[237] Appointments of directors of FSUEs are governed by the provisions of Federal Law No. 161-FZ which state merely that the directors are appointed and accountable to FPA and that FPA determines any certification requirements in this respect.[238]

In order to facilitate the adoption of the general corporate governance standards set in the 2014 Corporate Governance Code,[239] in 2017 the FPA analysed the annual reports of the 12 largest federal-owned companies with a view of verifying compliance with the Code.[240] The analysis showed high degrees of compliance with the Code in organisational issues, as well as shareholder rights and equitable treatment of shareholders while executing shareholders' rights or executive compensation frameworks for members of the board of directors. The FPA also estimated that among the 12 companies analysed, the areas with lower levels of compliance included procedures for the appointment of the board of directors, the risk management framework and internal control, disclosure of information, information policy and major corporate actions. [241]

In the area of disclosure and transparency, the OECD Guidelines state that '*SOEs should observe high standards of transparency and be subject to the same high-quality accounting, disclosure, compliance and auditing standards as listed companies*'.[242] In practice this can involve several practices related to: aggregate reporting on SOEs and fulfilment of their objectives; transparency of financial reporting (including on any financial or other assistance

[237] Gaidar Institute (2018).

[238] Section 21 of the Federal Law N.º 161-FZ of 14 November 2002 "*on State and Municipal Unitary Enterprises*" (as amended).

[239] Corporate Governance Code of Russia, published in the Official Journal of the Bank of Russia N.º 40 (1518) - 18 April 2014. The Code sets the principles for governance of all enterprises, not just SOEs.

[240] Gaidar Institute (2018).

[241] Gaidar Institute (2018) reports that the FPA assessed that sections of the Corporate Governance Code relating to these issues were adopted more than 70%. Gaidar Institute (2018), however, also expressed doubts about the objectivity of these assessments, in particular in relation to Gazprom (p. 392). In addition, the 12 largest Russian JSCs are likely not representative of the whole Russian SOE population.

[242] OECD (2016), p. 61.

received form the State); transparency of board governance and remuneration of board members and their qualifications. SOEs' annual financial statements should also be subject to an independent external audit based on high-quality standards.

The FPA provides an aggregate and on-line reporting facility, the Register of Federal Property,[243] which is, however, only available in Russian.[244] The register describes various elements of implementation of state ownership policy. However, this facility does not appear to detail such important characteristics as financial performance and turnover or employment in state enterprises,[245] board composition and remuneration, and it does not report on individual state enterprises. Unitary enterprises and state corporations are not subject to the standards that have to be observed by publicly listed companies. However, all legal entities are required to submit annual financial statements subject to external audit.[246]

4.6 RUSSIA'S SOES IN THE MARKET PLACE

When state enterprises engage in commercial or economic activities[247] and compete with privately-owned firms while at the same time receiving from the State pecuniary, in-kind or regulatory advantages which are unavailable to their private competitors, they may have anti-competitive effects and other impacts on markets. The chapter of the OECD Guidelines on State-owned Enterprises in the Marketplace lists a number of recommendations in this context, including:

- Separation between the State's ownership function and other State functions that may influence the conditions for state-owned enterprises;
- Standards of transparency and disclosure regarding the costs of SOEs combining economic activities with public policy objectives and funding by the State of the latter;

[243] Available at: http://rosim.ru/activities/reestr/rfi, accessed on 21 October 2019.

[244] Provision of such a report in English or other foreign languages is considered to be good practice (OECD, 2018).

[245] As mentioned above, employment figures are reported by Rosstat but for different categories of enterprises ('*state and municipal*') which quite likely include enterprises which are not managed by the FPA.

[246] Article 5 of the Federal Law N.º 307-FZ of 30 December 2008, "On Auditing", available at: http://ivo.garant.ru/#/document/12164283/paragraph/23770/doclist/0/selflink/0/context/307%2030.12.2008:1 , accessed on 21 October 2019.

[247] These key terms are used interchangeably and have many definitions. Earlier on, OECD, in its work on corporate governance of SOEs and using definitions used in the System of National Accounts (SNA) defined "*commercial*" so as to denote "*market producer*" which in turn was defined to depend on an assessment of whether or not the entity charged "*economically significant prices*", OECD (2013). Later on, a revised definition described economic activity of a state-owned enterprise as "*one that involves offering goods or services on a given market and which could, at least in principle, be carried out by a private operator in order to make profits. Quasi-corporations, which are autonomous commercial activities carried out inside the general government sector, should be considered as SOEs if they are financially autonomous and charge economically significant prices*". In a specific WTO context, on the other hand, the General Agreement on Trade in Services defines "*services provided in the exercise of governmental authority*" which are characterised as services which are "*supplied neither on a commercial basis nor in competition with one or more service suppliers*". As pointed out by Kowalski and Perepechay (2015), these key terms have been subject to varying interpretations by countries, for example in the context of postal services where some countries may have chosen, for example, to report their state postal services enterprise services provided in the exercise of governmental authority, while others have chosen otherwise.

- Extension of application of relevant general laws to SOEs;
- Various requirements to ensure SOEs face market-consistent access to financing; and competitive behaviour of SOEs as both bidders and procurers in Government procurement and other procurement situations.[248]

The remainder of this section takes on the most important aspects of each of these issues with a view to surveying to what extent the presence and governance of commercial State enterprises may have negatively impact the market forcess.

4.6.1 SEPARATION BETWEEN THE STATE'S OWNERSHIP FUNCTION AND STATE MARKET REGULATION

One of the key preconditions for ensuring a level playing field and fair competition in the market place when SOEs undertake economic activities as stated by the OECD Guidelines is that '*there should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation*'.[249]

In Russia, SOEs compete with the private sector in the following regulated markets: telecom, transportation, banking and finance, postal services, and health and energy.[250]

Formally, in Russia, the owner of federal State property is the FPA. In accordance with the Regulation on the FPA (Government Resolution No. 432 of 5 June 2008), the FPA exercises the powers of the owner in relation to federal property and property of the FSUE, institutions, shares, and property privatisation of property. Also, FPA is responsible for state property preservation, carries out the accounting and maintenance of the register of entrusted property, conducts an audit of its use, carries out on behalf of the state legal actions to protect the property and other rights, etc. The list of FPA's powers does not include regulation of individual markets or sectors.[251] Thus, the principle of separation between the State's ownership function and state market regulation could be seen as formally observed in Russia.

However, as mentioned above in Section 4.5.2., in cases where an SOE is of primary sector importance, the Government and line ministries set the agenda, strategic priorities and develop instructions for boards. For example, the Government influences key management decisions in large state enterprises by issuing special directives.[252] While the recent reforms mentioned in Section 4.5 seem to be reducing the influence of line ministries and giving more power to the FPA, some of these ministries continue to have influence over the ownership and management

[248] OECD (2015), p. 20.
[249] OECD (2015), p. 20.
[250] OECD (2012), Competitive Neutrality—National Practices, OECD Publishing, available at: https://www.oecd.org/daf/ca/50250966.pdf, accessed on 20 Feburay 2020, p. 18, and Chapter 10 of this report.
[251] Available at: https://www.rosim.ru/about/common/credentials, accessed on 15 November 2019.
[252] For example, on 6 October 2016 the Government issued a directive, in accordance with which representatives of the interests of the Russian Federation – members of the board of directors of PJSC Rosneft Oil Company – were obliged to vote for the purchase of shares of PJSC ANK Bashneft, if the price for 50.0755% of the company's shares was no more than RUB 330 billion. See: http://government.ru/news/24796/, accessed on 21 October 2019.

decisions related to SOEs, and at the same time regulate certain sectors and markets. But this is the case in any country that has a dual or twin system of SOE management with the main owning agency and line ministries.

A clear exception from the separation of the ownership and regulatory functions is the banking sector. This can be demonstrated on the example of Sberbank, 50% of whose shares (+1 share) belong to the CBRF, which at the same time is the main regulator of the banking sector in Russia. This means that the commercially operating Sberbank is partially owned by the regulator – the CBRF. At the same time, the CBRF can use Sberbank as an instrument of monetary policy.[253] See also Section 3.2.1.

4.6.2 ACCESS OF STAKEHOLDERS AND OTHER INTERESTED PARTIES TO EFFICIENT REDRESS THROUGH UNBIASED LEGAL OR ARBITRATION PROCESSES

In Russia, the legal framework which guides competitive neutrality[254] issues is to a large extent set by the following provisions: Article 8 of the Constitution, the Federal Law on Protection of Competition (′Antimonopoly law′), [255] and the Government Order on the reduction of administrative barriers and improvement of accessibility of public and municipal services.[256] In Russia, the antimonopoly laws apply to legal entities acting in the market place, irrespective of ownership. The FAS is responsible for oversight, investigation and enforcement of competition rules irrespective of enterprises' ownership status and includes cases of the activities of authorities implementing state functions. In addition, administrative and regulatory barriers are reportedly in the process of being reformed with the objective to remedy any advantages associated with the special status of state and municipal institutions operating on a commercial basis.[257]

Article 65 of the Civil Code indicates that bankruptcy proceedings can be initiated against virtually any legal entity, with the exception of religious organisations, political parties and kazennyye enterprises – one of the two types of unitary enterprise. A state corporation may be declared bankrupt if the federal law providing for its creation provides for this possibility.

This implies that the rest of the companies with state participation are subject to the bankruptcy rules and procedures established by the Federal Law on Insolvency (Bankruptcy) [258] and separate provisions of the Civil Code. Note that even in cases where bankruptcy of unitary

[253] Sberbank has some functions of the Central Bank. For example, in 2010, an experiment of the Central Bank began to transfer the functions of cash settlement centres in three regions of the Russian Federation (Moscow Region, St Petersburg and Vladimir Region) to Sberbank, which provided cash to credit organisations instead of remotely created checks (RCCs) for a fee, which reduced the cost of maintaining RCCs. Subsequently, the experiment continued and other banks were involved. As a result, from 1 January 2013 to 3 December 2018, the number of RCCs in the structure of the Central Bank decreased from 498 to 83.

[254] Competitive neutrality is a situation when enterprises are not discriminated against by the state irrespective of their ownership status.

[255] Federal Law N.º 135-FZ of 26 July 2006 "*on Protection of Competition*".

[256] Government Order N.º 1021-p of 10 June 2011 (as amended) "*on Approving the Concept for Reducing Administrative Barriers and Increasing the Availability of State and Municipal Services for 2011-2013 and the Action Plan for the Implementation of this Concept*".

[257] OECD (2012).

[258] Federal Law N.º 127 of 26 October 2002 "*on Insolvency (Bankruptcy)*".

enterprises is legally possible, satisfaction of creditors' claims may be difficult due to procedural difficulties which are related to the fact that the property of unitary enterprises is owned by the State. The main reason for the bankruptcy of state unitary enterprises is insolvency, that is, the inability of the company to meet the requirements of all creditors completely.

As for state corporations, their property remains the property of the Russian Federation. In accordance with Article 7(1) of the Law on non-commercial entities, the corporation is not responsible for the obligations of the Russian Federation, and the Russian Federation is not responsible for the obligations of the corporation. At the expense of a part of its property, authorised capital can be formed, which determines the minimum amount of a corporation's property, ensuring the interests of its creditors. The latter requirement is indicated in separate federal laws on the creation of each state corporation.[259]

Thus, the satisfaction of creditors' claims may be difficult in the case of unitary enterprises due to procedural difficulties because the State acts as the owner of the property of such enterprises, as well as in the case of state corporations to which the bankruptcy procedure is generally not applicable.

4.6.3 EXEMPTIONS FROM THE APPLICATION OF GENERAL LAWS, TAX CODES AND REGULATIONS

With regard to taxation issues, state and municipal unitary enterprises are commercial organisations and they are subject to the general taxation rules established by the Tax Code of the Russian Federation[260] (′Tax Code′), with some exceptions. A unitary enterprise, for example, is a VAT payer under the general regime. Despite the fact that the property of a unitary enterprise is owned by the State, the unitary enterprise needs to pay VAT on the receipts from leasing such property. In the case of the implementation of the functions of a managing organisation, a unitary enterprise may be exempted from paying VAT[261] if the relevant services are purchased directly from the organisations that perform them.

4.6.4 DISCLOSURE AND SEPARATION OF COMMERCIAL AND NON-COMMERCIAL ACTIVITIES

Disclosure and separation of commercial and non-commercial activities is necessary to monitor whether public funds extended by the Government to enterprises are used to cover public service obligations or for commercial purposes (e.g. through cross-subsidisation from public

[259] For example, according to Federal Law N.º 82-FZ 17 May 2007 "*on the state development corporation VEB.RF*", "*the authorised capital of VEB.RF is formed by: 1) the property of the Bank for Foreign Economic Affairs of the USSR transferred to the authorised capital of Vnesheconombank; 2) Federally owned shares of the Open Joint-Stock Company Russian Bank for Development and the State Specialised Russian Export-Import Bank (closed joint-stock company); 3) other property by decision of the Government of the Russian Federation to ensure the formation of the authorised capital of VEB.RF*".

[260] Tax Code of the Russian Federation N.º 146-FZ of 31 July 1998, Part 1 Tax Code, p. 1, available at: http://www.consultant.ru/document/cons_doc_LAW_19671/, accessed on 8 November 2019, and Part 2, http://www.consultant.ru/document/cons_doc_LAW_28165/, accessed on 2 September 2019.

[261] Article 149, paragraph 29 and Article 149, paragraph 30, item 3 of the Tax Code.

'*profit-making*' to commercial loss-making activities). In the latter case, SOEs may enjoy a competitive advantage in comparison with other companies.

Russia maintains specific rules on separating accounts between the commercial and non-commercial activities of state enterprises.[262] However, the Expert Council established by the Government,[263] in its report on the reform of unitary enterprises, concluded that there is a lack of complete and reliable information about the property of unitary enterprises, their financial and economic activities. This is especially true for municipal unitary enterprises. One of the main reasons for this is the large number of unitary enterprises and the associated difficulties in exercising control and audit.[264]

Since most unitary enterprises are, in fact, natural monopolies, they have incentives to include costs associated with servicing non-core assets[265] in order to justify the higher level of prices they quote in their commercial activities. Despite the fact that the FAS is making significant efforts to prevent unreasonable growth of the prices of natural monopolies, the problem has not been fully eradicated.[266]

4.6.5 MARKET-CONSISTENT CONDITIONS REGARDING ACCESS TO DEBT AND EQUITY FINANCE, PRESENCE AND NATURE OF STATE SUPPORT TO AND BY SOES

To make sure SOEs do not have asystematic advantage vis-a-vis private enterprises, their financing should comply with several conditions which are discussed briefly immediately below for the case of Russia.

4.6.5.1 COMMERCIAL NATURE OF RELATIONS WITH ALL OTHER FINANCIAL AND NON-FINANCIAL ENTITIES

Managers of Russian State enterprises are obliged by general corporate law[267] to act in the interest of their enterprises and to pursue commercial goals in their commercial operations. Whether this is the case is, however, difficult to establish when there are no separate rules, for example on disclosure of the nature of transactions and dealings with related parties.

[262] OECD (2012) and Kowalski and Perepechay (2015), *International Trade and Investment by State Enterprises*, OECD Trade Policy Paper No. 184, OECD Publishing, Paris, available at: http://dx.doi.org/10.1787/5jrtcr9x6c48-en, accessed on 21 October 2019.

[263] Available at: http://open.gov.ru/events/5514748/, accessed on 21 October 2019.

[264] Available at: http://open.gov.ru/upload/iblock/981/981e503e47ce185dc6715fc12992b264.pdf, accessed on 21 October 2019.

[265] Restaurants, laundry, sports teams, media, tourist companies, medical institutions, cultural recreation organisations, shares in other non-core commercial organisations, etc.

[266] According to the FAS, the difficulties in solving this problem are as follows: costs of non-core assets remained in some prices adopted before the transfer of price regulation functions to the FAS; in addition, current price legislation provides an opportunity to include in the price structure the costs of maintaining non-core assets at regional level. Thus, the main problem is the imperfection of the tariff legislation, in particular the lack of a unified approach to the calculation of prices of unitary enterprises.

[267] Federal Law N.º 208-FZ of 26 December 2006, "*on Joint-Stock Companies*", as amended.

The study conducted by Higher School of Economics together with the Association of Professional Investors[268] notes that, in general, SOEs under review comply with the principle of information disclosure. However, significant gaps relate to information on interested-party transactions, which occupy a significant share in the activities of companies. For example, VTB, Gazprom, Rosneft in 2015–2016 approved 291 such transactions, amounting to well more than RUB 51 trillion and reported them.[269] However, the companies' reports only indicate that the transactions were completed without disclosing material terms, in particular the counterparty and the price, which, it is important to note, does not violate the regulation on information disclosure of the Corporate Governance Code.[270] Nevertheless, most companies (including RusHydro, FGC UES, Aeroflot, ALROSA) covered by the study applied good disclosure practices, indicating all essential transaction terms, including item, price (limit values), counterparty, expiration date and other.

4.6.5.2 FINANCIAL AND OTHER SUPPORT THAT CONFERS AN ADVANTAGE OVER PRIVATE COMPETITORS

There are several documented cases where SOEs receive financial support not available to private operators or where specific conditions are in place from which only SOEs benefit. For example, Aeroflot is the only recipient of royalties that foreign air carriers flying through Siberia pay for using Russian airspace. The sum of these payments is estimated at about USD 600 million each year,[271] which is higher than the company's net profit for 2017 (USD 395 million).[272,273] Another example are the legal restrictions on the admission of companies to the development of deposits on the continental shelf.[274] Only Gazprom and Rosneft can explore and exploit such deposits on the continental shelf. In addition, Gazprom has an exclusive right to export gas through pipelines, and until 2013 Gazprom had a monopoly on all gas exports (including LNG).[275] Since there are also private companies in the aviation market, as well as in the oil and gas markets, these preferences can be considered as certain advantages of SOEs over private companies.

4.6.5.3 REQUIREMENT TO EARN RATES OF RETURN THAT ARE CONSISTENT WITH THOSE OBTAINED BY COMPETING PRIVATE ENTERPRISES

[268] Available at: https://iq.hse.ru/news/205006407.html, accessed on 21 October 2019.
[269] Ibid.
[270] The Corporate Governance Code is a set of rules recommended by the Central Bank for the management of public joint-stock companies, state corporations and other enterprises. Bank of Russia N.º 06-52 / 2463 of 10 April 2014 "*on the Corporate Governance Code*".
[271] Available at: https://www.novayagazeta.ru/articles/2017/03/13/71773-renta-na-vozduh, accessed on 22 July 2019.
[272] Calculated using 2017 average official USD/RUB exchange rate 58, 3086.
[273] Available at: https://www.aeroflot.ru/ru-en/news/60770, accessed on 22 July 2019.
[274] Federal Law N.º 58-FZ of 29 April 2008, "*on Amendments to Certain Legislative Acts of the Russian Federation and Recognizing the Certain Provisions of Legislative Acts of the Russian Federation Invalidating the Adoption of the Federal Law On the Procedure for Foreign Investment to business entities of strategic importance to ensure the defence of the country and the security of the state*", as amended.
[275] Federal Law N.º 117-FZ of 18 July 2006 "*on Gas Export*" (see also Chapter 10).

When SOEs' economic activities are not required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises, they are enjoying a competitive advantage.

In Russia, state enterprises are obliged to annually contribute to the budget the profit remaining after the payment of taxes and other obligatory payments in amounts and terms that are determined by the Government, authorised state bodies of the constituent entities of the Russian Federation or local governments.[276]

The rules for transferring part of the profits of FSUEs to the budget have been approved by the Government Decree No. 228 of 10 April 2002. However, Government Decree No. 1060-r of 20 June 2011 approved a list of FSUEs in respect of which a special procedure is adopted for the federal executive bodies to make decisions.[277]

In 2016, the rate of dividend payments for PJS state-owned companies was increased from 25% to 50%[278] of net profits.[279] According to Forbes Russia, the average dividend to net profit ratio in 2015–2017 was 33–34%.[280] In the summer of 2017, the Ministry of Finance proposed to legislate this dividend ratio, which, however, has not yet been implemented.

In 2018, the share of FSUEs' profits to be transferred to the federal budget was increased from 25% to 50%.[281] This proposal was made by the Ministry of Finance in 2016 in order to replenish the revenues of the federal budget and stimulate the privatisation of unitary enterprises. In fact, these transfers can be considered as a dividend payment. However, unlike with private companies which can determine the share of profits paid back to shareholders as dividends, these rates are fixed by the Government not subject to reduction. This actually puts state-owned enterprises at a disadvantage compared to other commercial enterprises

It should also be mentioned that not all state-owned companies agreed to immediately implement the law according to which the dividend payments were to be increased from 25 to 50%. For example, Rosneft paid less for about a year. But by mid-2017, it changed the dividend policy and began to return 50% of net profit to shareholders (including the state-owned Rosneftegaz). As of writing of this report, less than 50% of net profit is paid by Gazprom.[282]

[276] Article 42 of the Civil Code.

[277] These include the Russian Television and Radio Broadcasting Network, Space Communications, Rosmorport, Ostankino Television Technical Center, Russian Post, Administration of Civil Airports (Aerodromes), State Corporation for the Organization of Air Traffic in the Russian Federation, All-Russian State Television and Radio Broadcasting Company, Information Telegraph Agency of Russia (ITAR-TASS). Also these rules do not apply to the organisations of Roscosmos State Corporation (Government Resolution N.º 824 of 19 August 2016 "*on Measures for the Establishment of the State Corporation for Space Activity Roscosmos*".

[278] Government Order N.º 705-r of18 April 2016.

[279] Generally, a tradeoff between the replenishment of the federal budget and the investment activity of SOEs influences this decision.

[280] Available at: http://www.forbes.ru/finansy-i-investicii/360135-dividendnyy-urozhay-kakie-kompanii-vyplatyat-akcioneram-bolshe-vsego, accessed on 21 October 2019.

[281] Government Decree N.º 1224 of 12 October 2018 "*on Amendments to Certain Acts of the Government of the Russian Federation*".

[282] Available at: https://www.vedomosti.ru/economics/articles/2018/08/30/779478-minfin-vistupil-snizheniya-dividendov-dlya-investprogramm, accessed on 21 October 2019.

4.6.6 NON-DISCRIMINATORY AND TRANSPARENT TREATMENT OF SOES AND BY SOES OF OTHER ENTITIES IN PUBLIC PROCUREMENT

According to the OECD Guidelines: '*when SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency*'.

The general facts analysing state-induced distortions that are related to Government procurement regulations and practices in Russia are discussed in detail in Chapter 5 of this report.

As far as SOEs specifically are concerned, in Russia, some SOEs are covered by the general Government procurement law (see Section 5.2.1. concerning Federal Law No. 44-FZ of 5 April 2013), some by specific procurement legislation (see Section 5.2.1. concerning Federal Law No. 223-FZ of 18 July 2011). However, there are no laws or special regulations concerning non-discriminatory and transparent treatment of SOEs and by SOEs of other entities in public procurement. Nevertheless, according to statistics, in many cases, SOEs prefer to purchase from other state-owned enterprises. In particular, of the 'top 50' suppliers for state and municipal needs in 2016 in terms of all contracts concluded[283] nine were unitary enterprises, 15 economic entities fully state-owned and in ten of them the share of state ownership exceeded 25%. Thus, enterprises in which the state participates in one form or another accounted for about 70% (the total amount of contracts of these suppliers amount to RUB 669.6 billion) of the 50 largest suppliers in terms of the total of all contracts concluded for 2016. This suggests SOEs in Russia do benefit from publicly procured contracts disproportionately to their weight in the overall economy.

4.7 CHAPTER SUMMARY

State ownership is much less widespread than at the beginning of Russia's transition towards the market economy. It was declining up until the mid-2000s after which a certain tendency for renationalisation and a more strategic approach to state ownership has been observed. There is also some evidence that the State's footprint has increased over the most recent years. The overall contribution of the state sector to GDP has been estimated in the literature at around 30% while contributions to fixed capital formation and employment can be estimated at around 20 and 45%, respectively. Apart from public services, state ownership is still relatively significant in certain sectors of the economy such as, for example, finance, oil and gas, transport and communications, mining and extraction, but also certain segments of manufacturing such as fabricated metal products, transport equipment and computer, electronic and optical equipment.

[283] According to the Unified Information System of procurement, in the 'top 50' suppliers in 2016 in terms of all contracts concluded, the total amount of contracts of the largest suppliers for state and municipal needs was RUB 1 006 billion, that is 15.7% of the total amount of purchases on posted notices for 2016 (RUB 6 410 billion).

Russia seems to be using its SOEs to a certain extent to pursue industrial policies or strategic policy goals. It also faces challenges related to the still incomplete reform of corporate governance of its state enterprises. Russia has an organised approach to state ownership and it has been conducting reforms that bring it closer to the best practices in the area of corporate governance of state enterprises. The main remaining issues include the lack of a transparent system of state ownership and, particularly, some of the different legal rules that apply to Russia's unitary enterprises and state corporations. In sectors of primary importance, the Government and line ministries set the agenda, strategic priorities and develop instructions for boards, while at the same time regulating certain aspects of economic activity. This means that in many sectors SOEs represent a tool for potential state intervention in (regulated) markets. A clear example of lack of the separation between ownership and regulatory functions is the banking sector. Satisfaction of creditors' claims through bankruptcy may be difficult in the case of unitary enterprises and in the case of state corporations is generally not possible. Disclosure, separation of commercial and non-commercial activities and transparency of transactions with related parties also pose some problems. There is also evidence of financial support that confers an advantage over private competitors and of the de facto preferential treatment of SOEs in Government procurement and other procurement situations. Nevertheless, all state enterprises have to follow the general taxation rules and face demanding standards with respect to their dividends and contributions to the state budget.

5 PUBLIC PROCUREMENT

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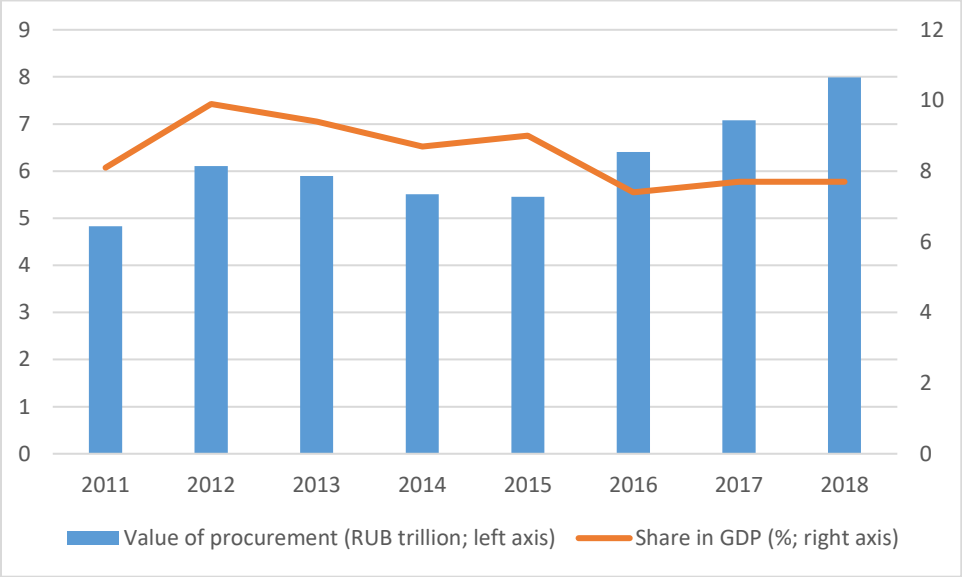
5.1 OVERVIEW AND VALUE OF THE RUSSIAN PROCUREMENT MARKET

Public procurement comprises the procurement of goods and services, as well as works purchased in order to accommodate state and municipal needs. It can be carried out by federal, regional or municipal governments or by other bodies of different legal status which carry out governmental missions, notably SOEs. In 2018, the Russian government procurement market amounted to RUB 8 trillion (EUR 108.4 billion), accounting for 7.7% of GDP excluding the procurement by SOEs and for some 20% including SOE procurement.[284] In comparison, public procurement accounted for about 20% of GDP in the EU, amounting to EUR 2.4 trillion.[285]

Figure 5.1: Value of Russian government procurement (RUB trillion) and its share in GDP (%), 2011–18[286]



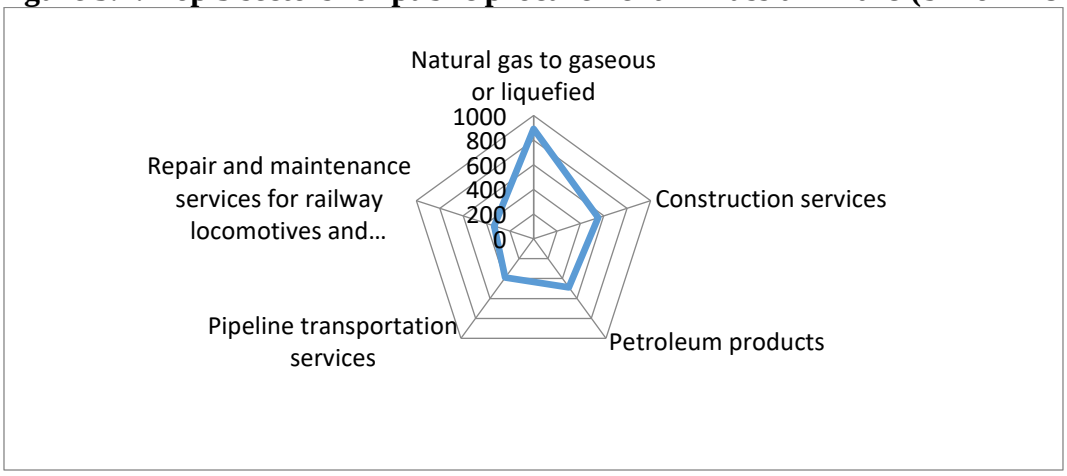
Source: WTO and MoF of Russia.

As illustrated in Figure 5.1, the Russian government procurement market has increased substantially in absolute terms since 2011. While customers concluded contracts of a total value of RUB 4.83 trillion in 2011, the value of the Russian government procurement market has increased by over 60% since then. In relative terms, however, the Russian procurement market has been relatively stagnant when expressed as a share of GDP. While it accounted for 8.1% of Russian GDP in 2011, its share has actually slightly decreased to 7.7% in 2018. The main sectors involved in public procurement in 2018 were construction of roads, buildings, repair

[284] See: https://www.interfax.ru/russia/646259, accessed on 21 October 2019.
[285] See: https://ec.europa.eu/commission/publications/eu-industrial-policy_en, accessed on 21 October 2019.
[286] WTO, *Trade Policy Review Body - Trade policy review - Report by the Secretariat - Russian Federation – Revision - WT/TPR/S/345/Rev.1*, available at: https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=((%20@Title=%20russian%20federation%20or%20russia%20or%20ussr)%20or%20(@CountryConcerned=%20russian%20federation%20or%20russia%20or%20ussr))%20and%20(%20(%20@Symbol=%20wt/tpr/s/*%20))&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true, accessed on 21 October 2019.

and maintenance services for railway locomotives and rolling stock, pipeline transportation services, and certain activities related to natural gas and petroleum products (see Figure 5.2).

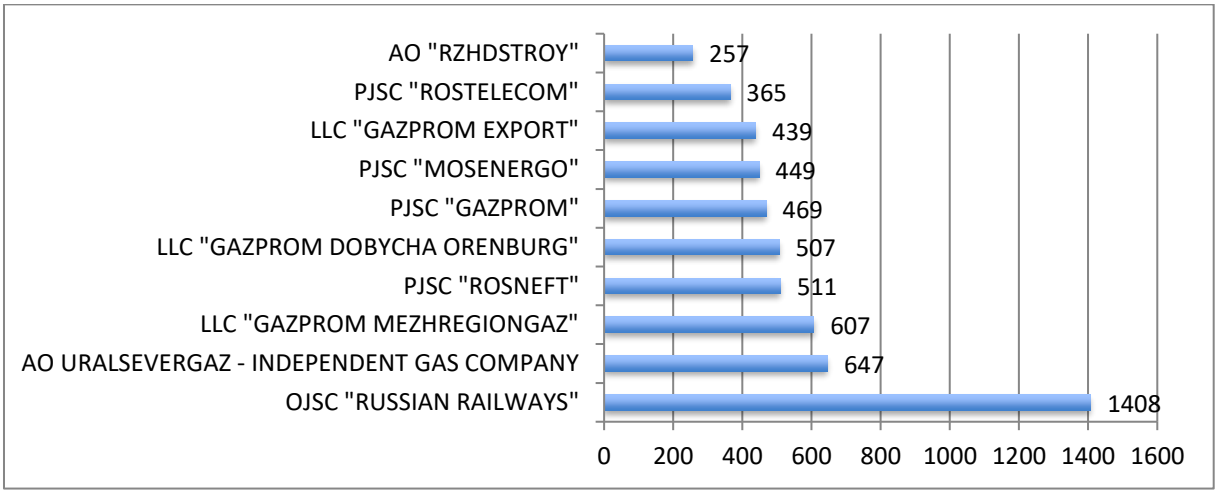
Figure 5.2: Top 5 sectors for public procurement in Russia in 2018 (billion RUB)[287]



Source: MoF of Russia, 2018.

By 31 December 2018, more than 90,000 organisations were registered in the unified procurement information system[288] as entities engaged in procurement in accordance with Federal Law No. 223-FZ (see Section 5.2). In 2018, the ten largest customers concluded contracts of a total amount of about RUB 5.6 trillion (Figure 5.3).

Figure 5.3: Largest customers by total amount of contracts concluded in 2018 (billion RUB)



Source: MoF of Russia, 2018.

Despite the growing number of the registered customers and the number of posted notices there is a significant decrease in the monetary volume of purchases for which information is publicly available. This was caused by the changes made to Law No. 223-FZ which resulted in an expansion of cases of procurement of goods and services which (although not being a state

[287] Note that the table lists the top 5 sectors out of about 100 reporting sectors in the market.

[288] The unified procurement information system is designed to provide free and free access to complete and reliable information about the contract system in the field of procurement and procurement of goods, works, services, certain types of legal entities, as well as for the generation, processing and storage of such information. Available at: http://zakupki.gov.ru/epz/main/public/home.html, accessed on 21 October 2019.

secret) are not subject to placement in the unified procurement information system - a move which has the capacity to reduce transparency in the market.

5.2 LEGAL FRAMEWORK

5.2.1 THE MAIN PROCUREMENT REGULATIONS

Russia initiated comprehensive reforms of its public procurement system in 2013 with the aim of increasing efficiency and preventing corruption, through the adoption of a new Government Procurement Law. Today's Russian procurement legislation is largely based on Federal Law No. 44-FZ of 5 April 2013 on the contract system in the field of procurement of goods, works, services for state and municipal needs[289] and Federal Law No. 223-FZ of 18 July 2011 on the procurement of goods, works, services by certain types of legal entities[290]. Both Law No. 44-FZ and Law No. 223-FZ regulate the conditions and procedures for concluding transactions for the purchase of goods, performance of work or provision of services, where one of the parties is a public authority or an organisation with sate participation in capital.

The main differences between both acts concern:

- Law No. 44-FZ considers only state organisations, while Law No.223-FZ also refers to enterprises with a state share in the authorised capital (which usually makes more than 50%) and some budget organisations;
- Law No. 44-FZ contains general regulations while Law No. 223-FZ lays down specific rules for individual types of procurement (see in particular Article 3 of Law No. 223-FZ).

The methods of public procurement are determined exhaustively in Law No. 44-FZ, while Law No. 223-FZ leaves this choice to the procuring entity.

The key modes of procurement foreseen by Russian legislation are, according to Law No. 44-FZ: tender (open tender, limited participation tender, two-stage tender, closed tender, closed tender with limited participation, closed two-stage tender), auction (electronic auction, closed auction), request for quotations, and request for proposals. The award criteria for all are: the price, expenses for the maintenance and repair of goods, the way the procurement outputs are used, quality, functional and environmental characteristics of the facility, and qualifications of bidders. [291] The most complex procedures are tenders and auctions.[292] As shown in Figure 5.4, these procedures are not as frequently applied as electronic auctions and purchases from a single supplier. Accordingly, this situation translates into the public procurement system being potentially less competitive and transparent.

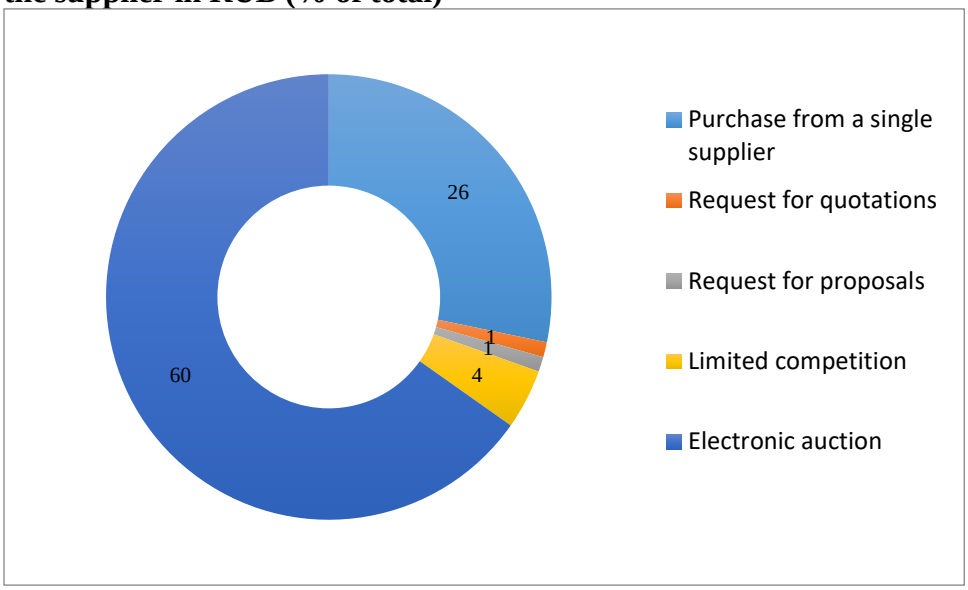
[289] Federal Law N.º 44-FZ of 5 April 2013 "*on the Contract System in the Field of Procurement of Goods, Works, Services for State and Municipal Needs*", available at: http://www.consultant.ru/document/cons_doc_LAW_144624/, accessed on 21 October 2019.

[290] Federal Law N.º 223-FZ of 18 July 2011 "*on the Procurement of Goods, Works, Services by certain Types of Legal Entities*", available at: http://www.consultant.ru/document/cons_doc_LAW_116964/, accessed on 21 October 2019.

[291] Article 32 of the Federal Law N.º 44-FZ.

[292] Baeva M., Zaitsev Yu., Orlova A., Ponomareva O. (2016), *Comparative analysis of regulating the sphere of state purchases in APEC economies*. *APEC Herald*. № 4 (02), pp. 26–41.

Figure 5.4: The total price in RUB of the contracts concluded by methods of determining the supplier in RUB (% of total)



Source: MoF of Russia, 2018.

The Law No. 44-FZ allows any legal entity to participate in public procurement, regardless of its location (Article 3(1)(4)). However, special regulations can be applied to different types of foreign companies operating in the Russian market and abroad, as well as to certain areas of public procurement. Moreover, Article 5 of Law No. 44-FZ gives the Government and the public entity which is in charge of a public procurement the right to establish the conditions for admission (up to and including a total ban) of foreign products to the domestic government procurement market. This can be done not only to ensure national security and national defence, but also to protect the domestic market and support domestic producers. There are bans and price preferences in relation to the procurement of certain types of goods (e.g. engineering products, medical products, software, etc.). The following section provides an overview of specific examples.

Eurasian Economic Union countries

Preferential conditions for participation in the Russian public procurement market apply for member states of the Euroasian Economic Union ('EAEU') (see Chapter 6). According to section 22 of the EAEU Treaty, all member countries must ensure that all potential suppliers (including residents of other EAEU member countries) have free access to their electronic trading procedures. Other countries cannot take part in public procurement because it is impossible to create a qualified electronic signature from outside the EAEU. To overcome this obstacle, large foreign companies would typically set up a legal entity in Russia.[293] EAEU States also provide for mutual national treatment and most favourable conditions in the field of procurement, compared with third countries, which are not part of the EAEU.

[293] Shmakov, A., *Who can participate in public procurement?* available at: https://zakupki.kontur.ru/site/articles/1197-kto-mojet, accessed on 25 March 2019.

Offshore companies

According to Article 3(4) of Law No. 44-FZ, offshore companies cannot participate in public procurement. Offshore companies are legal entities registered in the territory or in a State, which provides preferential tax treatment, and are exempted from the obligation to disclose information on financial transactions (offshore zones). This provision is confirmed also by Article 31.

Russian public interests abroad

Foreign providers can participate on equal conditions with Russian companies if the Government purchases services or goods abroad. For instance, this concerns the situation when Russian authorities defend their interests in the foreign courts, which requires legal advice, or they manage Russian property abroad. Foreign companies may become single service providers in the case of rental of real estate in foreign countries, medical treatment of Russian citizens abroad, as well as rating services in foreign countries.[294]

For transparency reasons the Government organizes mandatory public discussions. Based on the results of the mandatory public procurement review, changes may be made to procurement plans, schedules, procurement documentation or the procurement may be cancelled.[295] The monitoring of the procurement process is carried out by the Ministry of Economic Development.[296] Control of public procurement is exercised by the federal executive authorities and public associations.

5.2.2 SECTORAL LIMITATIONS

Government decrees restrict the procurement of foreign goods and services in various sectors. In terms of cross-cutting regulations, Government Decree No. 791 of 11 August 2014[297] sets out general restrictions for Russian customers to procure a number of consumer goods (e.g. fabrics, textile articles, specific types of clothing, leather and footwear, etc.) originating from foreign countries. Government Decree No. 1224 of 24 December 2013[298] establishes a ban on purchasing foreign goods and services for defence purposes. Additionally, Government Decree No. 925 of 16 September 2016,[299] of general application to all goods, works and services, grants a 15% price preference for domestically produced products or imposes a 15% discount on the price of foreign products offered in a tendering procedure.

[294] See: https://goscontract.info/podgotovka-k-tenderu/kak-uchastvovat-v-zakupkakh-inostrannomu-postavshchiku, accessed on 15 November 2019.

[295] This is a compulsory requirement for public procurement agreements exceeding RUB 1 billion (Article 20 of the Law N.º 44-FZ).

[296] Government Decree N.º 1193 of 3 November 2015 "*on the Procedure for Monitoring the Procurement of Goods, Work, Services for State and Municipal Needs*".

[297] Available at: https://legalacts.ru/doc/postanovlenie-pravitelstva-rf-ot-11082014-n-791/, accessed on 28 February 2020.

[298] Available at: http://static.government.ru/media/files/41d4aebed750fb05a5de.pdf and http://static.government.ru/media/files/Ws83S0GCIiu8ARmPxv2maND1TIpMjUf3.pdf, accessed on 22 October 2019.

[299] Available at: https://rg.ru/2016/09/27/tovari-dok.html, accessed on 22 October 2019.

There is also a set of regulations which provide for substantial limitations for both domestic and foreign companies.[300] For instance, there is a bid security and a cash deposit requirement which imposes a substantial financial burden on suppliers. To ensure they have the liquidity needed to provide a cash deposit, companies must set aside funding until the contract has been completed and approved by the contracting entity.[301] The governmental prepaid expenses cannot exceed 30% of the total contract value. This rule allows access to public procurement only for companies which have financial reserves or are ready to provide goods and/or services for the Government on credit.

Since 2014, a trend towards closure of the public procurement market for foreign suppliers has been developing in Russia. On the one hand, this is related to the goal of supporting the development of domestic industries. On the other hand, this tendency is also associated with the influence of the sanctions regime.[302] The import substitution policy (see Section 6.4) adopted by the Government in 2014–2015 strengthened the protectionist trend. On 4 August 2015, the Government established a Commission on import substitution, which has become responsible for import substitution support in agriculture, the defence industry, as well as mechanical engineering and information technologies.[303] This policy also affected the public procurement sector. Specific measures can be mentioned as examples: there is a ban on foreign products for purchases of machinery and equipment, in particular, when it comes to construction and mining, or medical equipment (in case there are domestic analogues). There are also restrictions in the textile industry. In some other industries, specific price preferences are applied. For example, in purchases by SOEs of telecom and radio-electronic products the allowable price difference between domestic and foreign goods, for which preference will be given to Russian companies, is 30% (see below).[304] Furthermore, Government Decree No. 1289 of 30 November 2015 and its further amendments, banned the procurement of imported drugs in the case of two or more applications from domestic manufacturers or companies from the EAEU.[305]

Since 2018, a change of instruments can be observed with regard to the implementation of an export support policy. In May 2018, a Presidential Decree was adopted according to which export support policy has become one of the key goals of the Government until 2024.[306] In

[300] Article 44 of Law N.º 44-FZ.

[301] World Bank Benchmarking Public Procurement (2017).

[302] Knobel A. and others (2019), *Sanctions: seriously and for a long time*, RANEPA, "Delo" Publishing House, p. 80 (in Russian), available at: ftp://w82.ranepa.ru/rnp/ppaper/021901.pdf, accessed on 11 March 2019.

[303] Government Decree N.º 785 of 4 August 2015 "on the creation of a government commission on import substitution", available at: http://static.government.ru/media/files/gP7IKCc3BsBTtEQuYjUxArQ28Dr3oyA3.pdf, accessed on 22 October 2019.

[304] For more details, see Baker McKenzie (2019), *New Limitations on Procurements of Foreign IT Products in Russia*, available at: https://www.bakermckenzie.com/en/insight/publications/2019/09/new-limitations-on-procurements-of-foreign, accessed on 22 October 2019.

[305] Available at: http://government.ru/docs/32611/, accessed on 11 December 2019.

[306] Presidential Decree N.º 204 of 7 May 2018 "*on National Goals and Strategic Tasks of the Development of the Russian Federation for the period up to 2024*", available at: http://www.kremlin.ru/acts/bank/43027, accessed on 22 October 2019.

order to achieve this goal, the Government purports to support high-productivity, export-oriented businesses in sectors of the economy that are characterized by modern technology and highly qualified employees - primarily in manufacturing and the agro-industrial sectors. In the long term, such policy has the potential to affect the public procurement market. For instance, the share of Russian government's public procurement expenditure to purchase services in the agriculture and IT sectors increased from 0.7% and 3% in 2017 to 1% and 4% in 2018, respectively.[307]

Information and communication technologies

The Government Decree No. 1236 of 16 November 2015[308] introduced a prohibition on the admission of computer programs and databases originating from foreign countries, as well as exclusive rights to such software for procurement purposes for state or municipal needs. A limited list of exceptions to this ban has been established: the absence of domestic counterparts, purchases for diplomatic and consular agencies, and software purchases in relation to a state secret.

Furthermore, Government Decree No. 878 of 10 July 2019[309] introduced a restrictive system linked to a State Register of domestic radio-electronic equipment. The said State Register includes: telecom products, for which, among others, the majority of intellectual property rights is Russian-owned, and which meet certain localization criteria, as well as radio-electronic products subject to localization requirements of Government Decree No. 719 of 17 July 2015.[310] According to Decree No.878, when two bidders offer domestic products included in the State Register, other offers featuring unregistered products - i.e. potentially foreign ones - are to be eliminated. The same Decree also introduced a 30% price preference for equipment included in the State Register in tenders organised by SOEs.

Rubber and plastic products

The orders of the Ministry of Economic Development No. 155 of 25 March 2014 and No. 847 of 13 November 2015[311] established certain restrictions for the procurement of products from

[307] Monitoring public procurement. The official web site of the MoF of Russia, available at: https://www.minfin.ru/ru/perfomance/contracts/purchases/, accessed on 22 October 2019.

[308] Government Decree N.º 1236 of 16 November 2015 "*on Imposing a Ban on the Admission of Software Originating from Foreign Countries for the Purpose of Procurement for State and Municipal Needs*", available at: http://www.garant.ru/products/ipo/prime/doc/71152170/, accessed on 22 October 2019.

[309] Government Decree No. 878 of 10 July 2019 "*on Measures Stimulating Domestic Production of Radio-Electronic Equipment by Means of a Public Procurement System*", available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102571587&intelsearch=878, accessed on 11 December 2019.

[310] Government Decree No. 719 of 17 July 2015 "*on the Confirmation of Production of Industrial Goods in the Russian Federation*", available at: http://pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102405827&backlink=1&&nd=102376501, accessed on 11 December 2019.

[311] Order of the Ministry of Economic Development N.º 847 of 13 November 2015 "*on Amendments to the Order of the Ministry of Economic Development of Russia No. 155 of 25 March 2014 "on the Conditions for Admission of Goods Originating from Foreign Countries for the Purpose of Procurement of Goods, Works and Services to ensure State and Municipal Needs*", available at: http://rulaws.ru/acts/Prikaz-Minekonomrazvitiya-Rossii-ot-13.11.2015-N-847/, accessed on 22 October 2019.

vulcanised rubber not included in other groups; hard rubber in all forms and products from it; floor coverings and mats from vulcanised porous rubber; and other plastic products.

Textiles industry

According to the Government Decree N.º 791 of 11 August 2014[312] purchases of textile goods originating in foreign countries (with the exception of the EAEU) can be limited by special rders of the Government. This legislation has been already applied and is associated with a ban on the purchase of foreign goods, except for goods from the EAEU.

Agriculture

The orders of the Ministry of Economic Development No. 847 of 13 November 2015 on Amendments to the Order of the Ministry of Economic Development of Russia and No. 126n of 4 June 2018 on the conditions for admission of goods originating from foreign countries for the purpose of procurement of goods, works and services to ensure state and municipal needs, establish a restrictive regime for the state procurement of certain crops, livestock and fisheries. The Government limits the participation of foreign companies, even if they can supply cheaper products. This means establishing conditions for admission to the purchase of foreign goods. The customer should give preference to applications in which goods offered originate in Russia and/or the EAEU. The auction contract is concluded if Russian or EAEU goods are offered at the price of the winner or if foreign goods are offered 15% cheaper than the winner's price.

Medicines and materials used for medical purposes

In accordance with the Government Decree No. 102 of 5 February,[313] restrictions have been imposed on the importation of a number of medical equipment items and materials for public procurement purposes. Import is limited not only for consumables, but also for specialised equipment, for example imports of radiological information systems for digital medical imaging. As a consequence, this creates problems with the digitalisation of healthcare due to the limited purchase possibilities of innovative and modern foreign equipment.[314] Procurement of X-ray diagnostic complexes, tomographs, electrocardiographs, instruments for studying sound vibrations in human organs, and other equipment is also limited. One of the aims and effects of such a policy is notably the imports of equipment in parts, followed by assembly by Russian companies.[315]

[312] Government Decree N.º 791 of 11 August 2014 "*on the Establishment of a Ban on the Admission of Light Industry Goods Originating from Foreign Countries, and (or) Rental Services for such Goods for the Purpose of Procurement for Federal Needs, the Needs of Constituent Entities of the Russian Federation and Municipal Needs*" (as amended), available at: http://base.garant.ru/70718510/, accessed on 22 October 2019.

[313] Government Decree N.º 102 of 5 February 2015 "*on Restrictions and Conditions for the Admission of Certain Types of Medical Devices Originating from Foreign Countries for the Purpose of Procurement for State and Municipal Needs*" (in Russian), available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102367173, accessed on 22 October 2019.

[314] Abroskin A.S., Zaitsev Yu.K., Idrisov, G.I., Knobel A.Yu., Ponomareva E.A. (2019), *Economic development in the digital era*, Delo, p. 60.

[315] *Ibidem*.

Machinery and equipment

There are restrictions on participation in government procurement for foreign manufacturers of cars and trucks, minibuses, trolley buses, trams or cranes (Government Decree No. 656 of 14 July 2014).[316] The procuring entity is not allowed to buy any of the 58 foreign goods listed by the Decree. The list among other things includes crawler tractor/dozers, tracked tractors, buses, trolley buses and diesel trucks.

Wood processing and wood products

The Government Decree No. 1072 of 5 September 2017 prohibited government purchases under Federal Law No. FZ-44 of furniture, wood products (a total of 29 items) from foreign suppliers until 1 December 2019.[317] To confirm the country of origin, participants had to provide a certificate of origin. At the time of writing of this report, no indications were available as to the continuation of this regime.

Apart from the above sectorial limitations, additional measures resulting in barriers in the Russian public procurement market, in their majority related to local content regulations, can be identified in the Trade Monitoring Database of the World Trade Organization,[318] as well as in the Market Access Database of the European Commission.[319] Such additional restrictions relate, for example, to radio-electronic products and furniture.[320]

5.2.3 SOE PROCUREMENT RULES

When it comes to state procurement legislation, the IMF points out that both general government and SOE regulation '*does not appear sufficiently aimed at strengthening competition and supporting SMEs*'.[321] According to the IMF, legislation allows SOEs to make use of non-competitive methods. In fact, in 2017 only 4% of SOEs' procurement was concluded through competitive methods such as tenders and auctions. In contrast, 31% of procurement was settled through single-supplier methods, while 65% was concluded using other non-competitive methods. Furthermore, 50% of the purchases for SOEs were by the top five largest SOEs, such as Rosneft and Russian Railways.[322] As for SMEs, procurement rules applied by

[316] Government Decree N.º 656 of 14 July 2014, available at: http://base.garant.ru/70695588/, accessed on 22 October 2019.

[317] Government Decree N.º 1072 of 5 September 2017, available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102443589&intelsearch=1072+%EE%F2+05.09.2017, accessed on 22 October 2019.

[318] Available at: http://tmdb.wto.org/, accessed on 22 October 2019.

[319] Available at: http://madb.europa.eu/madb/barriers_details.htm?isSps=false&barrier_id=11271, accessed on 22 October 2019.

[320] Report from the Commission to the Parliament and the Council "*on Trade and Investment Barriers. 1 January 2017–31 December 2017*", avaialbe at: https://ec.europa.eu/commission/news/annual-report-trade-and-investment-barriers-2018-jun-26_en, accessed on 22 October 2019.

[321] International Monetary Fund (2018), *Russian Federation: Selected Issues, IMF Country Report No. 18/276*, p. 4, available at: https://www.imf.org/en/Publications/CR/Issues/2018/09/12/Russian-Federation-Selected-Issues-46227, accessed on 22 October 2019.

[322] *Ibidem*.

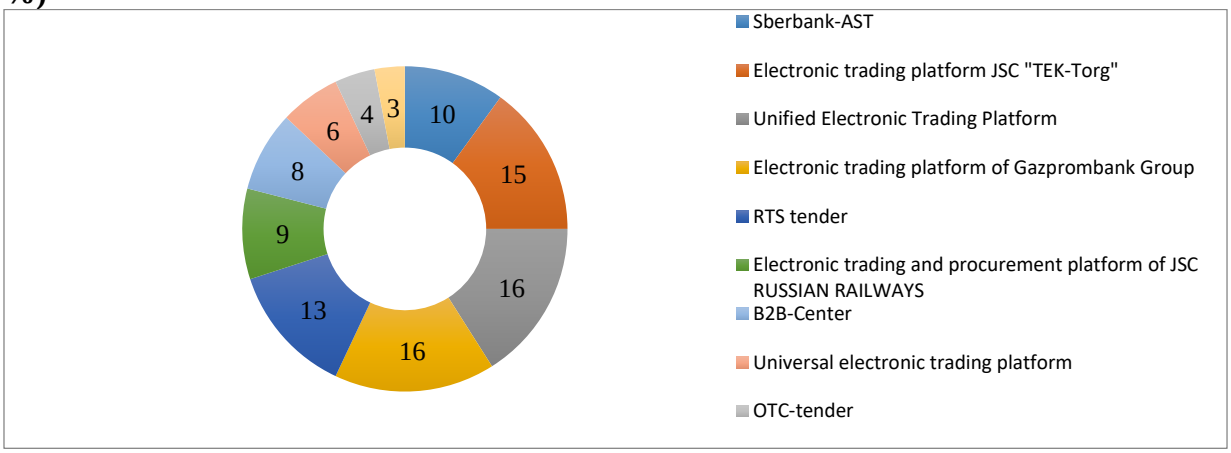
SOEs can result in constraining SMEs' market access, innovation, as well as their development.[323]

5.3 IMPLEMENTATION OF PUBLIC PROCUREMENT RULES

When it comes to the assessment of potential market distortions, it is important to differentiate between de jure and de facto barriers in public procurement. In addition to the overview of the Russian legal framework above, this section also includes an assessment of distortions resulting from de facto barriers.[324] Indeed, challenges of participation of foreign companies in the Russian procurement system can be of legal, but also of organizational or technical nature.[325]

In Russia, procurement procedures are implemented through ten main trading platforms (Table 5.5). The top five are the following: the Sberbank-AST trading system, the Unified Electronic Trading Platform, the All-Russian Electronic Trading System, the Russian Electronic Trading Platform (RTS-tender), and the Electronic Trading Platform of the State Procurement. From 2019, all public procurement participants are obliged to submit their applications via final proposals and via electronic trading platforms.[326]

Figure 5.5: Top ten electronic trading platforms by the value of announced projects (in %)



Source: MoF of Russia, 2018.

The World Bank provides regular assessments on the international benchmarking of public procurement regimes in different countries according to two main thematic pillars: the

[323] *Ibidem*.

[324] Aleksandrova, A.I., Ostapovets, E.A., Klochkova, A.V. (2017), *Directions of Improving the Public Procurement System in the Russian Federation*. *St. Petersburg State Polytechnical University Journal*. Economics, 10 (2), 21-32, available at: https://economy.spbstu.ru/userfiles/files/articles/2017/2/02_aleksandrova_ostapovets_klochkova.pdf, accessed on 22 October 2019.

[325] Emerging Markets Group. (2017), *Participation of Foreign Companies in the State Procurement of the Russian Federation*, available at: http://www.emg-russia.com/images/data/gallery/0_5772_Public_Procurement.Olga_Vorobyeva.EmergingMarketsGroup.pdf, accessed on 22 October 2019.

[326] Electronic trading platforms, available at: http://www.gos-zakaz.com/tender/etp.html, accessed on 22 October 2019.

procurement process, ranging from needs assessment to implementation of the procurement contract; and an analysis of complaint review mechanisms. The latest available report covers 180 economies from seven different regions, i.e. East Asia and Pacific, Europe and Central Asia, Latin America and Caribbean, Middle East and North Africa, OECD high-income, South Asia, and Sub-Saharan Africa.[327] Table 5.2 provides an overview of the individual indicators analysed for the first main thematic pillar, the procurement process, for Russia and other selected economies. The different public procurement practices and regulations are assessed, and final numerical scores are developed for each indicator, ranging from 0 to 100. A high score approaching 100 means that the economy is considered to align with internationally recognised good practices, while a score closer to zero signals that the procurement process falls short of such practices.

Russia scores a maximum score when it comes to needs assessment, call for tender and bid preparation, and also scores well on the content and management of procurement contracts (82) and bid submission (a score of 78). However, the indicator of payment of suppliers, in particular, receives a very low score of 33. By comparison, this is much lower than the score of other emerging markets such as India (59) and China (67). Also, the performance guarantee indicator score of 50 is behind other emerging markets (India, 54; China, 70) and OECD high-income countries.

Table 5.2: International benchmarking of public procurement processes indicators (0–100), 2017:

Scoring indicators	Germany	Japan	US	India	China	Russia
Needs assessment, call for tender, and bid preparation	76	70	98	63	56	100
Bid submission	29	67	57	75	94	78
Bid opening, evaluation and award	79	50	57	50	79	64
Content and management of procurement contracts	82	68	64	68	82	82
Performance guarantee	78	58	54	54	70	50
Payment of suppliers	67	67	100	59	67	33

Source: The World Bank (2016), *Benchmarking Public Procurement 2017 Report*, p.51, available at: http://bpp.worldbank.org/en/reports, accessed on 22 October 2019.

Regarding the World Bank's analysis of the second main thematic pillar of complaint review mechanisms, Russia has a first-tier review complaint mechanism in place. In addition, it is

[327] The World Bank (2016), *Benchmarking Public Procurement 2017 Report*, available at: http://bpp.worldbank.org/en/reports, accessed on 22 October 2019.

possible to appeal the first-tier review body's decision as Russia's legal framework[328] also stipulates conditions for a second-tier review.

5.3.1 CORRUPTION AND LACK OF TRANSPARENCY

Importantly, de facto procurement barriers can also include corruption and a lack of transparency.[329] In 2015, corruption was regarded as the most problematic factor for doing business in Russia by the World Economic Forum. Irregular payments and bribes occurred in order to obtain public contracts and also favouritism in decisions of Government officials was reported. In addition, diversion of public funds due to corruption was another reported problem.[330] Public procurement remains one of the areas of Government spending that ranks highest in corruption.[331] For example, in December 2017, 32% of businesses reported facing corruption in procurement processes at the municipal level.[332] According to expert estimates, the level of corruption in the procurement sector accounts for about 85–90% (the percentage of corrupt cases), whereas in OECD countries this figure constitutes 3–10%.[333] Furthermore, as result of arbitrary application of the current legislation, there is a trend towards the cartelisation of the public procurement market. The FAS highlighted the ongoing challenge of cartelisation in the Russian public procurement sector and the World Bank notes in a recent report a need to '*reverse a trend towards cartelisation of the economy, especially, in public procurement*'.[334] This topic is analysed in more detail in a case study in Section 5.5.

The current system of public procurement in Russia also does not ensure full transparency. The lack of transparency originates, for example, from overwhelmingly non-competitive SOE procurement contracts, where single supplier contracts amounted to over 50% of the volume of procurement in 2017.[335] The non-transparent character of SOE procurement rules is also illustrated by reports of informal pressure from Government officials discriminating against

[328] See Article 105 of Law N.º 44-FZ.

[329] Pakharukova, N. (2014), *Public procurement system in Russia in the process of transition: Guidelines for EU suppliers*, Helsinki Metropolia University of Applied Sciences, available at: https://www.theseus.fi/bitstream/handle/10024/83522/Pakharukova_theseus.pdf?sequence=1, accessed on 22 October 2019.

[330] Schwab, K., (2015), *The Global Competitiveness Report 2015–2016*, available at: http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf, accessed on 22 October 2019.

[331] US Department of State (2018), *2018 Investment Climate Statements: Russia*, available at: https://www.state.gov/reports/2018-investment-climate-statements/russia/, accessed on 22 October 2019.

[332] *Ibidem*.

[333] Available at: https://profile.ru/economics/item/126979-zakupochnye-stseny , accessed on 22 October 2019.

[334] The World Bank (2018) *Russia Economic Report*, available at: http://www.worldbank.org/en/country/russia/publication/rer, accessed on 22 October 2019.

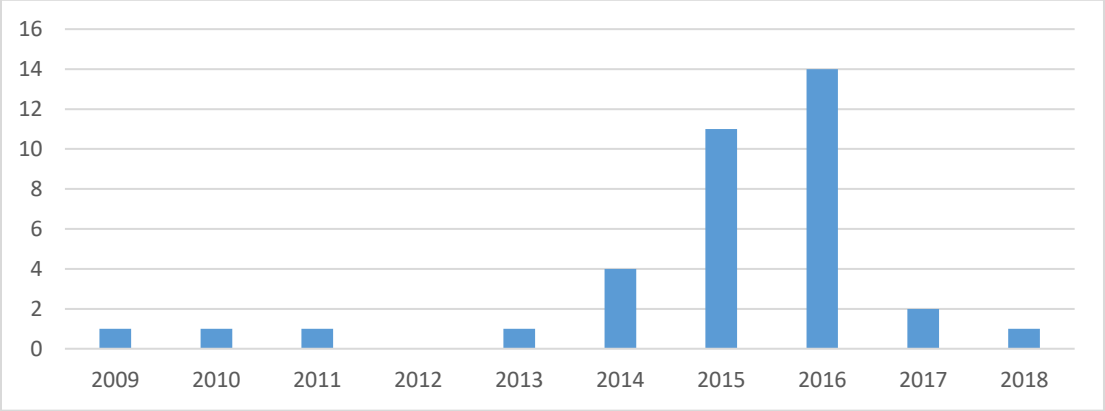
[335] International Monetary Fund (2018), *Russian Federation: Selected Issues*, IMF Country Report No. 18/276, p. 4, available at: https://www.imf.org/en/Publications/CR/Issues/2018/09/12/Russian-Federation-Selected-Issues-46227, accessed on 22 October 2019.

foreign suppliers.[336] In 2018, the law regulating SOE procurement was amended in order to increase transparency and facilitate better state monitoring of SOE corporate procedures.[337]

5.4 STATE INTERVENTION IN SECTORS

As outlined in Section 5.2, the legal provisions on public procurement in Russia are the source of numerous restrictions for foreign companies. According to the Global Trade Alert, a total of 36 new state interventions in public procurement that are classified as harmful have been introduced since 2009. Of these, 25 interventions were introduced in 2015 and 2016 alone (see Figure 5.6).[338]

Figure 5.6: Number of new harmful interventions related to public procurement in Russia [339]



Source: Global Trade Alert.[340]

The top 3 sectors affected by interventions are the following: 12 interventions concern the sectors of motor vehicles and trailers, six interventions concern machinery for the mining sector, and four interventions concern the agricultural or forestry machinery sector (see Table 5.3).

[336] U.S. Department of State. (2018), *2018 Investment Climate Statements: Russia*, available at:https://www.state.gov/reports/2018-investment-climate-statements/russia/, accessed on 22 October 2019.

[337] Federal Law N.º 505-FZ of 31 December 2017 "*amending the Federal Law "on Procurement of Goods, Works and Services by Certain Types of Legal Entities"*", available at: http://static.kremlin.ru/media/acts/files/0001201712310039.pdf, accessed on 22 October 2019.

[338] The term "*harmful*" is used in relation to foreign trading interests, as mentioned in the GTA handbook: "*We document beneficial as well as harmful changes in the relative treatment of foreign versus domestic commercial interests. Each GTA database entry provides information about the direction of the change (harmful or liberalising)* (…)". See: *The Complete GTA Handbook*, p. 1, available at: https://www.globaltradealert.org/data_extraction, accessed on 22 October 2019; the term "*intervention*" is used to describe a governmental change to market conditions, as mentioned in the GTA Handbook: "*The GTA database organises governmental changes to market conditions into three levels. From top to bottom, these three levels are the state act grouping, the state act and the intervention.*"

[339] Available at Global Trade Alert. Results obtained by search of import-related public procurement interventions since 1 January 2009.

[340] See: Global Trade Alert, available at: https://www.globaltradealert.org/, accessed on 22 October 2019.

Table 5.3: Sectors affected most often by harmful interventions related to public procurement in Russia since 1 January 2009[341]

Code	Name	Interventions
491	Motor vehicles, trailers and semi-trailers; parts and accessories thereof	12
444	Machinery for mining, quarrying and construction, and parts thereof	6
441	Agricultural or forestry machinery and parts thereof	4
435	Lifting and handling equipment and parts thereof	2
481	Medical and surgical equipment and orthopaedic appliances	2
442	Machine tools and parts and accessories thereof	2
282	Wearing apparel, except fur apparel	2
496	Aircraft and spacecraft, and parts thereof	2
283	Tanned or dressed fur skins and artificial fur; articles thereof (except headgear)	2
641	Local transport and sightseeing transportation services of passengers	2
475	Discs, tapes, solid-state non-volatile storage devices and other media, not recorded	2
653	Air and space transport services of freight	2
293	Footwear, with outer soles and uppers of rubber or plastics, or with uppers of leather or textile materials, other than sports footwear, footwear incorporating a protective metal toe cap and miscellaneous special footwear	2
476	Audio, video and other discs, tapes and other physical media, recorded	2
479	Cards with magnetic strips or chip	2

Source: Global Trade Alert.[342]

Turning to a more granular level, i.e. the products affected by interventions, the picture is as follows: the products that were most often affected by these interventions were motor vehicles for transport of persons and goods, as well as special purpose vehicles such as lorries, fire fighting vehicles, but also bulldozers or tractors (see Table 5.4).

Table 5.4: Products affected most often by harmful interventions related to public procurement in Russia since 1 January 2009[343]

Code	Name	Interventions
8702	Motor vehicles for the transport of ten or more persons, including the driver.	10

[341] Available at: *Global Trade Alert*. Results obtained by search of import-related public procurement interventions since 1 January 2009. The sectoral classification is based on the Common Product Classification (CPC, version 2.1) at the 3-digit level. For more detail on the sectoral classification, available at: https://www.globaltradealert.org/data_extraction, accessed on 22 October 2019.

[342] Available at: https://www.globaltradealert.org/, accessed on 22 October 2019.

[343] Global Trade Alert. Results obtained by search of import-related public procurement interventions since 1 January 2009. The product classification is based on the Harmonized System for goods classification. For more information on the product classification used, available at: https://www.globaltradealert.org/data_extraction, accessed on 22 October 2019.

8703	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 8702), including station wagons and racing cars.	5
8705	Special purpose motor vehicles, other than those principally designed for the transport of persons or goods (for example, breakdown lorries, crane lorries, fire fighting vehicles, concrete mixer lorries, road sweeper lorries, spraying lorries).	5
8704	Motor vehicles for the transport of goods.	4
8429	Self-propelled bulldozers, angledozers, graders, levellers, scrapers, mechanical shovels, excavators, shovel loaders, tamping machines and road rollers.	3
8701	Tractors (other than tractors of heading 8709).	3
8465	Machine tools (including machines for nailing, stapling, gluing or otherwise assembling) for working wood, cork, bone, hard rubber, hard plastics or similar hard materials.	2
8456	Machine tools for working any material by removal of material, by laser or other light or photon beam, ultrasonic, electro discharge, electrochemical, electron beam, ionic beam or plasma arc processes; waterjet cutting machines.	2
8457	Machining centres, unit construction machines (single station) and multi-station transfer machines, for working metal.	2
8523	Discs, tapes, solid state non-volatile storage devices, "smart cards" and other media for the recording of sound or of other phenomena, whether or not recorded, including matrices and masters for the production of discs, but excluding products of Chapter 37	2
8802	Other aircraft (for example, helicopters, aeroplanes); spacecraft (including satellites) and suborbital and spacecraft launch vehicles.	2
4303	Articles of apparel, clothing accessories and other articles of fur skin.	2
8458	Lathes (including turning centres) for removing metal.	2
8463	Other machine tools for working metal or cermets, without removing material.	2
8464	Machine tools for working stone, ceramics, concrete, asbestos cement or like mineral materials or for cold working glass.	2

Source: Global Trade Alert.[344]

5.5 COLLUSION IN THE RUSSIAN PUBLIC PROCUREMENT MARKET

According to the FAS, cartelisation of the Russian economy is an important issue, estimated to result in damages to Russian GDP of up to 2% in 2017. In particular, according to the FAS,

[344] See: https://www.globaltradealert.org/, accessed on 22 October 2019.

cartelisation is an important issue for the public procurement market. To give an example, the FAS estimated in 2017, that competitive bidding would result in a reduction of 20–22% in the tender prices, while in cases of bid-rigging[345] the price reduction did not exceed 0.5%. If extrapolated to the total procurement, the effect on the overall economy is "*colossal*" according to the FAS. The FAS stressed that the issue of cartelisation is of particular importance in the medical equipment and medical products sector.[346] For example, the FAS recently opened a case on cartelisation in this sector focusing on '*maintaining prices at e-auctions for supplying tools, equipment, expendables and other medical products for the needs of public and municipal health care institutions*'.[347] The examples illustrate that the issues of corruption and bid-rigging create distortions in the Russian public procurement system, due to inadequate enforcement by the government.[348]

5.6 Russia's Accession Negotiations to the WTO Government Procurement Agreement

Russia has had observer status in the World Trade Organisation (′WTO′) Government Procurement Agreement (′GPA′) Committee since 29 May 2013. Russia applied for accession to the WTO GPA in August 2016 and subsequently presented its initial GPA market access offer in June 2017.

Regarding its initial market access offer, Russia stated it covered 30% of the total regional government procurement. However, since the offer was tabled, delegations of GPA members stressed that '*significant future improvements, including fewer exceptions, an expanded coverage of goods, services and governmental entities, and lower thresholds*' would be necessary.[349] The geographical coverage of the documentation provided by Russia raised concerns by GPA parties.[350] Key concerns raised by GPA parties include high thresholds, a

[345] Bid-rigging is an illegal process that occurs when parties that would normally compete conspire and choose a winner of a bidding process. This practice can result in higher prices and lower quality of the winning bid compared to the bidding result of a competitive bidding process. See: OECD, *Guidelines form Fighting Bid Rigging in Public Procurement: Helping governments to obtain best value for money*, available at: https://www.oecd.org/competition/cartels/42851044.pdf , accessed on 22 October 2019.

[346] Federal Antimonopoly Service of the Russian Federation (2018), *Andrey Tenishev: Damages from Cartels Account Up To 2% of GDP*, available at: http://en.fas.gov.ru/press-center/news/detail.html?id=53205, accessed on 22 October 2019.

[347] Federal Antimonopoly Service of the Russian Federation. (2018), *FAS Opened A Case Upon the Findings of Monitoring Public Procurement of Medicines and Medical Products*, available at http://en.fas.gov.ru/press-center/news/detail.html?id=53561, accessed on 22 October 2019.

[348] Balsevich, A. and Podkolzina, E. A. (2014), *Indicators of Corruption in Public Procurement: The Example of Russian Regions* (25 November 2014). Higher School of Economics Research Paper No. WP BRP 76/EC/2014. Available at: https://ssrn.com/abstract=2530518 or http://dx.doi.org/10.2139/ssrn.2530518, accessed on 16 March 2020.

[349] World Trade Organization (2017), *Solid progress in talks on Australia's accession to the Government Procurement Agreement*, available at: https://www.wto.org/english/news_e/news17_e/gpro_21jun17_e.htm, accessed on 22 October 2019.

[350] World Trade Organization (2018), *Committee moves ahead on multiple accessions to Government Procurement Agreement*, available at: https://www.wto.org/english/news_e/news18_e/gpro_14mar18_e.htm, accessed on 22 October 2019.

large amount of exceptions, and limited entity coverage.[351] In October 2018, Russia informed GPA parties that certain sub-central entities would be covered by an upcoming revised offer and that it continues to update its public procurement legislation.[352]

It is difficult to analyse if and how recently introduced trade measures by Russia undermine the commitments planned to be made by the Government with respect to the WTO GPA, as this process is still ongoing. However, several concerns over Russia's adoption of recent policies that discriminate against imports in public procurement still exist among GPA parties. For example, a report by the United States Trade Representative ('USTR') office from February 2019 highlighted measures already described in this report, such as preferential pricing treatment (e.g. a 15% price preference for goods of EAEU origin in purchases for Government use), a ban on government procurement of certain imported products, and elements of a buy local policy.[353] The above facts confirm once again that state intervention and restrictions persist in the Russian government procurement market.

5.7 CHAPTER SUMMARY

Since 2011, the Russian government procurement market has increased by over 60% to a value of RUB 8 trillion in 2018, accounting for 7.7% of GDP. The main sectors of the government procurement market are the construction of roads, buildings, repair and maintenance services for railway locomotives and rolling stock, petroleum products, pipeline transportation services, and natural gas.

While the Government has since 2013 initiated a series of comprehensive reforms of Russia's public procurement system (among others to increase the efficiency and to prevent corruption), a number of significant restrictions for foreign companies, as well as domestic suppliers exist and are introduced in the area of government procurement. A large part of these restrictions is linked to localisation measures. Significant sectors affected are motor vehicles, medical devices, pharmaceuticals, as well as the IT sector.

The current system of public procurement in Russia is not competitive enough. One of the shortcomings of the procurement system arises from the differentiated treatment of domestic and foreign companies. Despite the fact that public procurement is open to all entities regardless of their origin, foreign companies, in fact, face a set of sectoral bans and restrictions (see Section 5.2). Since 2014, a trend towards the closure of the public procurement market for foreign suppliers has been developing in Russia. One of the reasons for this recent protectionist trend is the Government's aim to develop domestic industries. This overall protectionist trend is

[351] World Trade Organization (2018), *Australia's accession negotiations for government procurement pact reach milestone — Chair*, available at: https://www.wto.org/english/news_e/news18_e/gpro_27jun18_e.htm, accessed on 22 October 2019.

[352] World Trade Organization (2018), *Australia accepted as new party to government procurement pact*, available at: https://www.wto.org/english/news_e/news18_e/gpro_17oct18_e.htm, accessed on 22 October 2019.

[353] Office of the United States Trade Representative (2018), *2018 Report on the Implementation and Enforcement of Russia's WTO Commitments*, available at: https://ustr.gov/countries-regions/europe-middle-east/russia-and-eurasia/russia/2018-report-implementation-and, accessed on 22 October 2019.

reinforced by an ongoing import substitution policy. Moreover, most public procurement for SOEs is concluded via non-competitive methods and supplier concentration is high. This results in a loss of efficiency and in the foreclosure of the procurement market.

Corruption, too, is a source of distortion in the Russian public procurement market. According to expert estimates, the level of corruption in the procurement sector is much above the levels of OECD economies and irregular payments and bribes, favouritism of Government officials, as well as diversion of public funds were reported. Furthermore, Russia's FAS also pointed to the ongoing challenge of cartelisation in the Russian public procurement sector.

In addition, Russia's current system of public procurement does not ensure full transparency. One area where this is apparent is SOE procurement, for example due to non-competitive single supplier contracts and informal pressure from government officials discriminating against foreign suppliers.

6 RUSSIA'S TRADE AGREEMENTS AND EXPORT-IMPORT REGIME

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6.1 INTRODUCTION

This chapter first selectively reviews Russia's practices under the WTO, including the trade defence area. Second, Russia's free trade agreements (′FTAs′) are examined, with special emphasis on the EAEU, a customs union with responsibility also for trade defence and the non-tariff barriers (′NTBs′) policy of its members. Additional evidence is also provided on tariffs and the importance of NTBs in Russia and the EAEU. Third, the Russian import substitution policies introduced from 2014[354] are analysed, including the numerous incentives involved in these policies. Fourth, evidence on Russia's trade restrictiveness for services is provided, based on the OECD data. Finally, an overview is provided on sanctions, outlining their effect on trade and capital markets.

6.2 RUSSIA'S WTO MEMBERSHIP: A SELECTIVE REVIEW

After 18 years of negotiations, Russia became a member of the WTO in August 2012. WTO membership was a milestone in Russia's trade policy developments. Key sources of information on Russia's trade regime are its WTO accession documents,[355] as well as the 2016 WTO Trade Policy Review report (′TPR′).[356] Additional issues pertinent to Russia's export-import regime are addressed in other chapters, such as state-owned or state-controlled companies (Chapter 4), public procurement (Chapter 5), and Russian export taxes (Chapters 10, 12, 14-16 on particular sectors).

6.2.1 TARIFFS FOR TRADE IN GOODS

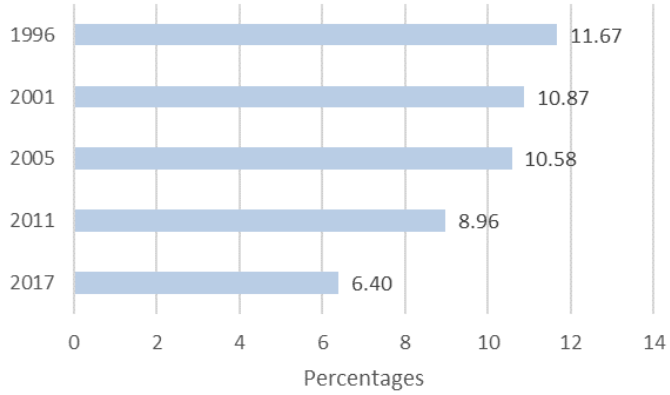
Russia's WTO membership led to a significant reduction in Russia's import tariffs, on top of earlier autonomous tariff cuts in the preceding years. Average Most Favoured Nation (′MFN′) applied tariffs for selected years are shown in Figure 6.1.

[354] In some areas, such as for example pharmaceuticals, even in the second half of 2000s.

[355] In particular, the Working Party report: World Trade Organization (2011), *Report of The Working Party on the Accession of The Russian Federation to the World Trade Organization*, WTO Document N.º WT/ACC/RUS/70 WT/MIN(11)/2, Geneva. This and other documents on Russia's WTO accession are available at: https://www.wto.org/english/thewto_e/acc_e/a1_russie_e.htm, accessed on 22 October 2019.

[356] World Trade Organization (2016), *Trade Policy Review - Report by the Secretariat*: *Russian Federation*, WTO Document N.º WT/TPR/S/345/Rev. 1, Geneva, available at www.wto.org, accessed on 15 November 2019. Further useful information on Russia's enforcement and implementation of WTO commitments is provided also by the annual reports of the USTR. As of April 2019, the latest available edition was the 2018 Report on the Implementation and Enforcement of Russia's WTO Commitments, available at: https://ustr.gov/sites/default/files/Russia-2018-WTO-Report.pdf, accessed on 22 October 2019.

Figure 6.1: Russia's applied tariff average for selected years 1996–2017



Source: Calculated from TRAINS data.[357]

Hence, tariffs had been cut from around 11.7 to 9.0% before WTO accession and declined further to 6.40% from 2011 to 2017. The tariffs shown here are simple averages across the 5 000+ products in the six-digit Harmonised System ('HS') classification. Trade-weighted averages are generally somewhat lower. Upon acceding to the WTO, Russia committed to binding tariffs for all goods and reducing their levels. This reform was to be undertaken in eight years, with the final simple average bound rate at 8.4%.[358] According to the schedule, the last step of binding and tariff reduction was to be completed in 2019.[359]

Russia has moderate levels of tariff variation across products. For example, TRAINS data for 2017 show an average of 8.80% for agriculture and food products (HS chapters 1–25), which is higher than the overall average of 6.40%. For machinery and transport equipment (HS chapters 84–89), the simple average is 4.06%. TPR contains more detail on Russia's tariff structure, which also reveals an element of tariff escalation.[360] Russia has many products with specific tariffs (value per quantity unit, e.g. EUR/kg) or mixed tariffs (a combination of *ad valorem* and specific tariffs).[361]

There have been some complaints and disputes about Russia's customs procedures and customs valuation[362] (see also Section 6.2.2 below). For example, the technical implementation of the common external tariff for the EAEU may have led to Russian tariffs that exceed Russia's

[357] "TRAINS" is the Trade Analysis Information System of UNCTAD, the United Nations Conference on Trade and Development, available at: https://unctad.org/en/Pages/DITC/Trade-Analysis/Non-Tariff-Measures/NTMs-trains.aspx, accessed on 22 October 2019.

[358] TPR, p. 46, average is for all of Russia's 11 557 tariff lines at the 10-digit HS level.

[359] According to TPR, the simple MFN applied tariff average in 2016 was 8.3%. With UNCTAD data, 6.73% is obtained. The difference may have two reasons: The first is that this report's average is based on 6-digit data, while TPR uses 10-digit tariffs with 11 557 products. In order to calculate averages, one also has to derive *ad valorem* equivalents ('AVEs') of the specific or mixed tariffs, and the method chosen may affect the results. This report's calculations have used AVEs calculated by UNCTAD and provided in WITS/TRAINS data.

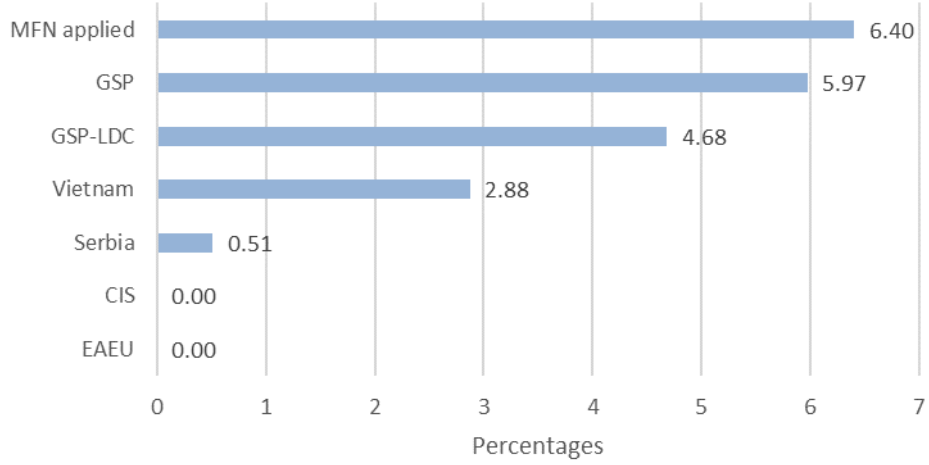
[360] Higher tariffs for processed than for unprocessed goods.

[361] Euro is mostly used as the currency for the purpose of specific tariffs in Russia, in addition to USD in few cases.

[362] Russia's system for customs valuation and procedures is described in the TPR, page 41ff.

bound tariffs at the WTO in some cases.[363] Another tariff issue is customs valuation within the EAEU which should set out rules that are consistent with the WTO. However, in discussions in the relevant WTO committee, some countries have raised concerns about Russia's practices, in particular about the use of reference prices that lead to higher tariffs for individual shipments.[364]

As far as preferential tariffs are concerned, Russia has completely eliminated tariffs in the EAEU and the Commonwealth of Independent States (′CIS′) free trade agreements. For details see Section 6.3.1 below. Figure 6.2 shows simple averages for all of Russia's tariff preferences in 2017.Figure 6.2: Russia's tariff preferences 2017, simple averages



Source: Calculated from TRAINS data.

Preferences under the Generalised System of Preferences (′GSP′) are limited even for the Least Developed Countries. On the other hand, there is full tariff elimination in the EAEU and CIS, and considerable reduction in the FTAs with Serbia[365] and Vietnam. Tariffs for Vietnam will be phased out by 2027.

6.2.2 RUSSIA IN TRADE DEFENCE

In the context of trade defence, it is important to observe that, from August 2012, the formal responsibility for this area was transferred from the participating nations to the EAEU. Hence, Russia formally operates via the EAEU even if it may have considerable influence on initiatives and implementation.

6.2.2.1 RUSSIA AND ANTI-DUMPING DUTIES

In the WTO, anti-dumping (′AD′) is used much more frequently than countervailing duties against prohibited subsidies, or safeguards under Art. XIX of the GATT. During 2012–2017, 23 AD measures were imposed by WTO members against Russia (2.3% of the WTO total of

[363] See e.g.: USTR (2017), *2017 Report on the Implementation and Enforcement of Russia's WTO Commitments*, p. 9.
[364] *Ibidem*, p. 10.
[365] At present Russia, Belarus, Kazakhstan have established a free trade regime with Serbia. Armenia and Kyrgyzstan do not have similar agreements with Serbia. An FTA was established between Russia and Serbia on 28 August 2000.

985). AD measures are more frequent in certain sectors, with base metals and articles, and chemicals, at the top. Hence, the top AD sectors coincide with key sectors in Russia's exports.[366] Russia has also become a user of AD, with 39 AD measures imposed by the mid-2019, of which 9 were against China.[367]

According to WTO data for 1995–2017, 20 out of the 25 EU cases against Russia occurred before Russia's WTO entry. In the period 2012–2018, the EU initiated seven AD investigations against Russia. In addition, AD duties were still in force from some earlier cases.[368] At the end of 2019, AD duties were in force for nine products.

6.2.2.2 RUSSIA AND SAFEGUARDS

Under its WTO membership, Russia/EAEU initiated four safeguard cases in 2011–2012, resulting in three safeguard measures.[369]

Russia introduced safeguard measures for (with WTO document identifiers in brackets):
- Tableware and kitchenware of porcelain (G/SG/N/11/RUS/2);
- Harvesters and modules thereof (G/SG/N/11/RUS/1);
- Pipes and tubes of stainless steel (G/SG/N/6/RUS/4, G/SG/N/8/RUS/3).

In 2018, Russia also initiated safeguard investigations for flat-rolled steel:
- Certain flat-rolled steel products (G/SG/N/6/RUS/5).

Given that the EAEU is responsible for safeguards, all these measures or initiations should apply to the EAEU as a whole. Looking at the WTO notifications, however, it seems that Kazakhstan has only notified the steel measures in 2018. Armenia and Kyrgyzstan only notified the earlier measures on tableware and harvesters.[370]

6.2.2.3 RUSSIA AND COUNTERVAILING DUTIES

As of early 2019, EAEU members have not introduced any countervailing duties (′CVDs′) yet, but Russia and Kazakhstan were each targeted three times. For Russia, only one of these three complaints resulted in a CVD - by Ukraine. This measure concerned cars and was implemented

[366] The full sector titles in the HS classification are "*XV Base metals and articles*" and "*VI Products of the chemical and allied industries*".

[367] Statistics are available at: https://www.wto.org/english/tratop_e/adp_e/adp_e.htm, accessed on 22 October 2019.

[368] Detailed information on EU AD cases against Russia is available at: http://trade.ec.europa.eu/tdi (search on Russian Federation), accessed on 22 October 2019.

[369] See the WTO safeguard statistics at: https://www.wto.org/english/tratop_e/safeg_e/safeg_e.htm#statistics, accessed on 22 October 2019.

[370] It could not be confirmed whether this is for technical reasons or lack of reporting or whether some measures are not implemented consistently by all EAEU members. Until 2017, Kyrgyzstan also had safeguard measures for wheat, where Kazakhstan is the main supplier.

from January 2016.[371] The other two CVD investigations were conducted by Canada and Turkey, respectively.[372]

6.2.2.4 RUSSIA IN WTO TRADE DISPUTES

Since its WTO accession, Russia has been involved in 15 WTO trade disputes; nine as a respondent and six as a complainant (Appendix Table A6.1). In addition, Russia has been involved as third party in 63 other disputes.[373] The WTO disputes illustrate Russian practices or differences in interpretation that may be relevant in future trade defence cases, and also shed light on Russia's general track record at the WTO.

As for cases with Russia as a respondent, the majority of them relates to non-tariff barriers or trade facilitation issues (see also Section 6.3.3). For cases with Russia as the complainant, most are related to trade defence. In general, Russia has implemented the WTO rulings, also in cases where existing measures had to be changed or abolished. Sometimes measures were discontinued before the WTO proceedings came to an end, anticipating the final decisions.

6.3 RUSSIA'S FREE TRADE AGREEMENTS AND THE EAEU

Beyond the WTO, the second major pillar of Russia's trade policy has been the network of trade agreements within the CIS. There have been a number of intra-CIS FTAs, some of which overlapped. Some of these FTAs are still in force, other have been discontinued. While many of these agreements were of limited depth and sometimes not even fully implemented, deeper and more binding integration was the aim of various FTAs since the 1990s. This eventually led to the formation of the EAEU in 2014 (entry into force 2015) which now comprises five countries of the former Soviet Union (′FSU′). Recently, Russia has also initiated several new FTAs beyond the CIS but lags behind in this aspect of global integration relative to other important trading countries.[374] The post-2014 frictions have likely delayed Russia's participation in some FTAs, e.g. negotiations between EAEU and European Free Trade Association (′EFTA′) were suspended in 2014 after 11 rounds of negotiations.[375]

6.3.1 THE EAEU

[371] WTO (2018), *Semi-annual report under Article 25.11 of the Agreement*, Ukraine. Document N.º G/SCM/N/334/UKR, Committee on Subsidies and Countervailing Measures, Geneva.

[372] For information on the Canada-Russia CVD investigation, see Canada Border Services Agency, available at: https://www.cbsa-asfc.gc.ca/sima-lmsi/i-e/ad1406/ad1406-fd-eng.html, accessed on 5 December 2019.

[373] WTO data of January 2019, available at: https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm, accessed on 22 October 2019. WTO members may participate as a third party in other disputes if they have a substantial interest in the matter being discussed, and if the complainant opens for such participation – this depends on the legal modalities in the notification of such disputes. See Art. 10 DSU, available at: https://www.wto.org/english/docs_e/legal_e/28-dsu_e.htm#10, accessed on 22 October 2019.

[374] See Chapter 3 in Melchior, A. (2018), *Free Trade Agreements and Globalisation. In the Shadow of Brexit and Trump*. Palgrave Macmillan.

[375] See: https://www.efta.int/free-trade/ongoing-negotiations-talks/russia-belarus-kazakhstan, accessed on 22 October 2019.

On 29 May 2014, Russia, Belarus and Kazakhstan signed the Treaty on the Establishment of the Eurasian Economic Union (′EAEU Treaty′), which resulted in the formation of a new international organisation of regional integration in the FSU space. To date, five states are members of the union, with Armenia and Kyrgyzstan having joined after the founders. The former regional integration initiatives of individual CIS countries, such as the customs union of Russia, Belarus and Kazakhstan and the Eurasian Economic Community formed the basis of the EAEU.

The organisational structure of the EAEU includes four key bodies: *(i)* the Supreme Eurasian Economic Council (′SEEC′), *(ii)* the Intergovernmental Council, *(iii)* the Eurasian Economic Commission (′EEC′)[376] and *(iv)* the Court of the EAEU. The SEEC is the Union's supreme body, composed of the heads of the member states. The Intergovernmental Council includes the heads of the member state governments. The Court of the EAEU ensures the application of the EAEU Treaty and other Union treaties by the Union member states and bodies. According to a scholar: '[t]*he Court of the Eurasian Economic Union is a specialised judicial body authorised to resolve disputes related to the implementation of international treaties concluded within the framework of the Union, and enforcement of the decisions of its governing bodies. Its rulings, for example, decisions on the Common Customs Tariff, have direct effect in the EAEU countries and are legally binding. As of today, the Court has primarily reviewed cases concerning the import quotas of the Union*'.[377] Thus far, most of the trade disputes among EAEU member states and with other countries have been resolved bilaterally and the EEC and its Court are rarely used as a platform for dispute resolution.

The EEC is a permanent supranational regulatory body of the Union, with a mandate to support the operation and development of the Union. It is subordinate to the SEEC, which is responsible for taking decisions on international agreements of the EAEU, including those concerning FTAs. The EEC implements these decisions. The voting power in the EEC is distributed equally among the member states. The EEC's main executive body is the Board that includes ten ministers (two from each member state). Such a representation scheme was agreed on in order to equalise the influence of Russia and the other member states. Despite representing 87% of the Union's total GDP, Russia has only 20% of the voting power.[378]

The revenues for member states are divided according to the proportion of the share of import customs duties that each member state receives from trade with third countries. In 2019, Russia's share is 85.32%: Kazakhstan – 7.11%; Belarus – 4.55%; Kyrgyzstan – 1.9%; Armenia – 1.1%.[379]

[376] See: http://www.eurasiancommission.org/en/Pages/about.aspx, accessed on 11 March 2019.

[377] Vinokurov, E. (2017). *Eurasian Economic Integration – 2017*, Report 43, Saint Petersburg, EDB Centre for Integration Studies, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2970408, accessed on 11 March 2019.

[378] *Ibidem*.

[379] *24.kg* (2018) *Dolya Kyrgyzstana v obshey kopilke EAES do konca 2019 goda ne izmenitsa (Kyrgyzstan's share in the total moneybox of the EAEU will not change until 2019)*, available at

According to some studies, actual Eurasian integration is still limited, with the goods markets integrated at 40% of the potential, the services market at 20%, the labour market at 60% and the capital market at 10%.[380] These figures indicate the percentage of barriers that have been substantially reduced or eliminated. Full-scale integration is hampered by a number of internal barriers, including differences in sanitary and phytosanitary (′SPS′) requirements, technical regulations, non-recognition of business permits, non-harmonised tax and trade legislation, different approaches and procedures for exercising control and supervision, differences in national regulation of state and municipal procurement and other barriers.

With respect to trade in goods, Kazakhstan had relatively low average tariffs before the EAEU and these tariff differences caused frictions within the EAEU. In view of this, various exemptions and transition measures are in place, and as a result the EAEU is not yet fully a customs union on the ground.[381] The elimination of NTBs also faces a number of difficulties. According to some estimates[382] the distribution of benefits from the elimination of NTBs is uneven. Armenia, Belarus and Kyrgyzstan benefit the most, while Russia and Kazakhstan benefit less (see Table 6.1). This is because NTB reductions affect some industries more than others, and the gains therefore depend on the industrial structure of each country. Such asymmetries complicate and delay the regional integration agenda.

Table 6.1: Potential annual effects for Russia and the EAEU countries from lowering intra-union barriers (estimates based on the general equilibrium model)[383]

Country	GDP effect, %	Effect in USD
Armenia	6.3%	+0.75 billion
Belarus	12%	+6.6 billion
Kazakhstan	0.5%	+0.9 billion
Kyrgyzstan	7.5%	+0.56 billion
Russia	0.8%	+10.6 billion

https://24.kg/ekonomika/88288_dolya_kyirgyizstana_vobschey_kopilke_eaes_dokontsa_2019_goda_neizmenitsya/, accessed on 11 March 2019.

[380] Knobel, A. (2015). *Eurasian Economic Union: Prospects and challenges for Development*. Issues of Economy. N3, 87-108, available at: https://elibrary.ru/item.asp?id=23046518, accessed on 11 March 2019.

[381] Movchan, V. and M. Emerson (2018), *The Eurasian Economic Union's problematic customs union*, 11 January 2018, available at: http://www.3dcftas.eu, accessed on 22 October 2019; and Tarr, D. G. (2016). *The Eurasian Economic Union of Russia, Belarus, Kazakhstan, Armenia, and the Kyrgyz Republic: Can It Succeed Where Its Predecessor Failed?*, Eastern European Economics, 54:1, 1–22, DOI: 10.1080/00128775.2015.1105672

[382] Knobel, A. (2015). *Eurasian Economic Union: Prospects and challenges for Development*.

[383] The computable general equilibrium model makes it possible to correctly take into account the differences in the mechanisms of the influence of reducing or eliminating non-tariff barriers from reducing or eliminating tariff restrictions in international trade, which is especially important when considering integration within the EAEU and the accession of new member countries. The key advantage of this model is the possibility of a comprehensive analysis of various markets (sectors, regions), as well as the ability to quantify the effects of changes in model parameters (socio-economic policy parameters, macroeconomic parameters), taking into account the interdependence of different markets.

EAEU	+1.2%	~+20 billion

Source: Calculated by Gaidar Institute.[384]

The EAEU is lacking truly supranational structures, since any decision by the EEC may be blocked by any EAEU State, at the political level, i.e. in the Intergovernmental Council or the SEEC. The EAEU institutions remain dependent on the interaction of the member countries, which characterises the EAEU as a more intergovernmental organisation than a supranational one. In addition, all the commitments of the EAEU Treaty, with the exception of plans to create a financial mega-regulator in Astana by 2025, relate to goods, that is, in fact, the completion of the creation of the customs union. Thus, the treaty has mainly political significance and has limited impact on actual practice in comparison with predecessors of the EAEU. In contrast to regulatory issues for goods, the coordination of issues on regulating access to the market for services, investments, and other issues, takes place mainly at a national level.

Moreover, the EAEU member states often take actions to defend their own national markets. Such actions include, in particular (see also Section 6.5): the Russian food embargo on imports from the EU, USA, Canada, Australia, Norway and Ukraine; Russia's application of the MFN regime in relation to goods from Ukraine and, possibly in the future, from other CIS countries; and Kazakhstan's accession to the WTO. As a result of the latter, Kazakhstan applies duties for goods from third countries lower than those envisaged by the EAEU's Common Customs Tariff.

6.3.2 RUSSIA'S FTAS: AN OVERVIEW

Until recently, Russian participation in regional integration processes was limited. WTO membership in 2012 provided non-discriminatory access to foreign markets, and this was the main focus beyond the CIS area. As of writing of this Report, Russia has concluded and operates FTAs with 13 countries (Table 6.2), of which the overwhelming majority are FSU countries. The share of FTA partner countries in Russia's total trade is, nevertheless, less than 15%.

Russia is actively participating in the regional Eurasian integration. On 15 April 1994, Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Uzbekistan and Ukraine signed an FTA – Agreement on the creation of a free-trade area.[385] This agreement was intended to become a multilateral legal framework for regional trade on preferential terms. Within the FTA, States were to eliminate tariff and non-tariff restrictions in their mutual trade in order to expand economic ties and promote economic development. However, this region-wide integration scheme has not been implemented in practice. Instead, the parties of the agreement have been cooperating in the form of bilateral FTAs. Since about 2000, negotiations on a CIS FTA have re-emerged. In 2011, Moldova, Tajikistan, Ukraine, Russia and Belarus signed the FTA of CIS, which came into force on 20 September 2012, with Uzbekistan joining in 2013. The protocol of the agreement provides for the non-application of import duties in mutual trade between the parties to the treaty and Uzbekistan, as well as

[384] Knobel, A. (2015), *Eurasian Economic Union: Prospects and challenges for Development*.

[385] For the full text, see for instance: https://www.wipo.int/edocs/lexdocs/treaties/en/ftacis/trt_ftacis.pdf, accessed on 26 April 2019.

defining the conditions for the application of other treaty provisions in relations between the parties. Russia has retained about 100 export duties in the CIS FTA agreement. Services, investment and migration issues are not covered by the agreement.

Table 6.2: The FTA partners of the EAEU countries

FTA partners	Armenia	Belarus	Kazakhstan	Kyrgyzstan	Russia
Azerbaijan	FTA CIS*	FTA CIS *	FTA CIS *	FTA CIS *	FTA CIS *
Moldova***	FTA CIS	FTA CIS	FTA CIS	FTA CIS	FTA CIS
Tajikistan	FTA CIS	FTA CIS	FTA CIS	FTA CIS	FTA CIS
Turkmenistan	FTA CIS *	FTA CIS *	FTA CIS *	FTA CIS *	FTA CIS *
Uzbekistan	FTA CIS	FTA CIS	FTA CIS	FTA CIS	FTA CIS
Georgia	FTA CIS *	FTA CIS *	FTA CIS *	FTA CIS *	FTA CIS *
Serbia		FTA	FTA		FTA
Ukraine	FTA CIS	FTA CIS	FTA CIS	FTA CIS	**
Vietnam	FTA Vietnam – EAEU				

Notes:

* For these countries, the Agreement of the CIS countries from 15 April 1994 "*On the creation of a free-trade area*" formally continues to operate, de facto in the form of bilateral FTAs. The countries that are not marked with an asterisk have reconfirmed their commitments on trade liberalisation by signing the FTA of CIS in 2011, which came into force on 20 September 2012.

** On 1 January 2016 Russia unilaterally withdrew from the Russia-Ukraine FTA, in reaction to the provisional entry into force of DCFTA part of the EU-Ukraine Association Agreement the same day. In addition, the parties apply a food embargo against each other (valid until 2019).

*** On 14 April 2017, Moldova applied to the SEEC for observer status within the Union.

Source: Internal compilation by the authors.

The FTA Agreement between the EAEU member countries and Vietnam, signed in 2015 and in force since 5 October 2016, was the first international agreement of the EAEU with a third country.[386] The tariff liberalisation stipulated by the agreement covers 88% of goods.[387] In accordance with the FTA, 12% of the trade turnover between the EAEU and Vietnam is exempt (this group includes items sensitive to the EAEU, such as tea, coffee, sugar, starch, instant drinks, pipes, clothing, etc.). The average rates of import duties in the mutual trade of the EEU

[386] Free Trade Agreement between the EAEU member states and the Socialist Republic of Vietnam, available at: https://investmentpolicyhub.unctad.org/IIA/countryGrouping/62/treaty/3573, accessed on 11 March 2019.

[387] Review of the Free Trade Agreement between the EEC member states and the Socialist Republic of Vietnam, available at: http://www.eurasiancommission.org/ru/act/trade/dotp/sogl_torg/Documents/%D0%9E%D0%B1%D0%B7%D0%BE%D1%80%20%D0%A1%D0%BE%D0%B3%D0%BB%D0%B0%D1%88%D0%B5%D0%BD%D0%B8%D1%8F%20%D0%BE%20%D1%81%D0%B2%D0%BE%D0%B1%D0%BE%D0%B4%D0%BD%D0%BE%D0%B9%20%D1%82%D0%BE%D1%80%D0%B3%D0%BE%D0%B2%D0%BB%D0%B5%20%D0%BC%D0%B5%D0%B6%D0%B4%D1%83%20%D1%81%D1%82%D1%80%D0%B0%D0%BD%D0%B0%D0%BC%D0%B8%20%D0%95%D0%90%D0%AD%D0%A1%20%D0%B8%20%D0%92%D1%8C%D0%B5%D1%82%D0%BD%D0%B0%D0%BC%D0%BE%D0%BC.pdf, accessed on 11 March 2019.

and Vietnam is planned to be gradually reduced from 10% (Vietnam) and 8% (EAEU) to zero in 2027. A free trade agreement between the EAEU and Serbia was signed on 25 October 2019.

6.3.2.1 FTAs UNDER NEGOTIATION

As of writing of this report, the EEC leads several negotiations on FTA agreements with other countries. On 16 October 2015, the SEEC[388] decided to start negotiations with Israel. In 2016, reports were prepared by joint EAEU research groups to initiate FTA negotiations between the EAEU and Egypt, India, Iran and Singapore. The process of concluding FTAs with these States is now at different stages. For example, on 17 May 2018 a temporary agreement was signed with Iran. The EAEU generally aims to conclude comprehensive FTAs that include, in addition to tariff liberalisation, issues of investment and customs cooperation, protection of intellectual property rights, regulation of e-commerce, industrial cooperation and other issues.

Moreover, the EEC is also reviewing proposals to conclude FTAs with Cambodia, Pakistan, Thailand, Tunisia, the Faroe Islands, Jordan, Chile and Brunei. In addition, the possibility of forming free trade zones with Korea and the Association of Southeast Asian Nations is being considered. A non-preferential agreement has been signed with China. This agreement focuses on creating favourable conditions for cooperation in infrastructure construction, industry, transport, investment, as well as expanding the access of subjects to individual markets. At the current stage of cooperation, tariff reductions are not envisaged.

6.3.3 NON-TARIFF BARRIERS IN RUSSIA AND THE EAEU

Russia's Ministry of Economic Development, the Ministry of Foreign Affairs and the Ministry of Industry and Trade have the main responsibility for managing foreign trade. However, '[w]*hen the Russian Federation joined the EAEU, the authority over many aspects of its foreign trade regime was transferred to EAEU institutions, notably the Eurasian Economic Commission (EEC)*'.[389] 140 competencies have been delegated to the EEC's supranational level by member states.[390] The EEC has decision-making responsibility in the following areas: '*tariff rates, transit trade, non-tariff measures (e.g. tariff-rate quotas, import licensing, and trade remedy procedures), customs policies (customs valuation, customs fees, and country of origin determinations), border enforcement of IPRs (intellectual property rights), establishment and administration of special economic and industrial zones, and the development of technical regulations and SPS measures. As a result, trade policy formulation in the Russian Federation is implemented through both national institutions and legislation and EAEU bodies and laws*'.[391]

[388] SEEC, available at: http://www.eaeunion.org/?lang=en#about-administration, accessed on 11 March 2019.
[389] WTO (2016), *Trade Policy Review: Russian Federation*, Trade Policy Review Body, N.º (16-4506), WT/TPR/S/345.
[390] Vinokurov, E. (2017), *Eurasian Economic Union: Current State and Preliminary Results*, *Russian Journal of Economics*, 3(1), pp. 54–70.
[391] WTO (2016), *Trade Policy Review: Russian Federation*, Trade Policy Review Body, N.º (16-4506), WT/TPR/S/345.

In practice, technical EAEU-wide issues are discussed by the EEC. However, EAEU member states are reluctant to delegate more authority to the EEC in relation to the definition of a common trade policy. Key decisions are still taken by the governments of the respective member states (see also section 6.3.1).

Trade protectionism is widespread among the EAEU member states. Despite ambitious goals, member states have shown little enthusiasm to dismantle barriers to trade.[392] In this regard, the EEC plays an important role in identifying NTBs - such as technical standards, SPS, competition and public procurement rules - to trade within the EAEU.[393]

Estimates on the level of NTBs in Russia and EAEU show that they are among the most restrictive in the world.[394] A recent study of NTBs in the EAEU shows that their complete elimination would boost internal trade within the Union by 24%.[395] Also, '[t]*he ad valorem equivalents of such barriers range from 10–30% of some countries' export value*'.[396] In the SPS field, EU and European Economic Area exporters have faced significant challenges and the Russian practice is still in a state of transition from the former regulatory approaches.[397] Unilateral application of restrictive NTBs by member states without conducting a dialogue with other members and the EEC remains widespread. Russia represents an example with its technical regulations (through other regulatory measures at the national level, such as certification, testing, obligatory standards etc.) effectively undermining the EAEU efforts.

The EEC issued a White Paper of NTBs in 2015 and has updated it twice, the last time in 2017. The paper is published on the EEC website titled '*Barriers, exemptions and restrictions in the EAEU*'.[398] As of 2017, the White Paper contained 60 obstacles as identified and agreed by all the Union members. Of these, 34 are restrictions, 17 are exemptions, and nine are barriers.[399] Some of the examples of the identified barriers are the following:

– Software suppliers from member states have no access to the information about public procurement in the IT sector in Russia. The Government prepared a draft law that would

[392] Vakulchuk, R. and Knobel, A. (2018), *Impact of Non-Tariff Barriers on Trade within the Eurasian Economic Union*, *Post-Communist Economies*, 30(4), pp. 459–481.

[393] Dragneva, R. and Wolczuk, K. (2017), *The Eurasian Economic Union Deals, Rules and the Exercise of Power*, Chatham House Research Paper.

[394] Tarr, D. (2015), *The Eurasian Customs Union among Russia, Belarus and Kazakhstan: Can It Succeed Where its Predecessor Failed?*, *Eastern European Economics*, 54, pp. 1–22.

[395] Vakulchuk, R. and Knobel, A. (2018).

[396] Dragneva, R. and Wolczuk, K. (2017).

[397] Black, R. and Kireeva, I. (2015), *Sanitary and Phytosanitary Issues for the Customs Union of Russian Federation, Belarus and Kazakhstan in Relation to Trade with Other CIS Countries and the EU, with Special Reference to Food of Non-animal Origin and Phytosanitary Controls* (2015). *Journal of World Trade, 49*(5), pp. 805–835.

[398] According to EEC, '[b]*arriers mean the obstacles in violation of the EAEU legislation. Restrictions mean the obstacles caused by lack of legal regulation of economic relations, the development of which is envisaged by the Union's legislation. Exemptions mean the exceptions provided by the EAEU legislation.*' - Eurasian Economic Commission (2017), available at: http://www.eurasiancommission.org/en/nae/news/Pages/3-04-2017.aspx, accessed on 13 December 2018.

[399] Eurasian Economic Commission (2017).

give the software development companies the right to participate in the procurement procedures along with Russian companies (see also Chapter 5);
- The collection of a rent tax imposed on coal exports from Kazakhstan to other member states. The EEC found that the tax was an equivalent to export duties that should not be applied in the domestic market of the EAEU;
- The application of 10% VAT on the sale of the horticultural, beekeeping, livestock-breeding and fish-breeding products produced in Belarus;
- The lack of free access for the vessels under the flags of the EAEU member states to the inland waterways of Russia was recognised as a restriction;
- The lack of unified norms and rules for plant quarantine in the EAEU was recognised as a restriction because it results in a number of challenges when selling the goods, in particular for vegetables and fruit;
- The restriction caused by the lack of unified methodology for calculation of the authorised scope of state support of the agriculture, which has a distorting effect on trade.[400]

The Eurasian Development Bank also provides information and data on the impact of NTBs on trade within the EAEU. In a survey conducted in 2015 and involving 530 entrepreneurs, the influence of various NTBs on mutual trade was measured. Table 6.3 shows the significance of different barriers on exports. SPS measures, technical barriers, pre-shipment inspection and other formalities, finance measures as well as subsidies and restrictions on government procurement were identified as exhibiting the most significant impact on EAEU exports.

Table 6.3: Assessment of the impact of NTBs on EAEU exports (average score)

	Belarus		Kazakhstan		Russia	
	Kazakh-stan	Russia	Belarus	Russia	Belarus	Kazakh-stan
Sanitary and phytosanitary measures	1.52	1.51	2.48	2.02	1.21	1.26
Technical barriers to trade	1.78	1.75	2.58	2.21	1.82	1.97
Pre-shipment inspection and other formalities	1.25	1.28	2.42	2.07	1.57	1.63
Contingent trade-protective measures	1.33	1.29	2.09	2.07	1.62	1.7
Non-automatic licensing, quotas, prohibitions and quantity-control measures other than for SPS and TBT reasons	1.34	1.32	2.15	1.97	1.54	1.61
Price control measures, including additional taxes and charges	1.65	1.62	2.48	2.07	2.11	2.22

[400] Eurasian Economic Commission (2017).

Finance measures, regulation of conditions of payment for imports in the destination country or the conditions for obtaining and using credit to finance imports	1.38	1.35	2.48	2.04	1.87	1.72
Measures affecting competition	1.48	1.46	2.30	2.05	2.34	2.32
Trade-related investment measures	1.32	1.3	2.21	1.95	1.49	1.52
Distribution restrictions	1.34	1.28	2.27	1.85	1.43	1.44
Restrictions on post-sales service	1.19	1.15	2.06	1.79	1.34	1.39
Subsidies, including export subsidies	1.42	1.41	2.06	1.94	1.38	1.25
Restrictions on government procurements	1.88	1.55	2.30	2.03	1.48	1.51
Protection of intellectual property rights	1.24	1.24	2.03	1.88	1.24	1.25
Rules of origin	1.41	1.32	2.21	1.97	1.15	1.27
Export-related measures	1.24	1.2	2.3	1.87	1.39	1.36
Average	1.41	1.38	2.28	1.99	1.56	1.59

Note: Grey colour shows an average score of NTBs exceeding the average value for all NTBs. The lower the score is, the lower the impact of restrictive barriers is on trade within the Single Economic Space.
Source: Eurasian Development Bank (2015).[401]

NTBs constitute a serious impediment to Russia's trade growth and complicate the country's trade with third countries. They raise costs for domestic production and also complicate the import substitution policy.

6.4 RUSSIA'S IMPORT SUBSTITUTION POLICIES

Import substitution implies a policy that aims at replacing foreign production with a domestic one. This policy typically takes the form of subsidies to domestic production and the imposition of import restrictions.[402]

Since the early 1990s, Russia has been struggling to diversify its economy away from the export of oil and gas and other primary commodities. Import substitution policy in Russia has been institutionalized from 2014. Before that, some measures existed but import substitution was not systematic and without the establishment of specific institutions for the purpose. However, it

[401] Eurasian Development Bank (2015), *Assessing the Impact of Non-Tariff Barriers in the EEU: Results of Enterprise Surveys*. Center for Integration Studies. Report 30, available at: https://eabr.org/upload/iblock/d99/report_30_ntb_2_en.pdf, accessed on 26 April 2019.

[402] These subsidies are generally prohibited under Art. 3.1 (b) of the Agreement on Subsidies and Countervailing Measures (′ASCM′), available at: https://www.wto.org/english/docs_e/legal_e/24-scm.pdf, accessed on 22 October 2019.

was regularly stressed by the political leadership that these measures are temporary and cannot become part of Russia's long-term economic strategy, as otherwise the country may be at the risk of isolation from the global economy.[403] President Putin noted that '*import substitution measures are not to replace foreign products with domestic products that are worse and more expensive*'.[404] Furthermore, he elaborated that:

> *The idea of import substitution itself is not universal and is not what we should strive for in the long run, because import substitution should not undermine competition. This is an extremely important thing. We should aim at producing products of such quality and price that it is competitive not just on our own, but on the world's markets (…) In some cases, we did it and are doing it to support domestic producers in difficult economic conditions, especially in situations when our partners violate and distort competition by imposing different sanctions, which are politically motivated, as they claim, but in fact are based on ambitions to gain some advantage.*[405]

However, it is difficult to assess the long-term perspectives of import substitution policies and to what extent they are going to be temporary, notably because such measures have created vested interests. Russia's trade balance in manufacturing has deteriorated rapidly since the turn of the century, and this has made diversification an even more urgent concern for Russia.

In 2015, a special Government agency was formed – the Government Commission on Import Substitution Commission[406, 407] (see for more details Section 12.2.3) – that reflected the importance attached to import substitution by the Government. According to the Government, the Government Commission on Import Substitution is a coordination body formed to ensure a coordinated action in import substitution by federal executive bodies, local governments and public organisations. It aims to reduce the import dependence of various industrial sectors and timely address the issues that local legal entities are facing within their respective industrial sectors.[408]

The task of the commission is '*to create appropriate conditions for Russian producers in those industries and sectors of the economy that remain highly dependent on imports. These include the machine tool industry and most sub-sectors of the engineering industry, radio-electronics, the light industry, pharmaceuticals and the medical industry*'; moreover, according to the Government '[o]*ur goal is not to substitute imported goods at any cost, especially for mediocre goods made in Russia… We are talking about helping Russian companies produce world-class,*

[403] Prime Minister Dmitry Medvedev speaking at the 6th Gaidar Economic Forum, Moscow, January 2015.
[404] See Ziguo, L. (2018), *Import substitution alone can't fix Russia's economy*, Global Times.
[405] TASS (2017), *Putin nazval importozameshenie v Rossii vremennym yavleniem (Putin named import substitution a temporary phenomenon)*, TASS Russian News Agency.
[406] Government Decree N.º 785/2015 "*on the Government Commission on Import Substitution*" (*Постановление Правительства РФ от 4 августа 2015 г. N 785 "О Правительственной комиссии по импортозамещению"*), available at: http://base.garant.ru/71152492/, accessed on 14 November 2019.
[407] *Pravitel'stvennaja komissija po importozameshheniju*.
[408] Government of the Russian Federation (2018), *Government Import Substitution Commission*, available at: http://government.ru/department/314/about/, accessed on 14 March 2019.

modern, high-quality and high-demand goods, which would be able to compete not only on our domestic market, but also internationally'.[409]

Other governmental bodies, such as the Ministry of Transport, the Ministry of Energy, the Ministry of Industry and Trade, as well as the Ministry of Digital Development, Telecom and Mass Communications, play an important role in shaping import substitution policies. In addition, local research centres, financial and commercial institutions were also invited by the Government to contribute to the programme by providing financial support and facilitating research and development for locally oriented production.

Russia's import substitution policy has not been very transparent since its announcement. The original act referred to in many import substitution-related documents and regulations, the Government Order No. 1936-r of 30 September 2014 entitled the Plan for the Promotion of Import Substitution in Industry is not available on-line.[410] Analyses and estimates of the economic signficance of the import substitution policy in the existing literature often rely on announcements by officials at various meetings but not on a full account of concrete legal acts.[411] One estimate dating back to the beginning of the operationalisation of the policy which was reportedly based on the announcement by the Ministry of Industry and Trade on 2 April 2015 reported on plans to pursue 2 059 projects across 19 sectors in the period 2016–2020 with the aim of producing 800 selected products in Russia. The total programme cost was estimated in 2017 to be EUR 35 billion.[412] Several categories of essential goods were identified: medicines, foodstuffs, manufacturing and machinery, as well as critical components for the defence sector.

Food and manufacturing are of particular importance in these import substitution measures. In 2016, the Government announced that the following manufacturing sectors are overly dependent on imports and thus have to be prioritised as part of import substitution and industrial diversification:

- Machine tool manufacture (90% imports);
- Civil aviation manufacturing (80%);
- Mechanical engineering (70%);
- Equipment supplies for the oil and gas sector (60%);

[409] Government of the Russian Federation (2015), *First meeting of the Government Commission on Import Substitution*, available at: http://www.government.ru/en/news/19246, accessed on 14 March 2019.

[410] None of the official platforms such as www.garant.ru or www.consultant.ru, giving public access to Russian legislation, have a reference to this order despite the fact that it is referred to on a number of times in other legislative acts. Status as of 29 March 2020.

[411] A likely reason for this is the lack of transparency with respect to import substitution policies, with numerous and and frequently amended legal acts and decisions at the central and regional levels which are difficult to track.

[412] Conolly, R. and Hanson, P. (2016), *Import Substitution and Economic Sovereignty in Russia, Chatham House Research Paper, Russia and Eurasia* Program, available at: https://www.chathamhouse.org/sites/default/files/publications/research/2016-06-09-import-substitution-russia-connolly-hanson.pdf, accessed on 30 March 2020, referring to the original source: Dzis'-Voynarovskii, N. (2015), '*ZAO "Rossiya"*' (*JSC "Russia"*), Novoe Vremya, 13 April 2015, available at: http://www.newtimes.ru/articles/detail/97063/, accessed on 30 March 2020.

– Production of power equipment (50%);
– Agricultural machinery (50–90% depending on a category).[413]

To implement these ambitious plans, the Government adopted a number of different measures and instruments to promote import substitution and respond to international sanctions. Table 6.4 specifies a range of state support measures that were put into practice (for further details on measures in the area of raw materials see Section 12.2.3).

Table 6.4. Import substitution measures introduced by the Government

Import substitution measures	Types of measures
Incentives	- Direct subsidies in governmental or municipal procurement - Co-financing schemes in R&D - Special grants to companies taking part in public procurement - Favourable lending conditions (federal budget loans on special terms) - Financing of new enterprises at the pre-production phase - 15% discount for producers in their "*Made in Russia*"[414] offers in public procurement - In agriculture: subsidies, refinancing of loans and tax incentives
Restrictions	- Import prohibitions as regards raw materials and processed products - Restrictions for state-owned companies on foreign imports - Bans in public procurement and SOEs' procurement - Requirement to localise processing and production facilities by foreign companies
Political measures	- Counter-sanctions - Food embargoes - SPS measures

[413] *Banki-v.ru* (2018), *Importozameshenie v Rossii s 2017 do 2020 goda (Import Substitution in Russia from 2017 to 2020)*, available at: http://banki-v.ru/economics/importozameshhenie-v-rossii/, accessed on 14 January 2019.

[414] The Government promotes the "*Made in Russia*" or *#MadeinRussia#* brand to popularise local production. Various channels also promote the import substitution measures. For instance, the Russian web source *Importozameshenie.ru* (Russian for "Import Substitution") is dedicated to the overview of Russian import substitution projects, key documents and latest trends in Russian industrial policies.

Source: Internal compilation based on the analysis of legal acts.

Provisions on import substitution measures related to public procurement are contained in the following legislative acts:

- Federal Law No. 44-FZ of 5 April 2013 (see Chapter 5);
- Federal Law No. 223-FZ of 18 July 2011 (see Chapter 5);
- Federal Law No. 488-FZ of 31 December 2014 on the Industrial Policy in the Russian Federation;[415]
- Government Decree No. 925 of 16 September 2016.[416, 417]

In particular, the Government Decree No. 925 is the main document that regulates import substitution in public procurement. It prioritises the purchase of Russian goods and services, or those produced within the EAEU, over foreign ones. The law is not specific on how this is to be achieved.

Government Decree No. 778 of 7 August 2014[418] regulates the import ban on foreign food products. Local producers of agricultural products benefited from the Government import bans and the embargo on food products from western countries such as Australia, Canada, the EU, Norway and the US launched in August 2014. Moreover, most of the agriculture products are subject to preferential treatment; a 15% discount for local producers is provided in public procurement contracts.[419] Regarding the trade dimension, Article 6 of the Decree stipulates that the Ministry of Industry and Trade, the Ministry of Agriculture, the Ministry of Economic Development and the FAS jointly with the trade chains association and trade organisations '*shall ensure coordination of the activity* [production and trade of local products]' in order to keep prices low.[420]

For goods to be classified as locally produced, they are either to be made or largely processed in Russia as defined by customs authorities. A producer is required to prove the sufficiency of processing for obtaining a certificate of Russian origin that is determined on an individual basis through the submission of an application (*zayavka*) to Rospromtest, an all-Russian certification

[415] Federal Law N.º 488-FZ of 31 December 2014 "*on Industrial Policy in the Russian Federation*", as amended, available at: http://base.garant.ru/70833138/, accessed on 30 October 2019.

[416] Government Decree N.º 925 of 16 September 2016 "*on the Priority of Russian Goods, Work and Services over Foreign Goods, Work and Services in Procurement by certain Types of Legal Entities*", available at: https://rg.ru/2016/09/27/tovari-dok.html, accessed on 5 March 2020.

[417] The Federal Laws N.º 44-FZ and N.º 223-FZ are general laws on procurement, which serve as a basis for the Federal Law N.º 488-FZ and the Government Decree N.º 925 regulating Russia's import substitutions policies in procurement.

[418] Government Resolution N.º 778 of 7 August 2014 "*on Measures to Implement the Russian President's Executive Orders N.º 560 of 6 August 2014, N.º 320 of 24 June 2015, N.º 305 of 29 June 2016 and N.º 293 of 30 June 2017*", available at: https://www.pc.camcom.it/internazionalizzazione/iniziative-e-progetti/government-of-the-russian-federation-risoluzione-7-08-2014-n.-778 and http://government.ru/en/docs/33337/, accessed on 25 October 2019.

[419] Heidemann, T. (2016) *Import Substitution in Russia – Food and Food Processing*, CMS Law Firm, available at: http://www.cms-lawnow.com/ealerts/2016/06/import-substitution-in-russia--food-and-food-processing, accessed on 12 December 2018.

[420] Government Decree N.º 925 of 16 September 2016.

centre.[421] The CIS-wide agreement on the Rules for Determining the Country of Origin of Goods in the CIS of 20 November 2009 contains the provisions on sufficient processing as regards the country of origin.

Foreign companies operating in Russia may also benefit from import substitution measures, if they are legal entities in Russia and have processing facilities and production in Russia.[422] The localisation rules for foreign companies were enacted by the Government Import Substitution Commission in 2015 and are reflected in various legal acts. Different localisation rules apply to different product groups.

Assessing the implementation and effects of import substitution policies, it is necessary to note that the main beneficiaries of these policies are big Russian State-owned enterprises. As for small and medium-sized enterprises, they remain largely excluded from import substitutions policies.[423]

Some changes triggered by import substitution measures can be observed in the economic sectors directly affected by them. The Government reported that production of agricultural machinery had increased by 50% in 2016.[424] The provision of subsidies to the Russian agricultural machinery sector poses a risk of trade conflict within the EAEU when it comes to exports. If Russia's increased agriculture machinery production is used for exports, this would be against the rules of the EAEU as it would undermine Belarusian exports of similar types of machinery.[425]

Agriculture and foodstuffs are the two areas where substantial changes, driven by import substitution measures and counter-sanctions, can be observed and which are also widely highlighted by Russian media. The oil price decrease, the rouble devaluation and the ban on food imports from several countries (in the form of counter-sanctions) laid the ground for the accelerated development of import substitution measures in agriculture as the largely increased prices on foreign goods make domestic products more affordable.[426] Table 6.5 shows how the share of imports in total retail trade in Russia changed over time.

[421] See the website of Rospromtest for more details, available at: http://www.rospromtest.ru/poryadok-sertifikacii-otechestvennoi-produkcii/, accessed on 22 October 2019.

[422] Connolly (2016), Connolly, R. and Hanson, P. (2016), *Import Substitution and Economic Sovereignty in Russia*. Research Paper, The Royal Institute of International Affairs, Chatham House.

[423] Ziguo, L. (2018) *Import substitution alone can't fix Russia's economy*, Global Times.

[424] *Agroinvestor* (2016), *The production of machinery saw 58% increase (Proizvodstvo tehniki vyroslo na 58%)*, available at: https://www.agroinvestor.ru/technologies/article/23917-proizvodstvo-tekhniki-vyroslo-na-58/, accessed on 14 January 2019.

[425] The relevant EAEU rules are Attachment n.º 28 of the EAEU Treaty of 29 May 2014 called "*Protocol of Unified Rules for the Provision of Industrial Subsidies*", and Attachment n.º 19 on "*Common Principles and Rules of Competition*". In particular, the Protocol (Attachment 28) contains clause no. 10 (Section III on *Zapreshennye subsidii* [prohibited subsidies] that states that, '[i]*f provision of a specific subsidy by a Member State results in damage to a sector of the national economy of another Member State, such subsidy shall be prohibited*.'

[426] Ziguo, L. (2018).

Table 6.5: Share of imports in total retail trade in Russia (in %)

	2005	2010	2013	2015	2016	2017	2018 (III)
Consumer goods	45	44	44	38	36	33	36
Foodstuffs	36	34	36	28	22	21	22

Source: Federal State Statistics Service (2018).[427]

Imports of consumer goods were reduced to 36% by the third quarter of 2018. A more significant change can be observed for foodstuffs, the import share of which was reduced from 36% in 2013 to 22% in 2018. Moreover, in some areas Russia expanded its exports. For instance, in agriculture, Russia became the world's biggest wheat exporter in 2018.[428] As the statistics show, Russia achieved varying degrees of import share reductions for all foodstuff groups after 2014. As of December 2018, the Federal Statistics Service provides statistics only on foodstuffs, agricultural products and trade in foodstuffs on the web-portal titled Import Substitution Indicators,[429] while other industries subject to import substitution measures are not covered.

6.5 RUSSIA'S TRADE RESTRICTIVENESS IN THE SERVICES SECTORS

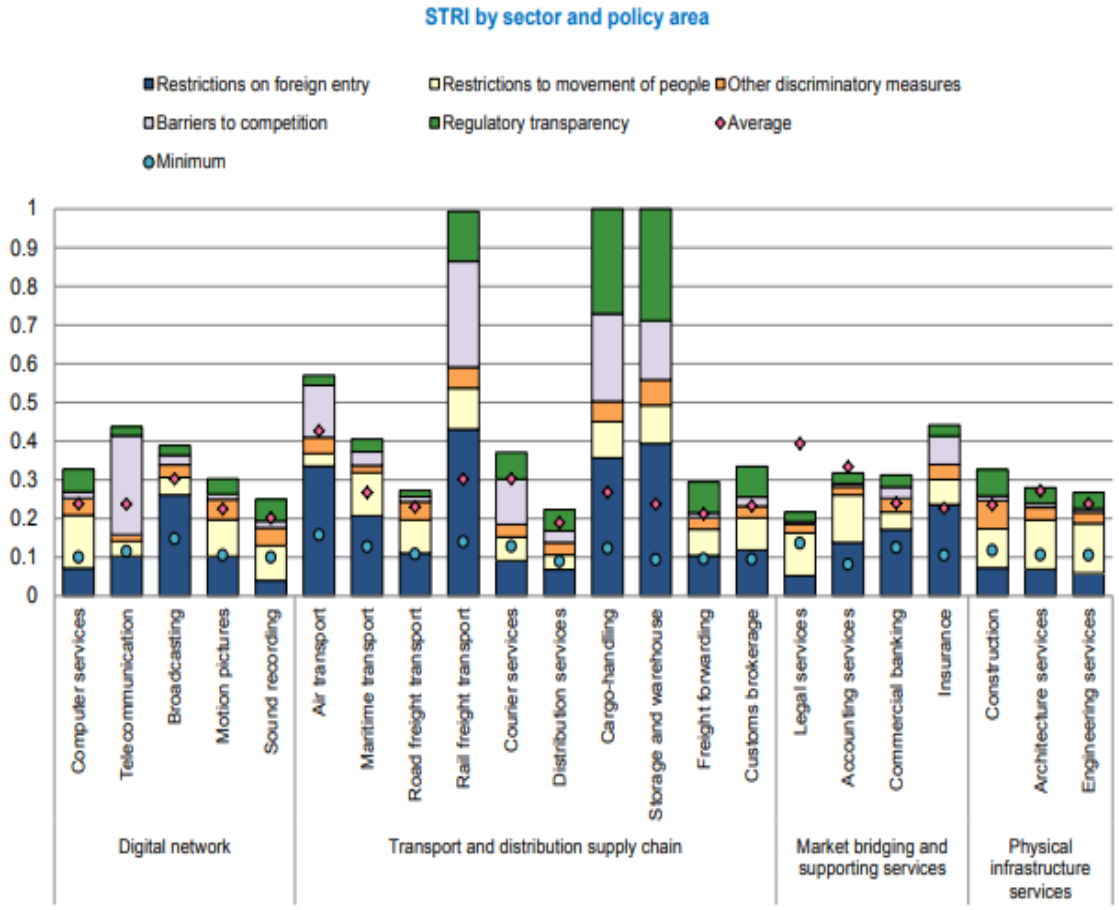
In global value chains, services play a key (and increasing) role and can be a significant part of the final price of physical goods. From this perspective, it is important to notice that some services related to the trade in goods are among the sectors most restricted in Russia. Figure 6.4 shows the most recent OECD's Services Trade Restrictiveness Index ('STRI') estimates by sector for Russia. Russia's trade restrictiveness is above the average for most services sectors, compared to the 35 countries for which the STRI is calculated. Three sectors, however, stand out as particularly restrictive: rail freight transport, cargo-handling and storage and storage/warehouse. Restrictions on foreign entry, barriers to competition and the lack of regulatory transparency are key drivers behind the high STRI scores for these sectors. Because of Russia's geography, internal transport costs are large and an important cost element in the final price for goods (see also Chapters 10, 11, 13, 14).

[427] Federal State Statistics Service (2018), *Pokazateli kharakterizuyushchie importozameshchenie v Rossii (Indicators characterising import substitution in Russia)*, available at: https://www.gks.ru/folder/11193, accessed on 10 December 2018.

[428] Medetsky, A. (2018), *Russia Is Exporting More Wheat Than Any Country in 25 Years*, Bloomberg.

[429] See for more details: https://www.gks.ru/folder/11193, accessed on 22 January 2020.

Figure 6.4: Russia's trade restrictiveness for services



Note: The STRI indices take values between zero and one, one being the most restrictive. They are calculated on the basis of the STRI regulatory database which contains information on regulation for the 35 OECD Members, Brazil, China, Colombia, Costa Rica India, Indonesia, Lithuania, Russia and South Africa. The STRI database records measures on a Most Favoured Nations basis. Preferential trade agreements are not taken into account. Air transport and road freight cover only commercial establishment (with accompanying movement of people).

Source: Reproduced from OECD web pages.[430]

6.6 SANCTIONS AND THEIR IMPACT

Over the past six years, Russia has faced sanctions imposed by western countries, primarily – but not only - in reaction to the illegal annexation of Crimea and Sevastopol in 2014 and destabilisation of Ukraine, including the ongoing conflict in the east of Ukraine. As of writing of this report, two types of sanctions are applied against Russia: individual sanctions (sanctions against individuals and entities) and sectoral sanctions (sanctions against certain types of operations in economy sectors, such as energy, finance or the defence industry). Moreover, some sanctions are related to investments and trade in the illegally annexed Crimea and

[430] See: http://www.oecd.org/trade/topics/services-trade/documents/oecd-stri-country-note-russian-federation.pdf, accessed on 22 November 2019.

Sevastopol. Both the EU and USA apply sanctions against persons and entities[431] as well as sectoral measures.

As for individual sanctions, the USA have put in place the Specially Designated Nationals and Blocked Persons List for visa restrictions, blocking property and accounts, a ban on the export/re-export of goods and services, the transfer of technology and materials, a ban on cooperation and business ties with physical and legal entities from the list, as well as with companies in which natural persons or legal entities from the list own 50% or more.[432] The EU applies visa restrictions, asset freezes in the EU, as well as a prohibition to make funds and economic resources directly or indirectly available to individuals and entities undermining the territorial integrity of Ukraine.[433] The sectoral sanctions from the US (Sectoral Sanctions Identifications) are associated with the following economic activities:

- In the financial sphere, the provision of financing to Russian financial organisations. Transactions with property and securities with a maturity of more than 14 days have also been banned;[434]
- In the energy sector, a ban was introduced on the provision of financing on operations with property, securities with a circulation period of more than 60 days,[435] onthe export/re-export of goods and technologies, on the provision of non-financial services related to the exploration and production of oil for the Arctic shelf, deep-sea oil extraction, shale gas production (For projects initiated after 29 January 2018, the ban applies regardless of the location);[436]
- In the defence sector, a ban was introduced on the export/import of arms and related materials, on dual-use goods and services, on the provision of debt financing for more than 30 days, as well as on transactions with property;[437]
- Secondary sanctions were introduced against non-US individuals and legal entities cooperating with Russian companies in the intelligence and defence industry and investing

[431] Also Canada, Norway or Australia introduced selective and targeted export controls following the illegal annexation of Crimea.

[432] Specially Designated Nationals and Blocked Persons List, available at: https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx, accessed on 22 October 2019.

[433] Council Regulation (EU) N.° 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1582640042486&uri=CELEX:02014R0269-20190914, accessed on 25 February 2020.

[434] Directive 1 (as amended on 29 September 2017) under Executive Order N.º 13662, available at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive1_20170929.pdf, accessed on 11 March 2019.

[435] Directive 2 (as amended on 29 September 2017) under Executive Order N.º 13662, available at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive2_20170929.pdf, accessed on 11 March 2019.

[436] Directive 4 under Executive Order N.º 13662, available at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive4.pdf, accessed on 11 March 2019.

[437] Directive 3 under Executive Order N.º 13662, available at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/eo13662_directive3.pdf, accessed on 11 March 2019.

in projects in which Russian participation is more than 33% (mainly in the oil and gas sector).[438]

From the EU side, the sectoral sanctions are the following:

- In the financial sector, sanctions prohibit individuals/legal entities of the EU from buying/selling, providing investment services and providing assistance in relation to securities and money market instruments with a maturity of more than 30 days to a five major state-owned Russian banks (Sberbank, VTB, Gazprombank, VEB, Rosselkhozbank), their subsidiaries outside the EU and those acting on their behalf or under their direction;[439]
- In the energy sector, sanctions prohibit individuals and legal entities of the EU from purchasing/selling, providing investment services and providing assistance in relation to securities and money market instruments with a maturity of more than 30 days to the largest oil companies (Rosneft, Transneft, Gazprom neft); a procedure has been introduced for licensing transactions on goods and technologies in the field of oil and other mineral production and exploration, while associated services necessary for deep water oil exploration and production, Arctic oil exploration or production and shale oil projects in Russia may not be provided;[440]
- In the defence sector, sanctions prohibit individuals/legal entities of the EU from buying/selling, providing investment services and providing assistance in relation to securities and money market instruments with a maturity of more than 30 days to three major defence companies, a ban was also introduced on the purchase/sale/transfer of weapons and ammunition, dual-use goods and technologies for military use.[441]

Sanctions associated with the illegal annexation of Crimea and Sevastopol were imposed by the US and the EU:

– USA: ban on the import and export of goods, services or technologies to and from Crimea, as well as a ban on investments and on banking services in the region; [442]
– EU: ban on importing goods originating in Crimea or Sevastopol and providing related financing and insurance, exporting some goods and technologies to Crimea and Sevastopol in the fields of transport, telecommunications, energy and prospection, exploration and production of oil, gas and mineral resources, investing in Crimea, providing services related

[438] Countering America's Adversaries Through Sanctions Act, available at: https://www.congress.gov/bill/115th-congress/house-bill/3364/text, accessed on 11 March 2019.

[439] Council Regulation (EU) N.º 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, available at: https://eur-lex.europa.eu/eli/reg/2014/833/oj, accessed on 11 March 2019.

[440] Council Regulation (EU) N.º 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, available at: https://eur-lex.europa.eu/eli/reg/2014/833/oj, accessed on 11 March 2019.

[441] *EU restrictive measures. Factsheet*, available at: https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/135804.pdf, accessed on 11 March 2019.

[442] Executive Order N.º 13685 of 19 December 2014, available at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo4.pdf, accessed on 11 March 2019.

to tourism activities, entering ports in the Crimean Peninsula for any ship providing cruise services, except in emergency cases for reasons of maritime safety.[443]

Sanctions which limit the activities in selected economic areas were further imposed:

- USA: freezing transactions with the FSB and the General Directorate of the General Staff of the Russian Federation Armed Forces; ban on any assistance (except urgent humanitarian aid, food supplies or agricultural goods) and on provision of loans and financial support to state authorities, limiting funding through privatisation or investment in the amount of USD 10 million; expansion of personal sanctions, the creation of additional sanctions lists related to actions in Crimea and Donbas (undermining cybersecurity, corruption etc.); [444]
- EU: suspension of new project financing in Russia by the EIB and the EBRD.[445]

Sanctions and other restrictive measures by the US, the EU, Canada, Australia and other countries against Russia were introduced as a reaction to Russian actions breaching the sovereignity and territorial intergrity of Ukraine. Simultaneously with the declaration of political goals, they have a pronounced economic dimension. One way or another, sanctions affect the Russian economy, the defence industry, the energy sector and other complexes, the financial and political systems, the international image, and undermine Russia's position in the global economic and political space. As a response, Russia has imposed countersanctions against Ukraine and EU/EFTA food imports.[446]

The United States has imposed sanctions upon Russian companies on different grounds beyond Russia's actions in Ukraine. For example, in April 2018, restrictions were imposed on Agrosoyuz CB '*for trading with the DPRK*' and '*long-term relations*' with the North Korean authorities. Table 6.6 illustrates the background and the main reasons for introduction of the sanctions by US against Russia. Table 6.7 provides a list of EU sanctions against Russia.

Table 6.6: Reasons/declared reasons for the introduction of US sanctions against Russia

Reasons for the imposition of sanctions	**Start of Action**	**Legislative Act**
Human rights abuses and corruption	14 December 2012	Sergei Magnitsky Rule of Law Accountability Act PL 112-208 Executive Order 13818

[443] EU restrictive measures in response to the crisis in Ukraine, available at: https://www.consilium.europa.eu/en/policies/sanctions/ukraine-crisis/, accessed on 11 March 2019.

[444] Ukraine and Russia Sanctions. Economic Sanctions and Policy Implementation. US Department of State, available at: https://www.state.gov/ukraine-and-russia-sanctions/, accessed on 22 October 2019.

[445] EU sanctions against Russia over Ukraine crisis. Available at: https://europa.eu/newsroom/highlights/special-coverage/eu-sanctions-against-russia-over-ukraine-crisis_en, accessed on 11 March 2019.

[446] It should be also noted that according to the official position of the Government, unilateral sanctions against Russia are illegal measures of a restrictive nature, since they have no international legal justification.

		National Defense Authorization Act for Fiscal Year 2017 PL 114-328 Support for the Sovereignty, Democracy, and Economic Stability of Ukraine Act PL 113-95
Criminal individuals and groups of Russian origin	20 December 2012	Executive Order 13581 Executive Order 13224
The annexation of Crimea and the violation of the territorial integrity of Ukraine	6 March 2014	Executive Order 13660 Executive Order 13661 Executive Order 13662 Executive Order 13685 Ukraine Freedom Support Act PL 113-272 Support for the Sovereignty, Democracy, and Economic Stability of Ukraine Act PL 113-95
Support for the Assad regime and its activities	8 May 2014	Executive Order 13582
Cyber security breach	1 April 2015	Executive Order 13694 Executive Order 13757
Interference in the US election	28 December 2016	Countering America's Adversaries Through Sanctions Act PL 115-44

		Executive Order 13757 Executive Order 13848
Violation of sanctions against North Korea	31 March 2017	Executive Order 13687 Executive Order 13722 Executive Order 13810 Executive Order 13382
Actions in Crimea and Donbass, human rights violations '*in the occupied territory*', supply of weapons to the Syrian government, undermining the cybersecurity of the US, interfering in the American elections of 2016	2 August 2017	Countering America's Adversaries Through Sanctions Act ('CAATSA')
Use of chemical weapons	27 August 2018 (2nd round on 2 August 2019)	Chemical and Biological Weapons Control and Warfare Elimination Act of 1991 PL 102-182
Construction of Nord Stream 2 pipeline	20 December 2019	Protecting Europe's Energy Security Act of 2019 ('PEESA') under the National Defence Authorization Act ('NDAA') for fiscal year 2020

Source: Internal compilation.

Table 6.7: List of EU sanctions against Russia[447]

Reasons for the imposition of sanctions	**Start of Action**	**Area of regulation**
Misappropriation of Ukrainian State funds	5 March 2014	Asset freeze against persons having been identified as responsible for the misappropriation of Ukrainian State funds
Actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine	17 March 2014	Travel ban and asset freeze against individuals: (a) natural persons responsible for, actively supporting or implementing, actions or policies which undermine or threaten the territorial integrity, sovereignty and independence of Ukraine, or stability or security in Ukraine, or which obstruct the work of international organisations in Ukraine, and natural persons associated with them; (b) natural persons actively supporting, materially or financially, or benefitting from, Russian decision-makers responsible for the annexation of Crimea or the destabilisation of Eastern Ukraine; or (c) natural persons conducting transactions with the separatist groups in the Donbass region of Ukraine. Asset freeze against entities: a) natural persons responsible for, actively supporting or implementing,

[447] In addition to these measures, there are also so called diplomatic measures in place, which are not based on a legal act but follow from the successive decisions that the European Council or the Foreign Affairs Council have taken and as such have no agreed review or expiry date (-No meetings of the G8; - Suspension of EU-Russia summits and EU member states summits with Russia; -Suspension of negotiations over Russia's joining the OECD and the International Energy Agency; - Suspension of bilateral talks with Russia on visa matters as well as of the EU-Russia New Agreement; -Suspension by EIB of new financing operations in Russia and coordination in the EBRD Board for the same; - Suspension of most of EU-Russia bilateral and regional cooperation programmes, except projects dealing exclusively with cross-border cooperation and civil society).

		actions or policies which undermine or threaten the territorial integrity, sovereignty and independence of Ukraine, or stability or security in Ukraine, or which obstruct the work of international organisations in Ukraine, and natural or legal persons, entities or bodies associated with them; (b) legal persons, entities or bodies supporting, materially or financially, actions which undermine or threaten the territorial integrity, sovereignty and independence of Ukraine; (c) legal persons, entities or bodies in Crimea or Sevastopol whose ownership has been transferred contrary to Ukrainian law, or legal persons, entities or bodies which have benefitted from such a transfer; (d) natural or legal persons, entities or bodies actively supporting, materially or financially, or benefitting from, Russian decision-makers responsible for the annexation of Crimea or the destabilisation of Eastern Ukraine; or (e) natural or legal persons, entities or bodies conducting transactions with the separatist groups in the Donbass region of Ukraine.
Illegal annexation of Crimea and Sevastopol	23 June 2014	As part of EU's non-recognition policy several measures have been imposed, such as prohibition on imports of goods originating from Crimea and Sevastopol, prohibition on investment in Crimea and Sevastopol and restrictions on goods and services in specific sectors including tourism, transport, telecommunications, energy.

Russia's actions destabilising the situation in Ukraine	31 July 2014	Sectoral measures (restriction on access to capital markets, arms embargo, export prohibition of dual use goods and prohibition to export certain equipments and certain sensitive technologies).
Restrictive measures against the proliferation and use of chemical weapons	15 October 2018	Asset freeze and travel ban against persons and/or entities directly responsible for the development and use of chemical weapons. As of 21 January 2019, four Russian officials are subject to a travel ban and asset freeze measures.

Source: Internal compilation.

While both the EU and US have generally imposed the same types of sanctions on Russia in the outset, certain differences arose after time, including:

- In September 2014, the US sanctions addressed energy companies, while the EU sanctions were directed against Russian energy companies and banks. In December 2014, the US imposed sanctions linked with activities in Crimea, which were subsequently supported by the EU. In particular, these sanctions included a ban on the import and export of goods, services, or technologies to and from Crimea, a ban on investments in the region, and the discontinuation of providing VISA and MASTERCARD services. After the conditions of work for VISA and MASTERCARD payment systems in Russia were changed, the operation of VISA and MASTERCARD cards issued in Russia was restored in Crimea. However, as of 2018, cards issued by foreign banks using these payment systems are not functioning in the peninsula, and the contactless payment technologies Android Pay and Apple Pay are also not available;
- In August 2017, the USA imposed secondary sanctions on individuals and legal entities of third countries who cooperate with companies from Russia or invest in projects with Russian participation of more than 33%;
- In April 2018, sectoral sanctions were tightened concerning a number of Russian companies listed by the US Treasury as Specially Designated Nationals (′SDN′). For these companies, this means not only a ban on funding from US residents, but also a freeze on assets in the USA and a ban on any operations with SDN companies for US residents. Moreover, US non-residents may become a subject to secondary sanctions in the case of cooperation with SDNs;
- The next wave of sanctions against Russia took place in August 2018, when the US imposed a ban on the delivery of military and dual-use products to Russia,[448] any assistance to Russia (except emergency humanitarian aid, foodstuffs or agricultural goods), as well as on the provision of loans and financial support to the Russian authorities;

[448] Corresponding sanctions were also imposed by the EU.

– The NDAA for the fiscal year 2020, signed by President Trump on 20 December 2019, includes sanctions provisions on Nord Stream 2 and TurkStream, two pipeline projects designed to ensure security of gas transits from Russia to the EU, while not transiting through Ukraine. The NDAA provisions consists of mandatory targeted sanctions (visa ban and blocking assets) against persons and entities that are selling, leasing or providing (or persons that facilitated transactions to provide) vessels that are used to construct deep sea pipelines for the Nord Stream 2 project and TurkStream as well as successors to these projects;
– The EU, as well as the US continued introducing additional targeted sanctions against Russian and Ukrainian individuals undermining or threatening the territorial integrity of Ukraine in 2017, 2018 and 2019.

The sanctions have had an impact on the Russian economy, but the estimates of the extent of this impact vary. The IMF estimated in 2018 the losses from western sanctions on the Russian economy as amounting to 1–1.5 percentage points of GDP per year.[449] The Economic Expert Group estimates the accumulated growth losses from the sanctions for the period of 2014–2017 at 8.4% of GDP.[450] According to Bloomberg estimates, Russia has lost 6% of its GDP between 2014 and 2018 (this figure includes also the effect of structural constraints and a drop in oil prices).[451] According to Gaidar Institute estimates, the loss of the Russian economy in terms of economic growth represents one percentage point of GDP per year.[452]

Since 2013, the value of exports to the EU declined by USD 117 billion, and imports from the EU fell by USD 53 billion, and therefore the EU's share in Russia's foreign trade decreased from 47.6% in 2013 to 39.3% in 2017. Russia's imports from the EU were at USD 81 billion in 2017, while its exports to the EU constituted about USD 150 billion. The reduction is largely attributed to fall in commodity prices, rouble devaluation, inflation in Russia, etc. However, Russia's food embargo totally banned imports of a number of EU food industry goods. Moreover, since 2013, exports to the EU of the following goods have declined: mineral fuels, products of inorganic chemistry, iron and steel, fats and oils of animal origin, and organic chemical compounds. The largest decline in imports from the EU was associated with goods such as nuclear reactors, boilers, ground transportation, electrical machinery and equipment, pharmaceutical products.

Concerning the macroeconomic spill-overs of sanctions and Russia's retaliatory measures on the EU economy, available evidence so far broadly confirm it remains limited and manageable overall, in particular the effects in 2018 and 2019 have been neutral (0% of GDP). As always,

[449] International Monetary Fund (2018), *Russian Federation: 2018 Article IV Consultation-Press Release; Staff Report* Country Report N.º 18/275, available at: https://www.imf.org/en/Publications/CR/Issues/2018/09/12/Russian-Federation-2018-Article-IV-Consultation-Press-Release-Staff-Report-46226, accessed on 11 March 2019.

[450] Gurvich E.T., Prilepsky I.V. (2015), The impact of financial sanctions on the Russian economy, *Russian Journal of Economics*, 1 359–385, http://dx.doi.org/10.1016/j.ruje.2016.02.002 , accessed on 24 July 2019.

[451] Bloomberg (2018), *Here's One Measure That Shows Sanctions on Russia*, available at: https://www.bloomberg.com/news/articles/2018-11-16/here-s-one-measure-that-shows-sanctions-on-russia-are-working, accessed on 22 October 2019.

[452] Knobel A. and others (2019), *Sanctions: seriously and for a long time*, RANEPA, "Delo", Publishing House. pp. 80 (in Russian), available at: ftp://w82.ranepa.ru/rnp/ppaper/021901.pdf, accessed on 11 March 2019.

the impact varies across member states, with those with stronger trade dependency with Russia more affected than others. 2018 marked an end to the strong recovery of EU exports to Russia observed in 2017 (+19%). In contrast, imports in 2018 (+17%) continued the upward trajectory observed in 2017 (+22%). Comparing 2013 and 2018, however, overall EU exports of goods to Russia were still 28.7% lower.

The Russian ban affecting EU agri-food products is worth EUR 5.1 billion (43% of exports to Russia in 2013). After an initial severe drop of all agri-food products in the first years following the introduction of the ban, EU exports of agri-food products to Russia resumed important growth of 16% in 2017. In 2018, they grew by another 2%. The situation of course differs per member states and per sector. In addition, EU overall agri-food exports increased by 14.6% since 2013. Aside from the food ban, Russia has several sanitary and phytosanitary measures in place on agricultural products currently subject to an import ban.

As for trade with the US, in 2013 the volume was low, so the decline was insignificant. Russia's share in the US foreign trade decreased from 1.1% to 0.8%, and the US' share of Russia's foreign trade, by contrast, increased from 2.0% to 2.1% in 2017. In general, there was a reorientation of trade from western countries to the countries of the Asia-Pacific Economic Cooperation and the EAEU members.

With respect to sanctions policy, the analysis above shows that the initiating countries have made a focus on financial sanctions, as well as sanctions directed directly against the political and military elite of Russia. The sanctions not only have an effect on GDP but are also reflected in the reduction of Russia's bilateral trade with western countries, the refusal of western investors to cooperate with Russian companies, but also with companies from the third countries due to the spread of "toxicity" of Russian business and the risk of introducing secondary sanctions. Other indirect effects are associated with the reduction of the inflow of foreign direct investment and the outflow of capital from Russia, the growth of uncertainty, expressed in the high volatility of the rouble and fluctuations in the financial market etc. In other words, the impact of sanctions on the Russian economy is not only the actual level of the sanctions, but the uncertainty about future sanctions' parameters.

6.7 CHAPTER SUMMARY

Russia's WTO membership from 2012 was a milestone in its trade policy development, leading to significant changes in Russia's law and trade policy practices. Russia has accepted WTO disciplines to a certain extent, even if there are issues about implementation in some areas such as specific tariffs, customs valuation and non-tariff barriers. Russia has been involved in a more than average number of trade defence cases, partly because it is exporting homogeneous goods that are often subject to such measures but also since Russia has become an active user of trade defence.

The WTO accession was followed by the formation of the EAEU in 2014, with common trade policies for goods including tariffs, non-tariff issues and trade defence. The EAEU represents a significant trade policy change for Russia and the other EAEU member countries, but the

implementation has not been completed, with frictions remaining among members with respect to tariffs, as well as the issue of supranationality. Non-tariff barriers remain a significant obstacle to intra-EAEU trade. The member countries are not yet fully coordinated at the WTO and conflicts are solved bilaterally. The EAEU is, however, more ambitious than former FTAs in the CIS area. Recently, Russia and partly the EAEU have initiated FTA negotiations with several countries, beyond agreements within the CIS that were already in place. However, with respect to Western Europe, Asia and the Americas, Russia's FTA participation is still limited.

With respect to services trade, Russia is a net importer with restrictiveness about the OECD average. However, some sectors related to transport and storage stand out as highly restrictive. With Russia's vast territory and remote locations of some of its natural resource production, transport costs can represent a large share of the final price, making transportation economically important.

Following the strong deterioration in Russia's trade balance in manufacturing over two decades and the commodity price decline from 2011–12, Russia introduced the so-called import substitution policies, with a large set of measures to replace imports by domestic production in a number of sectors. While the declared intention was that measures should be temporary, this is not yet clear in practice. Some of these measures may be challenged at the WTO, depending also on whether Russia becomes a member of the WTO's agreement on government procurement, as envisaged in ongoing negotiations.

Sanctions that were imposed on Russia following the illegal annexation by Crimea and Sevastopol and destabilisation of the situation in Ukraine have clearly harmed Russia and also harmed trade between Russia and the West, also due to Russian counter-measures notably in the agricultural sector. In addition to the direct impact of sanctions on individuals and businesses, sanctions also create large uncertainty that hampers business, reduces investment and leads to lower economic growth. To be noted nonetheless that other factors have had an impact over that period of time, like the drop in oil prices and the weakening of the Russian rouble.

Appendix Table A6.1: WTO disputes involving the Russian Federation

Cases with Russia as respondent (9)					
Complainant	Shorthand description	Legal key words	Request for consultations	WTO reference	Status
EU	Recycling fee on motor vehicles	Taxation, national treatment	July 2013	DS462	Composition of panel deferred after 2013
EU	Measures on the importation of live pigs, pork and other pig products from the European Union	SPS	April 2014	DS475	Compliance proceedings 2018
EU	Anti-dumping duties on light commercial vehicles from Germany and Italy	Anti-dumping	May 2014	DS479	Case completed 2018, measure discontinued
EU	Tariff treatment of certain agricultural and manufacturing products	Excessive tariffs above bound rates	October 2014	DS485	Panel report adopted 2016
Japan	Recycling fee on motor vehicles	Taxation, national treatment	July 2013	DS463	Pending, no panel established
Ukraine	Measures affecting the importation of railway equipment and parts thereof	TBT	October 2015	DS499	Panel appeal 2018
Ukraine	Measures concerning traffic in transit	Transit, trade administration	September 2016	DS512	Panel established 2017
Ukraine	Measures concerning the importation and transit of certain Ukrainian products	Transit, SPS, TBT, Trade Facilitation	October 2017	DS532	Consultations
USA	Additional duties on certain products from the United States	Additional duties in response to US steel and aluminium	August 2018	DS566	Consultations
With Russia as complainant (6)					

EU	EU cost adjustment methodologies and certain anti-dumping measures on imports from Russia	Anti-dumping, subsidies	December 2013	DS474	Panel established 2014 but not composed
EU	Certain measures relating to the energy sector	Organisation of gas trade	April 2014	DS476	Panel appeal 2018
EU	EU cost adjustment methodologies and certain anti-dumping measures on imports from Russia – (second complaint)	Anti-dumping, subsidies	May 2015	DS494	Panel established 2015 and panel proceedings ongoing
EU	Anti-dumping measures on certain cold-rolled flat steel products from Russia	Anti-dumping	January 2017	DS521	Consultations
Ukraine	Anti-dumping measures on ammonium nitrate	Anti-dumping	May 2015	DS493	Panel appeal 2018
Ukraine	Measures relating to trade in goods and services	Trade sanctions	May 2017	DS525	Consultations
USA	Certain measures on steel and aluminium products	US steel and aluminium measures	June 2018	DS554	Consultations
Russia has also been or is involved as a third party in 63 disputes, as of 14 December 2018. Information is available at www.wto.org					

Source: World Trade Organization, disputes by member, with links to further documents available at: https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm, accessed on 22 October 2019.

Appendix Table A6.2: Share of Russian imports in foodstuff groups over time (in %)

Foodstuff group	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Meat and poultry including sub-products	43.8	38.2	33.7	30	30.3	26.2	19.6	13.4	11	10.5
Beef including sub-products	61.7	61.8	64.5	59.5	59.9	59	57.3	48.1	40	40.9
Pork including sub-products	56.5	41.6	46.8	42.8	41.3	31	16.6	12.5	9.6	9.6
Poultry including sub-products	33.3	26.1	18.2	12.5	14	12.8	10	5.5	5	4.4
Canned meat	18.8	16.5	17.1	22	25.1	20	13.7	9	7.5	7.3
Sausages	1.1	1.3	1.3	1.7	3.4	3.2	2.2	1	1.5	1.7
Animal fats and oils	27.0	27.1	32.3	32.2	34.2	35.9	34.3	25.5	26.4	24.2
Cheese	41.3	41.2	47.4	46.1	47.8	48	37.3	23.3	28.2	27.3
Flour	0.2	0.1	0.9	1	0.7	1.5	0.9	0.8	1.9	1.3
Cereals	4.2	2.1	2.2	2	1.4	1.8	0.5	0.3	0.3	0.2
Oils	31.2	18.5	23.9	22	16.3	19	14.4	17.4	16.7	14.7
Dry milk and cream	30.0	37.3	60.1	40.7	48.4	60.5	49.4	56.4	59.1	52.7
Confectionary	10.3	6.8	11.1	11.6	12.5	12	9.3	5.9	6.1	6.7
Sugar	2.7	4.8	5.4	3.7	5.3	8.2	7.4	6.2	5.5	3.9

Source: Federal State Statistics Service (2018): Indicators characterising import substitution in Russia (Pokazately harakterizuyushie importozameshenie v Rossii), available at: https://www.gks.ru/folder/11193, accessed on 5 December 2019.

7 INVESTMENT

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7.1 INTRODUCTION

This chapter provides an overview of relevant laws and regulations that impact on foreign investment in Russia and other relevant issues related to investment: section 7.2 provides a brief description of the development of Russia's investment climate since the Ukraine crisis; section 7.3 provides an overview of the laws and regulations relevant for foreign investors in Russia, focusing on regulations that are horizontal, e.g. applicable across industries and markets respectively; section 7.4 outlines the laws and regulations for highly-regulated sectors that are attractive to foreign investors and it provides an overview of the prevailing legal restrictions; section 7.5 discusses the prevailing situation for sectors that are characterised by relatively tight foreign investment policies and it further discusses market characteristics that may impact negatively on the investment decisions of foreign investors.

7.2 OVERALL INVESTMENT CLIMATE AND TRENDS IN RUSSIAN FOREIGN DIRECT INVESTMENT

Russia's perceived investment climate deteriorated in the aftermath of the 2013–2014 Ukraine crisis. Negative macroeconomic projections generally dampened the expectations of foreign investors. Despite these developments, the Government managed to improve the country's position in international rankings on the quality of its legal institutions. At the same time, considerable investment restrictions still apply for a number of sectors.

7.2.1 DEVELOPMENT OF INVESTMENT CLIMATE

According to PricewaterhouseCoopers (′PWC′), Russia has carried out more than 30 legislative reforms in various policy areas that are relevant for foreign investors.[453] In the World Bank's 2015 Doing Business Report, Russia ranked among the top five countries by number of reforms, which were carried out in five of ten key areas surveyed by the World Bank: obtaining construction permits, accessing electricity, registering property, enforcing contracts, and protecting minority investors. Accordingly, in the World Bank's 2017 Doing Business report,[454] Russia ranks 40th, moving up from 120th in five years. Similarly, according to the World Economic Forum's Global Competitiveness Report 2018,[455] Russia now ranks 43rd of 140 economies, moving up the index from a rank of 67 in 2013.

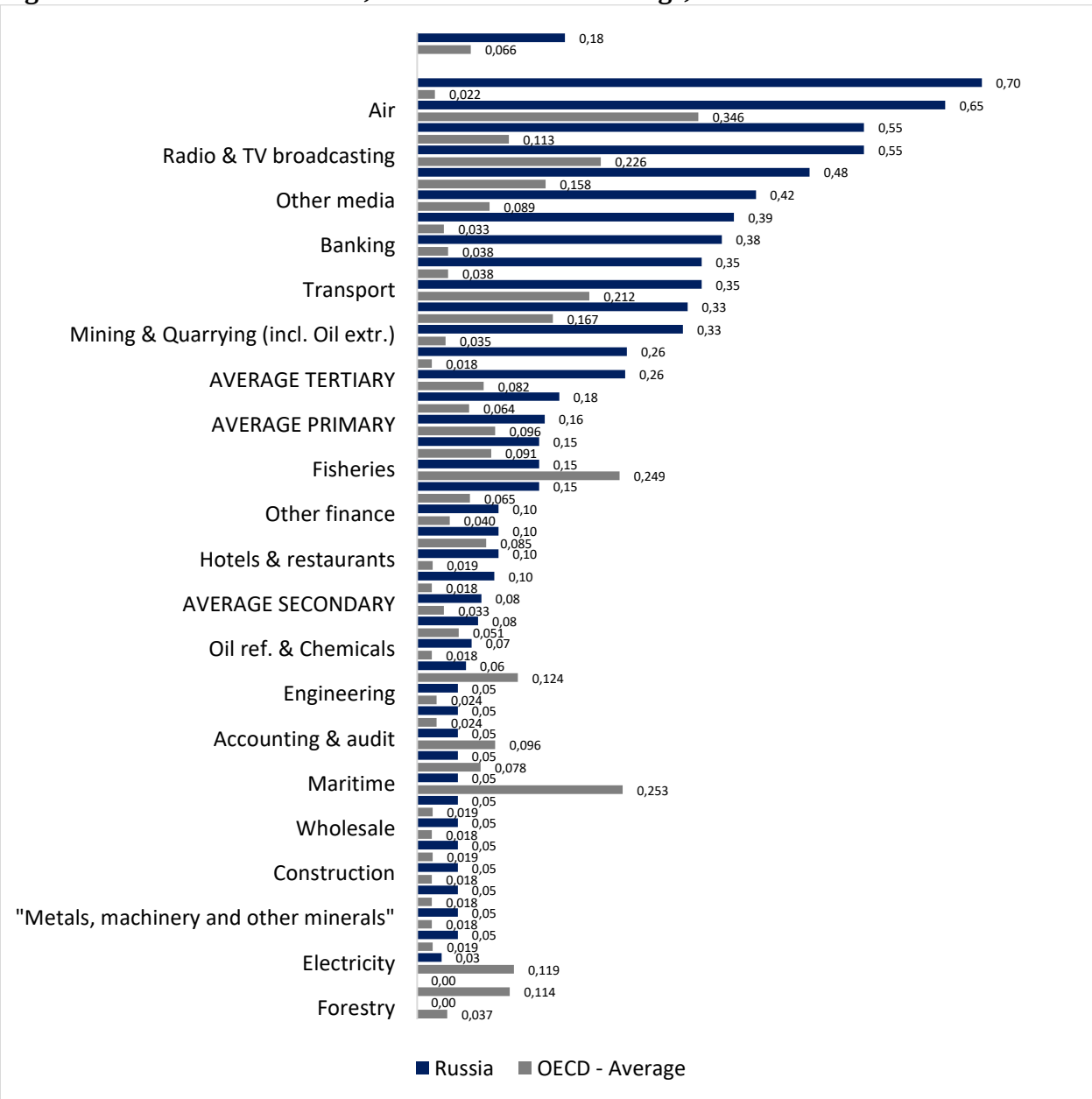
At the same time, as indicated by the 2017 OECD's foreign direct investment (′FDI′) restrictiveness index,[456] Russia still ranks poorly compared to OECD and EU countries for a number of policies. These include foreign equity limitations, discretionary screening or approval

[453] PWC (2015), *Doing Business and Investing in the Russian Federation*.
[454] World Bank (2017), *Doing Business Report.*
[455] World Economic Forum (2018), *The Global Competitiveness Report 2018.*
[456] See OECD data on FDI restrictiveness, available at: https://data.oecd.org/fdi/fdi-restrictiveness.htm, accessed on 6 May 2019.

mechanisms, restrictions on the employment of foreigners and other operational restrictions such as restrictions on branching and on capital repatriation and land ownership by foreign-owned enterprises.

The Government's restrictions on FDI go well beyond critical sectors for which many other countries also apply tight regulations, such as the defence sector or financial and legal services. Relatively tight restrictions on FDI also apply, for example, in the raw materials sector, telecommunications and media, as well as transport services. Sectoral indicators for regulatory restrictiveness, as measured by the OECD, are depicted in Figure 7.1.

Figure 7.1: FDI restrictiveness, Russia vs. OECD average, 2017



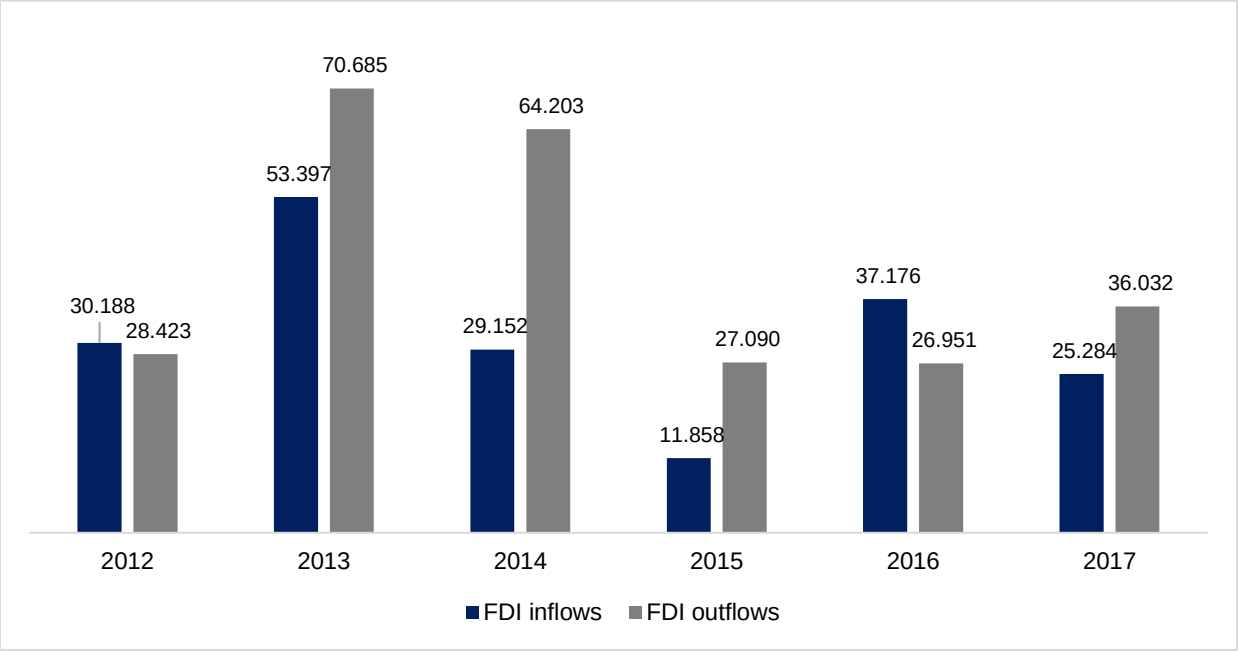
Source: OECD. Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The FDI Regulatory Restrictiveness Index ('FDI Index')

measures statutory restrictions on FDI across 22 economic sectors. It captures the restrictiveness of a country's FDI rules by looking at the four main types of restrictions on FDI: 1) foreign equity limitations; 2) discriminatory screening or approval mechanisms; 3) restrictions on the employment of foreigners as key personnel and 4) other operational restrictions, e.g. restrictions on branching and on capital repatriation or on land ownership by foreign-owned enterprises. The overall restrictiveness index is the average of sectoral scores.[457]

7.2.2 TRENDS IN RUSSIAN FDI

As regards FDI in Russia, both inflows and outflows have been relatively volatile in 2012–2017 (see Figure 7.2). After an increase in 2013, total FDI inflows to Russia decreased in 2014 and 2015, mainly due to the geopolitical tensions between Russia, the Ukraine and western countries, including the EU and the US. While FDI inflows rose to USD 37.1 billion in 2016, inflows fell once again in 2017 to USD 25.3 billion, the second lowest level since 2006.

Figure 7.2: FDI inflows and outflows, Russia, in million USD



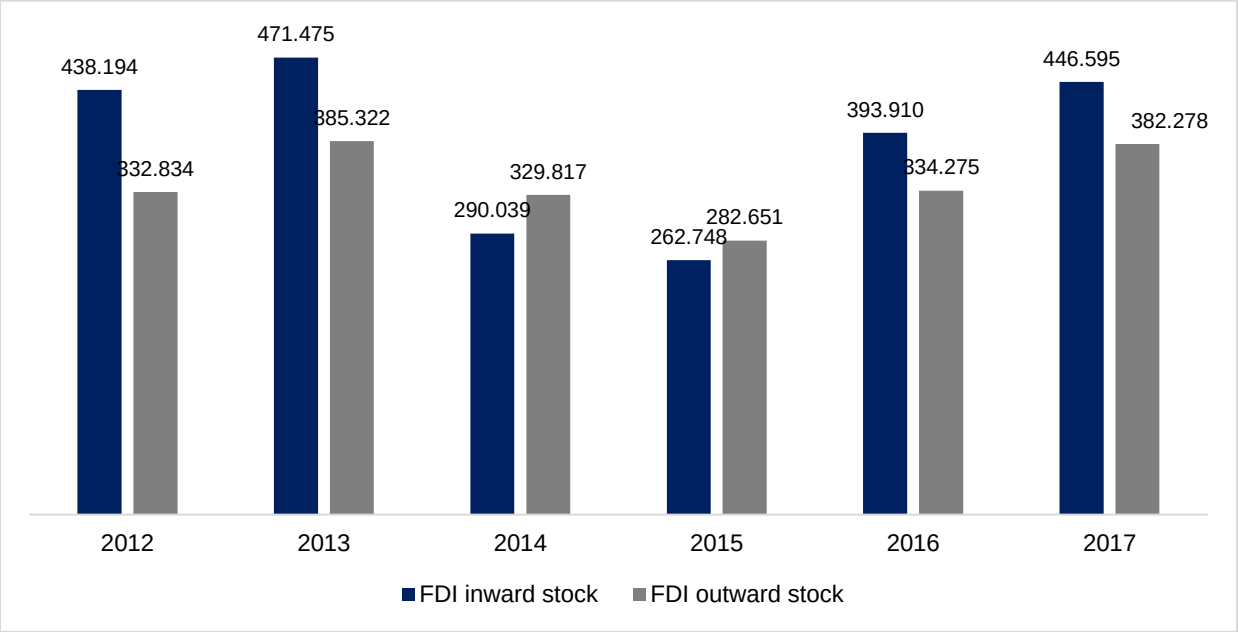
Source: UN World Investment Report 2018, p. 187.

Mirroring the development of FDI inflows, Russia's total FDI stock declined from USD 471 billion in 2013 to USD 263 billion in 2015. After increases in 2016 and 2017, Russian inward FDI stock

[457] The discriminatory nature of measures, i.e. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. The FDI Index is not a full measure of a country's investment climate. A range of other factors comes into play, including how FDI rules are implemented. Entry barriers can also arise for other reasons, including state ownership in key sectors. A country's ability to attract FDI will be affected also by other factors such as the size of its market, the extent of its integration with neighbours and even geography among others. Nonetheless, FDI rules can be a critical factor of a country's attractiveness to foreign investors. See OECD (2019), *OECD FDI Regulatory Restrictiveness Index*, available at: https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX&_ga=2.234036442.59712329.1546864330-1949182254.1539689578#, accessed on 22 October 2019.

amounted to USD 446 billion in 2017 (Figure 7.3), i.e. less than its 2013 level, representing 2% of the world's total FDI stock (compared to 40% for the EU and 34% for the US). Accordingly, Russia's FDI stock in the world's total FDI stock is lower than Russian GDP in world's GDP, which stood at 3.15% in 2017 in purchasing power parity ('PPP') terms.[458]

Figure 7.3: FDI inward and outward stock, Russia, in million USD



Source: UNCTAD, FDI/MNE database.

Investment data indicate that, similar to global FDI, inflows of EU FDI into Russia have been volatile and remained at a rather low level since 2014.[459] Nevertheless, at an aggregate level, the EU is still the biggest investor in Russia. CBRF data indicate that more than three quarters of FDI stocks in Russia come from EU member states.

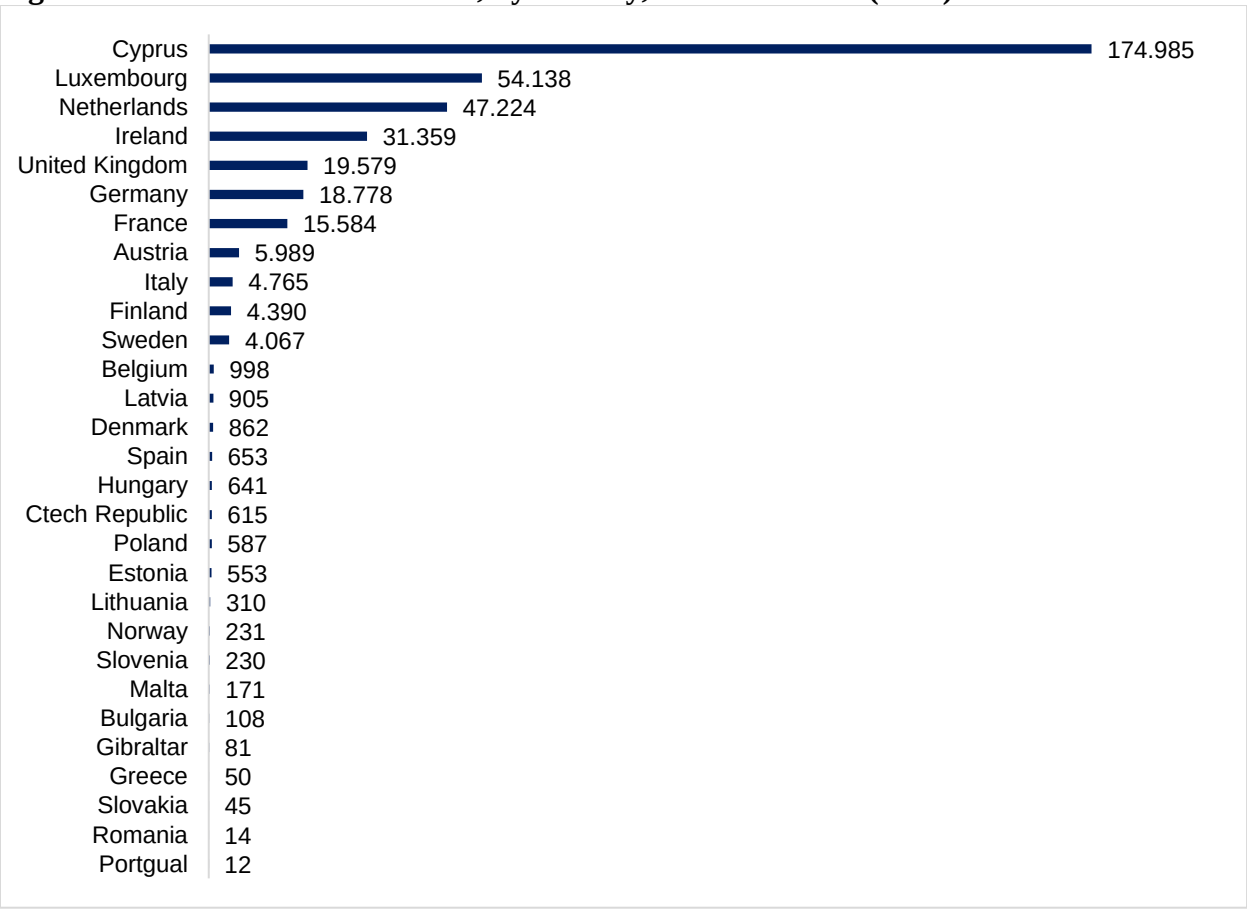
As shown by Figure 7.4, the major source of EU FDI stock in Russia is Cyprus (USD 174 billion), followed by Luxembourg (USD 54 billion), the Netherlands (USD 47.2 billion), Ireland (USD 31 billion), the United Kingdom (USD 20 billion), Germany (USD 18 billion), and France (USD 16 billion). EU FDI flows accounted for more than 50% of the total volume of incoming FDI in Russia in 2017. It should be noted that a substantial part of this stock represents repatriated capital of Russian origin domiciled in the EU. In addition, a large number of Russians and Russian firms use offshore regions as their base for business and investment activities, with many Russian firms

[458] Statista (2017), *Russia: Share of global gross domestic product (GDP) adjusted for Purchasing Power Parity (PPP) from 2014 to 2024*, available at: https://www.statista.com/statistics/271379/russias-share-of-global-gross-domestic-product-gdp/, accessed on 22 October 2019.

[459] European Commission (2017), *Main indicators for trade and investment with Russia*, available at: http://ec.europa.eu/trade/policy/countries-and-regions/countries/russia/, accessed on 22 October 2019.

using Cyprus as a capital transit hub.[460] Accordingly, Cyprus disproportionately high FDI stock in Russia reflects investment from Russian citizens/firms using Cyprus as an offshore intermediary location.[461] Similarly, Luxembourg acts as financial transit hub for Russian capital, i.e. a large part of Russian investments in Luxembourg is reinvested in Russia.[462] According to CBRF, in 2017 Luxembourg received almost USD 1.86 billion in FDI from Russia.

Figure 7.4: EU FDI stock in Russia, by country, in million USD (2017)



Source: CBRF.

EU FDI in Russia is most prominent in manufacturing (USD 99 billion), wholesale trade, retail trade and repair of motor vehicles (USD 78 billion), financial and insurance services (USD 56 billion), mining and quarrying (USD 36 billion), real estate activities (USD 18 billion),

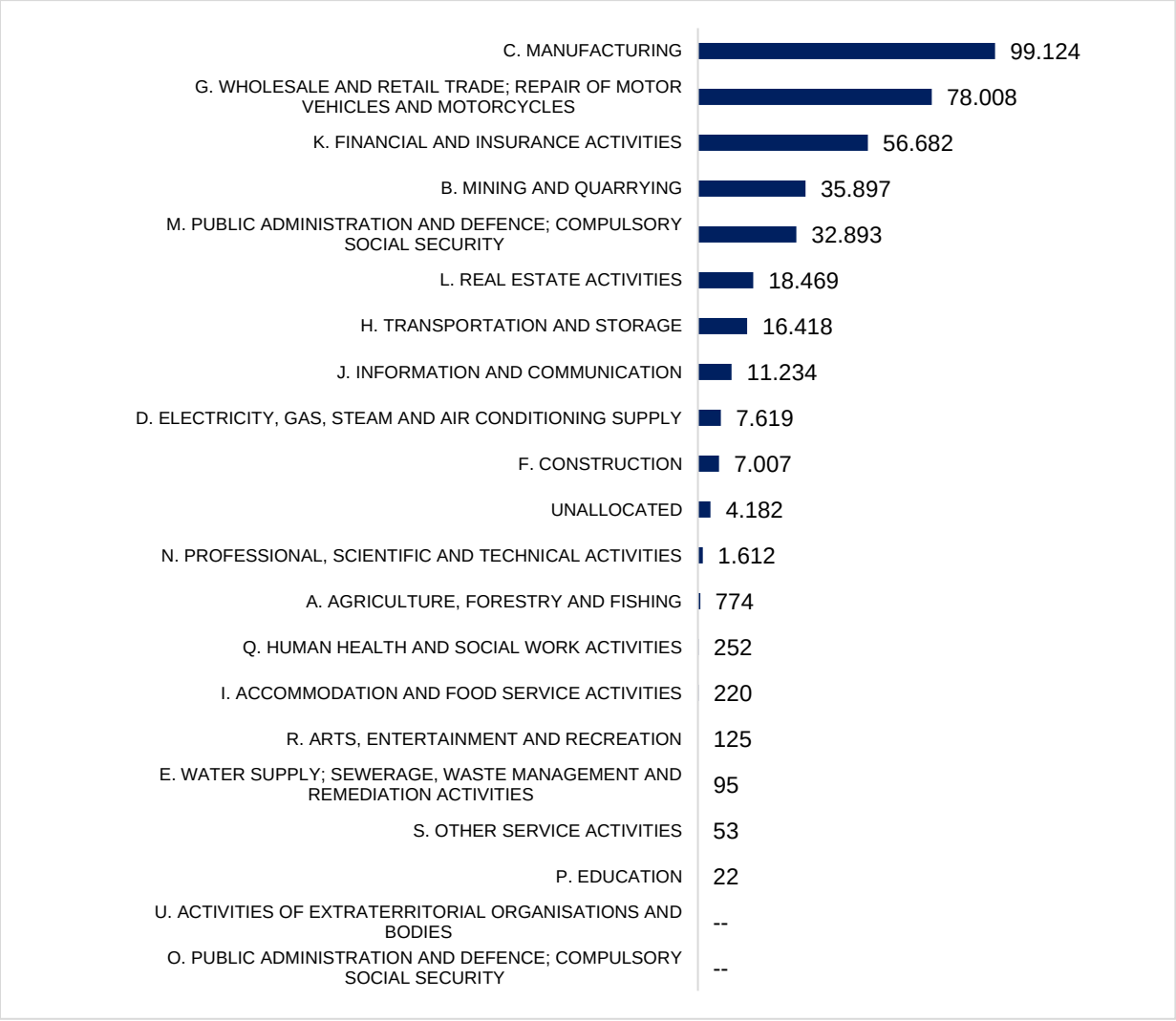
[460] Liuhto, K. (2018), *The economic relations between Cyprus and Russia*, available at: https://www.researchgate.net/publication/323143804_The_economic_relations_between_Cyprus_and_Russia, accessed on 22 October 2019.

[461] At least five leading Russian banks (VTB, Alfa Bank, AvoVAZbank, Privatbank, Promsvyazbank) have affiliates in Cyprus, as do numerous financial and investment affiliates of other Russian parent companies. See UNCTAD (2017), *Offshore orientation of Russian Federation FDI*, available at: https://unctad.org/en/PublicationChapters/diaeia2017d3a3_en.pdf, accessed on 22 October 2019.

[462] Liuhto, K. (2018), *The economic relations between Luxembourg and Russia*, available at: https://www.researchgate.net/publication/323779669_The_economic_relations_between_Luxembourg_and_Russia, accessed on 22 October 2019.

transportation and storage services (USD 16 billion), and information and communication sectors (USD 11 billion) (see Figure 7.5).

Figure 7.5: EU FDI stock in Russia, by industry, in million USD (2017)



Source: CBRF.

7.3 LAWS AND REGULATIONS GOVERNING INVESTMENT IN RUSSIA

The legislation regulating investments includes general rules that apply to both Russian and foreign investments, as well as rules that explicitly apply to foreign investors and often restrict foreign investment in certain sectors. Russian law indeed explicitly guarantees to foreign investors certain property rights to their investments in the Russia and to profits earned in Russia (see Section 7.3.2). Yet, several restrictions apply to foreign investors, particularly in sectors of strategic importance.

Laws that apply to both Russian and foreign investors generally aim to guarantee equal rights for both. Accordingly, foreign investors are generally subject to the same treatment as Russian

investors. Restrictions on business activities such as licensing, notifications and permission requirements generally apply to both Russian and foreign companies. In regulations on foreign investment, however, exemptions from equal treatment are permitted when it is deemed necessary to protect the Constitution, morality, health, human rights, and national security or defence, as well as for promoting the socio-economic development of Russia. In this respect, the Strategic Investments Law (see Section 7.3.2), with a declared objective to protect the country's defence capacity and state security '*establishes withdrawals of restrictive nature for foreign investors and for groups of persons which include a foreign investor when they participate in authorised capitals of economic companies which are of strategic importance for ensuring the country's defence capacity and state security*'. [463]

7.3.1 RULES APPLYING TO BOTH RUSSIAN AND FOREIGN INVESTMENTS

Rules applying to both Russian and foreign investments are stipulated in:

- The Civil Code;[464]
- The Federal Law on limited Liability Companies;[465]
- The Federal Law on joint-stock Companies;[466]
- The Federal Law on the State Registration of legal Entities and sole Proprietors;[467]
- The Federal Law on the Securities Market.[468]

These federal laws set out the general regulations for businesses and their organisational foundations, e.g. the legal requirements for the constituent documents (name, location etc.) and they regulate the general procedures for the establishment of legal entities, matters of corporate governance and state registration of legal entities. In addition, there are Russian antitrust rules contained in the Antimonopoly Law.[469]

7.3.2 RULES APPLYING TO FOREIGN INVESTMENTS

The main laws concerning foreign investors are the Foreign Investments Law[470] and the Strategic Investments Law.[471] The Foreign Investments Law is not applicable to foreign capital investments

[463] See Article 1 of Federal Law N.º 57-FZ, available at: http://www.rdbforum.com/uploads/files/Federal_Law_57.pdf, accessed on 22 October 2019. General information on the Foreign Investment Law is provided also by the Ministry for Economic Development, available at: http://en.smb.gov.ru/support/regulation/invest_law/, accessed on 22 October 2019.

[464] Available at: www.wipo.int/wipolex/en/text.jsp?file_id=385284, accessed on 24 January 2020.

[465] Federal Law N.º 14-FZ of 8 February 1998.

[466] Federal Law N.º 208-FZ of 26 December 1995.

[467] Federal Law N.º 129-FZ of 8 August 2001.

[468] Federal Law N.º 39-FZ of 22 April 1996.

[469] Federal Law N.º 135-FZ of 26 July 2006.

[470] Federal Law N.º 160-FZ of 09 July 1999 "*on Foreign Investments*", available at: https://www.wto.org/english/thewto_e/acc_e/rus_e/WTACCRUS58_LEG_41.pdf, accessed on 22 October 2019.

[471] Federal Law N.º 57-FZ of 29 April 2008 "*on the Procedure for Making Foreign Investments in Business Entities of Strategic Importance for the National Defence and Security of the Russian Federation*", available at: http://base.garant.ru/12160212, accessed on 8 May 2019.

in banks and credit organisations, insurance companies and non-commercial organisations (see Chapter 3 concerning the financial system).

The Foreign Investments Law provides basic guarantees for foreign investors regarding their rights, as well as profits generated in Russia. It guarantees a foreign investor's right to invest, gain income and profit, and the conditions for the commercial activities of foreign investors within Russian territory. The objective of the Law is to attract foreign investors by means of offering legal and economic stability.

At the same time, several restrictions on foreign investments are imposed by the Strategic Investments Law which regulates foreign investment in '*strategic entities*'. For companies that are of strategic importance to Russia (sometimes also called '*strategic companies*' or '*strategic entities*'), the Strategic Investments Law requires foreign investors to obtain prior clearance from the Government, or to submit a post-transaction notification after entering into certain transactions. In some cases, the Law even prohibits such investments.

Prior approval is required for transactions establishing control of foreign investors over companies of strategic importance. According to Article 4 on the Terms of transactions that establish control of foreign investors or a group of persons over the business entities of strategic importance:

> [t]*ransactions that result in establishing control of a foreign investor or a group of persons over the business entities of strategic importance are allowed upon a decision on preliminary approval of such transactions.*

Article 6 of the Strategic Investments Law lists the activities of strategic importance for national defence and state security (see Box 7.1). The list, entailing 42 types of strategic sectors of activity, includes:

- Natural resources, including activity affecting geophysical processes, geological exploration and recovery of natural resources, provided that such natural resources are located in a subsoil block deemed to be 'of federal importance';
- Defence, including activities connected with weapons and military equipment, radioactive materials, space, aviation and encryption, and security assessment and surveillance of infrastructure and means of transportation;
- Media, including television and radio broadcasting, and certain printing and publishing activities;
- Monopolies, including the activities of certain communications and railway companies (which have a dominant position in the Russian market), but also of various 'natural' monopolies.

Box 7.1: Sectors of strategic importance for national defence and state security

1. Works on modification of hydrometeorological processes and phenomena;
2. Works on modification of geophysical processes and phenomena;

3. Activities using agents of infection;
4. Setting-up, constructing, operating and decommissioning nuclear facilities, radiological sources, storage outlets for nuclear materials and radioactive substances, and nuclear waste storage;
5. Handling nuclear materials and radioactive substances, particularly in the exploration of uranium ores, and in the production, usage, processing, transportation and storage of nuclear materials and radioactive substances;
6. Handling radioactive waste during storage, processing, transportation and disposal;
7. Using nuclear materials and (or) radioactive substances for R&D;
8. Design and engineering of nuclear facilities, radiological sources, storage outlets for nuclear materials and radioactive substances, and nuclear waste storage;
9. Design and engineering of the equipment for nuclear facilities, radiological sources, storage outlets for nuclear materials and radioactive substances, and nuclear waste storage;
10. Expert examination of project, design and technological documentation and documents substantiating enforcement of the nuclear and radiation safety of nuclear facilities, radiological sources, storage outlets for nuclear materials and radioactive substances, nuclear waste storage, and handling nuclear materials, radioactive substances and radioactive waste;
11. Development and production of encryption (cryptographic) aids, or informational and telecommunication systems protected with encryption (cryptographic) aids that are subject to licensing;
12. Distribution of encryption (cryptographic) aids that are subject to licensing;
13. Engineering maintenance of encryption (cryptographic) aids that are subject to licensing;
14. Information encryption services;
15. Detecting electronic bugging equipment in the premises and technical devices (except if such activities serve the internal needs of a legal person);
16. Development, production, sales and purchasing for reselling special technical debugging equipment by legal persons involved in entrepreneurial activity;
17. Development of weapons and military equipment;
18. Manufacturing weapons and military equipment;
19. Repairing weapons and military equipment;
20. Disposal of weapons and military equipment;
21. Trading weapons and military equipment;
22. Manufacturing weapons and the main parts of firearms (except manufacturing cold steel, non-military and duty weapons);
23. Manufacturing shells and shell components (except manufacturing for non-military and duty weapons);

24. Trading weapons, the main parts of firearms, and shells (except trading cold steel, non-military and duty weapons and shells to non-military and duty weapons);
25. Development and manufacturing ammunition and components;
26. Disposal of ammunition and components;
27. Manufacturing explosive materials for industrial use and their distribution;
28. Enforcement of aviation security;
29. Space activities;
30. Developing aviation equipment, including dual-purpose equipment;
31. Manufacturing aviation equipment, including dual-purpose equipment;
32. Repairing aviation equipment, including dual-purpose equipment (except component repair by civil aviation organisations);
33. Testing aviation equipment, including dual-purpose equipment;
34. TV broadcasting to an area where 50% or more of the population of a constituent territory resides;
35. Radio broadcasting to an area where 50% or more of the population of a constituent territory resides;
36. Services offered by an economic entity which is included in the register of the subjects of natural monopolies in the sectors specified in Article 4 (1) Federal Law No. 147-FZ of 17 August 1995 on natural monopolies, except the subjects of natural monopolies in publicly accessible electric communications, publicly accessible postal services, services for heat energy transmission and electric power transmission through distribution networks;
37. Activities exercised by an economic entity which is included in the register, specified in Article 23 of the Antimonopoly Law and has a dominant position:

    a) within the geographic boundaries of Russia in the communications market (except internet access services);

    b) in the market of fixed telephone communications in five or more constituent territories;

    c) in the market of fixed telephone communications within the geographic boundaries of the cities with federal status;
38. Activities exercised by an economic entity that has a dominant position in the production and sales of metals and alloys with special qualities used for manufacturing weapons and military equipment;
39. Geological survey and (or) exploration and production of natural resources in subsurface areas with federal status;
40. Harvesting (catching) aquatic biological resources;
41. Printing activities exercised by an economic entity with the capacity to print at least 200 million print-sheets per month;

42. Editing and (or) publishing a periodical print publication with a circulation at least 1 million copies for each issue.

7.3.3 PROCEDURE FOR OBTAINING APPROVAL FOR INVESTMENT IN STRATEGIC SECTORS

Russia's investment control regime requires prior clearance for foreign investments in strategic entities.[472] Foreign investors are required to notify the FAS on any acquisition (direct or indirect) of 5% or more of the shares or participatory interests in a strategic entity. Failure to satisfy this obligation may result in the annulment of the investor's rights in respect of that entity. Following a reform of the Foreign Investment Law in 2017, the Government can decide whether a transaction by a foreign investor in respect of any business entity incorporated in Russia is subject to a prior approval even if such transaction does not involve any strategically important Russian entity (see Section 7.3.5). For strategic entities, the affected sectors as well as the procedural requirements are outlined mainly in Articles 8 to 13 of the Strategic Investments Law.

In order to obtain the approval for a planned transaction, a foreign investor must submit an application to the FAS. The approval procedure for applications consists of two stages: 1) the initial review of the application by the FAS and 2) if the FAS decides that the application requires further assessment, it is ultimately passed to the Commission on Monitoring Foreign Investment (sometimes referred to as the Commission on the Control of Foreign Investment), headed by the Prime Minister and consisting of representatives of various state bodies, e.g. the Head of the FAS, the Minister of Economic Development, the Minister of Natural Resources and Environmental Protection and others.[473] Based on the initial FAS assessment, the Commission reviews applications and decides whether to approve or reject the proposed transaction. Additional state authorities, such as the Federal Security Service, the Ministry of Defence, and the Commission on the Protection of State Secrets may be also involved in the assessment of the overall effect of the transaction in question.[474]

The FAS will pass on applications to the Commission:

- If it determines that the overall effect of the transaction establishes control over an entity in a strategic sector; or
- Where no control would be established, but as a result of the transaction a public foreign investor would gain (directly or indirectly):

[472] Jones Day (2018), *Foreign Investment Control Heats Up: A Global Survey of Existing Regimes and Potential Significant Changes on the Horizon*, available at: https://www.jonesday.com/files/upload/Foreign%20Investment%20Control%20Heats%20Up.pdf, accessed on 22 October 2019.

[473] The Commission's structure, as well as a list of its member is available at: http://government.ru/en/department/8/members/, accessed on 22 October 2019.

[474] Government Commission on Monitoring Foreign Investment, available at: http://government.ru/en/department/8/about/, accessed on 22 October 2019.

- More than 25% of the voting shares in a strategic entity or another right to block decisions of the management bodies of the strategic entity; or
- More than 5% of the voting shares in a subsoil strategic entity.

Formally, the review process should be completed within three months from the date the FAS registers the filing of the application. In some cases, the Commission can extend the deadline for additional three months. In practice, the entire review process takes up to nine months, partially because of the fact that the Commission holds meetings irregularly (only three to four times a year).[475]

7.3.4 DISCRETION REGARDING APPROVAL CRITERIA FOR FOREIGN INVESTMENT IN SECTORS OF STRATEGIC IMPORTANCE

Neither the Strategic Investments Law nor the secondary legislation establish any specific criteria the Commission should apply when assessing an application. As a general rule, however, a transaction will only be approved if it does not, as a whole, in the opinion of the Commission, constitute a potential threat to Russian defence or other security interests.[476] According to the FAS, between 2008 and 2017 the Commission received 484 applications for foreign investment, of which 229 were reviewed. Of those, the Commission granted preliminary approval for 216 cases (94% approval rate) but refused 13 cases. Among these cases feature Telenor's acquisition of voting shares of VimpelCom, OJSC Astrakhan Port's shares acquisition and acquisition of Petrovax Farm by Abbott Laboratories. The FAS also found that 193 applications did not require approval.[477]

However, the lack of specific criteria that the Commission should apply opens the door for political interference, given in particular that applications can be denied on various grounds and there is no express requirement for the Commission or the FAS to state the reasons for rejecting an application.[478]

7.3.5 AMENDMENTS TO RUSSIA'S LEGISLATION ON FOREIGN INVESTMENTS IN 2017

[476] Clifford Chance (2014), *A Legal Overview of Foreign Investment in Russia's Strategic Sectors*, available at: https://www.cliffordchance.com/briefings/2014/05/a_legal_overviewofforeigninvestmenti.html, accessed on 22 October 2019.

[477] FAS (2018), *Andrey Tsyganov: Attracting foreign investment is not an event, but an ordinary practice and constant work*, available at: https://fas.gov.ru/content/interviews/2228, accessed on 26 February 2020. Kaufmann S. and Abdulmenov A. (2017), *Significant amendments to the regulation of foreign investments in Russia introduced*, available at: https://www.dlapiper.com/ru/russia/insights/publications/2017/08/russia-amends-foreign-investments-regulations, accessed on 26 February 2020. Jones Day (2018), *Foreign Investment Control Heats Up*.

[478] Clifford Chance (2014), *A Legal Overview of Foreign Investment in Russia's Strategic Sectors*.

On 18 July 2017, two amendments to Russia's legal regime on investment entered into force following the adoption of Federal Law No. 165-FZ.[479] Both amendments, those related to the Foreign Investments Law, as well as to the Strategic Investments Law, increased the Government's discretionary power to oversee and/or veto certain types of domestic and foreign investment transactions. The most significant of the changes is a new regulatory regime that can require governmental approval for any transaction that a foreign investor has entered into with respect to any Russian legal entity, potentially even after the transaction has been completed. The areas where approval is necessary have been expanded. The amendments are reflected in Article 6 of the Foreign Investments Law.[480]

Under the amended law, if the Prime Minister so determines '*with the view of securing national defence and security of the state*', the Commission on Monitoring Foreign Investment can decide to review any transaction entered into by a foreign investor with respect to any Russian legal entity. That review could result in the Commission prohibiting the transaction.

The amendments to the Foreign Investments Law:[481]

- Grant the Government discretionary power to decide whether a transaction by a foreign investor in respect of any business entity incorporated in Russia is subject to prior governmental control in accordance with the procedure set forth by the Strategic Investments Law, even if such transactions do not involve any strategically important Russian entity;
- Stipulate that such transactions completed in the absence of prior clearance are null and void and may be subject to consequences set out by the Strategic Investments Law.[482]

The amendments came into force on 30 July 2017. According to the amended Law, the Chairman of the Commission may '*for the purposes of procuring the state defence and security*', at his or her sole discretion, request prior clearance of transactions being made by a foreign investor in respect of Russian business entities (i.e. joint-stock companies and limited liability companies). If the Chairman so decides, the FAS should, within three business days following the receipt of Chairman's decision, give a notice to the foreign investor that the respective transaction is subject to prior approval by the Commission in accordance with the procedure established by the FAS.

[479] Federal Law N.º 165-FZ of 18 July 2017 "*on Amendments to Article 6 of the Federal Law 'on Foreign Investments in the Russian Federation' and the Federal Law 'on the Procedure for Making Foreign Investments in Economic Societies that are of Strategic Importance for Ensuring the Defence of the Country and State Security'*", available at: https://rg.ru/2017/07/21/investicii-dok.html, accessed on 22 October 2019.

[480] *Ibidem*.

[481] For a summary, see Cleary Gottlieb (2017), *Further Significant Amendments to the Russian Legislation on Foreign Investments: Transactions Made by Foreign Investors in Respect of Russian Businesses Became Subject to Discretionary Governmental Control*, available at: https://www.clearygottlieb.com/~/media/organize-archive/cgsh/files/2017/publications/alert-memos/transactions-by-foreign-investors-in-respect-of-russian-businesses-8-7-17.pdf, accessed on 22 October 2019.

[482] In certain circumstances, the FAS may also claim in court that a foreign investor and/or entities controlled by it be deprived of their voting rights in respect of equity interests in the Russian entity. Other consequences provided in Article 15 of the Strategic Investments Law may also be applied to such transaction.

The amendments to the Strategic Investments Law:[483]

- Narrowed the scope of its application in certain respects by stipulating that Law does not apply to transactions made by acquirers controlled by Russia, its constituent entities or Russian citizens;
- Extended the list of strategic activities to: 1) activities related to the use of nuclear energy for peaceful purposes; 2) activity of electronic trading platform operators within the contracting system of public procurements; and 3) production and sale of special metals and alloys used in weapons and military equipment manufacturing;
- Made the list of restrictions and obligations that the Commission on Monitoring Foreign Investment can impose on foreign investors of the target entity as a condition of clearance open-ended (prior to the amendments, the Strategic Investments Law contained an exhaustive list of restrictions and obligations that the Commission could impose as a condition for clearance);
- Set forth that foreign investors that fail to notify acquisitions of 5% or more equity interest in a company in a strategically important sector may be deprived of their voting rights;
- Provide that offshore companies or investors controlled by an offshore company are now effectively treated as foreign investors. Such entities may not acquire control over a strategic company or own, hold or use the main operational assets of a strategic company if the value of such assets is 25% or more of the strategic company's total assets. The notion of control includes owning more than 50% of the voting shares of the strategic company but may capture a less than 50% shareholder that affords effective control.[484]

In addition to these amendments, on 1 July 2017, the President signed into law amendments to Federal Law No. 178-FZ of 21 December 2001 on privatisation of state and municipal assets, aimed at its de-offshorisation.[485] According to the amendments, offshore companies established in 40 (non-EU) jurisdictions are banned from purchases of Russian State or municipality owned assets in privatisation sales and from acquisition of control over Russian strategic companies (or their assets). The amendments are part the Russian de-offshorisation legislation, which also implements the Multilateral agreement on the automatic exchange of tax information.[486] Certain jurisdictions, which are often used for corporate holdings of Russian businesses, such as Cyprus, Luxemburg and the Netherlands, are not on this list.

7.3.6 PROTECTION OF COMPETITION AND MERGER CONTROL

[483] Article 3(2), Article 6, Article 9 (2), Article 10(1), Article 12 and Article 15 were amended.

[484] For example, a 40% shareholding in a public company that otherwise has a broad diversified shareholder base with no other major shareholder.

[485] For a summary, see Cleary Gottlieb (2017), *Offshores Restricted from Participation in Privatizations and Acquisitions of Russian Strategic Companies*, available at: https://www.clearygottlieb.com/-/media/organize-archive/cgsh/files/2017/publications/alert-memos/offshores-restricted-from-participation-in-privatizations-and-acquisitions-of-russian-7-10-17.pdf, accessed on 22 October 2019.

[486] The Multilateral agreement on the automatic exchange of tax information. Available at: https://read.oecd-ilibrary.org/taxation/the-multilateral-convention-on-mutual-administrative-assistance-in-tax-matters_9789264115606-en#page3, accessed on 22 October 2019.

The Antimonopoly Law defines its main objective in its Article 1 as protection of competition including on the one hand, prevention and restriction of monopolistic activity and unfair competition, and on the other hand, prevention, restriction, elimination of competition by federal executive authorities and othe public authorities exercising the functions of the State. The control over compliance with the antimonopoly legislation is entrusted with the FAS,[487] an authorized federal executive body directly subordinated to the Government, without being part of it. Apart from this general task, the FAS has also specific competences in selected areas, such as the legislation in the field of natural monopolies, price regulation, public procurement or foreign investments in business entities of strategic importance for the Russian national defence and state security.[488]

More specifically, the Antimonopoly Law contains special rules applying to investment, such as transactions that involve financial organisations and natural monopolies, namely those on merger control in the commodity and financial markets concerning transactions in which the targets are:

- Russian entities; or
- Foreign entities operating in Russia (including those that do not have physical presence there).

Generally, under the Russian competition law, the legal test for clearance is competition related. However, political considerations may have an impact on the review process. According to some sources '*public interest seems to be taking on increased importance in the review process*'.[489] Some transactions related to certain strategic sectors seem indeed to have given rise to political rather than competition-related considerations in the past. In some cases, clearance was denied or made conditional on behavioural commitments, or the approval process took much longer than usual. In practice, assessments are made by the FAS in cooperation with other Government authorities, including those supervising the relevant markets, however, there are no formal tests applied with respect to the question whether or not a deal gives rise to political or public interest concerns.[490]

7.3.7 LOCAL PARTNER AND TECHNOLOGY TRANSFER REQUIREMENTS

Following an OECD analysis, Russia does not formally apply 1) joint-venture requirements in specific sectors, 2) requirements regarding the transfer of technology to the local partner in the joint-venture, 3) reviews of FDI on the basis of potential technology-related benefits, 4) requirements to submit IPR-related information to the regulator to gain FDI approval, or 5)

[487] According to Article 22 of the Antimonopoly law.
[488] See: http://en.fas.gov.ru/about/what-we-do/general-information.html, accessed on 3 March 2020.
[489] GTDT (2018), *Merger Control in Russia*, available at: https://gettingthedealthrough.com/area/20/jurisdiction/26/merger-control-2019-russia/, accessed on 22 October 2019.
[490] See also OECD (2017), *Annual Report on Competition Policy Developments in the Russian Federation*, available at: https://one.oecd.org/document/DAF/COMP/AR(2018)26/en/pdf, accessed on 06 May 2019.

business licences conditional on the technological benefits of the project undertaken.[491] However, in practice joint-venture obligations implicitly arise from the Strategic Investments Law for strategic sectors. Regarding technology transfer, FAS has been recently considering expanding its regulatory toolkit by imposing technology transfer requirements (see below on the Bayer/Monsanto case).

Investors from abroad are generally not subject to joint-venture regulations. Foreign investors in Russia can generally choose from a range of different forms of business representation, e.g. Russian legal entities, representative offices or branches of foreign legal entities. Russian legal entities may be established in different forms such as joint-stock companies, limited liability companies and partnerships. Exceptions apply, as discussed above in Section 7.3.2, in strategic business sectors, for which joint ventures are an implicit requirement. For example, a maximum foreign ownership cap of 20% applies to mass media companies,[492] which, according to a ruling by the Constitutional Court of Russia in January 2019, is a legitimate restriction.[493] Under the law, foreigners are not allowed to directly own shares in a Russian mass media/broadcasting entity or control the editorial content of Russian mass media. Foreign ownership caps also apply to insurance companies and banks (see Chapter 3). As of writing of this report, foreign banks and insurance companies cannot directly operate in the Russian market. However, they can be represented in Russia by their subsidiaries (affiliated companies), which are separate legal entities fully regulated by the Russian legislation. However, from 22 August 2021 insurance companies will be allowed to operate in Russia through their branches.[494]

Foreign investors engaged in the exploration and production of subsoil fields are also subject to specific rules (see Section 7.4.1.).

Political considerations may play a greater role in the future assessment of foreign investment and mergers and acquisitions in Russia. In the recent Bayer/Monsanto case (closed on 7 June 2018), for example, the FAS came to the conclusion that the transaction might have a negative impact on the Russian agricultural technologies market. The FAS finally approved the transaction pursuant to Article 33(2)(1) of the Antimonopoly Law,[495] but at the same time ruled that Bayer must transfer

[491] Kowalski, P., Rabaioli, D., and Vallejo, S. (2017), *International Technology Transfer measures in an interconnected world: Lessons and policy implications*, OECD Trade Policy Papers, No. 206, OECD Publishing, Paris.

[492] See amendments to article 19.1 of Law N.º 2124-1 of 27 December 1991 on Mass Media, available at: http://www.policy.hu/myagmar/Russian_Mass_Media_Law_I.PDF, accessed on 22 October 2019.

[493] The Moscow Times (2019), *Restricting Foreign Ownership of Media Is Legal, Russia's Top Court Rules*, available at: https://www.themoscowtimes.com/2019/01/17/restricting-foreign-ownership-media-legal-russias-top-court-rules-a64178, accessed on 22 October 2019.

[494] *Foreign insurers will be able to open branches in the Russian Federation from August 2021*, available at: https://tass.ru/ekonomika/4862539, accessed on 18 March 2019.

[495] Nadmitov, Ivanov and Partners (2018), *Review of the decision of the FAS to extend the period for considering the application of Bayer AG to review the acquisition of a 100% stake in Monsanto Company*, available at: http://en.nadmitov.com/work/russian-fas-agreed-on-the-merger-of-bayer-and-monsanto-for-66-billion/, accessed on 2 December 2019.

the know-how relating to molecular selection tools and the germplasm for selected crops necessary to create highly productive seeds. According to the FAS, in February 2019, top executives of the Technology Transfer Centre, an institutions in charge of facilitating and monitoring the technology transfer to Russian entities, had a meeting with representatives of companies that can be potential transferees of molecular selection means and germplasms.[496] In addition, the FAS required Bayer to grant Russian companies access to some of its software and technology solutions so that Russian companies could potentially compete with foreign companies on equal terms.[497]

In short, in the Bayer/Monsanto case the FAS decided to use a set of new legal mechanisms[498] such as 1) the transfer of technologies (instead of imposing traditional behavioural or structural remedies that are used in most of the cases with competition concerns) and 2) the creation of an institution of independent trustees to monitor the transfer of technologies and obligations imposed on the parties. The provisions of the Bayer/Monsanto decision are based on the National Strategy for Scientific and Technological Development of the Russian Federation, the Agrotechnology Foresight 2030, the Federal Programme for Scientific and Technological Development of Agricultural Sector for 2017–2025, and the Federal Targeted Programme on Digital Economy.

The FAS argued:

> *As the most balanced solution meeting objectives of competition protection and not creating impassable obstacles to the proposed transaction, it was chosen to establish behavioural remedies aimed at creating conditions for the development of potential competition from the side of the Russian companies by providing them with an effective transfer of technology available for and specific to agro-climatic conditions in Russia in combination with granting access to data and knowledge required for the development of the new varieties/hybrids of key crops within which the Russian market mostly depends on the import of genetic materials, as well as to solutions in the field of digital farming.*[499]

Moreover, Russian authorities are likely to increase in the future the use of behavioural remedies. As the digitalisation of the economy advances in Russia, affecting all sectors of the economy

[496] FAS (2019), *The purpose of FAS 'Bayer' order is to create conditions for developing Russian selection business*, available at: http://en.fas.gov.ru/press-center/news/detail.html?id=53867, accessed on 22 October 2019.

[497] FAS (2018), *The FAS Russia Approved the Bayer/Monsanto Deal*, available at: https://en.fas.gov.ru/press-center/news/detail.html?id=52952, accessed on 22 October 2019. See also GTDT (2018), *Merger Control in Russia*, available at: https://gettingthedealthrough.com/area/20/jurisdiction/26/merger-control-2019-russia/, accessed on 22 October 2019

[498] FAS (2018), *Russia agrees deal on Bayer and Monsanto merger*, available at: https://fas.gov.ru/news/24815, accessed on 22 October 2019.

[499] FAS (2018), *Russia applies access and behavioural remedies in the Bayer/Monsanto merger*, available at: https://en.fas.gov.ru/press-center/news/detail.html?id=52417, accessed on 22 October 2019.

greater Government intervention is likely for companies whose business models utilise digital platforms, network effects and companies facilitating algorithms and big data.

7.3.8 LICENSING REQUIREMENTS

The Federal Law on Licensing of Certain Types of Activity[500] regulates relationships between federal executive bodies, the executive bodies of Russian regions, legal entities and individual entrepreneurs in connection with the licensing of specific types of activities. According to Article 17 of the Law, more than 100 types of activities shall be subject to licensing. The list of sectors covers a wide range of manufacturing and services sectors (see Annex 7.1). Licences and permits are granted by federal and local authorities.

7.4 SECTOR-SPECIFIC RESTRICTIONS

In addition to the horizontal regulations, there are at least 16 sectoral legislative acts which have an impact on foreign investment in Russia. These laws affect several parts of the economy, e.g. financial services, the chemical industry and the raw materials sector. This section outlines the key legislative features of these sectoral policies, which often constitute barriers to trade and investment. Annex 7.2 provides examples of sector-specific restrictions for the production of chemicals, medicines, the real estate sector, banking services, telecommunication services, agriculture, R&D, as well as electricity production.[501]

7.4.1 EXTRACTION AND RAW MATERIALS

The Constitution contains general norms on natural resources. Natural resources are considered strategic assets that fall within the joint jurisdiction of the federal authorities and the regional authorities at the location of the deposit. According to Article 9 of the Constitution, '[l]*and and other natural resources shall be utilised and protected* […] *as the basis of life and activity of the people living in corresponding territories*', whereby '[l]*and and other natural resources may be in private, state, municipal and other forms of ownership*'.

The relevant laws related to activities associated with the extraction of oil and the mining of minerals are:

– The Law on Subsoil of 21 February 1992 (the Subsoil Law);[502]

[500] Federal Law N.º 99-FZ of 4 May 2011 "*on Licensing Certain Types of Activities*", as amended, available at: http://www.consultant.ru/document/cons_doc_LAW_113658/, accessed on 22 October 2019.

[501] Global Trade Alert database on investment restrictions, available at: https://www.globaltradealert.org, accessed on 22 October 2019.

[502] Law N.º 2395-1 of 21 February 1992 "*on Subsoil*", as amended, available at: http://cis-legislation.com/document.fwx?rgn=1494, accessed on 22 October 2019.

– The Federal Law on Precious Metals and Precious Stones;[503]
– The Federal Law on Production Sharing Agreements of 30 December 1995;[504]
– The Strategic Investments Law.

In addition, several environmental protection laws apply.

The Government can restrict the participation of Russian entities in which foreign investors directly or indirectly hold shares in any auction or tender for the right to subsoil use of a deposit of federal significance. Furthermore, the Strategic Investments Law (see Section 7.3.2) regulates access of foreign investors to the mining industry. It essentially grants privileges to Russian companies that play key roles in the sector and restricts foreign firms from developing large or strategic deposits.

Foreign investors must obtain the prior consent of the Commission on Monitoring Foreign Investment if they seek to acquire control in a company that holds a subsoil licence for a deposit of federal significance (see Article 6 of the Strategic Investment Law). Like for strategic entities in general, control for the subsoil sector is defined as either *(i)* ownership of 25% or more of voting shares or *(ii)* a right to appoint an individual executive body or 25% or more of the members of the management bodies or *(iii)* an ability to otherwise control the decisions of the strategic company (Article 2(3) of the Strategic Investments Law).

Amendments to the Foreign Investments Law and the Strategic Investments Law from December 2011 broadened the scope of investments that foreigners can carry out in Russian strategic companies dealing with the exploration and extraction of minerals and relaxed the limits on foreign investments in strategic industries. The amendments:
– Lifted the ceilings of foreign ownership in certain sectors;
– Eliminated the requirement to obtain governmental approval for acquisitions of (direct or indirect) control of up to 25% of shares of companies that develop federal subsoil resources (the previous limit was 10%);
– Exempted international financial organisations in which the Government is a stakeholder from certain approval requirements;
– Stripped companies in certain sectors of their status as strategic companies for the purpose of the application of foreign investment rules.

For companies engaged in strategic activities other than the use of federal subsoil plots, i.e. companies engaged in geological studies of subsoil and/or mineral exploration (Article 6 of the

[503] Federal Law N.º 41-FZ of 26 March 1998 "*on Precious Metals and Precious Stones*", available at: https://www.wto.org/english/thewto_e/acc_e/rus_e/WTACCRUS48A5_LEG_58.pdf, accessed on 22 October 2019.
[504] Federal Law N.º 225-FZ of 30 December 1995 "*on Production Sharing Agreements"*, available at: https://www.wto.org/english/thewto_e/acc_e/rus_e/WTACCRUS48_LEG_76.pdf, accessed on 22 October 2019.

Strategic Investments Law), the preliminary consent of the Government is required when the foreign investors acquire:

- More than 50% (directly or indirectly) of the total number of votes at shareholder level;
- The right to appoint *(i)* the chief executive officer, and/or *(ii)* more than 50% of the members of a collegial executive body of the strategic company;
- The unconditional ability to elect more than 50% of the members of the board of directors (supervisory council) or other collegial governing body of the strategic company.

If the investors are controlled by foreign governments or are established in certain offshore jurisdictions, special rules apply: prior approval is required for all transactions that would allow the acquisition, directly or indirectly, of 25% or more of voting shares, or similar blocking rights over any Russian entity whether strategic or non-strategic. In addition, the Strategic Investment Law completely prohibits a state-owned foreign investor from gaining control over a strategic entity.

In 2017, the restrictions for foreign extraction and mining companies were tightened. Under the amendments to the Strategic Investments Law introduced in July 2017 (see Section 7.3.3), Russian authorities can require any transaction by a foreign investor to be approved under the same procedure as for strategic companies, if such approval is deemed to be required to ensure national defence or state security. Moreover, the Government can also restrict the participation of Russian entities in which foreign investors directly or indirectly hold shares in any auction or tender for the right of subsoil use of a deposit of federal significance.[505]

7.4.2 TELECOMMUNICATIONS AND DATA LOCALISATION

The federal regulations establish restrictions on foreign investors and groups of persons that include a foreign investor on their participation in the authorised capital of the business entities of strategic importance for the country's defence and state security. Article 3(2) of the Strategic Investments Law refers in that respect to the strategic enterprises included in the register provided by the Antimonopoly Law (see Section 7.3.6.) and occupying a dominant position:

- On the Russian territory in the market of communication services (except internet access services);
- In the territories of five or more constituent entities (regions) in the market of fixed telephone services; or
- Within the geographical boundaries of cities of federal significance in the fixed telephony market.

[505] Law N.º 2395-1 of 21 February 1992, as amended, "*on Subsoil*", available at: http://cis-legislation.com/document.fwx?rgn=1494, accessed on 22 October 2019.

The prior approval by the FAS is necessary for any transaction by which a foreign investor acquires control over such business entities in the telecommunication sector. In addition, licences are required for such activities as the provision of communication services or television broadcasting.

Furthermore, since September 2015, the Russian data localisation law[506] requires companies operating in the country to store Russian users' or clients' personal data on servers physically located in Russia.[507] According to Article 18(5) of the Law, a personal data operator is obliged to ensure recording, systematisation, accumulation, storage, clarification (updating, modification) and extraction of the personal data of Russian citizens using databases located in the Russian territory. The Government states that this requirement was enacted to prevent the illegal use of Russian citizens' personal information and to protect their constitutional rights to privacy, personal and family secrets. The law has significant implications for companies that collect personal information from Russian citizens, even if those companies do not have any physical presence within Russia.

The legal requirements on the governance of personal data can create significant costs for companies that do business in Russia. Compliance with this Law, for example, requires the involvement of lawyers and ICT specialists to create systems and policies for dealing with personal data. Companies that already conduct business activities in Russia need to review their database content and their systems for dealing with personal data in Russia.

Some stakeholders argue that data localisation laws impede cross-border data flows, which are crucial for ICT and non-ICT sectors.[508] Several studies conclude that data localisation policies raise businesses' costs and thus have a negative impact on business activity and investment.[509] In addition, data localisation policies, particularly those adopted in jurisdictions characterised by high levels of corruption (perception) and low indicators regarding the quality of governmental

[506] Federal Law N.º 242-FZ of 21 July 2014 "*on Amendments to Certain Legislative Acts of the Russian Federation regarding the Clarification of the Procedure for Processing Personal Data in Information and Telecommunication Networks*", available at: http://wko.at/ooe/Branchen/Industrie/Zusendungen/FEDERAL%20LAW2.pdf, accessed on 8 May 2019.

[507] Proskauer (2015) provides a summary of major implication for businesses, available at: https://privacylaw.proskauer.com/2015/08/articles/international/a-primer-on-russias-new-data-localization-law/, accessed on 22 October 2019. Another summary with respect to the implications for businesses is provided by Financierworldwide (2017), available at: https://www.financierworldwide.com/how-to-comply-with-the-russian-requirements-on-localisation-of-personal-data#.XJpaBS2ZOqA, accessed on 22 October 2019.

[508] Business Europe (2014), *Forced localisation - Letter from Markus J. Beyrer to Jean-Luc Demarty*, available at: https://www.businesseurope.eu/sites/buseur/files/media/imported/2014-00930-E.pdf, accessed on 22 October 2019.

[509] See, e.g., Leviathan Security Group. (2015), *Quantifying the Cost of Forced Localization*, available at: https://static1.squarespace.com/static/556340ece4b0869396f21099/t/559dad76e4b0899d97726a8b/1436396918881/Quantifying+the+Cost+of+Forced+Localization.pdf, accessed on 22 October 2019; Brookings Institution (2018), *Regulating for a digital economy, understanding the importance of cross-border data flows in Asia*, available at: https://www.brookings.edu/wp-content/uploads/2018/03/digital-economy_meltzer_lovelock_web.pdf, accessed on 22 October 2019.

institutions, can have a negative impact on investor trust. Accordingly, Russia's data localisation law is likely to have caused a dampening effect on Russian inward-FDI since its adoption in 2014.

7.4.3 METALLURGICAL PRODUCTION

The Strategic Investments Law (see Section 7.3.2) considers '*activities exercised by an economic entity that has a dominant position in the production and sales of metals and alloys with special qualities used for manufacturing weapons and military equipment*' as activities of strategic importance. Accordingly, several investment-related restrictions apply for foreign investors and groups of persons that include a foreign investor regarding their participation in the authorised capital of business entities.

According to Article 4 of the Strategic Investments Law, transactions involving the establishment of control of a foreign investor over a business entity of strategic importance should be carried out with the consent of the FAS. This provision is burdensome for foreign investors. Metallurgical companies, which in addition to the production and sale of metals and alloys with special properties used in the manufacture of weapons and military equipment, (can) produce metals and alloys that are not sensitive, also face difficulties in attracting foreign investment. These difficulties mostly relate to the process of justification and approval by the FAS (see Section 7.3.6).

7.4.4 ELECTRICITY, GAS AND STEAM, AIR CONDITIONING

According to the Federal Law on Gas Supply in the Russian Federation (see Chapter 10),[510] when buying and selling shares of the owners of regional gas supply systems,[511] the share of foreign citizens or foreign organisations cannot exceed 20% of the total number of ordinary shares of the owners of these systems. The total sum of shares of the owners of the Unified Gas Supply System (see Section 10.2.2) cannot exceed 50%, whereas the other 50% of shares must belong to the Government. Moreover, gas transportation in a pipeline is a type of activity that is of strategic importance for ensuring the country's defence and state security in accordance with the Strategic Investments Law (see Section 7.3.6).

7.5 IMPACT OF RUSSIA'S LEGISLATION AND ITS IMPLEMENTATION ON INVESTMENT

There is very little company-specific information available pointing to discriminatory treatment by the Government and relevant surveys and survey data are not available either. However, ownership requirements and the obligation to submit confidential data for approval, particularly in

[510] Federal Law N.º 69 FZ of 31 March 1999 "*on Gas Supply in the Russian Federation*", available at: base.garant.ru/180285/, accessed on 26 July 2019.

[511] There is a single gas supply system in Russia, which covers most of Russian territory. However, there are extra separate main gas pipelines in the Far East of Russia: 'Sakhalin–Khabarovsk–Vladivostok', 'Sobolevo–Petropavlovsk–Kamchatsky', which are operated by the Gazprom Group (for more details see Chapter 10).

sectors of strategic importance, as well as the burdensome approval procedures for investments in Russia may have had a deterrent effect on the investment decisions of foreign investors.

The restrictiveness of Russia's foreign investment regulations needs to be put into perspective by looking at regulations applied by other countries. Generally, foreign investment regulations are also common outside Russia. However, industry data indicate that Russia's investment regime creates market structures in many industries, which are characterised by high levels of market concentration and high levels of SOE participation. Barriers for foreign companies decrease the contestability of existing market dominant positions by potential competition and have a negative impact on price discovery processes.

Moreover, sanctions and counter-sanctions politics (see Chapter 6) resulted in the emergence of extra regulations in Russia, which caused foreign investors to leave the country. These restrictions mainly extended the number of strategic areas and decision-making process on FDI permission. The overall outflow of capital from the country, which can to a significant extent be attributed to the sanctions, in 2015 exceeded USD 22 billion, which accounted for about 1.5% of Russia's GDP.[512] According to estimates, sanctions and relevant regulations caused investments to decrease by 5%, whereas the decline in oil prices resulted in a 24% FDI reduction during the period 2014–2017.[513]

Restrictions to foreign ownership, particularly in sectors deemed strategic by the Government (e.g. equity caps) can disincentivise FDI and therefore effectively prevent investment-induced competition. However, it is difficult to attribute the investment-related policies to specific sectoral outcomes in the Russian economy as markets are regulated by a number of additional policies that impact on business activities. In fact, several other policies, such as preferential treatment for SOEs or SOE subsidiaries in public procurement, subsidies and preferential tax treatment,[514] actually contribute to low levels of intra-industry competition, low rates of innovation and high levels of economic inefficiencies across sectors in Russia (see also Chapters 4 and 5).

7.6 CHAPTER SUMMARY

Since 2009, several legislative measures have contributed to an improvement in Russia's investment climate (see Section 7.2). Yet, Russia's regime for investment is still heavily regulated. A number of horizontal regulations are in place and investment in certain industries is also

[512] Zajcev Yu. K., Knobel' A.Yu. (2018), Pryamye inostrannye investicii v pervom polugodii 2017 (*Foreign direct investment in the first half of 2017*).) g, *Ekonomicheskoe razvitie Rossii*. N.º 1, S. 7-11 (In Russian), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3093229, accessed on 24 January 2020.

[513] Gurvich,E., Ilya Prilepskiy, I. (2015), *The Impact of financial sanctions on the Russian economy*, *Russian Journal of Economics* 1, pp. 359–385.

[514] PONARS (2017), *Monopolies Rising – Consolidation in the Russian Economy*, PONARS Eurasia Policy Memo N.º 491, available at: http://www.ponarseurasia.org/sites/default/files/policy-memos-pdf/Pepm491_Szakonyi_Memo_Nov2017.pdf, accessed on 22 October 2019.

governed by sector-specific policies which tend to be burdensome for foreign investors, for instance with respect to private investment in commodities, telecommunications and financial services.

The Government generally aims for fair and equitable treatment of foreign investors (see Section 7.3). Accordingly, foreign investors are allowed to make investments in various forms, unless specifically prohibited. Yet, several restrictions apply for foreign investment in sectors of strategic importance, mainly sectors critical to defence, national security and consumer safety, including certain manufacturing sectors, healthcare and communication services, as well as the exploration and extraction of minerals (see Section 7.3.2). For these sectors, the Government operates an investment control regime, whereby foreign investors are required to obtain prior clearance for specific types of investment (see Sections 7.3.3 and 7.3.4). However, neither the Law on Strategic Investments nor secondary legislation establish any specific criteria to be applied by the Government bodies when assessing an application from a foreign investor. At the same time, jurisprudence in this field is still limited. Additional regulations apply for financial and insurance services (see Chapter 3), as well as for telecommunications services, the metallurgical production sector and several network industries (see Sections 7.4.1 to 7.4.4).

In 2017, an amendment to the Foreign Investments Law introduced a new policy according to which the Chairman of the Government Commission on Monitoring Foreign Investment can decide that any transaction to be entered into by a foreign investor in non-strategic entities also requires prior approval of the Commission. Decisions shall be made '*with the view to securing national defence and security of the state*' and would be based on the opinions of the Government authorities, including the authorities supervising the sectors in which the entity concerned operates. The law potentially increases the Government discretion regarding the approval of FDI in Russia and legal uncertainties on the side of foreign investors.

Russia does not formally apply joint-venture requirements in specific sectors or requirements regarding the transfer of technology to the local partner in a joint-venture (see Section 7.3.7). In practice, however, joint-venture obligations implicitly arise from foreign ownership thresholds, particularly in strategic sectors and in financial services. Moreover, since 2018 the FAS is also taking technology transfer requirements into consideration as an extension of its regulatory toolkit. Finally, a great number of commercial activities are subject to licensing, whereby licences are granted by federal and local authorities (see Section 7.3.8).

The impact of Russia's legislation and respective law enforcement practices are generally difficult to assess. Company-specific information on explicit discriminatory treatment is scarce. Little survey data indicating discriminatory treatment by the Government and/or its officials is available. However, various statistics indicate that Russia's economy suffers from high state participation rates and high levels of market concentration in a number of sectors, particularly in strategic sectors (energy, defence) and natural monopolies (electricity, gas, water, and railway transportation), as well as in the financial services sector (see Chapters 3, 4, 9, 10, 11).

Annex A7.1: Types of Activities Subject to Licensing according to Article 17 of Federal Law on Licensing of Certain Types of Activity

1. Development of aviation equipment, in particular dual-purpose aviation equipment;
2. Manufacture of aviation equipment, in particular dual-purpose aviation equipment;
3. Repair of aviation equipment, in particular dual-purpose aviation equipment;
4. Testing of aviation equipment, in particular dual-purpose aviation equipment;
5. Distributing encoding (encryption) facilities;
6. Maintaining encoding (encryption) facilities;
7. Provision of information encryption services;
8. Development and manufacture of encoding (encryption) facilities protected by means of encoding (encryption) facilities of information and telecommunication systems;
9. Detecting electronic devices intended for concealed information gathering on premises and in technical facilities (except for instances when the said activity is pursued to cater for the legal entity's or individual businessperson's own needs);
10. Development and/or manufacture of classified information protection means;
11. Classified information technical protection;
12. Development, manufacture, sale and acquisition for the purpose of sale of special technical devices intended for concealed information gathering by individual businesspeople and legal entities engaged in business activities;
13. Manufacture of counterfeit-proof printed products, in particular securities forms and also the trade in said products;
14. Development of weapons and military equipment;
15. Manufacture of weapons and military equipment;
16. Repair of weapons and military equipment;
17. Disposal of weapons and military equipment;
18. Trade in weapons and military equipment;
19. Manufacture of arms and basic parts of firearms;
20. Manufacture of cartridges for arms and of cartridge components;
21. Trade in arms and basic parts of firearms;
22. Trade in cartridges for arms;
23. Exhibition of arms, basic part of firearms, cartridges for arms;
24. Collecting arms, basic parts of firearms, cartridges for arms;
25. Development and manufacture of ammunition and components thereof;
26. Disposal of ammunition and components thereof;
27. Carrying out works and rendering services related to the storage, carriage and destruction of chemical weapons;
28. Operation of blast and fire hazardous production facilities;
29. Abrogated upon the expiry of 90 days after the date of the official publication of Federal Law No. 258-FZ of 8 November 2007;
30. Operation of chemical-hazardous production facilities;

31. Industrial safety expert examination;
32. Manufacture of industrial explosives;
33. Storage of industrial explosives;
34. Application of industrial explosives;
35. Distributing industrial explosives;
36. Manufacture of fireworks;
37. Distributing fireworks belonging to Class IV and Class V under the State standard;
38. Fire-fighting;
39. Carrying out works related to the installation, repair and maintenance of fire safety facilities for buildings and structures;
40. Performance of mine surveying;
41. Restoring objects classified as items of cultural heritage (historical and cultural monuments);
42. Geodetic activity;
43. Mapping activity;
44. Performance of works related to exerting an active effect on hydrometeorological processes and phenomena;
45. Performance of works related to exerting an active effect on geophysical processes and phenomena;
46. Activities in the field of hydrometeorology and adjacent fields;
47. Pharmaceutical activity;
48. Manufacture of medicinal drugs;
49. Manufacture of medical equipment;
50. Maintenance of medical equipment (except for instances when the said activity is pursued to cater for the legal entity's or individual businessperson’s own needs);
51. Providing prosthetic and orthopaedic assistance on the basis of individual orders;
52. Activity connected with the turnover of narcotic drugs and psychotropic substances (cultivation of plants, production, manufacture, processing, storage, carriage, realisation, distribution, acquisition, use, destruction) entered in List I according to Federal Law No. 3-FZ of 8 January 1998 on Narcotic Drugs and Psychotropic Substances;
53. Activity relating to the circulation of narcotics and psychotropic substances (development, production, manufacture, processing, storage, carriage, release, sale, distribution, acquisition, use, destruction) given in List II according to Federal Law No. 3-FZ of 8 January 1998 on Narcotics and Psychotropic Substances;
54. Activity relating to the circulation of the psychotropic substances (development, production, manufacture, processing, storage, carriage, release, sale, distribution, acquisition, use, destruction) given in List III according to Federal Law No. 3-FZ of 8 January 1998 on Narcotics and Psychotropic Substances;
55. Activity relating to the use of germs causing contagious diseases;
56. Sea passenger transport;
57. Sea cargo transport;

58. Inland waterway passenger transport;
59. Inland waterway cargo transport;
60. Air passenger transport (except for carriage by air by state aircraft, experimental aircraft and civil aircraft, including aircraft for general use, without the collection of a charge);
61. Air cargo transport, (except for carriage by air by state aircraft, experimental aircraft, civil aircraft, including general aircraft, without the collection of a charge);
62. Motor road passenger transport by means of vehicles with a capacity of over eight persons (except for instances when the said activity is pursued to cater for a legal entity's or individual businessperson's own needs);
63. Railway passenger and luggage transport;
64. Cargo railway transport;
65. Freight luggage railway transport;
66. Cargo transport (cargo movement without making a contract of carriage) using general purpose railways, except for the removal of cargo received from show railways and its return to show railways;
67. Abrogated;
68. Inland waterway transportation loading/unloading as applied to hazardous cargo carried by inland water transport;
69. Loading/unloading as applied to hazardous cargo in seaports;
70. Loading/unloading as applied to hazardous cargo carried by rail;
71. Sea towing (except for instances when the said activity is pursued to cater for a legal entity's or individual businessperson's own needs);
72. Abrogated;
73. Abrogated;
74. Collecting, using, neutralising, transporting and placing hazardous wastage;
75. Manufacture and sale of specialised gambling facilities intended for gambling business;
76. Abrogated;
77. Organisation and carrying out of games of chance and (or) bets, including with the use of gambling tables and other gambling facilities at the premises of casinos (activity of casinos);
78. Abrogated;
79. Organisation and carrying out of games of chance and (or) bets, including with the use of gambling facilities (except for gambling tables);
80. Abrogated;
81. Non-state (private) security guard activity;
82. Non-state (private) detective activity;
83. Procurement, processing and sale of scrap non-ferrous metals;
84. Procurement, processing and sale of scrap ferrous metals;
85. Activity relating to arranging jobs for Russian citizens beyond the borders of Russia;
86. Abrogated;
87. Abrogated;

88. Playback (making copies) of audio and video works and soundtracks on all and any kind of media;
89. Abrogated;
90. Auditing;
91. Abrogated;
92. Abrogated;
93. Abrogated;
94. Abrogated;
95. Abrogated
96. Manufacture and repair of metering facilities;
97. Abrogated;
98. Outer space activity;
99. Medical activity;
100. Abrogated;
101. Activity of ensuring air safety;
102. Abrogated;
103. Abrogated;
104. Abrogated;
105. Designing of buildings and installations, except for installations of seasonal or auxiliary purpose;
106. Construction of buildings and installations, except for installations of seasonal or auxiliary purpose;
107. Engineering investigations for the construction of buildings and installations, except for installations of seasonal or auxiliary purpose;
108. Abrogated;
109. Abrogated;
110. Activities associated with organisation of and carrying on gambling at book-maker's offices and totalizators.

Annex 7.2: Sectors of the Russian economy subject to FDI restrictions

The following categories of FDI restrictions are observed in various sectors of the Russian economy:

1. Formal legal restrictions (Cat 1);
2. Onerous procedures to obtain permits or licences its terms of time, cost, qualification requirements (Cat 2);
3. Technical regulation and GOST[515] restrictions for foreign suppliers / products (Cat 3);
4. Overloading of the sector with control and supervision activities (Cat 4);
5. Special barriers (Cat 5).

These categories of FDI restrictions translate into the following measures in selected sectors:

Production of chemicals and chemical products

- Amendments to the Federal Law of 1 June 2015 on State Regulation of Production and Turning of Ethyl Alcohol, Alcohol and Alcohol Containing Products and on Limiting Consumption (Drinking) of Alcohol Products (Cat 2);
- Questioning the principles of good laboratory practice developed within the framework of the OECD which allow most States with a chemical regulation system (in particular, in the EU, USA, Canada, Japan) to accept the test results obtained in any State if they are meaningful (Cat 5).

Telecommunications

- Restrictions in line with Strategic Investments Law which refer to the strategic enterprises included in the register provided for by the Antimonopoly Law and holding a dominant position in Russia (or in the territories of five or more constituent entities) in the communication services market, except internet access services (Cat 1);
- Licence requirement for the provision of communication services, as well as for television broadcasting. Problems of obtaining the licences are primarily due to the large number of licensed activities whereby the telecom operator, in the course of carrying out its core business, is obliged to obtain up to ten licences (Cat 2);
- Order of the Ministry of Communications and Mass Media No. 226 of 12 September 2011 approves the regulations of the functions of control and supervision in the field of communications issued by the Federal Service for Supervision in the Sphere of Telecom, Information Technologies and Mass Communications (Cat 4);
- Commercial presence in Russia is required for providing cross-border telecommunications services, despite the fact that Article 69 of the Federal No. 126-FZ of 7 July 2003 on Communications establishes that foreign organisations or citizens providing communication services in Russia enjoy the legal regime established for Russian citizens and organisations (taking into account the principle of reciprocity), unless otherwise established by international treaties or laws. Article 70 of the Law determines that in order to provide communication

[515] Gosudarstvenii Standart (set of technical standards maintained by the Euro-Asian Council for Standardization).

services within the global information and telecommunication networks in Russia, it is obligatory to set-up Russian communication operators (Cat 5).

Real Estate

- In accordance with Articles 15 and 22 of the Land Code of the Russian Federation ('LCRF'),[516] foreign citizens, stateless persons, and legal entities cannot own, or lease land plots located in border areas (Cat 1);
- The requirement to transfer land legally in the ownership of a foreign citizen or entity (arising for example from a change in the land categorization according to Articles 15 and 22 of the Federal Law No. 101 of 10 July 2002 on the turnover of agricultural land). Moreover, plots of agricultural land cannot be jointly owned by spouses, one of whom is a foreign person (Cat 5).

Financial services, except insurance and pension funding

- Investment in the banking sector: quota for the aggregate participation of non-residents in the Russian banking system, implementation of banking operations by credit institutions with foreign investment, if in the relevant foreign countries restrictions on their establishment and activity apply to banks with Russian investments and branches (Cat 1);
- Financial institutions are to implement the currency control in line with the Federal Law No. 173 of 10 December 2003 on Currency Regulation and Currency Control, with significant fines in case of non-compliance (Cat 4).

Manufacturing of medicines and materials for medical purposes

- Licence for the production of medicines, with the costs amounting to RUB 7 500. Duration of the procedure to issue the licence amounts to 45 days. When obtaining a licence for the production of medicines, the licensee acquires the right to produce any medicine. At the same time, manufacturing techniques are different and require the availability of appropriate specialised equipment and specialists. It is often unclear which specific combination of activities the business entity has the right to carry out under a licence (Cat 2);
- There are no technical regulations governing the production of medicines in the EAEU. However, in 2016, an agreement was adopted on common principles and rules for the circulation of medical devices (medical devices and medical equipment) within the EAEU (Cat 3);
- Complex drug registration system: a single drug market is being created in the EAEU, which implies a single registration mechanism for the EAEU countries. However, the system, launched in 2018, suffers from problems of information resources compatibility and of electronic interaction between regulatory authorities and expert institutions within the EAEU (Cat 5).

Agriculture

- A number of special rules for foreigners is in place (Cat 1);
- Non-compliance of the norms under the EUAU technical regulations relating to crop and livestock production with the standards adopted in GOST (Cat 3).

Research and Development

[516] See Chapter 8.

– Restrictions on investing in strategically important sectors in line with the Strategic Investments Law as described in Section 7.3.2 are applicable to a number to research and development activities, such as production of encryption (cryptographic) tools, the use of nuclear materials and (or) radioactive substances during research and development activities or development and production of military equipment. Making transactions involving the acquisition of property of such business entities, the acquisition of shares, the acquisition of manager functions is allowed only if there is a decision on prior approval of such transactions with the FAS (Cat 1).

Electricity, gas and steam supply

– According to the Federal Law on Gas Supply, when buying and selling shares of the owners of regional gas supply systems, the share of foreign citizens or foreign organisations should not exceed 20% of the total number of ordinary shares of the owners of these systems. For owners of the Russia's Unified Gas Supply System ('UGSS' - see Chapter 10), it cannot be more than 50% (Cat 1);
– Electricity transmission services and gas transportation through pipelines are natural monopolies, i.e. subject to price regulation, carried out by determining (establishing) prices (tariffs) or their limit level (Cat 5);
– Gas transportation in a pipeline is of strategic importance for ensuring the country's defence security in accordance with the Strategic Investments Law. Consequently, establishing the control by a foreign investor over such business entities is subject to a positive decision by the FAS (Cat 5);
– Insufficient legal regulation of competitive relations persists in the electricity market. The FAS did not approve the method for determining the compliance of price bids for the sale of electricity with the requirements of economic feasibility. Effective detection of price manipulation in the electricity market is therefore impeded (Cat 5).

Source: Internal compilation.

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8.1 INTRODUCTION

This chapter addresses the development of a land market and potential distortions in land prices after the establishment in Russia of land-use rights transactions. It describes the development of the legal framework for urban and rural land with estimates of current transactions for rural[517] and urban use[518] mainly through leasing but also through the purchase and sale of land rights. It provides an example of prices with regard to one region, Smolensk. It also assesses the degree to which the Government influences costs relating to environmental pollution.

8.2 LEGAL FRAMEWORK

8.2.1 RELEVANT LAWS

The list below provides an overview of the main legislative acts concerning ownership and other rights related to land:

- Fundamental (Framework) land legislation of the USSR on the Principles of Land Legislation of the Union of the USSR (′Fundamental Framework′);[519]
- RSFSR[520] Law on the Peasant (Farm) Economy;[521]
- RSFSR Law on Land Reform;[522]
- Resolution of the Congress of People's Deputies RSFSR on the Programme for the Revival of the Russian Village and the Development of the Agro-Industrial Complex;[523]
- Amendment to Art. 12 of the Constitution;[524]
- Programme of land reform on the territory of RSFSR;[525]

[517] Land used for agriculture.

[518] Land for commercial use.

[519] USSR Supreme Council resolution N.º 1252-1 of 28 February 1990. See also Decree of 25 April 1990 of the Presidium of the Supreme Council of RSFSR "*About the granting and withdrawal of land*".

[520] Russian Soviet Federated Soviet Republic

[521] Adopted on 22 November 1990. The first mention of private landholding in Russian law. The law was later abrogated.

[522] Adopted on 23 November 1990. Procedures for introducing private property in land. The law was later abrogated.

[523] Adopted on 3 December 1990. See also Law of the RSFSR of 21 December 1990 "*on Social Development of the Village*"; Law of the RSFSR N.º 445-1 of 25 December 1990 "*on Enterprises and Entrepreneurial Activity*"; Resolution of the Council of Ministers of the RSFSR of 4 January 1991 "*on Support for the Development of Peasant Farms, Associations, Unions and Cooperatives*".

[524] Adopted on 15 December 1990. By this law, land could be given as inheritance, at which point it becomes private property in perpetuity, otherwise it can be given only to the State. The importance of this law also rests in a ten-year moratorium on buying or selling of inherited land. The law was later abrogated.

[525] Adopted on 18 January 1991 by the Council of Ministers of the RSFSR. The programme was later abrogated as the concept of privatization evolved. See also Resolution of the Council of Ministers of the RSFSR of 22 February 1991 "*on Granting to Citizens Land Plots for Gardening, Horticulture and Animal Husbandry*"; Resolution of the Council of Ministers of the RSFSR of 17 September 1991 "*on Approving Forms for the State Act on the Right of Land Ownership, Lifelong inherited Possession, and perpetual (permanent) Use of Land*".

- Land Code of the RSFSR;[526]
- Presidential Decree on Urgent Measures to Implement Land Reform in the RSFSR;[527]
- Resolution of the Council of Ministers – Government of the Russian Federation on Approval of Purchase and Sale of Land Plots by Citizens;[528]
- Programme of the Council of Ministers of the Russian Federation for 1993–1995 on Development of reforms and stabilisation of the Russian economy;[529]
- Presidential Decree on Regulation of Land Relations and Development of Agrarian Reform in Russia;[530]
- Presidential Decree on the State Land Cadastre and Registration of Documents on Property Rights;[531]
- The Constitution (see Chapter 2);[532]
- Government Resolution on the Practice of Agrarian Reforms in Nizhny Novgorod Region (currently in force); [533]

[526] Adopted on 25 April 1991. A key step forward, even though the moratorium inhibited its realization: land could now be categorised as state, private or collectively owned. The land code was replaced by the LCRF in 2001 (see below).

[527] Adopted on 27 December 1991. See also RSFSR Law of 11 October 1991 "*on Payment for the Land*"; Presidential Decree N.º 213 of 2 March 1992 "*on the Procedure for Establishing free Transfer of Land Plots to Citizens' Property*"; Presidential Decree N.º 301 of 25 March 1992 "*On the sale of land plots to citizens and legal entities during privatisation of state and municipal enterprises*" (permission to buy or rent land under privatised structures or enterprises), decree later abrogated; Government Resolution N.º 708 of 4 September 1992 "*on the Procedure of Privatisation and Reorganisation of Enterprises and Organisations of Agro-Industrial Complex*" (methods for privatising agricultural organisations were developed: individuals and firms entitled to buy land were identified), resolution later abrogated.

[528] Resolution of the Council of Ministers – Government of the Russian Federation N.º 503 of 30 May 1993, the resolution was later abrogated, but the citizens' rights were repeatedly updated. See in this respect the Presidential Decree N.º 198 of 14 February 1996 "*on the Right of Citizens and Legal Entities to own Land Plots under Real Estate Structures in Rural Areas*".

[529] Adopted on 6 August 1993, updated and broadened by the Government Resolution N.º 791 of 6 July 1994 "*on the Programme of Agrarian Reform in the Russian Federation for 1994–1995*", and by the Presidential Decree of 18 June 1996 "*on the Federal Target Programme of Stabilisation and Development of Agro-Industrial Production for 1996–2000*" or the Government Resolution N.º 446 of 14 July 2007 "*on the State Programme for Agricultural Development and Regulation of Markets for Agricultural Products, Raw Materials and Foodstuffs for 2008–2012*".

[530] Decree N.º 1767 of 27 October 1993. It contained for the first mention of a land plot as immovable property regulated by civil law and it reglemented its exchange by sale, inheritance, mortgage, and investment in fixed capital; its registration and rights to it in the land book. The decree was later abrogated.

[531] Presidential Decree N.º 2130 of 11 December 1993 "*on Regulation of Land Relations and Development of Agrarian Reform in Russia*".

[532] For related guarantees, see also the Presidential Decree N.º 337 of 7 March 1996 "*on Guarantees of Constitutional Rights of Citizens to Land*".

[533] Government Resolution N.º 324 of 15 April 1994. See also, Government Resolution N.º 138 of 6 March 1992 "*on the Advancement of Agrarian Reform in the Russian Federation*"; Resolution of the Government of the Russian Federation N.º 708 of 4 September 1992 "*on the Procedure of Privatisation and Reorganisation of Enterprises and Organisations of Agro-Industrial Complex*" (methods for privatising agricultural organisations were developed: individuals and firms entitled to buy land were identified); Resolution of the Supreme Soviet of the Russian Federation N.º 5309-1 of 1 July 1993 "*on Features of Transformation into Joint-Stock Companies of Cooperative-State (State-Cooperative) Enterprises, Organisations and their Associations in the Agro-Industrial Complex*"; Government Resolution N.º 86 of 29 December 1991 "*on the Procedure of Reorganisation of Collective*

- Civil Code of the Russian Federation, Chapter 17 on Rights to own and other Rights concerning the Land, set aside until approval of the Land Code of the Russian Federation[534] (see Chapter 2);
- Government Resolution on Procedures for the Exercise of Rights by the Owners of Land and Property Shares;[535]
- Federal Law on State Registration of Rights to Immovable Property and Transactions;[536]
- Federal Law on Mortgages (Real Estate Pledges);[537]
- Federal Law on Appraisal Activities in the Russian Federation;[538]
- Federal Law on the State Land Cadastre;[539]
- Land Code of the Russian Federation (′LCRF′);[540]
- Federal Law on Privatisation of State and Municipal Property;[541]
- Federal Law on Amendments and Additions to Part two of the Tax Code of the Russian Federation and other Acts of Legislation of the Russian Federation on Taxes and Fees;[542]
- Federal Law on Environmental Protection;[543]
- Federal Law on the Turnover of Agricultural Land;[544]
- Federal Law on Peasant (Farm) Economy;[545]
- Federal Law on Amendments to Chapter 26.1 of the Second Part of the Tax Code of the Russian Federation and some other Acts of Legislation of the Russian Federation;[546]
- Federal Law on Amendments to the Federal Law on Mortgage (Pledge) of Real Estate;[547]
- Federal Law on the Transfer of Lands from one Category to Another;[548]
- Federal Law on the State Cadastre for Real Estate;[549]
- Government Decree on Rental Rates;[550]

and State Farms"; and Government Resolution N.º 179 of 29 March 1994 "*on Procedures to Transform Cooperative-State (State-Cooperative) Enterprises, Organisations and their Associations in the Agro-Industrial Complex into Joint-Stock Companies*".

534 Adopted on 21 October 1994.
535 Adopted on 1 February 1995.
536 Federal Law N.º 122 of 21 July 1997.
537 Federal Law N.º 102 of 16 July 1998.
538 Federal Law N.º 135 of 29 July 1998.
539 Federal Law N.º 28 of 2 January 2000, the law was later abrogated.
540 Federal Law N.º 136 of 25 October 2001, setting out rights to receiving land for perpetual use and lifetime inheritance and providing a legal framework on land-related contracts, with the exception of agricultural land.
541 Federal Law N.º 178 of 21 December 2001.
542 Federal Law N.º 187 of 29 December 2001, the law was later abrogated.
543 Federal Law N.º 7 of 10 January 2002.
544 Federal Law No. 101 of 24 July 2002, specifying the terms for contractual operations involving agricultural land.
545 Federal Law N.º 74 of 11 June 2003.
546 Federal Law N.º 147 of 11 November 2003.
547 Federal Law N.º 1 of 5 February 2004.
548 Federal Law N.º 172 of 21 December 2004.
549 Federal Law N.º 221 of 24 July 2007.
550 Government Decree N.º 582 of 16 July 2009.

- Order of the Ministry of Economic Development on Guidelines for State Cadastral Valuation;[551]
- Government Resolution on the Calculation and Collection of fees for a negative impact on the environment;[552]
- Government Order on Approval of the List of Pollutants for which Measures of State Regulation in the Field of Environmental Protection are Applied;[553]
- Government Decree on Rates of Fines for Negative Environmental Impact and Additional Factors.[554]

8.2.2 SUMMARY OF LEGAL DEVELOPMENTS

In the FSU, until the early 1990s, the State held a monopoly on the provision, seizure and redistribution of land which was owned collectively by citizens. Personal use of the land was limited to individuals' plots which could be used specifically for household purposes.[555] The legal basis for land reform across the regions and republics of the Soviet Union was developed in the Fundamental Framework, which established an individual's right to own land and also allowed land leasing.[556]

Going beyond the Fundamental Framework, two legislative RSFSR acts adopted in November 1990 - the Law on the Peasant (Farming) Economy and the Law on Land Reform - fully confirmed private ownership of plots used for agricultural production. The legislation allowed collective and state farms to divide the land into shares among members of agricultural organisations, so that individual farmers can exit the collective or state farm and start their own farm.[557] However, a moratorium[558] remained on the sale of agricultural land, effectively thwarting private landholding until 2002.

The Constitution of 1993 (see Chapter 2) declared the principle that land could be privately owned, and that procedures and regulations would follow in the Civil Code. The 1994 Civil Code (see Chapter 2), confirmed in Chapter 17, Article 130 that land was considered immovable property. However, Chapter 17 of the Civil Code was not implemented until the entry into force of the LCRF in 2001 and even in the LCRF, agricultural land was still excluded from sale and purchase

[551] Order N.º 226 of 12 May 2017, registered with the Ministry of Justice on 29 May 2017, N.º 46860.
[552] Government Resolution N.º 255 of 3 March 2017.
[553] Government Order N.º 1316-p of 8 July 2015.
[554] Government Decree N.º 913 of 13 September 2016.
[555] Schneider Jr, R.C., (1989), *Developments in Soviet property law*, *Fordham International Law Journal,* vol. 13, pp. 446-480.
[556] See articles 5, 6, 7, 23, 24 25, 26 of the Fundamental Framework.
[557] Skyner, L., (2001), *Political conflict and legal uncertainty: the privatisation of land ownership in Russia*, *Europe-Asia Studies*, Vol. 53, N.º 7, pp. 981–999.
[558] See footnote 525.

transactions.[559] Only following the 2002 LCRF amendment by the Law on the Exchange of Agricultural Land, could agricultural land finally be sold under the Land Code's terms.

Chapter 6 of the LCRF sets forth the procedures and terms for the acquisition and purchase of land. Legal entities may acquire ownership of land: (*i)* by purchase from individuals and legal entities, (*ii*) by purchase of land for new production or the extension of current production from the Government or (*iii*) by an exchange of contracts among individuals and legal entities.

Chapter 6 of the LCRF further lays down the privatisation procedures for land purchase and determination of prices with and without auctions of land plots owned by state and municipal agencies. The main rules on how land owned by the State is sold are the following:[560]

- By auction to the highest bidder (if there is one bid, the offered price is accepted);
- In case of transfer to state or municipal property without an auction by the state or municipal agency, the price of the plot so transferred may not exceed the cadastral value or another price estimate if set by federal law;
- The Government also offers stimulus through buyouts to users, such as agricultural organisations or peasant farms, from state and municipal agencies for 15% of the cadastral valuation.

There are constraints remaining in relation to the land market.[561] At the farm level, land surveys that were required prior to sale could be costly, and the prior public announcement that was required could lead to a gap of up to two years between the announcement and the sale. Also, some regional governments refused to permit the sale of land. Article 72 of the Constitution established a joint competence between the federation and regional governments on land laws, and the slow implementation by regions limited the impact of reform legislation on the portion of privately-owned land, which in 2018 still remained just under 8%.

Under the currently applicable laws, foreigners and foreign firms are allowed to own land except where specifically prohibited, such as in 380 cities and ports located along the border (for instance St Petersburg) and in specifically designated areas.[562] The President can grant exemptions from these limitation or may impose additional regulations on these land plots and structures located on them.[563] However, restrictions on foreign land ownership remain largely formal since they can be easily circumvented by setting up a chain of Russian legal entities.[564]

[559] Bertaud, A. and Renaud, B., *Socialist cities without land markets*, Journal of urban economics 41, N.º 1(1997), pp. 137-151, available at: https://www.sciencedirect.com/science/article/pii/S0094119096910979, accessed on 6 February 2020.

[560] Article 39.4.

[561] Wegren, S. K. (1997), *Land reform and the land market in Russia: Operation, constraints and prospects. Europe-Asia Studies* 49, N.º 6 (959-987).

[562] Article 62 (3) of the Constitution; Art. 5 (2) of LCRF; Presidential Decree N.º 26 of 9 January 2011.

[563] Article 35, point 5 LCRF.

[564] Lerman, Z. and Shagaida, N. (2007), *Land policies and agricultural land markets in Russia*, *Land Use Policy*, Vol. 24, N.º 1, pp. 14–23.

8.3 DESCRIPTION OF LAND RESOURCES

Russia's 1.7 billion hectares of land are divided into seven categories by land use, as indicated in Table 8.1. Under the Russian law, as reflected in the Constitution, the LCRF or the Civil Code, land is considered a natural resource along with water, forest and the subsoil. Land is therefore not an ordinary good but a national asset, and it must be used efficiently and rationally. For this reason, the legal regime concerning land is separate from the regime governing structures located on that land. Moreover, agricultural and urban land is subject to a special regime where waterways, forests, protected territories and reserves are designated as a limited natural resource.[565]

Table 8.1: Russian land fund categories (1 January 2018)

	Land fund category (use)	**Hectares**	**%**
	Total land within the boundaries of Russia	**1 712 519 500**	**100**
1	Agricultural land, total (rural)	383 227 700	22.4
2	Settled land, total (urban)	20 453 000	1.2
3	Total land for industry, energy, transport, communications, broadcasting, television, computer science, for space programmes, defence, security and other special purposes (of this category, 2,163,000 hectares are used for industry).	17 454 900	1
4	Protected territories and land under protected objects	47 694 200	2.8
5	Forests	1 126 289 000	65.8
6	Under water	28 069 900	1.6
7	Reserves	89 330 800	5.2

Source: Federal Service for Government Registration, Cadastre and Cartography; Data about the distribution of land in the Russian Federation 1 January 2018 (for the Russian Federation), Form 22-1, chart 4, Data about the distribution of land by category and form of ownership 1 January 2018, th. Ha (*Rosreestr Svedeniia o nalichii i raspredelenii zemel' v Rossiiskoi Federatsii na 1 January 2018 (v tselom po Rossiiskoi Federatsii) Forma 22-1, chart 4, Svedeniia o nalichii i raspredelenii zemel' po kategoriiam i formam sobstvennosti (na 1 ianvaria 2018 goda), tys. ga*.).[566]

8.4 STRUCTURE OF LAND OWNERSHIP

8.4.1 THE LAND MARKET

[565] Article 1, point 1.1 LCRF.

[566] Available at: https://rosreestr.ru/upload/Doc/18-upr/%D0%A1%D0%B2%D0%B5%D0%B4%D0%B5%D0%BD%D0%B8%D1%8F%20%D0%BF%D0%BE%20%D1%84.22%20%D0%B7%D0%B0%202017%20%D0%B3%D0%BE%D0%B4%20(%D0%BF%D0%BE%20%D0%A0%D0%A4)_%D0%BD%D0%B0%20%D1%81%D0%B0%D0%B9%D1%82.XLS, accessed on 22 October 2019.

The dynamic structure of landownership is tracked by statistics on land transactions. The Government records the total number of transactions by individuals, legal entities, and by state (federal and regional) and municipal authorities (see Table 8.2).

Table 8.2: Number of market transactions and distribution by category of owner/user (2012, 2015–2017)

	2012	2015	2016	2017
Individuals and juridical entities	1 958 439	1 364 951	1 479 272	1 379 122
Local government agencies		369 685	296 618	271 481
All land plots in Russia	34 239 187	35 929 398	36 598 910	36 786 015
Percentage of plot transactions	5.7	4.8	4.9	4.5

Source: Data on transactions involving land (ЕМИСС Информация о сделках с землей); available at: https://www.fedstat.ru/organizations/?expandId=947217#fpsr947217, accessed on 22 October 2019.

Most transactions are among individuals with small plots of a few hundredths of a hectare. State and municipal land make up 16–21% of the total. Again, a large portion of land plots are owned by the State. The data above show that land transactions remained relatively stable in number, by share of transactions and by distribution among categories of owners and users.

Table 8.3 below shows land purchase transactions by category of land use. It also shows the average size of a plot for industrial use, outside the boundaries of settlements, to be in the range of 4–6 hectares, and on land under settlement, about 2.5 hectares.

Table 8.3: Sale of state (federal and regional) and municipal land in Russia (2009–2012)

	2009		2010		2011		2012	
	Transactions	Hectares (thousand)	Transactions	Hectares (thousand)	Transactions	Hectares (thousand)	Transactions	Hectares (thousand)
By juridical entities:								
For use in industry and other purposes outside the	2 802	17 066.14	3 033	13 667.58	2 762	14 074.16	2 899	10 848.97

boundaries of settlements								
Under settlement	10 915	23 629.60	9 693	21 682.63	8 477	202 209.13	11 149	25 117.07
Total	**13 717**	**40 695.74**	**12 726**	**35 350.21**	**11 239**	**216 283.29**	**14 048**	**35 966.04**

Source: Russian Registry. State report about conditions and land use in the Russian Federation in 2012 (*Rosreestr. Государственный (национальный) доклад о состоянии и использовании земель в Российской Федерации в 2012 году*), 2013.[567]

8.4.2 LANDOWNERSHIP STRUCTURE

Only a small portion of the available land is owned privately. The portion of land in private ownership is relatively high only in the categories of agricultural land with 33.3% and urban land with 24.4%. By contrast, when it comes to industrial land, some 90% are still owned by the Government. In 2019, the majority of private owners of land plots were individual citizens. Their share is more than 100 million hectares of land, just under one-quarter of rural and urban land (see categories of land use in Table 8.1). Table 8.4 below provides an overview of the land ownership structure by use category.

Table 8.4: Ownership structure of land by use category (%) (1 January 2018)

	Category of land	**Total**	**Owned by individuals**	**Owned by legal entities**	**State and municipal property**
1	Agricultural land	100	28.3	5.0	66.7
	Specifically used for farming in category 1:	100	55.5	9.2	35.5
2	Urban land	100	21.4	3.0	75.6
3	Land used for industry, energy, transportation, communication, radio and television, IT, space exploration, defence, security and other special purposes	100	0.2	1.6	98.2
	Specifically used for industry in category 3:	100	1.0	9.8	89.2

[567] Available at: https://rosreestr.ru/upload/documenty/doc_gos-doc2012.rar, accessed on 22 October 2019.

4	Land of specially protected territories and objects	100			100
5	Forested land	100			100
6	Land under waterways	100			100
7	Reserves	100			100
8	Total land in the Russia	100	6.6	1.2	92.2

Source: Russian Registry Data on the distribution of land in the Russian Federation on 1 January 2018 (*Rosreestr Сведения о наличии и распределении земель в Российской Федерации на 1 January 2018*).[568]

8.5 ROLE OF THE GOVERNMENT

The Russian land market is weakly developed in part because information about available plots is not well circulated and because demand is weak. Governmental authorities, at the central as well as local levels, sell the land at prices indicated in appraisal estimates, generally the same as nominal cadastral value.

The price of land is determined by demand and by the cadastral valuation. Ideally, the cadastral values should be approximately the market value. Mass appraisals were carried out in the early 1990s by the valuing of a group of properties as of a given date and using common data, standardised methods, and statistical testing. Generally, the assessors took the average value of land in the cadastral unit without consideration of individual distinctions, including access, encumbrances and restrictions on economic activity. Consequently, the prices resulting from the mass appraisal did not reflect the differences among individual parcels with diverse structures used for industrial production.

Table 8.5 below shows that in most regions, industrial land within settlements represented the most expensive category of land. But land used for industry is still overwhelmingly owned by the public sector, with the average price of land for industrial use across the country amounting to USD 4.2/m^2.

Table 8.5: Average price of state and municipal land sold by individuals and juridical entities in the Russian Federation (2012, the latest date for which data are available) (RUB/m^2)

	Individuals and their associations:		**Peasant (farmer) households and**

[568] Available at: https://rosreestr.ru/upload/Doc/18-upr/%D0%A1%D0%B2%D0%B5%D0%B4%D0%B5%D0%BD%D0%B8%D1%8F%20%D0%BF%D0%BE%20%D1%84.22%20%D0%B7%D0%B0%202017%20%D0%B3%D0%BE%D0%B4%20(%D0%BF%D0%BE%20%D0%A0%D0%A4)_%D0%BD%D0%B0%20%D1%81%D0%B0%D0%B9%D1%82.XLS, accessed on 22 October 2019.

Federal districts	For individual residence and dacha construction		For horticulture and livestock production on individual		Legal entities for use in industry and other special purposes		Agricultural associations	
	Under settlement	Not under settlement	Under settlement	Not under settlement	Under settlement	Not under settlement	Under settlement	Not under settlement
Russian Federation	136.11	19.84	28.28	12.92	131.50	35.10	4.01	17.83
Central	58.70	74.11	38.26	10.96	186.08	21.24	7.01	3.41
North-Western	538.96*[1]	29.46	71.99	16.11	77.68	47.89	8.86	4.55
Southern	159.05	3.61	52.85	21.49	309.43	150.30	5.27	122.48*[2]
Northern Caucasus	133.92	-	2.97	4.54	209.39	6.80	1.82	2.80
Volga	48.94	24.71	19.63	24.98	101.64	21.91	3.02	2.84
Urals	28.28	0.18	13.01	1.89	49.52	13.53	2.62	5.43
Siberian	53.98	2.95	8.21	10.61	71.23	14.66	1.64	0.36
Far Eastern	67.03	3.86	19.28	12.75	47.04	4.47	1.88	0.79

*[1]Including in the Kaliningrad oblast, RUB 2 299.95/m^2 and in the city of St Petersburg, RUB 3 220.77/m^2.

*[2]Including in the Krasnodar region, RUB 729.66/m^2.

Source: Rosreestr. Government (National) Report on Land Use in the Russian Federation (2012), M.2013, available at: https://rosreestr.ru/upload/documenty/doc_gos-doc2012.rar, accessed on 22 October 2019.

In view of the small number of privately-owned plots on industrial land and the relatively low non market-based price valuations, there has been a low demand for new plots and only limited change in the land categorisation (see Table 8.6 below) in the recent years. Between 2008 and 2015, the volume of land used in industrial production increased by only 4.8%, and afterwards by 0.2–0.5% annually.

Table 8.6: Change in land area by category (%)

	Category of land	(2015–2008)/2008	(2015–2016)/2015	(2017–2018)/2017
1	Agricultural land	-5.0	-0.03	-0.1

2	Land under settlement	6.8	0.25	0.4
3	Land under industry and other special uses	4.8	0.48	0.2
4	Land under protected territories and objects	38.7	0.46	0.9
5	Forested land	1.9	-0.01	0.0
6	Land under waterways	0.7	0.06	0.0
7	Land reserves	-13.6	0.2	-0.2

Source: Russian Registry, Data on the distribution of land in the Russian Federation Rosreestr (*Сведения о наличии и распределении земель в Российской Федерации на 01.01.2018*), available at: https://rosreestr.ru/site/activity/sostoyanie-zemel-rossii/gosudarstvennyy-natsionalnyy-doklad-o-sostoyanii-i-ispolzovanii-zemel-v-rossiyskoy-federatsii/, accessed on 22 October 2019.

8.5.1 LAND RENTAL RATES

Among the factors potentially affecting the price of industrial land are land rental rates. The rates are determined in line with Government Decree on Rental Rates of 16 July 2009.[569] The Decree sets rental rate ceilings for property where the type of economic activity is of *'great public importance'*, and where there is a need to support activities by limiting the maximum payment of a land tax or by a transfer of the land to the user for free. Land plots used for projects such as thermal power plants, gas pipelines and Olympic facilities, for example, are leased at rates determined by the Ministry of Economic Development.

Annual rental rates of land plots used for industrial production are further determined by the privatisation appraisal process, as well as by auctions. Rental rates for land leased without tender are determined based on the cadastral valuation or leased at rates recommended by the Ministry of Economic Development. The rental rate (a percentage of the cadastral value) depends on the type of owner, the location, as well as the activity foreseen to be carried out on the land. The following rates are examples of rates where land is leased without tender at rates recommended by the Ministry: agricultural land - 0.6% of the cadastral value; land without structures for subsoil use - 2% of the cadastral value; land without intent to pursue economic activity - 0.01% of the cadastral value; land below existing structures - 1.5% of the cadastral value, but not in excess of the amount of the land tax. Cadastral valuation[570] remains the most likely base for rental rates.

In the Smolensk region, for example,[571] mass appraisal was used for cadastral valuation. Plots under factories and office buildings, structures and other facilities, were valued to give equal

[569] Available at: https://cis-legislation.com/document.fwx?rgn=28609, accessed on 16 March 2020.
[570] Order of the Ministry of Economic Development N.º226 of 12 May 2017 (op.cit.).
[571] Decree of the Administration of the Smolensk region N.º 614 of 6 October 2011 "*on the Results of State Cadastral Valuation of Land for Industry, Energy, Transport, Communications, Broadcasting, Television, Computer, Land for Space Activities, Land Defence, Security and other Special Purposes on the Territory of the Smolensk Region.*"

treatment to all organisations at RUB 85.48 (USD 1.30)/m^2. Similarly, with regard to land used for agriculture, the valuation carried out in the course of the mass appraisal did not take into account differences relating to the type of production. The valuation only reflected whether the land was an individual supplementary plot or part of a larger land unit.

In practice, mass appraisal uses a statistical method which allows different assumptions and can lead to conflicts between the owners and users of plots and the agencies that make or confirm valuations. The cadastral assessment consists of the following stages: (*i*) the decision on conducting an assessment (by the executive agency, either the regional or municipal government), (*ii*) the assessment and (*iii*) the confirmation of the assessment by the executive agency that took the decision.

Also, in practice, given that local agencies have a dominant role in the process, overestimation is inherent in the cadastral prices used for rental rates and the land tax, which is the main local tax. There are local fiscal incentives to overestimate land values, and in practice, it often happens that appraisers cannot confirm the actual basis for their valuations.[572] Rosreestra[573] data shows that almost half of all complaints regarding cadastral value result in accepting the complaint. Court records show an even higher success rate for the plaintiff.[574] For example, in 2016, only 7% of cases were lost by the plaintiff, and even when lost, the dispute resolution tended to at least partially satisfy the plaintiff. Reviews tend to result in a downward valuation.

8.5.2 LAND TAX

The basis, incidence and the procedure for calculation of the land tax are governed by Chapter 31 of the Tax Code (see Chapter 4). It is paid by all organisations and individuals which either own or have the right of permanent use or lifetime inheritable possession of taxable land. The tax is levied on land in use with the cadastral value as the base:

- 0.3% for agricultural land used in agricultural production;
- 1.5% for all other land plots used by industry.

These tax rates are roughly comparable to those in Europe, and given the low taxation rate, the potential for introducing market distortions by taxation appears insignificant.[575]

[572] Martinez-Vazquez, J., Timofeev, A. and Boex, J. (2006), *Reforming Regional Local Finance in Russia*, The World Bank.

[573] The Federal Service for State Registration, Cadaster and Cartography ('Rosreestr') is a federal body of the executive branch responsible for state registration of rights to immovable property and land transactions, for the state cadastral registration of real estate, land management and state land monitoring.

[574] Medova, I. (2017). *Nalog Otsenka Berezhet*, *Roseestr* (13 October 2017), available at: https://rosreestr.ru/site/press/news/nalog-otsenka-berezhet/, accessed on 22 October 2019.

[575] Timofeev, A., *Land and Property Taxes in Russia*, in *International Handbook of Land and Property Taxation*, Edward Elgar Publishing, 2004, ch. 20; available at: https://doi.org/10.4337/9781845421434.00029, accessed on 22 October 2019.

8.5.3 PAYMENT FOR NEGATIVE ENVIRONMENTAL IMPACT

The Law on Environmental Protection[576] stipulates that activities with a negative impact on the environment are liable to fines for:

- Emissions of air pollutants from stationary and mobile objects;
- Discharge of pollutants into surface and ground water;
- Disposal of industrial and consumer waste.

All facilities with harmful effects must be registered. They are ranked according to the environmental threat into four classes: 1 (most) to 4 (least). The frequency of inspections is determined by the level of risk to the environment. With the exception of category 4, facilities with harmful effects may be subject to fines.

The rates of fines are set by the Government as follows:

- For pollutant emissions of nitrogen dioxide in the atmosphere from stationary sources in 2016, RUB 133.1/t, and in 2019, RUB 138.8/t (less than USD 2/t, as of 15 November 2018);
- For discharge of the pollutant acrylonitrile into water, in 2016, RUB 70 522.9/t, and in 2019, RUB 73 553.2/t (more than USD 1 052.00);
- For the storage of hazardous waste, class 1, in 2016, RUB 4 452.4/t and in 2018, RUB 4 643.7/t; class 4 waste disposal (with the exception of low-hazard solid municipal waste) in 2016, RUB 635.9/t and in 2018, RUB 663.2/t (USD 69).

In addition to the payment of fines, firms have an administrative liability under the Code of Administrative Offences,[577] and entities emitting pollutants into the atmosphere with harmful effects on human life and health and the environment must obtain permits issued by the federal executive authority for environmental protection. For emissions of harmful substances (pollutants) into the atmosphere by a stationary source over the maximum allowable, or violation of permissions, or in the absence of permission, the economic activity of the polluter is liable to limitation, suspension or termination. There are penalties and fees for the elimination of the consequences of environmental pollution. Fines are set according to the gravity of the infringement, and the payments required are based on the costs of eliminating or nullifying the threat.

With regard to the negative environmental impact of industrial production, price information is fragmentary, and it can only be used in particular instances. For example, the cost of soil contamination can be determined by the price of services, including the cost of replacing the soil, where such prices are known and where there is a market price for uncontaminated soil. However,

[576] Federal Law N.º 7-FZ of 10 January 2002 "*on Environmental Protection*", available at: https://www.asser.nl/upload/eel-webroot/www/documents/Federal%20Law%20on%20Environmental%20Protection%20Russia_ENG.pdf, accessed on 16 March 2020.

[577] Federal Law N.º 195-Fz of 30 December 2001 "*Code of Administrative Offences of The Russian Federation*", available at: https://www.wipo.int/edocs/lexdocs/laws/en/ru/ru073en.pdf, accessed on 22 October 2019.

where the damage calculations are for water or air pollution, determining the cost of the clean-up produces relative responses, depending upon what is considered the pollution-related bad practice.

8.5.4 IMPLEMENTATION OF ENVIRONMENTAL STANDARDS

The following section provides an overview of the fundamental multilateral environmental agreements, including their ratification process in Russia

8.5.4.1 THE UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE; KYOTO PROTOCOL TO THE UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE (1997), RUSSIA SIGNED IN 1999 AND RATIFIED IN 2004; EXTENSION [PARIS AGREEMENT], RATIFIED IN 2019.

Russia, which accounts for nearly 5% of global greenhouse emissions, remains the largest of the 12 signatories that have not yet formally ratified the (second period) agreement. In March 2018, ratification gained the support of the Russian union of industrialists and entrepreneurs.[578] Apart from producers' interest groups, the main reason for the delayed ratification is probably not only political opposition but also the ongoing inventory of Russia's forests and their capacity to absorb CO_2, which is expected to be completed in the course of 2020.[579]

A presidential adviser observed at the Climate Change Conference in December 2018 that Russia supports the collective efforts of all countries to combat climate warming and to reduce greenhouse gas emissions.[580] He further remarked that despite Russia's growing economy, during 2011–2016 greenhouse gas emissions (CO_2 equivalent) increased by only 0.3% (without taking into account the absorption of part of the carbon by forests, that is, net emissions), making Russia's accomplishment here is significantly better than in the US, China and Brazil.

Table 8.7 Greenhouse Gas Emissions by Sector

Greenhouse Gas Emissions by Sector [1)]

(millions of tons of CO_2 equivalent per year)

	2005	2010	2011	2012	2013	2014	2015	2016	2016/ 2011	2016/2005
Energy [2)]	2 037	2 138	2 199	2 214	2 153	2 153	2 162	2 175	**0.99**	**1.07**

[578] *Taking the lead is inevitable* [Vozglavit' neizbezhnoe], Kommersant (25 January 2019).

[579] Sauer, N., and Collett-White, R. (2019), *Russia floats first law to regulate CO2 emissions*, Climate Home News.

[580] Comments by adviser to the President, Special Presidential Representative on Climate Issues Ruslan Edelgeriyev, at the Joint High-Level Segment of the 24th Conference of the Parties to the UN Framework Convention on Climate Change (COP24), the 14th Meeting of the Parties to the Kyoto Protocol (CMP 14) and the 1st Conference of Signatories to the Paris Agreement (CMA 1), available at: http://en.kremlin.ru/events/administration/59393, accessed on 22 October 2019.

Industrial Processing and use of industrial products	208	197	200	216	221	221	219	218		**1.05**
Agriculture	138	140	135	140	135	136	136	134		**0.97**
Land use, land-use change and foreign management [3)]	-496	-630	-648	-615	-611	-652	-603	-634		**1.28**
Waste	89	98	101	104	106	111	113	116		**1.30**
Total, excluding land use, land use change and forestry	**2 472**	**2 573**	**2 635**	**2 674**	**2 615**	**2 620**	**2 630**	**2 644**	**1.00**	**1.07**
Total, including land use, land use change and forestry	**1 976**	**1 944**	**1 986**	**2 059**	**2 004**	**1 968**	**2 027**	**2 009**	**1.01**	**1.02**

1) Data from the Russian national inventory of anthropogenic emissions from sources and removals by sinks of greenhouse gases not controlled by the Montreal Protocol;

2) Taking into account losses and technological emissions into the atmosphere;

3) Minus sign means the absorption of greenhouse gases from the atmosphere.

Source: Russia national inventory of emissions.

Russia will not have to stretch its budget to meet its emissions commitments for 2020 to 2030, which range from 25% to 30% below 1990 levels. Russia is already running 30% below levels in 1990, given that the collapse of the Soviet economy led to a sweeping reduction in the production of heavy industry.

8.5.4.2 Convention on International Trade in Endangered Species of Wild Fauna and Flora, CITES [Washington Convention] (1975), Russia joined in 1992[581]

2017 was the year of Ecology and Specially Protected Areas in Russia. Specially protected areas have doubled since of transition to a market economy began in 1992. Most of these areas have never been open to tourism, since the Government's policy is '*conservation plus science*' not '*conservation plus recreation*', by contrast with the US, for example. One major protected area is Russia's Great Arctic State Nature Reserve, established in 1993, which covers some 42 000 km^2. Like other protected areas, these are open mainly as field labs with limited access, if any, for private visitors.

8.5.4.3 Montreal Protocol on Substances that Deplete the Ozone Layer; Russia joined 1987; ratified London amendment 1992

[581] Russia joined by continuing the previous membership to CITES by the Soviet Union.

The Montreal Protocol called for the phasing out of the consumption of hydrochlorofluorocarbons beginning in 2004 until the complete end of consumption in 2030. Russia's compliance shows 99.5% phased out by 2020 and 100% by 2030.

8.5.4.4 Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal; Russia signed in 1990 and ratified in 1995

Post-Soviet Russia brought significant improvements in hazardous waste management and its disposal. With the hazardous environmental legacies of the Soviet era, Russian authorities took significant steps to clean up nuclear waste in Arctic areas, and the extent of radioactive contamination is relatively low, since atmospheric nuclear tests and the dumping at sea of radioactive waste was discontinued. Calculations based on worst case scenarios for the nuclear reactors dumped in the Kara Sea show that the main challenges concerning hazardous waste management in priority regions are related to the lack of environmentally sound hazardous waste treatment technology, the lack of coordination on the collection of information on hazardous waste and inefficient enforcement of legislation. The clean-up has been partially funded by European countries and Japan, with Norway alone contributing USD 230 million since the mid-1990s.

8.5.4.5 Stockholm Convention on Persistent Organic Pollutants (POPs); Russia signed in 2002 and ratified in 2011; national plan approved 2017

Regardless of the heavy decline of pollutants during the country's economic restructuring phase, Russia's recent carbon emissions have been on an upward trend. The International Energy Agency predicts 11.2% growth in Russia's energy-related carbon dioxide emissions between 2009 and 2020. [582] Despite the Government's objective to modernise Russia for an era of greener international markets, a large portion of Russia's energy infrastructure, which includes nuclear and pipelines, is outdated.

8.5.4.6 Convention on Biological Diversity; Russia signed in 1992 and ratified in 1995

Habitat degradation in Russia represents a serious challenge for biological diversity. The ecosystems of the tundra, taiga, steppes and old-growth forests are deteriorating. Steppes and broad-leaved forests are the most threatened biomes and have almost disappeared. Biodiversity and ecosystem undergo pressure, as biodiversity declines at a rate of 2–5% annually. Land degradation from oil and gas exploration is extensive, and there are negative effects of natural (e.g. climate change) and anthropogenic stresses on biodiversity.

Most of the pollution found in the Arctic originates from the atmospheric emissions of Western Europe, North America and Asia, but Russia also produces pollutants (e.g. 2.5 million tons of sulphur dioxide are produced annually in addition to sulphates, sulphides, chlorides, phosphates and oil products, all of which contribute to habitat degradation and bioaccumulation in animals).

[582] U.S. Energy Information Administration (2017), *Russia Overview*, available at: https://www.eia.gov/beta/international/analysis.php?iso=RUS, accessed on 22 October 2019.

The taiga ecosystem is especially threatened by wind erosion and the tendency towards desertification. Moreover, frequent forest fires, illegal logging and forest replacement by secondary small-leaved species all contribute to forest habitat deterioration.[583]

8.6 CHAPTER SUMMARY

Russia has vast land resources and the Government owns the preponderance of land and the rural and urban land market is weakly developed. The Government does not set or apply norms which would result in affecting the cost of land, neither in law nor in practice. Nonetheless, prices do not fully reflect market indicators due to a number of factors. First of all, the number of land transactions is low in Russia which limits the importance of demand in determining the price. As a result, the cadastral valuation remains the prevailing way of setting the prices in a significant number of transactions (excluding plots used in actual production). Until 2000, there was practically no market for firms to purchase land zoned as industrial, and such land transactions remain a very small percentage of the totality of land transactions. Overall, no policies are in place which would result in systematically over- or understating the value of land, neither for private nor for state-owned enterprises.

Moreover, at the level of laws, environmental impacts of various types of industrial activities are not reflected in the prices of land which diminishes the incentives of economic operators to improve their environmental track record.

[583] Convention on Biodiversity, *Russia profile*; available at: https://www.cbd.int/countries/profile/?country=ru, accessed on 22 October 2019.

9 CAPITAL

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9.1 INTRODUCTION

This chapter examines a number of salient issues in relation to capital, access to finance, and the institutions of the financial sector in Russia. While approximately a third of the financial sector still remains in nominally private hands,[584] and the extent of state involvement is not uniform across the sector (as Chapter 3 showed, banking is more heavily targeted than capital markets and non-bank financial institutions (′NBFIs′) play a large role), the predominance of the banking sector in providing capital means that access to finance has become more difficult.[585] Indeed, the large involvement of the State in financial intermediation in Russia, a trend which has been increasing over the past decade, has resulted in the top five banks by assets being in State hands (see Chapter 3). This chapter will examine the institutional relationships between the State and the financial sector, focusing on the institutional mechanisms which facilitate or hinder access to finance, and how this structure influences the allocation of capital within the economy. In particular, the chapter will examine:

- The salient aspects of the financial sector's institutional set-up and trend towards a centrally driven consolidation;
- Difficulties in access to finance in general;
- The bias towards access to finance for SOEs and large firms; and
- Politically rather than economically motivated lending and how this impacts access to finance for SMEs.

9.2 INSTITUTIONAL ARRANGEMENTS AND HEALTH OF THE FINANCIAL SECTOR

As already noted in Chapter 3 on Russia's financial sector more broadly, the nature of the banking sector in Russia is similar to most emerging markets, with a preponderance of state-owned or state-supported financial institutions, surrounded by private banks and NBFIs (such as microfinance or shadow banking) to provide supplementary funding. Unlike other emerging markets, however, Russia has seen the State's share in the banking sector increase in recent years rather than decrease, a result of both Government strategy and exigencies brought on by financial difficulties and sanctions.

The CBRF puts the State's share of the banking sector at 70% of the sector's total capital holdings in 2017 (and 58.5% of all assets), an increase in capital holdings from 61% in 2016 and a massive

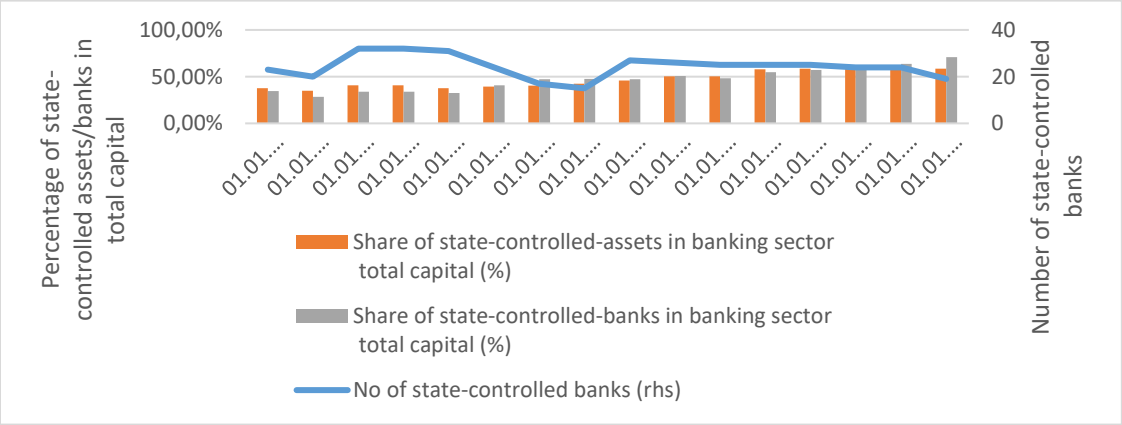
[584] Prime News Agency (2018), *ACRA: State ownership in Russian banking sector rises to 70%*, available at: http://www.1prime.biz/news/_ACRA_State_ownership_in_Russian_banking_sector_rises_to_70/0/%7B0F8F861A-CEB5-4A7E-92F1-329C51264DBF%7D.uif, accessed on 24 April 2019.

[585] IMF (2016), *Russian Federation: Financial Sector Assessment Program: Detailed Assessment of Observance Basel Core Principles for Effective Banking Supervision (BCP)*, Washington DC, IMF Press, available at: https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Russian-Federation-Financial-Sector-Assessment-Program-Detailed-Assessment-of-Observance-44285, accessed on 16 December 2018.

increase from just 2012 (Figure 9.1). In line with broader Government strategies to secure resources for domestic development, the move into the banking sector was also done in order to better channel resources into state-favoured industries and sectors.[586,587]

These state-supported banks enjoy explicit and implicit guarantees from the Government in the event of financial issues, a reality which has advantaged state-owned banks to the detriment of their rivals.[588] Indeed, a secondary effect of this consolidation has been a decrease in the share of foreign banks in the market, with UniCredit, Raiffeisenbank and Societe Generale now ensconced in the second tier of Russian banking, far behind their domestic rivals.[589] The implication of this move for the overall banking sector's health may be consequential, as recent research has found that foreign-owned banks are by far the most efficient banks in Russia across a broad range of metrics.[590]

Figure 9.1 - Extent of State Control of the Banking Sector, 2002-2017



Source: Based on CBRF data.

Apart from direct ownership, regulation of the financial sector in Russia is done by the CBRF, which was granted unified supervision of the sector in a 2013 reform[591] to create a mega-regulator

[586] Vernikov, A. (2014), *National Champions in Russia's Banking Services Market*, *Problems of Economic Transition*, *57* (4), pp. 3-25, especially pp. 8-15.

[587] Abramov, A., Radygin, A., & Chernova, M. (2017), *State-owned enterprises in the Russian market: Ownership structure and their role in the economy*. *Russian Journal of Economics*, *3*(1), 1-23, pp. 20-22, available at. https://www.sciencedirect.com/science/article/pii/S2405473917300016, accessed on 3 December 2018.

[588] Vernikov, A. (2017), *Measuring Institutional Change: The Case of the Russian Banking Industry*. *Journal of Institutional Studies (Журнал институциональных исследований)*, *9*(2), 199-136, pp.17-22.

[589] Orlova, K. (2018). *Russia's Great Bank Takeover*, available at: https://www.the-american-interest.com/2018/01/12/russias-great-bank-takeover/, accessed on 3 December 2018.

[590] Belousova, V., Karminsky, A., & Kozyr, I. (2018), *Bank ownership and profit efficiency of Russian banks*. Bank of Finland Institute of Economies in Transition ('BOFIT'), *BOFIT Discussion Papers*, *2018*(5), 4-22, pp. 4, 19, available at: https://helda.helsinki.fi/bof/bitstream/handle/123456789/15214/dp0518.pdf;jsessionid=1DD036EF26E738A830CBEB2A7AB1B2FB?sequence=2, accessed on 3 December 2018.

[591] Federal Law N.º 251-FZ of 23 July 2013 "*On Amendments to certain Legislative Acts of the Russian Federation in Connection with the Transfer to the Central Bank of the Russian Federation of Authority to Regulate, Control and Supervise Financial Markets*".

(see also Chapter 3). The supervisory functions from the (now-disbanded) Federal Financial Markets Service was transferred to the CBRF, which now includes '*regulation of insurance and pension markets, professional security market participants, investment funds, actuary activities, rating agencies, microfinance organisations, as well as* […] *the development of financial market infrastructure and instruments*' in addition to the CBRF's traditional role in overseeing the formal banking sector.[592] All of these functions are to be undertaken in pursuit of the goals enumerated in the Federal Law on the Central Bank[593] namely:

- To develop and strengthen the Russian banking system; to ensure stability of and develop the national payment system;[594]
- To develop the Russian financial market;[595]
- To ensure stability of the Russian financial market. [596]

Under this mandate, the CBRF has been very active in overseeing the structure of banking in Russia, including cracking down on zombie and undercapitalized banks and forcing closures where deemed necessary. According to the IMF, the total number of credit institutions in the country by end-2017 was 561, down from 923 at the end of 2013, with closure of 62 institutions in 2017 and 110 in 2016.[597] According to Rosstat data, the number has fallen further to 499 as of 1 November 2018, meaning an additional 62 closures through 2018. This objective of strengthening the financial sector has also extended to insurance companies and non-governmental pension funds, where the CBR has also been cleaning its registration lists and closing illiquid firms and firms deemed to be '*unscrupulous*'.[598]

The IMF has noted that these efforts have paid off and the banking system is in a better position in terms of financial stability in 2018 than it was in 2015 or 2016,[599] a result confirmed by research conducted by the CBRF on loan volatility in Russia.[600] Moreover, bad loans in the banking sector appeared to have peaked in 2014, and have been coming down ever since (Figure 9.2). At the individual financial institution level, state-owned banks show healthier balance sheets overall, with higher Tier 1 capital ratios than their private counterparts, but with lower efficiency and

[592] Speech by Elvira Nabiullina, Governor of the Bank of Russia, at the Federation Council, Moscow, 15 February 2017, p. 2, available at: https://www.bis.org/review/r170314h.pdf, accessed on 11 February 2019.
[593] See Chapter 3.
[594] As amended by Federal Law N.º 162-FZ of 27 June 2011, "*On amendments to certain legislative acts of the Russian Federation in connection with the adoption of the Federal Law on the National Payment System"*.
[595] As amended by Federal Law N.º 251-FZ of 23 July 2013.
[596] Article 8 of the Federal Law "*on the Central Bank of the Russian Federation (Bank of Russia)*".
[597] International Monetary Fund (2018), *Russian Federation: Selected Issues*, IMF Country Report 18/276, p. 19, available at: https://www.imf.org/~/media/Files/Publications/CR/2018/cr18276.ashx, accessed on 27 November 2018.
[598] Speech by Elvira Nabiullina, Governor of the Bank of Russia, at the International Financial Congress, Moscow, 13 July 2017, available at https://www.bis.org/review/r170825d.htm, accessed on 27 November 2018.
[599] International Monetary Fund (2018), *Russian Federation: Selected Issues.*
[600] Kruglova, A., & Ushakova, Y. (2017), Effect of Banking Sector Resolution on Competition and Stability, *Bank of Russia Working Paper No. WPS22*, p. 18, available at: http://cbr.ru/Content/Document/File/27559/wps_22_e.pdf, accessed on 27 November 2018.

profitability due to a lack of competition.[601] Coupled with aggressive acquisition strategies,[602] the tight margins of post-sanctions Russia have created the environment for failures such as with B&N Bank.[603] This has also allowed the CBRF to argue for the forced merger of Otkrytie (more on this below in Section 9.5) and B&N Bank to avoid these issues with risk management going forward.[604]

However, the sustainability and desirability of this state of affairs is questionable. The first concern is that the results in clearing bad loans have been attained via effectively transferring money from savers to cover bad investments. In particular, the main institution used for cleaning-up the balance sheets of insolvent banks, the Central Bank Consolidation Fund (a dedicated fund for bank bailouts), is using funds from savers and depositors to Russian sovereign and corporate bonds rather than to other, potentially more lucrative and/or desired investment opportunities. An example of this movement can be seen in the acquisition of Promsvyazbank, which has been designated as a '*special purpose bank for serving the military-industrial-complex-business*'. In this sense, Russian taxpayers have financially supported the Government in directing lending and effectively removing market constraints for one financial institution.[605]

An additional issue which may arise in the future is the dual role of the CBRF as both an owner and regulator of banks which have come under Government control. It is possible that this will create a conflict of interest, as it is unknown if CBRF can impartially apply regulations to a bank it officially owns. If this results in an uneven playing field for some (larger) banks vis-a-vis other, less politically connected or smaller banks, it could have deleterious consequences for overall financial stability going forward. In particular, banks given an exemption from regulations are likely to engage in riskier trading.[606] With financial stability less assured, there is also potential for access to capital to be more tenuous.

[601] International Monetary Fund (2018), *Russian Federation: Selected Issues.* Tier 1 capital refers to a bank's "*core*" capital, including equity capital and disclosed reserves, basically the liquidity on hand to keep the bank functioning. The capital ratio is the ratio of Tier 1 capital to a bank's risk-weighted assets.

[602] Atnashev, T., & Vashakmadze, T. (2017), *Internationalization of Russian Business: A Double-Headed Strategy?; in The Challenge of Bric Multinationals*, Emerald Group Publishing Limited, pp. 423-450.

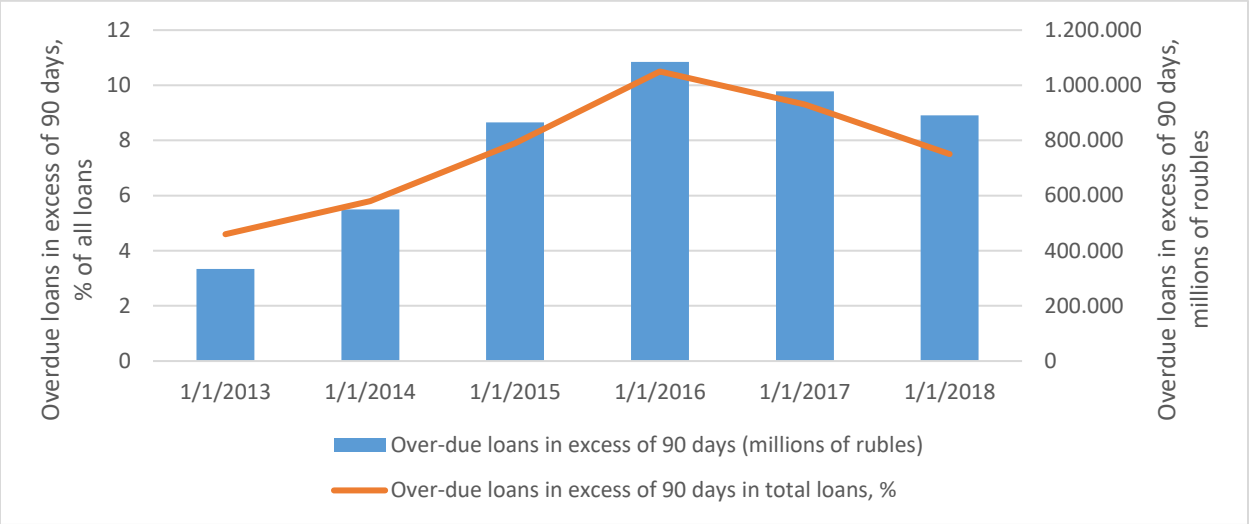
[603] Reuters, (2017), *Bank bailout hits Russia as B&N asks central bank for aid*, 20 September 2017, available at: https://www.reuters.com/article/us-russia-banks-b-n-request/bank-bailout-hits-russia-as-bn-asks-central-bank-for-aid-idUSKCN1BV1CN, accessed on 4 December 2018.

[604] Gazeta.ru (2018), "*Открытие' Бинбанка: оставят только хорошее*" *[Otkrytie Binbank: Leaving Only the Good]*, available at: https://www.gazeta.ru/business/2018/02/02/11634517.shtml, accessed on 4 December 2018.

[605] Plakhova-Freshville, D. (2018), *There are concerns that Putin could be using Russia's banking sector clean-up to raid cash for the state budget*, available at: https://www.businessinsider.com/putin-may-be-using-russian-banking-clean-up-to-raid-cash-for-the-state-2018-3?r=US&IR=T, accessed on 4 December 2018.

[606] The Economist. (2017), *A purge of Russia's banks is not finished yet*, available at: https://www.economist.com/finance-and-economics/2017/11/23/a-purge-of-russias-banks-is-not-finished-yet, accessed on 4 December 2018.

Figure 9.2 - Non-performing Loans in the Russian Banking Sector, 2012-2017



Source: CBRF.

9.3 Overall Access to Capital

Given these deficiencies in the institutional set-up of the financial sector, and in particular the decreasing amount of competition fostered by the State's increasing presence, there are also difficulties by firms in the Russian economy accessing capital (a result predicted by theory and demonstrated across the globe).[607]

Difficulties in accessing capital begin at the individual and household level, where, since 1992, international organizations have noted that Russia is under-banked, and even as of 2012, approximately 46 million citizens were either unbanked or under-banked.[608] More recently, the CBRF noted that the number of bank branches per 100 000 people was '*gradually declining in Russia. While there were on average 27.1 bank branches per 100 000 people in 2010, this figure for the end of 2017 was 23.1*.'.[609] Given the vast territorial expanses of Russia, even the consolidation of a few major banks can result in a reduction in access to finance in Russia's regions for both households and small businesses.

[607] See Love, I., & Martínez Pería, M. S. (2014), *How bank competition affects firms' access to finance*, *The World Bank Economic Review*, *29*(3), pp. 413-448.

[608] Data cited in, *inter alia*, Alliance for Financial Inclusion (2012), *Financial access in Russia: challenges and constraints*, Bangkok: Alliance for Financial Inclusion, available at: https://www.afi-global.org/sites/default/files/pdfimages/AFI_GrantSnapshot_Russia.pdf, accessed on 21 February 2020.

[609] Simanovskiy, A., Morozov, A., Sinyakov, A., Porshakov, A., Pomelnikova, M., Ushakova, Y., Markelov, V., & Bezdudniy, M. (2018), *The 2008–2017 Decade in the Russian Banking Sector: Trends and Factors* (No. wps31), p. 13, available at: http://www.cbr.ru/content/document/file/43934/wp31_e.pdf, accessed on 5 December 2018. The same report noted that the overall availability of access to finance for households was at substantially the same level in 2017 as it was in 2008. For comparison's sake, the average in the EU in 2016 was 26.88 branches per 100 000 people (based on World Bank data).

In other emerging markets, microfinance has stepped in to fill this void, and Russia has also seen explosive growth in the sector since 2013. Much as during the 19th century, where savings *kasses* provided financial intermediation where St. Petersburg-based banks could not,[610] modern Russia has seen microfinance institutions grow five-fold from 2013 to 2017. However, the Government and especially regional governments have attempted to discourage microcredit institutions from growing further, placing interest caps (or even banning microcredit outright) and railing against perceived predatory practices.[611] With finance being increasingly directed towards state-run and strategic industries (see Chapter 3), the policies affecting microcredit institutions are likely to further hamper access to finance at the household and SME level.

Finally, financial literacy in the country remains low, with the OECD in late 2018 noting that overall financial literacy in Russia was on par with Mexico and behind Jordan, Albania, and Belarus.[612] Recognizing this, the Ministry of Finance has launched a project to increase financial literacy from 2017 to 2023, but progress has been slow.[613] In tandem with the rising cost of capital (as measured by interest rates, see Section 9.4), overall trust in banks and the banking sector has also been on decline, dropping 20% from 2014 to 2015.[614] Concomitant with this decline in trust has been a '*flight to familiarity*', where depositors in the regions eschew unfamiliar banks and put their trust in regional and local banks that they are familiar with.[615]

The latest World Bank survey of formal finance in Russia was last conducted in 2012, but even before the global financial crisis of 2008, the responses were telling: 28% of the 4 220 firms surveyed noted that access to finance was a problem (second only to tax rates amongst all problems), while only 6.3% of firms had investments financed by banks and 84.3% of firms financed investments internally.[616] While the fact that different categories of companies do not

[610] Garvy, G. (1972), Banking under the tsars and the Soviets, *The Journal of Economic History*, *32*(4), pp. 869-893.

[611] Karnaukh, M. (2017), *Why Russian regions want to ban microcredits*, Russia Beyond the Headlines, available at: https://www.rbth.com/business/2017/06/08/why-russian-regions-want-to-ban-microcredits_779105, accessed on 5 December 2018.

[612] Monticone, C. (2018), *Financial Literacy in the CIS and at a Global Level*, Presentation at the OECD-Russia Global Symposium "Advancing financial literacy globally: implementation and innovation", Moscow, available at: http://www.oecd.org/daf/fin/financial-education/Russia-FinEdu-2018-Session2.pdf, accessed on 5 December 2018.

[613] Ministry of Finance, 13 November 2017, *At a conference in Sochi, the Russian Ministry of Finance will present the Roadmap for the implementation of a Financial Literacy Development Strategy* ("*На конференции в Сочи Минфин России представит Дорожную карту реализации Стратегии развития финансовой грамотности*"), available at: https://www.minfin.ru/ru/om/fingram/, accessed on 27 January 2020.

[614] Cited in Barua, A. & Gunnion, L. (2015*). Russia: The slide continues*, Deloitte Insights Global Economic Outlook, Q3 2015, 23 July, available at: https://www2.deloitte.com/content/dam/Deloitte/nl/Documents/finance/deloitte-nl-finance-global-economic-outlook-q3-2015.pdf**,** accessed on 2 December 2019.

[615] Schoors, K., Semenova, M., & Zubanov, A. (2017), Depositor discipline in Russian regions: Flight to familiarity or trust in local authorities?, *BOFIT Discussion Papers*, *2017*(1), p. 25, available at: https://helda.helsinki.fi/bof/bitstream/handle/123456789/14505/dp0117.pdf, accessed on 23 December 2018.

[616] World Bank (2012), *Russian Federation Country Profile: Enterprise Survey*, Washington DC, p. 13, available at: http://documents.worldbank.org/curated/en/957071468307163560/Enterprise-surveys-Russian-Federation-country-profile-2012, accessed on 2 December 2019.

have the same level of access to finance is not Russia-specific, politically-connected SOEs (i.e. firms with owners/CEOs who are well-known to have connections to the Kremlin), and larger firms (to some extent, there is necessarily overlap amongst these categories) can more easily tap both capital markets and utilize internal financing than SMEs in Russia.[617,618,619] As the IMF notes, '*the large state presence in the financial sector may result in a biased allocation of savings that benefits large players, both state and non-state, further supporting economic concentration*'[620] (see also Chapter 3). This assertion is backed-up by anecdotal evidence on the difficulty of obtaining capital for micro and small enterprises (and to a lesser extent for medium-sized enterprises), but the data also suggests that the bulk of investment in the economy is coming from large firms. Indeed, the percentage of fixed investment in the economy attributable to small firms has held steady since 2015 at approximately 21% of all investment in Russia, with larger and state-owned firms comprising the other 79%.[621]

Moreover, whilesome of the largest firms are precisely those who have been targeted by sanctions, and thus they have suffered immensely in capital markets, it should be borne in mind that it is easier for larger firms to shift their ample deposits from abroad to Russian-owned mega-banks such as VTB and Sberbank and to continue using this finance for investment.[622,623] Thus, the differential effects of sanctions have been felt at the very largest firms and to a lesser extent with smaller and micro-sized enterprises (due to financial intermediaries having less capital), while medium and large-size firms have had less of an issue.

As a last important point, given the vast expanse of the Russian landmass, there is also a spatial effect with regard to access to finance. According to data from the CBRF, the vast majority of banks and bank branches are located in Moscow and the European part of Russia, meaning difficulties for firms in the regions and especially in the Far East to obtain financing.[624] Studies done before the global financial crisis of 2008 noted that bank competition in the regions differed

[617] Vernikov, A. (2012), *The impact of state-controlled banks on the Russian banking sector*, *Eurasian Geography and Economics*, *53*(2), 250-266. p. 254.

[618] Guriev, S. (2016), *Russia's Constrained Economy: How the Kremlin Can Spur Growth*, *Foreign Affairs*, *95*, pp. 18-22.

[619] Davydov, D. (2018), *Does state ownership of banks matter? Russian evidence from the financial crisis*, *Journal of Emerging Market Finance*, *17*(2), 250-285, p. 258.

[620] IMF (2018), *Russian Federation: Selected Issues*, p. 12.

[621] Based on data from Rosstat and summarized by BOFIT, available at: https://www.bofit.fi/en/monitoring/weekly/2018/vw201850_2/, accessed on 24 April 2019. As a comparison, SMEs regularly comprise approximately 30% of fixed investment in the US (according to Federal Reserve data).

[622] Financial Times (2018), *This time, sanctions on Russia are having the desired effect*, available at: https://www.ft.com/content/cad69cf4-3e40-11e8-bcc8-cebcb81f1f90, accessed on 24 April 2019, and Rapoza, K. (2018), *How Russia's Largest Companies Have Weathered Sanctions.* Forbes.com, 6 June 2018, available at: https://www.forbes.com/sites/kenrapoza/2018/06/06/2018-global-2000-how-the-biggest-russian-companies-have-weathered-sanctions/, accessed on 2 December 2019.

[623] Reuters (2018), *Sanctions fail to stem access to finance for Russian corporates*, available at: https://uk.reuters.com/article/russia-sanctions-banks-idUKL8N13F1FC20151120, accessed on 23 December 2018.

[624] Simanovskiy, A. *et al.* (2018), pp. 13-14.

substantially, as did access to finance, with the most developed regions also showing higher bank competition and greater access to finance.[625] Much as at the central level, there is a degree of political interference and ownership at the regional level, with regional and local authorities controlling regional and local banks across Russia. However, the grip of local banks on access to finance and interference by local authorities has been gradually decreasing over time, in particular due to reduced power of the regional banks in the aftermath of the global financial crisis and following the imposition of sanctions.[626] In any event, combined with the prevalence of banks owned by state-owned firms (such as the Russian Regional Development Bank, owned by Rosneft), access to finance in Russia's regions has become simultaneously more restricted and also more dependent on political goals rather than market conditions.

9.4 CAPITAL COST

The above difficulties in accessing capital have been compounded by the reality that the price of capital in Russia is high even for the firms that are able to access it. The country being an emerging market, Russian firms have always paid a premium on capital, with interest rates as set by the CBRF consistently above those from the ECB or the US Federal Reserve. For example, based on data from the CBRF, the premium on capital in Russia during the global financial crisis of 2008-2009 ranged from 5% to almost 10% (9.75% in February, March, and April 2009). Rather than lessening over time and converging with western financial markets, this premium has spiked as a result of the economic downturn from 2014 to 2015 (Figure 9.3). This has translated into a high capital cost for firms and affected firm strategies, as evidence exists that Russian private firms issue corporate debt (bonds) only when there are reductions in the cost of capital as measured by interest rates.[627] At the same time, the high interest rate environment also enticed savers into the formal financial sector, increasing bank deposits by 25% in 2015 alone, as noted above in Section 9.3. However, this larger pool of capital has gone to mainly large state-owned banks, and thus access to finance across all strata of companies apart from the largest/state-owned/politically connected is still limited.[628]

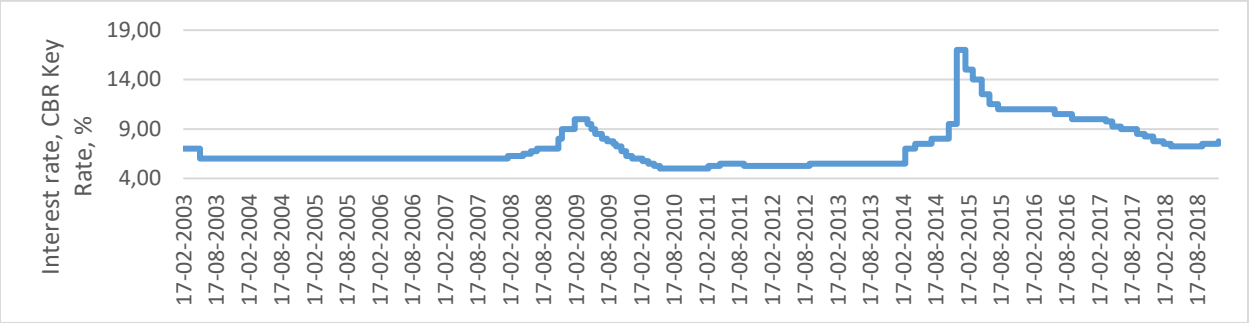
[625] Anzoátegui, D., Pería, M. S. M., & Melecky, M. (2012), *Bank competition in Russia: An examination at different levels of aggregation*. *Emerging Markets Review*, *13*(1), pp. 42-57.

[626] Gorkina, T. I. (2015), *Regional structure of the Russian banking system at the present stage*, *Regional Research of Russia*, *5*(1), 23-30, pp. 26-29.

[627] Zavertiaeva, M., & Nechaeva, I. (2017), *Impact of Market Timing on the Capital Structure of Russian Companies*. *Journal of Economics and Business*, *92*, 10-28, p. 20.

[628] Speech by Elvira Nabiullina, Governor of the Bank of Russia, at the Federation Council, Moscow, 15 February 2017, p. 1.

Figure 9.3 - CBRF Key Rate, 2003-2018



Source: CBRF.

The rising cost of capital has also had a further impact on access to finance in Russia by hitting small and medium-sized financial institutions hardest, as losses across small- to medium-sized banks have become pronounced during the sanctions/recession period. Indeed, as Table 9.1 shows, the drivers for both the performance of return on assets and return on equity since 2014 have been the largest and the (relatively insignificant) micro banks, with banks holding assets above RUB 6 million and under RUB 50 million seeing substantial losses in 2014, 2015, and 2016.[629] Part of the reason for this performance also may have been the shift towards a fully-floating exchange rate in 2014-2015, which acted as a stabilizer to absorb external shocks but had a deleterious effect on firms with high foreign exposure and insufficient diversification. This summarizes the fate of many private banks and banks within the medium asset range, as the largest banks could diversify this risk away somewhat.

Table 9.1 - Breakdown of credit institutions by value of assets (millions of RUB)

		1-5	6-20	21-50	51-200	201-500	501+	**Total**
	as of							
Return on assets, %	31-Jan-18	2	-3	2	1	1	0	1
	31-Jan-17	2	1	-2	1	1	0	1
	31-Jan-16	1	0	-1	0	0	1	0
	31-Jan-15	1	1	-2	1	1	3	1
Return on equity, %	31-Jan-18	18	-41	20	7	5	1	8
	31-Jan-17	18	9	-24	5	5	1	11
	31-Jan-16	8	0	-12	3	1	4	3

[629] Based on data from the CBRF. Breakdown of number of banks by value of assets does not harmonize with data on groupings of credit institutions by registered capital, hence the approximation.

31-Jan-15	11	8	-19	4	8	10	6

Source: Compiled based on CBRF data.

In addition to interest rates, the low rating of Russian sovereign debt raises the cost of borrowing within the country. This has eased somewhat since early 2018, as S&P Global Ratings upgraded Russia's debt to investment grade. On the heels of economic problems and western sanctions, Russian debt was downgraded from BBB-/A-3 to BB+/B in early 2015, with S&P noting that the financial sector was highly vulnerable to further shocks.[630] The reversal of this downgrade in January 2018, coming just before the presidential elections was anticipated for some time,[631] and was seen as a vindication of the CBRF monetary policy and the fiscal prudence of authorities in keeping the Government debt low.[632] In the months following the sovereign upgrade, S&P also upgraded the ratings of several large Russian corporates, including Gazprom, Transneft, Rushydro, and Russian Railways, meaning cheaper borrowing costs for these state-owned firms. This upgrade may also have had beneficial effects for Russian firms to obtain financing from external sources, principally countries which are not aligned with the US or EU or have ignored western sanctions (such as the BRICS economies).

9.5 State Support in Obtaining Capital

With a financial sector stratifying into mega- and micro-sized banks and an increase in the State's involvement in financial intermediation (as noted above and in Chapter 3), there is also evidence that state support to the financial sector (for support to other sectors, see Chapters 14-16) has increased substantially since 2013 and the advent of sanctions on Russian financial institutions. This aid has taken various forms.

The main channel through which this support for the financial sector has occurred is the State's outsize role in ownership, which has allowed the State to directly inject capital into banks where it deemed necessary. With international capital markets closing off due to western sanctions, liquidity troubles and an increase in bad debts in the corporate sector (see Section 9.2 and especially Figure 9.2) have led several banks to request Government intervention, increasing the State's role in the sector both directly and indirectly. For example, in 2017, Otkrytie Bank was

[630] Treanor, J. (2015), *Russia downgraded to junk status for first time in decade, The Guardian*, available at: https://www.theguardian.com/business/2015/jan/26/russia-downgraded-junk-status-decade-credit-rating, accessed on 24 April 2019.

[631] *Experts Expect S & P to upgrade Russia's rating to Investment Level*, Tass.ru (2017), (*Эксперты ждут от S&P повышения рейтинга РФ до инвестиционного уровня)*, available at: https://tass.ru/ekonomika/4564611, accessed on 4 January 2019.

[632] S&P Research Update (2017), *Russian Federation 'BB+/B' And 'BBB-/A-3' Ratings Affirmed; Outlooks Positive*, available at: https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=1916053&SctArtId=437518&from=CM&nsl_code=LIME&sourceObjectId=20030407&sourceRevId=87&fee_ind=N&exp_date=20270919-16:48:17, accessed on 4 January 2019.

promised the largest bailout to date in Russia, a package which was originally targeted at USD 6.9 billion but has since grown. With the additional bailouts of B&N Bank and Promsvyazbank and their subsequent nationalization (see Chapter 3) in 2017, approximately RUB 1 500 billion was provided to the three banks and an additional RUB 1 000 billion has been requested, bringing the total bailout package to approximately USD 46 billion at then-current exchange rates.[633]

Control of banks has also allowed for politically rather than economically-determined lending, meaning that the ultimate owners of the bank (the Government) have a large say in determining where capital is flowing based on considerations other than market ones. There is evidence that state-owned banks performed a vital role in keeping capital flowing during the long crisis period since 2008, increasing rather than decreasing lending at the behest of Government (a situation that, in and of itself, may have been salutary if one does not consider the costs of this decision).[634] A study of the behaviour of state-owned banks during the global financial crisis also found that '*Russian financial market institutions were rendered into a vehicle for inter-bank lending under control of the CBRF, being used not only for direct financing of consumers and larger firms but also to move resources around the banking sector strategically'*.[635] In this sense, the increased state involvement in ownership has led to higher levels of capital available for large Russian companies than would have been available otherwise, given the presence of sanctions and economic downturn. It should be noted though again that access to finance is likely conditioned on political connections and the size of the specific firm seeking capital.[636]

The aforementioned bank bailouts throughout 2017 represented a substantial (and unforeseen) burden on the CBRF, as it required a direct massive injection of liquidity into the financial sector. However, the CBRF noted in 2018 that a large part of its traditional liquidity functions during both the global financial crisis and the onset of the latest economic downturn in 2015 were mitigated somewhat by fiscal policy, mainly through spending of sovereign wealth funds.[637] However, the downturn in oil prices had the dual effect of harming the economy and depleting these wealth funds; indeed, the sovereign wealth funds only saw a replenishment when oil returned to a price exceeding USD 60 a barrel in May 2018. Sovereign wealth funds saw a sharp increase again in

[633] Reuters (2018), *Exclusive: Russia considers extra $17 billion bailout for two rescued banks – sources*, available at: https://www.reuters.com/article/us-russia-banks-bailouts-exclusive/exclusive-russia-considers-extra-17-billion-bailout-for-two-rescued-banks-sources-idUSKCN1GS2BJ, accessed on 4 January 2019.

[634] Davydov, D. (2018), *Does state ownership of banks matter? Russian evidence from the financial crisis*. *Journal of Emerging Market Finance*, 17(2), pp. 250–285, p. 268.

[635] Viktorov, I., & Abramov, A. (2016), *The state capture of Russian non-bank financial institutions and markets after the 2008 crisis*, *Competition & Change*, *20*(1), pp. 3-20. Quote is from p. 3.

[636] Panibratov, A., & Michailova, S. (2019), The role of state ownership and home government political support in Russian multinationals' internationalization, *International Journal of Emerging Markets*, forthcoming. See also Rutland, P. (2018), The Political Elite in Post-Soviet Russia, *in The Palgrave Handbook of Political Elites*, pp. 273-294, Palgrave Macmillan, London.

[637] Simanovskiy, A., Morozov, A., Sinyakov, A., Porshakov, A., Pomelnikova, M., Ushakova, Y., Markelov, V., & Bezdudniy, M. (2018), *The 2008–2017 Decade in the Russian Banking Sector: Trends and Factors*, p. 24.

their size only in May 2018, going from RUB 3 930 billion (USD 63.9 billion at then-current exchange rates) to RUB 4 839 billion (USD 77.1 billion) in one month.

9.6 CHAPTER SUMMARY

This chapter has examined capital and access to capital in the Russian economy, seen through the institutions which intermediate capital: the Government and the financial structure. The increase in state involvement has led to a worsening stratification of the sector into mega-sized and micro-sized banks, with the middle tier squeezed out, creating difficulties in access to capital for SMEs. On the other hand, state-owned firms have had little problems in obtaining capital, which has been a key component of the Government policy since the global financial crisis. Standing at the centre of these structural changes is the CBRF, which has pursued an aggressive strategy towards consolidating the financial sector while attempting to enlarge access to capital. At the same time, it is facing difficulties in its role as mega-regulator, as it both controls and regulates several banks. This conflict of interest may also create difficulties for systemic stability in the longer run.

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[638] This chapter draws on data on supply, consumption and trade of energy from a variety of sources. Sometimes, region, energy type or fuel definitions differ between these sources which may result in data discrepancies. Whenever possible these differences are clarified but in some cases this is not possible due to a lack of clear-cut definitions in original sources.

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10.1 INTRODUCTION AND OVERVIEW OF THE RUSSIAN ENERGY SECTOR

Russia is a leading global energy producer. According to the latest internationally-comparable data, in 2018, after China and the US, Russia was the world's third largest primary energy producer,[639] the second largest producer of natural gas (after the US) accounting for 17.3% of global production, the fourth largest oil producer (after the US, China and Saudi Arabia) accounting for 12.6% of global production, the sixth largest coal producer (after China, India, the US, Japan and South Korea) accounting for 5.6% of global production, the fourth largest producer of nuclear energy (after China, the US and France), and fifth largest producer of hydroelectricity (after China, Brazil, Canada and the US).[640]

After a gradual decline in the share of gas and corresponding small increases in shares of other fuels in the 2007-18 period, oil and gas accounted each for approximately one third of Russia's primary energy production on average in the period 2016-18 (see Table 10.1). Gas remains the main fuel consumed domestically: in the period 2016-2018, on average, natural gas accounted for approximately 54% of primary energy consumption (this includes both residential and industrial consumption), while oil, coal, nuclear and hydro energy accounted for respectively 21, 12, 7 and 6%. These shares remained relatively stable in the 2007-18 period (Table 10.1).

Oil is Russia's main energy export: in the period 2016-18, oil accounted on average for 41% of Russia's net energy exports, while gas, coal, nuclear and hydro energy accounted for, respectively, 17, 12, 16 and 14%. In general, significant proportions of all kinds of primary energy produced by Russia are destined for foreign markets as shown by the respective domestic consumption to production ratios (Table 10.1). In 2018, in the case of natural gas, the country's domestic consumption was equivalent to 68% of production, while for oil, coal, nuclear and hydropower these ratios were, respectively, at 26, 40, 23 and 23%. Coal is the only fuel for which the ratio of domestic consumption to production decreased significantly – from 65% in 2007 to 40% in 2018, suggesting a significant increase in export orientation of this sector. In the case of other fuels these ratios remained largely stable in the same period (Table 10.1).

These basic statistics show that in Russia all primary energy fuel types play an important role, both in terms of domestic and external economic management. The functioning of Russia's domestic energy markets has important economic and political implications in terms of competitiveness of the domestic industry, as well as affordability of energy to residential consumers in an energy-rich and climatically-challenged country. Energy is also an important source of tax revenue (oil and gas accounted for more than one third of the federal budget revenues in 2018) but also arguably an important lever for the country's foreign policy. This provides a context for, on the one hand,

[639] BP (2019), *BP Statistical Review of World Energy 2019*, available at: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2019-full-report.pdf, accessed on 14 August 2019. Primary energy is defined as all commercially-traded fuels, including modern renewables used to generate electricity.

[640] *Ibidem.*

Russia's traditionally state-dominated approach to the management of its energy sectors and, on the other hand, the recent attempts at increasing the role of market-based principles in the country's energy markets. These initiatives emerged around 2010 and included the gradual expansion of the share of the ′independent′ producers in the total volume of domestic sales of natural gas, as well as the reform of taxation of extraction and exports of energy products which has the potential to equalise the tax treatment of domestically consumed and export-oriented energy products. However, a host of monopoly rights and the regulated prices, particularly in the natural gas sector remain an important mechanism influencing the energy markets in the country. The major elements of the tax reform still remain to be implemented and the current policies related to taxation of exports of energy continue to exercise a downward pressure on domestic energy prices.

This chapter is organised as follows. Section 10.2 presents the key market structure and ownership features in principal energy sub-sectors. Section 10.3 lays out key elements of the legal framework relevant for the energy sector as a whole. Section 10.4 discusses main taxes applicable to the energy sector and their recent reforms. Section 10.5 provides information on state support programmes in the sector while Section 10.6 discusses specific regulations applying to pricing of different energy sources and their trade on the Saint-Petersburg International Mercantile Exchange. Section 10.7 summarises the main findings of the chapter.

Table 10.1: Russia's primary energy production and consumption by fuel (millions of tonnes of oil equivalents, 2008–2018)

		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	av. growth 07-15	av. growth 16-18
Oil	production (mt)	497.3	494.3	501.4	512.3	519.5	526.7	532.2	535.1	541.8	555.9	554.3	563.3	1.08%	1.32%
	consumption (mt)	130.0	133.6	128.2	133.3	142.2	144.6	144.3	152.3	144.3	147.9	146.0	146.3	1.40%	0.47%
	net exports (mt)	367.4	360.6	373.2	379.0	377.2	382.1	387.9	382.8	397.5	408.1	408.3	417.1	1.01%	1.62%
	consumption/production ratio (%)	26%	27%	26%	26%	27%	27%	27%	28%	27%	27%	26%	26%		
	% primary energy production	33%	33%	35%	34%	34%	34%	34%	34%	34%	34%	33%	32%		
	% primary energy consumption	19%	20%	20%	20%	21%	21%	21%	22%	22%	22%	21%	20%		
	% primary energy net exports	44%	44%	46%	45%	44%	44%	43%	43%	43%	43%	41%	40%		
Gas	production (mtoe)	517.3	525.8	461.0	514.5	530.4	517.5	528.4	508.3	502.5	506.7	546.5	575.7	-0.16%	4.67%
	consumption (mtoe)	368.7	363.5	342.0	364.5	374.6	368.6	365.3	363.0	351.4	361.7	370.7	390.8	-0.54%	3.61%
	net exports (mtoe)	148.6	162.3	119.0	150.0	155.8	149.0	163.1	145.3	151.1	145.0	175.8	184.9	1.33%	7.44%
	consumption/production ratio (%)	71%	69%	74%	71%	71%	71%	69%	71%	70%	71%	68%	68%		
	% primary energy production	35%	35%	32%	34%	34%	33%	33%	32%	32%	31%	32%	33%		
	% primary energy consumption	55%	54%	54%	55%	55%	54%	54%	53%	52%	53%	54%	55%		
	% primary energy net exports	18%	20%	15%	18%	18%	17%	18%	16%	16%	15%	17%	18%		
Coal	production (mtoe)	143.5	149.0	141.7	151.0	157.6	168.3	173.1	176.6	186.4	194.0	205.8	220.2	3.38%	5.72%
	consumption (mtoe)	93.9	100.7	92.2	90.5	94.0	98.4	90.5	87.6	92.2	89.3	83.9	88.0	-0.07%	-1.41%
	net exports (mtoe)	49.6	48.2	49.6	60.4	63.6	69.9	82.6	89.0	94.2	104.7	121.9	132.1	8.62%	11.98%
	consumption/production ratio (%)	65%	68%	65%	60%	60%	58%	52%	50%	49%	46%	41%	40%		
	% primary energy production	10%	10%	10%	10%	10%	11%	11%	11%	12%	12%	12%	13%		
	% primary energy consumption	14%	15%	14%	14%	14%	14%	13%	13%	14%	13%	12%	12%		
	% primary energy net exports	6%	6%	6%	7%	7%	8%	9%	10%	10%	11%	12%	13%		
Nuclear	production (mtoe)	160.1	163.1	163.6	170.4	172.9	177.5	172.5	180.8	195.5	196.6	203.2	204.5	2.57%	1.52%
	consumption (mtoe)	36.2	36.9	37.0	38.6	39.1	40.2	39.0	40.9	44.2	44.5	46.0	46.3	2.57%	1.52%
	net exports (mtoe)	123.8	126.2	126.6	131.9	133.8	137.4	133.5	139.9	151.2	152.1	157.2	158.2	2.58%	1.53%
	consumption/production ratio (%)	23%	23%	23%	23%	23%	23%	23%	23%	23%	23%	23%	23%		
	% primary energy production	11%	11%	11%	11%	11%	11%	11%	11%	12%	12%	12%	12%		
	% primary energy consumption	5%	5%	6%	6%	6%	6%	6%	6%	7%	6%	7%	6%		
	% primary energy net exports	15%	15%	16%	16%	16%	16%	15%	16%	16%	16%	16%	15%		
Hydropower	production (mtoe)	177.1	164.8	174.2	166.5	163.1	163.5	181.2	173.4	168.0	184.8	185.3	190.2	-0.50%	4.31%
	consumption (mtoe)	40.1	37.3	39.4	37.7	36.9	37.0	41.0	39.2	38.0	41.8	41.9	43.0	-0.50%	4.31%
	net exports (mtoe)	137.0	127.5	134.8	128.8	126.2	126.5	140.2	134.2	130.0	142.9	143.4	147.2	-0.50%	4.31%
	consumption/production ratio (%)	23%	23%	23%	23%	23%	23%	23%	23%	23%	23%	23%	23%		
	% primary energy production	12%	11%	12%	11%	11%	11%	11%	11%	11%	11%	11%	11%		
	% primary energy consumption	6%	6%	6%	6%	5%	5%	6%	6%	6%	6%	6%	6%		
	% primary energy net exports	17%	15%	17%	15%	15%	15%	15%	15%	14%	15%	14%	14%		

Source: U.S. Energy Information Administration, Based on BP Statistical Review of World Energy.[641]

[641] U.S. Energy Information Administration (2017), *Country Analysis Brief: Russia*, available at|: https://www.eia.gov/beta/international/analysis.php?iso=RUS, accessed on 30 March 2019.

10.2 MARKET STRUCTURES AND OWNERSHIP

10.2.1 OIL SUBSECTOR

Russia is one of the world's largest oil[642] producers: in 2018, its oil production equalled 563.34 million tonnes (′mt′ for the purposes of this Chapter) representing 12.6% of total global production. The country's 80 billion barrels of proven crude oil reserves accounted for 4.8% of world's total reserves.[643] Oil production has been on the rise in recent years: with average annual growth rate increasing from 1.08% in the period 2007–2015 to 1.32% in the period 2016-18.[644] In 2018, Russia's exports of crude oil and oil products overtook that of Saudi Arabia's (12% of global exports) making the country the world's largest exporter. The most important importers of Russian crude oil in 2018 were countries in Europe[645] (153.3 mt, equivalent to 53% of total Russia's exports), China (71.6 mt, 26%) and other CIS economies[646] (together accounting for 18.5 mt, 7%).[647]

While Russia's main oil reserves and production are located in West Siberia and in the Urals-Volga region, the fields in East Siberia and the Arctic have been accounting for increasing shares of production and exploration, reflecting the ongoing process of offsetting of the declining output from aging fields in other regions. These developments have been supported by the Government's policies in the form of tax incentives designed to aid development of difficult-to-develop resources such as Arctic offshore and low-permeability reservoirs, including shale reservoirs (see Sections 10.4 and 10.5) but they have also been impeded by the US' and EU's sanctions post 2014 which banned provision of technology in support of Russian new deep water, Arctic offshore, or shale projects.[648]

[642] Following the definition in the BP Statistical Review, oil includes: crude oil; shale oil; oil sands; condensates (both lease condensate and gas plant condensate) and NGLs (natural gas liquids – ethane, LPG and naphtha separated from the production of natural gas). The definition excludes liquid fuels from other sources such as biomass and derivatives of coal and natural gas.

[643] Based data provided by U.S. Energy Information Administration's International Energy Statistics, available at: https://www.eia.gov/beta/international/data/browser/#/?pa=0000000000000000000008&c=ruvvvvvfvtvnvv1urvvvfvvvvvvfvvvou20evvvvvvvvvnvvuvs&ct=0&tl_id=5-A&vs=INTL.57-6-AFG-BB.A&cy=2016&vo=0&v=H&start=1980, accessed on 29 August 2019.

[644] BP (2018), *BP Statistical Review of World Energy 2018*, available at: https://www.bp.com/content/dam/bp/en/corporate/pdf/energy-economics/statistical-review/bp-stats-review-2018-full-report.pdf, accessed on 23 May 2019.

[645] As defined in BP (2018), the category *Europe* are European members of the OECD plus Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Cyprus, the former Yugoslav Republic of Macedonia, Georgia, Gibraltar, Latvia, Lithuania, Malta, Montenegro, Romania and Serbia.

[646] As defined in BP (2018), the category Commonwealth of Independent States (CIS) is composed: Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

[647] BP (2018).

[648] U.S. Energy Information Administration (2017), *Country Analysis Brief: Russia*, available at: https://www.eia.gov/beta/international/analysis_includes/countries_long/Russia/russia.pdf, accessed on 7 November 2019.

As of 1 January 2019, there have been 290 companies licensed to produce oil and gas condensate (oil liquids) from the subsoil resources.[649] The subsector is highly integrated, with 85.2% of Russia's oil production delivered by 100 entities included in the structure of 11 vertically integrated companies (′VIC′). The remaining production was controlled by 187 companies not included in the structure of the VICs and three companies that operated under partnership and production sharing agreements.[650]

In 2018, Russia's nine largest oil-producing companies produced close to 457.9 mt of the resource or 82% of the total: Rosneft (194.2 mt or 35% of the total), Lukoil (82.1 mt, 15%), Surgutneftegas (60.9 mt, 11%), Gazprom Neft (39.5 mt, 7%), Tatneft (28.6 mt, 5%), Bashneft (18.9 mt, 3%), Slavneft (13.8 mt, 2%), Novatek (11.8 mt, 2%) and Russneft (7.1 mt, 1%) (Figure 10.1). The largest companies in the subsector have remained under the Government's influence: Rosneft's major shareholder is Rosneftegaz (fully owned by the Government[651]); Gazprom Neft is a subsidiary of Gazprom[652] which is majority state-owned, Tatneft is partially owned by the Republic of Tatarstan, while Bashneft is majority-owned by Rosneft. Slavneft is a formerly state-owned company of the Government of Belarus and it is currently controlled jointly by two Russian state-owned companies: Rosneft and Gazprom.[653] Lukoil is a former state-owned enterprise which was privatised in 1993 and is currently the largest Russian private oil producing company. Surgutneftegaz was also created in 1993 by merging previously state-owned companies and is today a fully privately-owned company. Russneft and Novatek are also privately-owned.

These figures suggest therefore that in the period 2015-18, Russian State-owned companies accounted for a stable share of oil production of 54-53%. This however may not truly reflect the actual extent of the influence of the Government on the oil-producing industry as even the privately-owned oil producers have a close relation with the Kremlin.[654] The latter is not surprising given the strategic and economic importance of the energy sector and the economic significance of these energy companies' operations in Russia.

[649] Ministry of Energy of the Russian Federation (2018), *Extraction of crude oil*, available at: https://minenergo.gov.ru/node/1209, accessed on 1 September 2019.

[650] Partnership and production sharing agreements are contractual arrangements for petroleum extraction and development under which the State as the owner of mineral resources engages a private oil company as a contractor to provide technical and financial services for exploration and development operations by offering it an entitlement to a specified share of the oil produced.

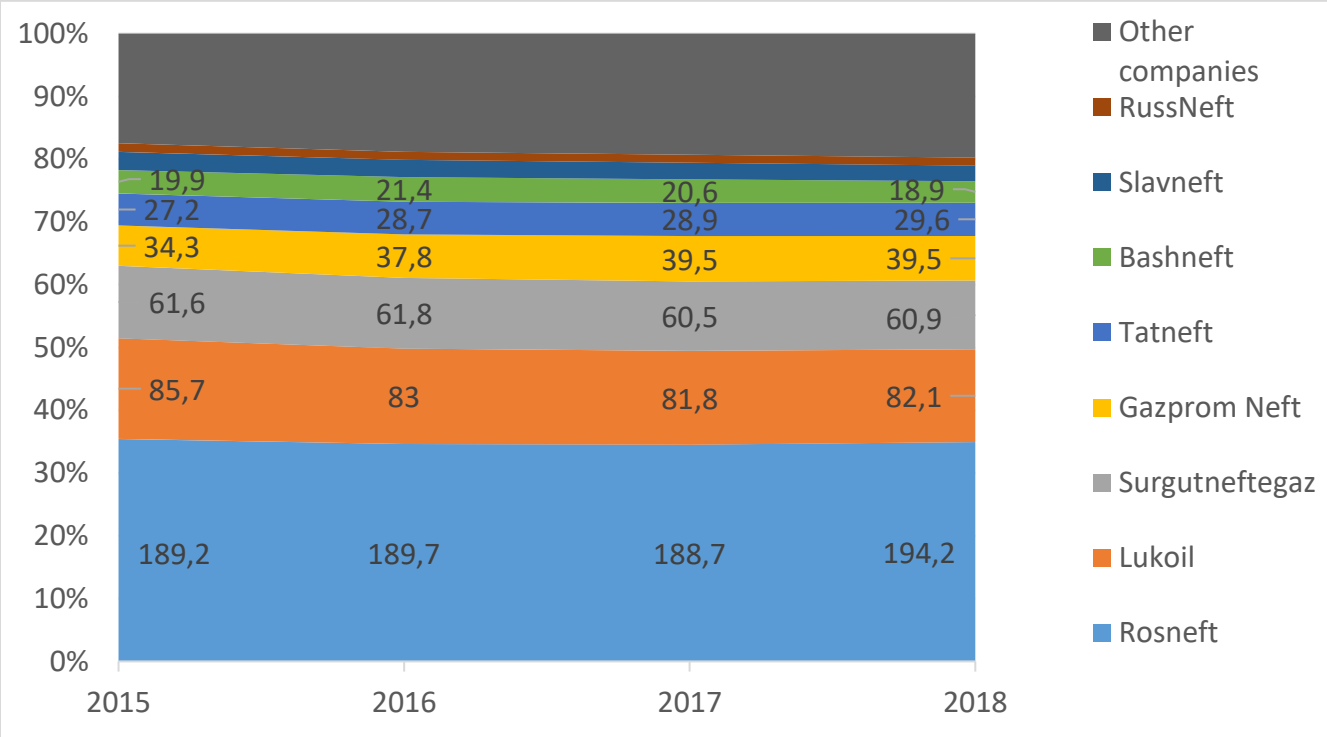
[651] Through the FPA.

[652] Throughout the chapter, the company is referred to as either ′PJSC Gazprom′ or ′Gazprom′.

[653] The company's official website reports that Rosneft and Gazprom Neft control 99.7% of the company's shares on a par, available at: http://www.slavneft.ru/eng/company/history/, accessed on 1 September 2019.

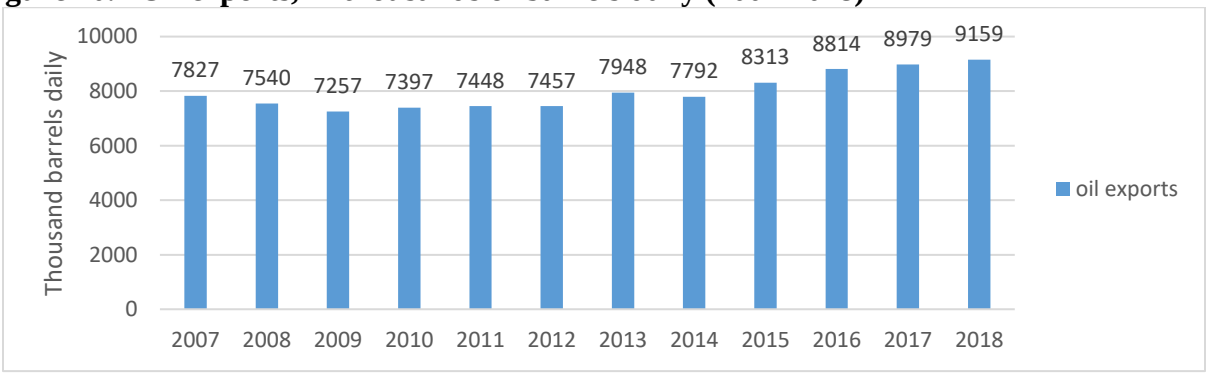
[654] The former state-owned company Surgutneftegaz, for example, due to its importance as an oil producer, as well as financial reserves holder, is seen as a company that is closely linked to the Kremlin, see:
Bne IntelliNews (2019), *Russia's privately owned oil major Surgutneftegaz makes more profit from its cash pile than producing oil*, available at: https://www.intellinews.com/russia-s-privately-owned-oil-major-surgutneftegaz-makes-more-profit-from-its-cash-pile-than-producing-oil-160637/, accessed on 8 November 2019.

Figure 10.1 Oil production of the largest Russian oil companies (% shares)



Source: Deloitte (2019), Overview of the Russian oilfield services market -2019, Deloitte CIS Research Center, Moscow.[655]

Figure 10.2 Oil exports, in thousands of barrels daily (2007-2018)[656]



Source: data presented in the BP Statistical Review 2019.

The recent slight variations in output observed (Table 10.1) can be explained by Russia's signing an agreement with Organization of Petroleum Exporting Countries ('OPEC') and other oil-producing economies in 2016. The decision aimed to lower production to remedy a supply glut

[655] Deloitte (2019), *Overview of the Russian oilfield services market – 2019*, Moscow, available at: https://www2.deloitte.com/content/dam/Deloitte/ru/Documents/energy-resources/oil-gas-survey-2019-en.pdf, accessed on 8 November 2019.

[656] Internal calculations based on the data presented in the BP Statistical Review 2019.

and support oil prices in 2017 and 2018.[657] However, in light of international developments, OPEC decided to increase output and Russia more than reversed the initial cut[658] as reflected in increasing export volumes in the recent years (Figure 10.2).

10.2.2 NATURAL GAS AND LIQUEFIED NATURAL GAS SUBSECTOR

With 575.65 million tonnes of oil equivalent (′mtoe′) of natural gas produced in 2018, Russia was the world's second largest producer accounting for 17.3% of global production. Longer term trends in production dynamics suggest however that the country has been gradually losing its share in global production; its production grew at an average annual growth rate of approximately 1% in the period of 2007-18 when the world's total production was growing at an average annual rate of 2.9% (Figure 10.3). In 2018, Russia still harboured the world's largest proven reserves of gas. Located in West Siberia, mainly in the Yamal-Nenets Autonomous Region, they were estimated at 38.9 trillion cubic meters in 2018 (19.8% of the global stock). However, the annual average growth rate of Russian reserves reached 1.3% in the period 2007-2018, which was also below the world average of 1.9%. The reserve-to-production ratio[659] was at 58.2 years in 2018 which was above the one for the world as whole (50.9 years), as well as the ratios recorded for both Americas (46.3 for South and Central America and 13.2 for North America), suggesting a longer than average time to potential exhaustion of the reserves at the current rate of extraction.[660]

As of 1 January 2018, there were 254 gas and associated petroleum gas mining companies in Russia.[661] The Gazprom Group has long dominated gas production in Russia, accounting as of 2018 for 74% of national natural gas production (499 billion cubic meters ('bcm')). Novatek produced 69 bcm of gas (10% of Russia's total production), Rosneft 67 bcm (10%), Lukoil 28 bcm (4%), and Surgutneftegaz 10 bcm (1%) (See Figure 10.4).

At the end of 2018, the Russian Federation, represented by FPA, was Gazprom's largest shareholder, with the direct stake amounting to 38.37%. Another 10.97% and 0.89% of equity was controlled by Rosneftegaz and Rosgazifikatsiya respectively.[662] Rosneftegaz, which is itself fully state-owned, controls the majority of Rosneft, the third largest Russian natural gas producer in 2018 and 74.55% stake in Rosgazifikatsiya. As Gazprom itself reported in its 2018 annual

[657] In line with IEA's data and Rosneft annual calculations, the resultant shortage in the oil market equalled 0.4 million barrels (mmb) per day in 2017 (Rosneft Annual Report 2017, p. 20).

[658] Russia recorded higher production from the market leader, Rosneft; on the other hand, GazpromNeft reported slightly lower output.

[659] Reserves-to-production ratio is the outcome of dividing the end-of-year reserves by the production achieved that year. The result is the length of time during which the reserves would last, should the production be maintained at that rate.

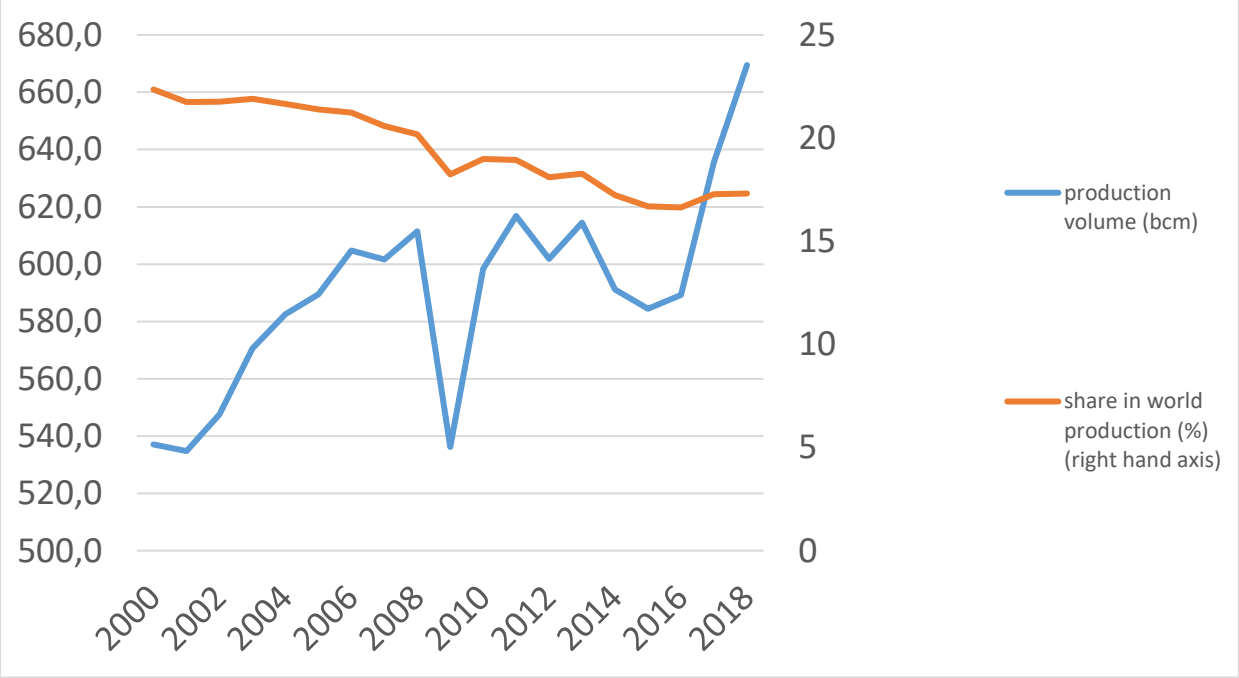
[660] BP (2019), *BP Statistical Review of World Energy 2019*, available at: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2019-full-report.pdf, accessed on 14 August 2019.

[661] Ministry of Energy of the Russian Federation, *About gas industry*, available at: https://minenergo.gov.ru/node/1156, accessed on 1 April 2019.

[662] The remaining shares were owned by ADR holders and sundry investors, both private and institutional. Source: Gazprom's 2018 Annual Report.

report,[663] its cumulative shareholding is controlled directly or indirectly by the Russian Federation and, calculated by direct addition, totals 50.23%. Novatek and Lukoil are considered to be independent companies; both of them are fully privately-owned companies, although Lukoil is a former state-owned enterprise (see section 10.2.1 above). Rosneft is also referred to as independent, because it is not considered a part of Gazprom Group and thus is not subject to some of the state regulation and the related rights and obligations granted by the State specifically to Gazprom (see Section 10.6.1), even though it is related to Gazprom through the common parent company Rosneftgaz and controlled by the State as the ultimate owner.

Figure 10.3 Russia's overall natural gas production and its share in the world production



Source: BP Statistical Review of World Energy for 2019.

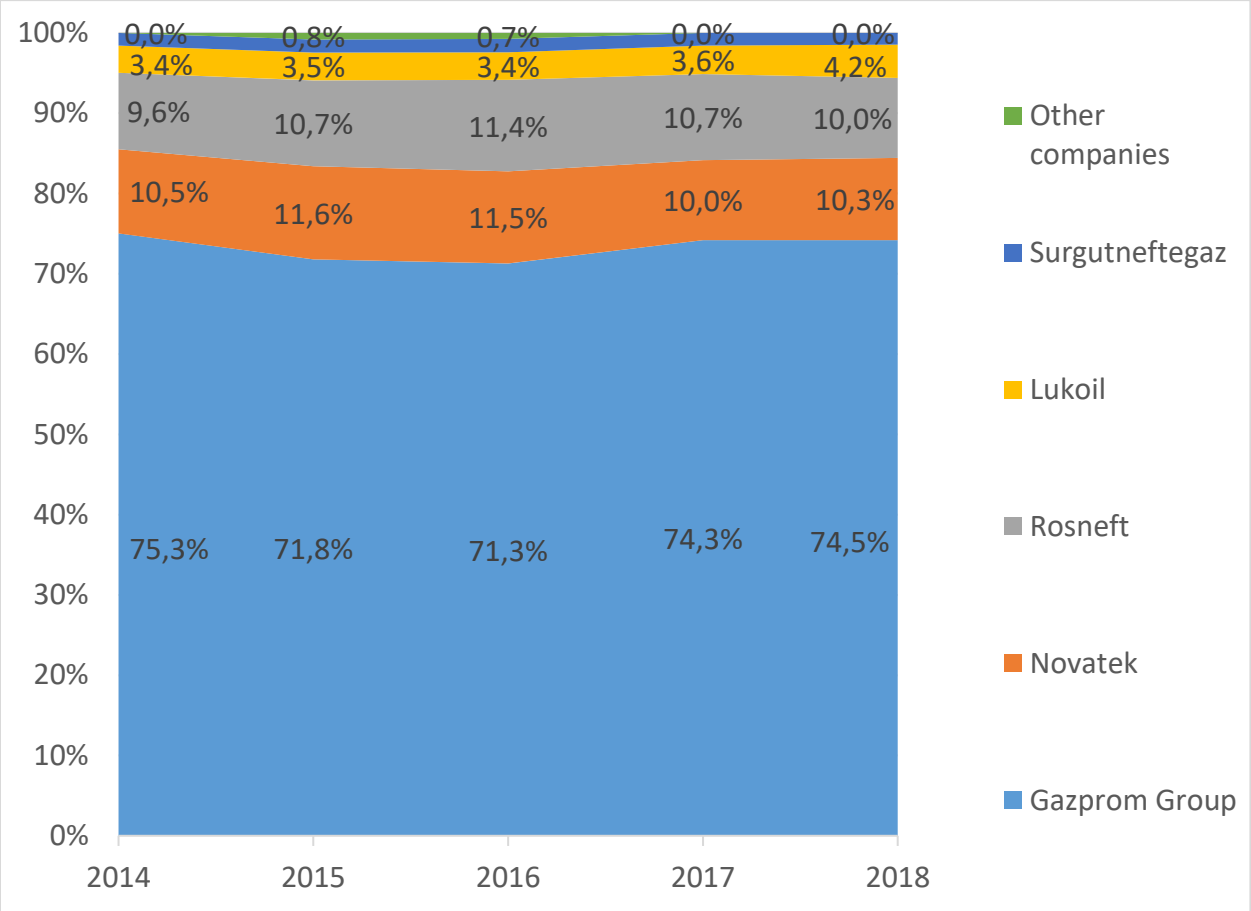
The Gazprom's Group share in Russia's production remained relatively stable in the period 2014-18 although a rebound from 71% in 2016 to 74% in 2018 was observed and it coincided with the decline of Novatek's and Rosneft's shares from approximately 11 to 10% (Figure 10.4). Lukoil's share increased from 3.4% in 2014 to 4.2% in 2018. These figures show that Gazprom's production share has not been decreasing decisively in recent years to the benefit of other companies.[664] Moreover, the Group is also by far the largest gas producer internationally, outdistancing with its gas production volumes by a factor of four or more such large international players as the Royal

[663] Gazprom (2018), *Reports 2018*, available at: https://www.gazprom.com/investors/disclosure/reports/2018/, accessed on 8 November 2019.

[664] It should be noted however that, as regards the remaining market segments, the market structure is different, with Rosneft and Lukoil dominating both hydrocarbon production and oil and stable gas condensate refining sectors.

Dutch Shell, Petro China, Exxon Mobil or BP.[665] Overall, through ownership of Gazprom and Rosneft the State controls today over 85% of Russia's natural gas production.

Figure 10.4. Natural gas production of the largest Russian companies (% shares)



Source: Internal calculations based on BP Statistical Review of World Energy for 2019, combined with information from companies' annual reports.

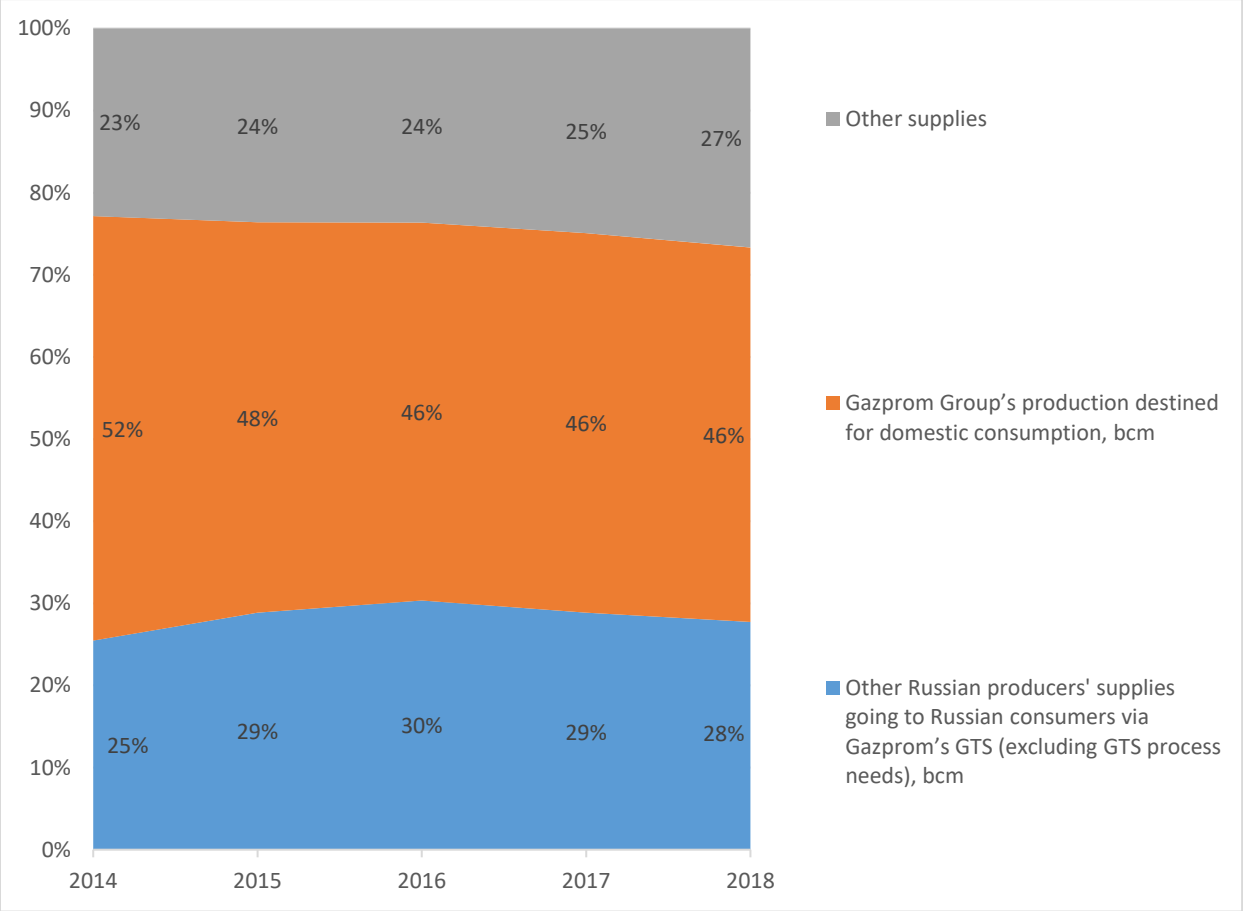
Gazprom remains also an undisputed leader as far as internal market share is concerned.[666] This is not only because it directly satisfies 46% of domestic consumption but also because further 28% of domestic consumption is satisfied by other producers through the Gas Transmission System ('GTS') (Figure 10.5), the transportation part of Russia's Unified Gas Supply System ('UGSS') over which Gazprom maintains statutory ownership and control granted to it by the State. Gazprom manages the GTS, allocates capacity to independent companies and determines routes for their gas transport to consumers (for a more detailed discussion of Gazprom's ownership of the UGSS and

[665] See for example page 46 of *Gazprom's 2018 Annual Report*, available at: http://www.gazprom.com/f/posts/67/776998/gazprom-annual-report-2018-en.pdf, accessed on 10 September 2019.

[666] PJSC Gazprom's official annual reports and financial statements remain one of the few standardised and complete (in terms of quality and time span) sources of data regarding the development of the Russian domestic energy market. Therefore, to avoid divergences in measurement techniques and to preserve the consistency of data used, the analysis in this sub-section draws on them, among other (Russian and international) sources.

the implications for its dominant role in domestic gas transmission and supply see Section 10.2.2.1). Gas supplied by the independent companies through GTS is not subject to regulated consumer prices, but it is subject to regulated gas transportation tariffs (see Section 10.6.1) and the latter depend also on transport routes allocated to independent companies by Gazprom. This means that in 2018, 74% of the country's internal natural gas consumption was controlled either directly or indirectly by Gazprom.

Figure 10. 5 Gazprom's contribution to domestic gas consumption in Russia, 2014–2018 (% shares)



Source: Calculations based on Gazprom's 2018 Annual Report.[667]

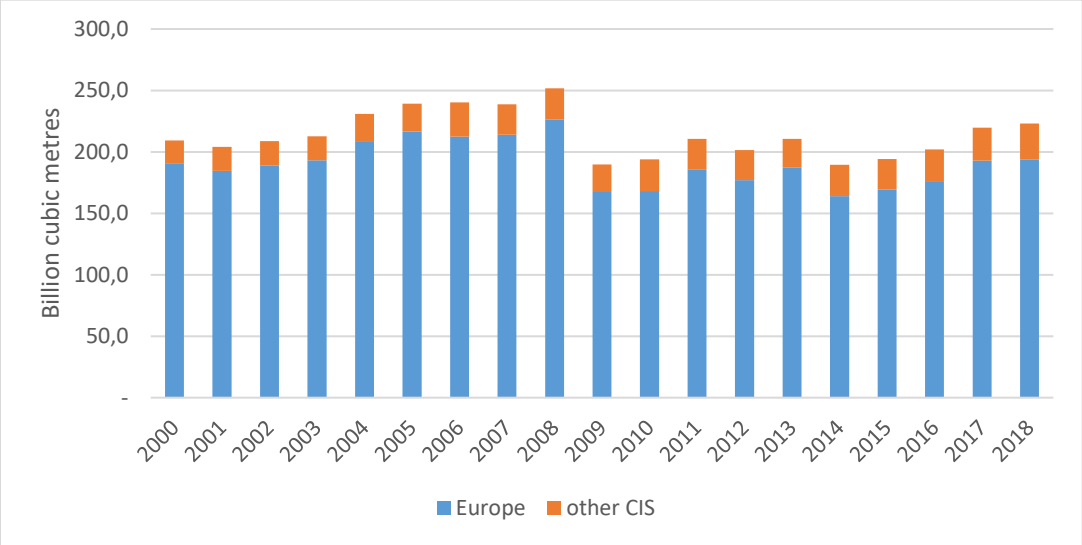
Europe is a chief destination for Russian gas exports (Figure 10.6). In 2018, 223 bcm (or 33% of Russia's natural gas production) was exported via pipelines, mainly to Europe (194 bcm or 87% of all exports, including Turkey and Ukraine)[668] and CIS (29 bcm or 13% of exports). Russian exports of gas to Europe constituted also 20.5% of total exports of gas by all countries (23.6% of world export flows, if CIS countries are included in the calculations). The bulk of exports to Europe

[667] Gazprom's Annual Report 2018, Table "*Gazprom's contribution to covering domestic gas consumption in Russia, 2014–2018*", p. 72.

[668] Attention: BP (2019) *BP Statistical Review of World Energy* includes both Ukraine and Turkey as part of Europe. Separate data for Ukraine, Spain and Belgium are not available in the database.

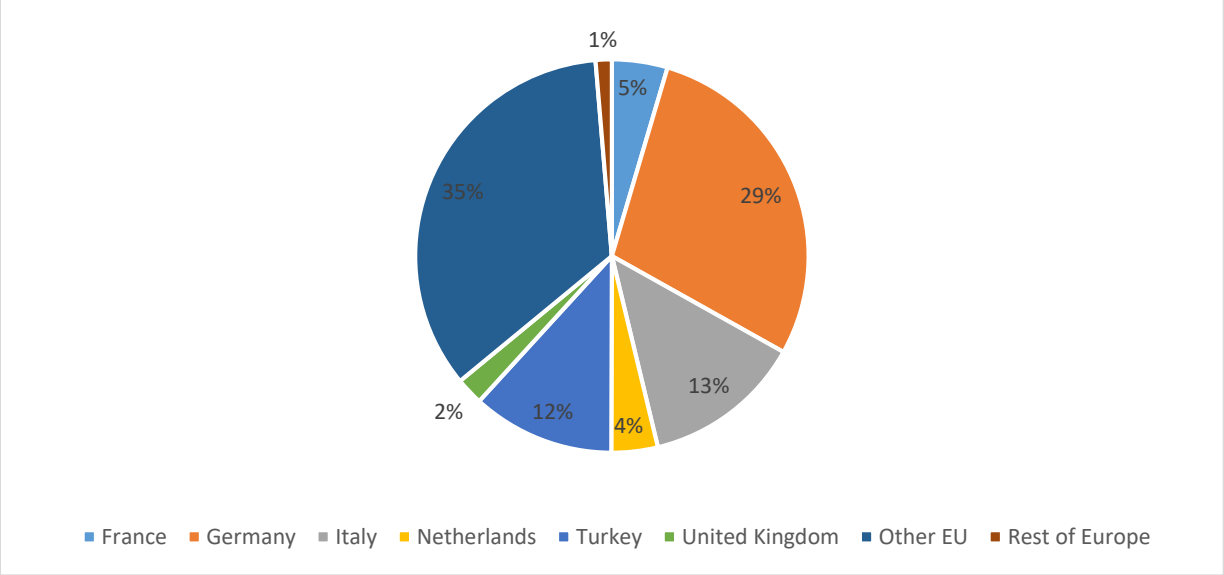
was destined for Germany (29%) and Italy (13%) (Figure 10.7). From the European importers' point of view, Russian gas constituted over 40% of total natural gas imports by Europe and over 50% of imports by the CIS countries. Because of its domination in the upstream segments of the Russian gas sector, as well its legal monopoly on pipeline gas exports (see Section 10.2.2.1), Gazprom has also dominated the exports destined to Europe, increasing its share of European gas imports from 26% in 2012 to 37% in 2018 (Figure 10.8) and outdistancing other players such as Statoil and Sonatrach.

Figure 10.6 Russian pipeline gas exports 2000-2018



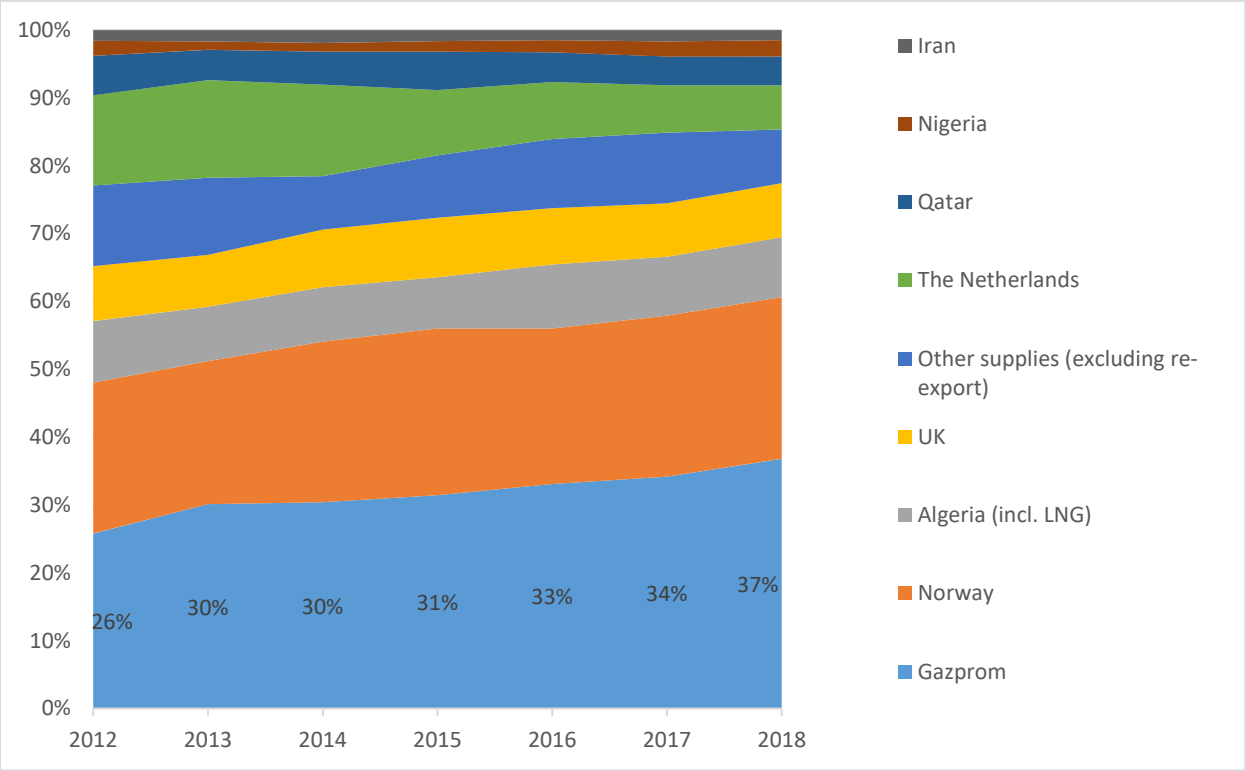
Note: BP categorisations sometimes include Ukraine in the CIS category, here *exports to other CIS* exclude Ukraine which is included in the Europe aggregate.
Source: Internal calculations based on the data retrieved from the BP Statistical Review of World Energy for 2019.

Figure 10.7 Russian gas exports to Europe in 2018



Source: Internal calculations based on the data retrieved from the BP Statistical Review of World Energy for 2019 database.

Figure 10.8 Gazprom's position in gas supplies to Europe, 2012–2018 (% shares)



Source: Internal calculations based on Gazprom's 2018 Annual Report.

10.2.2.1 Gazprom's ownership of the Unified Gas Supply System and its dominant role in domestic gas transport and supply, and monopoly in international gas trade

The rules governing gas transmission and distribution within the domestic market are laid out in the Federal Law No.147-FZ of 17 August 1995 on Natural Monopolies ('Law on Natural Monopolies')[669] and the Federal Law No. 69-FZ of 31 March 1999 on Gas Supply in the Russian Federation ('Law on Gas Supply').[670] As described in Articles 5-7 of the Law on Gas Supply, the Federal Gas Supply system is composed of the UGSS, regional gas supply systems,[671] gas distribution systems[672] and independent organisations.[673] The UGSS covers the European part of

[669] Available at: http://ivo.garant.ru/#/document/10104442/paragraph/43639:0, accessed on 19 September 2019.
[670] Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102058940, accessed on 19 September 2019.
[671] These are the main gas supply systems in the territories of the respective constituent entities of the Russian Federation which are not connected to the UGSS (Article 7 of the Law on Gas Supply.
[672] Gas distribution systems are facilities designed to transport and supply gas directly to its consumers in the corresponding territories of the Russian Federation, is independent of the Unified gas supply system and regional gas supply systems (Article 7).
[673] These are not defined specifically in the Law on Gas Supply.

Russia excluding eastern Siberia and the Far East where gas is supplied via the regional gas supply systems.[674]

According to Article 4 of the Law on Natural Monopolies, transportation of gas in pipelines is a natural monopoly. Article 15 of the Law on Gas supply requires that the UGSS - the world's largest gas transmission system comprising some 158,200 kilometres of gas trunklines and branches and 218 compressor stations - remains state-owned. This is guaranteed by stipulating that at least 50% plus one share of its ordinary shares are owned directly by the Russian Federation or indirectly via entities in which the Russian Federation owns more than 50%. Gazprom, in which the Russian Federation has long held a majority stake, is the current owner of the UGSS.[675] As per Article 27 of the Law on Gas supply, Gazprom as the owner of the UGSS, is obliged to provide access to UGSS' gas pipelines to independent gas suppliers, which, unlike Gazprom, can supply gas to consumers at unregulated prices[676] (see Section 10.6.1), if: *(1)* spare capacity in the gas pipelines is available; and *(2)* the gas by independent suppliers meets certain quality criteria. In 2018, Gazprom reports to have pumped 136.4 bcm of gas for 25 independent companies, which amounted to 19.7% of total distribution of gas via Gazprom's GTS[677] (693.1 bcm).[678] Non-discriminatory third party access to non-UGSS pipelines is governed by the same law, but the Government has only established rules of access to UGSS.[679] Only a general framework of access

[674] The powers of the federal and local governments in the field of gas supply are described in Article 9 of the Law where the former is responsible for areas such as the development and implementation of state policy in the field of gas supply, regulation of strategic gas reserves, standardisation, balance of gas production and consumption, prices and transportation tariffs, while the local governments are responsible for issues related directly to the organisation of gas supply to the population.

[675] The legal basis for this is the Presidential Decree N.º 1333 of 5 November 1992 "*on the Transformation of the State Gas Concern Gazprom into the Russian Joint Stock Company Gazprom"* where Article 3 states that, *"Gazprom's charter capital is formed from 100 percent of the capital of enterprises consisting of property of the Unified gas supply system located belonging to the federal property*", available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102019464&intelsearch=%D3%EA%E0%E7%EE%EC+%CF%F0%E5%E7%E8%E4%E5%ED%F2%E0+%D0%EE%F1%F1%E8%E9%F1%EA%EE%E9+%D4%E5%E4%E5%F0%E0%F6%E8%E8+%EE%F2+5+%ED%EE%FF%E1%F0%FF+1992+%E3%EE%E4%E0+%E8+%CF%EE%F1%F2%E0%ED%EE%E2%EB%E5%ED%E8%E5%EC+%CF%F0%E0%E2%E8%F2%E5%EB%FC%F1%F2%E2%E0+%D0%EE%F1%F1%E8%E8+%EE%F2+17+%F4%E5%E2%F0%E0%EB%FF+1993+%E3%EE%E4%E0+%AB%C3%E0%E7%EF%F0%EE%EC%BB+%F1%F2%E0%EB+%E0%EA%F6%E8%EE%ED%E5%F0%ED%FB%EC+%EE%E1%F9%E5%F1%F2%E2%EE%EC, accessed on 18 October 2019.

[676] They do however still have to pay to Gazprom tariffs for gas transmission and these are regulated by State (see Section 10.6.1).

[677] Most of Gazprom's GTS forms part of UGSS, available at: https://www.gazprom.com/about/production/transportation/, accessed on 18 October 2019. Note also that this share is lower than the one that could be inferred from Figure 10.5. However, Figure 10.5 gives a share of independent suppliers in supply to domestic users while the figure cited here from Gazprom sources is the share of gas pumped for independent gas producers through Gazprom's GTS (136.4 bcm) in total transmission of gas within the GTS (693.1 bcm in 2018), including exports and imports of gas.

[678] The discrepancy of this figure with the one given for the entire Russian gas production at some 670 bcm in 2018 (Figure 10.3) is due to the fact that foreign gas sourced from some of the FSU countries in Central Asia is also transported within the GTS.

[679] Government Resolution N.º 858 of 14 July 1997 "*on Ensuring Access of Third Parties to the Gazprom Gas Transportation System*" (with amendments from 20 November 1999 N.º 1275, 2 November 2000 N.º 843, 3 May

to non-UGS system currently exists and the new pipeline developments in the non-UGS system in eastern Siberia and the Far East in recent years make the application of these general rules particularly problematic.[680] In addition, the Law on Gas supply does not provide for the possibility of regulatory bodies to monitor Gazprom's technical abilities and the UGSS spare capacity which gives the company a degree of discretion for setting the conditions for third parties' access to the gas pipelines. Moreover, the framework does not specify liability for failure to provide (or an untimely provision of) access to the gas transportation systems, if technical opportunities are adequate.

Finally, Gazprom, as the owner of the UGSS charges to third parties gas transmission tariffs for transportation of their gas through UGSS and non-UGSS networks (including third party pipelines). These tariffs are set by the State (for more on how these tariffs are set see Section 10.6.1) and depend on where the gas enters and exits the system, as well as on the route that it takes between these points. The latter is determined by Gazprom, the central operator and manager of the UGSS, and takes into account the parameters and balance of the whole system so as to minimise a total volume of transportation in the UGSS as a whole. Transport by the shortest route is therefore not required by law and there have been complaints in the past by independent companies about allegedly circuitous routes selected for transport of their gas through the UGSS by Gazprom.[681]

Gazprom's discretion and the company's resulting ability to obstruct independent gas producers' access to the transmission and distribution facilities can lead to shifts in prices of the resource obtained by them. This situation may allow the company to achieve monetary profits on the price differences obtained by purchasing the resource from the independent companies. This can also include limiting independent companies' access to information and tenders which can lead to possible pricing distortions in tendering procedures. In this context, it seems that the monopolistic rights of Gazprom with respect to the UGSS allows it to further strengthen its market position.[682]

Gazprom also remains the sole entity with the right to sell natural gas to markets beyond Russia, as per Article 3, Exclusive Right to Gas Export, of the Federal Law No. 117-FZ of 18 July 2006 on Gas Export ('Law on Gas Export'), which states that '*[…] The exclusive right to gas export*

2001 N.º 334, 16 April 2012 N.º 323, 19 June 2014 N.º 566), available at: http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=164592, accessed on 18 October 2019.

[680] For example, as compared to established pipeline systems serving established locations, the concept of spare capacity is more difficult in the context of newly developed pipelines (many of them with new Asian export markets in mind) while from an economic and legal point of view allocation of new capacity should be part and parcel of new projects development. See Yafimava, K. (2015), *Evolution of gas pipeline regulation in Russia: Third party access, capacity allocation and transportation tariffs*, Oxford, Institute of Energy Studies, Paper No. 95, available at: https://www.oxfordenergy.org/publications/evolution-of-gas-pipeline-regulation-in-russia-third-party-access-capacity-allocation-and-transportation-tariffs/?v=9b7d173b068d, accessed on 15 October 2019.

[681] See e.g. Yafimava, K. (2015), p. 34.

[682] See e.g. Glazunov, M. (2016), *Corporate Strategy in Post-Communist Russia*, Routledge Contemporary Russia and Eastern Europe Series, Routledge; 1st ed., pp. 111-113, p. 121.

shall be granted to the organisation being the owner of the unified gas supply system or to a branch company thereof in whose authorized capital the share of participation of the organisation being the owner of the unified gas supply system amounts to 100 per cent'.[683]

Gazprom's export monopoly was somewhat diminished in 2013, as a result of the liberalisation of liquefied natural gas ('LNG') export activities. Until December 2013, in line with the Law on Gas Export, the owner of the UGSS, that is Gazprom or its entirely owned subsidiary Gazpromexport, had the sole right of exporting gas outside Russia, be it as pipeline gas or as LNG. In December 2013, the law was amended to allow certain entities, meeting specific criteria, to engage in LNG exports. These criteria state that the exporting rights can be granted to companies which, as of January 2013, have provisions in their subsoil use license which allow for the building of an LNG unit (facility) and/or the transportation of the extracted resource to an appropriate facility for liquefaction; alternatively the companies which operate on subsoil plots located within inland sea waters, territorial sea, or continental shelf and which are under either direct or indirect control of the State via a stake of at least 50% in their equity and their subsidiaries.[684] Even though this amendment improved the position of Novatek (an independent company) and Rosneft (a state-owned company),[685] it did not impact exports of conventional gas from Russia via pipelines and the monopolistic position of Gazprom in the piped gas trade.[686,687] Indeed, the change in the legal framework had an impact on Rosneft and Novatek with their respective LNG projects in Sakhalin and in the Arctic. As of writing of this report, the entry to the export market remains blocked for other market participants, as they do not meet the above-mentioned criteria.[688]

As for Gazprom's export monopoly rights, the latest official governmental statements that were possible to identify in the preparation of this report[689] did not indicate an intention to alter the company's monopolistic position. It has to be noted however that in 2018 the press reported that a reform was proposed by the Russian Center of Strategic Research[690] whereby Gazprom would

[683] Available at: http://ivo.garant.ru/#/document/12148416/paragraph/1:0, accessed on 19 September 2019.

[684] Article 2, Section 3 of the Law on Gas Export. See also Josefson, J.A and Rotar, A. (2014), *Russian LNG: export liberalization*, available at: https://www.lexology.com/library/detail.aspx?g=96f723b2-edbe-4d38-beab-ffc315413932, accessed on 14 August 2018.

[685] Kardaś, S. (2013), *A feigned liberalisation: Russia is restricting Gazprom's monopoly on exports*, Centre for Eastern Studies N.º 121.

[686] Gazprom's 2013 Annual Report notes, however, that *"LNG exports liberalised in December 2013 also affected the Company's image among investors,*" p. 107.

[687] Hille, K. (2013), *Russia paves way for limited liberalisation of LNG exports*, Financial Times, available at: https://www.ft.com/content/810adb6e-539c-11e3-b425-00144feabdc0, accessed on 8 November 2019.

[688] See e.g. Mitrova, T. (2013), *Russian LNG: The Long Road to Export*, IFRI Russia/NIS Center, available at: https://www.ifri.org/sites/default/files/atoms/files/defifrimitrovalngengdecember2013.pdf, accessed on 8 November 2019.

[689] TASS (2017), *Gazprom's gas export monopoly status out of discussion — deputy minister*; available at: http://tass.com/economy/967662, accessed on 25 March 2019.

[690] A non-governmental institution with which the authorities engage but which does not express their mainstream views.

relinquish its monopoly over the UGSS in the period 2021–22 while exports liberalisation in the sector would begin in 2027. [691]

10.2.2.2 LIQUEFIED NATURAL GAS

The development of Russian LNG segment has implications for Russian domestic energy market, as well as for international energy markets. LNG is produced out of natural gas by cooling it down to liquid form for ease of storage and transport. Provided appropriate infrastructure exists (such as terminals for sea, train or road LNG transport), LNG can be transported on long distances to specific locations independently of the pipeline system. Russian LNG market has developed rapidly over the last decade. Reliable statistics on domestic LNG consumption in Russia are not readily available by and expert sources usually treat LNG as a typical export product and distinguish it from domestically-consumed gas.[692] It is thus plausible to assume that while some trade in LNG may be taking place within Russia, the majority of LNG produced in the country is destined for foreign markets. Having said that, LNG is produced from natural gas and its production depends on the cost of and access to the latter. Demand for LNG thus feeds into the demand for gas supplied via pipelines. LNG and natural gas markets are thus interconnected.

In 2018, by exporting 24.9 bcm of LNG, Russia accounted for 5.8% of global LNG exports, up from 2.7% in 2009, when the field Sakhalin-2 went online and Russia started exporting LNG (see Figure 10.9 for information on the recent dynamic of Russia's LNG exports). It is estimated that the Yamal field, operating at full capacity, will likely increase Russia's yearly capacity twofold (to ca. 10% of global LNG exports).

So far, the LNG projects in the Arctic have markedly boosted Russian LNG production. The Government's support of the segment has been of a particular economic importance: to promote LNG exports, the Government undertook several actions, such as abolishing the export duties on new Arctic offshore oil and gas projects (see also Section 10.5); moreover, it granted the rights to export LNG to independent companies, such as Novatek and the state-owned, but independent

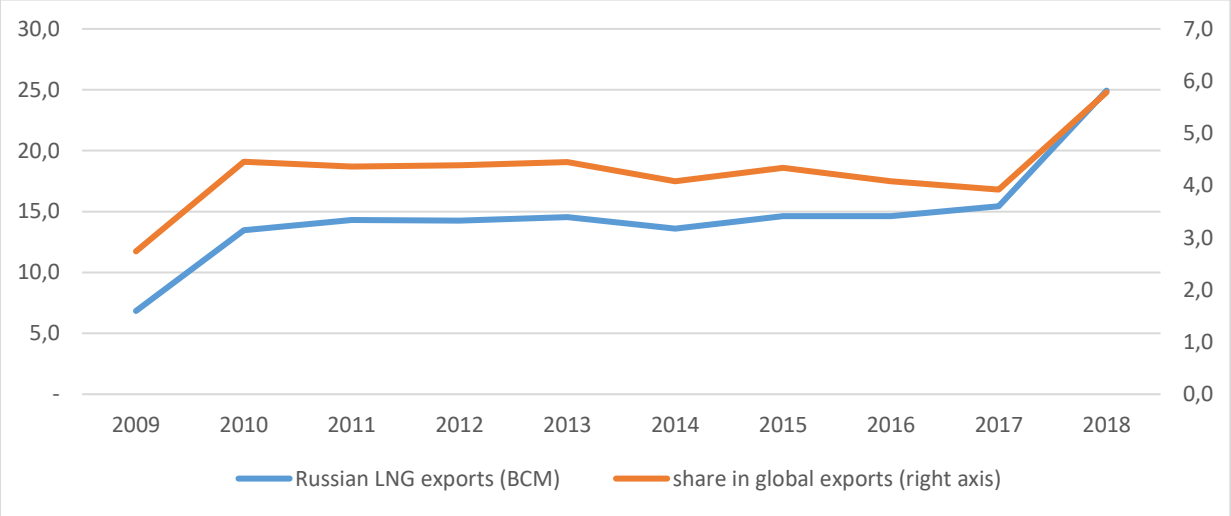
[691] BiznesAlert (2018), *Raport CSR: Gazprom powinien stracić monopol na eksport gazu z Rosji https://biznesalert.pl/gazprom-rosja-eksport/* (in English: *CSR Report: Gazprom to lose its monopolistic position as Russia's gas exporter*); CSR (2017), *Experts discuss the problems of natural monopolies*, available at: https://www.csr.ru/news/eksperty-obsudili-problemy-estestvennyh-monopolij/, accessed on 25 March 2019.

[692] For example, the McKinsey's Global Gas and LNG Outlook to 2035 includes in the category "gas consumed where produced" only data in flows with countries for Malaysia and Indonesia, but not Russia (McKinsey (2018), *Global Gas & LNG Outlook to 2035*, available at: https://www.mckinsey.com/solutions/energy-insights/global-gas-lng-outlook-to-2035/~/media/3C7FB7DF5E4A47E393AF0CDB080FAD08.ashx, accessed on 8 November 2019). Also, Novatek, in its 2018 Annual Report reports that it *"sells its natural gas on the Russian domestic market through the Unified Gas Supply System (UGSS) and on international markets mainly in the form of liquefied natural gas (LNG)."* PAO NOVATEK (2019), *PAO NOVATEK Annual Report 2018*, available at: http://www.novatek.ru/common/upload/doc/04_NOVATEK_AR_2018_ENG_15.pdf, accessed on 8 November 2019).

from Gazprom, Rosneft (see Section 10.2.2.1 for an explanation of the relevant legal amendment to the Law On Gas Export).

The development of the Arctic natural resources was in fact at the origin of the independent companies' ability to export gas. Novatek has long argued for the abolition of Gazprom's gas exports monopoly and against having to rely on its infrastructure[693] and, as discussed in Section 10.2.2.1, it partially succeeded in its efforts as testified by the amendments to regulations pertaining to LNG exports. More recently, the Government Resolution No. 1663 of 27 December 2017[694] allowed in turn Gazprom and its subsidiaries to apply unregulated (and presumably higher) tariffs in selling natural gas to economic agents in the LNG subsector for liquefaction and export purposes. This suggests indirectly that LNG production and exports by companies other than Gazprom are gaining in importance.

Figure 10.9 Russia's LNG exports



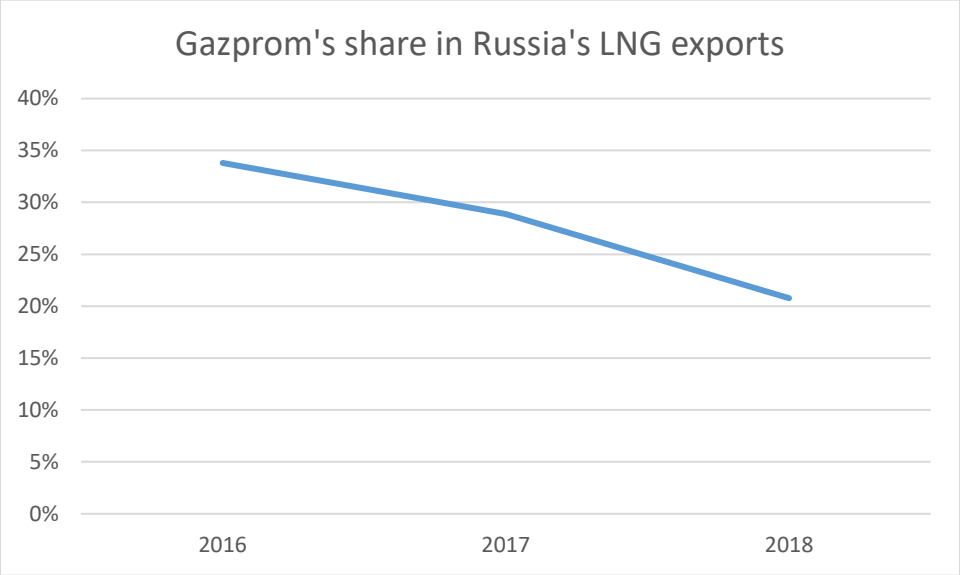
Source: BP Statiscal Review

Until recently, Russia had only one large-scale LNG plant, Sakhalin-2 in Russia's Far East, led (through majority ownership of the project) by Gazprom. In 2018, another large-scale plant, Yamal LNG on the Arctic Yamal peninsula, majority owned by Novatek, reached its full capacity and shipped its first cargoes to Europe, Asia Pacific and Latin America.[695] In addition, a number of other large-scale LNG projects in Russia are at various stages of planning.[696] Available estimates

[693] Chen (2018).
[694] Available at: http://www.consultant.ru/document/cons_doc_LAW_286507/92d969e26a4326c5d02fa79b8f9cf4994ee5633b/, accessed on 8 November 2019.
[695] Novatek (2018), *Annual Report*.
[696] See e.g. the section on "*Russia's large-scale liquefied natural gas projects*" in: https://www.eia.gov/beta/international/analysis_includes/countries_long/Russia/russia.pdf, accessed on 21 February 2020.

regarding Russia's LNG production capacity[697] suggest that Novatek's Yamal LNG production unit is likely to gain market share in the future and may overtake other LNG production units, with Shtokman,[698] Sakhalin-1, Sakhalin-2 and possibly Vladivostok LNG, all belonging to Gazprom, being the few comparable competitors. This reflects a concentration of large-scale LNG production in the hands of Gazprom and Novatek in the foreseeable future. It should be noted however that currently Gazprom's share of the LNG exports, while still at above 20% in 2018, is already much smaller than the share in the gas delivered via pipelines and that it has been falling (Figure 10.10).

Figure 10.10 Gazprom's share in Russia's LNG exports



Source: Internal calculations based on BP Statiscal Review and Gazprom's 2018 Annual Report.

10.2.3 COAL SUBSECTOR

As of 2018, Russia held, after the US, world's second largest proved coal[699] reserves (15% of world's total).[700] However, with 220 mtoe of coal production it was only the worlds' sixth largest coal producer accounting for approximately 6% of the world's total production. The reserves-to-production ratio was higher than in most other coal-producing regions.[701] Production has

[697] Russian LNG: Becoming a Global Force, in: The Oxford Institute for Energy Studies (2019), available at: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2019/11/Russian-LNG-Becoming-a-Global-Force-NG-154.pdf, accessed on 29 January 2020.

[698] Shtokman, one of the world's biggest known offshore gas fields, was abandoned *"until better times"* in 2012, see: Staalesen, A. (2017), *Gazprom hints comeback for Shtokman project*, The Barents Observer, available at: https://thebarentsobserver.com/en/industry-and-energy/2017/10/gazprom-hints-comeback-shtokman-project, accessed on 8 November 2019.

[699] The BP (2019) definition used in this report includes commercial solid fuels, i.e. bituminous coal and anthracite (hard coal), lignite and brown (sub-bituminous) coal, and other commercial solid fuels. It also includes coal produced for coal-to-liquids and coal-to-gas transformations (see BP, 2019, p. 40).

[700] In comparison, Europe taken as a whole accounts only for 12.8%.

[701] Data based on the 2019 BP Statistical Review of World Energy.

nevertheless been growing faster than in the case of other primary energy fuels, with the rate of growth increasing from the average of 3.4% in the 2007-15 period to 5.7% in the 2016-18 period.

This expansion was driven largely by rapidly growing export sales, with the annual rate of growth increasing from 8.6% in the 2007-15 period to 12% in 2016-18 period, while domestic consumption of coal in Russia has actually been declining (Table 10.1 and Figure 10.11). The rates of exports growth were however comparable to or lower than those of other major coal exporters such as China, India, Australia or Indonesia, suggesting this growth was largely driven by demand in world markets. With its 136.2 mtoe of coal exports, in 2018 Russia was the world's third most significant coal exporter accounting for 15.9% of the global market, with Australia (export flows accounting for 29% of global coal exports) and China (with exports at the level of 25.7% of global flows) being the leaders of the market.[702]

The largest centre of coal mining in Russia is the Kuznetsk coal basin, contributing 59% of all domestic coal supplies. Other significant sites include Kansk-Achinsk (9.4% of production), South Yakutia (4.3% of production), Pechora (2.2% of production) and Donetsk basin (1.4% of production).

As of January 2018, 161 coal mines were active in Russia with a total production capacity of 453 mt.[703] The industry has been almost completely privatised: according to Rosstat, in 2017 state and municipal enterprises accounted for only about 0.03% of the value of production in the mining of coal and lignite sectors.[704] The market is however relatively concentrated with the largest three coal producers accounting for over 40% of total production: SUEK (with production amounting to 107.7 mt and 26% market share in 2017), Ural Mining Metallurgical Company ('UMMC') incorporating Kuzbassrazrezugol (46 mt, 11% market share in 2017), and SDS Ugol (25 mt, 6% market share in 2017) (see also Table 10.2).

Coking plants purchased 32.8 mt of coal in 2017. Supplies of coal to the population of Russia amounted to 21.8 mt. The remaining 29.4 mt of coal consumption comprised large industrial sectors including metallurgy, cement production, and joint-stock company Russian Railways. [705]

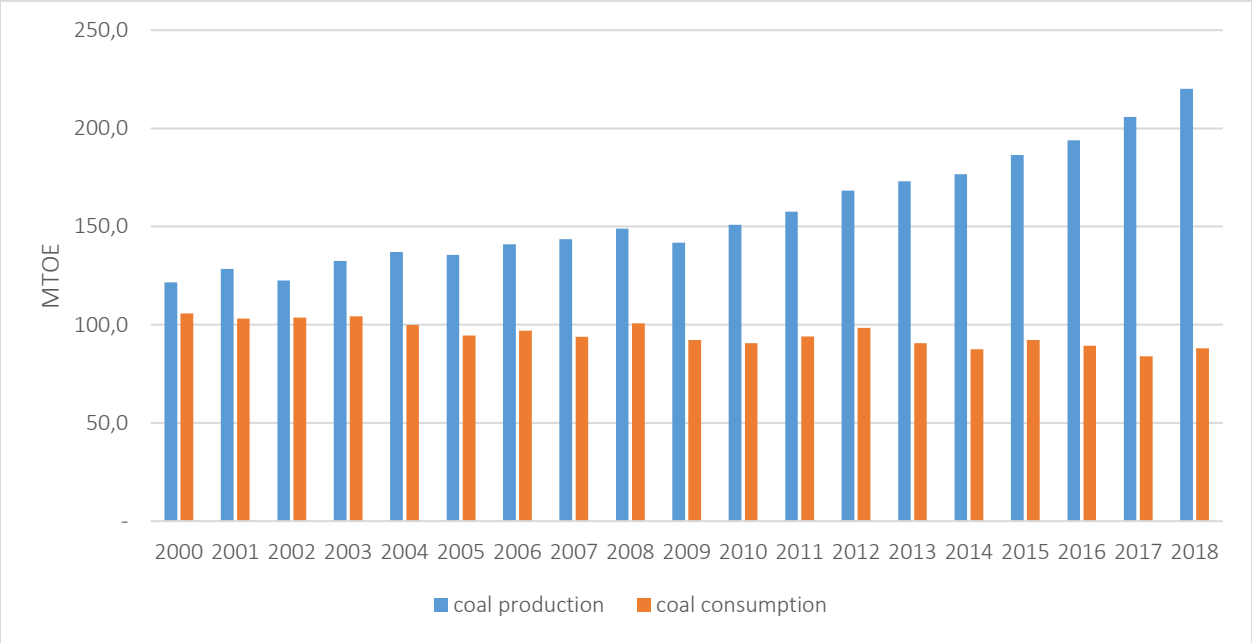
[702] Data retrieved from BP Statistical Review of World Energy 1965-2019; the .xlsx file available at https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html, accessed on 10 September 2019.

[703] Ministry of Energy of the Russian Federation (2018), *Gas: about the industry*, available at: https://minenergo.gov.ru/node/433, accessed on 8 November 2019.

[704] Internal calculations based on Rosstat (2018), *Russian Statistical Yearbook, Table 16.4: "Volume of shipped own produced goods, works performed and services rendered by ownership type in 2017"*; available at: https://www.gks.ru/free_doc/doc_2018/year/year18.pdf, accessed on 20 February 2020.

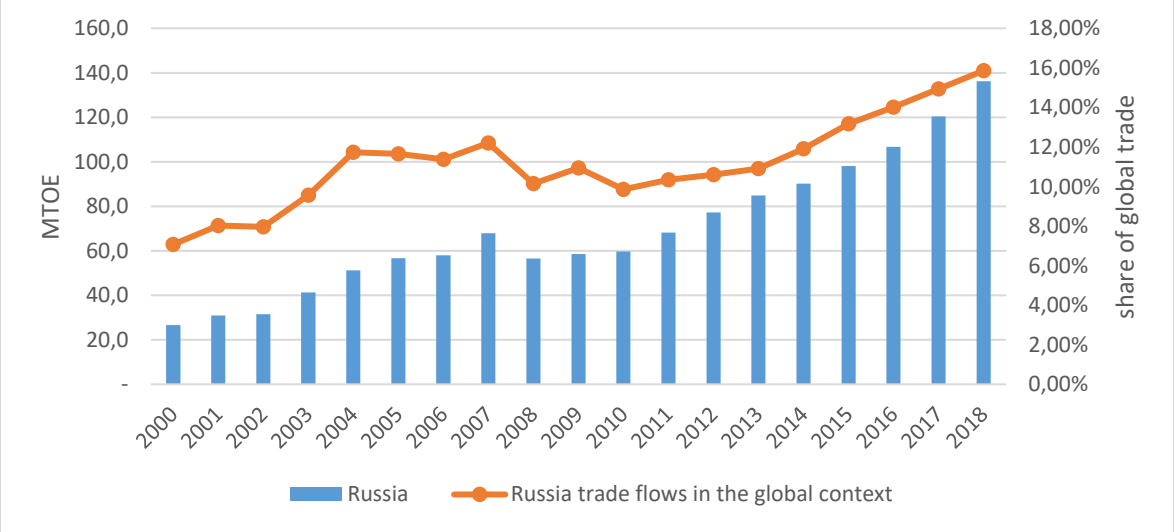
[705] Analytical Center for the Government of the Russian Federation (2017), *Statistical Collection: Fuel and Energy Complex of Russia*, June 2017 Issue, available at: http://ac.gov.ru/files/publication/a/13691.pdf, accessed on 7 January 2019.

Figure 10.11 Russia's production, consumption and exports of coal (2000-2018 in mtoe)[706]



Source: Internal calculations based on the data retrieved from the BP Statistical Review of World Energy database 1965-2018.

Figure 10.12 Russia's exports of coal 2000-2018[707]



Source: BP Statistical Review of World Energy 1965-2019.

[706] File available at: https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html, accessed on 6 September 2019.

[707] Data retrieved from BP Statistical Review of World Energy 1965-2019; the .xlsx file available at https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html, accessed on 10 September 2019.

Table 10.2 Russia's coal extraction by company [708]

Russia's coal extraction by company in 2011-2017 (thousand tons)							
Company Name	2011	2012	2013	2014	2015	2016	2017
«SUEK» JSC	92 217,6	97 466,5	96 452,4	98 860,4	97 755,7	105 364,2	107 778,3
«SDS Ugol» holding	19 321,4	21 518,8	21 995,2	25 516,4	25 447,1	24 579,7	24 660,4
«Kuzbassrazrezugol» public company	46 986,2	45 416,0	43 851,4	43 472,9	44 392,1	44 343,7	46 351,0
«RUK» (Novokuznetsk) LLC	9 268,1	10 789,5	12 541,8	11 546,0	10 231,2	11 182,5	10 967,4
«РУК» (Mezhdurechensk) LLC	6 251,2	7002,1	7823,7	10 202,1	10 351,9	10 511,8	11 435,2
«Kompania Vostsibugol» LLC	15 800,0	16 750,7	15 687,9	11 962,0	12 737,3	13 153,3	13 811,4
«Yuzhniy Kuzbass» PJSC	14 068,4	14 142,1	15 123,5	11 965,7	10 082,0	9 052,0	8 137,5
«Kuzbasskaya TK» PJSC	8 736,0	8711,0	10 146,0	10 608,0	11 002,0	11 682,0	13 226,0
«Mezhdirechye» JSC	5 664,7	6 339,4	6 125,2	6 551,5	6 761,4	6 367,4	6 243,8
«Vorkutaugol» JSC	7 156,2	9 562,7	12 116,8	11 359,8	13 160,1	9 454,9	8 684,7
«MMK-Ugol» LLC	4 035,7	3 951,3	3 287,4	3 657,5	3 582,7	3 416,2	3 614,4
«Yakutugol» holding	8 044,6	10028,9	10 033,8	9 472,9	9 147,3	9 905,4	8 346,2
«Shahta «Zarechnaya» JSC	4 603,9	4 682,2	4 172,9	5 607,9	5 043,1	2 875,9	1 795,2

Source: Central Dispatch Management of Fuel and Energy Complex 2018.[709]

10.2.4 ELECTRICITY SUBSECTOR

Producing 1110.8 terawatt-hours in 2018, Russia was the world's fourth largest electricity producer (after China, the US and India) accounting for 4.2% of the global production.[710] Almost half of the country's electricity is generated from natural gas, while the rest is spread relatively evenly across the nuclear, hydro and coal segments (Figure 10.13). The dominance of gas as the principal fuel in the electricity sector points to important links between electricity generation and the domestic and international gas markets, where supplies to domestic electric power generation companies (and other domestic gas consumers) compete with gas exports, which are a major source of the country's foreign currency revenue. This provides an incentive to Russian policy makers responsible for the country's energy policy and the electric power-generating companies themselves to gradually diversify away from gas towards other fuels. However, the fuel mix used for electricity generation, as well as connectivity within and outside of the Russian borders, differ markedly across the seven territorial divisions of the Russian electricity systems (united energy

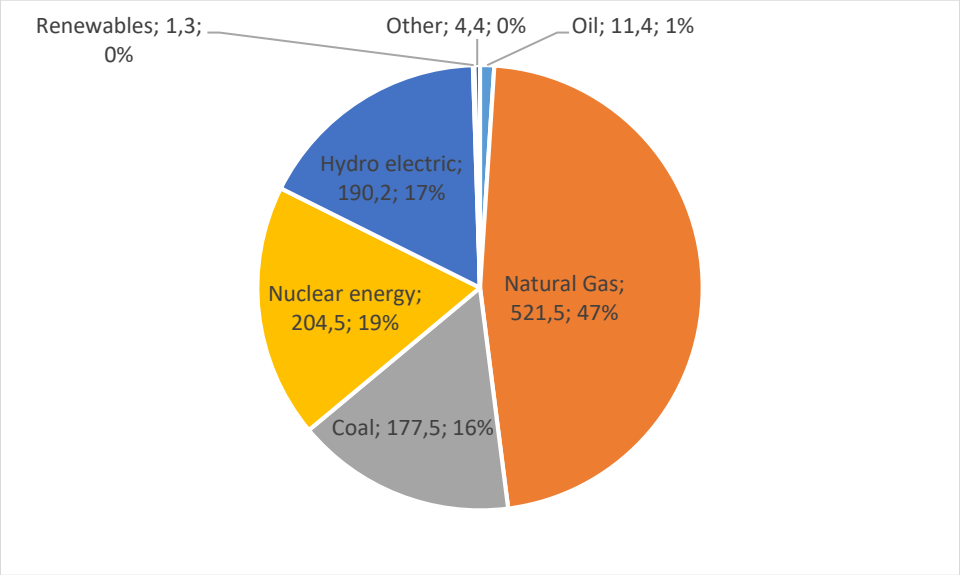
[708] Table 10.2 presents data from Russian sources whereas the data presented in the previous figures originate from BP Statistical Review of World Energy. Discrepancies in the information presented may be a result of aggregation methods or/and information availability specific to these two sources; these differences do not alter the main conclusions flowing from the analysis of these tables.

[709] Central Dispatch Management of Fuel and Energy Complex (2018), *Coal in Russia and the World: production, consumption, export, import*, available at: http://www.cdu.ru/tek_russia/articles/5/499/, accessed on 2 January 2019.

[710] BP Statistical Review of World Energy database 1965-2018.

systems - ′UES′). Thermal co-generation plants dominate in the Northwest, Central, Middle Volga and The Far East regions, while South and Urals are dominated by condensation thermal plants, and Siberia by hydropower plants. The European territorial divisions in European Russia are well connected within and to the systems outside of the Russian borders.

Figure 10.13 Electricity generation in Russia by fuel (TWh%), 2018



Since the beginning of the country's transition towards a market-based economy, Russia's electric power generation sector has undergone extensive reforms, initiated in late 1990s with a change of management and then gradual unbundling of Russia's RAO UES, then a state-controlled monopoly dominating over two-thirds of generation capacity and over 95% of transmission and distribution volumes. [711] The reforms aimed to create, through necessary additional investments and restructuring, a sustainable and technologically-advanced electric power sector which would be based on market principles and would ensure economically efficient and stable supply of electricity and heat to industrial and household consumers. As a result of reforms RAO UES was separated into regulated entities, including an independent system operator, trading and transmission systems administrators (federal level), and several distribution companies (regional level)) and market-based competitors in the generation and retail segments.

In the generation segment, this resulted in separation from the RAO UES and then privatisation or partial privatisation of six wholesale thermal power generating companies and fourteen territorial power generating companies which provide district heating and power. Several companies belonging to the generation and retail sector were purchased by private sector investors, including

[711] E.g. Khokhlov, A. and Melnikov, Y. (2018), *Market liberalization and decarbonization of the Russian electricity industry: perpetuum pendulum*, OIES Oxford Energy Comment, available at: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2018/05/Market-liberalization-and-decarbonization-of-the-Russian-electricity-industry-perpetuum-pendulum-Comment.pdf, accessed on 7 January 2019.

foreign energy firms such as E.ON, Enel, Fortum and RWE.[712] Separately, hydro power generation assets of RAO UES were allocated to RusHydro in 2004[713] and the nuclear power generating assets of the federal Atomic Energy Agency were transferred to the State Atomic Energy Corporation Rosatom in 2007. An important component of the reform was the creation of competitive wholesale and retail markets for both electricity and capacity[714] governed by a set of market rules and procedures (see Section. 10.6.4).

Although, overall, the pro-market reforms of the Russian electrical power generation sector resulted in partial privatisation and significant deregulation of certain market segments and in new investments in capacity,[715] they also entailed persisting concentration of power generation among the top players, several of whom are still majority-owned by the State. It has been estimated[716] for example that just ten companies control over 80% of installed generating capacity in Russia and that over half of the country's capacity belongs to utilities where the State is an important holder: RusHydro (in which the State owns more than 60% of shares),[717] Inter RAO (where the state-owned Rosneftgaz Group currently owns approximately 28% of shares and Federal Grid Corporation an additional 9%),[718,719] Gazpromenergoholding (owned by Gazprom),[720] and the state-owned Rosenergoatom, an electric power division of Rosatom.[721] State control over the retail

[712] See e.g. Khokhlov and Melnikov (2018) and EBRD, *Russia Country Profile*, available at: https://www.ebrd.com/downloads/legal/irc/countries/russia.pdf, accessed on 16 September 2019.

[713] JSC RusHydro was established on 26 December 2004 as part of the state programme reforming the electric power industry in accordance with the Decree of the Government of the Russian Federation N°. 1254-R of 1 September 2003, available at: http://pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102072000&backlink=1&nd=102083132&rdk= m, accessed on 8 November 2019. The company has been trading under its current name since June 2011 having been named Federal Hydrogeneration Company at the time of its establishment. RusHydro was established as a 100% subsidiary of JSC RAO of Russia, available at: http://www.rushydro.ru/company/history/, accessed on 8 November 2019.

[714] Capacity refers to adequate generating resources to ensure that the demand for electricity can be met at all times and is treated as a market separate from the actual trade of electricity.

[715] Khokhlov and Melnikov (2018).

[716] *Ibidem.*

[717] See RusHydro's official website, available at: http://www.eng.rushydro.ru/company/in_brief/, accessed on 8 November 2019.

[718] See the capital structure as of 4 June 2019, available at: https://www.interrao.ru/en/company/capital/, accessed on 16 September 2019.

[719] Until 2017, before RusHydro sold its stake on Inter RAO, the State's overall stake in Inter RAO was above 51%.

[720] Moscow-based Gazprom Energoholding LLC (formerly known as Gazoenergeticheskaya Kompaniya OAO having changed the name to Gazprom Energoholding LLC in May 2009) operates as a subsidiary of PJSC Gazprom. Gazprom Energoholding LLC is involved in electricity generation and the sale of gas and coal fired power in the Russian Federation).

[721] JSC Rosenergoatom was founded in 1992 and is the operator of nuclear power plants in Russia. It engages in all stages of the life cycle of nuclear plants, as regards selection of construction sites, project design, construction, commissioning, operation, decommissioning, and other operating functions. See the company's official website, available at: https://www.rosenergoatom.ru/en/about-us/history/, accessed on 8 November 2019.

segment is considered less significant than in the generation segment but market concentration, due to strong position held by legacy companies in their historic territories, are still deemed high.[722]

The operation of the country's transmission grid, the Unified National Power Grid (′UNPG′), remains also under state control through the Federal Grid Company, which inherited the backbone power grid from the RAO UES and is currently the transmission system operator. The Federal Grid Company is controlled by the FPA and the electric power transferred within its grids covers nearly half of total power consumption in the country.[723]

Another mechanism of persisting state control is related to the so-called capacity supply agreements, which are agreements between generation companies and the Government to build new capacity requested by the Government in exchange for compensation above regular capacity market prices (with a view to covering the cost of the new investment, as well as a certain rate of return on invested capital). These were launched in 2010 and since then some 100 such agreements were signed across Russia. Some of the effects of these agreements were positive (e.g. new investments, renewing of aging assets, greater energy efficiency of the resulting new capacity, etc.). There were however also some negative effects which are still affecting the functioning of the Russian power system, such as the decoupling of capacity investment decisions from the capacity market conditions (which rather respond to attractive prices set in these agreements by the Government for specific projects) and the generally overly optimistic estimates of capacity needs by the Government which resulted in overcapacity.[724]

10.3 KEY ELEMENTS OF THE GENERAL LEGAL FRAMEWORK RELEVANT FOR THE ENERGY SECTOR

Article 72 (c) of the Constitution states that: '*The joint jurisdiction of the Russian Federation and the subjects of the Russian Federation includes*, […] *issues of possession, use and disposal of land, subsoil, water and other natural resources*'.[725] The regulatory powers over the energy sector are distributed among several ministries and state and regional authorities. Indeed, at the federal level, both chambers of the Parliament (see Chapter 2) deal with energy-related questions through specific committees (e.g. the Committee on Natural Monopolies or the Committee on Natural Resources and Environmental Protection in the Federation Council or Energy Committee in the State Duma) and cooperate with experts and top-level representatives of major energy companies. Additionally, the Ministry of Economic Development issues regulations related to the general framework of state economic planning, the Ministry of Energy is responsible for the formulation and implementation of the energy policy and regulations, the provision of state services and the

[722] See e.g. Khokhlov and Melnikov (2018) who report that six companies control over half on national electric power consumption.
[723] Available at: https://www.fsk-ees.ru/eng/company/history/, accessed on 8 November 2019.
[724] See Khokhlov and Melnikov (2018).
[725] Chapter 3 "The Federal Structure," Article 72 (c) of the Constitution.

management of state property in the production of oil and fuel resources. The Ministry of Natural Resources and Environment, responsible mainly for mapping, exploration, utilisation and production of Russia's resources, through its Federal Subsoil Resources Management Agency, regulates oil and gas extraction licensing and levies fines for violations of environmental regulations. The FAS, working under the Ministry of Finance and reporting directly to the Government, regulates tariffs on natural monopolies, in particular in the oil, gas and electricity sectors. The Finance Ministry is responsible for taxation of the sector (see also Section 10.4).

The legal framework, which determines the functioning of the energy sector includes: the Constitution, the Law on Gas Supply, Federal Law on Electric Power Industry (of March 2003), Federal Law on Heating Supply (July 2010), Federal Law on Conserving Energy and Improving Energy Efficiency (2010), Federal Law on Subsoil (1995), Federal Law on Production Sharing Agreements (1995), the Law on Natural Monopolies, Federal Law on Environmental Protection (2002), Federal Law on Industrial and Consumer Waste (1998), the Antimonopoly Law, Federal Law on Industrial Safety of Hazardous Industrial Objects (2014), Government Resolution on Pricing in the Field of Regulated Prices (Tariffs) for Electric Power (2011), Rules for operation, review, repair and scrappage of infield oil pipelines (1993), Rules for liquidation of accidents and damage at industrial pipelines (2001), and The Strategic Programme for the Development of the Arctic up to 2020.[726]

The Government laid out its overall energy policy objectives in the Energy Strategy of Russia up to 2030 in 2010.[727] The policy aims to facilitate the transition to an innovative path of economic development in line with the Conception of Long-Term Social and Economic Development of the Russian Federation up to 2020. At the end of 2018, an updated version of the 2012 Energy Security Doctrine was approved, aiming to enhance the domestic energy sector's preparedness for facing up to future challenges, identifying additional support measures in the sector, and allowing the sector to respond to unfair competition. A new Energy Strategy of Russia up to 2035 was, at the moment of writing this report, still in draft version.

10.3.1 STATE MONOPOLIES

The Law on Natural Monopolies [728] enumerates and regulates relevant entities' activities. Specifically, it regulates transmission of oil and gas products via trunk pipelines, as well as natural

[726] This list is non-exhaustive.

[727] Government of the Russian Federation (2010), *Energy Strategy of Russia for the period up to 2030 (ES-2030)*, available at: http://www.energystrategy.ru/projects/docs/ES-2030_(Eng).pdf, accessed on 21 February 2020. Its main objective is to facilitate the transition to an innovative path of economic development in line with the country's economic goals. It provides for increased energy efficiency, transformation of the energy resources production system, creation of a competitive market, and integration with global energy market.

[728] Federal Law of 19 July 1995 "*on Natural Monopolies*", as amended, available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102037075&intelsearch=%CE+%E5%F1%F2%E5%F1%F2%E2%E5%ED%ED%FB%F5+%EC%EE%ED%EE%EF%EE%EB%E8%FF%F5, accessed on 16 March 2020.

gas transportation using pipelines, services on the transmission of electric power and heat energy. In light of these regulations, the following companies fall into the category of natural monopolies:

- Transneft (concerning oil);
- Transnefteprodukt (concerning oil products);
- Gazprom (concerning natural gas);
- Inter RAO (concerning electricity).[729]

Russian natural monopolies are the most prominent in the natural gas subsector, with the following gas supply systems in operation: the UGSS[730] described in Article 6 of the Law on Gas Supply, regional gas supply systems, gas distribution systems, and independent organisations.[731]

The indivisibility of the UGSS posited by law aims at ensuring a predictable supply of gas and reliable functioning of the facilities. In particular, the legislator notes that the technological and supervisory management of the relevant facilities connected to the UGSS, irrespective of its ownership, are to be carried out in a centralised manner by the entity owning the UGSS. The entity who legally owns the UGSS-related facilities is not allowed to lay them off without obtaining prior permission from the owner of the UGSS itself, as long as their mutual contract for the connection is valid.

Past attempts at dividing the structure into three separate groups of agents responsible for the processes of production, supply, and transportation respectively,[732] have not yielded any results as it appeared difficult both from the political, as well as legal perspectives.[733] In the public debate on this issue, arguments have been put forward that the reform would make the Russian pipeline gas more competitive *vis-a-vis* LNG which increasingly influences global markets,[734] although

[729] Full lists of companies with the status of natural monopoly per sector are available at: https://fas.gov.ru/documents/602570, accessed on 8 November 2019.

[730] In 2013, Gazprom's exclusive right to export gas from Russia was amended to allow new producers (the 'independents', in particular Novatek) to export LNG – see Section 10.2.2.2. A major part of the UGSS system is the GTS. Nearly all gas supplies within Russia (except supplies to the Norilsk, Yakutsk and Sakhalin regions which are supplied through regional systems) are delivered through the GTS. The GTS gas flows are controlled and managed by 17 Gazprom wholly-owned Gazprom Transgaz gas transmission companies.

[731] According to the legal definition set forth in the Law on Gas Supply, an independent organisation is an entity producing and supplying gas; such an organisation is – formally - independent of the owners of UGSS and the gas transmission systems GTS (the UGSS and regional supply systems are vertically integrated according Article 14 of the Law on Gas Supply (Indivisibility of the UGSS)).

[732] Contemplated by the Government in the 1990s and the 2000s but postponed indefinitely.

[733] Yafimava, K. (2015), *Evolution of gas pipeline regulation in Russia: Third party access, capacity allocation and transportation tariffs, Oxford Institute of Energy Studies Paper*, NG 95, available at: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/03/NG-95.pdf, accessed on 8 November 2019.

[734] For example, according to Sputniknews.com, in July 2017 the Russian Security Council's inter-agency commission recommended that the Russian Government should "*determine the priority directions of the state policy for development of the LNG industry, coordinate a strategy for* [gas deliveries] *to target markets, conditions for liberalization of gas export with the consideration of existing risks for economic security* [of Russia*] as the structure of energy demand* [in the world] *is changing*", available at: https://sputniknews.com/business/201708071056246815-russia-security-council-liberalization-gas-export/, accessed on 18 March 2019.

development of LNG production is also sometimes portrayed as a potential threat to the country's energy security.

10.3.2 THE FEDERAL ANTIMONOPOLY SERVICE

The FAS is responsible for control of the implementation of legislation related to natural monopolies and it also has responsibility for the regulation of tariffs (e.g. as regards gas and electricity prices) for certain goods and services, as well as foreign investments in business entities deemed strategically important in terms of national defence and state security. The FAS' scope of activities is, however, not limited to the control and supervision of regulatory compliance – the organisation takes part in the processes of development of sectoral and/or functional policies pertaining to domestic markets in which it also promotes competitive behaviours. More importantly, the FAS remains the sole authority in Russia ensuring compliance with anti-monopoly regulations at all levels of economic activity. The organisation deals with complaints, appeals, decision-making, as well as issuing notifications and controlling the execution of issued prescriptions. Additionally, the FAS is empowered to impose administrative sanctions to protect state interests.

A number of energy-related cases investigated by FAS proved that Gazprom violated competition law, for instance by certain stock exchange practices[735] or by indexing tariffs on gas transportation for independent producers,[736] or created a competition-restrictive environment.[737] For example, in May 2018, the FAS fined Gazprom and its subsidiary Gazprom Mezhregiongaz [738] for, respectively, ca. USD 3.5 million and ca. USD 6,600[739] for violating competition law.[740,741] According to the FAS, the company attempted to increase its share in the local market by unlawfully taking over consumers from SVGK (the Gas company of the Central Volga region).[742]

[735] Federal Antimonopoly Service (2018), *Russia's FAS warns Gazprom about inadmissibility of terminating gas sale on the stock exchange*, available at: https://fas.gov.ru/news/26135, accessed on 3 January 2019.

[736] Federal Antimonopoly Service (2018), FAS in media: FAS to discuss indexation of Gazprom's tariffs for the independents' gas transportation in September, *RIA Novosti*, available at: https://fas.gov.ru/publications/16166, accessed on 8 November 2019.

[737] InterFax (2013), *SETP negotiates price with pipe plants, Gazprom does not overpay*, available at: https://www.interfax.ru/interview/296084, accessed on 30 January 2019.

[738] Gazprom Mezhregiongaz was founded in 1996. The company's line of business includes the wholesale distribution of petroleum and petroleum products, available at: https://www.bloomberg.com/profile/company/0683844D:RU, accessed on 8 November 2019.

[739] Average conversion rates RUB/USD at RUB 62.3202 RUB for USD 1, available at: https://www.x-rates.com/average/?from=USD&to=RUB&amount=1&year=2018, accessed on 26 November 2019.

[740] Federal Antimonopoly Service (2018), *Russia's FAS fines a group of persons from Gazprom for violating anti-monopoly law*, available at: https://fas.gov.ru/news/24945, accessed on 8 November 2019.

[741] Other parties found to have violated competition law included the region's authorities, including the Samara Region Governor and the regional Ministry of Energy and Housing.

[742] Kommersant (2018), *FAS fines structures of Gazprom with 221.4 million roubles*, available at: https://www.kommersant.ru/doc/3630550, accessed on 8 November 2019.

10.3.3 FDI REGULATION RELEVANT TO THE ENERGY SECTOR AND SELECTED FDI DEVELOPMENTS

As regards international investment and cooperation in strategic economic areas, the Government is entitled to draw and implement relevant state policies, including with regard to the energy sector. In particular, Article 23 of the Foreign Investment Law empowers the Government to determine the '*feasibility of imposing bans and restrictions on foreign investment*'[743] and produce bills enumerating these bans and restrictions. The State also proposes supervisory measures of activities of foreign investors within Russia. A number of legal acts, including the Constitution,[744] determine the legal framework related to foreign investment in general.[745] However, the Strategic Investment Law describes the issues of particular relevance to the energy sector which has been deemed of strategic importance.[746] Chapter 7 provides more information on possible distortions related to the FDI regimes and Section 7.4.1 in particular describes in detail restrictions specific to the extraction and raw materials sector.

Historical data show that inflows and outflows of foreign capital to the Russian mining and quarrying (including oil extraction) segment followed two distinct trends (Figure 10.14a). Firstly, the inflows of capital to the sector seem to have grown (as part of the total foreign capital inflow) – one particular increase can be discerned between the years 2012 and 2013 and then – between 2015 and 2016. Secondly, capital outflows (as percentage of total capital outflows) declined significantly in the period 2013-2015. Russia appears to have been developing dynamically during the first spike,[747] recovering from a bout of recession in 2008-09. The international sanctions introduced in March/April 2014 by the USA and EU among others, seem to have found their temporary reflection in the sector-level net FDI flows (Figure10.14b). Net inflows remained flat between 2013 and 2014 (the y/y change +6%), which counted for an extraordinary economic

[743] Article 23 of Foreign Investment Law.

[744] Specifically, sections in Articles 8, 15, 34, and 36 make provisions for the freedom and protection of property rights of entrepreneurial activity carried out by both domestic and international entities. Furthermore, the Constitution states that the jurisdiction of the Russian Federation includes, inter alia (Article 71 and Article 72), "federal state property and its management", "federal budget, federal taxes and dues, federal funds of regional development". The joint jurisdiction of the Russian Federation and the subjects of the Russian Federation also encompasses, inter alia, "issues of possession, use and disposal of land, subsoil, water and other natural resources" as well as "establishment of common principles of taxation and dues in the Russian Federation". The assignment of these matters to the joint jurisdiction of the Russian Federation and its subjects enables the latter group to enact legislative acts pertaining to jointly administered areas beyond the jurisdiction of the Russian Federation (see also Chapter 2).

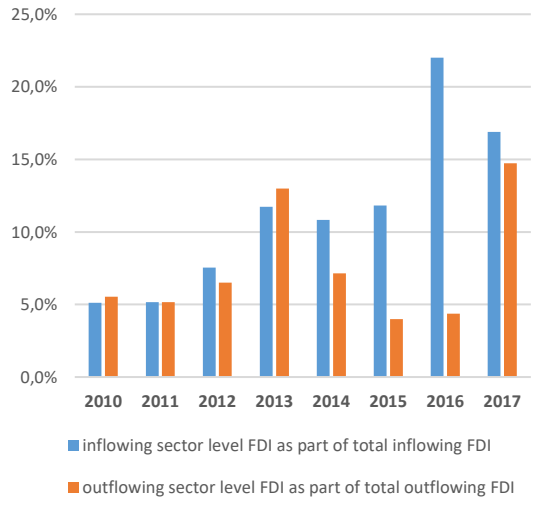
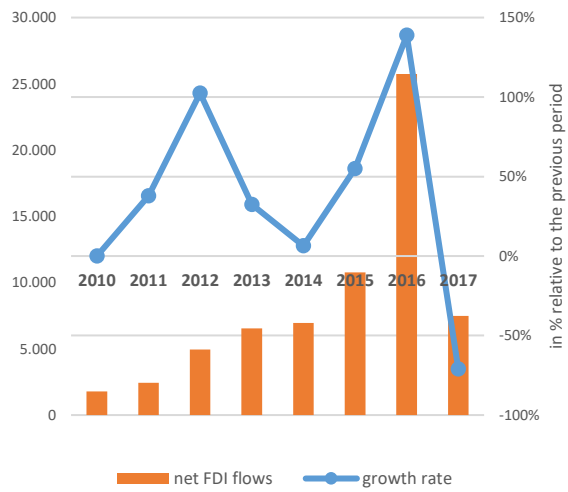
[745] Such as the Constitution, the Federal Law N57-FZ "*Procedures for Foreign Investments in the Business Entities of Strategic Importance for Russian National Defence and State Security"*, the Federal Law N.º 160-FZ of 9 July 1999 *"on Foreign Investments in the Russian Federation"*, and the Tax Code of the Russian Federation.

[746] Clause 39 Article 6 of the Federal Law N.º 57-FZ *"Procedures for Foreign Investments in the Business Entities of Strategic Importance for Russian National Defence and State Security"*. Russian original text available at: http://base.garant.ru/12160212/8b7b3c1c76e91f88d33c08b3736aa67a/, accessed on 16 September 2019.

[747] Babitch, S. (2013), A Statistical Investigation of Foreign Investment in the Process of Modernization of the Russian Economy: Regional Dimension, *Russian Foreign Economy Journal*, 6, pp. 81-89.

occurrence since 2010 (apart from the dramatic plunge between the years 2016 and 2017).[748] It may be argued that the drop observed between 2016 and 2017 was a natural correction occurring after the spike in 2016. The peak in financial inflows that year was caused by the sale of a minority stake in Rosneft to foreign investors which translated into an uncommonly high inflow of FDI.

Figure 10.14 FDI in Russia's mining and quarrying of fuel and energy materials

Figure 10.4a Sector-specific FDI flows as part of total economy-wide FDI flows	**Figure 10.4b Net FDI flows (USD mln, left axis) in mining and quarrying of fuel and energy materials**
	

Source: Internal calculations based on the data retrieved from the CBRF.

10.4 TAXATION OF ENERGY PRODUCTION AND TRADE

Russia initiated some small-scale reforms already in 2014, due to a rebound in oil prices in the global markets which drove domestic prices of oil products. In addition, in May and June 2018, the Government decided to redesign the tax framework by implementing a reform of specific taxes related to different energy sources, as well as general economy-wide reforms such as raising the general VAT rates and increasing the retirement age. All this constituted the steps of a broader plan by which the Government aimed to improve the budgetary situation and revive the whole

[748] Economic data provided by NATO Review indicate that the sanctions implemented by the western nations exacerbated the macroeconomic situation in Russia caused by a plunge in oil prices recorded late in 2014. The combined outcome of the sanctions and the decrease in prices of oil exerted pressure on the Russian rouble and contributed to capital flight. Simultaneously, limitations on the access to financing drove the Russian State decision-makers to deploy some of the country's foreign reserves in order to help the domestic entities subjected to the most severe sanctions. It is furthermore observed that these economic developments pressured the CBRF to raise its interest rates in December 2014 and stop defending the value of the domestic currency. Based on: NATO Review (2015), *Sanctions after Crimea: Have they worked?* The original text available at: https://www.nato.int/docu/review/2015/Russia/sanctions-after-crimea-have-they-worked/EN/index.htm, accessed on 18 October 2019.

domestic economy.[749,750] It was estimated that the overhaul of the tax framework could increase the state budget by roughly RUB 1 trillion (in form of additional income) over the following six years (up to 2024). As far as taxation of energy was concerned, the planned reforms were set to decrease taxes related to exports of energy and increase the taxes related to extraction.[751] If (or when) fully implemented, this plan would likely improve the functioning of the Russian energy markets and, in particular, it would remove one factor that may be contributing to a price wedge between the domestic and export prices of energy.

According to the Tax Code, the commercial minerals covered by tax regulations include, *inter alia*: oil shales, coal, peat, raw hydrocarbons, and commercial ores.[752] The domestic energy sector[753] is subject to a tax framework which combines royalties (the most prominent is the mineral extraction tax (′MET′))[754,755], additional income tax on hydrocarbon extraction (′AIT′), corporate profit tax,[756] VAT, and export taxes and excise duties.

10.4.1 THE MINERAL EXTRACTION TAX

[749] The reforms were part of a revival plan accepted by the State Duma as May Decrees (2018) which defined broad economic development goals up to the year 2024 inclusive, available at: http://en.kremlin.ru/events/president/news/57425, accessed on 2 September 2019. The original announcement is available at: https://minenergo.gov.ru/view-pdf/11246/84473, accessed on 2 September 2019.

[750] Throughout the analysis in this sub-chapter, the role of taxes in the energy sector is considered in terms of their distortionary potential to decrease the efficiency of the energy and other related sectors of the economy. The role of taxes as corrective policy devices in the case of externalities or limiting the use of non-renewable resources is beyond the analysis. The approach also abstracts from the budget revenue dimension of taxes.

[751] Khrennikova, D. (2018), *Russian Oil Getting Ready for Biggest Tax Overhaul in 20 Years*; available at: https://www.bloomberg.com/news/articles/2018-07-25/russian-oil-getting-ready-for-biggest-tax-overhaul-in-20-years, accessed on 21 March 2019.

[752] The entire list of commercial minerals is presented in Article 337 Extracted Commercial Mineral point 2 of Chapter 26 of the Tax Code.

[753] There does not exist a separate tax on electricity in Russia. Power industry companies remain subject to largely the same tax framework as companies operating in other sectors. One notable exception is that electricity lines are exempt from firms' property taxes. Carbon emission taxes are currently not applicable to power generation.

[754] In other sources, the MET is also referred to as MRET.

[755] PWC (2019), *Worldwide Tax Summaries: Russian Federation*, available at: http://taxsummaries.pwc.com/frmTerritoryPrintPreview?openForm&countryName=Russian%20Federation&Type=Corporate, accessed on 22 March 2019.

[756] Oil and gas producers are obliged to pay a country-wide sector-unspecific, corporate profit tax amounting to a maximum of 20%. In the years 2017-2024, out of the 20% paid by enterprises, 17% is transferred to the treasury of the member region where a given company is registered whereas the remaining 3% is intended for the federal treasury. It is noteworthy that the regional regulations allow the tax rate (17%) payable to relevant constituent regions of the Russian Federation to be lowered for certain categories of taxpayers, typically large-scale investors (between RUB 50-150 billion). The reduced local tax rate granted before 3 September 2018 are to remain binding until their respective expiration dates, but not beyond 1 January 2023 – effective on 1 January 2019, the constituent regions lost their right to reduced profit tax rates. This solution has been introduced to increase tax revenues (PWC (20019), *Russian Federation Corporate - Taxes on corporate income*, available at: http://taxsummaries.pwc.com/ID/Russian-Federation-Corporate-Taxes-on-corporate-income, accessed on 26 August 2019 and KPMG (2018), *Key Tax Changes in 2019 - Key Tax Amendments in 2018*; the original text available at: https://assets.kpmg/content/dam/kpmg/ru/pdf/2019/02/ru-en-Tax-update-2018-2.pdf, accessed on 28 August 2019.

The MET is paid by organizations and private entrepreneurs who are deemed to be users of subsurface resources according to Art. 334 of the Tax Code.[757] In line with Arts. 336 and 337 of the Tax Code,[758] the MET's taxation object is commercial minerals, including but not limited to: oil shales, coal, peat, raw hydrocarbons (including gas condensate from all kinds of raw hydrocarbon deposits) and natural ores. Taxpayers are obliged to determine the tax base relative to each kind of extracted mineral in an independent manner. MET is paid on monthly basis, with the tax rates determined according to the kind of resource in question (Art. 342 and 343 of the Tax Code) and a complex range of coefficients and parameters which are summarised below.

For example, the gas-specific default tax rate is multiplied by the base value of a standard fuel unit (S_{fu}[759]) and by a coefficient describing the difficulty of gas production from combustible natural gas and/or gas condensate from a given hydrocarbon feed deposit (C_c[760]). The gas-specific tax rate is calculated by the taxpayer independently for the extraction of natural combustible gas and/or gas condensate. The final value of the coefficient is also influenced by profitability of exports (C_{gp}).[761],[762] C_{gp} is set to 1) 1.4441 - for the period from 1 January 2019 to 31 December 2021 inclusive - for taxpayers (owners) of the UGSS and/or organizations in which the owners of the UGSS participate in a direct or indirect manner (with their share exceeding 50%)[763] or 2) 1.0 for other taxpayers.[764] As of 1 January 2022, the C_{gp} is to be set to 1[765] for all taxpayers. In the case of gas condensate, the thus obtained base rate is also multiplied by the correction factor K_{km}.[766] When calculating the tax rate for natural gas, the product of the base rate (S_{fu} and C_c) is summed up with the value of the indicator for the costs of transportation (T_g).[767]

The legislative amendments discussed at the beginning of this subsection temporarily modified the procedures pertaining to calculation of the MET. Moreover, the amendments extended tax

[757] Article 334 of the Tax Code, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/, accessed on 2 September 2019.
[758] Articles 336 and 337 of the Tax Code, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/, accessed on 2 September 2019.
[759] Clause 1 Article 342.4 of the Tax Code, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/17ab5ff9db5d69bbb14e114ac0c4e4fc3e99fb01/, accessed on 11 November 2019.
[760] The coefficient is supposed to reflect the depth of a given hydrocarbon deposit which takes values from 1 to 0.5. See Clause 7 Article 342.4 of the Tax Code.
[761] Clause 1 of Article 342.4 of the Tax Code.
[762] Clause 1 of Article 342.4 of the Tax Code.
[763] Exceptions to this rule include 1) organizations in which one of the owners with a share in equity of at least 50% is a Russian organization in which the owners of the UGSS participate in a direct or indirect manner and the total share of their participation does not exceed 15% and 2) taxpayers for whom the coefficient calculated based on the results of the tax period characterizing the share of extracted natural combustible gas (excluding associated gas) in the total volume of hydrocarbon production does not exceed 0.35 (As per Clause 18 Article 342.4).
[764] Clause 18 Article 342.4 of the Tax Code.
[765] Clause 17 Article 342.4 of the Tax Code.
[766] Clause 15 Article 342.4 of the Tax Code.
[767] Clause 14 Article 342.4 of the Tax Code.

deductions[768] to the extraction of gas condensate, if processed to obtain natural gas liquids[769] (available from January 2018). This tax deduction, applicable in the period between 1 January 2018 and 31 December 2027, was estimated in the literature to amount to a total RUB 350 billion (USD 5.5697 billion). [770,771]

For coal, the MET rate is specified (in RUB per ton) depending on the type of the resource (anthracite, coking coal, brown coal and other coal). For peat, on the other hand, the tax rate is expressed in percentages.[772] The relevant rates need to be adjusted for 1) deflator coefficients, established for each type of the resource (quarterly for each next quarter and accounting for changes in coal prices in Russia recorded in the previous three months) as well as 2) deflator coefficients which were utilised in previous calculations of the tax. The relevant coefficients are determined and published by the Government.[773]

10.4.2 Additional Income Tax from Hydrocarbon Extraction

As of 1 January 2019, the Government introduced the AIT from Hydrocarbon Extraction[774] to support exploitation of low-margin areas yielding oil, gas and LNG. The tax is designed so that companies which engage in mineral extraction share the risks and benefits associated with the development of new fields with the State. To that end, the AIT regime moves the chief fiscal burden to later periods of a hydrocarbon field utilisation and indicates that the tax would become payable during a given project's payback period, with the tax burden being correlated directly with each area's yield (for example, should a specific field be exceptionally profitable, the taxpayer would be obliged to remit half of the profits derived from it to the State). This is in contrast with the previous system, which associated the tax burden with the volume of the resource produced - the AIT instead is levied on the profits derived from hydrocarbon production, thus better

[768] The legal provisions state that the MET deductions for the extraction of natural gas from subsurface sites situated either entirely or partially in the Black Sea intended to take effect from January 2018 until the end of 2020 (Introduced by Federal Law No. 286-FZ of 30 September 2017). This deduction is available for economic entities registered in the Republic of Crimea or in Sevastopol before 2017 (the eligibility to apply this tool depends upon (1) the amount of expenses paid by the entity in question in the period beginning 1 January 2018 until the end of the tax period for which the tax deduction is considered for the acquisition, construction, manufacture, and delivery of fixed assets and (2) the condition that the said fixed assets are included in investment aimed at developing gas transportation systems of the Republic of Crimea or Sevastopol.)

[769] The new tax regulations have been fashioned in a way which aligns production costs of natural gas liquids (NGLs) obtained from different raw materials such as e.g. gas condensate, natural gas and associated petroleum gas.

[770] Conversion rate used in this paragraph (62.8397 RUB/USD) was based on data from the Central Bank of Russia, calculated as a yearly average for the year 2018 derived from daily weighted spot averages reported by the CBR, available at: https://www.cbr.ru/eng/hd_base/micex_doc/, accessed on 28 august 2019.

[771] For all subsurface sites taken as a whole (for details refer to Borodin, V., Borisov, D. and Sokolova, A. (2017)).

[772] As per Article 342 of the Tax Code the rate for peat is 4.0%.

[773] Summary table based on the different Resolutions/Decisions/Notes of the Ministry of Economic Development are available at: https://www.nalog.ru/rn77/taxation/taxes/ndpi/kd/, accessed on 11 November 2019.

[774] The new tax is introduced as part of the amendment published in the Federal Law N.º 199-ФЗ of 19 July 2018 "*on Amendments to Parts One and Two of the Tax Code of the Russian Federation*"; Russian original text available at http://www.consultant.ru/document/cons_doc_LAW_302868/, accessed on 11 November 2019 or http://publication.pravo.gov.ru/Document/View/0001201807190065, accessed on 2 September 2019.

accounting for the real dynamics of the investment and site development processes. The amendment also foresees regulations allowing for loss-shifting,[775] if losses are incurred in preceding periods (including the ones recorded prior the introduction of the additional income tax).[776]

However, the introduction of AIT has not covered the entire sector. In the first phase of its implementation, the tax has been applied to four groups of areas (activities). These categories include: greenfield sites in the Republic of Sakha, Irkutsk Region, Krasnoyarsk Region and Nenets Autonomous District (Group 1), fields defined in Note 8 to the Unified Goods Nomenclature for Foreign Economic Activities of the EAEU[777,778] (Group 2), brownfields in the Khanty-Mansiisk and Yamal-Nenets Autonomous Districts, the Republic of Komi, and the Tyumen Province (Group 3 and Group 4).[779] AIT replaced the existing income tax for producers of hydrocarbon energy carriers; moreover, it contributed to a reduction of MET for several subsoil fields.[780] Lastly, AIT payers (oil producers) are entitled to exemptions from export duties during the "tax holiday" period for oil coming from greenfield sites in the Republic of Sakha, Irkutsk Region, Krasnoyarsk Region and Nenets Autonomous District where the level of oil depletion has not reached 5%.[781]

10.4.3 VALUE ADDED TAX

[775] The AIT regulations propose a coefficient equal to 1.163 for carrying forward the losses; the proposed solution also compensates for losses related to depreciation.

[776] The discussion of AIT based on the legal information provided by PWC (2018), *Tax Flash Report - Additional income tax for hydrocarbon producers – the bill is adopted by the State Duma*, Issue nº. 26, available at: https://www.pwc.ru/en/tax-consulting-services/assets/legislation/tax-flash-report-2018-26-eng.pdf, accessed on 11 November 2019.

[777] Some of the fields include Yurubcheno-Tokhomskoye oil and gas condensate field, Talakan oil and gas condensate field, Kuyumbinskoye oil and gas condensate field, Severo-Talakanskoye oil field, Vostochno-Alinsky oil field, Verkhnepeleduyskoye gas and condensate field. The entire list is specified in Note 8 to the unified Goods Nomenclature for Foreign Economic Activities of the Eurasian Economic Union as at 1 January 2018. Original text available at: http://www.eurasiancommission.org/ru/act/trade/catr/ett/Documents/TNVED_02.01.2017.pdf , accessed on 3 September 2019.

[778] It should be noted that based on the sub-clause 7 clause 1 of Article 35 of the Federal Law N. 5003-1 "*On the Customs Tariffs*" exemption from duty rates is valid for both Group 1 and 2 under the condition that "*when calculating the mineral extraction tax in relation to oil extracted in such a subsoil block, the Cg coefficient, determined in accordance with the procedure established by Article 342.6 of the Tax Code of the Russian Federation, is applied in the amount of less than 1*".

[779] The difference in classification hinges on the level of oil depletion. For example, in Group 4 the threshold level of depletion is fixed at no more than 5%. For Group 3, on the other hand, the depletion ratio needs to be greater than or equal to 20% but below or equal to 80% (as of 1 January 2017) or above or equal to 10% but less than or equal to 80% (as of 1 January 2017) if the depletion level of the site exceeded 1% at 1 January 2011 and the site has been subject to development for the minimum of six years at 1 January 2017.

[780] The AIT, while not a substitute for the mineral extraction tax, does reduce the MET-related burden. Put differently, firms which are obliged to pay AIT will still have to pay MET, however, the amount payable of the latter will be reduced.

[781] Tax on Additional Income from Hydrocarbon Production, available at KPMG in Russia and CIS (2018), p. 6, available at: https://assets.kpmg/content/dam/kpmg/ru/pdf/2018/10/ru-en-tax-on-additional-income-from-hydrocarbon-production.pdf, accessed on 9 September 2019.

The Tax Code names three kinds of VAT payers: 1) organisations, 2) individual entrepreneurs and 3) entities or natural persons recognised as obliged to pay VAT in connection with the movement of goods across the customs border (in line with appropriate legislation of the EAEU and Russia).[782]

In the context of energy resources, and in line Art. 146(1)(1) of the Tax Code, the VAT object is primarily the sale of goods and services within Russia (including sales of collateral and transfer of goods and property rights).[783] Mineral resources and services related to their trade in the internal market are taxed at the standard rate set at 20%.[784] However, as regards export of mineral resources (either raw or processed), the 0% rate applies. Specifically, the 0% VAT is utilised for sale of the following:

- Goods exported in the customs procedure of export;
- Goods placed under the customs procedure of the free customs area;
- Goods exported in the customs procedure and meant for re-exports and placed under the customs procedure awaiting processing in a given customs zone and/or goods obtained as a result of processing of goods placed under the customs procedure for processing at the customs territory;
- Goods exported in line with customs procedures relevant for re-exports and placed previously under the customs procedure of the duty-free zone;
- Goods exported from the territory of Russia to the territory of a member state of the EAEU, in cases provided for by the EAEU Treaty.

The 0% rate is therefore applicable to exports of mineral resources. Moreover, according to Article 164(2) of the Tax Code, it is also applicable to export-related services for mineral resources transportation, such as:

- International shipment of goods meant for export;[785]

[782] Clause 1 of Article 143 of the Tax Code, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/2ade1f82a7dbf4c31bcce5c8df14ca42d9fd66b7/, accessed on 12 September 2019.

[783] Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/08c2f3c592f23af58538e4378ae625a583418fb0/, accessed on 12 September 2019.

[784] Clause 3 Article 164 of Tax Code, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/35cc6698564adc4507baa31c9cfdbb4f2516d068/, accessed on 12 September 2019. Prior to 01.01.2019, the standard tax rate was set at 18% (changes introduced by Federal Law N.º 303-FZ of 3 August 2018 "*on amendments to certain legislative acts of the Russian Federation on taxes and fees*". The original Russian text available at: http://publication.pravo.gov.ru/Document/View/0001201808030106?index=2&rangeSize=1, accessed on 12 September 2019.

[785] International shipment is understood as transportation of goods by sea, river vessels, mixed vessels, aircraft, rail and motor vehicles in which the point of departure or destination of goods is located outside the territory of Russia, according to Sub-clause 1 Clause 2 Article 164 of the Tax Code, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/35cc6698564adc4507baa31c9cfdbb4f2516d068/, accessed on 12 September 2019.

- Services provided by entities carrying out oil and oil derivatives pipeline transport;[786]
- Services specific to organising pipeline transport for natural gas (meant for exports or imported);[787]
- Services provided by the organisation controlling the unified Russian electric transmission gird for transmission of electric energy (supply of power to third countries);[788]
- Services provided in relation to shipment of goods;
- Raw hydrocarbon materials extracted from offshore fields and associated goods, obtained from their technological redistribution (such as stable condensate, liquefied natural gas, a wide fraction of light hydrocarbons) exported from a departure point within Russia.[789]

Exports of energy therefore receive a VAT treatment which is more favourable than that of energy consumed domestically, which is a typical feature of the VAT, applied in many countries.

10.4.4 EXCISE TAX

The Tax Code enumerates three kinds of excise duty payers: 1) organisations; 2) private entrepreneurs; 3) entities which fulfil certain requirements of the Customs Code of the Russian Federation.[790] In each case, the said entities become excise duty payers, if they engage in activities deemed as taxable (for example, operations involving straight-run petrol).[791] In the context of energy resources, taxable goods include (as per Article 181 of the Tax Code): oil feed,[792] petrol, diesel fuels, straight-run fuel, and motor oils for diesel and/or injection engines as well as dark marine oil and natural gas. The tax base is identified separately for each kind of taxable goods and the tax rates are set forth in Article 193 of the Tax Code. The excise tax rate specific for oil feed and straight-run fuel are determined by the taxpayer (in RUB/ton) with application of specific formulas prescribed by the Tax Code.[793]

The latest changes in the excise duties for specific kinds of fuels are presented below (Table 10.3) and were introduced as part of the recent tax reform.

[786] Sub-clause 2 Clause 2 Article 164 of the Tax Code.
[787] Sub-clause 3 Clause 2 Article 164 of the Tax Code.
[788] Sub-clause 4 Clause 2 Article 164 of the Tax Code.
[789] Sub-clause 9 Clause 2 Article 164 of the Tax Code.
[790] Available at: http://www.consultant.ru/document/cons_doc_LAW_624/, accessed on 9 December 2019.
[791] The Tax Code includes in this case petrol fractions obtained during oil-processing, gas condensate, associated petroleum gas, natural gas, oil shales, coal as well as other "*raw materials and processed products thereof with the exception of automobile petrol and petrochemical products*" (Tax Code, Art. 181, p. 10).
[792] According to Sub-clause 13.1 Clause 1 of Article 181 of the Tax Code, oil feedstock is understood as a hydrocarbon mixture consisting either one or several of the following ingredients: oil, stable gas condensate, vacuum gas oil, tar, and fuel oil, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/c4dda76950086823809763473e10fa70d9707463/, accessed on 10 September 2019.
[793] Article 193 of the Tax Code.

Table 10.3: Excise duties on oil products[794]

in RUB per ton	2019	2020	2021
Class 5 car petrol	12 314	12 752	13 262
Non-class 5 car petrol		13 100	13 624
Aviation (kerosene)	2 800	2 800	2 800
Engine oils for diesel and (or) carburettor (injection) engines	5 400	5 616	5 841
Diesel fuel	8 541	8 835	9 188
Medium distillates	9 241	9 535	9 916

Source: Internal calculations based on Article 193 of the Tax Code.

The Tax Code also states that dark marine fuel is an excisable good, with the appropriate rate (in RUB per tonne) determined by a dedicated formula.[795] Lastly, excise tax rate for natural gas is set at 30%, unless international treaties of which Russia is part, provide otherwise.[796]

The taxpayer is also entitled to apply for deductions of excise tax on excisable goods, as per Articles from 200 to 204 of the Tax Code.[797]

10.4.5 CUSTOMS DUTIES

Customs duties in Russia are regulated by the Federal Law No. 311-FZ of 19 November 2010 on Customs Regulations in the Russian Federation[798] (and amended by the Federal Law No. 5003-1-FZ of 21 May 1993 on the Customs Tariffs).[799] Since the cessation of the Eurasian Economic Community (′EurAsEC′), the EAEU Treaty has regulated the issues previously controlled by the EurAsEC. The Federal Law No. 311-FZ establishes the chief objectives of both export and import customs in Russia, identifies entities obliged to pay customs duties (Articles 114 and 124) and enumerates the official entities permitted to establish relevant customs tariffs (as per Article 130, customs fees for customs transactions are established by the Government), and the circumstances of the relevant payments, such as for example, granting relief from payment (Article 131), describes the issues related to valuation of goods, as well as enumerates official sources of relevant regulations (for example international trade agreements). The EAEU Treaty creates the regulatory framework of trade policies of the EAEU towards third parties, as well as the policies directly applicable to customs-free intra-EAEU trade flows and establishment of a common energy

[794] Clause 1 Article 193 of the Tax Code.
[795] Article 193 of the Tax Code.
[796] Clause 5 Article 193 of the Tax Code.
[797] Article 200 of the Tax Code, Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_28165/ad62eb9727ec32a8089809a28add34550082d271/, accessed on 13 September 2019.
[798] Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_107181/, accessed on 2 September 2019.
[799] Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_1995/, accessed on 2 September 2019.

segment (Section XX, Art. 79-85 of the Federal Law No. 311-FZ) among other issues. In the context of international trade in energy products, such as crude oil and petroleum products, additional legislation complements the legal framework, for example: the Government Resolution No. 276[800] of 29 March 2013 which sets forth the methodology utilised by the Russian Ministry for Economic Development to establish relevant export duty rates, or the Resolution of the Government of the Russian Federation No. 1277-p[801] of 14 July 2014 on approving the list of organizations granted the exclusive right to export natural gas in a liquefied state which lists eligible exporters.[802]

10.4.5.1 EXPORT DUTY ON GAS

Russia applies to natural gas an export duty of 30% (expressed as a percentage of the customs value given either in RUB, EUR, or USD). For LNG and for gas condensate the export tax is 0% (see also Section 10.2.2.2).[803] The current export duty for natural gas[804] has been at an unchanged level since 2001, when the export duty was raised from 5% (but not less than EUR 2.5 per ton) to 30%.[805] Before 2001, the applicable rate was higher, at the level of 10% (but not less than EUR 5 euro per ton).[806] On the other hand, gas condensate export duty rates have undergone numerous changes over the last years. In fact, the applicable rate has been re-set up to 5 times annually. The most recent data indicate that the export duty reached as much as USD 460.7 per ton[807] in March

[800] Russian original text available at: https://cis-legislation.com/document.fwx?rgn=58799, accessed on 2 September 2019.

[801] Russian original text available at: http://docs.cntd.ru/document/420207758, accessed on 2 September 2019.

[802] For the details regarding the legal issues around the export of natural gas, natural monopolies, and gradual liberalisation of the LNG market please refer to Box 1 and the Federal Law N.º 117-FZ of 18 July 2006 "*on Gas Exports*", Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_61577/, accessed on 2 September 2019.

[803] Government Decree N.º 754 of 30 August 2013 (as amended) "*on the approval of export customs duty rates on goods exported from the Russian Federation outside the member states of the Customs Union agreements and on the recognition of certain acts of the Russian Government as invalid*", available at: http://www.consultant.ru/document/cons_doc_LAW_151402/9d94169a4428cf0558b3b622d66f6b9e2d8ee439/, accessed on 10 September 2019.

[804] Government Decree N.º 754 and Government Decree N.º 705 of 25 July 2014 are among the amendments to Government Decree N.º 754, available at: http://pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102356437&backlink=1&&nd=102357670, accessed on 15 October 2019.

[805] Government Decree N.º 706 of 2 November 2001 "*on Partial Amendments to the Decree of the Russian Government N.º798 of 12 July 1999*", available at: http://pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102060990&backlink=1&&nd=102072890, accessed on 15 October 2019.

[806] Government Decree N.º 411of 28 May 2001 "*on Amendments and Additions to the Decree of the Government of the Russian Federation N.º 798 of 12 July 1999*", available at: http://pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102060990&backlink=1&&nd=102071260, accessed on 15 October 2019.

[807] Government Decree N.º 205 of 25 March 2012 "*on the Approval of the Rates of Export Customs Duties on crude Oil and on certain Categories of Goods produced from oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements"* (amending Decree of the Government of the Russian Federation N.º 695 of 16 November 2006 *"on Approval of Export Customs Duty Rates for Crude Oil and Crude Oil Products Obtained from Bituminous Rocks, and Goods produced from Oil exported from the*

2012 only to be decreased the following month to USD 448.6 per ton.[808] This rate was changed eight more times in 2012, to settle at USD 395.6 per ton at the end of December.[809] The first quarter of 2013 brought three raises of the rate – in January it equalled USD 403.3 per ton,[810] in February - 420.6 per ton[811] while in March it was set at USD 401.5 per ton.[812] The export duties on gas condensate were repealed in June 2013.

Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements", available at: http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102109966&backlink=1&&nd=102154633, accessed on 15 October 2019. Russian original text of the Government Decree N.º 695 available at: http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102140362&backlink=1&&nd=102109966, accessed on 15 October 2019.

[808] Government Decreee N.º 352 of 23 March 2012 2012 "*on the Approval of the Rates of Export Customs Duties on crude Oil and on certain Categories of Goods produced from oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements"* (amending Decree of the Government of the Russian Federation N.º 695 of 16 November 2006 *"on Approval of Export Customs Duty Rates for Crude Oil and Crude Oil Products Obtained from Bituminous Rocks, and Goods produced from Oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements*", Russian original text available at: http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102109966&backlink=1&&nd=102155928, accessed on 15 October 2019.

[809] Government Decree N.º 1368 of 21 December 2012 "*on the Approval of the Rates of Export Customs Duties on crude Oil and on certain Categories of Goods produced from Oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements*" amending Decree of the Government of the Russian Federation N.º 695 of 16 November 2006 *"on Approval of Export Customs Duty Rates for crude Oil and crude Oil Products obtained from Bituminous Rocks, and Goods produced from Oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements*", Russian original text available at: http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102109966&backlink=1&&nd=102161876, access on 15 October 2019.

[810] Government Decree N.º 27 of 23 January 2013 "*on the approval of the rates of export customs duties on crude oil and on certain categories of goods produced from oil exported from the territory of the Russian Federation outside the borders of the States Parties to the Customs Union agreements*" amending Decree of the Government of the Russian Federation N.º 695 of 16 November 2006 *"on approval of export customs duty rates for crude oil and crude oil products obtained from bituminous rocks, and goods produced from oil exported from the territory of the Russian Federation outside the borders of the States Parties to the Customs Union agreements*", Russian original text available at: http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102109966&backlink=1&&nd=102162784, accessed on 15 October 2019.

[811] Government Decree N.º 150 of 25 February 2013 "*on the Approval of the Rates of Export Customs Duties on crude Oil and on certain Categories of Goods produced from Oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements"* amending Decree of the Government of the Russian Federation N.º 695 of 16 November 2006 *"on Approval of Export Customs Duty Rates for crude Oil and crude Oil Products obtained from Bituminous Rocks, and Goods produced from Oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements*", Russian original text available at: http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102109966&backlink=1&&nd=102163495, accessed on 15 October 2019.

[812] Government Decree N.º 261 of 27 March 2013 "*on the Approval of the Rates of Export Customs Duties on crude Oil and on certain Categories of Goods produced from Oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements"* amending Decree of the Government of the Russian Federation N.º 695 of 16 November 2006 *"on Approval of Export Customs Duty Rates for crude*

It can be argued that the gas condensate export duty rate, with its multiple changes introduced annually could well have been an important tool in Russian export policies, especially as both export duty rates for natural gas and LNG have not displayed such volatility. The relatively high export duty rates on gas condensate recorded mid-2012 contrast sharply with the 0% rate introduced in late 2013 (which could be understood as a measure of exports market liberalisation for that product). Changes in export duty rates for both oil (see Section 10.4.5.3 on phasing out export duties on oil) and gas appear as an important part of the redesigning of the Russian taxation system – the zero export duty rate is set to be replaced by greater fiscal burdens associated with other taxes applicable to the energy sector (see for example section 10.4.1 on the mineral extraction tax).

10.4.5.2 Export duty on Coal

In the case of coal, the dominating export duty rate was set at 6.5% before 2016 (for coke and semi-coke from coal, lignite or peat, whether or not agglomerated; coal retort for the production of electrodes, coke and semi-coke from lignite and other purposes). These materials have been excluded from the official list of goods subject to export customs duty rates by the Government Resolution No. 797 of 15 August 2016.[813]

10.4.5.3 Export Duties on Crude Oil

While exports of the resource to the Republic of Kazakhstan, Kyrgyzstan and Belarus are either entirely or up to a specific limit outside the scope of export duties, the rest of international trade in Russian crude oil is subject to export duties. In line with Article 3.1(4) of the Federal Law No. 5003-1-FZ, export customs applicable for oil cannot exceed the standard marginal export duty rates established in line with pre-defined formulas.[814]

Federal Law No. 5003-1-FZ also foresees a number of exemptions from export duties applicable to oil produced from new offshore sites. The list includes, among others:

– Fields whose territories are located in 100% in the Sea of Azov or in 50% in the Baltic Sea, the Black Sea, the Pechora Sea, the White Sea, or in the Russian territories of the Caspian Sea or the Sea of Okhotsk (until end of March 2032),

Oil and crude Oil Products obtained from Bituminous Rocks, and Goods produced from Oil exported from the Territory of the Russian Federation outside the Borders of the States Parties to the Customs Union Agreements" Russian original text available at: http://www.pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102109966&backlink=1&&nd=102164153, accessed on 15 October 2019.

[813] Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_203594/0f1ded31a923d74aff0ec13c6705d56ce6c21a17/#dst100010, accessed on 10 September 2019.

[814] See the Methodology for calculating of export duty rates for crude oil, available at: http://www.consultant.ru/document/cons_doc_LAW_144198/687324a2405700312d275ed58bb81913cc230503/#dst234, accessed on 5 September 2019.

– Fields whose territories are located (at least in 50%) in the Black Sea, the Sea of Okhotsk (north of the 55-parallel north), or the Barents Sea (south of the 72-parallel north) – until end of March 2042;
– Fields whose territories are located, at least in 50% in the area of the Kara Sea, the Barents Sea, Eastern Arctic – indefinitely.

Federal Law No. 305-FZ[815] of 3 August 2018 amended parts of the Law on Customs Tariff. Specifically, it provided the Government with the right to implement protective export duty rate for crude oil (Table 10.4), which may remain binding for six months starting from the month in which the hike of the price of crude oil exceeds 15% (for at least three consecutive months).[816,817]

Table 10.4 Special export customs duty rates if the hike of the price of crude oil exceeds 15% for at least an entire quarter[818]

Urals price (P)	**export customs duty rate (max)**
≤182.50	0%
P > 182.50	29.20 + 45% * (P – 182.50)

Source: Internal calculations

Federal Law No. 5003-1-FZ moreover states that the export duty rates applicable for specific categories of oil derivatives (i.e. petroleum products) are set by the Government. The regulations state that the relevant energy carriers exported to the Republic of Belarus, Armenia, Tajikistan and Kyrgyzstan, within legally indicated limits, are exempt from export duty rates. Additionally, the Government Resolution No. 276[819] of 29 March 2013 establishes a binding methodology utilised for calculation of the duty rates associated with specific petroleum products, whereby the rate is the result of multiplying the export duty rate per ton and the estimated coefficient relevant for a given type of petroleum product.[820]

[815] Federal Law N.º 305-FZ of 3 August 2018 "*on Amendments to Article 3.1 of the Law of the Russian Federation on Customs Tariff*", Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_304092/, accessed on 2 September 2019.

[816] "(...) *the coefficient characterizing the level of change in crude oil prices for the monitoring period exceeded the value of 0.15 (...)*" as stated in Clause 6 Article 1 of the Federal Law N.º 305-FZ (adding this provision to Clause 6.2 Article 3.1 of the Federal Law N.º 5003-1 "On Customs Tariffs").

[817] However, these protective measures do not apply to cases in which approaches from Clause 3 and Clause 5 of the Methodology are applicable, in line with Art. 3.1(6.2) of the Federal Law N.º 5003-1-FZ, introduced by the Federal Law N.º 305-FZ of 3 August 2018.

[818] Russian original text available at: http://www.consultant.ru/document/cons_doc_LAW_304092/, accessed on 2 September 2019.

[819] Russian original text available at: http://pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102147162&backlink=1&&nd=102164158, accessed on 6 September 2019.

[820] Specifically, the formula is as follows: $R_o = C_p * R_{co}$ where C_p equals the estimated coefficient (from 2017 onwards, for gasoline, light, medium distillates, lubricants and diesel equal to 0.3; for naphtha 0.55) and R_{co} is the rate of export duty applicable to crude oil (per tonne).

The amendments of both the Customs Tariff Law and Tax Code, in force since 1 January 2019, focus on stimulating exports (both in terms of volume and revenue) by gradually abolishing (by 2024) export duties on crude oil and oil-related products and increasing the MET and excise duties on petroleum feedstocks.[821] The goal of the amendments is reached via the introduction of new coefficients to the formula for calculation of the MET on both oil and gas,[822] mirroring export duties on oil and tracking the USD/RUB exchange rate. As the oil export duty rate is the basis for determining export duties on oil derivatives, these products would stop incurring export duties from 2024 onwards. The withdrawal of export duties may push domestic feedstock prices[823] up (especially as far as regards oil), since feedstock domestic pricing is usually chained with the export netback price.[824] If this were to happen, refineries would likely suffer profit margin reductions whereas consumers of petroleum products would be faced with higher market prices.

Prevent the change of prices in the domestic market stemming from the reform of the Tax Code, the Government designed tax breaks for refining units and it plans to support refineries by conducting technology-upgrading investment projects of a total value of at least USD 950 million until 2024.[825] Moreover, at the time of writing, a negative excise tax[826] is being considered for refineries where high-octane gasoline and diesel fuel constitute a minimum of 10% of total output on the domestic market, as well as for the refining subsidiaries of oil producers which have so far been affected by international sanctions. In practice, all large domestic oil firms are likely to benefit from tax breaks for their refineries (even if the impact of the tax breaks might be somewhat mitigated by the increases in the MET). These measures are supposed to be temporary and are scheduled to undergo a gradual withdrawal once the above-discussed tax reform is completed by 2024.[827]

821 For a detailed account of the reforms, together with the mathematical formulae used to calculate relevant taxes, see: Borodin, V., Sokolova, A., and Nikolaeva, A. (2018), *ECU Tax Bulletin - Completion of the Oil and Gas "Tax Manoeuvre": Bills Passed in the Third Reading*; available at: https://www.ey.com/Publication/vwLUAssets/EY-ECU-Bulletin-30-July-2018-Eng/$FILE/EY-ECU-Bulletin-30-July-2018-Eng.pdf, accessed on 21 March 2019.

822 The new coefficient is the result of the following equation: RUB/USD exchange rate * ED * C_adj where ED stands for export duty equivalent and C_adj has a pre-defined value fixed for each year in the period 2018-2024 (for exact values and calculation methods refer to https://www.ey.com/ru/en/services/tax/ey-zavershenie-nalogovogo-manevra-v-neftegazovoi-otrasli, accessed on 2 September 2019).

823 Feedstock prices are the prices of inputs (raw materials) utilised in conversion processes – for example, as regards the energy sector crude oil may be thought of as feedstock for petroleum.

824 I.e., the global price less export duties and costs of transport.

825 Such as plants located far from large ports – e.g. in Siberia. Remote oil refineries may profit from a new logistic coefficient introduced in addition to the excise tax. This could help the refining subsidiaries of Rosneft Oil co PJSC, Gazprom and LUKoil PJSC obtain greater tax deductions which means that these companies are likely to reap significant financial benefits from tax and business optimisation while applying this measure.

826 I.e. return the excise tax from the volumes of oil sent for processing.

827 Summary based on Khrennikova, D. (2018), *Russian Oil Getting Ready for Biggest Tax Overhaul in 20 Years*, Bloomberg, available at: https://www.bloomberg.com/news/articles/2018-07-25/russian-oil-getting-ready-for-biggest-tax-overhaul-in-20-years, accessed on 8 October 2019, and Mazneva, E. and Khrennikova, D. (2018), *Russian Oil Faces Next Challenge Now That OPEC Deal Is Complete*, Bloomberg, available at:

10.5 STATE SUPPORT TO THE ENERGY SECTOR

10.5.1 STATE SUPPORT PROGRAMMES

Similarly to other Russian industries, the energy sector has been subject to state support via official programmes promoting development. One of the most important initiatives in this area has been a comprehensive programme Energy Development in the period 2013-2024 (′Energy Development Programme′)[828] pursuant to the Government Resolution No. 1950-r of 11 November 2010.[829] The Energy Development Programme includes several sub-programmes: 1) energy saving and increasing energy efficiency; 2) development and modernisation of the energy sector; 3) development of the Russian hydrocarbon sector;[830] 4) restructuring and development of the Russian coal sector; 5) development of renewable energy; and 6) support for the implementation of the programme.[831] In the meantime, the Energy Development Programme's parameters were redefined to align it with the Presidential Decree No. 204 of 7 May 2018 'On National Goals and Strategic Tasks of the Development of the Russian Federation for the Period until 2024'[832] and with the document presenting the Main Lines of Actions (alternatively Areas or Directions of Activities; Course of Action) of the Government for the Period until 20248.[833] As of writing of this report, the Energy Development Programme provides sub-programmes focused on a sectoral level, 33 indicators and 21 main activities. The activities also include two federal projects and one departmental project: 1) Federal project on Guaranteed provision of affordable electricity; 2) Federal project on Guaranteed Transport of Oil, Oil Products, Gas and Gas Condensate; and 3)

https://www.bloomberg.com/news/articles/2018-07-04/russian-oil-faces-next-challenge-now-that-opec-deal-is-complete, accessed on 8 October 2019.

828 Up until March 2019 it was known as the state programme: Energy Efficiency and Energy Sector Development, 2013-2020

829 Russian original text available at https://www.garant.ru/products/ipo/prime/doc/99749/, accessed on 3 September 2019.

830 This includes improvements in the hydrocarbon (oil and natural gas) subsector, including production, transportation and processing. The objective to meet European standards in product refining processes pushed Russian producers to increase the depth of refining (the difference between raw material and marketable product) and move towards higher levels of production.

831 This programme's objective has been to ensure fuel and energy resources supply reliability in the Russian Federation, smaller environmental imprint of the fuel and energy industries (thus, a more efficient utilisation of the resources in question). The programme's initiatives mirror the goals set in the Russian Federation's Long-Term Socio-Economic Development Concept until 2020 and are derived from the targets set forth in the country's Energy Strategy until 2030. By the year 2020, the support initiative is to 1) reduce energy intensity of Russia's GDP by 13.5% (in comparison to 2007), 2) set the ratio of technological innovation costs in the costs of goods manufactures and delivered at 2.5%, 3) reduce greenhouse gas emissions to 393 million metric tonnes of CO2 equivalent, 4) increase share of technologically innovative enterprises in the entire population of firms so that it reaches 25%, and 5) increase corporate research and development costs up to 3% of firm revenue in innovative entities.

832 The so-called May Decrees 2018 which defined economic development goals up to the year 2024 inclusive, available at: http://en.kremlin.ru/events/president/news/57425, accessed on 11 November 2019. Russian original announcement, available at: https://minenergo.gov.ru/view-pdf/11246/84473, accessed on 3 September 2019.

833 Main Lines of Actions (Areas/Direction of Activities) is a detailed extension of the May Decrees, available at: http://static.government.ru/media/files/ne0vGNJUk9SQjlGNNsXlX2d2CpCho9qS.pdf, accessed on 10 October 2019.

Departmental project 'Digital Energy'. The Energy Development Programme features several sub-programmes aiming to ameliorate energy conservation, development and modernization of the electric power industry,[834] development of the oil and gas industries,[835] development of the gas industry (valid until December 2018), [836] restructuring and development of coal and peat industry,[837] development of the use of renewable energy sources,[838] and lastly, an executive sub-programme focused on operationalising the implementation of the sub-programmes included in the Energy Development Programme.[839] For the years 2013-2024, the Government provided budget allocations for the implementation of the Programme amounting to RUB 134.5 billion (see Table 10.5 below for details).

Table 10.5 Annual budget allocations to specific sub-programmes under the Energy Development Programme for the period 2013-2024 with their respective expected results[840] (all financial quotas are in RUB thousands).

	Subprogram budget allocation (from the federal budget, in thousands of RUB)		Expected results
	I Phase	II Phase	
Subprogram 'Development and	19 689 261.1, including:	19 566 704, including:	• Implementation of Guaranteed Provision of Affordable Electricity;

834 The sub-programme centres on meeting the demand for electric energy and supplying it in a reliable and efficient manner while taking into consideration the estimated requirements of sustainable socio-economic development of the country.

835 The sub-programme focuses on creating conditions conducive to development and modernisation of the oil and gas industries via utilisation of advanced technologies.

836 The sub-programme hinges on development of the gas industry which would provide gas for the needs of the internal market and fulfil the contractual obligations related to export of natural gas, boost production and export volumes of LNG, as well as raise the volume and depth of gas processing.

837 The initiative is focused on providing conditions conducive to the modernization and development of coal industry and its organizations (for example, development of production potential and thus ensuring stable domestic market) and for solving social issues in coal mining regions (such as environmental safety).

838 The sub-programme centres on stimulating the production of electric energy via generation of facilities powered by renewable energy sources.

839 The executive sub-programme focuses on providing organizational, informational and analytical support for the activities of the Ministry of Energy, as well as creating an environment allowing for the development of innovative technologies in the energy and fossil fuels sectors.

840 Government Decree N.º 321 of 15 April 2014 "*On Approval of the State Programme of the Russian Federation 'Energy Development'"* with updates introduced in March 2019 (Government Decree N.º 335 of 28 March 2019 *"On Amendments to the Decree of the Government of the Russian Federation of 15 April 2014 No. 321)*", available at: http://static.government.ru/media/files/hCXeK4Aif1AlRvaAHUFxW4GvOIO36NyP.pdf, accessed on 10 October 2019) to align the document with the Presidential Decree N.º 204 of 7 May 2018 "*on National Goals and Strategic Tasks of the Development of the Russian Federation for the Period until 2024*" and with the "*Main Lines of Actions (alternatively Areas or Directions of Activities; Course of Action) of the Government of the Russian Federation for the Period until 2024, approved at the 27th Government meeting of 27 September 2019, N.º 8028p-P13*", available at: http://government.ru/news/34168/, accessed on 10 October 2019. The Main Lines of Actions is a detailed extension of the May Decree. No separate legal act approving it is available, it is only stated in the top right corner of the front page in the published file "*I approve -- the President of the Russian Federation – D. Medvedev – 29 September 2018*", available at: http://static.government.ru/media/files/ne0vGNJUk9SQjlGNNsXlX2d2CpCho9qS.pdf, accessed on 10 October 2019.

modernization of the electric power industry′	for 2013 – 4 719 794 for 2014 - 1 500 000; for 2015 - 2 372 957.5; for 2016 - 3 121 200; for 2017 - 2 215 554.6 for 2018 – 5 759 755;	for 2019 – 8 825 050 for 2020 - 9 523 550 for 2021 – 1 218 104	• Creation of energy supply facilities of the Chaun-Bilibino energy centre of the Chukotka Autonomous Region (necessary to replace the withdrawn capacities of the Bilibino nuclear power plant); • compensation provided for the shortfall in income of electric power companies when bringing prices (tariffs) for electric energy to an economically justified level in the Republic of Crimea and the city of Sevastopol; • increases (11.5 times by 2024 as compared to 2017) in the share of installed capacity of facilities operating on the basis of renewable energy sources in the total volume of generating capacities of the Unified Energy System of Russia
Subprogram ′Development of the oil industry′	1 300 000 including: for 2013 – 1 300 000.	budget allocations for the implementation of the second phase are not required	• implementation of Guaranteed Transport of Oil, Petroleum Products, Gas and Gas Condensate′; • reaching the planned volumes of oil production, including gas condensate, and gas; • increasing the depth of oil refining at oil refineries at the end of 2024 to 87.1%; • increasing, by 2024, the volume of production of LNG by 3.9 times as compared to 2017; • increasing, by 2024, the volume of production of large-capacity polymers has

			by 1.8 times compared to 2017.
Subprogram ′Development of the gas industry′	no budgetary provision for the subprogram is required	no budgetary provision for the subprogram is required	• commissioning of 3 new fields by 2018; • increasing in the length of the linear part of gas pipelines by 2018; • increasing the active capacity of underground gas storages by 10.8 bcm by 2018; • increasing the share of LNG exports in total gas exports to 8.5% by 2018; • increasing production capacities of LNG to 15.5 million tons/year (by 2018) as a result of commissioning of a new LNG production unit • increasing, by 2018, production of gas in the Far Eastern Federal District by 12.7% as compared to 2012; • increasing the production volume of large-capacity polymers to 6.4 million tons/year by 2018; • supplying natural gas to the Far East at the level of 13.2% by 2018.
Subprogram ′Restructuring and development of the coal and peat industry′	23 752 110.4 including: for 2013 – 8 153 759,1; for 2014 – 3 498 036,1; for 2015 – 2 588 133,8; for 2016 – 3 457 024.6; for 2017 – 3 120 643.6; for 2018 – 2 934 513.2;	24 496 707.5 including: for 2019 – 4 527 414.6; for 2020 – 4 469 803; for 2021 – 4 417 844.2; for 2022 – 3 893 842; for 2023 – 3 921 793.7; for 2024 – 3 266 010;	• the planned volumes of coal and peat extraction were achieved; • reduction of pollutants' emission (per ton of production); • issuing insurance policies for supplementary pensions; • relocating citizens from sub-standard housing; • supplying free rations of coal for domestic needs for citizens falling into preferential categories;

			• projects alleviating the negative consequences of mining.

External analyses provided historical information about regional transfers and financial support to SMEs, support in terms of know-how and relevant technology provided by research institutes and universities[841] linked to the oil and gas subsectors. Additionally, regional (municipal) governing bodies may boost the attractiveness of resource exploration by lowering regionally managed taxes (these tax cuts usually applied to smaller firms – however, relevant data regarding their estimated values remained unavailable).[842] These expenditures, which are separate from the above-presented figures from the Energy Development Programme, aimed to reach USD 810 million on annual basis in the period between 2011 and 2020.[843] Their overriding goal has been to boost investment activities related to exploration and prospecting for domestic hydrocarbon resources.[844]

Apart from the programmes at municipal level, several state-controlled banks have continued to provide funding to companies operating in the sector, although it is not clear to what extent these may have been provided on commercial or non-commercial terms. The available information provides insight on the extent of the Russia's banks' involvement in the sector. By way of example:

1. Sberbank's (see Chapter 3 concerning Sberbank being controlled by the State) loans and advances to the oil and gas subsector amounted to 7.8% and 8.8% of the bank's loans portfolio in 2016 and 2017 respectively;[845]
2. VTB's (see Chapter 3 concerning VTB being controlled by the State) latest financial data indicate that the bank's involvement in the oil and gas segments amounted to 18% in 2017 (15% in 2016). At the same time, the bank reported the development of its commodity market-related

841 Pickard and Makhijani (2014, p. 2) based on the insights of Gerasimchuk (2012) indicated that the academic units likely supporting the exploration of oil and gas included: Gubkin University of Oil and Gas (Moscow), Saint-Petersburg State Mining University, All-Russia Scientific and Research Geo-Exploration Institute (Saint Petersburg), Tyumen State Oil and Gas University and Ufa State Oil Technical University.

842 Pickard, S. and Makhijan, S. (2014), *Fossil fuel exploration subsidies: Russia, Overseas Development Institute*, available at: https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9267.pdf, accessed on 7 January 2019, and Gerasimchuk, I. (2012), *Fossil fuels – At What Cost? Government support for upstream oil and gas activities in Russia*, Moscow and Geneva, WWF-Russia and Global Subsidies Initiative, available at: http://www.iisd.org/gsi/sites/default/files/ffs_awc_russia_eng.pdf, accessed on 11 November 2019.

843 Pickard, S. and Makhijan, S. (2014).

844 Funding of the exploration of the Arctic via a programme included in the Federal Target Programme World Ocean was a separate issue – for this the Government delivered means of a magnitude of USD 5.8 million in 2010 alone (Gerasimchuk, I. (2012), *Fossil fuels – At What Cost? Government support for upstream oil and gas activities in Russia*, Moscow and Geneva, WWF-Russia and Global Subsidies Initiative, available at: http://www.iisd.org/gsi/sites/default/files/ffs_awc_russia_eng.pdf, accessed on 11 November 2019.

845 Sberbank (2018), *Consolidated Financial Statements: Sberbank of Russia and its subsidiaries for the year ended 31 December 2017 with Independent Auditor's Report*, available at: https://www.sberbank.com/common/img/uploaded/files/info/word_eng_ye2017-04fteet.pdf, accessed on 11 November 2019.

transactions, such as option structures for hedging and a long-term prepayment of future supplies of 1.8 million tons of crude oil with an independent oil-producing company.[846] VTB's operations in 2018 highlighted its strengthening position in the commodities market, especially in the energy sector;[847]

3. Gazprombank's (see Chapter 3 concerning Gazprombank being controlled by the State) most recent financial data[848] suggests that the loans for the oil sector in 2018 (2017) amounted to 17% (11.3%) of the bank's total loan portfolio; these figures for the gas industry stood at 8.1% (11.0%); for electric power industry at 5.9% (6.2%), and for the nuclear industry at 0.1% (0.1%). The latest reports[849] regarding the bank's operations highlight its active engagement in the energy sector, although it is not clear whether the operations could be considered as related lending. For example, Gazprombank discloses significant financial operations performed on behalf of Rosneft (a one-off bond offering on the local market amounting to RUB 50 billion), Gazprom[850] (an amount equivalent to EUR 1 billion was raised in two tranches on the local market) as well as RusHydro (Eurobonds issued in two national currencies, RUB and CNY). The bank also issued guarantees, including those in favour of the national tax authorities to RusHydro Group's subsidiaries and dependent entities. Apart from that, the bank engaged in nuclear energy sector development and in petrochemicals and processing of gas and oil. As for the latter, the bank has participated actively in refineries' modernisation (specifically, in the second stage of the works at the Omsk Refinery); moreover, Gazprombank has also been engaged in the implementation of Novatek's Arctic LNG 2 project.

10.5.2 RUSSIAN FOSSIL FUELS SUBSIDIES IN THE GLOBAL CONTEXT

In its 2019 estimation, the IMF distinguishes between subsidies to consumers and producers. The former, which are the focus of the summary prepared for the purposes of this chapter, appear if consumers, both final and intermediate (such as households or enterprises), are charged prices beneath an appropriate benchmark price.[851] The latter emerge when prices obtained by the

846 VTB (2018), *Annual Report 2017*, St. Petersburg: VTB Group, available at: https://www.vtb.com/-/media/Files/aktsioneram-i-investoram/2018/eng/vtb_ar2017_en_23apr18.pdf, accessed on 11 November 2019.

847 VTB (2019), *Annual Report 2018*, VTB Group, available at. https://ar2018.vtb.com/?_ga=2.8235826.1066346614.1567407892-130592588.1567407892, accessed on 11 November 2019.

848 Gazprombank Group (2019), *Consolidated Financial Statements Year Ended 31 December 2018*, p. 50, available at: https://www.gazprombank.ru/upload/files/iblock/092/GPB_IFRS_2018_12m_ENG.pdf, accessed on 2 September 2019.

849 Gazprombank Group, *Annual Report 2018*, available at: https://www.gazprombank.ru/upload/files/iblock/da1/GPB_AR18_RUS_v4.pdf, accessed 23 January 2020.

850 Since 2013 the bank has been the company's corporate broker.

851 IMF differentiates between two kinds of consumer subsidies: pre- and post-tax subsidies. The former is a narrow category highlighting differences between fuel prices charged to consumers and the relevant supply costs. The latter captures the difference between the actual prices charged to consumers and the amounts that would be charged, if fuel prices wholly reflected the impact of supply costs, the taxes approximating environmental costs and revenue requirements. (See Coady, D. et al. (2019), Global Fossil Fuel Subsidies Remain Large: An Update Based on Country-Level Estimates, *International Monetary Fund Working Paper No. 19/89*, available at:

supplying side are greater than a specific benchmark.[852] In most cases, consumer and producer subsidies co-exist; at the same time, despite differing economic consequences, they are difficult to differentiate (for example, producer[853] subsidies might not be passed onto consumers in the form of lower prices and they may not translate into excessive utilisation of energy).

According to the IMF, world post-tax subsidies equalled, in nominal terms, USD 4.7 trillion and USD 5.2 trillion in the years 2015 and 2017, respectively. As for the structural decomposition of global post-tax subsidies carried by the IMF, coal emerged as the most important fuel, with petroleum trailing close behind. Both natural gas and electricity were relatively less important.[854]

In this context, the country-specific estimation of fossil fuel subsidies in Russia emerges as significant, whether expressed in nominal or relative terms. The estimation results for the year 2015 indicate that the total nominal amount of the Russian post-tax subsidies reached USD 551 billion, which made the country the world's third largest subsidiser (behind China - USD 1432 billion, and the USA - USD 649 billion). When calculated as post-tax subsidies per capita, Russia came first with USD 3832 per capita (followed by Saudi Arabia - USD 3709, and the United Arab Emirates - USD 2452). The country also scored high in relative terms – in 2015 Russian post-tax subsidies accounted for 40.3% of its GDP (in this case, only Ukraine's result was greater and amounted to 66.7% of GDP).[855]

The findings presented by the OECD in 2019[856] further highlighted the significance of subsidies pertaining to the petroleum segment in Russia. Even though domestic prices of petroleum result

https://www.imf.org/en/Publications/WP/Issues/2019/05/02/Global-Fossil-Fuel-Subsidies-Remain-Large-An-Update-Based-on-Country-Level-Estimates-46509, accessed on 30August 2019).

852 The benchmark price appropriate for internationally-traded fuels is based on the international market price adjusted for the supply costs (associated with distribution and transportation). If energy carriers are not traded, as for example in the case of electricity, the benchmark is based on the cost (price) of recovery obtained by domestic producers (based on the price-gap approach). In the estimation process of energy's benchmark price, both environmental costs and general consumption taxes are also considered. This approach does not allow to identify producer subsidies (they emerge, if suppliers of energy are economically inefficient i.e. they incur loss at benchmark prices) – this is especially important in the case of emerging and developing markets where cost-recovery prices may be excessively high due to operational inefficiencies of state-owned companies in the energy sector. On the other hand, the approach does help to quantify (implicit) consumer subsidies, especially as concerns the subsidies provided by oil-exporting economies (which supply petroleum products to consumers below the internationally-traded prices, as in: Koplow, D. (2009), *Measuring Energy Subsidies Using the Price-Gap Approach: What Does it Leave Out?*, International Institute for Sustainable Development, available at: https://www.iisd.org/pdf/2009/bali_2_copenhagen_ff_subsidies_pricegap.pdf, accessed on 30 August 2019), Coady, D., Parry, I., Sears, L., and Shang, B. (2015) and Coady, D., et al. (2019)).

853 Producer-related subsidies most likely materialise when enterprises receive either direct or indirect help (which could take form of, for example, prices above the costs of supply, preferential tax arrangements or transfers from the State budget) which does not decrease prices charged to consumers (as in: Organization for Economic Co-operation and Development (OECD) (2018), *OECD Companion to the Inventory of Support Measures for Fossil Fuels 2018*, OECD Publishing, Paris)).

854 *Ibidem*, p. 20.

855 *Ibidem*, p. 35.

856 The quantitative results presented by the OECD are derived from an arithmetic sum of the support measures identified by the OECD Inventory of Support Measures for Fossil Fuels (which catalogues and quantifies both

largely from market forces (see Section 10.6.2), the State does intervene to curb their increases (especially via export taxes). Particularly, the export tax rates set on crude oil are reported to exceed the duty rates specific for petroleum, incentivising investment in refining capacity. In line with the OECD's results, it seems that Russia has continuously heavily subsidised the petroleum segment. From 2014 (when the total fossil fuels subsidies for petroleum were below USD 250 billion in nominal terms), the support grew significantly, exceeding, in the year 2017, the level of USD 450 billion. In contrast, fossil fuels subsidies in the natural gas sub-sector remained relatively flat in the years 2007-2017 (2013 was the only year for which a slight increase, up to USD 10 billion, was recorded).[857] As for the hydrocarbons segment (as well as electricity), it appears to have benefitted the most from the fiscal support for fossil fuels: firstly, regulated tariffs for natural gas (and electricity) kept at artificially low levels resulted in significant support on the consumption side (see Section 10.6.1) (although the OECD does not include these tariffs in their calculations due to the lack of relevant data); secondly, the largest hydrocarbons-producing state-owned companies, such as Rosneft or Gazprom have been the main beneficiaries of numerous tax and customs duty exemptions (see Section 10.4).

10.6 PRICING REGULATIONS AND MECHANISMS

10.6.1 NATURAL GAS

As documented in Section 10.2.2, over 85% of Russia's gas production is accounted for by state-owned companies, mainly those belonging to the Gazprom Group (approximately 75% of production), as well as Rosneft (10%). Gazprom is the owner of the UGSS which gives it a privileged position in sourcing and distributing gas within Russia although this also imposes on Gazprom obligations related to maintenance and modernisation of UGSS. The company controls, directly or indirectly (via managing the UGSS and providing transmission and other UGSS-related services to other producers), some 74% of gas supplies within the Russian market. Gazprom is also the sole authorised exporter of piped gas outside Russia and it accounts for 20% of the LNG export segment, the most liberalised part of the Russian gas sector.

The channels of influence described in this section concern state regulations and practices related to pricing of gas including the role played in these by Gazprom. The remainder of this section first gives an overview of the evolution of policies related to gas pricing since the 1990s (Section 10. 6.1.1) before describing the current regulations relevant for gas pricing (Section 10.6.1.2). This is followed by a summary of main developments as regards the organised trade of gas on the Saint-Petersburg International Mercantile Exchange (′SPIMEX′, Section 10.6.1.3) and a comparison of

direct budgetary support measures as well as tax expenditures offering financial support for either (or both) production or (and) consumption of specific fossil fuels in OECD economies as well as eight partner economies (Russia among them)). Due to the fact that these measures are focused on budgetary costs and foregone revenues, the estimations presented for Russia (or, more broadly speaking, for all partner economies) fail to convey the amount of the support delivered via artificially decreased prices on domestic markets. Hence, these results should not be compared directly with the figures presented by other entities, International Energy Agency among them.

857 OECD (2019), *Fossil fuel support - Country note - Russia*, p. 2, available at: http://www.oecd.org/fossil-fuels/data/, accessed on 22 January 2020.

pricing in Russia's domestic market and for exports (Section 10.6.1.4). Section 10.6.1.5 concludes with a discussion of the possible influence of all these factors on gas pricing in the country.

10.6.1.1 A Summary of Main Policy Developments in the Area of Gas Pricing since the early 1990s

The current regulations related to gas pricing which are described in Section 10.6.1.2 reflect the evolution of the public debate on the effects of gas pricing policies and of Government decisions dating back to the collapse of the Soviet Union in 1991. In the Soviet era prices of all the gas produced and consumed within the country were regulated. Gazprom was created in 1989 out of the Ministry of Gas Industry as the Soviet Union's first state-run corporate enterprise. It produced some 94% of Russia's total output and was also the largest enterprise in Russia's economy in 1991. This explains why, while other commodity prices were being liberalised already in the early 1990s, it was decided that gas prices charged by Gazprom needed to remain regulated by the State. They were initially set by the Ministry of Energy. In 1997 the authority of price setting was transferred to the Federal Energy Commission, to the Federal Tariff Service (′FTS′) in 2001 and to the FAS in 2015 after its merger with the FTS.

From the early 1990s different levels of regulated gas prices were being set for industrial and residential customers with the former paying initially a price as much as 30 times higher than the latter.[858] Nevertheless, the industrial prices were already then the key benchmark for the Russian gas sector as they covered more than 85% of the country's demand.[859] The Government control of gas prices in the early 1990s meant that Gazprom was charging domestic industrial consumers prices which were at below 20, 10 and 30% of the export netback prices in 1991, 1992 and 1993, respectively.[860]

Nevertheless, despite being controlled by the State, the regulated gas tariffs rose very fast in the first part of the 1990s as a result of being indexed to inflation which reached very high rates in that period.[861] This is reported to have generated a very significant non-payment problem among gas consumers, which peaked in 1997 when Gazprom reported being paid for only 29% of its domestic sales, and contributed to the larger issue of financial underperformance in the Russian economy which culminated in the 1998 debt default and currency devaluation crisis.[862]

Government Decree No. 1021 of 29 December 2000 on State Regulation of Gas Prices, Tariffs for Transportation Services and Fees for Technological Connection of Gas-using Equipment to Gas

858 Henderson (2011).
859 *Ibidem.*
860 *Ibidem,* p. 12.
861 *Ibidem,* p. 12.
862 *Ibidem.*

Distribution Networks in the Russian Federation ('Decree on State Regulation of Gas Prices')[863] was departing from the inflation-indexed gas tariff setting and gave the State the right to set regulated tariffs rather than linking them to inflation. While wholesale gas pricing was supposed to be based on costs of production and a regulated mark-up, in reality, it is not possible to determine whether and how economic costs were taken into account because data and methodology used for these calculations were not public.[864] The expert literature argues that the cost-plus principle was generally not followed and that prices were set discretionally at the top political decision-making level.[865]

Together with the collapse in global oil prices in 1999, which brought European gas prices down, this meant reduced revenues for Gazprom both in the domestic and foreign markets. Despite a series of 20-25% regulated price increases announced by the FTS in the years 2000-2004, in 2005 domestic industrial prices were still at the level of only 42% of the export netback and in 2006 they decreased further to below 40%. At that time, an OECD study estimated that not only was Gazprom providing gas to domestic consumers at a significant discount as compared to clients in Europe, but also that the prices at which it was providing gas to domestic consumers were below the long run marginal cost of its asset base, implying a possibly significant subsidy.[866] While, as the authors of the study themselves admitted, estimating long rung marginal costs is difficult and has to rely on a number of significant assumptions, the hypothesis that Gazprom was selling gas to domestic industrial consumers at prices which were below the costs of production seems to be confirmed by Gazprom's management admission in 2010 that 2009 was the first year in which the company made profit on domestic gas sales.[867]

These differences in prices and the development of two-tier market comprising Gazprom and its affiliates selling gas at artificially low regulated prices and the independent companies selling at unregulated prices are reported to have led the Government to introduce further pricing targets in 2006. Government Resolution No. 333 of 28 May 2007[868] on Improvement of State Regulation of Gas Prices stipulated a market-based pricing principle based on netback parity to take effect on 1 January 2011. During the 2007-10 period, regulated prices were to be calculated at a discount

863 The Resolution, as currently in force, is available at: http://ivo.garant.ru/#/document/12121555/paragraph/50430:0, accessed on 19 September 2019.

864 Idrisov and Gordeev (2017).

865 *Ibidem*, p. 4.

866 See OECD (2004), *Economic Survey: Russian Federation*, OECD Publishing, Paris, and the discussion of these estimates in Henderson (2011).

867 Interfax, 2 May 2010, "*Gazprom posts first profit on domestic sales in 2009*", Moscow.

868 Available at: http://www.consultant.ru/cons/cgi/online.cgi?rnd=3560736456A6366311938AF7E7736F9A&req=doc&base=LAW&n=110862&dst=100010&fld=134&REFFIELD=134&REFDST=100005&REFDOC=179107&REFBASE=LAW&stat=refcode%3D10881%3Bdstident%3D100010%3Bindex%3D14#1ljuzkg136q, accessed on 19 October 2019.

(however different for each year and determined by the FTS) to European netback price with the aim of achieving the netback parity in January 2011.

While in 2007 domestic industrial prices were at below 40% of the export netback price, in 2010 they increased only to approximately 50%. One of the reasons cited for the failure to increase prices substantially was that the 2006 netback parity targets were set by the State on the basis of unrealistic oil price and exchange rate assumptions.[869] In December 2010, the deadline for export netback parity was again shifted to 2014.[870]

With its accession to the WTO in 2012, Russia undertook specific commitments with regard to gas pricing, as documented in the Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization which stipulates Russia's legal obligations towards other WTO members.[871] Despite those obligations, a new formula for wholesale prices for Gazprom based mainly on export pricing, and partly on various other technical or state-driven factors was introduced by the FTS in April 2014[872] (see Section 10.6.1.2). At the same time, the date for the netback target was again postponed until 2017[873] but the domestic downturn of 2014/2015 has subsequently made this target also impossible to achieve as the Government allegedly wanted to avoid gas price increases when the economy and citizens were struggling.[874]

In the recent years, prices based on the pricing formula appear as having been set along a seemingly inconsistent path: they were increased by 15% in July 2013, left unadjusted in 2014, increased by

869 This is the argument put forward convincingly by Henderson (2011) and Yafimava (2015). Henderson (2011) argues for example that when in 2006/2007 the Government announced the netback parity target, the oil price assumption being used was USD 55/barrel and the RUB/USD exchange rate was approximately at 25, while between 2006/07 and 2011 the oil price has been fluctuating between 40 and 150 USD/barrel, and stabilised at around 105-115 USD/barrel in 2011, and the exchange rate moved to approximately 30 RUB/USD. The implied rapid increase in export prices of natural gas (which are themselves tied to the price of oil through long term contracts which are indexed to oil prices) in the period 2006-2012 made the achievement of the netback parity largely impossible.

870 Government Resolution N.º 1205 of 31 December 2010 "*on Improving the State Regulation of Prices*", available at: http://www.consultant.ru/cons/cgi/online.cgi?rnd=04F50F93467CB1A5ACFA5E6BD7356C3C&req=doc&base=LAW&n=185803&dst=100040&fld=134&REFFIELD=134&REFDST=1000000007&REFDOC=110862&REFBASE=LAW&stat=refcode%3D19827%3Bdstident%3D100040%3Bindex%3D9#1k48wjj6ejo, accessed on 12 November 2019.

871 See paragraphs 129-132 in World Trade Organization (2011), *Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization*.

872 The Order of the FTS N.º 165-e of 14 July 2014, available at: http://www.consultant.ru/cons/cgi/online.cgi?rnd=04F50F93467CB1A5ACFA5E6BD7356C3C&req=doc&base=LAW&n=160641&dst=100007&fld=134&stat=refcode%3D16876%3Bdstident%3D100007%3Bindex%3D0#1wc62c9d7qv, accessed on 12 November 2019.

873 Government Resolution N.º 342 of 15 April 2014, available at: http://www.consultant.ru/cons/cgi/online.cgi?rnd=04F50F93467CB1A5ACFA5E6BD7356C3C&req=doc&base=LAW&n=161957&dst=100018&fld=134&REFFIELD=134&REFDST=1000000010&REFDOC=185803&REFBASE=LAW&stat=refcode%3D19827%3Bdstident%3D100018%3Bindex%3D14#d28ssnhl8a0, accessed on 12 November 2019.

874 Yafimava (2015).

7.5% in 2015, then unadjusted in 2016 and further increased by 3.9% in July 2017.[875] In particular, it is worth noting with regard to year 2016 that a price increase of 2% was at the time considered. However, the FAS, which then took over price-setting obligations from the FTS, decided the wholesale prices would rather remain unadjusted that year.[876]

Recently, increases of 3.4% and of 1.4% were acted for 2018[877] and 2019[878] respectively with the assumption this would be below the forecasted rate of inflation.

10.6.1.2 Main Current Regulations related to Gas Pricing

As outlined in the previous section, the set of currently binding regulations related to gas pricing is an outcome of introduction of many Government resolutions and orders of FTS and, later, FAS and their subsequent amendments. The key legislative act that sets the principles of gas provision in Russia and lays out the associated state responsibilities and powers is the Federal Law on Gas Supplies (see also Section 10.2.2.1). The principal legislative act that governs the pricing of natural gas in Russia is the Decree on State Regulation of Gas Prices. Article 2 of the Resolution states that generally:

> *The regulated wholesale price and payment for supply and marketing services apply to gas produced by the public joint-stock company Gazprom and its affiliates, as well as owners of regional gas supply systems.*

Article 3 further states that the:

> *Gas price for a gas consumer at the interface between gas distribution networks and gas consumer networks is formed from the regulated wholesale gas price or wholesale gas price, determined by agreement of the parties, taking into account the established limit levels, tariffs for services for its transportation through gas distribution networks, special allowances to tariffs for gas transportation services through gas distribution networks intended for financing gasification programs, and fees for supply and marketing services.*

Article 4 further determines that the following prices and tariffs are subject to regulation:

875 Henderson, J., Mitrova, T., Heather, P., Orlova, E. and Sergeeva, Z. (2018), *The SPIMEX Gas Exchange: Russian Gas Trading Possibilities*, *OIES Paper*, NG 126, p. 6

876 "*Regulated gas prices in Russia rising 3.9% after two year freeze*". Interfax news (2017), *Regulated gas prices in Russia rising 3.9% after two-year freeze*, available at: http://www.interfax.com/newsinf.asp?id=763859, accessed on 23 October 2019.

877 Прогноз социально-экономического развития Российской Федерации на 2018 год и на плановый период 2019 и 2020 годов, p. 33, available at: http://economy.gov.ru/wps/wcm/connect/2e83e62b-ebc6-4570-9d7b-ae0beba79f63/prognoz2018_2020.pdf?MOD=AJPERES&CACHEID=2e83e62b-ebc6-4570-9d7b-ae0beba79f63, accessed on 13 Decmeber 2019

878 Прогноз социально-экономического развития Российской Федерации на период до 2024 года, p. 25, available at: http://economy.gov.ru/wps/wcm/connect/60223a2f-38c5-4685-96f4-6c6476ea3593/prognoz24svod.pdf?MOD=AJPERES&CACHEID=60223a2f-38c5-4685-96f4-6c6476ea3593, accessed on 13 December 2019.

– Wholesale prices for gas, with the exception of wholesale prices for natural gas sold on organized tenders;
– Tariffs for gas transportation services through main gas pipelines for independent organizations;
– Tariffs for gas transportation services through gas pipelines owned by independent gas transportation organizations;
– Tariffs for gas transportation services through gas distribution networks;
– The amount of payment for supply and distribution services rendered to gas consumers by its suppliers (while regulating the wholesale prices for gas);
– Retail prices for gas sold to the public;
– Special allowances to the tariffs for gas transportation services through gas distribution networks, intended for financing gasification program;
– Payment for technological connection of gas-using equipment to gas distribution networks and (or) standardized tariff rates determining its value.

This price regulation does not apply to wholesale price for gas produced by Gazprom (and its subsidiaries) and sold to entities producing LNG or methanol (for methanol it concerns contracts concluded after 1 November 2018 with supply beginning after 1 January 2020 (Article 4.1)).

The regulation of tariffs is entrusted to FAS (Article 7), as the federal executive body in the field of state regulation of prices and tariffs[879] in coordination with the Ministry of Economic Development. The regulation is to be undertaken separately for each organization engaged in regulated activities, allegedly based on separate accounting products (services) and costs of their production (Article 12).

Prices of gas are regulated according to principles set out in Part IV of the Resolution entitled Principles of formation and State regulation of gas prices and tariffs for transportation service. According to Article 11, fixed prices (tariffs) or their maximum levels are set so as to take into account a range of economic, fiscal and developmental circumstances, including:
(1) Recovery of economically justified costs of gas production (including all steps from extraction to the consumer), as well as reimbursement of economically justified costs associated with transportation and distribution of gas (when regulating tariffs) (Article 4a);
(2) Reasonable rate of return on capital used in regulated activities (Article 4b);
(3) The goals of satisfying the demand for gas while also balancing the interests of sellers and buyers of gas (Article 4c);
(4) Taking into account all taxes and other obligatory payments (Article 4d);

[879] This is not stated directly but can be inferred from FAS's role as the federal body responsible for regulation of prices and tariffs. In fact, FAS issues orders on approval of wholesale gas prices which are referring to the Decree on State Regulation of Gas Prices as their legal basis, such as e.g. the FAS Order N.º 1088/18 of 03 August 2018, available at: http://publication.pravo.gov.ru/Document/View/0001201808100029?index=0&rangeSize=1, accessed on 12 November 2019.

(5) Taking into account the difference in the cost of transportation and supply to various groups of consumers and to different regions (Article 4e);
(6) The development of intra-industry (in the gas supply) and inter-industry (between replacement fuels) competition, as well as '*the application of the method of comparing the wholesale price of gas with the price of gas on foreign markets'* (Article 4f);
(7) Recovery of economically justified costs of the provision of services for technological connection to gas distribution networks (Article 4g);
(8) In the case of prices of gas destined for exports the tariff should reflect, where applicable and in co-ordination with appropriate authorities, the conditions of payback of an investment project for the construction of new infrastructure and the level of return on invested capital in cases where gas supply was made possible through the creation of new regional gas supply systems (Article 11.1);
(9) Taking into account inflation through appropriate indexation to the Government's official forecasts of inflation (Article 11.2).

Article 13 echoes to a large extent the provisions of Article 11. Indeed, it stipulates that the initial data for the calculation of regulated prices (tariffs) are: estimated volume of products (services) for the regulatory period, determined on the basis of the approved balance of gas production and sale in Russia; estimated total revenue (for the regulatory period) required to compensate for economically reasonable costs attributable to the cost of production (works, services), and to provide organizations engaged in regulated activities with the profit necessary for their self-financing, as well as the means to pay all taxes and other obligatory payments in accordance with the Russian legislation (Article 13).

Importantly, profits from gas exports are to be taken into account when calculating the domestic price based on economically justified costs and reasonable profit (Article 14b). If followed, it can effectively mean that proceeds from exports act as a cross-subsidy to domestic prices, through their reflection in the level of state-regulated tariffs.

Regulated gas prices, tariffs for gas transportation services through gas distribution networks, special surcharges to gas distribution services, tariffs for financing gasification programs, and fees for supply and sales services rendered to gas consumers by their suppliers can be differentiated by groups of consumers depending on their connection to networks of various pressures, on price zones, on season, on time of conclusion and the duration of contracts for gas supply, on gas extraction modes, on the volume of consumption and other factors (Article 15). This last element and the many criteria above demonstrate the complexity of the state regulation system and point to the state entities' wide capacity to adjust (and by the same token reduce) the costs of gas for particular gas-using industries or individual users. In short, they leave an important degree of discretion to the institution that is supposed to regulate the prices and tariffs.

10.6.1.2.1 Wholesale price formula

According to the Article 15.1 of the Resolution, wholesale prices for gas produced by Gazprom and its affiliates (with the exception of organized tenders) are determined by agreement of the parties when entering into gas supply contracts (including long-term), including in cases of its resale, and '*have to be in the range between the maximum and minimum levels of wholesale prices'*.[880] Between January 2011 and July 2015, the minimum and maximum wholesale prices, where the maximum wholesale price is per Article 15.2 of the Resolution the minimum wholesale price increased by 10%, were being set using the gas price formula discussed below by the FTS and then, since July 2015, by FAS. This means that the range of prices at which Gazprom's or its affiliated parties' gas can be sold or resold to wholesale customers is linked tightly to the regulated minimum wholesale price.

According to Articles 16 and 17 of the Resolution, state regulation of prices is carried out in the prescribed manner at the initiative of regulatory authorities or on the basis of applications from organizations engaged in regulated activities (e.g. Gazprom) which must present to FAS, among other documents, a calculation of new prices and tariffs approved by FAS in coordination with the Ministry of Economic Development, as well as a detailed justification of the proposed changes. The information provided is verified by a committee consisting of executive authorities of the constituent entities of the Russian Federation in the field of state regulation of tariffs.

The current wholesale gas price formula was laid out in the FTS Order No. 1142-e of 9 July 2014 (as amended on 24 March 2015).[881]

One of the formula's originally stated objectives is to ultimately ensure equal profitability of gas supplies to consumers in Russia and consumers located outside the CIS and to take into account the price of alternative fuels (Paragraph 3 of Order No. 1142-e). The domestic price is calculated at the exit from the main pipeline and it is differentiated across different price zones. It is calculated as:

$$P_D = P_{EP} \times R \times P \qquad \text{(Equation 2 in Order No. 1142-e)}$$

The meaning of each constituent element of this formula appears as follows:

(R) Is the reduction coefficient ensuring a downward correspondence of gas prices changes with past consumer gas price changes and is set annually by FAS based on parameters established by the Government. It is referred to in the literature as the export netback discount

[880] This applies to groups of consumers (except for the population) who entered into gas supply agreements after 1 July 2007, or are purchasing gas in volumes exceeding those specified in gas supply agreements for 2007 (Article 15.1).

[881] Available at: http://www.consultant.ru/cons/cgi/online.cgi?req=doc&base=LAW&n=179107&fld=134&dst=1000000001,0&rnd=0.7637873661093604#05531593746703105, accessed on 12 November 2019.

coefficient.[882] The R coefficient is the key factor creating a wedge between an export netback price level and the domestic price;

(P) Is the price zone differentiation coefficient — a scaling parameter for different prices zones reflecting adjustments taking into account a range of factors such as different levels of socio-economic development, distance from the gas production site as well as routing of gas flows, costs and degree of use of alternative fuels and presence of independent gas suppliers, also set by FAS based on average parameters established by the Government[883] (see also Article 11 of the Decree on State Regulation of Gas Prices);

(P_{EP}) Is a key variable which is obtained by deducting from the export gas prices at the border (P_E) the amount of customs duties (where C_D is the rate of export customs duty), the value of the costs of transportation and storage of gas when it is sold outside the territories of the CIS (C_T); and the difference between the average cost of transport from production sites to the border of Russia and the average cost of transporting gas from production sites to consumers within Russia (DC_T):

$$P_{EP}=P_E-(1-C_D/100\%)-C_T-DC_T \qquad \text{(Equation 3 in Order No. 1142-e)}$$

Regarding C_T and DC_T it, it should be noted that only Gazprom has access to data requited for their computation, which appears as not being available in the public domain nor verifiable. This gives either Gazprom or the Russian authorities the capacity to present or use complex technical information on transport and storage costs of gas unknown to the public in a way that the estimated cost adjustments create a certain wedge between export price and domestic prices, possibly differing from what the actual gas transport and storage conditions would entail. Moreover, the costs of gas transmission are also regulated by the State and so the entire legal set-up does not permit to exclude that this parameter may be used by the Russian authorities to shape domestic prices of gas, now or in the future, for state policy purposes, rather than Gazprom's commercial interests.

P_E is determined on the basis of the following formula:

$$P_E= (0.2097*M+0.2685*G)*E_X \qquad \text{(Equation 3 in Order No. 1142-e)}$$

Where (M) is the *average price of oil fuel* with a sulphur content of 1 percent,[884] and (G) is *the average price of gas oil* with a sulphur content of 0.1 percent; while (E_X) is the exchange rate of

882 See Para 11 of the Order N.º 1142-e and the reference in it to the corresponding Para 2 of Government Resolution N.º 1205 "*on Improving the State Regulation of Gas prices of 31 December 2010*", which was also the resolution that postponed the 2011 target for achieving the export netback parity in January 2011 (see the discussion of sequence of events in Section 6.1.1.1).

883 *Ibidem*.

884 This and the other average are calculated on the basis of minimum and maximum values reported for the FOB delivery Amsterdam -Rotterdam – Antwerp with vessels up to 50,000 barrels).

rouble against the US dollar established by the CBRF at the end of the period corresponding to the calculation of average fuel prices.[885]

As regards the practical application of this formula to calculation of legally binding wholesale prices, FAS is in charge of issuing the orders that approve wholesale prices for gas produced by Gazprom and its affiliates, intended for subsequent sale to the public. These orders may give concrete values of wholesale prices for gas produced by Gazprom and its affiliates, sold to Russian consumers, specified in RUB per 1000 m^3 and differentiated by regions[886] but they may also give the minimum and maximum wholesale prices.[887]

Due to the lack of transparency regarding the process behind the wholesale price-setting of gas, it is not possible to determine whether, and if so how, the application of the formula and in particular the setting of the different coefficients which determine the domestic prices really reflect any of the economic or social goals stipulated by the law. This is because there are many criteria that authorities may choose to take into account in their calculation of regulated prices (Article 11 of the Decree on State Regulation of Gas Prices) and only the final regulated prices, rather than all their constituent components, are made public by the authorities.

A comparison of average domestic and export gas prices published officially by Gazprom presented in Section 10.6.1.4 with announcements of regulated tariffs and developments in key economic variables, such as oil prices, the exchange rate as well as inflation, suggests that the announcements were not related strongly to inflation developments, although they seem to have reflected the Government's intent to intervene and restrain price increases in the context of the Ukraine crisis, the subsequent sanctions imposed on Russia by the EU and the US and the economic recession. Some correspondence with the world oil prices and export prices can be observed with the dynamic of regulated prices being lowered by authorities when international prices fall, thereby proving that the State intervenes strongly in the yearly price dynamics, effectively preventing prices to approach the allegedly intended export netback parity.

885 The linkage of gas prices to that basket of fuels is typical for Gazprom export contracts with European consumers (see Idrisov and Gordeev (2017), p. 6).

886 See for example the Order of the Federal Antimonopoly Service N.º 1087/18 of 03August 2018 *"on approval of wholesale prices for gas produced by PJSC Gazprom and its affiliates, sold to consumers of the Russian Federation except for the population and consumers of the Russian Federation specified in clause 15.1 of the Basic Provisions the formation and state regulation of gas prices, tariffs for transportation services and fees for the technological connection of gas-using equipment to gas distribution networks in the Russian Federation"*, available at: https://img.rg.ru/pril/157/98/76/51849.pdf, accessed on 12 November 2019.

887 As specified in Art 15.1 of the Government Decision N.º 2001 of 29 December 2000 *"On State Regulation of Gas prices, Tariffs for Transportation Services and Fees for Technological Connection of Gas-using Equipment to Gas Distribution Networks in the Russian Federation"*.

10.6.1.2.2 Household prices[888]

As stipulated by the Federal Law on Gas Supplies in the Russian Federation regional gas supply and gas distribution systems are separate from the nationwide UGSS. They are owned by private or state-owned organisations and their activities are controlled by authorised local authorities in line with the federal legislation (Article 7 of the Law). It is for the local governments to organise the supply of gas to the population and thus retail prices for gas sold to the population are determined by orders of relevant local authorities according to the methodology approved by FAS.[889] Retail prices of gas sold to the population thus typically vary depending on the region, technical specifications (households with/without fitted gas metering) and utilisation purposes.

10.6.1.3 Organised trade of gas on the Saint-Petersburg International Mercantile Exchange

The Saint-Petersburg International Mercantile Exchange ('SPIMEX'),[890, 891] started operating in 2008 as a commodity exchange for trading in oil and oil-related products[892] and it encompasses the organised trade of gas that is not covered by the state regulation of wholesale gas prices discussed in Section 10.6.1.2. Its establishment was a direct result of the decision of the Presidential Commission for Strategic Development of the Fuel and Energy Sector and

888 This refers to the price of gas sold to the public to meet personal, family, household and other needs (except gas for refuelling vehicles) not related to business (professional) activities, with the exception of retail prices for liquefied gas (Government Resolution N.º 1021 of 29 December 2000 "*on State Regulations for Gas Prices and Transmission Service Tariffs in the Russian Federation*", available at: http://base.garant.ru/12121555/, accessed on 12 November 2019).

889 For example, gas tariffs for the population of Moscow for the second half of 2019 were set by the Order of the Department of Economic Policy and Development of the City of Moscow N.º 55-TR of 24 June 2019 "*on the Establishment of Retail Prices for Gas sold to the Population of the City of Moscow*", available at: http://gazmsk.ru/files/1561724012.pdf, accessed on 20 September 2019.

890 SPIMEX's activities are regulated by the Federal law and a number of subordinate regulatory acts adopted by the President and the Government of the Russian Federation, as well as by Federal Ministries and Departments, availale at: SPIMEX, *Regulatory Framework*, available at: http://spimex.com/about/law/, accessed on 2 April 2019.

891 This subsection is based on the publication by Henderson, J., Mitrova, T., Heather, P., Orlova, E. and Sergeeva, Z. (2018), *The SPIMEX Gas Exchange: Russian Gas Trading Possibilities*, *OIES Paper*, NG 126, pp 10–14, available at: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2018/01/The-SPIMEX-Gas-Exchange-Russian-Gas-Trading-Possibilities-NG-126.pdf, accessed on 15 March 2019, unless explicitly stated otherwise.

892 Apart from oil, oil derivatives and gas (since October 2014), commodities such as timber are also traded on SPIMEX. It is worth noticing that trade in gas had support from the Presidential Energy Commission, which suggested that the idea was promoted at the highest levels of the Russian administration.

Environmental Safety.[893] Currently, as the largest commodity exchange in Russia,[894] SPIMEX offers spot as well as derivative trading in a wide array of financial instruments acting to provide mechanisms of price setting for basic commodities produced in Russia and the CIS region.

As far as gas products are concerned, in the period 2014–2018, SPIMEX organised the sale of ca. 60 bcm of natural gas (with 15.1 bcm sold in 2018).[895] In 2017, the gas traded exclusively at SPIMEX constituted less than 9% of the entire natural gas trade on Russia's domestic market (according to Gazprom's data, the volume of the resource traded reached 229.9 bcm in 2017).[896] From the beginning, the SPIMEX Gas Exchange aimed to provide the opportunity to trade gas at four locations, all placed around compressor stations (′CS′) on the domestic trunk pipeline system: Nadym CS, Vyngapurovskaya CS, Yuzhno-Balykskaya CS and Parabel CS. All of the compressor stations apart from the Parabel CS are close to gas production sites. In fact, Nadym CS is located centrally in the core of West Siberia, which made it the key trading location with trading volumes dominating the other three compressor stations in the period 2015-17. As a consequence, SPIMEX decided that Vyngapurovskaya CS, Yuzhno-Balykskaya CS should be merged into a location labelled Lokosovo.

Gas-related contracts offered at SPIMEX were initially relatively simple with prices quoted in the RUB/mcm format (e.g. for one month ahead at a size of 100,000 cubic metres). Only as late as October 2015 was a day-ahead contract implemented. All trade remains bilateral, i.e. the resale of gas on SPIMEX is impossible. Furthermore, only gas produced directly by a supplier qualifies for sale on SPIMEX – once purchased it has to be taken for consumption; moreover, the 'excess' of gas under contracts from producing parties (such as e.g. Gazprom or independent gas producers) is not to be re-sold to a third participant in the market.

893 Presidential Decree N.º 859 of 15 June 2012 "*on the Commission under the President of the Russian Federation on the Development Strategy of the Fuel and Energy Complex and Environmental Safety*", available at: http://publication.pravo.gov.ru/Document/View/0001201207030001, accessed on 12 November 2019. According to Clause 4 of the Decree, the main tasks of the Commission are, for example: ensuring coordinated actions of the federal executive bodies and executive bodies of the constituent entities of the Russian Federation on the development and implementation of the main directions of State policy in the field of the fuel and energy complex, development of the main directions for improving regulatory frameworks in the fields of energy and fuels, industrial and energy security, rational use of mineral resources and their protection, ensuring the efficiency and transparency of the activities of the organizations of the fuel and energy complex with State participation, development of measures to modernize the capacities of oil and gas refineries, providing the domestic market with raw materials and products of its processing in the required volumes, coordinating the activities of federal executive bodies, executive bodies of the constituent entities of the Russian Federation and organizations for the implementation of such measures. The Commission is headed by the President and there are more than 40 members, from both corporate, as well as administrative spheres.

894 Currently, the Moscow Stock Exchange ('MOEX') offers access to Brent Crude Oil and Light Sweet Crude Oil Derivatives, available at: https://www.moex.com/en/derivatives/, accessed on 18 March 2019.

895 Rosneft Annual Report 2018, p. 146.

896 Gazprom (2017), *PJSC Gazprom Annual Report 2017*, available at: http://www.gazprom.com/f/posts/60/709300/gazprom-annual-report-2017-eng.pdf, accessed on 12 November 2019.

Currently, the SPIMEX Gas Exchange does not offer any kind of risk-hedging instruments (futures and similar contracts related to natural gas have not been introduced at the time of writing of this report). When a transaction is completed, Gazprom Mezhregiongaz Delivery is responsible for the transportation services of the gas purchased. Access to the relevant pipeline transmission network is foreseen for all gas traded on SPIMEX at a pre-set tariff. However, access to the pipeline network is not automatic. It has to be agreed upon in advance of any trade being completed and Gazprom enjoys discretion in granting this access (see also Section 10.2.2.1). This fact has raised concerns that Gazprom may have an important conflict of interest as the firm acquires prior knowledge of the scope of the trading activity. Since the launch of the SPIMEX gas trading platform, Gazprom has also played a major role in trading. Indeed, the company dominated the sales of gas in the period 2015–17, and because its pipeline network is used for delivery, the company has assumed the role of balancer for gas sold out of SPIMEX onto the domestic gas market. Moreover, PJSC Gazprom featured on both sides of the exchange, because the regional subsidiaries of Gazprom-owned Mezhregiongaz were important buyers of the resource. Importantly, even though the number of purchasing parties on SPIMEX Gas Exchange usually nominally exceeded 60 in 2017, participation of PJSC Gazprom's subsidiaries accounted for up to two-thirds of the total. [897,898]

On the supply side, non-Gazprom sources totalled only 2.25 bcm in the first three quarters of 2017 out of the legally permissible 17.5 bcm[899] (which in relative terms translates into 12.85%).[900]

Other important gas-buying parties included electricity producers such as Enel Russia or industrial companies such as EuroChem. As for Rosneft and Novatek, they emerged as both purchasers and sellers of gas, aiming to meet the demands of long-term contractual consumers when the demand was the highest. On the supply side, both firms were the most active sellers (other companies [e.g. Lukoil] participated to a lesser extent) but their presence was not constant. Gazprom's 2018 share

897 Henderson, J., Mitrova, T., Heather, P., Orlova, E., and Sergeeva, Z. (2018), *The SPIMEX Gas Exchange: Russian Gas Trading Possibilities*, *OIES Paper NG 126*, p. 13, available at: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2018/01/The-SPIMEX-Gas-Exchange-Russian-Gas-Trading-Possibilities-NG-126.pdf, accessed on 16 August 2019.

898 Henderson et al. (2018) noted that other important buyers of the resource included power generation companies such as Enel Russia and industrial companies like Eurochem (which was the most prominent buyer on the exchange in July 2017), as well as several commercial agents. As for Rosneft and Novatek, they also emerged as both purchasing and selling parties, buying the resource to fulfil the requirements of their long-term contract customers when the consumption was the most elevated (p. 13).

899 In line with the Government Decree N.º 323 of 16 April 2012 "*on the Sale of Natural Gas at organized Tenders and Amendments to the Acts of the Government of the Russian Federation on State Regulation of Gas Prices and Access to the Gas Transportation System of the Public Joint-Stock Company Gazprom*", available at: http://gov.garant.ru/document?id=70064732&byPara=1&sub=194, accessed on 12 November 2019, there was a principle of parity between independent companies and Gazprom. This fact translated into Gazprom being allowed to sell no more gas annually than 17.5 bcm. However, since 30 August 2019, in line with the Government Decree N.º 1063 of 17 August 2019 "*on Amendments to the Decree of the Government of the Russian Federation N.º 323 of 16 April 2012*", this amount was changed to 25 bcm per year.

900 Henderson et al. (2018).

in the total sales on SPIMEX was at 87% of the total of natural exchange-traded gas within the reporting year 2018,[901] with Rosneft's participation at 7%, Novatek's at 5% and other firms accounting for the remaining 1%.[902]

Provided that SPIMEX aims to increase the liquidity of its markets, Gazprom, due to its business position, emerges as a natural provider of additional gas. Gazprom's dominant position, however, raises the issue of the price setting validity, as Gazprom may impact prices by controlling the level of flows of the resource eligible for sale. This problem was highlighted many times in the relevant social surveys, with some, for example, indicating that '*(…) there is one supplier [Gazprom] and one buyer [Mezhregiongaz] at the exchange*'.[903] Objections to this end were raised not only from other market participants but also from the Ministry of Economic Development as Gazprom retains the capacity to further boost its control over the Russian market. Indeed, this situation allows the company to wholly undermine the institution of an open gas market by the lowering of prices to displace the independent companies and gain further control of the market and prices.

Gazprom's ability to influence the market can be exemplified by events recorded in January 2019 when the volume sold by Russian natural gas producers on SPIMEX plummeted by nearly 30% year-on-year: only a total of 1.1 bcm were sold (a decline of ca. 470 mcm year-on-year). This market shift occurred due to uncertainty regarding Gazprom's participation in trade (as a result, prices were higher in January 2019 than throughout the entire 2018). This would stem out from the fact that, while Gazprom has remained the most important seller and supplier on SPIMEX, its actions appear to have been more focused on the international markets.[904,905]

10.6.1.3.1 Shortcomings of the SPIMEX exchange system[906]

In sum, the efficiency of the SPIMEX is hindered by several serious shortcomings, such as the state of competition and the price-setting mechanisms; the liquidity and depth of the market; and the adequacy of trading infrastructure. These points can be developed as follows:

1. SPIMEX's trading platforms do not allow for trade to take place on a continuous basis. As exemplified by the SPIMEX Gas Exchange, the gas cannot be re-sold to third parties. This

[901] PJSC Gazprom's gas volumes sold via SPIMEX amounted to 13.6 bcm, which remained within the limit of 17.5 bcm legally placed on the company gas sales via exchange-based route (Gazprom Annual Report 2018, p. 73)

[902] Henderson et al. (2018)., p. 13.

[903] *Ibidem*, p. 16.

[904] Gazprom Export, Gazprom's subsidiary, runs an electronic sales platform; the vehicle made 134 mcm of deliveries to European markets in January, whereas in December 2018 the company sold 515 mcm on a front-month basis.

[905] Available at: https://www.icis.com/explore/resources/news/2019/02/01/10313627/january-trade-on-spimex-down-30-year-on-year/, accessed on 15 March 2019.

[906] If not explicitly stated otherwise, the section is based on Henderson, J., Mitrova, T., Heather, P., Orlova, E. and Sergeeva, Z. (2018), *The SPIMEX Gas Exchange: Russian Gas Trading Possibilities*, *OIES Paper NG 126*, pp. 15–21, available at: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2018/01/The-SPIMEX-Gas-Exchange-Russian-Gas-Trading-Possibilities-NG-126.pdf, accessed on 15 March 2019.

limits competition in the domestic market and does not motivate Gazprom to sell extra gas on the exchange to other traders and companies, which could otherwise enable the latter to either sell the product to new customers or to trade it as a financial instrument;

2. Greater influence of the market-determined prices of natural gas in the Russian market is linked with the threat of elevated volatility – this could potentially destabilise the industrial and household sectors. Currently, the resilience of the market to external shocks, as well as its liquidity are limited due to an underdeveloped gas derivatives market;

3. Currently, not all parties participating in the market are granted access to the gas transportation infrastructure at a fair and predictable tariff.[907] Third-party access to the UGSS has been mandatory since 1999 but in practice several restrictions remain (see Section 10.2.2). Gazprom can withdraw the right of access granted to a non-Gazprom trading party – hence the company has a discretionary lever over gas purchasers. Also, while in the case of SPIMEX, this access has been granted for the gas traded on the platform, parties participating to SPIMEX have to arrange gas transport in advance through Gazprom, which provides the latter with first-hand prior knowledge of the potential demand and creates a competitive advantage for the company;

4. The issue of gas transportation mechanisms is linked with tariff setting (see Section 10.6.1 for an elaboration on price setting mechanisms). Currently, the tariff consists of two parts: (1) a fixed element related to the capacity charge, and (2) a fee related to the route of transportation. Gazprom can modify the latter by managing the overall system.[908] Therefore, SPIMEX Gas Exchange participants do not have reliable information regarding the exact price of their purchased gas once it is delivered to the destination;

5. The price of natural gas traded on the SPIMEX platform closely correlates with the regulated price. Since the establishment of SPIMEX Gas Exchange, prices agreed on the SPIMEX platform are 3 – 5% below the administratively regulated prices. By way of illustration, in the period 2014–17, the administratively-controlled price rose by 11.7% (in compound terms) while the mean SPIMEX-determined price grew by 11.04%. The positive correlation provides incentive for all gas producers not to press for price deregulation, assuming it ensures a stable rate of growth over time. This incentive appears especially strong considering the fact that the regulation currently in force harnesses Gazprom's capacity to compete with the independents

[907] Heather, P. (2015), *The Evolution of European traded gas hubs*, NG 104, Oxford Institute for Energy Studies and Henderson, J., Mitrova, T., Heather, P., Orlova (2018).

[908] As stated by the Vice-President of SPIMEX, Anton Karpov, who in 2017 was in charge of the exchange gas trade, the second part of the tariff depends on the process of delivery and is calculated based on the length of the actual route used to flow the gas, available at: NEFTE Compass (2017), *Gas Trading Takes Off as Spimex Fine-Tunes Market Mechanisms*, Vol. 26, N.º 3, available at: http://spimex.com/upload/iblock/2ff/2ffc99c227461696460b1887a0893d5f.pdf, accessed on 16 August 2019.

(see Sections 10.2.2 and 10.3). On the other hand, the Government's policy to assure economic growth and moderate inflation may hinder further price hikes.

10.6.1.4 PRICING IN RUSSIA'S DOMESTIC MARKET AND FOR EXPORTS

A comparison of average gas prices (net of VAT, including excise tax and customs duties) charged by Gazprom in Russia, the FSU countries and the '*Far Abroad*' countries (mostly Europe) allows to broadly compare price differentials between Russian domestic piped gas prices (which is subject to state intervention) and export piped gas prices, together with the developments in key economic variables, such as oil prices, the exchange rate, as well as inflation (Figure 10.17).[909]

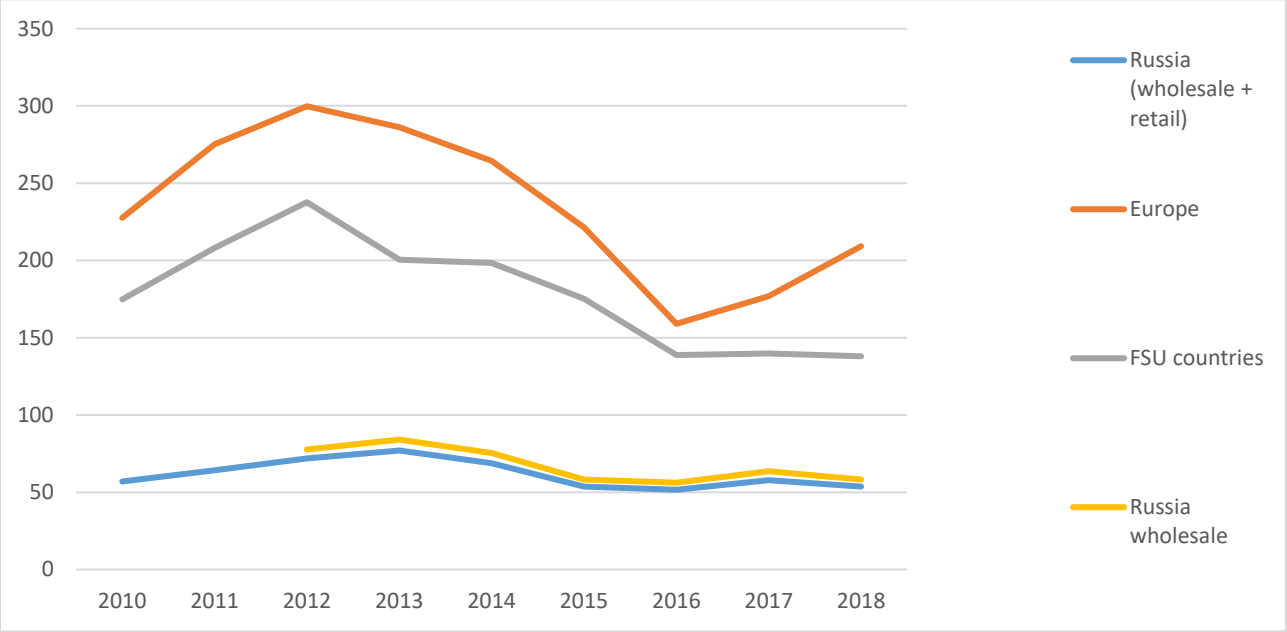
In fact, in the entire period 2010-2018, Russian export prices were over three times higher than their domestic counterparts: the smallest difference was observed in 2017, when the average domestic price reached 33% of the average export price. The lowest relative levels of domestic prices, at 23 and 24% of export prices, were observed respectively in 2011 and 2015. After a series of annual increases of average Russian domestic prices in years 2011-13, which were also above the corresponding inflation rates, prices decreased in the next three years with the largest decrease of 22% recorded in 2015, while inflation was on the rise[910]. While these decreases were more moderate than decreases of prices of gas supplied to foreign countries and the ratio of Russian to export prices actually increased in this period, these domestic pricing developments reflected the clear aim and action of the Government to interfere and steer prices into restraining their increases in the context of the Ukraine crisis, the subsequent sanctions imposed on Russia by the EU and the US and the economic recession (as reflected in the sequence of regulated price setting events described in Section 10.6.1.1.1).

The period 2013-2015 marked also a decrease in world oil prices which was nevertheless also accompanied by the depreciation of the rouble which smoothed the impact of oil price decreases in terms of domestic currency. In this context, some correspondence between world oil prices, export prices and the dynamic of regulated prices can also be observed – with the latter being lowered by authorities when international prices fall, thereby effectively preventing increases towards export prices.

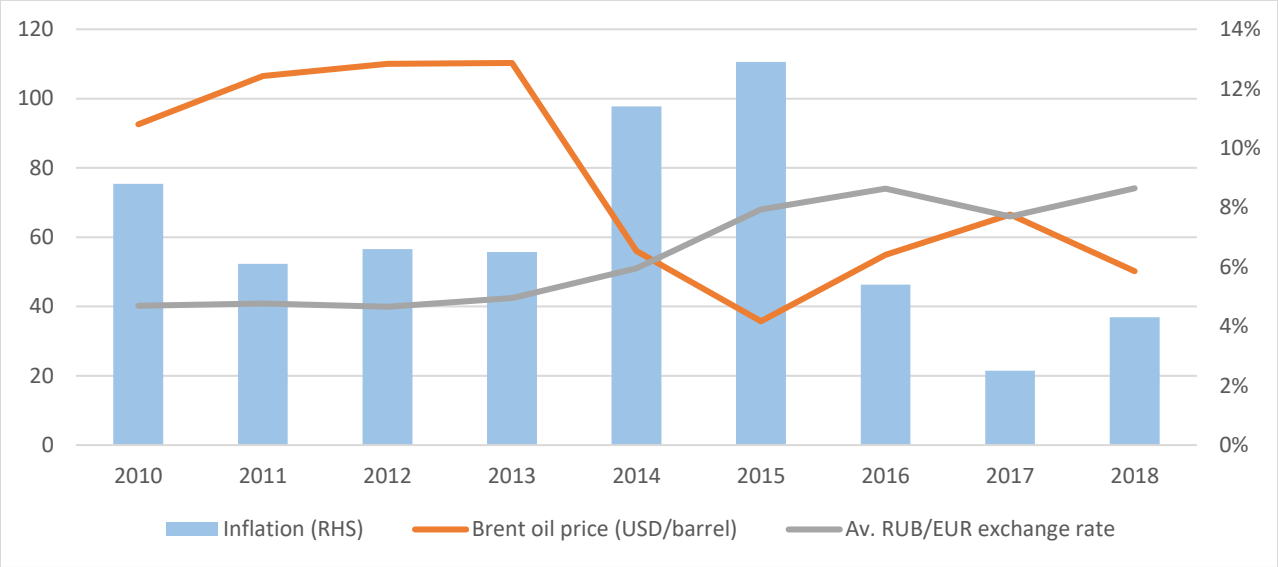
[910] Overall, while inflation is one of the factors taken into account in price-setting (See Section 10.6.1.2), given the current lack of clear criteria upon which the regulated prices are being set, it appears only that regulated prices did not seem correlated with inflation developments.

Figure 10.17 Average natural gas price, oil Brent prices, RUB/EUR exchange rate and inflation

Panel A. Gas prices in RUB (net of VAT, including excise tax and customs duties)



Panel B. Selected economic indicators



Source: Internal calculations based on Gazprom in Figures 2018 data.

10.6.1.5 Conclusions on state interventions in gas pricing

The Government's approach to regulation of gas pricing has evolved considerably since the collapse of the Soviet Union with different strategies adopted by the Government. While as of writing of this report market forces play a much larger role in the sector than at the beginning of

the transition, gas price formation is still broadly shaped by the State (Section 10.6.1.1.). Retail tariffs are tightly regulated and are significantly lower than those for industrial customers. Wholesale prices for industrial users supplied by Gazprom and its subsidiaries are also set by the State. They are not explicitly differentiated by types of industries in which these consumers operate but they are set accordingly to a price formula in which many parameters are determined by the State or related entities like Gazprom, and/or in a non-transparent manner (Section 10.6.1.2).

The wholesale gas pricing formula links the domestic price to the export price rather than to specific actual cost of production of gas in Russia. It explicitly refers to export prices and deducts from them the costs of transport to the border (also regulated by the State) and taxation of gas exports. While this is supposed to reflect the netback parity approach which has been a point of reference for the reforms of the gas pricing system since the mid-2000s (albeit with different emphasis in different periods), many key parameters of the formula, such as e.g. the reduction coefficient which is the key factor creating a wedge between the export netback and the domestic prices, or the regional price zone differentiation coefficient are determined by state entities based on criteria which do not appear transparent. Transportation costs coefficients are also determined by state entities on the basis of information supplied by Gazprom and calculated based on its internal technical data and methodologies. Against this background, the current system appears as diverging substantially from a price formation based on the interplay of market forces, or even on commercial considerations in relation to Gazprom's operations. This system features a wide capacity of distorting domestic wholesale gas prices. In this context, effects of cross-subsidisation across regions, as well as between the domestic and export sales by Gazprom have been raised often in the past, not only in the context of what effects state-induced distortions in Russia's gas market may cause in international gas and product markets but also in the context of welfare effects and efficiency of allocation of productive resources within the economy of Russia.[911]

Russian State practices with respect to pricing of gas used by other industries have indeed been identified as an issue in the international context in the past, for example when Russia was acceeeding to the WTO,[912] as well as in a number of trade remedy cases. As far as the EU trade remedy cases are concerned, in the case of in a number of EU trade remedy cases. In the case of *certain seamless pipes and tubes, of iron or steel originating in Russia*, among other findings, the European Commission drew on Gazprom's annual report and found that the state-owned energy producer charged the domestic steel producers much less for gas used in production than it charged its customers in Eastern and Western Europe. The European Commission concluded that this was

911 The main points of this debate are summarised in Section 10.6.1.

912 Russian gas market structure and gas pricing are mentioned in several places in World Trade Organization (2011), Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization. This reflects a keen interest of WTO members in this isue when examining Russia's readiness to join the organisation. See also Furculita, C. (2017), Russian Gas Dual Pricing Consistency with WTO Law: A Question That Might Have Been Answered. Available at: https://ssrn.com/abstract=3169167 or http://dx.doi.org/10.2139/ssrn.3169167, accessed on 30 March 2020.

an implication of the company's formal obligation to supply gas to Russian consumers at prices regulated then by the FTS which were at the time – as they are also today – lower than the international prices for natural gas.[913] In view of these findings, it was considered that the gas prices paid by Russian producers in the investigated period could not reasonably reflect the costs associated with the production and distribution of gas. Similarly, in the case of imports of c*ertain welded tubes and pipes of iron or non-alloy steel*, the European Commission found that that the domestic gas price paid by the exporting producers was around one fourth of the export price from Russia, far below market prices paid in unregulated markets and, consequently, not reasonably reflected in the exporting producers' records.[914] In view of these findings, the calculations of gas costs of the concerned Russian exporting producers had to be adjusted based on the price of gas for export to Western Europe at the German/Czech border in Waidhaus (the main hub for Russian gas sales to the EU), net of transport costs and excise duty and adjusted for local distribution costs.[915]

At the same time, independent production and exchange of natural gas on SPIMEX is developing in Russia and certain customers, including large industrial producers increasingly buy gas at unregulated prices from independent suppliers.[916] However, several pieces of evidence, as presented below, suggest that these unregulated prices still closely follow prices regulated by the State which are charged by Gazprom.

The presence of independent producers creates some degree of competition for Gazprom, particularly in those industrial regions of Russia where Gazprom's presence coincides with that of some of the key industrial production facilities of independent producers, such as in Yamal-Nenets

913 Council Regulation (EC) N.º 954/2006 of 27 June 2006, recital 95ff, available at: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:175:0004:0038:EN:PDF, accessed on 12 November 2019.

914 Council Regulation (EC) No 1256/2008 of 16 December 2008, recital 111, available at: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:343:0001:0038:EN:PDF, accessed on 12 November 2019.

915 Russia challenged these antidumping regulations in two disputes brought by it to the WTO in 2014 and 2016. These were, respectively: DS474: European Union — Cost Adjustment Methodologies and Certain Anti-Dumping Measures on Imports from Russia and DS494: European Union — Cost Adjustment Methodologies and Certain Anti-Dumping Measures on Imports from Russia — (Second complaint). In these cases Russia, among other issues, challenged: "*the replacement and adjustment of the costs of production of the product under consideration actually borne by foreign producers and exporters, including the costs of energy inputs such as gas and electricity, by using prices including those outside the country of origin and exportation that do not reflect the costs of production in the country of origin and exportation actually borne*". See European Union – Cost Adjustment Methodologies and Certain Ant-Dumping Measure on Imports from Russia (Second Complaint), WT/DS494/1, World Trade Organization.

916 This is for example the case for an increasing share of Russia's largest steelmakers. See for instance: http://www.novatek.ru/ru/press/releases/index.php?id_4=580, accessed on 13 November 2019; https://www.severstal.com/rus/media/news/document3960.phtml, accessed on 13 November 2019; https://www.forbes.ru/news/306737-rosneft-i-evraz-podpisali-soglashenie-na-postavku-gaza, accessed on 13 November 2019; https://nlmk.com/ru/media-center/news-groups/nlmk-and-novatek-sign-5-year-contracts-for-supply-of-natural-gas/, accessed on 13 November 2019.

and Khanty-Mansiysk Autonomous district and the Tyumen region.[917] There the 'independents' can compete with Gazprom by offering lower prices because they are not subject to price regulations and do not have to use Gazprom's piping facilities to pump gas on long distances. In 2017, this allegedly prompted Gazprom to ask for derogations from the regulated minimum prices when the company was seeking permission to sell to eligible consumers at a 10% discount. However, due to the State's discretion in price-setting, this commercially driven initiative has so far not been supported, allegedly due to fears of what effect such price competition in the industrial segment may have on household prices.[918]

The independent producers could arguably compete on a larger scale with Gazprom if they were charged the same tariffs for pumping gas and tariffs for storage in underground storage facilities that Gazprom gives to its subsidiaries, which is not the case.[919] Chapter 14 on steel cites some accounts of large steel companies ready to pay higher prices for gas to independent companies but the reasons for this remain unclear.[920] However, even if a certain degree of price competition exists now in the Russian gas market, given the current shares of Gazprom in the domestic and export markets as well as its statutory powers, Gazprom-produced (and Gazprom affiliate-produced) wholesale domestic gas prices are likely to continue to be used as benchmarks for other market players such as Rosneft or Novatek. In its Annual Report for 2017, Novatek, for example, reports that its revenues from natural gas sales in 2017 increased, among others, because of the increase of Russian domestic regulated prices.[921] It stems from the above description of the overall pricing set-up in Russia that unregulated prices, while allowing independent companies to seemingly make profits, cannot convincingly be considered as genuinely market-determined. All this points to the fact that regulated prices of natural gas in Russia have also an effect of impacting competition in the market strands which aspire to be gradually evolving towards market-based price setting.

[917] Akhmadiev, E. (2017), *Increasing prices to the people, reducing the prices for the business. How Gazprom wants its tariffs to be increased*, LifeRu, available at: https://life.ru/t/%D1%8D%D0%BA%D0%BE%D0%BD%D0%BE%D0%BC%D0%B8%D0%BA%D0%B0/980228/narodu_povysim_bizniesu_skiniem_kak_ghazprom_budiet_podnimat_tarify, accessed on 12 November 2019.

[918] R Line (2017), *Gazprom offers the government to increase gas prices for the population and give a discount to intermediaries*, available at: http://www.rline.tv/news/2017-04-04-gazprom-predlagaet-pravitelstvu-uvelichit-tseny-na-gaz-dlya-naseleniya-i-dat-skidku-posrednikam/, accessed on 12 November 2019.

[919] Akhmadiev, E. (2017)

[920] Two possible reasons are better quality of supplied services (i.e. better terms of contracts, beyond pricing) or the fact that there are limits to the volume of gas supplied by Gazprom at regulated prices (beyond these limits consumers must buy at unregulated prices). Idrisov and Goreev (2017) also suggest that the regional harmonisation of gas prices aimed at ensuring equal access creates situations where gas supplied at regulated tariffs is under-priced (e.g. from industrial users' needs point of view) and overpriced in other regions. This can create a situation of independent companies being able to profitably charge either lower or higher than Gazprom prices.

[921] PAO NOVATEK (2018), *Annual Report 2017*, p. 23, available at: http://www.novatek.ru/common/upload/doc/AR_FS_2017_ENG.pdf, accessed on 12 November 2019.

Moreover, it should be noted that FAS' regulatory powers in the area of setting gas prices and tariffs have been subject to criticism from the gas industry. Recently, Novatek and Transneft have asked the President to strip FAS of some of its powers: according to the two companies, the tariff policy for transporting oil and gas should fall within the remit of the Ministry of Energy. Some of the allegations were related to the lack of transparency and comprehensibility of documents produced by FAS to regulate prices in the industry, including when it took over the FTS in 2015.[922] At the same time, the two companies argued that gas price regulation should better take into account the developmental challenges faced by the industry rather than, for example, criteria related to inflation.[923]

The discussion of the differences in Russia's domestic gas prices and prices charged to foreign consumers in its export markets (section 10.6.1.4) shows that the domestic prices have remained at a level of approximately one-third of the export prices. Timing and size of the most recent adjustments of regulated gas tariffs do not seem correlated with inflation dynamics but rather seem to reflect political and socio-economic policy objectives. What is more, the Government seems to lower or freeze regulated domestic prices at times of low global prices, which prevents convergence towards export prices. As stated above, the latest international comparisons show also that, in 2018, in Russia and in other countries of the FSU regulated pricing mechanisms accounted for much higher shares of gas pricing than in other regions. They also show that Russia's wholesale gas prices remain among the lowest in the world.

10.6.2 OIL AND PETROLEUM PRICES

While the domestic prices of both crude oil and oil derivatives are subject to supply and demand forces, instances have been recorded of discretionary interventions by the Government in some oil product segments. Prices of oil and oil products are also shaped by relevant taxes and customs duties, which also depend on the final destination of the goods in question (see Section 10.4). Given the strategic importance of Urals Crude oil prices for the financial security of the entire economy, the Government retains the right to deploy specific fiscal instruments if the prevailing market conditions demand it (see Section 10.4). As far as taxation policies are concerned, one of these instruments - export taxation - is not only a source of tax revenue but, through the practice of export tax escalation (e.g. setting export tax rates for crude oils at levels that are higher than export taxes for processed petroleum products), taxation can be used as an instrument to influence competitiveness of different segments of the oil and oil products industry (see Section 10.4).

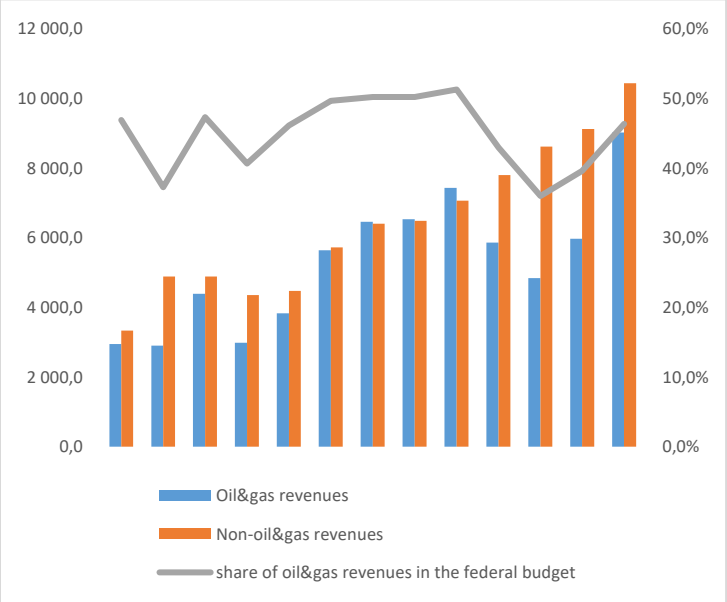
International crude oil prices are an important factor determining the design and execution of the federal budget, with the revenues from oil and gas accounting for roughly 40%-50% of the total federal budget over the years (Figure 10.21a). Thus, Urals Crude oil prices - the official benchmark

922 See for instance: Interfax, *Regulated gas prices in Russia, rising 3.9% after two year freeze*, 3 July 2017.

923 Petlevoy, V. (2019), *Novatek and Transneft asked the President to deprive FAS of powers*, Vedomosti, available at: https://www.vedomosti.ru/business/articles/2019/03/27/797574-gazovik-neftyanik, accessed on 13 November 2019.

for pricing of the Russian crude oil earmarked for international markets - are utilised not only when planning budgetary expenditures but also projecting macroeconomic development (Figure 10.21b).[924]

Figure 10.21a Federal budget execution 2006-2018[925]

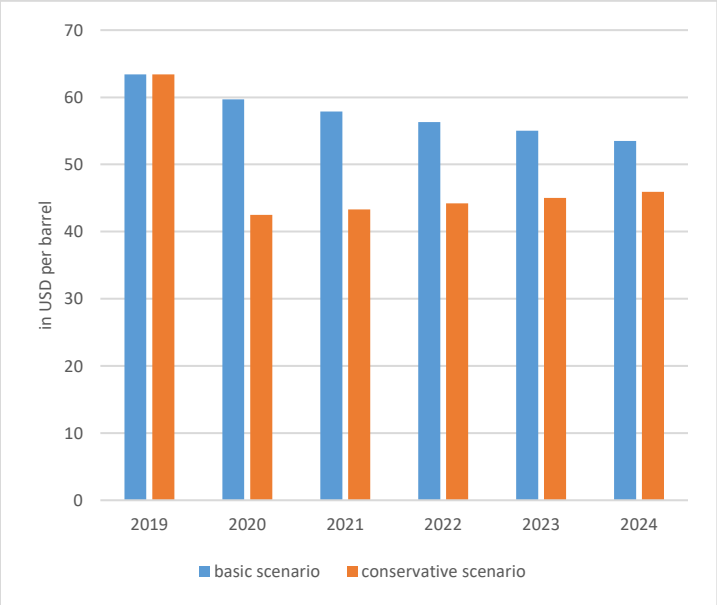


Source: Internal calculations based on the data retrieved from Ministry of Finance (2019).

[924] As per "*Scenario conditions, main parameters of socio-economic development of the Russian Federation forecast and projected changes in prices (tariffs) for goods, services of economic entities engaged in regulated activities in the infrastructure sector for 2020 and for the planning period 2021 and 2022*", available at: http://economy.gov.ru/wps/wcm/connect/5a7eb203-78e7-4824-8564-f5fdaf9fc0b4/Сценарные+условия2020.pdf?MOD=AJPERES&CACHEID=5a7eb203-78e7-4824-8564-f5fdaf9fc0b4, accessed on 12 September 2019.

[925] Internal calculations based on the data retrieved from Ministry of Finance (2019), *Federal budget of the Russian Federation - Brief information on the federal budget execution*, an xlsx file available at: https://www.minfin.ru/en/statistics/fedbud/, accessed on 13 September 2019.

Figure 10.21.b Projected Urals Crude prices[926]



Source: Internal calculations based on data from Ministry of Econoomic Development of the Russian Federation.

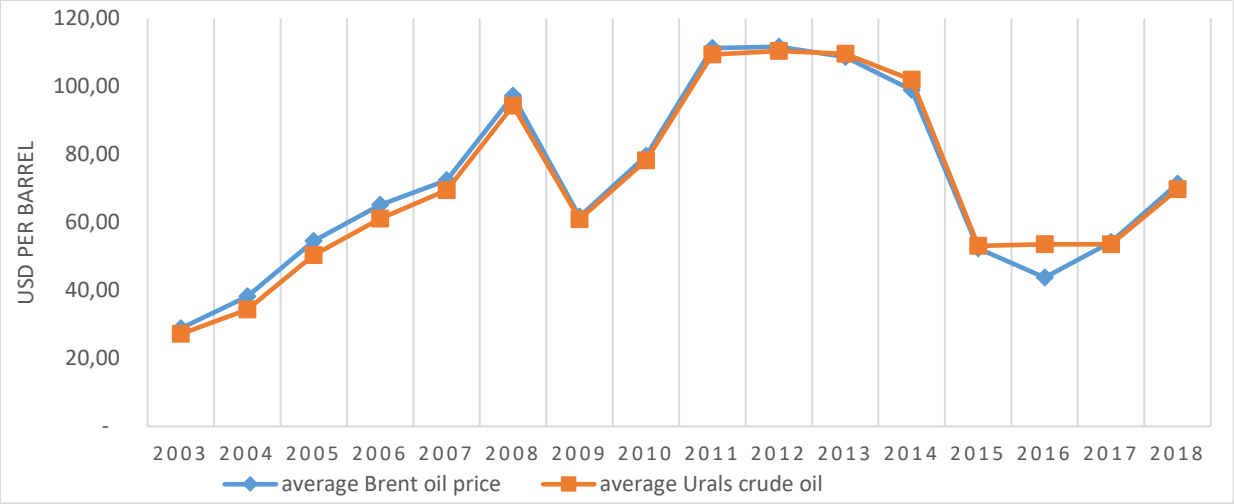
Crude oil prices are usually benchmarked to three major indices: Brent Blend, West Texas Intermediate and Dubai Crude. Of these three, the Brent Blend (also known as Brent Crude) is the most important crude oil trade benchmark in Europe – it is used to price more than 50% of the globally traded oil supplies (tracking the value of oil mix from fifteen fields in the North Sea). Urals Crude oil (tracking the price of the mix of oil of Urals, the Volga region, and of western Siberia) is the official benchmark for pricing of the Russian crude oil earmarked for international markets. Over the last 15 years, the Brent and Urals Crude indices correlated very closely (Figure 10.22).[927, 928]

[926] Based on the data retrieved from: http://economy.gov.ru/minec/about/structure/depMacro/2019042102, accessed on 12 September 2019.

[927] Comment: A simple correlation analysis in MS Excel indicates that the arithmetic averages plotted in Figure 10.18 correlated positively at the level of 99%.

[928] Brent recorded only marginally higher values in the period leading up to the Great Financial Crisis of 2007-09. In 2016, Brent dipped more than the Urals – the latter maintained the mean value of USD 53.55 per barrel for three consecutive years (between 2015 and 2017 inclusive). Both indices also grew similarly – Brent's price increased by 32% between 2017 and 2018 while the value or Urals' index augmented by 30%.

Figure 20.22 Crude oil annual average prices 2003-2018[929]



Source: Based on the data retrieved from BP.

While the Urals Crude tracks the price of oil destined for exports, the SPIMEX has maintained domestic indices for regional crude oil prices since 2011. Those are aggregate metrics of producer's prices mirroring the dominating tendencies and mean levels of crude oil prices specific for the most significant domestic oil sites (i.e. Timan-Pechora, Volga-Ural and West Siberia).

929 Based on the data retrieved from BP, *Statistical Review of World Energy 1965-2019*– for Brent prices, the .xlsx file available at: https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html, accessed on 11 September 2019 and – for Urals crude prices, for the years 2003-2012 available at: http://economy.gov.ru/minec/resources/a136ef804eef3228adf7ef33ff830e22/%D0%A6%D0%B5%D0%BD%D1%8B_Urals(14-03-2013).xls, accessed on 13 November 2019; for the years 2013-2016, information available at: http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/doc20130118_02; http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/doc20130226_05, and http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/doc20130321_01, accessed on 13 November 2019; for the year 2017, information available at: http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201715011, accessed on 13 November 2019; for the year 2018 (monthly values available in separate files, month's number in parentheses below):
(1)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201814023;
(2)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201813038;
(3)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201812042;
(4)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201807052;
(5)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201807062;
(6)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201804071;
(7)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201813081;
(8)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201804091;
(9)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201803103;
(10)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/201808112;
(11)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/2018061211;
(12)http://economy.gov.ru/minec/activity/sections/foreigneconomicactivity/monitoring/2019110103, accessed on (to all of the above) 11 September 2019.

These metrics, called Regional Crude Oil Price Indices, can be divided into two groups: 1) stock indices computed on monthly basis (for the Timan-Pechora region only), based on the value of contracts realised during trading sessions in SPIMEX Oil Section[930] and 2) over-the-counter (′OTC′) indices,[931] also computed monthly, relying on the information delivered by SPIMEX (in line with the requirements set forth by the Government Decree No. 623 of 23 July 2013).[932] To mirror the current average exchange and OTC prices of the resource in the domestic market most accurately, in both cases correction terms and transportation tariffs are excluded, so that only information on prices and contracts' volumes are utilised in the computation process.

The domestic crude oil exchange index has remained at an elevated, yet flat, level from the beginning of the year 2018,[933] when investors' activities were the weakest (Figure 10.23.a). In fact, there have been only two trades recorded in 2019,[934] none in the preceding year, and only three in 2017. Given the low level of market liquidity,[935] the exchange index may have been failing its market valuation purpose since late 2016. On the other hand, lower values of the index (accompanied by greater volumes of contracts realised and greater investors' engagement in the market) were recorded in the period directly preceding the decline in Ural's crude prices (the second half of 2014). Thus, for almost two years, i.e. until February 2016, contracts' volume (and the number of trades, not plotted below) ensured that the market remained relatively liquid, thus allowing for more transparent price-setting procedures. The behaviour pattern of the exchange index for Timan-Pechora over the considered period did not differ much from its OTC equivalent (Figure 10.23.b) in terms of weak investor activity - out of the 68 months in the considered period, trades (in the case of the OTC index) were recorded only in 27 of them (in 39.7% of cases, specifically) – still less than in the case of the exchange index where investors were active in 33 out of the 68 months considered (48.5% of the entire period). Still, both the stock index and OTC values of crude oil traded domestically from Timan-Pechora, at roughly USD 45.56 and USD

930 Regional exchange indices are computed as the weighted mean price of all exchange contracts realised between the 20th of the last month and the 6th of the current month inclusive, for a given oil and/or gas field. The computation procedure does not include the agreements realised on the basis of targeted applications and contracts whose volume was below 1000 tons, based on the information available at: http://spimex.com/indexes/neft/rgn/info.php, accessed on 11 September 2019.

931 Regional over-the-counter indices are computed as weighted average prices of all such contracts, registered between the 20th of the last month and the 6th of the current month, pertaining to the terms of shipment from one of the oil-pumping hubs in within the oil and/or gas field. As was the case with the regional exchange indices, only contracts for the pipeline supplies to the domestic market (which exceed 1000 tons in volume) are considered, based on the information available at: http://spimex.com/indexes/neft/rgn/info.php , accessed on 11 September 2019.

932 Government Decree No. 623 of 23 July 2013 "*on the Approval of the Regulation on the Provision of Information on Contracts concluded by Parties other than organized Tenders* [⋯]", avaliable at: http://www.consultant.ru/document/cons_doc_LAW_149954/, accessed on 11 September 2019.

933 This trend of investors' prevailing inactivity first commenced in 2015.

934 As of writing of this report.

935 Reliable market valuation is achievable only if the market is liquid and investor activity high. The less liquid and more shallow the market, the less transparent the price-setting mechanisms.

51.73 per barrel respectively were lower than the 2018 average Urals Crude, which reached USD 68.71,[936] showing a positive gap between international and domestic prices of Russian crude.

Figure 10.23a Stock index for Timan-Pechora in the period 2014-2019 (monthly observations) [937]

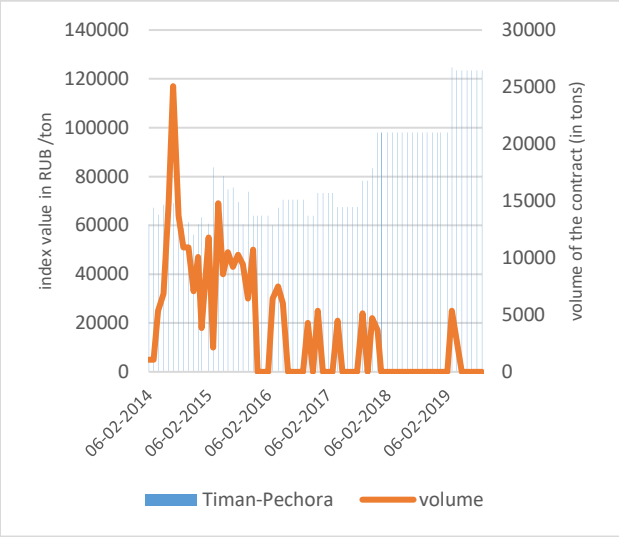
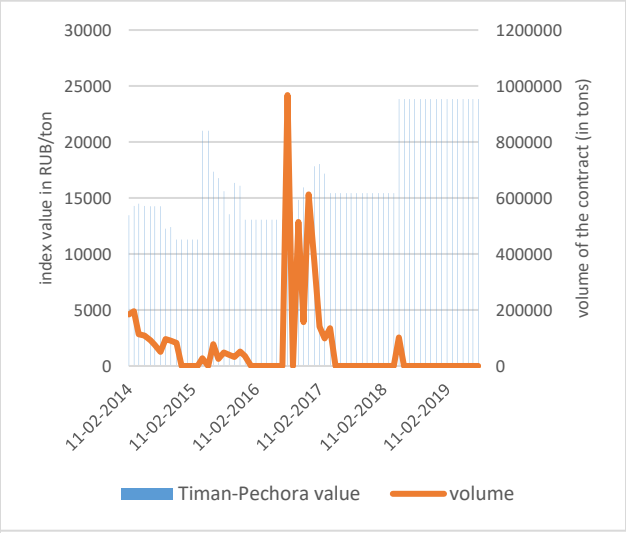


Figure 10.23b OTC index for Timan-Pechora in the period 2014-2019 (monthly observations)[938]



Source: Based on the data available on SPIMEX website.

The two other OTC indices, for Volga-Urals and West Siberia, reflect a more liquid commodity market (Figure 10.24) – even though in the entire period the volume of trades was volatile for both of the metrics (the Urals-Volga OTC index did not record any contract for six months within the period), however, the values of the two indices have displayed significant level of correlation, reaching 95%.[939] Even though the volume of trades recorded for the Urals-Volga region did not match West Siberia, it did track its major trend. Their mean values recorded for the year 2018 exceeded the two indices pricing the resource mined at Timan-Pechora, reaching, in both cases, a mean value of RUB 24 557.8 per ton, which translated into USD 53.28 per barrel, much lower than the export-oriented Urals Crude.

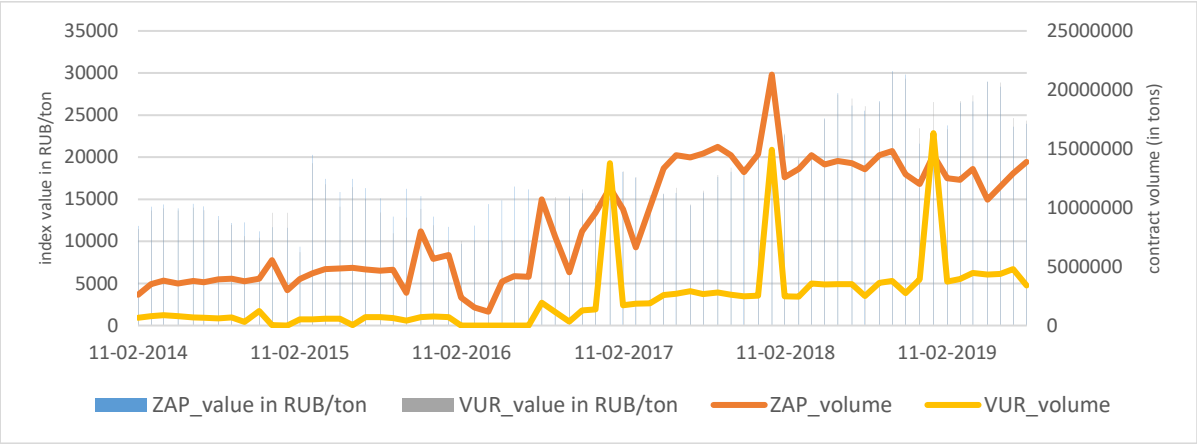
936 Comment: 1 ton of crude oil equals approximately 7.33 barrels of the resource (as per Approximate conversion factors – Statistical Review of World Energy; slide 1). Average rouble to US dollar conversion rate for the year 2018 equalled 62.867 (according to the data provided by CBRF). All calculations are internal.

937 Based on the data available at: http://spimex.com/indexes/neft/rgn/data.php, accessed on 11 September 2019.

938 Based on the data available at: http://spimex.com/indexes/neft/otc-rgn/data.php, accessed on 11 September 2019.

939 Comment: the high correlation makes the Urals-Volga index value indistinguishable from the West Siberia at times.

Figure 10.24 OTC indices for Urals-Volga and West Siberia (monthly observations) in the period 2014-2019[940]



Even though there exist domestic market pricing mechanisms for both oil and oil derivatives, governmental discretionary policy measures affecting potentially oil and oil products prices include instances of price fixing agreements with market players. For example, in November 2018, following a phase of quick rises of petrol and diesel prices, the Government intervened[941] in oil derivatives' pricing in order to: 1) influence the sale of oil derivatives (wholesale and retail) in Russia; 2) freeze petroleum prices for product suppliers for '*small wholesale*',[942] so that the supply is sufficient to satisfy the demand of independent parties in the internal commodity market; and 3) to keep the growth rate of the retail prices for petroleum products traded from 1 January 2019 at the maximum of 1.7% and from 1 February 2019 onwards by no more than the officially projected mean yearly inflation rate.[943]

While a more thorough assessment of the extent to which these policies have impact on oil and oil product price formation in Russia was not possible due to the lack of data, certain comparisons presented in the remainder of this section, as well as international comparisons of fossil fuel subsidisation discussed in Section 10.5.2 suggest that domestic consumers of oil and oil products pay prices that are lower than those seen in international markets.

940 Based on the data available at: http://spimex.com/indexes/neft/otc-rgn/data.php, accessed on 11 September 2019.

941 This refers specific decisions (supposedly aligning with reforms of the Tax Code) as specified in Protocol N.º DK-P9-206pr of 31October 2018.

942 Defined, for the purposes of the referenced document, as '*the sale of petroleum products from storage, production and transhipment carried out by shipment to road transport or transfer in a tank for use for business purposes or for other purposes not related to personal, family, home or other similar use*' in the Russian original text available at: http://government.ru/orders/selection/401/34582/, accessed on 13 September 2019.

943 As per the announcement about decisions following the meeting on the current situation in the oil products market and promising measures aimed at stabilizing and developing the retail oil products market. Russian original text available at: http://government.ru/orders/selection/401/34582/, accessed on 13 September 2019.

Computation of oil derivatives' prices on SPIMEX relies on contracts pertaining to the supplies of the resource of the largest oil refining units in Russia and realised during trade sessions. Certain of these indices have their OTC counterparts.[944] Thus, SPIMEX provides information on the following groups of indices:[945]

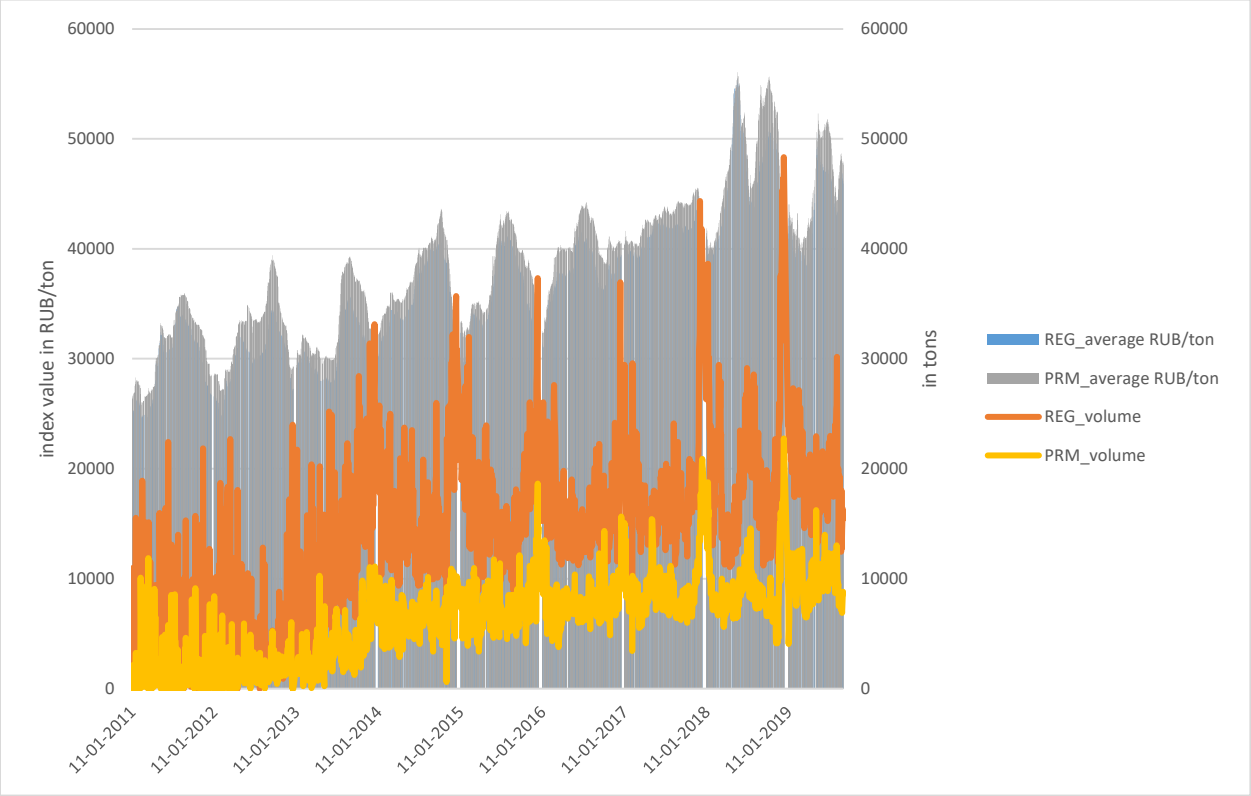
- Composite index (a single metric based on the weighted sum of the values of the National Light Petroleum Price Indices) mirroring the state of the exchange market for light petroleum products. It tracks the changes in the value of the average ton of the resource on the internal market (index values calculated in points);
- National indices (single price indices) mirror the mean cost of a given type of oil derivative[946] recorded in the internal market; the national indices are either exchange-based or OTC.

[944] If a given refinery provides input for computation of exchange indices, it automatically participates in the calculation of a relevant OTC index – in both cases the same values for corrective terms and transportation costs are utilised).

[945] Apart from the five major metrics' groups, oil derivatives are also priced via the UIA index and OTP metrics (computed for summer and off-season diesel fuels). The former tracks the price of jet engine fuel at the airports of the Moscow aviation hub; the most important feature of this index is that it reflects the price dynamics for civil aviation, as opposed to the Regional Jet Fuel Price Index in Moscow. The latter mirror the price dynamics of oil derivative products' held in tanks of commodity supply operators.

[946] These include Regular 92, Premium 95, DT Summer, DT Off-season, DT winter, TS (RT), fuel oil and liquid petrol gas (LPG).

Figure 10.25 Exchange-based national indices for Premium and Regular petroleum (2011-2019) based on daily observations[947]



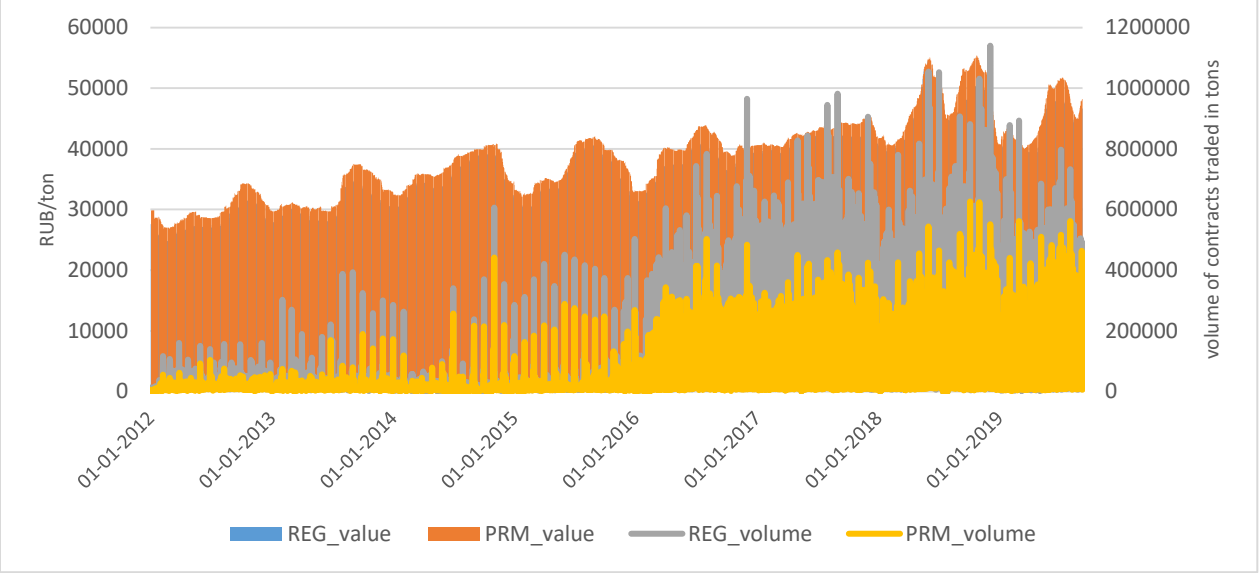
Comment: due to correlation between the REG and PRM averages reaching 98%, REG averages are not visible in the graph.
Source: Internal calculations based on the data retrieved from SPIMEX.

Markets for petroleum products appear to have been more liquid as opposed to crude oil, hence valuation processes are likely more accurate. Both exchange (Figure 10.25) and OTC (Figure 10.26) indices indicate that the volume of the regular (′REG′) petroleum[948] traded exceeded the volume of the premium (′PRM′) product.[949] Even though the values of both exchange and OTC indices followed a growth trend since their respective launches (in 2011/2012), the volatility of volumes traded in the case of the exchange index was significantly greater. Still, it has been the OTC contracts that exhibited higher trade volumes, with the regular petroleum overshadowing premium. At the same time, the premium petroleum indices reached higher values– at the very peak, in June 2018, OTC-based metric amounted to an average of RUB 54 075 per ton, that is roughly USD 101.5 per barrel (OTC; Figure 10.26), only to increase more to the level of RUB 54 863 mid-October 2018, i.e. USD 94.4 per barrel, given the negative changes observed in the exchange rate. Meanwhile, the exchange-based index for premium petroleum reached a mean of

947 Internal calculations based on the data retrieved from: http://spimex.com/indexes/oil_products/national/data/, accessed on 12 September 2019.
948 Regular petroleum 92 (lower octane).
949 Premium petroleum 95 (higher octane).

RUB 55 144 at that time as well, i.e. USD 98.91 per barrel (with the value of the exchange index at the record level of an average of RUB 55 413 per ton that is USD 105.09 per barrel at the end of May 2018 – Figure 10.25).[950]

Figure 10.26 OTC indices for Premium and Regular petroleum (2011-2019) based on daily observations[951]



Comment: due to correlation between the REG and PRM averages reaching 98%, REG averages are not visible in the graph.
Source: internal calculations from data retrieved from SPIMEX.

Finally, SPIMEX computes both combined exchange and OTC prices for major refining units in Russia. In this case, the procedure is calibrated to eliminate contracts bearing non-market prices and/or volumes.[952] Thus, consolidated prices at production sites mirror the dynamics of prices of oil derivatives for the largest refineries in the country (these are later used as input for computation of regional, territorial and national price indicators) both as stock-based metrics as well as OTC. The former are computed as weighted price averages of exchange contracts realised during a working day on the basis of delivery assigned to a specific production site (with shipment carried out by rail or pipelines). The exchange prices indicators include the combined price indicator tracking the primary market (which is computed on the basis of agreements in which the supplier is the producer located at a specific site) and the aggregate price indicators which reflect the secondary market (relying on the data derived from all contracts realised at a given production site, also including those under which the supplier is not a petroleum-producing entity). The OTC-

950 Comment: 1 ton of crude oil equals approximately 8.5 barrels of the resource (as per Approximate conversion factors – Statistical Review of World Energy; slide 1). Average applicable conversion rate for the entire year 2018 equalled 1 USD = 62.867; averages for specific months equalled, as follows: May 2018 – 1 USD = 62.2216; June 2018 – 1 USD = 62.8130; October 2018 – 1 USD = 65.7869 (according to the data provided by the Central Bank of the Russian Federation). All calculations are internal.

951 Internal calculations based on the data available at: http://spimex.com/indexes/oil_products/national/data/, accessed on 12 September 2019.

952 Under the assumption that the forward contracts, negotiated on OTC bases are used in such cases.

based indicators (only for the primary market) are computed as weighted average prices of such contracts (shipped from the production site via railway or pipelines).

Summing up, in relation to organised trade and formalised procedures of pricing of oil and petroleum, it appears that the applied identical mechanisms are more useful and more often utilised in the case of the latter resource. Indeed, as shown in this sub-chapter, markets for petroleum products (their specific kind notwithstanding) have drawn more investor attention than their oil counterparts. As greater volumes and higher level of activity make for a more liquid and stable market, it is likely that the petroleum prices recorded in the period considered reflected the resource's price better than in the case of crude oil. This seems important, especially as low activity in the oil segment have rendered even the most sophisticated valuation mechanisms inapplicable. In this respect at least, the prices of crude oil recorded in SPIMEX in the scrutinised period should be treated with care as they likely failed to convey the resource marketable value (understood as the price obtained in a liquid and active market).

10.6.3 COAL

Like oil and oil products, prices of coal and derivative products are set in principle by market forces. However, as is also the case with other energy products, their prices are influenced by applicable fiscal procedures (see Section 10.4). In addition, since the Russian coal mining regions are located long distances from the nearest terminals in seaports, railways serve as the most important means of the delivery. For example, delivering coal to one of the Pacific coast ports from the Kuznetsk coal basin means the coal has to be transported 4000 km within Russia which may lead to a significant increase in the transport component in the price of Russian coal products[953] (see also Chapters 11 and 14). For the coal industry, this means that the costs of transport may have important influence on the purchaser's price of the resource, both on the domestic market as well as for export purposes. As discussed in Chapter 11, estimates of relative competitiveness of rail and road modes of transport in Russia suggest that rail freight is generally more economic on distances exceeding, depending on the source of calculations, from 400 to 1 000 kilometres. It is estimated that in Russia coal and coke have average hauls of around 1 500 kilometres, suggesting that rail is on average the preferred mode of transport for these products.[954] According to Rosstat official transport statistics, in 2017, coal accounted for 26% of the country's rail freight. The cost of Russian coal thus depends on the design of the state-regulated rail tariffs which favour long-distance shipments.

The main features of Russia's transportation tariffs are covered in Chapter 11, while some of its key features relevant for the Russian coal and coke markets can be summarised as follows: first, Russian railroads are owned and run by Russian Railways, a fully state-owned company which

953 Central Dispatch Management of Fuel and Energy Complex, *Coal in Russia and the World: production*.

954 Pittman, R. (2011), *Blame the Switchman? Russia Railways Restructuring After ten Years*, Economic Analysis Group Discussion Papers, U.S. Department of Justice, available at: https://www.justice.gov/sites/default/files/atr/legacy/2011/03/08/267882a.pdf, accessed on 13 November 2019.

also essentially has a monopoly on provision of locomotive services.[955] Second, the rail transportation tariffs are regulated according to a complicated - several hundred page-long - tariff schedule, the Federal Tariff Service Resolution on approval of the price list No. 10-01 - Tariffs for transportation of goods and infrastructure services performed by Russian railways (2003 Price List No. 10-01), which sets the country-wide tariffs for the main component of the cost of freight transport by rail — the payment for infrastructure and locomotive services, typically accounting for about 85% of total charges.[956] While these tariffs increased continuously in the past years broadly in line with inflation, the inflation minus approach adopted by the Government in 2017 effectively resulted in a real lowering of these (Chapter 11). Third, coal belongs to Class 1 commodity in the Price List No. 10-01, a class of products for which long distance transportation costs are estimated by various experts to be priced below cost (and they are estimated to be cross-subsidised by elevated costs of shipment of Class 3 goods such as chemicals and metals, machinery, and most finished manufactured goods, including steel products, see Chapters 11 and 14). However, one counterargument to cross-subsidisation of transport of Class 1 commodities such as coal are estimates which suggest that Russian rail transport is still less cost-efficient when compared with seaborne transportation of raw materials.[957]

The influence of transport costs on prices of coal might be illustrated somewhat more indirectly by comparing producer's and purchaser's prices; the maximum difference between producer's[958] and purchaser's prices[959] of coal in the period 2005-2016 equalled RUB 1 517 per ton, while the minimum difference amounted to RUB 686 per ton (see Figure 10.27 and 10.28 for reference on prices' path formation in the years 2005-2018).

955 Some private operators have a small number of locomotives which are nevertheless used mainly for internal logistical purposes on short distances.

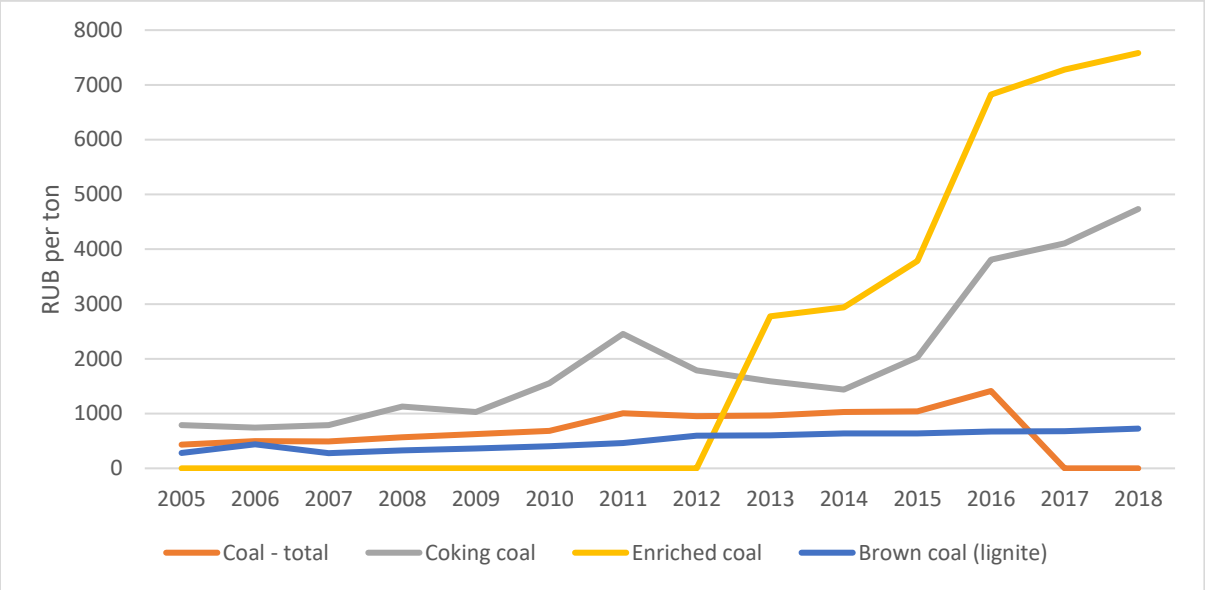
956 While RZD is subject to regulated tariff in wagon services, private operators are not and they can and do set this part of the price according to market conditions.

957 For instance, the cost of in-Russian railroad transportation of iron ore for a distance of 1 100 kilometres was estimated to a 16 000 kilometres transportation cost of iron ore from Brazil to China, available at: http://www.railsystem.info/, accessed on 13 November 2019.

958 In line with the OECD Glossary of statistical terms, the producer's price "(…) *is the amount receivable by the producer from the purchaser for a unit of a good or service produced as output minus any VAT, or similar deductible tax, invoiced to the purchaser; it excludes any transport charges invoiced separately by the producer*", available at: https://stats.oecd.org/glossary/detail.asp?ID=2144, accessed on 15 October 2019.

959 The final average (purchaser's) price is shaped by several factors raging from general to sector-specific, for example inflation, seasonal fluctuations and conditions of purchase as well as registration of prices for goods in line with the established nomenclature. Apart from these, value added tax (VAT rate 20% - standard rate), Article 164, Clause 3 of the Tax Code, available at: http://www.consultant.ru/document/cons_doc_LAW_28165/35cc6698564adc4507baa31c9cfdbb4f2516d068/, accessed on 9 September 2019. Prior to 1 January 2019 – 18% (amendment introduced by Federal Law N.º 303-FZ "*on Amendments to certain Legislative Acts of the Russian Federation on Taxes and Fees*", available at: http://publication.pravo.gov.ru/Document/View/0001201808030106?index=2&rangeSize=1, accessed on 9 September 2019) transportation, sales, as well as intermediary costs are included in the final price.

Figure 10.27 Average domestic producer's prices of coal in Russia in the period 2005-2018[960]



Source: data retrieved from Federal State Statistic Service.

In the period 2005-2018 coking coal price appeared as the most volatile, rising steadily from 2015 onwards and reaching, in 2018, RUB 11 029 per ton. Also, the relative difference[961] between producer's and purchaser's prices of coking coal was the greatest as compared to other kinds of coal.[962] For example, in the year 2008 it reached 300% and from that point fell into a declining trend to level out at 133% in the year 2018.[963]

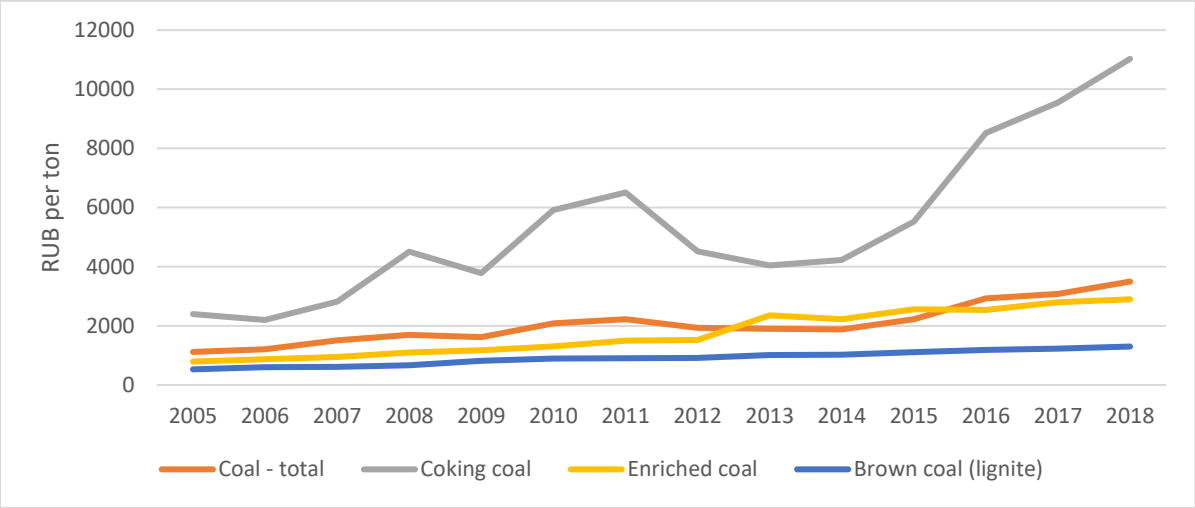
960 Data for the period 2010-2018 retrieved from *Average producer prices of selected industrial goods from 2010. (Средние цены производителей на отдельные виды промышленных товаров с 2010г)*, available at: http://www.gks.ru/free_doc/new_site/prices/prom/cena-okpd.htm, accessed on 9 September 2019 and for the period 1998-2009 from *Average producer prices of selected industrial goods until 2009 (based on OKP) (Средние цены производителей на отдельные виды промышленных товаров до 2009г. (на основе ОКП))*, available at: https://www.gks.ru/storage/mediabank/bd_1904001[1].htm, accessed on 9 September 2019. Data for enriched coal not available in the database until 2012.

961 Calculated as (purchaser's price – producer's price)/producer's price

962 Comment on enriched coal: it appears that naturally occurring radioactive materials included in the resource may become enriched in coal combustion residues during the process of elimination of carbon during coal combustion, as in: Ahmed, U., and Joubert, A. (2019), *Establishing a Relationship between Coal Quality and the Enrichment of Radionuclides in Coal Combustion Residues*, World Journal of Nuclear Science and Technology 09(03), pp.113-126.

963 Internal calculations, based on the data retrieved from *Average producer prices of selected industrial goods from 2010)* and, for the period 1998-2009, from *Average producer prices of selected industrial goods until 2009 (Based on OKP)*

Figure 10.28 Average domestic purchase prices of coal for organisations in Russia[964]



Source: data retrieved from Federal State Statistic Service.

In Russia, coal is traded as a commodity, on OTC basis. SPIMEX has registered OTC transactions for several coal-mining regions. Data obtained from such trades is utilised for calculation of territorial coal price indices which are summary metrics of producer prices reflecting the general dynamics and average levels of the resource's price at Russian mining sites. Territorial OTC indices are calculated on monthly basis relying on information regarding the OTC contracts (their average prices of resources shipped directly from a relevant production site). The calculation method considers only the contracts for the supply of coal to the internal market by rail, relying only on the information pertaining to price levels and volumes of contracts and omitting correction coefficients and transportation tariffs. In effect, they are intended to mirror most effectively current average coal prices recorded in the largest coal-producing sites in the country. The territorial indices include, among others, brown coal,[965] high- and low-energy coal,[966] coking coal,[967] and

964 Data retrieved from *Average prices of selected goods purchased by organizations (Средние цены на приобретенные организациями отдельные виды товаров),* available at: http://www.gks.ru/free_doc/new_site/prices/prom/tab-cena_tov.htm, accessed on 9 September 2019.

965 Brown coal derives from naturally compressed peat; as the most harmful for health, this resource is utilised only as a fuel for steam-electric power generation – Encyclopedia Britannica, *Lignite*, available at: https://www.britannica.com/science/lignite, accessed on 15 October 2019.

966 Low-energy and high-energy coal (apart from brown coal and anthracite which are explained separately) may include: bituminous and sub-bituminous coal, the former of which is used as a fuel in steam-electric power generation as well as for coke-making purposes; the latter, whose properties fall between those of brown coal and bituminous coal, is utilised (together with brown coal) as a fuel for steam-electric power generation - Encyclopedia Britannica, *Bituminous coal*, available at: https://www.britannica.com/science/bituminous-coal, accessed on 15 October 2019.

967 Coking coal (alternatively metallurgical coal) is burnt at high temperatures in order to produce steel; available at: https://globalnews.ca/news/627069/the-coal-facts-thermal-coal-vs-metallurgical-coal/, accessed on 15 October 2019.

anthracite[968] which are mined in the nine following regions: Pechora (Komi Republic), Rostov regions, Kuzbass (regions including Kemerovo and Novosibirsk), Minusinsk (Republic of Khakassia), Krasnoyarsk (Krasnoyarsk Territory), Irkutsk, Yakutia (Republic of Sakha), Transbaikalia (Trans-Baikal Territory and the Republic of Buryatia) as well as the Far East (i.e. Amur Region, Khabarovsk Territory and Primorsky Territory).[969]

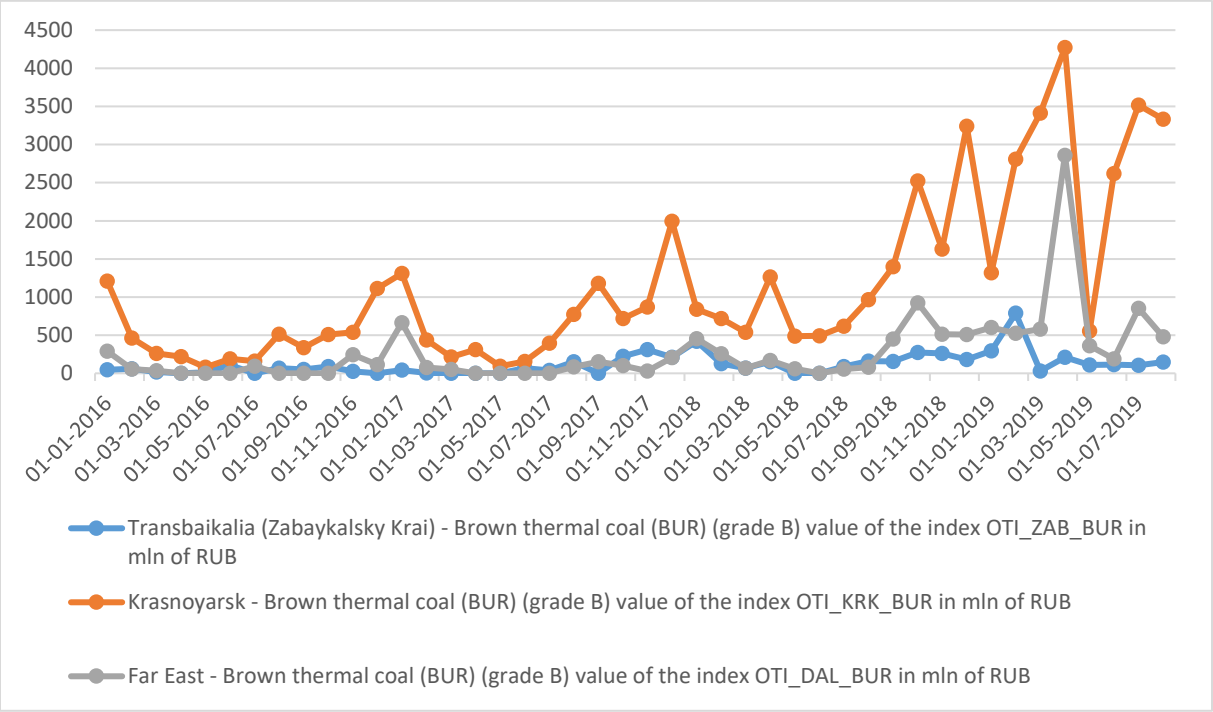
The development path of brown coal mined in three different regions can provide an example. The volatility (and prices) of the Krasnoyarsk-mined brown coal appear to have been the most elevated in the period starting from January 2016 (Figure 10.29). Geographically, both Krasnoyarsk and Zabaykalsky Krai are part of East Siberia, yet, the index specific for Krasnoyarsk has been characterised by the greatest level of trading activity, with both the highest number of transactions and the highest volume of resource traded. Even though the Far East index appears to have tracked the Krasnoyrsk's, the latter's volatility of contract values rose (in annual terms) – for the year 2016 the volatility amounted to RUB 343.56 million (USD 5.15 million), in 2017 it increased to RUB 541.76 million (USD 9.29 million) and to RUB 833.6 million in 2018 (as for the eight months in 2019, the realised volatility of contract values equalled RUB 1 148.34 million, i.e. USD 17.69 million).[970]

968 Anthracite (also know as e.g. black coal, hard coal or dark coal or coffee coal) has the highest energy density of all types of coal and is the highest ranking of coals - Encyclopedia Britannica, *Anthracite*, available at: https://www.britannica.com/science/anthracite, accessed on 15 October 2019.

969 Based on the information available at: http://spimex.com/indexes/coal/territorial/info.php, accessed on 10 September 2019.

970 Average RUB/USD exchange rates calculated based on the data provided by the CBRF, data available at: https://www.cbr.ru/eng/hd_base/micex_doc/, accessed on 17 September 2019.

Figure 10.29 Brown thermal coal indices 2016-2019 monthly averages[971]



Source: data retrieved from SPIMEX.

The prices of Russian coal on the spot market destined for exports to Eastern Asia changed from USD 52 per ton in May 2016 to USD 91 in August 2017; those in the Baltic ports changed from USD 46 to 80 per ton.[972] The prices of coking coal on the domestic market in Russia only partly correlate with international markets. This phenomenon may be explained by the developments observed in the sector in the last decade. As shown previously (see Section 10.2.3), the main driver of coal production in Russia has been a significant increase of exports since the beginning of the 2000s, especially to countries which could not afford investment in environmentally friendly energy generation technologies, located in Africa (such as Egypt, Nigeria, Malawi)[973] and Asia (such as China). As a result of a prolonged price slump in the period 2011-2016 and several company failures, the demand for coal outweighed the supply in the global markets. This created favourable competitive situation for Russian mining companies and thus export of coal exceeded the volume supplied to the internal market.[974]

971 Data plotted in the figure retrieved from: *The values of territorial coal price indices (in roubles per ton) throughout history*, available at: http://spimex.com/indexes/coal/data/, accessed on 10 September 2019.

972 Deputy Minister of Energy Anatoly Yanovsky (2017), *Money diverted into coal*, Rossiyskaya Gazeta, available at: https://rg.ru/2017/08/22/ianovskij-v-riade-regionov-ugol-edinstvennyj-istochnik-energii-i-tepla.html, accessed on 30 January 2019.

973 The list is not exhaustive, for exemplary purposes only, excluding South Africa.

974 Data quoted in this section retrieved from the BP Statistical Review of World Energy 1965-2019; the .xlsx file available at: https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html, accessed on 10 September 2019.

Moreover, the internal demand decreased as a result of inter-fuel competition with gas and the introduction of coke-substituting blast-furnace smelting technologies in the steel sector (see Chapter 14). In the westernmost parts of the country, coal has been replaced by gas (which became more competitive under the State's regulations pertaining to gas pricing – see Section 10.6.1) On the other hand, in more isolated parts of the country, for example Siberia, coal has remained the dominating source for generation of electricity and heat. This imbalance in the resource's utilisation and trade (both within Russia as well as between the domestic and export markets) arguably makes comparisons of Russian and international coal prices difficult.

10.6.4 ELECTRICITY

Currently, as is the case of other energy sectors, the responsibility for regulation, efficient functioning, development and reforms of the electric power sector lies with the Ministry of Energy and the Ministry of Economic Development, while FAS is responsible for setting of regulated tariffs in the sector. In addition, the association Non-profit Partnership Council for Organizing Efficient System of Trading at Wholesale and Retail Electricity and Capacity Market (′NP Market Council′) has been established as a non-commercial organisation responsible for overseeing the proper execution of Wholesale Electricity Market rules.[975] The main legislative act governing the sector is the Federal Law No. 35-FZ of 26 March 2003 On Electric Power Industry (′Law on Electric Industry′).[976]

Entities which are covered by the provisions of the Law on Electric Industry include entities that generate electricity, heat and capacity,[977] purchase and sell electricity and capacity, supply power to consumers, provide services related to electricity transmission, perform dispatching activities in the electric power industry, conduct retail sales of electricity (capacity), organize the purchase and sale of electricity and capacity (Article 3 of the Law on Electric Industry).

Article 6 of the Law on Electric Industry lays out the general goals of regulation in the electric power sector. These include a balance of public or State's goals, as well as economic interests of private and state-owned actors in the field. As far as the public goals are concerned, the Law stipulates that these include maintaining energy security and uninterrupted functioning of the industry in order to meet the demand of electric energy consumers and the unity of the economic space in the field of electric energy circulation. In terms of economic considerations, the Law emphasises: freedom of economic activity in the electric power industry; maintaining the balance of economic interests of suppliers and consumers; the use of market relations and competition as one of the main tools for creating a sustainable system to satisfy the demand for electric energy;

975 See the organisation's official website, available at: http://www.en.np-sr.ru/en/srnen/index.htm, accessed on 13 November 2019.

976 Federal Law N.º 35-FZ of 26 March 2003 "*on Electric Power Industry*", as amended, available at: http://ivo.garant.ru/#/document/185656/paragraph/17:0, accessed on 13 November 2019.

977 Capacity refers to adequate generating resources to ensure that the demand for electricity can be met at all times and is treated as a market separate from the actual trade of electricity.

ensuring non-discriminatory and stable conditions for carrying out entrepreneurial activities in the electric power industry; as well as ensuring an economically justified return on invested capital in activities where state regulation of prices and tariffs applies.

Article 8(2) of the Law on Electric Industry requires that the Russian Federation controls the national electric network by managing the unified national electric grid[978] via direct or indirect ownership of at least the majority of its capital stake. This requirement is currently met by the ownership of the network by the state-owned Federal Grid Company (′FGC′, see also Section 10.2.4). FGC concludes mandatory[979] agreements with other market participants included in the unified national electric grid, which determine the procedure for using the network, while also taking into account their economic interests such as return on capital (Article 8(3) of the Law on Electric Industry). Importantly, barring some exceptions related to its own energy use, as well as to compensation for losses and to technological support, FGC and its affiliates are prohibited from selling and purchasing electric energy. This is markedly different from Gazprom in the gas sector who is the main producer and trader of gas, while also being the manager of the UGSS and the main implementing body of regulated gas prices policies. FGC solely provides services of transferring electric energy through the unified national electric network to wholesale market entities, as well as to other actors who are lawfully connected to the network and have appropriate facilities, including those engaging in cross-border trade or wholesale customers located abroad (Article 9(1) of the Law on Electric Industry).

The principles of state regulation of the electric power industry are laid out in Chapter 5 of the Law on Electric Industry. In addition to some of the above-discussed general goals of regulation of the electric power industry, additional goals include: ensuring the availability of electric energy for consumers and protecting their rights; development of a competitive electric energy market and limitation of monopolistic activity of individual electric power industry entities; ensuring non-discriminatory access to the services of natural monopolies in the electric power industry and to the services of the entities of the wholesale commercial infrastructure; maintaining state regulation in the areas of the electric power industry, in which there are no or limited conditions for competition; ensuring access of consumers of electric energy to information on the functioning of the wholesale and retail markets, as well as on the activities of electric power industry entities (Article 20(1) of the Law on Electric Industry).

10.6.4.1 Regulation of wholesale and retail electricity prices

According to Article 20(2) of the Law on Electric Industry, state regulation of prices and tariffs for certain types of products (services) is one of the many methods of state regulation and control in the sector. The specifics of price regulation are stipulated both in the Law on the Electric

[978] What is included in the unified national electric grid is determined on the basis of criteria and procedures established by the government (Article 21.1 of the Law).

[979] This is motivated by maintain the integrity and stability of the unified network.

Industry and in the Government Order No. 1178 of 29 December 2011 on Pricing in the Field of regulated Prices (Tariffs) in the Electric Power Industry.[980]

The country has a two-tier electricity market - wholesale and retail. In the wholesale market, electricity suppliers (generating companies, importers of electricity) supply electric power to wholesale buyers (guaranteeing suppliers, sales companies, large consumers, electricity exporters). Wholesale market participants may trade on the day-ahead market or under unregulated bilateral agreements. The free-market price is derived from the bids submitted by both companies that supply and/or purchase for the following day – in effect, the existing market structure and supply and demand determine the equilibrium price.[981] The wholesale power and capacity market is divided into three independent geographic zones: (1) the first pricing zone (Russia's European area and the Urals); (2) the second pricing zone (Siberia); (3) the non-price zone (the classification of regions into the non-price zone depends on technical criteria, such as isolation from the unified energy system of Russia, as well as socio-economic objectives of support to remote regions).[982] The division is important, among other reasons, due to the fact that electric power can be traded at largely free prices according to unregulated bilateral agreements only between participants within the same pricing zone.

In the retail market (governed by Government Resolution No. 442[983] of 4 May 2012), power is supplied to both industrial and residential consumers (households). Generally, the wholesale market prices translate into the retail market prices, with FAS setting the tariffs for households as well as retail industrial consumers.[984] Retail tariffs are regulated by the FAS through measures such as price caps. These are differentiated by categories of end users and are typically the sum of the following components: weighted average generation cost, capacity cost in the wholesale market, cost of ancillary and system services, and retail supply cost (including distribution).[985]

Thus, electricity prices paid by industrial users in the retail market partially reflect regulated retail tariffs and partially the situation in the wholesale markets which in some parts of the country are exposed to market forces more than in others. As a result, retail industrial electricity prices in

980 Available at: https://cis-legislation.com/document.fwx?rgn=49359, accessed on 25 February 2020.

981 Josefson and Rotar (2018), *Electricity regulation in the Russian Federation: overview*.

982 *Ibidem*.

983 Government Resolution N.º 442 of 4 May 2012, "*On Functioning of Retail Electricity Markets, Complete and (or) Partial Restriction of Mode of Electric Energy Consumption"* (along with *the Basic Provisions for Operation of Retail Electricity Markets, Rules of Full and (or) Partial Restriction of the Mode of Electric Energy Consumption*), available at: http://www.consultant.ru/document/cons_doc_LAW_130498/, accessed on 8 January 2019.

984 FAS Order N.º 1354/17 of 13 October 2017 "*on Marginal minimum and maximum levels of tariffs for electrical energy (power) for 2018*", available at: http://www.consultant.ru/document/cons_doc_LAW_283981/, accessed on 13 November 2019.

985 EBRD, *Russia Country Profile*, available at: https://www.ebrd.com/downloads/legal/irc/countries/russia.pdf, accessed on 13 November 2019.

Russia are estimated to be much lower than in the EU and the US.[986] In addition, as documented in figures prepared by the Ministry of Energy showing average retail prices of electricity for final consumers in 2016–2017,[987] prices paid by the mining and processing industries, for example, are about 25% lower than those paid in agriculture or other economic activities. This suggests that depending on the region of operation and other firm-specific circumstances, lower electricity prices might be a source of competitive advantage in different sectors of the Russian economy.

In addition, both wholesale and retail markets have regulated pricing segments. In particular, as per Article 23.1(4) of the Law on the Electric Industry, certain tariffs, such as tariffs for electric power transmission services or tariffs for services to ensure system reliability, are regulated for both the wholesale and retail market, in the whole territory of the country. These include, for example: tariffs for electric power transmission services through a single national electric grid (determined by FAS), as well as territorial grids (determined by Regional Energy Commissions);[988] tariffs for services to ensure system reliability; and tariffs for services of operational dispatch control.

As far as the wholesale market is concerned, there are also additional regulated components of the electricity price which are added to the equilibrium price of the wholesale market such as, for example, allowances for capacity or renewable energy generation (Article 23.1(2) of the Law on the Electric Industry). In addition, for the wholesale market, in territories that are grouped into price zones, the components of the price of electrical energy which are related to the equilibrium price of the wholesale market are not regulated. In the non-price zone, electricity is supplied at prices regulated by FAS (Article 23.1(2) of the Law on the Electric Industry).[989] In sum, the wholesale market prices are an outcome of both regulated tariffs and market forces, with market forces playing a larger role in the price zone and regulation in non-price zone.

10.7 CHAPTER SUMMARY

Russia is both a world leader in energy production, giving it comparative advantage in energy-intensive activities, as well as a country with heterogeneous geographical, climatic and social

986 See e.g. Table 3-12: Changes in retail industrial electricity prices compared to EU prices, constant 2017 EUR/MWh in Trinomics (2019), *Study on Energy Prices, Costs and Subsidies and their Impact on Industry and Households*, available at: https://ec.europa.eu/energy/sites/ener/files/documents/energy_prices_and_costs_-final_report-v12.3.pdf, accessed on 13 November 2019.

987 Analytical Center for the Government of the Russian Federation (2018), "*Russian Energy – 2017"*, p. 56, available at: http://ac.gov.ru/files/publication/a/17271.pdf, accessed on 6 December 2019.

988 Regional Energy Commissions are regulatory governmental agencies that operate on a regional level and apply the rules and methodology guidelines issued by the FAS. Information on regional regulators, including the legal basis for their activities, is provided by FAS and available at: http://fas.gov.ru/pages/activity/tariffregulation/regionalnyie-reguliruyushhie-organyi.html, accessed on 25 February 2020.

989 See also FAS Order N.º 1354/17 of 13 October 2017 "*on Marginal Minimum and Maximum Levels of Tariffs for Electrical Energy (Power) for 2018*", available at: http://www.consultant.ru/document/cons_doc_LAW_283981/, accessed on 13 November 2019.

conditions. Energy is an important source of tax revenue and foreign exchange earnings for the country. Functioning of domestic energy markets, which are also influenced by its policies towards energy exports, thus plays an important role for the country, both in terms of domestic and external economic and strategic management. This provides for an important context for, on the one hand, Russia's traditionally strategic and state-dominated approach to the management of its energy sectors and, on the other for the attempts at improving the efficiency of the energy sectors through increasing the role of market-based principles. One recent example of such reforms is the on-going overhaul of taxation of extraction and exports of energy products which has the potential to equalise the tax treatment of domestically consumed and export-oriented energy products. However, major elements of the tax reform still need to be implemented and the policies related to taxation energy exports in place at the time of writing of this report continue to exercise a downward pressure on domestic energy prices across the different energy sectors. In addition, a host of monopoly rights and the state regulated prices, particularly in the natural gas sector and, albeit to a lesser extent, the electrical power sector remain an important mechanism influencing the functioning of energy markets in the country.

The largest companies in the oil subsector have remained under the Government's influence with state-owned companies accounting for over half of production in recent years while other key players have been reported to maintain close informal links with the State (Section 10.2.1). While the domestic prices of both crude oil and oil derivatives are largely subject to supply and demand forces, some instances have been recorded of discretionary interventions by the Government in some oil product segments (Section 10.6.2). Prices of oil and oil products are also shaped by relevant taxes and customs duties, which depend on the final destination of the goods in question. Given the strategic importance of oil prices for the financial security of the entire economy, the Government retains the right to deploy specific fiscal instruments, if the prevailing market conditions demand it.

The coal industry has been almost completely privatised but the market is relatively concentrated. Like oil and oil products, prices of coal and derivative products are set in principle by market forces (Section 10.2.3). However, their prices are also influenced by applicable fiscal procedures. In addition, since the Russian coal mining regions are located long distances from the nearest terminals in seaports, the cost of Russian coal depends on the state-regulated rail tariffs implemented by the Russian Railways, the state monopolist owning and running Russian railroads. These regulated tariffs define coal as a product for which long distance transportation costs are cross subsidised by elevated costs of shipment for other products (Section 10.6.3).

Russia's natural gas production is dominated by state-owned companies, Gazprom in particular. Gazprom owns the Russian pipelines system UGSS which gives it a privileged position in sourcing and distributing gas within Russia (Section 10.2.2). The company controls, directly or indirectly via managing the UGSS, the overwhelming majority of gas supplies within the Russian market. Gazprom is also the sole authorised exporter of piped gas outside Russia and it accounts for a significant share of the LNG export segment, which is the most liberalised part of the Russian gas

sector. In addition, the State regulates pricing of gas through a set of regulations and Gazprom plays a key role in implementing these regulations (Section 10.6.1). The domestic wholesale prices in Russia have been consistently below export prices. This stems from the approach to domestic regulated price setting based on a formula that explicitly links the domestic price to many variables - primarily the export price, which is reduced by a plethora of elements, such as the costs of transport to the border, export taxes, the regional price zone differentiation coefficients, or the state-set reduction coefficient, which is a key parameter creating a wedge between the export netback and the domestic prices. Transportation costs coefficients are also determined by state entities on the basis of information supplied by Gazprom and calculated based on its internal technical data and methodologies. All the coefficients above can, therefore, be manipulated to lower domestic prices. Timing and size of some of the most recent adjustments of regulated gas prices do not appear to be related strongly with domestic economic indicators but rather to political situation and international price developments, preventing convergence towards export prices. While independent production and the unregulated organised exchange of natural gas are developing in Russia, several pieces of evidence suggest that prices offered in these segments of the market still closely follow prices charged by Gazprom (Section 10.6.1.5).

In the electric power sector, the pro-market reforms of the Russian electrical power generation sector resulted in partial privatisation and significant deregulation of certain market segments. Nonetheless, just ten companies control over 80% of installed generating capacity and over half of the country's capacity belongs to utilities where the State is an important holder (Section 10.2.4). In addition, capacity market development has been influenced by state policies. Electricity prices paid by industrial users in the retail market partially reflect regulated retail tariffs and partially the situation in the wholesale markets, which in some parts of the country are exposed to market forces more than in others. Although regulated electricity prices and tariffs do not explicitly differentiate by the type of using industry, but rather geographical location and characteristics of end users, there are reasons to believe that the state regulation of electricity prices may effectively confer competitive advantages to some sectors of the Russian economy (Section 10.6.4).

11 TRANSPORTATION

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11.1 GENERAL TRENDS

Transportation in Russia entails travelling and transporting goods over enormous distances, by rail, road, air and water (inland and maritime).[990] Due to the size of the country, Russia's transportation system is among the most used in the world. While Russia's railway network is not as long as those of Europe or China, it ranks first in the world in terms of use for freight purposes (in billion tons/kilometre), ahead of the US and China (Figure 11.1).

Figure 11.1: Comparison of area, population, GDP and freight transport, 2016–2017

Indicator	Russia	US	China	EU
Area in thousand km^2	17 098.3	9 831.5	9 562.9	4 422.8
Population in millions	144.5	325.72	1 386.4	512.5
GDP in billion current USD[991]	1 577.52	19 390.6	12 237.7	17 270.8
Transport as % of GDP	6.3	8.9	<5[992]	5
Freight rail transport in billion tons/km	2 493	2 448	2 379	416
Length of rail network in thousand km	87	258	124	217
Freight road transport in billion tons/km	255	2 953	6 108	1 913
Length of road network in thousand km	1 666	6 586	4 696	4 852[993]

Source: Rosstat, World Bank, OECD, Eurostat, EU Science Hub, United States Department of Transportation, 2017 China Statistical Yearbook, European Union Road Federation.

However, according to the World Economic Forum,[994] the quality of the transportation system is relatively poor (for quality of roads, Russia ranks 114th out of 137 analysed countries, quality of railroads – 23rd, quality of ports – 66th and quality of air transport – 59th).

The transportation network covers Russia's territory unevenly. The European part is dense while the remote Siberian or Far East regions often lack regular connections. Given that weather

990 This chapter does not cover the issues related to passenger transportation (which are outside the scope of this analysis), and pipeline transportation of oil and gas which are covered in Chapter 10.

991 Data retrieved from the World Bank database, available at: https://databank.worldbank.org/source/world-development-indicators, accessed on 4 February 2020. USD figures for GDP are converted from domestic currencies using average official exchange rates.

992 Transportation, postal and telecommunication services, software industry.

993 Data as of the end of 2013, according to Nicodeme, C., Diamandouros, K., Diez, J., Durso, C., Arampidou, K., & Nuri, A.K. (2017), *2 European Union Road Federation Report*, Road Statistics Yearbook 2017, p. 20, available at: http://www.erf.be/wp-content/uploads/2018/01/Road_statistics_2017.pdf, accessed on 30 March 2019.

994 World Economic Forum. (2017), *The Global Competitiveness Report 2017–2018*, p. 249, available at: http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf, accessed on 31 January 2019.

conditions play a part in the transport network making paved roads hard to maintain in extreme temperatures and rivers are oriented along the north-south axis, railroads have long been responsible for the most reliable traffic of goods and passengers. Since 2010, Russia's infrastructure has been integrating with international transport corridors and numerous projects are being implemented in this field (e.g. One Belt One Road, Europe-western China transit route, Euro-Asian Transport Links).

For the purpose of this report, only rail and road transportation are analysed due to their significance, as they are responsible for over 95% of total freight volumes and turnover.

11.1.1 REGULATORY FRAMEWORK

The Transport Strategy 2030 (′Strategy 2030′),[995] adopted in 2008 and revised in 2018, is the main nationwide policy document outlining governmental goals. Among the most important goals of Strategy 2030 are the creation of a competitive transport and logistic services market and integration of Russia into the global transport system. The federal programme Development of Transport System for 2010–2020, adopted in 2001 and extended in 2017 to 2021[996] is a federal financing scheme which aims to create better cohesion between investments and long-term priorities, and minimise the impact of short-term considerations (such as budget or politics). Transportation improvement goals are also enumerated in other documents, for example, President Executive Order on National Goals and Strategic Objectives of the Russian Federation to 2024.[997] According to the plans of the Ministry of Transport published in February 2019, implementation of the presidential objective *Safe and Quality Roads* will require RUB 4 779.7 billion (approximately USD 73 billion), and *Development of Transport Infrastructure* around RUB 6 348.1 billion (approximately USD 97 billion). These amounts will come from federal and regional budgets as well as extra budgetary sources.[998]

The Russian transportation market has been recovering after the economic crisis of 2014–2016. It contributes to the development of the country directly (e.g. enhancing regional convergence or participation in global value chains), determines economic ties between regions (and affects the costs of regional goods and services) but it also contributes indirectly as an input to the State's

995 Transport strategy of the Russian Federation for the period up to 2030, available at: https://www.mintrans.ru/file/395059, accessed on 31 January 2019.

996 More information on the site of the Federal Treasury Institution *Directorate of the state customer for realization of the Federal target programme Modernization of transport system of Russia* (*FTI ROSTRANSMODERNIZATSIYA*), available at: http://ppp-transport.ru/en/, accessed on 31 January 2019.

997 President of Russia News Service (2018), "*The President signed the Executive Order on National Goals and Strategic Objectives of the Russian Federation through to 2024",* available at: http://en.kremlin.ru/events/president/news/57425, accessed on 31 January 2019.

998 More details can be found in the Government statistics: for Safe and Good Roads, available at: http://static.government.ru/media/files/SUROPF7YM0AWhTbZV4vyTSe4cggh8Gwe.pdf, accessed on 29 October 2019; and for Development of Transport Infrastructure, available at: http://static.government.ru/media/files/mMrrbr3q9P6cGfWP3WxSmf7lCvAhrLob.pdf, accessed on 30 March 2019.

wealth. In 2017, this sector accounted for around 6.3% of Russia's GDP which amounted to USD 1.57 trillion (see Figure 11.1).[999] The current growth of the transportation sector can be attributed to the rapid growth of the retail trade (retailers develop new areas of activity and expand across the country),[1000] as well as supportive measures of the Government (e.g. targeted projects and investments such as National Goals and Strategic Objectives). Domestic transport plays an important role in the import substitution policy resulting from sanctions imposed on Russia and Russian countersanctions (see Chapter 6), with a preference given to Russian goods, as well as trade reorientation. In this context, modernisation of the transport system and implementation of innovative transportation projects are set as governmental goals. Some types of goods previously imported from neighbouring countries, over short distances, are now being transported from remote Russian regions where they are produced. Also, China has become a major trading partner of Russia, while on the other hand trade with the EU was decreasing, which impacts on transport in Russia. The transport industry itself is also subject to changes related to import substitution – Russia aims to increase its own production of components for several types of locomotives, airplanes, and road equipment and is implementing relevant policies and financing schemes for this purpose (e.g. the Russian Federation State Programme on Aviation Industry Development 2013–2025).[1001]

Russia's economic recovery in 2016–2018 and more Government investment in the transport sector have resulted in an increase in freight volumes (Figure 11.2). There were also overall increases in freight tariffs in the same period (with the exception of rail and air transportation) (Figure 11.3).

Figure 11.2: Freight transport in Russia

Total freight transport in Russia by mode	**International (import, export, transit) freight transport (out of total)**	**Length of transport lines**

[999] According to RZD Partner, in 2017, the contribution of the transport complex of the Russia to the country's GDP amounted to RUB 5.8 trillion (*В 2017 году вклад транспортного комплекса РФ в ВВП страны составил 5,8 трлн руб*), see: http://www.rzd-partner.ru/other/news/v-17-g-vklad-transportnogo-kompleksa-rf-v-vvp-strany-sostavil-5-8-trln-rub/, accessed on 4 April 2019.

[1000] PwC (2018), *Springtime in Russian retail: major trends and consumer insights*, https://www.pwc.ru/en/assets/r&c-trends-and-economy-eng-edits.pdf, accessed on 29 January 2019.

[1001] *Russian Federation State Program on Aviation Industry Development 2013–2025 (Государственная Программа Российской Федерации Развитие авиационной промышленности на 2013–2025 годы*), available at: http://minpromtorg.gov.ru/common/upload/files/docs/GP_RAP_dop_chast_bez_prilozhenii.pdf, accessed on 7 April 2019.

	2005	2010	2015	2016	2017	2017	2017	2017
	goods transported in million tons					% share	in million tons	in 1 000 km
Total transport	**8 118.8**	**6 688.1**	**6 827**	**6 866.1**	**6 933.3**	100.00%		
rail	1 273	1 312	1 329	1 325	**1 384**	**19.96%**	n/a	**87**
road	6 685	5 236	5 357	5 397	**5 404**	**77.94%**	n/a	**1 666**
sea	26	37	19	25	25	0.36%	7.9	n/a
internal water	134	102	121	118	119	1.72%	29.7	101.5
air	0.8	1.1	1	1.1	1.3	0.02%	0.9	n/a
	goods transported in billion tons/km						in billion tons/km	
Total transport	**2 201.8**	**2 368.7**	**2 664.6**	**2 708.6**	**2 868.9**	100.00%		
rail	1 858	2 011	2 306	2 344	**2 493**	**86.90%**	n/a	
road	194	199	247	248	**255**	**8.89%**	n/a	
sea	60	100	42	43	46	1.60%	33.5	
internal water	87	54	64	67	67	2.34%	35.9	
air	2.8	4.7	5.6	6.6	7.9	0.28%	7	

Source: Rosstat.[1002]

Figure 11.3: Freight tariff indices by main transport mode and CPI inflation

December to December of previous year; ***percent***	2000	2005	2010	2012	2013	2014	2015[1003]	2016	2017
Cargo transport	**151.5**	**116.6**	**133.1**	**107.5**	**108.0**	**100.9**	**111.5**	**105.6**	**109.0**
of which:									
railway	169.3	113.3	109.4	105.6	105.4	102.3	112.9	108.7	104.0
road	136.6	114.3	103.7	105.3	104.2	107.2	106.4	100.6	102.8
sea	109.3	109.4	98.9	95.3	103.3	144.1	114.4	90.1	103.4
inland water	119.2	111.0	106.7	106.3	107.5	140.0	113.5	97.8	108.3

[1002] Rosstat, *Transport in Russia* (2018) p. 33, available at: http://www.gks.ru/free_doc/doc_2018/transp18.pdf, accessed on 9 January 2019.

[1003] As stated in Rosstat document: "*Excluding data on the Crimean Federal District*".

air	112.9	114.1	104.2	108.9	103.1	105.7	107.6	120.7	115.3
CPI inflation[1004]	**120.2**	**110.9**	**108.8**	**106.6**	**106.5**	**111.4**	**112.9**	**105.4**	**102.5**

Note on Figure 11.3: The table expresses percent changes of tariffs year-on-year using indices. The list does not cover the pipeline transportation that is included in the total in Rosstat data.
Source: Rosstat.[1005]

11.2 TRANSPORTATION SYSTEM ELEMENTS

11.2.1 RAIL

Since the dissolution of the USSR, Russian rail transport has undergone substantial changes.[1006] The railway reform, aimed to increase private sector investment and enhance competition, was implemented gradually over 15 years from 2001 and comprised numerous phases. Initially it dealt with the legal framework, as well as the separation of policies and regulatory functions from business and commercial activities. Because of the division of the Ministry of Railways, the fully state-owned joint stock company Russian Railways (′RZD′) was established in 2003, together with the Federal Railway Transport Agency.[1007] Consequent reforms included asset unbundling and legal separation of some RZD activities, as well as the privatisation of RZD subsidiaries and adjustments of tariff policies.[1008]

The Law on Natural Monopolies[1009] enumerates railway transportation among natural monopolies; hence, RZD's activities have to be regulated by the federal authorities. As a result, the Government sets the company's main goals. These are included in the Strategy for Railway Development in the Russian Federation to 2030,[1010] as well as other acts, such as the Presidential Executive Order.[1011] In March 2019, the Government approved the 2025 Long Term Development Programme for

1004 Federal State Statistics Service, *Consumer price indices for goods and services in the Russian Federation in 1991-2018*, available at: http://www.gks.ru/free_doc/new_site/prices/potr/tab-potr1.htm, accessed on 29 January 2019.

1005 *Ibidem*.

1006 The Structural Railway Reform Programme in 2001, adoption of the laws "*on Rail Transport in the Russian Federation*" and "*The Railway Transport Charter of the Russian Federation*", etc. (see Annex 11.1).

1007 Russian Railways, *General Issues*, available at: http://eng.rzd.ru/statice/portal/en?STRUCTURE_ID=4119&layer_id=4516&id=2221, accessed on 9 January 2019.

1008 EBRD, Bruce Murray (2014), *Russian Railway Reform Programme*, 2014, pp. 14-15, available at: http://www.ebrd.com/documents/evaluation/special-study-russian-railway-sector-evaluation-working-paper-1.pdf, accessed on 30 March 2019.

1009 See Section 10.2.2.1.

1010 *Strategy for development of railway transport in the Russian Federation until 2030*, available at: http://static.government.ru/media/files/DkdcT7dHs4fGLrhkK5lk0egvr4rA2QZi.pdf, accessed on 9 January 2019.

1011 President of Russia News Service (2018), *The President signed Executive Order on National Goals and Strategic Objectives of the Russian Federation through to 2024*, available at: http://en.kremlin.ru/events/president/news/57425, accessed on 31 January 2019.

Russian Railways.[1012] Contribution to the country's development through railway densification, enhancement of integrated services and container traffic, improvements in quality, security and speed of freight services, as well as digitalisation of the railways, are among the main objectives of the programme.

RZD's share of Russia's GDP amounted to 2.2% in 2012, and 1.4% in 2014. RZD is the third largest railroad operator in the world in terms of revenue.[1013] The railway sector accounts for 5–6% of Russian electricity use and 10% of fuel (diesel) consumption.[1014]

After the reforms, RZD retains the monopoly for the provision of rail infrastructure and continues to control all main line locomotive and traction services. However, the regulatory framework (Federal Law on Railway Transport and Federal Law on Charter of Railway Transport)[1015] gives third party wagon operators (not carriers) the right to access this infrastructure on a non-discriminatory basis. Therefore, private sector participation is possible, mainly in wagon ownership and freight railcar operations. In 2017, private operators' fleet accounted for almost 83% of all Russian railcars.[1016] Accordingly, due to the diminution of the wagon market share, RZD's share of railway freight turnover plummeted from 78.2% in 2003 to around 17% in 2017. The ten biggest companies present in the Russian market are: Federal Freight (АО ФГК), Freight One - UCL Rail (АО ПГК), Neftetransservis (АО НефтеТрансСервис), Globaltrans, Transoil (ООО Трансойл), SUEK (АО СУЭК), RTC (ГК РТК), PTK - Pervaya Tyazhelovesnaya Kompaniya (АО ПТК), Novotrans (ГК Новотранс), Gazpromtrans (ООО Газпромтранс) and together, they account for around 60% of the market.[1017]

Freight rail volumes are mainly comprised of commodities: coal, oil products (crude is predominantly transported via pipelines), metals, ores and construction materials (see Figure 11.4).[1018] In terms of export handling by cargo type, hard coal, oil and oil products account for

[1012] *2025 Long Term Development Programme for Russian Railways* (долгосрочная программа развития открытого акционерного общества "Российские железные дороги" до 2025 года), available at: http://static.government.ru/media/files/zcAMxApAgyO7PnJ42aXtXAga2RXSVoKu.pdf, accessed on 30 March 2019.

[1013] Railway Technology (2018), *The world biggest railway operators in 2018*, available at: https://www.railway-technology.com/features/worlds-biggest-railway-operators-2018/, accessed on 4 January 2019.

[1014] Railway Technology (2008), *Russia the rail giant*, available at: https://www.railway-technology.com/features/feature2073/, accessed on 4 January 2019.

[1015] RZD, *Structural reform of the national railway system*, availabale at: http://eng.rzd.ru/statice/public/en?STRUCTURE_ID=23, accessed on 7 April 2019

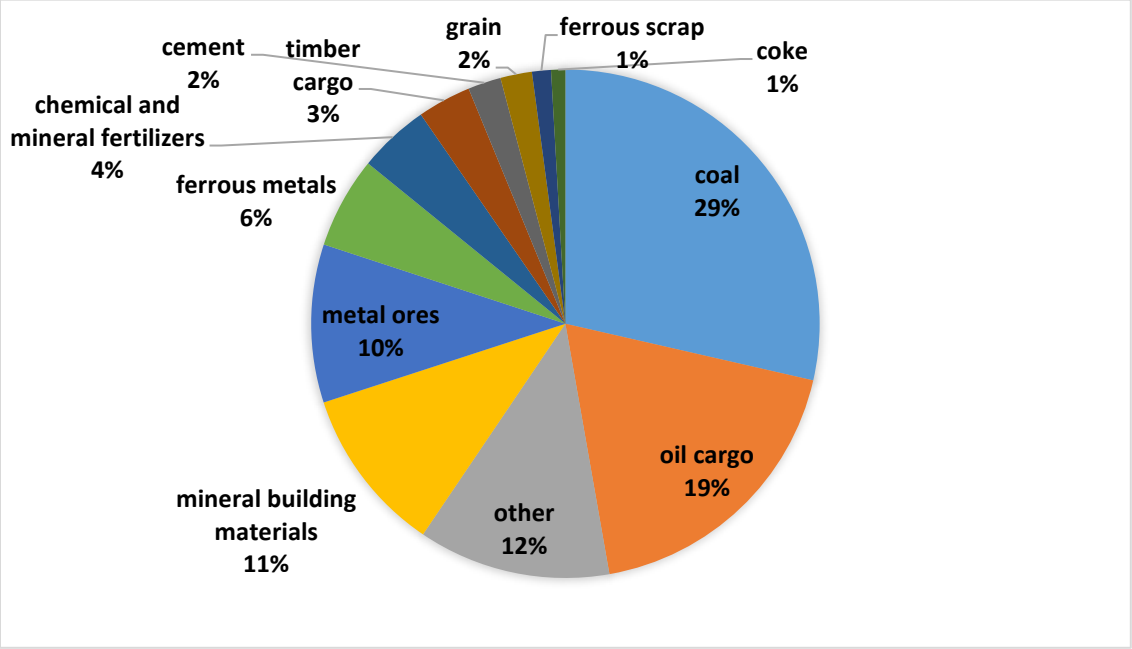
[1016] Gobaltrans, *Industry Overview*, available at: http://www.globaltrans.com/about-us/rail-industry-market/industry-overview/, accessed on 29 January 2019.

[1017] EY, *Overview of the freight industry in Russia in 2018 (Обзор отрасли грузоперевозок в России, 2018 год)*, p. 7, available at: https://ru.investinrussia.com/data/file/ey-freight-transportation-survey-2018.pdf, accessed on 4 January 2019.

[1018] For more details, see United Wagon Company (2018), *Overview of the Russian Railway Market in 2017*, available at: https://www.uniwagon.com/en/multimedia/expert/overview-russian-railway-market-2017/, accessed on 29 October 2019.

over 60% of transported goods.[1019] Nonetheless, in 2017 RZD noted an important increase, 40% year-on-year, of transported and exported grains, as a result of a record harvest and state subsidies in the form of transportation tariff discounts, while domestic grain transport decreased by 3%.[1020] It is important to note that in case of RZD, in 2017 coal, which accounted for 43% of company's freight tonnage, was responsible for only 20% of the total RZD revenue, while transportation of oil products and oil (16% of freight volume) gave 28% of revenue. This confirms a general trend of an increasing share of low-value-added goods in railway transportation.[1021]

Figure 11.3: Structure of railway transport per type of goods in 2017[1022]



Source: Rosstat.

11.2.2 ROAD

Commercial road transportation is hampered by underdeveloped infrastructure. There are around 1.7 million km of roads in Russia, of which two-thirds are paved. As financing of road development comes from the federal and regional budgets (only a small share comes from the new

[1019] Russian Railways, *Condensed Annual Report 2017*, available at: https://ar2017.rzd.ru/en#development-strategy, accessed on 29 January 2019.

[1020] EY (2018), *Overview of the freight industry in Russia in 2018 (Обзор отрасли грузоперевозок в России, 2018 год)*, p. 5, available at: https://ru.investinrussia.com/data/file/ey-freight-transportation-survey-2018.pdf, accessed on 4 January 2019.

[1021] *Ibidem*, p. 6.

[1022] Rosstat (2018), *Transport in Russia*, available at: http://www.gks.ru/free_doc/doc_2018/transp18.pdf, accessed on 9 January 2019.

tax system and toll-roads constructed by private-public partnership), this branch of the transportation sector is now under governmental scrutiny.

The Federal Law on Charter of Road Transport and Urban Land Electric Transport,[1023] as well as the Government Decree on Approval of the Rules for the Road Freight Transport[1024] regulates road transport. In 2014, the Government proposed a road expansion plan[1025] focused on increasing network density. In October 2018, the Ministry of Transportation submitted to the Government a draft plan for the modernisation of the truck road infrastructure, with the aim of increasing the transport infrastructure quality[1026] by 14.6% and mobility of Russians by 15% by 2024. This would also allow for better connections between Russia's '*centres of economic growth*'.[1027, 1028] In order to remedy major problems in the sector, the State Duma is working on the Laws on Organization of Road Freight Transportation[1029] and on the Transport of Transit Goods (Goods) through the Territory of the Russian Federation.[1030] These will provide for more regulation and standardisation (e.g. carriers' registration, technical and drivers' health reporting, implementation of tachographs

[1023] Federal Law of 26 October 2007 "*Charter of road transport and urban land electric transport*", as amended, (*Федеральный Закон "Устав автомобильного транспорта и городского наземного электрического транспорта*"), available at: http://pravo.gov.ru/proxy/ips/?docbody=&prevDoc=102146898&backlink=1&&nd=102117867, accessed on 7 April 2019.

[1024] Government Decree N.º 272 of 15 April 2011 "*on Approval of the Rules for the Road Freight Transport* ("*Постановление Об утверждении Правил перевозок грузов автомобильным транспортом*"), available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102146898, accessed on 7 April 2019.

[1025] Kremlin Press Service (2014), *Presidium of the State Council on the improvement of the network of highways (Президиум Госсовета по вопросам совершенствования сети автодорог)*, available at: http://kremlin.ru/events/president/news/46754, accessed on 30 March 2019.

[1026] The index takes into account the condition and load of roads, as part of general infrastructure development index for agglomerations, available at: https://infraone.ru/analitika/Index_razvitiia_infrastruktury_Rossii_InfraONE_Research.pdf, accessed on 9 January 2019.

[1027] Centres of economic growth consist of around 40 urban agglomerations (plus prospective ones) each with a population not less than 0.5 million located within 200 km from its centre, each contributing over 1% to Russia's total GDP growth, as indicated in the *Draft strategy of spatial development of the Russian Federation until 2025*.

[1028] Analytical Center for the Government of the Russian Federation (2018), *All the conditions for drastically improving the transport links between urban agglomerations are in place*, available at: http://ac.gov.ru/en/commentary/018261.html, accessed on 6 January 2019.

[1029] Draft Law "*on Organization of Road Freight Transportation*" ("*Об организации перевозок грузов автомобильным транспортом в Российской Федерации"*), available at: http://sozd.duma.gov.ru/download/BF2D4275-FD9F-446A-9702-E889CC296C36, accessed on 7 April 2019.

[1030] Draft Law "*on the Transport of Transit Goods (Goods) through the Territory of the Russian Federation*" ("О перевозках транзитных грузов (товаров) через территорию Российской Федерации"), available at: http://sozd.duma.gov.ru/download/D85E7FFF-FE63-45AF-9EC6-97F50D67DA7E, accessed on 7 April 2019.

with the already existing electronic toll collection system Platon[1031] and navigation system GLONASS – Russian equivalent of GPS, etc.).[1032]

Russia's truck fleet comprises 3.73 million trucks and 4.1 million light commercial vehicles.[1033] Road freight transport accounts for the major share of the total freight tonnage with over 5.4 billion tons carried in 2017. The road freight market is divided among a whole range of different companies: from global transport and logistic handling to local firms. Freight forwarding companies (10% of which have foreign capital) dominate in the segment of large and medium-sized operators. According to 2017 estimates, over 80% of Russian haulage companies are private enterprises. The market for commercial cargo traffic is fragmented and the 15 largest companies have around 15% of market share.[1034] A significant number of drivers and SMEs were affected by the 2014 crisis, due to the currency devaluation and increased costs. The implementation of new regulations and the Platon system have also had a negative impact on smaller companies. As a result, some types of freight have been overtaken by larger transport companies and other modes of transport. For instance, railway has begun to transport more construction materials.

11.3 TRANSPORTATION TARIFFS

11.3.1 RAIL TARIFFS

The Russian Government regulates the tariffs of natural monopolies, which includes railway services. RZD's main tariffs for the domestic movement of freight (infrastructure, locomotive traction and wagons) are regulated under the 2003 Price List No. 10-01.[1035] It is a complex document (with over 400 pages solely of tariff tables) distinguishing three broad classes of commodities and determining individual tariffs in each group, taking into account the haulage distance, shipment size and related charges. The tariffs are uniform for all users of the RZD's services. The FAS approves amendments to railway transport tariffs, taking into account their potential macroeconomic, social or political impact. Since 2013, RZD has had the right to

[1031] Platon Electronic Toll Collection (ETC) system was introduced in 2015 to facilitate and process the collection of toll charges offsetting the damage caused to Russian Federal Highways by vehicles exceeding 12 tons of gross vehicle weight (HGV N3 sub-category), available at: http://platon.ru/en/about/, accessed on 31 January 2019.

[1032] Russian Container Company, *Regulation of trucking in Russian increases the cost of delivery*, available at: http://ruscont.com/en/2018/07/30/regulation-of-road-freight-increases-the-cost-of-delivery/, accessed on 31 January 2019.

[1033] JOC (2018), *Russia's new truck transport regulation likely to boost shipping costs*, available at: https://www.joc.com/trucking-logistics/new-rules-push-russian-trucking-costs_20180726.html, accessed on 4 January 2019.

[1034] M.A. Research (2018), *The share of TOP-15 road carriers in terms of volume exceeded 15% (Доля ТОП-15 автоперевозчиков в стоимостном объеме рынка превысила 15%)*, available at: https://ma-research.ru/analytics/item/164-dolya-top-15-avtoperevozchikov-v-stoimostnom-ob-eme-rynka-prevysila-15.html, accessed on 10 January 2019.

[1035] *The Russian Railway cargo transportation and infrastructure usage fees* (*Прейскурант № 10-01 "Тарифы на перевозки грузов и услуги инфраструктуры, выполняемые российскими железными дорогами*"), available at: http://www.rzd.ru/doc/public/ru/accessible?STRUCTURE_ID=704&layer_id=5104&id=6188 and http://www.rzd.ru/dbmm/download?vp=1&load=y&col_id=9098&id=891, accessed on 4 January 2019.

introduce a surcharge or provide a discount to base rates, determined in a specific percentage range. In 2018, the surcharge could amount to a maximum of 8% (implemented for all export goods except thermal coal) and the discount could amount up to 50% (the so-called tariff corridor). For example, the company's management was allowed to establish reduction coefficients for large capacity containers (e.g. up to 12.8%) in order to attract additional volumes of freight.[1036]

However, at the end of 2017, the Government set a new tariff policy for RZD for the 2018–2025 period.[1037] The basic indexation of railway freight tariffs is limited to the 0,1 % below the level of inflation which means for example, for an inflation level of 4%, the RZD tariff indexation amounts to 3.9%. In addition, until 2025 there is a surcharge of 2% for capital infrastructure repair. In 2018, the Government increased the company's tariffs by 5.4%, composed of a basic 3.9% and another 1.5% related to the adjustment of Russian tax legislation (compared to 2017). The increase in tariffs aims at compensating for the increase of tax on the company's properties in regions that are paid to regional budgets. In the longer term, the Government does not intend to increase tariffs in real terms, preferring to keep them linked to inflation levels. Such long-term tariffs minimise price-related risks for customers. Yet, the existing regulated tariff system negatively affects the competitiveness of railway transport compared to other modes of transport, mainly road, as it limits the responsiveness of the company to economic fluctuations and is not connected to prices and tariffs of other industries, which supply the company with technical and material resources.

Since 2019, the 8% surcharge coefficient applies to all exported goods except energy gases, oil and aluminium based on the regulator's decision. Therefore, the company is no longer able to add its own surcharge for exported goods.[1038] RZD is, however, encouraged by the Government to keep applying long-term (up to ten years) discounts of up to 50% on the tariffs to support the development of operator enterprises and solve the issue of rolling stock shortage. In 2016, a shortage of rolling stock (caused by a reduction in the ageing freight wagon fleet) and tariff changes (RZD were then allowed to alter them) increased costs of transporting goods by 25–30%.

[1036] Russian Railways (2018), *Russian Railways introduces discounts of up to 12.8% for transportation of large-capacity containers*, available at: http://eng.rzd.ru/newse/public/en?STRUCTURE_ID=15&layer_id=4839&id=107312, accessed on 10 January 2019.

[1037] FAS Order N.º 1482/18 of 30 October 2018 "*on the Indexation of Tariff Rates, Fees and Charges for the Transportation of Goods and Services for the Use of Infrastructure for the Transport of Goods performed (rendered) by Russian Railways OJSC*" ("Об индексации ставок тарифов, сборов и платы за перевозку грузов и услуги по использованию инфраструктуры при перевозках грузов, выполняемые (оказываемые) ОАО Российские железные дороги"), available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102489105&intelsearch=%F2%E0%F0%E8%F4%ED%FB%E9+%EF%F0%E5%E9%F1%EA%F3%F0%E0%ED%F2+%D0%C6%C4, accessed on 29 October 2019.

[1038] FAS, *The board of the FAS of Russia approved amendments to the tariff price list for the carriage of goods by railway transport* (правление ФАС России утвердило поправки в тарифный прейскурант на перевозку грузов железнодорожным транспорто), available at: https://fas.gov.ru/news/26339, accessed on 7 April 2019.

In order to mitigate the problem, in 2018, the Government implemented a 6% tariff penalty for running empty rail cars.[1039]

The overall tariff justification is threefold: encouragement of long-distance shipments (mainly coal), ensuring competitiveness of railway against road and inland water transport, as well as limitation of the shipping charge to a targeted percentage of the final commodity price. In addition, Russia's railway tariffs are expected to provide aid to industry and ports in remote locations. Hence, the RZD board implements temporary discounts products to and from specific locations, for individual companies, both for domestic and cross-border transport. For example, at the end of 2018 it decided to support the transport of copper ore, copper-zinc ore, copper concentrate, ferrous scrap, as well as the transportation of mineral, natural and artificial waters, carbonated fruit and berry drinks, etc.[1040] In June 2018, RZD announced 6 month discounts for transportation of large-capacity containers, ranging from 6% (for transportation from the railway stations owned by Far Eastern Railways) up to 12,8% (for import shipments through the land border crossings at Zabaikalsk with China). Furthermore, some of the discounts affect specific goods transported over a specific distance, for example grains, fertilizers, metals transported up to 1 100 km (competing with road or water transport). Furthermore, some of the big companies such as Novatek, NLMK, or PhosAgro were also benefitting from cheaper rates. The targeted railway tariff reduction constitutes, in reality, state support, putting some producers in a privileged position, as well as increasing the competitiveness of the railways.

Such a railway tariff policy causes concerns in importing countries. For example, introduction of a discount on railway tariffs for exported grains from some of Russia's regions was widely questioned by WTO members in 2017.[1041]

As a result, major railway transport inefficiencies (or distortions) come from a weak relation of transportation tariffs with actual transportation costs. For example, they do not take into account the transport routes, nor do they vary between commodities.[1042] Classification of goods into three tariff groups (depending on their profit potential, e.g., first class freight comprises coal, while third class is reserved for high-profit goods) coupled with tariff alterations and cross-subsidising

1039 *Ibidem*.

1040 Russian Railways, *Protocol from the RZD Board meeting* (Протокол ОАО "РЖД" от 12.11.2018 № 54), available at: http://doc.rzd.ru/doc/public/ru?STRUCTURE_ID=704&layer_id=5104&refererLayerId=5103&id=6957, accessed on 4 January 2019.

1041 "*In accordance with WTO requirements, the tariff policy of the railways of CIS member nations for international freight shipments involving Russian Railways contains only base transit tariff rates*." Russian Railways, Principles of freight transportation tariff policy, Russian Railways. (2016), *Annual Report for 2016*, available at: https://ar2016.rzd.ru/pdf/ar/en/company-overview_market-review_tariff-policy.pdf, accessed on 3 January 2019.

1042 Asian Development Bank (2014), *Rail Infrastructure Tariffs – Enabling Private Sector Development in Mongolia's Railway Sector*, available at: https://www.adb.org/sites/default/files/publication/31216/rail-infrastructure-tariffs-mongolia.pdf, accessed on 30 January 2019.

passenger transportation, make the sector's costs non-transparent. Despite the fact that liberalisation of the railway sector is being discussed, as of writing of this report, further development of the railway sector depends on state support and demand for railway services from the main industries. Besides the new tariff policy, the railway segment can benefit from infrastructure investment of RUB 4.8 trillion (USD 71.6 billion) by 2025, encouraging rail operators' cooperation with ports and maritime transport, and implementation of the container transport regulation aimed at retaining rail dominance over this segment (at the expense of road transport). As far as RZD are concerned, the group receives subsidies and grants from the federal and regional governments for compensation of the effects of tariff regulation, for capital repairs, acquisition of assets and others.[1043,1044] In 2017, it received RUB 69 billion (USD 1 billion) in the form of charter capital contributions (including contributions in the form of real estate owned by the Government) and RUB 48 billion (USD 0.71 billion) of subsidies.[1045]

In addition to the domestic transport rules and tariffs, RZD signed tariff agreements with railway companies from CIS countries and with the International Rail Transit Tariff participants.[1046] The domestic tariffs charged by private operators and operating RZD subsidiaries are not regulated and are determined by market forces. This unregulated segment is perceived by market participants as highly competitive.

11.3.2 ROAD TRANSPORTATION TARIFFS

Transport companies set autonomously the rates they charge for road transport. The road freight transport rate for one ton/kilometre depends on many factors: region, distance, direction (one-way or return), load, type of carrier, truck brand (Russian or foreign), special requirements (cooling, security), size of the service provider, type of contract (short/long term), applied taxes and charges, insurances etc. Usually the companies set tariffs for longer periods, around two years; however, they can quickly be adapted to changing economic conditions. One of the key elements of transportation pricing is the cost of fuel (petroleum fuels are responsible for over 90% of total fuel

[1043] Government Decision N.º 844 of 17 October 2011 "*on Establishing a Preferential Tariff for Public Rail Infrastructure Services and Approval of Rules for Granting Subsidies from the Federal Budget to Russian Railways […]*" ("Об установлении льготного исключительного тарифа на услуги по использованию инфраструктуры железнодорожного транспорта общего пользования и утверждении Правил предоставления субсидий из федерального бюджета открытому акционерному обществу Российские железные дороги" (…)), available at: http://pravo.gov.ru/proxy/ips/?doc_itself=&nd=102151146&page=1&rdk=10#I0, accessed on 7 April 2019.

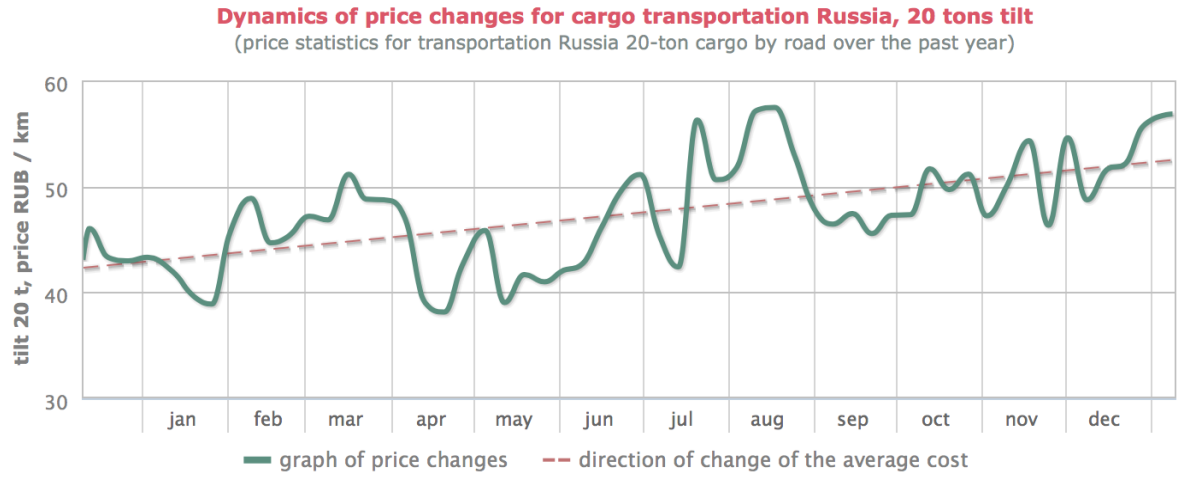
[1044] Russian Railways (2018), *2017 Consolidated Financial Statement Prepared in Accordance with IFRS*, available at: http://eng.rzd.ru/dbmm/download?vp=49&load=y&col_id=121&id=16550, accessed on 8 January 2019.

[1045] Russian Railways, *Condensed Annual Report 2017*, p. 25, available at: https://ar2017.rzd.ru/en#development-strategy, accessed on 29 January 2019.

[1046] Russian Railways, *Terms and Concepts*, available at: http://eng.rzd.ru/statice/public/en?STRUCTURE_ID=4323, accessed on 7 April 2019.

consumption, with very little use of compressed natural gas). It amounts to around 35–40% of the total rate.[1047] However, the price of fuel amounts to only about half of the fuel price in the EU.

Figure 11.4: Examples of price changes for cargo transportation in Russia (20 tons tilt) in 2018



Source: Della.[1048]

Russian auto carriers and foreign companies operating in the local market are expected to increase their tariffs, which are still much lower than in the EU market. A number of obligations such as taxes and fees (the Platon system helps in implementation of higher fines aiming at better market supervision and exclusion of illegal practices), technical requirements (the GLONASS navigation system), professional criteria, and administrative requirements (implementation of the national registry of carriers, hence probably a limitation of competition), are expected to increase truck cargo companies' costs by 10–15%[1049] which, as a consequence, will be translated into higher tariffs. Nonetheless, the difference between the higher EU and lower Russian tariffs,[1050] together with the expected development of logistics (and intermodal cooperation), simplified legal cargo procedures in day-to-day operations and digitalisation of the segment are expected to keep Russia's road tariffs at a competitive level. This can allow an increase in the export of Russian transportation services to the EU.

11.4 CHAPTER SUMMARY

[1047] Vedomosti, *Rail and road carriers compete for cargo* (Железная дорога и автоперевозчики конкурируют за грузы), available at: https://www.vedomosti.ru/business/articles/2014/12/02/rzhd-teryaet-klientov, accessed on 5 January 2019.

[1048] Della, *Transportation prices*, available at: https://www.della-ru.com/price/local/, accessed on 2 January 2019.

[1049] Russian Container Company, *Regulation of trucking in Russia increases the cost of delivery*, available at: https://ruscont.com/en/2018/07/30/regulation-of-road-freight-increases-the-cost-of-delivery/, accessed on 28 June 2019.

[1050] *Ibidem*.

It is difficult to make a comparison of the transportation costs and tariffs between Russia and other countries due to the lack of sufficient data and the specifics of the Russian economy, such as the large territory, long distances, abundance of energy resources, etc. It is easier to observe the growing competition between rail and road transportation in Russia. Until recently, it was considered that road transport can compete with rail transport only on distances up to 1 000 km. However, increases in rail tariffs make longer road shipments commercially viable, with, especially, road container transport (up to 2 500 km) and road non-bulk cargo (food, machinery up to 1 500 km) transport now competitive with rail. The average transportation distance for one ton of cargo per mode of transport in 2017 amounted to 1 977 km for rail, 46 km for road transport and 675 km for inland water transport.[1051] Hence, the main and crucial task for the Government is not regulating inter-segment competition, but the creation of synergies between modes of transport through implementation of strategic policies such as the Executive Order on National Goals and Strategic Objectives. The emerging logistics market is foreseen as one of the tools for better sector coordination – in 2018 Russia was ranked 75 out of 160 countries (against 99 out of 160 in 2016) in the World Bank's Logistics Performance Index.[1052]

Nonetheless, the development of railway transportation and regulation of competition in this market is, largely, in hands of the Government. The intervention of the Government seems to go beyond the regulation that is necessary because of the status of RZD as a natural monopoly. There is subsidisation to compensate the losses from regulated freight tariffs but also other non-market parameters (such as the below-inflation cap) influence the determination of railway freight tariffs. It can lead to a decrease of the share of rail transportation costs in the total price of goods transported on the railway. Additional price discounts that are being applied to certain types of goods from specific locations suggest the existence of even lower pricing margins and support for other industries at the expense of RZD (financed partially from the federal budget). Therefore, it seems that the under-pricing of transportation costs by regulated and subsidised railways tariffs creates an advantage for some industries. There are no similar distortions in the road transportation segment.

[1051] EY (2018), *Overview of the freight industry in Russia in 2018*, p. 8.

[1052] World Bank, *Logistics Performance Index*, available at: https://lpi.worldbank.org/international/global, accessed on 31 January 2019.

Annex 11.1. - Main regulations related to transport (this list is not exhaustive)

Strategies and programmes

- Programme for Development of small and medium-size enterprises in the field of transport (*Программа Развитие малого и среднего предпринимательства в сфере транспорта*);[1053]
- Programme for Development of Transport System for 2010-2020 (*Программа Развитие транспортной системы России (2010 - 2020 годы)*);[1054]
- Long Term Development Programme for Russian Railways until 2025 (*Долгосрочная программа развития открытого акционерного общества "Российские железные дороги до 2025 года"*);[1055]
- Railway structural reform programme (*Программа структурной реформы на железнодорожном транспорте*);[1056]
- Strategy for development of railway transport in the Russian Federation until 2030 (*Стратегия развития железнодорожного транспорта в Российской Федерации до 2030 года*);[1057]
- Programme of the Russian Federation "Development of the transport system" (*Программа Российской Федерации "Развитие транспортной системы"*);[1058]
- Transport strategy of the Russian Federation for the period up to 2030 (*Транспортная стратегия российской федерации на период до 2030 года*).[1059]

Laws and Codes

- Air Code of the Russian Federation (*Воздушный кодекс Российской Федерации*);[1060]
- Civil Code, Chapter 41;[1061]
- Code of Inland Water Transport of the Russian Federation (*Кодекс внутреннего водного транспорта Российской Федерации*);[1062]
- Customs Code of the Russian Federation (*Таможенный кодекс Российской Федерации*) and since 2017 Customs code of the Eurasian economic Union (*Таможенный кодекс Евразийского экономического союза*);[1063]

[1053] Available at: https://www.mintrans.ru/documents/7/500?type=7, accessed on 17 March 2020.
[1054] Available at: http://www.roszeldor.ru/feder_programms_razv_transport, accessed on 17 March 2020.
[1055] Available at: file:///C:/Users/sochmpe/annex%2011.1/dokument%203.pdf, accessed on 17 March 2020.
[1056] Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102071110, accessed on 17 March 2020.
[1057] See section 11.2.1.
[1058] Available at: http://government.ru/rugovclassifier/841/events/, accessed on 17 March 2020.
[1059] See section 11.1.1.
[1060] Available at: http://kremlin.ru/acts/bank/10705/page/1, accessed on 8 December 2019.
[1061] Chapter 41 - Transport Expedition (*Глава 41 - Транспортная экспедиция*).
[1062] Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102069974, accessed on 8 December 2019.
[1063] Available at: http://www.consultant.ru/document/cons_doc_LAW_624/ and since 2017 http://www.consultant.ru/document/cons_doc_LAW_215315/, accessed on 8 December 2019.

- Merchant Shipping Code of the Russian Federation (*Кодекс торгового мореплавания Российской Федерации*);[1064]
- Tax Code;[1065]
- Charter of railway transport of the Russian Federation (*Устав железнодорожного транспорта Российской Федерации*);[1066]
- Federal Law of 11 June 2003 on Freight Forwarding Activities (*Федеральный закон о транспортно-экспедиционной деятельности*);[1067]
- Federal Law of 27 December 2020 on Railway Transport in the Russian Federation (*Федеральный закон О железнодорожном транспорте в Российской Федерации*);[1068]
- Law on Natural Monopolies;[1069]
- Federal Law of 15 November 1995 on Road Safety (*Федеральный закон о безопасности дорожного движения*);[1070]
- Federal Law of 26 October 2007 on the Charter of road transport and urban land electric transport (*Федеральный Закон "Устав автомобильного транспорта и городского наземного электрического транспорта"*);[1071]
- Presidential Decree on National Goals and Strategic Objectives of the Russian Federation to 2024 (*Указ О национальных целях и стратегических задачах развития Российской Федерации на период до 2024 года*);[1072]

1064 Available at: http://www.consultant.ru/document/cons_doc_LAW_22916/, accessed on 8 December 2019.
1065 See Section 4.6.3.
1066 Available at: http://www.consultant.ru/cons/cgi/online.cgi?req=doc&base=LAW&n=322882&fld=134&dst=1000000001,0&rnd=0.3466173979674738#042992811489686033, accessed on 17 March 2020.
1067 Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102082415&intelsearch=%D4%E5%E4%E5%F0%E0%EB%FC%ED%FB%E9+%E7%E0%EA%EE%ED+%EE+%F2%F0%E0%ED%F1%EF%EE%F0%F2%ED%EE-%FD%EA%F1%EF%E5%E4%E8%F6%E8%EE%ED%ED%EE%E9+%E4%E5%FF%F2%E5%EB%FC%ED%EE%F1%F2%E8, accessed on 8 December 2019.
1068 Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102079677, accessed on 17 March 2020.
1069 See Section 10.2.2.1.
1070 Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102038671&intelsearch=%EE+%E1%E5%E7%EE%EF%E0%F1%ED%EE%F1%F2%E8+%E4%EE%F0%EE%E6%ED%EE%E3%EE+%E4%E2%E8%E6%E5%ED%E8%FF, accessed on 8 December 2019.
1071 Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102117867&intelsearch=+%D3%F1%F2%E0%E2+%E0%E2%F2%EE%EC%EE%E1%E8%EB%FC%ED%EE%E3%EE+%F2%F0%E0%ED%F1%EF%EE%F0%F2%E0+%E8+%E3%EE%F0%EE%E4%F1%EA%EE%E3%EE+%ED%E0%E7%E5%EC%ED%EE%E3%EE+%FD%EB%E5%EA%F2%F0%E8%F7%E5%F1%EA%EE%E3%EE+%F2%F0%E0%ED%F1%EF%EE%F0%F2%E0, accessed on 8 December 2019
1072 Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102468157&intelsearch=%CE+%ED%E0%F6%E8%EE%ED%E0%EB%FC%ED%FB%F5+%F6%E5%EB%FF%F5+%E8+%F1%F2%F0%E0%F2%E5%E3%E8%F7%E5%F1%EA%E8%F5+%E7%E0%E4%E0%F7%E0%F5+%F0%E0%E7%E2%E8%F2%E8%FF+%D0%EE%F1

– Government Decree No. 272 of 15 April 2011 on Approval of the Rules for the Road Freight Transport (*Постановление Об утверждении Правил перевозок грузов автомобильным транспортом*);[1073]
– FAS Order No. 1482 of 30 October 2018 on the Indexation of Tariff Rates, Fees and Charges for the Transportation of Goods and Services for the Use of Infrastructure for the Transport of Goods Performed (rendered) by Russian Railways OJSC (*Приказ Федеральной антимонопольной службы от 30.10.2018 г. № 1482/18 "О внесении изменений в приказ ФАС России от 10 декабря 2015 года № 1226/15 "Об индексации ставок тарифов, сборов и платы за перевозку грузов и услуги по использованию инфраструктуры при перевозках грузов, выполняемые (оказываемые) ОАО "Российские железные дороги"*);[1074]
- Federal Tariff Service Resolution on Approval of the Price List No. 10-01 - Tariffs for Transportation of Goods and Infrastructure Services Performed by Russian Railways (*Тарифы на перевозки грузов и услуги инфраструктуры, выполняемые российскими железными дорогами*).[1075]

%F1%E8%E9%F1%EA%EE%E9+%D4%E5%E4%E5%F0%E0%F6%E8%E8+%ED%E0+%EF%E5%F0%E8%EE%E4+%E4%EE+2024+%E3%EE%E4%E0, accessed on 8 December 2019.

[1073] Available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102146898&intelsearch=%CE%E1+%F3%F2%E2%E5%F0%E6%E4%E5%ED%E8%E8+%CF%F0%E0%E2%E8%EB+%EF%E5%F0%E5%E2%EE%E7%EE%EA+%E3%F0%F3%E7%EE%E2+%E0%E2%F2%EE%EC%EE%E1%E8%EB%FC%ED%FB%EC+%F2%F0%E0%ED%F1%EF%EE%F0%F2%EE%EC, accessed on 8 December 2019.

[1074] Available at: https://cdnimg.rg.ru/pril/162/56/69/52775.pdf, accessed on 17 March 2020.

[1075] See Section 11.3.1.

12 RAW MATERIALS AND OTHER MATERIAL INPUTS

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12.1 INTRODUCTION

Raw materials can be classified into several basic groups. For example, the OECD, which developed an inventory of export restrictions, categorised raw materials into minerals, metals, wood, and primary agricultural products. This chapter covers non-ferrous metals (except for aluminium and iron), wood-based products, and primary agricultural commodities. Other raw materials are analysed in other parts of this report (see in particular Chapters 14 and 15).

Russia's territory is abundant in natural resources. The country possesses around 25% of the world's forest area, it ranks first in proven reserves of nickel and wolfram, and has the third largest copper, cobalt, zinc and molybdenum reserves. Russia also has 17% of globally proved reserves of rare metals and rare earth metals. Russia ranks first in the world for exports of nickel, chrome and aluminium, and holds second and third place for global exports of titanium products, fourth place for the world's copper exports, and seventh place for exports of lead. There are vast reserves of palladium (platinum group metal) in Russia and the country is currently the biggest producer of this critical raw material (′CRM′) and one of four key exporters of palladium. Eight percent of the EU's palladium demand is supplied by Russia. Russia is also a substantial global producer of scandium (26% vs. China 66%), tungsten (4% vs. China 84%) and vanadium (20% vs. China 53% and South Africa 25%). Therefore, Russia remains one of the main suppliers of raw materials, including those which are crucial for the sustainable functioning of an economy and are considered as CRMs, to the world market and to the EU.[1076] Along with China, South Africa, and the US, Russia is one of the key countries in the CRMs category.

In this regard, market-distorting measures (state support and interventions, export restrictions) may first cause supply shortages, price volatility and impact industries and consumers around the world, including the EU. Second, these can create an unfair competitive advantage for Russia's domestic consumers of raw materials, as they might lower the prices of these materials on the Russian domestic market.

Russia depends heavily on exports of raw materials, e.g. the share of exports in the total output of non-ferrous metals amounts to 85%, for nickel it reaches 97%, and for copper accounts for 72%. Export taxes on raw materials are an essential source of federal budget revenues. However, in recent years, Russia has made efforts to diversify away from a commodity-oriented economy. This also applies to the raw materials sector. For example, in non-ferrous metallurgy, Russia specialises

[1076] The European Commission included Russia on the 2017 list of CRMs for the EU as a main importer of such materials as cobalt, scandium, and vanadium. In the EU imports of these materials, Russia's share accounted for 91%, 67%, and 67% respectively (average 2010–2014), European Commission (2017), *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the 2017 List of Critical Raw Materials for the EU*,Brussels, COM(2017) 490 final, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0490&from=EN, accessed on 30 October 2019.

in the processing of concentrates into primary metals that are subsequently exported. By contrast, in 2014-2017, the share of goods with high added value in total output amounted only to 20%. As a consequence, Russia has to import finished metal products for domestic consumption (e.g. in 2017 imported aluminium and cooper products accounted for up to 30% in domestic consumption).[1077] The share of non-ferrous metallurgical products s in the country's GDP is about 2.3%, accounting for 3.8% of industrial production and 3.6% of exports. Yet, the Government aims to further increase the contribution of this sector to the economy by expanding domestic demand and stimulating import substitution.

The situation in the timber industry is similar. The level of income from one hectare of exploited forests in Russia is 10–15 times lower than in such countries as Finland, Sweden, and the US. According to the Ministry of Natural Resources, the economic effect of forest use per one hectare in Russia is USD 38, while in Sweden and Finland it is USD 508 and 512, respectively (with comparable forest conditions and forest characteristics).[1078] The contribution of the timber industry to Russia's GDP is around 0.5–0.7%. The Government's aim is to double this in the coming years and to decrease the share of exports of unprocessed timber in total logging.

To achieve these goals and increase the competitiveness of its raw material industries, the Government has set up a framework to provide substantial support in various forms, e.g. subsidies, tax reductions and exemptions, export restrictions to specific sectors and enterprises. Therefore, the objective of this chapter is to analyse Russia's legal regulations that have been in place since 2013 in the raw material sector, to take Stock of state support provisions envisaged in legislation, and to assess them against their possible market-distorting nature.

12.2 STRATEGIC PLANNING DOCUMENTS FOR RAW MATERIALS

12.2.1 OVERVIEW OF STRATEGIC PLANNING DOCUMENTS

There are a number of economy-wide and sector-specific policy documents that include provisions and statements relevant to raw materials. Russian State programmes not only set the objectives for developing various economic sectors, including those related to raw materials. They also envisage economic policy measures that should be used for achieving the goals contained therein and determine the required resources, e.g. funding. Strategic planning documents directly or indirectly guide the development and adoption of future legislation and specific support measures, such as subsidies, concessionary interest rates, preferential tax regimes, tax reductions, tax holidays, capital investments, etc. for specific sectors and enterprises. These measures aim at stimulating

[1077] Russian non-ferrous metallurgy is promised a bright future (Российской цветной металлургии обещают светлое будущее Металлургический бюллетень. Информационное агентство) (2017), Metallurgical Bulletin. Information Agency metaltorg.ru, available at: https://www.metaltorg.ru/analytics/publication/?id=4321, accessed on 30 October 2019.

[1078] Nikolay Dorofeev (2017), Николай Дорофеев (2017), *Where the Russian round timber is heading* (*Куда катится российский кругляк*, Парламентская газета), *Parliamentary newspaper*, available at: https://www.pnp.ru/economics/kuda-katitsya-rossiyskiy-kruglyak.html, accessed on 8 January 2019.

additional production of raw materials, increasing the share of domestic products in total consumption, reducing capital costs and increasing investment, as well as changing the structure of output towards products with higher added value.

State programmes are developed in accordance with the Federal Law No. 172-FZ of 28 June 2014 on Strategic Planning in the Russian Federation.[1079] This law determines the need for the preparation of strategic planning documents for goal-setting, forecasting, planning and programming at federal level, at the level of the constituent entities of the Russian Federation, and at the level of municipalities. The strategic planning documents relevant for raw materials are as follows:

- The Forecast of Socio-Economic Development of the Russian Federation for 2018, and planning periods 2019–2020[1080] (adopted on 27 October 2017) and the Forecast of Socio-Economic Development of Russian Federation until 2024 (adopted on 21 September 2018);[1081]
- The State Programme on Development of Industry and Increasing its Competitiveness;[1082]
- The Plan for the Promotion of Import Substitution in Industry approved by the Governmetn Order No. 1936-r of 30 September 2014 (see Section 6.4); pursuant to this plan, federal executive bodies drew up industry-specific action plans for import substitution in 20 industries, including the non-ferrous metallurgy and timber sectors;
- The Strategy for the Russian Federation Timber Industry Development until 2030[1083] (adopted on 24 September 2018);
- The Strategy for the Russian Federation Non-Ferrous Metallurgy Development for 2014–2020 and up to 2030;[1084]

[1079] Federal Law N.º 172-FZ of 28 June 2014 "*on Strategic Planning in the Russian Federation*" (with amendments and additions) (*Федеральный закон от 28 июня 2014 г. N 172-ФЗ "О стратегическом планировании в Российской Федерации" (с изменениями и дополнениями)*), available at: http://base.garant.ru/70684666/, accessed on 30 October 2019.

[1080] The Forecast of Socio-Economic Development of the Russian Federation for 2018, and planning periods 2019–2020 (Прогноз социально-экономического развития Российской Федерации на 2018 год и на плановый период 2019 и 2020 годов), available at: http://legalacts.ru/doc/prognoz-sotsialno-ekonomicheskogo-razvitija-rossiiskoi-federatsii-na-2018-god-i/, accessed on 30 October 2019.

[1081] The Forecast of Socio-Economic Development of Russian Federation until 2024 (Прогноз социально-экономического развития Российской Федерации на период до 2024 года), available at: http://economy.gov.ru/minec/activity/sections/macro/201801101, accessed on 30 October 2019.

[1082] Government Resolution N.º 328 of 15 April 2014 "*on Approval of the State Program of the Russian Federation The development of Industry and Increase its Competitiveness*", available at: http://base.garant.ru/70643464/c97cd9b59d97ee89f8842c374b081d6f/#block_45, accessed on 30 October 2019. Subsequent changes were made on 31 March 2017, 10 February, 30 March, 1 October and 14 December 2018, as well as 29 March 2019.

[1083] Government Resolution N.º 1989 of 20 September 2018 "*Strategy for the Timber Industry Development until 2030"* (Стратегии развития лесного комплекса до 2030 года), available at: http://government.ru/docs/34064/, accessed on 30 October 2019.

[1084] Strategy of development of non-ferrous metallurgy in Russia for 2014–2020 and perspectives until 2030, approved by the Order of the Ministry of Industry and Trade N.º 839 of 5 May 2014 (Стратегия развития цветной металлургии России на 2014 - 2020 годы и на перспективу до 2030 года (утв. приказом Министерства промышленности и торговли РФ от 5 мая 2014 г. № 839)), available at: https://www.garant.ru/products/ipo/prime/doc/70595824/, accessed on 14 November 2019.

– The Strategy for The Development of the Mineral Resource Base of Russia until 2035 (adopted on 22 December 2018).

As of drafting this Report, a Strategy for Russia's metallurgical industry development until 2030 was also in preparation.

12.2.2 SOCIO-ECONOMIC AND INDUSTRIAL DEVELOPMENT PROGRAMMES

12.2.2.1 THE FORECAST OF SOCIO-ECONOMIC DEVELOPMENT OF THE RUSSIAN FEDERATION FOR 2018, AND PLANNING PERIODS 2019–2020 AND THE FORECAST OF SOCIO-ECONOMIC DEVELOPMENT OF RUSSIAN FEDERATION UNTIL 2024

The two forecasts describe characteristics of the non-ferrous metallurgy industry, the timber industry, and other non-metal mineral industries. They also describe challenges to the development of these industries and provide key projection indicators (production growth rates of main non-ferrous metals, and timber industry products). The Forecast of Socio-Economic Development until 2024 indicates that in 2018 the rise in output of non-ferrous metallurgy was mainly attributed to the production of such primary metals as copper, lead, zinc, magnesium, cobalt and titanium while output of high added value products was substantially reduced. The forecast states the necessity to pursue an active investment policy in the mid-term period in order to develop the raw materials base and conduct deep modernisation of this sector. For example, it envisages finalising the modernisation of the mining and metallurgical company Norilsk Nickel, creating processing enterprises in the special economic zone Titanium Valley, and conducting technical re-equipment of plants for the processing of non-ferrous metals and the further development of non-ferrous metals deposits. In the case of the timber industry, one of the primary objectives is to increase the share of higher value-added products in total output.

12.2.2.2 THE STATE PROGRAMME ON DEVELOPMENT OF INDUSTRY AND ICREASING ITS COMPETITIVENESS

The programme was adopted in 2014 and initially comprised 21 sub-programmes, including those focused on raw material development, and in particular rare metals and rare earth metals. In 2016, the first stage of implementation of the sub-programme on the Development of the industry of rare metals and rare earth metals of the State Programme on Development of Industry and Icreasing itsl Competitiveness was completed. The Ministry of Industry and Trade reported that in the period 2013–2016 budgetary funding for this sub-programme amounted to RUB 4.1 billion (EUR 70.4 million), and the extra-budgetary public funding accounted for RUB 4.6 billion (EUR 79 million).[1085]

[1085] Report on the goals and objectives of the Ministry of Industry and Trade of Russia for 2017 and key performance results for 2016 (Доклад о целях и задачах Минпромторга России на 2017 год и основных результатах деятельности за 2016 год), available at:

In 2017, the programme was amended, and the number of sub-programmes reduced to eight.[1086] The new version of the programme contains the sub-programme on the Development of the Production of Traditional and New Materials, which among the wide range of targets includes those aimed at:

- The creation of conditions for the growth of consumption of domestic metal products in the Russian market, as well as a competitive rare earth industry with a full technological cycle to meet the needs of the domestic defence industry, civil sector industries and with the specific aim to gain access to foreign markets;
- Increasing competitiveness of the timber industry by improving the investment climate and implementing investment projects;
- Increasing production and export of high-quality wood-paper products with high added value.

This sub-programme sets around 40 quantitative indicators[1087] to achieve objectives related to the development of production and exports of non-ferrous, composite and wood materials, of which 16 refer to rare metals and rare earth metals. In particular, it is envisaged that the production volume of rare metals (niobium, tantalum, germanium, gallium, iridium) and rare earth metals should be increased by 42.6% in 2020 in comparison to 2015.[1088] Specific indicators are set for the growth in production of refined unprocessed copper and unalloyed nickel production. The sub-programme also provides that funding should be allocated from the federal budget to achieve the desired objectives. In particular, it is envisaged that in the period 2013–2020, the budget allocations for this sub-programme would account for RUB 26.5 billion (EUR 423.3 million).[1089]

http://minpromtorg.gov.ru/common/upload/files/Minpromtorg_blok_15.03_final_for_web.pdf, accessed on 30 October 2019.

1086 Government Decree N.º 328 of 15 April 2014, as amended on 31 March 2107, "*on the Approval of the State Programme of the Russian Federation On Industrial Development and Improving Industrial Competitiveness*" (Постановление Правительства Российской Федерации от 15 апреля 2014 г. N 328 Об утверждении государственной программы Российской Федерации "Развитие промышленности и повышение ее конкурентоспособности"), available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102352828, accessed on 30 October 2019.

1087 E.g. output growth rates for nickel, copper, aluminium, rare metals and rare earth metals, the growth rate of investment in fixed assets, the share of imports in the total domestic consumption of critical rare earth metals, exports of metals (in USD million), the volume of goods produced and shipped, etc.

1088 Government Decree N.º 328 of 15 April 2014, as amended on 31 March 2107, Sub-programme 4.

1089 Government Decree N.º 368-15 of 30 March 2018 "*on Amendments to the State Programme of the Russian Federation 'On Industrial Development and Improving Industrial Competitiveness*", p.18 (Постановление Правительства Российской Федерации "О внесении изменений в государственную программу Российской Федерации "Развитие промышленности и повышение ее конкурентоспособности" от 30 марта 2018 г. No 368-15 с 18), available at: http://static.government.ru/media/files/IsdJAVb6jh5tA0MW2YI2DcKf5q7wBz51.pdf, accessed on 30 October 2019; Government Decree N.º 355-23 of 29 March 2019 "*on Amendments to the State Programme of the Russian Federation "On Industrial Development and Improving Industrial Competitiveness*" (Постановление Правительства Российской Федерации "О внесении изменений в государственную программу Российской Федерации "Развитие промышленности и повышение ее конкурентоспособности" от 29 марта 2019 г. No 355-23 с 18), available at: http://pravo.gov.ru/laws/acts/30/515353455051.html , accessed on 14 November 2019.

12.2.3 IMPORT SUBSTITUTION PLANS

Import substitution policies are implemented in the context of the larger import substitution strategy ancompassing several manufacturing and natural resources sectors (see also Section 6.4). Import substitution plans in non-ferrous metallurgy and timber[1090] until 2020 set quantitative targets for a decrease in the share of imports of ores, concentrates and alloys of non-ferrous metals for domestic consumption, and for the development of higher-value-added manufacturing with increased use of domestic materials, and a reduction in imports of specific products. Thus, the import substitution plan in non-ferrous metallurgy sets a target to decrease the share of imports in the consumption of tin and titanium ores from 80% and 95% respectively in 2018 to 20% and 50% in 2020, for tin and beryllium alloys this share should be decreased in 2018–2020 by 10 percentage points, and for rare earth metals the reduction should be from 90% to 50%.[1091] According to the import substitution plan in the timber industry, the share of imports in the consumption of cellulose should be decreased to 50% by 2020.

The Ministry of Industry and Trade developed a list of priority and critical products, services and software in terms of import substitution and national security. It contains more than 800 types of products, including raw materials, e.g. non-ferrous and rare earth metals, their main producers and justification of criticality (high share of imports, criticality from the point of view of national security, in terms of the influence on the development of other industries, and the economy as a whole). This list served as a basis for developing import substitution plans.[1092]

The Government also created a body named the Government Commission on Import Substitution to ensure the coordinated actions of all authorities (see Section 6.4) in order to implement the state policy in the field of import substitution and Russia also adopted support measures, including the provision of subsidies from the federal budget. These measures can be grouped into several broad categories:

– Subsidising interest on loans (Government Decree No. 3 of 3 January 2014);[1093]

[1090] Order of the Ministry of Industry and Trade of 31 March 2015 "*on Approval of the Plan of Measures for Import substitution in the timber industry of the Russian Federation*" ("Приказ Министерства промышленности и торговли Российской Федерации от 31 марта 2015 г. Об утверждении плана мероприятий по импортозамещению в лесопромышленном комплексе Российской Федерации"), available at: http://minpromtorg.gov.ru/common/upload/o_data/addition_material//657.pdf, accessed on 14 November 2019.

[1091] Order N.º1665 of 25 April 2018 "*on Approving the Plan of Measures for Import Substitution in the Non-Ferrous Metallurgy Industry of the Russian Federation*", (Приказ от 25 апреля 2018 г. N 1665 Об утверждении плана мероприятий по импортозамещению в отрасли цветной металлургии Российской Федерации. С. 3.), p. 3, available at: http://minpromtorg.gov.ru/common/upload/o_data/addition_material//651_tsvet.met.pdf, accessed on 14 November 2019.

[1092] Manturov D.V., Nikitin G.S., Osmankov V.S, *Planning of import substitution in the Russian industry: the practice of Russian government*, Economic portal (Мантуров Д.В., Никитин Г.С., Осьманков В.С. Планирование импортозамещения в российской промышленности: практика российского государственного управления. Экономический портал), available at: http://institutiones.com/industry/2888-planirovanie-importozamescheniya-rossiiskoi-promyshlennosti.html, accessed on 14 November 2019.

[1093] Government Decree N.º 3 of 3 January 2014 "*on Approval of the Rules for the Provision of Subsidies from the Federal Budget to Russian Organizations for the Reimbursement of Part of the Cost of Paying Interest on Loans*

– Subsidising part or the total of the R&D costs (Government Decree N.º1312 of 30 December 2013).[1094] According to the decree up to 100% of the R&D costs of a project can be subsidised;
– Financing through development institutions (preferential loans from the Industrial Development Fund (′IDF′));[1095]
– Special investment contracts (′SPICs′) (Government Decree N.º 708 of 16 July 2015).[1096]

In 2015, the Ministry of Economic Development announced that 14 projects in non-ferrous metallurgy would be supported by the Government in the framework of the import substitution plan.[1097]

12.2.4 SPECIFIC SECTORAL PLANNING OR STRATEGIES

12.2.4.1 STRATEGIES FOR NON-FERROUS METALLURGY DEVELOPMENT

The Strategy for the Russian Federation Non-Ferrous Metallurgy Development for 2014– 2020 and up to 2030 analyses the situation in the market of non-ferrous metals (copper, lead, zinc, nickel,

received in 2014 - 2019 by Russian Credit Organizations and the State Corporation Bank for Development and Foreign Economic Affairs [Vnesheconombank], as well as in International Financial Organizations established in Accordance with International Treaties in which the Russian Federation is involved in the Implementation of integrated Investment Projects in Priority Areas of the Civil Industry and [or] the Payment of Coupon Income on Bonds issued in 2014 - 2019 as part of the Implementation of Integrated Investment Projects in Priority Areas of Civil Industry" (Постановление Правительства Российской Федерации от 3 января 2014 г. №3. Об утверждении Правил предоставления субсидий из федерального бюджета российским организациям на возмещение части затрат на уплату процентов по кредитам, полученным в 2014 - 2019 годах российских кредитных организациях и государственной корпорации "Банк развития и внешнеэкономической деятельност (Внешэкономбанк)", а также в международных финансовых организациях, созданных в соответствии с международными договорами, в которых участвует Российская Федерация, на реализацию комплексных инвестиционных проектов по приоритетным направлениям гражданской промышленности и (или) выплату купонного дохода по облигациям выпущенным в 2014 - 2019 годах в рамках реализации комплексных инвестиционных проектов по приоритетным направлениям гражданской промышленности), available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102170582&rdk=&backlink=1, accessed on 14 November 2019.

1094 Government Decree N.º1312 of 30 December 2013 "*on Approval of the Rules for Granting Subsidies from the Federal Budget to Russian organisations for Reimbursement of Part of the Costs of Research and Development in Priority Areas of the Civil Industry as Part of the Implementation of Investment Projects…*" (Постановление Правительства Российской Федерации от 30 декабря 2013 г. No 1312 Об утверждении Правил предоставления субсидий из федерального бюджета российским организациям на компенсацию части затрат на проведение научно-исследовательских и опытно-конструкторских работ по приоритетным направлениям гражданской промышленности …), available at: http://static.government.ru/media/files/41d4b3fc59636e3722d2.pdf, accessed on 14 November 2019.

1095 Industry Development Fund: Development Projects Programme (Фонд Развития Промышленности: Программа "Проекты развития), available at: http://frprf.ru/zaymy/proekty-razvitiya/, accessed on 14 November 2019.

1096 Government Decree N.º 708 of 16 July 2015 "*on Special Investment Contracts for Individual Industries*" (as amended) (Постановление Правительства РФ от 16 июля 2015 г. N 708 "О специальных инвестиционных контрактах для отдельных отраслей промышленности" (с изменениями и дополнениями)), available at: http://base.garant.ru/71137900/, accessed on 14 November 2019.

1097 Akhmadiev, E., (2015), *A third of the metallurgists' investment projects will receive state support*, *Izvestiya* (Господдержку получат треть инвестпроектов металлургов, Известия), available at: https://iz.ru/news/588342, accessed on 14 November 2019.

tin, molybdenum, tungsten, antimony, zirconium, rhenium, mercury, rare earth metals) in Russia and abroad, gives an account of the main challenges facing this sector, and provides the Government's guidance and planning elements regarding this sector. It also contains a production and consumption forecast for the main non-ferrous metals, including rare earth metals, and development projections for the main socio-economic indicators of this sector until 2020 and 2030, respectively.

According to the Strategy, competitiveness of non-ferrous metallurgy should be improved by:

- The creation of reserves of non-ferrous metals;[1098]
- An increase in the share of consumption of non-ferrous metals produced by Russian metallurgical companies on the domestic market;
- An increase in export efficiency.

However, according to the Strategy, there are several factors that negatively impact the development of this sector, most of all the geographical location of a number of metallurgical enterprises (the Urals, Siberia), and the long distances between mining and processing enterprises, both of which complicate export logistics.

In addition, the Strategy states that the level of state support provided through electricity and freight transportation tariffs is low. Therefore, due to the high costs associated with tariffs and services of natural monopolies the competitiveness of Russia's metallurgical companies producing non-ferrous metals on the world market will decline, and if world prices are low, exports will become low-profit and even unprofitable.

The Strategy emphasises, therefore, the need to provide comprehensive governmental support measures to increase the competitiveness of non-ferrous metallurgy and to implement investment projects. These measures entail:[1099]

- Provision of state support for implementation of investment projects;
- Provision of state guarantees (for debt refinancing) for loans obtained from foreign companies;
- Stimulation of restructuring of inefficient mining and processing plants, and co-financing the conservation of metallurgical enterprises at the expense of the federal and regional budgets;
- Purchasing of non-ferrous metals for state reserves;
- State co-financing of R&D;
- Development of production of non-ferrous metals with higher added value.

12.2.4.2 STRATEGY FOR DEVELOPMENT OF THE TIMBER INDUSTRY

[1098] The creation of reserves for aluminium, nickel and copper has been considered. However, the Government decided to only create reserves for aluminium. In accordance with the Government Order N.º 2582-p of 26 November 2018, RUB 10 billion were allocated from the Government's reserve fund to the Federal Agency for State Reserves for the purchase of up to 50 000 tons of aluminium, available at: http://publication.pravo.gov.ru/Document/View/0001201811280003, accessed on 14 November 2019.

[1099] For more details see Sections 12.3.1, 12.3.2, and 12.5.

The Strategy for the Timber Industry Development until 2030 (′Timber Strategy′) sets an extensive range of indicators for the development of Russia's timber industry until 2030. It points out that Russian timber is potentially underutilised because domestic companies tend to produce mainly low-value-added goods, such as roundwood, lumber, and plywood. According to the Timber Strategy, the support of projects geared towards the development of higher value-added activities is therefore indispensable for achieving the development objectives of this sector. The priorities for the timber sector include expansion of export-oriented pulp manufacturing, the growth of cardboard production for the domestic market, and manufacturing sawn wood, as well as plywood-slab (equally oriented to domestic and export markets). Development of private enterprises that produce engineered wood is also envisaged in the Timber Strategy. Such businesses, if necessary, will be supported by the State with specific measures.

To achieve its objectives, the Timber Strategy envisages the following support mechanisms:
- Supporting investment projects of processing companies;
- Stimulating the demand and the development of markets for timber products, in particular sawn timber;
- Ensuring the availability of the existing raw materials base;
- Implementation of import substitution plans.

The Timber Strategy stipulates that the development of processing industries will be promoted via existing state support measures and additional actions proposed by the strategy for the implementation of investment projects, including support from the federal budget (see Section 12.3).

12.3 INDUSTRY SUPPORT MEASURES

As previously mentioned, Russia's strategic planning documents can be followed up by legislation and implementation of economic policy measures, including forms of state support, to attain the objectives and carry out the tasks set by these documents. The goal of such measures is to support investment projects, stimulate import substitution and exports, as well as to improve the financial performance of key industrial enterprises. They can have as effect a reduction of production costs, and in particular the cost of capital and the boosting of additional production and exports. The Ministry of Industry and Trade indicates that there are more than 600 measures that support industrial development in the country at federal and regional levels.[1100] These measures are either sector-specific or horizontal (targeted to different sectors of the economy). However, producers of raw materials in Russia can take advantage of both types of support.

[1100] Ministry of Industry and Trade, *In Russia, over 600 support measures for industrial development are being implemented* (В России реализуются свыше 600 мер поддержки на промышленное развитие), available at: http://minpromtorg.gov.ru/press-centre/news/#!v_rossii_realizuyutsya_svyshe_600_mer_podderzhki_na_promyshlennoe_razvitie, accessed on 30 October 2019.

12.3.1 HORIZONTAL SUPPORT MEASURES

In order to implement the objectives of the State Programme on Development of Industry and Increasing its Competitiveness (see Section 12.2.1), the Government adopted the Decree No. 3 of 3 January 2014 concerning subsidies from the federal budget to Russian organisations for reimbursement of a part of costs of paying interest on loans received in 2014–2019 (see Section 12.2.3). According to the Decree, subsidies should be provided for the implementation of complex investment projects in priority areas of civil industry and/or the payment of coupon income on bonds issued in 2014–2019 in order to implement complex investment projects in priority areas of civil industry. The priority areas are defined broadly within the framework of the State Programme on Development of Industry and Increasing its Competitiveness. Therefore, any industrial enterprise, including raw material producers, could in principle be eligible to receive a subsidy if the investment project aims to create a new enterprise or expand the production capacities of existing ones.

The Decree further stipulates that subsidies should be provided for the payment of interest on loans received from Russian credit institutions and Vnesheconombank (see Section 3.2.1), as well as from international financial organisations of which Russia is a member. However, subsidies also may be granted for the replenishment of working capital. The IDF is the governmental entity responsible for granting such type of subsidies.

The IDF is also responsible for the provision of state support in the form of concessional loans for up to seven years for import substitution and export-oriented projects. The base interest rate on an IDF loan is 5%, decreased to 3% if a company, which obtained lending, purchases Russian equipment, and to 1% if its value of exports exceeds 50% of the loan.[1101] This interest rate is much below that of the average commercial interest rate in Russia, which, for example, amounted to 12–13%, 11–12% and 8.5–9% in 2016, 2017 and 2018, respectively.[1102]

The Government also adopted Decree No. 214 of 12 March 2015[1103] concerning provision of subsidies to industrial enterprises on the payment of interest on working capital loans. This type

[1101] Industry Development Fund: Development Projects Programme.

[1102] Weighted average interest rates on loans provided by credit organisations to non-financial organisations in roubles, CBRF (Средневзвешенные процентные ставки по кредитам, предоставленным кредитными организациями нефинансовым организациям в рублях. Центральный банк Российской Федерации), available at: https://www.cbr.ru/statistics/pdko/int_rat/, accessed on 30 October 2019.

[1103] Government Decree N.º ºf 12 March 2015 "*on Approval of Rules of Providing Subsidies from the Federal Budget in 2015–2018 for Reimbursement of the Part of the Costs Incurred by Industrial Enterprises in 2015–2018 Yars on the Payment of the Interest on Working Capital Loans Obtained in Russian credit Organisations and the State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank), as well as from International Financial Organisations of which the Russian Federation is a member"* (Постановление Правительства РФ от 12.03.2015 N 214 (ред. от 27.06.2019) "Об утверждении Правил предоставления в 2015 - 2019 годах субсидий из федерального бюджета организациям промышленности для возмещения части затрат, понесенных в 2015 - 2019 годах на уплату процентов по кредитам, полученным в российских кредитных организациях и государственной корпорации "Банк развития и внешнеэкономической деятельности (Внешэкономбанк)", а также в международных финансовых

of subsidy has also been granted for financing current business activities. The state budget for 2015–2017 has made specific provision of RUB 6 billion (EUR 88 million) for this purpose.

This Decree was part of the anti-crisis plan and aimed at improving the financial situation of key industrial enterprises. In particular, companies which operate in the timber, pulp and paper and woodworking industries, the rare metals and rare earths industry, and which obtained loans in 2015 for a three-year term, are eligible for such subsidies. The Decree further specifies that enterprises, in order to be eligible, should also feature in the list of systemically important institutions, approved by the Government Commission on Economic Development and Integration, or the list of organisations that have a significant impact on industry and trade, approved by the Ministry of Industry and Trade. The Ministry of Industry and Trade noted that such support helped enterprises to reduce the costs of production, while increasing their output and, consequently, reducing sales prices for consumers.[1104]

Horizontal support measures also involve state support for R&D. Government Decree No. 1312/2013 of 30 December 2013 established the rules for granting subsidies from the federal budget to Russian organisations for the reimbursement of part of the costs of conducting R&D in priority industrial sectors, as part of the implementation of investment projects. The Ministry of Industry and Trade is responsible for granting the support. The Decree was adopted to ensure the implementation of the State Programme on Development of Industry and Increasing its Competitiveness (see box 12.1 for more details).

In 2017, the Government endowed the Russian Export Centre as the entity in charge of providing subsidies from the federal budget to Russian organisations for the compensation of part of their transportation costs under Government Decree No. 496 of 26 April 2017[1105] (see Box 12.1 for more details). The amount of the eligible subsidy is calculated on the basis of a formula.[1106]

Box 12.1: Horizontal support measures for non-ferrous metallurgy

организациях, созданных в соответствии с международными договорами, в которых участвует Российская Федерация, на пополнение оборотных средств), available at: http://rulaws.ru/goverment/Postanovlenie-Pravitelstva-RF-ot-12.03.2015-N-214/, accessed on 14 November 2019.

1104 *On the provision of subsidies to industry organisations for reimbursement of loans* (О предоставлении субсидий организациям промышленности на возмещение затрат по кредитам), available at: http://government.ru/docs/22752/, accessed on 30 October 2019.

1105 Government Decree N.º 496 of 26 April 2017 "o*n the Provision of Subsidies from the Federal Budget to Russian Organisations ... for Compensation of a Part of the Transportation Costs*" (Постановление Правительства Российской Федерации от 26 апреля 2017 г. № 496 О предоставлении субсидий из федерального бюджета российским организациям … на компенсацию части затрат на транспортировку продукции), http://static.government.ru/media/files/49LofXu2AL7w6l0BSDDsP8AiPRA19cf8.pdf, accessed on 30 October 2019.

1106 The total subsidy depends essentially on the number of transportation activities by mode, the related actual expenditures, a subsidization rate (of 0.8, 0.6 or 0.2) and is overall limited by maximum costs amounts. See pp. 3-4 of the Rules attached to Decree N.º 496/2017.

The Ministry of Industry and Trade reported that, in 2016, Government subsidies granted under the Decree No. 1312 of 30 December 2013) amounted to RUB 123.8 million (EUR 1.7 million). They were provided mainly to aluminium producers (LLC OK RUSAL ITC, LLC AGRISOVGAZ). In addition, Government support in the framework of the programmes of the IDF amounted to RUB 623 million (EUR 8.4 million).[1107] In particular, such support was provided to LLC "Lit", which has been working in the industrial casting of steel, iron, non-ferrous metals.

In 2017, state support to non-ferrous metallurgy within the framework of horizontal measures of government support (Decree No. 1312 of 30 December 2013, Decree No. 3 of 3 January 2014, Decree No. 496 of 26 April 2017) amounted to RUB 450.5 million (EUR 6.8 million). The subsidies were provided to eight companies, including PJSC Ruspolimet, which carries out production of nickel and titanium-based alloys, copper and aluminium alloys. State support was also granted in the framework of the programmes of the IDF to several enterprises, e.g. JSC "Zakamensk" (mining and processing of tungsten molybdenum ore) and LLC "Lit". This amounted to RUB 2 billion (EUR 30.3 million).[1108]

12.3.2 SECTOR SPECIFIC MEASURES OF SUPPORT

12.3.2.1 NON-FERROUS METALS

12.3.2.1.1 Compensation for interest rates on loans

One area of such support in the non-ferrous metallurgy sector focuses on the development of rare metals and rare earth metals. The Government issued a special Decree No. 42 of 21 January 2017[1109] which was elaborated and adopted under the sub-programme *Development of the production of traditional and new materials* of the State Programme on Development of Industry and Increasing its Competitiveness in order to stimulate investment activities of companies.

[1107] *Report on the goals and objectives of the Ministry of Industry and Trade of Russia for 2017 and key performance results for 2016*, p. 101 (Доклад о целях и задачах Минпромторга России на 2016 год и основных результатах деятельности за 2016 год. С. 101), available at: http://minpromtorg.gov.ru/common/upload/00-113_.pdf, accessed on 30 October 2019.

[1108] *Report on the goals and objectives of the Ministry of Industry and Trade of Russia for 2018 and key performance results for 201*, p. 87 (Министерство промышленности Российской Федерации (2018) Доклад о целях и задачах Минпромторга России на 2018 год и основных результатах деятельности за 2017 год. *С. 85*), available at: http://minpromtorg.gov.ru/common/upload/docVersions/5ad48d069014f/actual/Minpromtorg_press2.pdf, accessed on 30 October 2019.

[1109] Government Decree N.º 42 of 21 January 2017 "*on approval of the Rules for Granting Subsidies from the Federal Budget to Russian organisations for Compensation of Interest Rates on Investment Loans in the Production of Rare and Rare Earth Metals*" (Постановление Правительства РФ от 21 January 2014 N 42 (ред. от 29.06.2017) "Об утверждении Правил предоставления субсидий из федерального бюджета российским организациям на компенсацию процентных ставок по инвестиционным кредитам в сфере производства редких и редкоземельных металлов"), available at: http://pravo-mag.ru/pravitelstvo-rf/Postanovlenie-Pravitelstva-RF-ot-21.01.2014-N-42, accessed on 30 October 2019.

The subsidy amount that a company can obtain is calculated as follows (Article 9):

- For loans received in Russian roubles the amount equivalent to two-thirds of the interest paid in a billing period. However, the compensation for interest rates cannot exceed an amount calculated based on two-thirds of the established refinancing rate of the CBRF, effective on the date for interest payments on a loan;
- For loans received in foreign currency, a financial contribution is provided in Russian roubles and can compensate for two-thirds of the costs of paying the interest on a loan in a billing period at the exchange rate of the CBRF on the date of the repayment of the interest. The subsidy amount cannot exceed an amount calculated based on a rate equivalent to 4% per annum in the foreign currency.

Such subsidies should be provided if a company that produces rare metals and rare earth metals faces the following problems:

- Lack of affordable investment lending. In such a case, Government support can be provided in the form of a subsidy on the interest rate on investment loans, granting state guarantees, reimbursement of the costs for paying fees under guarantee contracts, and loans;
- Lack of working capital. Government support may consist of a subsidy of the interest rates on the creation of inter-seasonal stocks of raw materials, a subsidy for the purchase of consumables, raw materials and components, a subsidy for the cost of replenishing working capital and financing of current production activities;
- The Decree also defines the types of eligible investment expenses that can be financed by loans for which interest support can be obtained;
- Acquisition, construction, manufacture, delivery of fixed assets, including customs duties and customs fees, construction and commissioning, construction or reconstruction of industrial premises, as well as the purchase of equipment;
- Acquisition of land plots or the conclusion of long-term lease agreements for land plots for the creation of production capacity;
- Design, reconstruction, technical re-equipment and modernisation of fixed assets;
- Acquisition and creation of experimental industrial equipment;
- Acquisition and implementation of automation and operational management systems;
- Design and survey work, development of project documentation;
- Geological exploration, construction of facilities for the extraction, storage and processing of mineral raw materials, transportation and infrastructure, as well as other costs associated with the development of rare metals and rare earth metals within the framework of the project.

12.3.2.1.2 Tax Breaks

In November 2018, the Government proposed a law reducing the tax rate on mineral extraction for rare metals from 8% (average level for non-ferrous metals) to 4.8%. In February 2019, the State

Duma adopted it in the first reading.[1110] According to the Law, the tax reduction will be applied not only for lithium, rubidium, caesium, beryllium, strontium, cadmium and scandium, but also for such elements as yttrium, lanthanides, indium, thallium, gallium, germanium, zirconium, hafnium, vanadium, niobium, tantalum, bismuth, selenium, tellurium and rhenium.[1111]

Another sector-specific measure is the tax break on the extraction of tin. In accordance with the Federal Law of 27 November 2017 No 335-FZ on Amendments to Parts One and Two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation[1112] the zero rate of the extraction tax on marketable tin ores, which are mined in areas located fully or partially in the territory of the Far Eastern Federal District was extended until 31 December 2022.[1113]

12.3.2.2 TIMBER INDUSTRY

The timber industry in Russia has been undergoing changes driven by legal regulation at federal level, with the Ministry of Industry and Trade and the Ministry of Economic Development as key driving actors. The policy aim is to boost the development of the timber industry through increased exports of domestically processed wood products instead of exports of unprocessed timber. The Government thus also seeks positive effects on employment.[1114]

In 2014, the Government Decree No. 1319 of 5 December 2014[1115] was adopted as part of the State Programme on Development of Industry and Increasing its Competitiveness. The Decree stipulates that subsidies could cover the reimbursement of the following costs:

[1110] *The State Duma reduces the rate of mineral extraction tax on the extraction of ores of rare metals* (Госдума снижает ставку НДПИ на добычу руд редких металлов), available at: https://www.pnp.ru/economics/dlya-dobytchikov-litiya-rubidiya-i-stronciya-predusmotryat-lgoty.html, accessed on 30 October 2019.

[1111] Burmistrova, S., Mikheeva, A. (2018), *The Government Approved a Reduction in the Tax on the Extraction of Rare Metals*. RBC. 30 November 2018. (Светлана Бурмистрова, Анна Михеева (2018) В правительстве одобрили снижение налога на добычу редких металлов. РБК. 30 ноября 2018), available at: https://www.rbc.ru/business/30/11/2018/5bffc5299a794717a45de247, accessed on 30 October 2019.

[1112] Federal Law N.º 335-FZ of 27 November 2017 "*on Amendments to Parts One and Two of the Tax Code of the Russian Federation and certain legislative acts of the Russian Federation*" (Федеральный закон от 27 November 2017 No 335-ФЗ "о внесении изменений в части первую и вторую налогового Кодекса Российской Федерации и отдельные законодательные акты Российской Федерации"), available at: http://kremlin.ru/acts/bank/42522, accessed on 30 October 2019.

[1113] *Tin mining companies in the Far East will be given benefits – Goldstein* (Добывающим олово предприятиям Дальнего Востока предоставят льготы – Гольдштейн), available at: https://magadanmedia.ru/news/645906/, accessed on 30 October 2019.

[1114] Solntsev, A. (2017). *Only his processors will be able to export wood. Information Agency Railways Partner.ru* (Солнцев, А., (2017) Лес смогут вывозить за рубеж только его переработчики. Информационное агентство РЖД Партнер.ру), available at: http://www.rzd-partner.ru/logistics/news/les-smogut-vyvozit-za-rubezh-tolko-ego-pererabotchiki/, accessed on 30 October 2019.

[1115] Government Decree N.º 1319 of 5 December 2014 "*on the Approval of the Rules for the Provision of Subsidies from the Federal Budget to Russian Timber Processing Enterprises of the Far Eastern Federal District Participating in the Implementation of Priority Investment Projects in the Field of Forest Development, to reimburse Part of the Costs incurred in 2013-2014 for Implementation of such Projects*" (Постановление Правительства Российской Федерации от 5 декабря 2014 г. No 1319 Об утверждении Правил предоставления субсидий из федерального бюджета российским лесоперерабатывающим предприятиям Дальневосточного федерального округа, участвующим в реализации приоритетных инвестиционных

– Payments (except for the down payment) under equipment and vehicle leasing agreements, with the exception of passenger vehicles (50% of the amount of the actual costs incurred);
– Payment of the interest on loans received in credit institutions and in Vnesheconombank for the implementation of projects;
– Transportation by rail of harvested wood and finished products between stations in the Far East Federal District (90% of the total amount of the actual costs incurred);
– Payment of contracts for the provision of services for the delivery of harvested wood and finished products, including the cost of transportation by water;
– Wages of employees, including compensation and incentive payments.

Decree No. 777 31 July 2015 reduced the investment threshold required to obtain subsidies from RUB 4 billion bn to RUB 1 billion.[1116] This Decree also has limited the eligible costs to:
– Payments (except for the down payment) under equipment and vehicle leasing contracts, with the exception of passenger vehicles (50% of the actual costs incurred);
– Payment of interest on loans received in credit institutions and in Vnesheconombank for the implementation of projects;
– Transportation by rail of harvested wood and finished products from departure stations located in the region to destination stations located in the same region (100% of the amount of the actual costs incurred).

In 2014, 2015, and 2016 the subsidies under this scheme amounted to RUB 1.5 billion (EUR 29.4 million), RUR 2.2 billion (EUR 32.4 million), and RUB 1.95 billion (EUR 26.4 million) respectively. The Ministry of Industry and Trade indicated that in 2014 the Government also spent RUB 1.14 billion (EUR 22.3 million) for partial reimbursement of the interest paid on loans to companies that operated in the timber industry.[1117] At the end of July 2017, on the initiative of the Ministry of Industry and Trade, the programme of subsidising the timber processing enterprises of the Far East was extended to 2017–2018 (Decree No. 866 of 22 July 2017).[1118]

проектов в области освоения лесов, на возмещение части затрат, осуществленных в 2013–2014 годах на реализацию таких проектов), available at: http://government.ru/docs/16025/, accessed on 30 October 2019.

1116 Government Decree N.º 777 of 31 July 2015 "*on Amendments to the Decree of the Government of the Russian Federation N.º 1319 of 5 December 2014*" (Постановление от 31 июля 2015 года №777 О внесении изменений в постановление Правительства Российской Федерации от 5 декабря 2014 г. No 1319), available at: http://government.ru/docs/19124/, accessed on 30 October 2019.

1117 Potapkin, V. A. (2015). *Measures of state support to enterprises of the timber industry of the Russian Federation,* available at: http://minpromtorg.gov.ru/common/upload/files/docs/Gospodderzhka_lesopromyshlennyy_kompleks[1].pdf, accessed on 30 October 2019.

1118 Government Decree N.º 866 of 22 July 2017 "*on Amendments to the Decree of the Government of the Russian Federation N.º 1319 of 5 December 2014* (Постановление Правительства Российской Федерации от 22 июля 2017 г. N 866 О внесении изменений в Постановление Правительства Российской Федерации от 5 декабря 2014 г. N 1319), available at: http://static.government.ru/media/files/I8KAvCAuGf3oRr5bGnAxCPwCAnOrHj6I.pdf, accessed on 30 October 2019.

The Federal Law No. 415-FZ of 2016 on the Federal Budget for 2017 and for the Planning Period of 2018 and 2019 allocated RUB 1.3 billionn (EUR 20 million) of subsidies in 2017 and RUB 700 million (EUR 10.8 million) in 2018 for this purpose.[1119]

In 2017, the Government adopted the Decree No. 1158 of 25 September 2017 on Approval of the Rules for Providing Subsidies from the Federal Budget to Russian Organisations of the Timber Industry for Reimbursement of Part of Costs for Paying Interest on Loans Received in Russian Credit Institutions in 2014–2016 for the Creation of Inter-seasonal Stocks of Raw Materials and Fuel.[1120] This form of subsidy is provided to:

a) Logging companies of the timber industry:
   - For the purchase of spare parts, components, articles and integral parts of forestry equipment;
   - For transportation services (excluding export deliveries) of unprocessed timber;
   - For fuels and lubricants.

b) Timber processing companies of the timber industry:
   - For the purchase of raw timber;
   - For transportation services (excluding export deliveries) of unprocessed timber;
   - On fuels and lubricants.

The amounts of subsidies granted under this scheme are shown in Box 12.2.

In 2007, the Government adopted the Decree No. 419 of 30 June 2007 on Priority Investment Projects in Forest Development,[1121] which sought to stimulate investment aimed at the creation or modernisation of the forestry and wood-processing infrastructure. On that basis, the rent for the forest plot used for the implementation of a priority investment project couln be reduced by half

[1119] See the explanatory note to the Government Decree "*on the Extension of the Programme of Support for Timber processing Enterprises of the Far Eastern Federal District, implementing Priority Investment Projects*" (О продлении программы поддержки лесоперерабатывающих предприятий Дальневосточного федерального округа, реализующих приоритетные инвестпроекты), available at http://government.ru/docs/28580/, accessed on 30 October 2019.

[1120] Government Decree N.º 1158 of 25 September 2017 "*on the Approval of the Rules for the provision of subsidies from the federal budget to Russian timber industry organizations for the reimbursement of part of the cost of paying interest on loans received from Russian credit organizations in 2014 - 2016 for the purpose of creating off-season supplies of raw materials and fuel, and on the recognition as invalid of certain acts of the Government of the Russian Federation*" (Постановление Правительства Российской Федерации от 25 сентября 2017 г. Об утверждении Правил предоставления из федерального бюджета субсидий российским организациям лесопромышленного комплекса на возмещение части затрат на уплату процентов по кредитам, полученным в российских кредитных организациях в 2014 - 2016 годах на цели создания межсезонных запасов сырья, материалов и топлива, и о признании утратившими силу некоторых актов Правительства Российской Федерации), available at: http://static.government.ru/media/acts/files/0001201709280004.pdf, accessed on 30 October 2019.

[1121] Government Decree N.º 419 of 30 June 2007 *"on Priority Investment Projects in Forest Development"* (Постановление Правительства Российской Федерации о приоритетных инвестиционных проектах в области освоения лесов), available at: http://www.consultant.ru/cons/cgi/online.cgi?req=doc&base=LAW&n=164302&fld=134&dst=1000000001,0&rnd=0.61296034601486#09109654472343868, accessed on 29 March 2020.

during the payback period of a project. In 2018, Government Decree No. 190 of 23 February 2018 on the Priority Investment Projects in Forest Exploitation and on Amendments and Repeal of Certain Acts of the Government of Russian Federation[1122] amended some provisions of Decree No. 419.

The Ministry of Industry and Trade noted that advantages granted by the mechanism of priority investment projects allowed the attraction of investments for the implementation of 140 such projects in the wood and timber industry.[1123] Certain of these projects benefited from a plethora of state support schemes, combining both federal and local measures. For instance, the Russian Forest Products Group is carrying out a comprehensive investment project on the creation of the Far Eastern Centre for the Deep Processing of Wood, in Amursk, Khabarovsk Territory. The project is being implemented with the active support of the Ministry of Industry and Trade, the Ministry of Environmental Development and the Government of the Khabarovsk Territory; it has the status of a National Priority Project in Forest Development.[1124]

According to the Minister of Industry and Trade, the timber industry also has been supported with export subsidies.[1125] For example, in 2018, the Russian Export Centre allocated RUB 3 billion (EUR 40.5 million) to support exporters of wood products (e.g. plywood, pulp, chipboard, and sawn wood). Subsidies have been introduced to reimburse 80% of the transportation cost to the borders, foreign certification, and participation in international exhibitions.[1126]

Box 12.2: Government sector-specific and horizontal support measures of the timber industry complex.

[1122] Government Decree N.º 190 of 23 February 2018 "*on the Priority Investment Projects in Forest Exploitation and on Amendments and Repeal of Certain Acts of the Government of Russian Federation*" (Постановление Правительства Российской Федерации от 23 февраля 2018 года N 190 О приоритетных инвестиционных проектах в области освоения лесов и об изменении и признании утратившими силу некоторых актов Правительства Российской Федерации), available at: http://docs.cntd.ru/document/556622505, accessed on 30 October 2019.

[1123] Виктор Евтухов (2017). *Продукция ЛПК из России может претендовать на рынок АТР*, РИА Новости. 5 сентября 2017 (Evtukhov, V. (2017), *Timber products from Russia can open the door to Asia-Pacific market*, RIA News), available at: https://ria.ru/20170905/1501827685.html, accessed on 30 October 2019.

[1124] *The RFP Group launched a new sawn timber plant in Amursk, Khabarovsk Territory* (2017), (*Группа RFP запустила новый завод по производству пиломатериалов в г. Амурске Хабаровского края*), available at: http://www.rfpgroup.ru/news/gruppa-rfp-zapustila-novyy-zavod-po-proizvodstvu-pilomaterialov-v-g-amurske-habarovskogo-kraya, accessed on 30 October 2019.

[1125] Ministry of Industry and Trade (2018), *Exports of Russian timber industry grew by 17%* (*'Экспорт продукции российского леспрома вырос на 17%'*), Moscow, available at: http://minpromtorg.gov.ru/common/tool/createpdf.php?module=NEWS&id=1340314416&lang=1&version=0, accessed on 30 October 2019.

[1126] Fomicheva, E. (2017) *Russian wood exporters are compensated for shipping costs. Delovoy Preterburg* (Екатерина Фомичева (2017) *Экспортерам товаров из российской древесины компенсируют затраты на доставку. Деловой Петербург)*, available at: https://www.dp.ru/a/2017/12/26/article, accessed on 26 March 2019.

In 2015, 25 timber industry enterprises received subsidies of RUB 462.8 million (EUR 6.8 million).[1127]

In 2016, 77 enterprises received state support consisting of subsidised interest repayments and of the reimbursement of expenses amounting to RUB 3.5 billion (EUR 47 million) to: [1128]

- Replenish working capital and finance current production activities (28 enterprises received RUB 372 million (EUR 5 million));
- Create inter-seasonal stocks of raw materials and fuel (27 enterprises received RUB 225 million (EUR 3 million);
- Create new processing industries for complex processing of raw wood (eight enterprises received RUB 300 million (EUR 4 million));
- Implement new investment projects in priority areas of industry (ten enterprises received RUB 655.8 million (EUR 9 million));
- Reimburse part of expenses incurred in 2013–2016 for the implementation of priority investment projects in the field of forest development (four enterprises of the Far Eastern Federal District received RUB 1.95 billion (EUR 23.4 million)). Also, two organisations were provided with a subsidy of RUB 75 million (EUR 1 million) to compensate for part of the costs of research and development as part of investment projects.

In 2017, state support provided to enterprises of the timber industry from the federal budget amounted to RUB 5.2 billion (EUR 78.7 million): [1129]

- Subsidies of RUB 400 million (EUR 6.1 million) for the formation of inter-season stocks of raw materials and fuel;
- Subsidies of RUB 1.3 billion (EUR 19.7 million) for the implementation of priority investment projects in the field of forest development in the Far Eastern Federal District;
- Subsidies of RUB 812.9 million (EUR 12.3 million) for the implementation of new investment projects in priority areas of industry;
- Subsidies of RUB 2.6 billion (EUR 29.4 million) for compensation of part of transportation costs;

[1127] *Report on the goals and objectives of the Ministry of Industry and Trade of Russia for 2017 and key performance results for 2016* (*Доклад о целях и задачах Минпромторга России на 2016 год и основных результатах деятельности за 2015 год*), available at: http://minpromtorg.gov.ru/common/upload/00-113_.pdf, accessed on 30 October 2019.

[1128] *Report on the goals and objectives of the Ministry of Industry and Trade of Russia for 2017 and key performance results for 2016*, p. 37 (*Доклад о целях и задачах Минпромторга России на 2017 год и основных результатах деятельности за 2016 год, С.37*), available at: http://minpromtorg.gov.ru/common/upload/files/Minpromtorg_blok_15.03_final_for_web.pdf, accessed on 30 October 2019.

[1129] *Report on the goals and objectives of the Ministry of Industry and Trade of Russia for 2018 and key performance results for 2017*, p. 34 (*Доклад о целях и задачах Минпромторга России на 2018 год и основных результатах деятельности за 2017 год. С. 34*), available at: http://minpromtorg.gov.ru/common/upload/docVersions/5ad48d069014f/actual/Minpromtorg_press2.pdf, accessed on 30 October 2019.

- Subsidy of RUB 50 million (EUR 0.8 million) for reimbursement of part of R&D costs;
- The amount of support in the form of concessional loans from the Industrial Development Fund accounted for RUB 2.2 bn (EUR 33.3 million).

12.3.3 SUPPORT FOR LARGE-SCALE INVESTMENT PROJECTS

SPICs and regional investment projects (′RIPs′) are one of the forms of investment support that has been actively used by Russian producers of raw materials. This includes a wide range of measures, e.g. tax exemptions or accelerated depreciation of fixed assets. Besides the latter, support can also be granted though certain tax deductions related to investment. These schemes are described in Sections 12.3.3.1 and 12.3.3.2.

12.3.3.1 SPECIAL INVESTMENT CONTRACTS

The mechanism of SPICs was introduced by Federal Law No. 488-FZ (see Chapter 6). A SPIC is an agreement between an investor and the government, which fixes the obligations of the company implementing the investment project, as well as the obligations of the federal and/or regional government in the provision of support measures. The Government Decrees No. 708 of 16 July 2015[1130] and No. 1564 of 16 December 2017[1131,1132] define the basic requirements for the conclusion of a SPIC. The Ministry of Industry and Trade or any other federal executive body authorised by the Government has the right to conclude SPICs. SPICs can also be concluded by a constituent entity of the Federation and at municipal level. The term of the SPIC should not exceed ten years.

The Federal Law No. 144 of 23 May 2016[1133] established a preferential taxation regime for SPICs and RIPs:

- Taxes and fees (rates of profit tax paid to federal and regional budgets can be reduced to 0%, some other tax incentives can be provided by regional and municipal authorities);
- Accelerated depreciation coefficient (not higher than 2);

[1130] See Section 12.2.3

[1131] Government Decree N.º1564 of 16 December 2017 "*on Amendments to Certain Acts of the Government of the Russian Federation on Issues Related to a Special Investment Contract*" (*"Постановление Правительства РФ от 16 декабря 2017 г. N 1564 "О внесении изменений в некоторые акты Правительства Российской Федерации по вопросам, касающимся специального инвестиционного контракта*"), available at: http://base.garant.ru/71837916/, accessed on 30 October 2019.

[1132] The template form of a SPIC contract no longer contains an exhaustive list of industries in which is possible to conclude a SPIC. However, it is noted that a SPIC can also be concluded in the energy sector, in the agro-industrial sector.

[1133] Federal Law N.º 144-FZ of 23 May 2016 "*on Amendments to Parts One and Two of the Tax Code of the Russian Federation*" (*Федеральный закон от 23 мая 2016 г. N 144-ФЗ "О внесении изменений в части первую и вторую Налогового кодекса Российской Федерации*), available at: http://pravo.gov.ru/proxy/ips/?docbody=&firstDoc=1&lastDoc=1&nd=102398359, accessed on 30 October 2019.

– Option to apply reduced property tax rate.

Non-tax measures of support provided under this type of contract include:[1134]

– Option to purchase goods, works, services, which are subject to regulated pricing, at preferential tariffs;[1135]
– Option to obtain financing of the pre-production stage of projects at a concessional rate of 5% from the IDF;[1136]
– Non-tax measures of state support (subsidies, state guarantees, and other measures).

The Minister of Industry noted that SPICs are not only a federal initiative and that regional authorities are involved in the elaboration of measures related to such contracts. By 2018, 48 constituent entities of the Federation have adopted regulations that allow an investor to use a number of SPIC's incentive measures, and 15 SPICs have been already concluded on a regional level.[1137]

Box 12.3: SPIC examples

The authorities of Sverdlovsk the region signed a SPIC with "Machine-building plant named after M.I. Kalinin" until 2027. The purpose of this contract is to create an industrial complex that produces moulds from ferrous and non-ferrous metals, and special steel. Regional authorities, in their turn, reduced the tax rate on profit paid into regional budget.[1138]

VSMPO-AVISMA corporation, a vertically integrated producer of titanium, and the Government of the Sverdlovsk region signed a SPIC until 2023. This contract envisages that the company should conduct modernisation and increase the output of titanium products. The Sverdlovsk region, in its turn, decreased profit taxes payed by VSMPO-AVISMA to the regional budget. This allowed the company to increase the volume of investment in its own production.[1139]

[1134] KPMG в России и СНГ (2018). *Специальный инвестиционный контракт как новая мера поддержки инвесторов* (KPMG in Russia and the CIS (2018), *Special investment contract as a new measure of investor's support*), available at: https://assets.kpmg.com/content/dam/kpmg/ru/pdf/2017/10/ru-en-special-investment-contract.pdf, accessed on 30 October 2019.

[1135] Potapkin (2015).

[1136] *Ibidem*.

[1137] *In Russia, over 600 support measures for industrial development are being implemented (op. cit.*).

[1138] *Свердловские власти дали МЗиК льготу по налогу на прибыль на 10 лет. РБК.* (*Sverdlovsk authorities grant MZiK rebate on income tax for 10 years*. RBC, available at: https://ekb.rbc.ru/ekb/freenews/5b88f4ee9a7947221c23ff63, accessed on 30 October 2019.

[1139] VSMPO-AVISMA Corporation and the Government of the Sverdlovsk Region Signed a Contract, (*Корпорация ВСМПО-АВИСМА и Правительство Свердловской области заключили контракт),* available at: http://www.vsmpo.ru/ru/news/181/Korporacija_VSMPOAVISMA_i_Pravitelstvo_Sverdlovskoj_oblasti_zaklju chili_kontrakt, accessed on 30 October 2019.

The Ministry of Industry and Trade also expects that SPICs will be one of the main instruments of implementation of large-scale investment projects in the timber industry, in particular, in the construction of pulp mill plants (e.g. the project of the Russian Forest Products Group and Chinese company China Chentong Holdings Group for the construction of a pulp mill in the Khabarovsk Territory).[1140]

12.3.3.2 REGIONAL INVESTMENT PROJECT

RIPs are types of special fiscal schemes that are provided for in Chapter 3.3 of the Tax Code.[1141] According to Part 1, Art. 25.8 of the Tax Code, a RIP is aimed at the production of goods that meet the special requirements established by law.

Initially, this type of support could only be obtained if it was located in Eastern Siberia, the Transbaikal region, and the Far East, where large amounts of raw material resources are located (timber, non-ferrous metals, e.g. antimony, tungsten, lead, copper). However, in 2016, amendments to the legislation[1142] were introduced that allow implementing RIPs by any other entity of the Federation. As a result, some constituent entities issued special laws on RIPs[1143] with requirements regarding such projects and privileges that companies can obtain. The basic rules stipulate that:

- Companies that are included into the register of RIPs will not pay any profit tax to the federal budget[1144] for investment projects implemented in Eastern Siberia and the Far East within ten years from receiving profit. For projects implemented in other territories of Russia no profit tax will be payed to the federal budget during the period of a profit tax reduction granted by another constituent entity of the Federation (if the company receives such privilege from a constituent entity);

[1140] Stanislavets, D. (2017), *Viktor Evtukhov: Russian forest products can lay claim to the ATR market* (*Станиславец, Д. (2017), Виктор Евтухов: продукция ЛПК из России может претендовать на рынок АТР*; available at: http://www.bumprom.ru/index.php?ids=324&sub_id=25871, accessed on 30 October 2019.

[1141] See Section 4.6.3.

[1142] Federal Law N.º 144-FZ of 23 May 2016 (op. cit.).

[1143] The Law of the Republic of Bashkortostan N.º 506-z of 16 June 2017 "*on Regional Investment Projects in the Republic of Bashkortostan*" (*Закон Республики Башкортостан от 16 июня 2017 года N 506-з "О региональных инвестиционных проектах в Республике Башкортостан*"), available at: http://docs.cntd.ru/document/450244413, accessed on 30 October 2019; *The regional government approved the procedure for inclusion in the register of participants of regional investment projects* (*Правительство области одобрило порядок включения в реестр участников региональных инвестиционных проектов*), available at: https://kurganobl.ru/content/pravitelstvo-oblasti-odobrilo-poryadok-vklyucheniya-v-reestr-uchastnikov-regionalnyh, accessed on 30 October 2019.

[1144] KPMG. (2016), *Changes in legislation on special investment contracts and regional investment projects (Изменения законодательства о специальных инвестиционных контрактах и региональных инвестиционных проектах*), available at: https://home.kpmg.com/ru/ru/home/insights/2016/06/alerts-tax-issue-96.html, accessed on 30 October 2019.

- For RIPs implemented in Eastern Siberia and the Far East, a constituent entity of the Federation may introduce a reduced tax rate on profit of not more than 10% during the first five years of earning profits and not less than 10% during the next five years;
- For companies implementing RIPs in other regions (beyond Eastern Siberia and Far East) a constituent entity of the Federation can reduce the profit tax rate to 10% from the time profits are first earned until the moment the rate of tax reduction matches the value of the project's capital investments. The value of tax reduction is calculated cumulatively for tax periods;
- Companies that should not be included in the register of RIPs in Eastern Siberia and the Far East are subject to the following tax rates:
  - 0% tax rate on profits to the federal budget within ten years since application for the provision of such support;
  - 0–10% tax rate on profits to the budget of a constituent entity of the Federation during the first five years and no less than 10% during the next five years.

In addition, companies that implement RIP projects may apply for reduction of mineral extraction tax rates.

Box 12.4: RIP examples

Norilsk Nickel has requested the Krasnoyarsk regional authorities to introduce a RIP mechanism for the implementation of the South Cluster project, and thereby to reduce its tax rate.[1145]

The Ministry of Economic Development of the Khabarovsk Territory conferred the RIP participation status to Svetloye LLC (mining of precious metals, production of gold and silver). This status allows the enterprise to apply for preferential rates on income tax and mineral extraction tax.

The authorities of Irkutsk region have also been considering the possibility of including the ZAO Technoinvest Alliance, the operator of a rare earth mine, in the list of regional investment projects.[1146]

A constituent entity of the Federation may also provide additional tax support to priority projects. Svyatogor,[1147] which is a copper smelting plant and part of the Ural Mining and Metallurgical

[1145] "*Norilsk Nickel" presented at the Krasnoyarsk Economic Forum projects of the economic zone "Yenisei Siberia* (*"Норникель" представил на Красноярском экономическом форуме проекты экономической зоны "Енисейская Сибирь"*), available at: https://www.nornickel.ru/news-and-media/press-releases-and-news/nornikel-predstavil-na-krasnoyarskom-ekonomicheskom-forume-proekty-ekonomicheskoy-zony-eniseyskaya-sibir/, accessed on 30 October 2019.

[1146] Golovina, E. (2015). *Rarities will appear later: The launch of the mining and enrichment plant on the basis of the Zashikhinsky deposit of rare metals has been moved (Головина, Е. (2015) Редкости появятся позже: Запуск ГОКа на базе Зашихинского месторождения редких металлов перенесен. Коммерсант*), available at: https://www.kommersant.ru/doc/2650913, accessed on 30 October 2019.

[1147] Svyatogor (Krasnouralsk) (*"Святогор" (Красноуральск*))

Company, received the status of priority project from the regional authority. The company invested in modernisation and therefore was exempted from property tax for a period of five years. The tax support accounted for more than RUB 700 million (approximately EUR 10.7 million) over the period of five-year.[1148]

Box 12.5: Example of regional clustering of RIP

The authorities of the Arkhangelsk region have a special register for priority investment projects,[1149] which were granted tax breaks in the form of a reduced tax rate on profit. In particular, this register contains projects such as:

- Construction of a sawmill and woodworking plant in the Maimaksan district of Arkhangelsk (with a capacity of 250 000 m^3 of sawn timber per year), the project is being developed by ZAO Lesozavod 25;
- Construction of a modern full-cycle timber processing plant in the Arkhangelsk region (with a capacity of 750 000 $m^3$of sawn timber per year), the project is being developed by LLC ULK Group of Companies;
- Construction of a mining and processing plant on the basis of the Pavlovskoye lead-zinc mineral area (South Island of the Novaya Zemlya archipelago). The project has been implemented by JSC First Mining Company (Moscow). The tax breaks from regional authorities may account for RUB 0.5 billion.[1150]

12.4 EXPORT RESTRICTIONS

Export restrictions have an impact not only on trade but also on domestic prices, which in turn lowers feedstock and costs of downstream products, thereby improving the competitiveness of domestic companies compared to their foreign counterparts. The OECD classifies the following measures as export restrictions: export tax, export quotas, export bans, licensing requirements.

In recent years, especially after its WTO accession, Russia reduced export duties to zero for many raw materials. However, export duties are still applied for many resource-based products such as metals, timber, and some agricultural commodities.

This section looks into export duties (tax), quotas, and bans on the key raw materials (energy-related export restrictions are discussed in Chapter 10).

[1148] *"Svyatogor" became a priority for the authorities in exchange for modernisation* (*"Святогор" стал приоритетом для властей взамен на модернизацию*), available at: http://pravdaurfo.ru/articles/117550-kozicyn-vyrval-lgoty-v-700-millionov-dlya-biznesa, accessed on 30 October 2019.

[1149] Available at: http://regcouncil.ru/territories/arhangelskaya-oblast/, accessed on 30 October 2019.

[1150] *The development project of the Pavlovsk field on Novaya Zemlya received the status of a priority project of the Arkhangelsk region* (*Проект освоения Павловского месторождения на Новой Земле получил статус приоритетного проекта Архангельской области*), available at: http://www.atomic-energy.ru/news/2018/03/06/83864, accessed on 30 October 2019.

12.4.1 WOOD-BASED PRODUCTS

Russia applies export restrictions (including quotas, duties and licences) to wood and wood materials in order to change the pattern of production and exports and to ensure a greater degree of wood processing in the country.

Quotas refer to upper quantitative limits set upon exports of certain raw materials from Russia. As opposed to quotas export duty is a tax set upon exporters of certain raw materials from the territory of Russia. In order to qualify for export of raw materials such as timber from the territory of Russia a licence for foreign economic activity needs to be issued by the competent authority to the exporter, the upper qualitative limits set upon the exports adhered to and export duties paid for.

There are two key legal acts relative to exports of timber: (i) the Government Decree No. 779 of 30 July 2012[1151] regulating quotas; (ii) the Government Decree No. 754 of 30 August 2013 concerning export duties.[1152] The application of export duties was first introduced in the Federal Law on Customs Tariff of 21 May 1993.[1153] The Law defines the procedures for applying export duties and lists the goods subject to these duties, the duty rates, as well as the exemptions from the application of export duties.[1154]

12.4.1.1 LICENSING AND QUOTAS ON EXPORTS OF RAW WOOD

Tariff quotas are administered on the basis of one-time licences issued by the territorial bodies of the Ministry of Industry and Trade.[1155] The one-time licence is issued for one year only with specific rules applying to those companies which are engaged in export activities. Licences are valid for a given calendar year, i.e. from 1 January to 31 December.

Decree No. 779 determines the procedures for the distribution of quotas between exporting companies and covers specific types of raw timber, spruce, pine, and European fir.[1156] From

[1151] Government Decree N.º779 of 30 July 2012 "*on Tariff Quotas for Certain Types of Coniferous Timber, Exported Outside the Territory of the Russian Federation and the Territory of the Member States of the Customs Union*", as amended, available at: https://normativ.kontur.ru/document?moduleId=1&documentId=301719, accessed on 30 October 2019.

[1152] Government Decree N.º 754 of 30 August 2013 "*on Approval of Rates of Export Customs Duties for Goods Exported from the Territory of the Russian Federation and Territory of Member States of the Customs Union*", as amended, available at: http://www.consultant.ru/cons/cgi/online.cgi?req=doc&base=LAW&n=302915&rnd=939209FAC77D96BDF2C5D272098DAC6B&from=301306-33#0606612357120662, accessed on 30 October 2019.

[1153] Federal law N.º 5003-1 of 21 May 1993 (op. cit.).

[1154] Ibidem.

[1155] Available at: http://minpromtorg.gov.ru/docs/kvoty/, accessed on 30 October 2019.

[1156] These rules determine the procedure for the distribution of tariff quotas between participants in foreign economic activity in relation to common spruce or white European fir (codes of EAEC EEA 4403 23 110 0, 4403 23 190 0 and 4403 24,100 0) and ordinary pine (codes: TN BED EAEC 4403 21 110 0, 4403 21 190 0 и 4403 22 100 0) exported outside the territory of Russia and the territory of the states, parties to the Customs Union agreements, to third countries, with the exception of the EU (as amended by the Governmant Decree N.º 307 of 20 March 2018).

August 2012 to November 2013, the rules allowed for granting export quotas and corresponding licences for coniferous timber conditionally: only those lease holders of forest plots that did not have lease arrears or those who sub-leased from the leaseholders were entitled.[1157] Based on two other Decrees quotas have been extended to spruce (*Picea jezoensis*), white fir (*Abies nephrolepis*) and Dahurian larch (*Larix dahurica*) – see Subsections 12.4.1.2 and 12.4.1.3. A total of four million cubic metres is allocated for exports annually. An in-quota export duty is applied for the above types of timber in the amount of 6.5%, but not less than EUR 4 per cubic metre (whereas the out-of-quota duty is 25%, but not less than EUR 15 per cubic metre). These rules cover market participants engaged in foreign trade with '*no unfulfilled obligation to pay taxes, fees, insurance premiums, penalties, fines, interest to be paid in accordance with the legislation of the Russian Federation*'. The allowed share of exports of forest products produced by market players engaged in foreign trade is: at least 20% of the total value of exports from 1 January 2018; from 1 January 2019 at least 25%; from 1 January 2020 not less than 30%; and from 1 January 2021 not less than 35%.[1158]

12.4.1.1.1 Ordinary fir or white European fir, and Scots pine

According to Decree 779, exports of specific types of coniferous timber – ordinary fir or white European fir, and Scots pine – are subject to quotas. The Decree envisages two categories of quotas distribution among participants engaged in foreign trade activity in relation to exports of raw wood resources outside of the EAEU. One of them relates to exports to countries outside the EU, and the other applies to the EU.

The Decree states that the Ministry of Economic Development together with the Ministry of Industry and Trade and the Federal Customs Service shall hold consultations with the European Commission on the exchange of information on the use of tariff quotas approved by the Decree.

According to the legislation referred to in this chapter, quotas can only be be distributed to wood-processing companies with established wood processing facilities which export timber products.[1159] The most up-to-date list of companies benefiting from quotas has been published by the Ministry of Industry and Trade in 2019.[1160] It is worth mentioning that the forestry sector is

[1157] LesProm (2014), *The Russian Government again fundamentally changed the approach to the distribution of export tariff quotas for softwood* (*Правительство РФ опять принципиально изменило подход к распределению экспортных тарифных квот на хвойную древесину*), available at: https://lesprominform.ru/news.html?id=5283, accessed on 30 October 2019.

[1158] RAO BumProm (2018), *Tariff quotas for the export of certain types of coniferous wood approved by the Russian government* (*Тарифные квоты на экспорт отдельных видов хвойной древесины утвердило правительство России*), available at: http://www.bumprom.ru/index.php?ids=272&sub_id=26485, accessed on 30 October 2019.

[1159] Solntsev (2017)

[1160] Distribution of volumes of tariff quotas established for ordinary spruce or white European fir and common pine exported outside the territory of the Russian Federation and the territory of the states parties to the Customs Union agreements to third countries, with the exception of the European Union, between participants in foreign economic activity in 2019; available at:

likely to become a new focus area following the Government's publication of the Forest Sector Development Strategy up to 2030 in September 2018.[1161]

The list of annual quotas is as follows (thousands of cubic metres, tcm):[1162]

- Ordinary fir (*Picea abies Karst*), or European white fir (*Abies alba Mill.*), TN BED EAEU codes 4403 23 110 0, 4403 23 190 0 and 4403 24 100 0: annual quota of 6 246.5 tcm, allocated between the EU 5 960.6 tcm and other countries: 285.9 tcm;
- Pine ordinary (*Pinus sylvestris L.*), TN BED EAEUcodes 4403 21 110 0, 4403 21 190 0 and 4403 22 100 0: annual quota of 1 6038.2 tcm including EU 3 645.9 tcm and other countries 12 392.3 tcm.

12.4.1.1.2 Spruce, white fir and larch

In 2017 and in 2018, the Government established additional tariff quotas on certain other types of wood: spruce (*Picea jezoensis*), white fir (*Abies nephrolepis*) and larch (*Larix dahurica*). The amendments to the export quotas system on wood materials were introduced by means of the Government Decree No. 1520 of 12 December 2017[1163] and Government Decree No. 1521 of 12 December 2017, [1164] both of which have been in force since 1 January 2018. Drawing on Decree No. 779, Decree No. 1520 introduced quotas for spruce, fir, larch and wood processing products as listed in the latter Decree. The quotas introduced by Decree No. 1520 specifically relate to the wood industry in Russia's Far East and sets out a quota of 4 million m^3 annually. The quotas can be allocated only to companies that possess wood processing facilities. A reduced rate of export customs duty of 6.5% (but not less than EUR 4 per 1 m^3) was applied for the abovementioned wood types exported within the framework of the quota, however, in September 2019, Government Decree No. 1169 of 7 September 2019 doubled the export customs duty to 13%.[1165]

12.4.1.2 EXPORT DUTIES

http://minpromtorg.gov.ru/common/upload/files/docs//prilozhenie_k_prikazu_na_2019_tablitsa.pdf, accessed on 30 October 2019.

1161 Government Resolution N.º 1989-r of 20 September 2018 approving the Strategy for the development of the forest complex of the Russian Federation until 2030, available at: http://static.government.ru/media/files/cA4eYSe0MObgNpm5hSavTdIxID77KCTL.pdf, accessed on 30 October 2019.

1162 Government Decree N.º 779 of 30 July 2012 (op. cit.).

1163 Government Decree N.º 1520 of 12 December 2017 "o*n Tariff Quotas for certain Types of Timber exported Outside the Territory of the Russian Federation to Third Countries*"; available at: http://static.government.ru/media/files/Qek05dP8egcmIcn7oLlJw4VtAGwuw5EQ.pdf, accessed on 30 October 2019.

1164 Government Decree N.º1521 of 12 December 2017 "*on Introduction of the Amendments into Export Tariff Rates*", available at: http://static.government.ru/media/files/35HAa6shmus0zPvbw9QAu25iqswKyO00.pdf, accessed on 30 October 2019.

1165 Available at: http://whatwood.ru/english/the-government-increased-export-duties-on-unprocessed-soft-timber-of-far-eastern-species/, accessed on 23 March 2020.

Besides licensing and quotas, the Government regulates exports of wood products by means of export duties. The Government Decree No. 754 of 30 August 2013 on Approval of Rates of Export Customs Duties for Goods Exported from the Territory of the Russian Federation and Territory of member states of the Customs Union[1166] regulates export taxes on coniferous timber. Since 2012, Russia, to fulfil its WTO obligations, decreased its export duties on raw wood destined for the EU from 25% to 13% for spruce, and to 15% for pine. Any exports in excess of quotas are subject to a prohibitive duty set at 80% but not less than EUR 55.20 per cubic metre.[1167] Based on Decree No. 754 there are eight categories (codes) of coniferous timber, which are subject to export duties.

In 2017, the export duties schedule for wood products was amended. Decree No. 1521 established temporary export duties for logs of spruce and fir, other timber from spruce and fir, raw fir and spruce timber, softwood logs, other softwood timber, and unprocessed softwood:[1168]

(1) 1 January 2019 – 31 December 2019: 40% but no less than EUR 27.6 per 1 m^3;
(2) 1 January 2020 – 31 December 2020: 60% but not less than EUR 36.8 per 1 m^3;
(3) 1 January 2021 – 31 December 2021: 80% but not less than EUR 55.2 per 1 m^3.

Below is the list of all wood materials subject to export duty as of 2019:[1169]

- Logs of coniferous wood, any degree of impregnation, not less than 6 m, but not more than 18 m in length and with a butt circumference of more than 45 cm but not more than 90 cm (4403 11 000): 25% but not less than EUR 15 per 1 m^3;
- Other (logs of coniferous wood) (4403 11 00 9): 25% but not less than EUR 15 per 1m^3;
- From oak (4403 12 000): 20% but not less than EUR 30 per 1 m^3;
- From beech wood (4403 12 000): EUR 100 per 1 m^3;
- Ash (*Fraxinus spp.*), sawn or chipped lengthwise, sliced or peeled, whether or not planed, sanded or end-jointed, of a thickness of more than 6 mm: 10% but not less than EUR 12 per 1 m^3;
- Beech (*Fagus spp.*), sawn or chipped lengthwise, sliced or peeled, whether or not planed, sanded or end-jointed, of a thickness of more than 6 mm: 10% but not less than EUR 10 per 1 m^3;
- From ash (4403 12 000): EUR 100 per 1 m^3;
- Other (4403 12 000): 25% but not less than EUR 15 per 1 m^3;
- Logs (common spruce) (4403 21 110 0): 80% but not less than EUR 55.2 per 1 m^3;
- Logs for which the tariff quota is established, if there is a licence issued by the competent authority (4403 21 110 0): 15%;
- Other (4403 21 190 0): 80% but not less than EUR 55.2 per 1 m^3;

[1166] As amended by Government Decree No. 307 of 20 March 2018.
[1167] Mordyushenko, O. (2017, September 6). *Forest bends to quota. Government will impose export restrictions on round timber (Les klonitsya pod kvotu. Pravitel'stvo vvedet ogranicheniya na eksport kruglyaka)*, available at: https://www.kommersant.ru/doc/3403041, accessed on 30 October 2019.
[1168] TN BED EAEU codes 4403239100, 4403239900, 4403249000, 4403259100, 4403259900, 4403 26 000 0
[1169] Government Decree N.º 574 of 30 August 2013 (op. cit.).

- Other for which the tariff quota is established, if there is a licence issued by the competent authority (4403 21 190 0): 15%;
- Logs (4403 21 910 0): 25% but not less than EUR 15 per 1 m^3;
- Other (4403 21 990 0): 25% but not less than EUR 15 per 1 m^3;
- Ordinary pine (*Pinus sylvestris L.*) kind (4403 22 100 0): 80% but not less than EUR 55.2 per 1 m^3;
- Ordinary pine (*Pinus sylvestris L.*) kind for which the tariff quota is established, if there is a licence issued by the competent authority (4403 22 100 0): 15%;
- Other pine (4403 22 900 0): 25% but not less than EUR 15 per 1 m^3;
- Logs (4403 23 110 0): 80% but not less than EUR 55.2 per 1 m^3;
- Logs for which the tariff quota is established, if there is a licence issued by the competent authority (4403 23 110 0): 13%;
- Other (4403 23 190 0): 80% but not less than EUR 55.2 per 1 m^3;
- Other for which the tariff quota is established, if there is a licence issued by the competent authority (4403 23 190 0): 13%;
- Logs (4403 23 910 0): 25% but not less than EUR 15 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Logs of spruce ayan (*Picea jezoensis*) or white fir (*Abies nephrolepis*) for which the tariff quota is set, with a licence issued by the competent authority (4403 23 910 0): 6.5% but not less than EUR 4 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Other (4403 23 990 0): 25% but not less than EUR 15 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Other spruce ayan (*Picea jezoensis*) or white fir (*Abies nephrolepis*), for which the tariff quota is set, with a licence issued by the competent authority (4403 23 990 0): 6.5% but not less than EUR 4 per 1 m^3;
- Fir of (*Picea abies Karst.*) kind or white European fir (*Abies alba Mill.*) kind (4403 24 100 0): 80% but not less than EUR 55.2 per 1 m^3;
- Fir of (*Picea abies Karst.*) kind or European white fir (*Abies alba Mill.*) kind, for which the tariff quota is set, with a licence issued by the competent authority (4403 24 100 0): 13%;
- Spruce or other fir (4403 24 900 0): 25% but not less than EUR 15 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);

- Spruce (*Picea jezoensis*) or white fir (*Abies nephrolepis*), for which the tariff quota is set, with a licence issued by the competent authority (4403 24 900 0): 6.5% but not less than EUR 4 EUR per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Logs (4403 25 910 0): 25% but not less than EUR 15 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Logs from Dahurian larch (*Larix dahurica*), for which the tariff quota is set, with a licence issued by the competent authority (4403 25 910 0): 6.5% but not less than EUR 4 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Other (4403 25 990 0): 25% but not less than EUR 15 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Other of Dahurian larch (*Larix dahurica*), for which the tariff quota is set, with a licence issued by the competent authority (4403 25 990 0): 6.5% but not less than EUR 4 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Other (4403 26 000 0): 25% but not less than EUR 15 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Other of Dahurian larch (*Larix dahurica*), for which the tariff quota is set, with a licence issued by the competent authority (4403 26 000 0): 6.5% but not less than EUR 4 per 1 m^3 (*1 January 2019 – 31 December 2019 – 40% but not less than EUR 27.6 per 1 m^3; 1 January 2020 – 31 December 2020 – 60% but not less than EUR 36.8 per 1 m^3; from 1 January 2021: 80% but not less than EUR 55.2 per 1 m^3);
- Other (4403 49 950 9): EUR 100 per 1 m^3;
- Logs (4403 91 100 0): 20% but not less than EUR 30 per 1 m^3;
- Other (4403 91 900 0): 20% but not less than EUR 30 per 1 m^3;
- Logs (4403 93 100 0): EUR 100 per 1 m^3;
- Other (4403 93 900 0): EUR 100 per 1 m^3;
- From beech wood (*Fagus spp.*), other (4403 94 000 0): EUR 100 per 1 m^3;
- Logs with a diameter of the smallest cross section of at least 15 cm, length of at least 1 m (4403 95 000 1): 7%;

– Other (4403 95 000 9): 7%;
– Other (4403 96 000 9): 7%;
– From poplar (4403 97 000 1): 10% but not less than EUR 5 per 1 m^3;
– From aspen (*Populus adenopoda*, *Populus davidiana*, *Populus grandidentata*, *Populus sieboldii*, *Populus tremula*, *Populus tremuloides*) (4403 97 000 2): 5%;
– From eucalyptus (*Eucalyptus spp.*) (4403 98 000 0): 10% but not less than EUR 5 per 1 m^3;
– From ash wood (4403 99 000 1): EUR 100 per 1 m^3;
– Other (4403 99 000 9): EUR 100 per 1 m^3;
– From beech wood (*Fagus spp.*) (4407 92 000 0): 10% but not less than EUR 10 per 1 m^3;
– Processed planing; having end connections, whether or not machined by planing or grinding (4407 95 100 0): 10% but not less than EUR 12 per 1 m^3;
– Processed by grinding (4407 95 910 0): 10% but not less than EUR 12 per 1 m^3;
– Other (4407 95 990 0): 10% but not less than EUR 12 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 150 1): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 150 3): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 150 5): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 150 7): 5% but not less than EUR 6 per 1 m^3;
– Oak, beech or ash (4408 90 150 9): 5% but not less than EUR 6 per 1 m^3;
– Oak, beech or ash (4408 90 350 1): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 850 1): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 850 3): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 850 5): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 850 7): 5% but not less than EUR 6 per 1 m^3;
– Oak, beech or ash (4408 90 850 9): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 950 1): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 950 3): 5% but not less than EUR 6 per 1 m^3;
– Having at least one layer of oak, beech or ash (4408 90 950 5): 5% but not less than EUR 6 per 1 m^3;

– Having at least one layer of oak, beech or ash (4408 90 950 7): 5% but not less than EUR 6 per 1 m^3;
– Oak, beech or ash (4408 90 950 9): 5% but not less than EUR 6 per 1 m^3.

12.4.2 PROPOSED EXPORT RESTRICTIONS IN THE WOOD SECTOR

In December 2018, a group of members of the State Duma proposed a draft bill No. 470635-7 on Amendment to Article 29 of the Forest Code of the Russian Federation. The bill sought the introduction of an 11 year (1 January 2020 - 31 December 2030) ban on exports from Russia of unprocessed industry softwood.[1170] According to the draft bill, Article 29 of the Forest Code of the Russian Federation should be amended to include a clause that allows the harvesting of softwood (pine, spruce, fir, cedar and larch) only if it is subsequently processed in the territory of Russia. Such an amendment could contravene Russia's international obligations and would likely inflict damage on enterprises in the neighbouring countries of Russia, including EU member states. At the time of writing of this report, no ban on exports of unprocessed industry softwood has been legislated.[1171]

12.4.3 NON-FERROUS METALS

The Federal Law on Customs Tariff of 21 May 1993[1172] is the main legal act regulating exports of non-ferrous metals. Additionally, Federal Law No. 89 of 24 June 1998 on Production and Consumption Waste[1173] regulates, among others, matters related to non-ferrous scrap metal.

After its WTO accession, Russia reduced the list of non-ferrous metal goods that are subject to export duties. However, export of the below non-ferrous metal products[1174] are still subject to duties:
– Tungsten ores and concentrates: 10%;
– Copper waste and scrap (excluding ingots or other similar unwrought shapes, of re-melted copper waste and scrap), ashes and residues containing copper: 10% but not less than EUR 84 per 1 000 kg;
– Nickel waste and scrap (excluding ingots or other similar unwrought shapes, of re-melted nickel waste and scrap), ashes and residues containing nickel: 10% but not less than EUR 240 per 1 000 kg;

[1170] Results of the meetings of the Council of the State Duma on 5 December 2018; available at: https://www.consultant.ru/law/review/lawmaking/cw2018-12-05.html, accessed on 30 October 2019.
[1171] See: https://www.ecolex.org/details/legislation/forest-code-no-200-fz-lex-faoc068489/, as well as for example: http://whatwood.ru/english/the-government-increased-export-duties-on-unprocessed-soft-timber-of-far-eastern-species/, both accessed on 23 March 2020.
[1172] Federal law N.º 5003-1 of 21 May 1993 (op. cit.).
[1173] Federal law N.º 89-FZ of 24 June 1998 (as amended) "*on Production and Consumption Wastes*" (Федеральный закон от 24 June 1998 N 89-ФЗ (ред. от 25.12.2018) "Об отходах производства и потребления"), available at: http://www.consultant.ru/document/cons_doc_LAW_19109/44185ef06da432e70f785d8707266a85457e790b/#dst100113, accessed on 30 October 2019.
[1174] Except aluminium.

- Lead waste and scrap (excluding ashes and residues from lead production heading No 2620, and ingots or other similar unwrought shapes, of re-melted waste): 10% but not less than EUR 35 per 1 000 kg;
- Zinc waste and scrap (excluding ash and residues from zinc production heading 2620, ingots and other similar unwrought shapes, of re-melted waste and scrap): 10% but not less than EUR 60 per 1 000 kg;
- Tungsten waste and scrap (excluding ash and residues containing tungsten): 7.5%;
- Magnesium waste and scrap (excluding ash and residues containing magnesium, and rasping, turnings and granules graded according to size): 20% but not less than EUR 138 per 1 000 kg;
- Cobalt waste and scrap (excluding ash and residues containing cobalt): 10% but not less than EUR 400 per 1 000 kg;
- Titanium waste and scrap (excluding ash and residues containing titanium): 10% but not less than EUR 75 per 1 000 kg.

The EEC developed a draft decision supplementing the list of goods that are important for the domestic market of the EAEU and for which, in exceptional cases, temporary bans or quantitative restrictions on exports may be imposed.[1175]

It is worth noting that tax avoidance schemes are not uncommon when exporting raw materials such as non-ferrous metals and scrap metals. One of the problems is selling at fictitious values. According to the Federal Customs Service, only for 2016 – 2017, 2.13 million tons of ferrous scrap were exported from the territory of the Far East with an average declared price of USD 166 per ton (or ca. RUB 9 700) rather than reportedly a real price of USD 293 (or RUB 17 600).[1176]

12.4.4 AGRICULTURAL PRODUCTS

Russia's WTO commitments do not include commitments with regard to export duties or restrictions for agricultural products.

The list of agricultural products subject to export duties in 2018 included:
- Low erucic acid rape or colza seeds: for sowing 6.5% but not less than EUR 11.4 per 1 000 kg;
- High erucic rape or colza seeds: for sowing 6.5% but not less than EUR 11.4 per 1 000 kg;
- Sunflower seeds, whether or not broken: for sowing 6.5% but not less than EUR 9.75 per 1 000 kg;
- Sunflower peeled: in grey husk and with white stripes: 6.5% but not less than EUR 9.75 per 1 000 kg;
- Rapeseed for sowing: 6.5% but not less than EUR 11.4 per 1 000 kg;
- Rapeseed other: 6.5% but not less than EUR 11.4 per 1 000 kg;

[1175] Board of the Eurasian Economic Commission, Decision N.º 83 of 26 June 2016, available at: http://docs.cntd.ru/document/456010097, accessed on 30 October 2019.

[1176] East Russia. (2018), *Against scrap there are tricks*, available at: https://www.eastrussia.ru/en/material/protiv-loma-est-priemy/, accessed on 30 October 2019.

- Whole raw hides and skins of bovine or equine animals of not more than 8 kg: EUR 200 per 1 000 kg;
- Whole raw hides and skins of bovine or equine animals of more than 16 kg, fresh, or salted: EUR 200 per 1 000 kg;
- Butts, bends, bellies and split raw hides and skins of bovine or equine animals, whether or not dehaired, fresh, or salted, dried, limed (other): EUR 200 per 1 000 kg;
- Raw skins of sheep or lambs, with wool on, fresh or salted, dried, limed, pickled or otherwise preserved (excl. those of Astrakhan, Caracul, Persian): EUR 200 per 1 000 kg;
- Raw skins of sheep or lambs, without wool on, pickled: EUR 200 per 1 000 kg;
- Raw skins of sheep or lambs, without wool on, fresh or salted, dried, limed or otherwise preserved, whether or not split (excluding pickled or parchment-dressed): EUR 200 per 1 000 kg;
- Raw hides and skins of reptiles, fresh or salted, dried, limed, pickled or otherwise preserved (excluding parchment-dressed): EUR 200 per 1 000 kg;
- Raw hides and skins of swine, fresh, or salted, dried, limed, pickled or otherwise preserved, whether or not dehaired or split (excluding parchment-dressed): EUR 200 per 1 000 kg;
- Raw hides and skins, fresh, or salted, dried, limed, pickled or otherwise preserved, whether or not dehaired, incl. bird skins without feathers or down: EUR 200 per 1 000 kg.

On 26 September 2016, Russia removed an export tax on wheat and has extended the zero duty until 1 July 2019. Announcing the decision to extend the zero duty on wheat, Russia's Deputy Prime Minister clarified that when grain exports could jeopardise interests of domestic market the Government would use existing protective mechanisms such as export duties or quotas.[1177] The above example illustrates how export restrictions or the relaxation of such restrictions are used in Russia as a trade and market regulating measure.

12.5 STOCKPILING AND STATE TRADING

Federal Law No. 79 of 23 November 1994 on the State Material Reserve[1178] sets out the general principles concerning stockpiling, using, and replenishing of the state material reserve, in which the stocks of raw materials are kept. The Federal Agency for State Reserves is responsible for the management of the state material.[1179]

The state reserve is intended for (Article 3):

[1177] Economics and Life (26 June 2018), *Zero export uty on wheat extended for another year*. (*Экономика и жизнь, "Нулевую экспортную пошлину на пшеницу продлят ещё на год"*), available at: https://www.eg-online.ru/print/news/375396/, accessed on 30 October 2019.

[1178] Federal Law N.º 79 of 23 November 1994 "o*n the State Material Reserve",* as amended, (Федеральный закон Российской Федерации О государственном материальном резерве (с изменениями)), available at: http://docs.cntd.ru/document/9039689, accessed on 30 October 2019.

[1179] Federal Agency for State Reserves (*Федеральное агентство по государственным резервам*), available at: https://www.rosreserv.ru, accessed on 30 October 2019.

– Ensuring Russia's mobilisation needs;
– Ensuring emergency work in emergency response;
– Providing state support to various sectors of the economy, organisations, constituent entities of the Federation in order to stabilise the economy in the event of temporary supply disruptions of the most important types of raw materials and fuel and energy resources, food, in the case of imbalances between supply and demand in the domestic market;
– Humanitarian assistance;
– Regulation of the market.

Information on the storage, use, and replenishment of Government reserves and their stocks are state secrets (Article 11(6)). There is practically no reliable information confirming the use of the state reserve for regulating the market or eliminating the disparity between supply and demand. However, some examples of State's stockpiling intervention can be cited: for example, in 2018, the Government allocated up to RUB 10 billion for the purchase of 50 000 tons of aluminium and its storage in the state reserve[1180] (see also Section 15.5). This is slightly more than 1% of UC Rusal's annual production in 2017. In another move, in 2015, the Government considered the establishment of a special fund for rare earth metals in the state material reserve.[1181] It also considered, due to rising prices of metals, the use of ferrous and non-ferrous metals from the state reserve to guarantee the implementation of state programmes and state procurement in the defence area.[1182] However, these proposals were not put into practice.

The State also regulates the creation of inventories and trade in precious metals and stones. Government Resolution No. 1646-p of 30 September 2010[1183] established the Gokhran of Russia, a state-owned repository responsible for the storage, pricing, selling and procurement of precious metals (gold, silver, platinum and platinum group metals) and precious stones (natural diamonds, emeralds, rubies, sapphires and alexandrites, natural pearls in raw (natural) and processed and unique amber formations). Gokhran operates under the Ministry of Finance and the buying and selling of the relevant goods is carried out by Gokhran based on world market prices.[1184]

[1180] Government Order N.º. 2582-p of 26 November 2018 stipulates that RUB 10 billion should be allocated from the Government's reserve fund to the Federal Agency for State Reserves for the purchase of up to 50,000 tons of aluminium; available at: http://publication.pravo.gov.ru/Document/View/0001201811280003, accessed on 30 October 2019.

[1181] Skupov, B. (2017), *Solomon Mine of Rosreserv*, Construction Expert (*Борис Скупов (2017) Соломоновы копи Росрезерва. Строительный эксперт*), available at: https://ardexpert.ru/article/9699, accessed on 14 November 2019.

[1182] Telmanov, D. (2015), *Rogozin worries about metal* (*Денис Тельманов (2015), Рогозин переживает за металл. Газета.Ru*), available at: https://www.gazeta.ru/politics/2015/02/09_a_6406585.shtml, accessed on 30 October 2019.

[1183] Government Resolution N.º 1646-p of 30 September 2010 (*Распоряжение Правительства Российской Федерации от 30 сентября 2010 г. N 1646-р г.*), available at: https://rg.ru/2011/02/16/fku-site-dok.html, accessed on 30 October 2019.

[1184] Gokhran of Russia, available at: http://www.gokhran.ru/en/, accessed on 30 October 2019.

One of the objectives of Gokhran's purchase of precious metals and stones is the support of Russian producers and the prevention of price decline. Thus, in 2015, Gokhran, for the first time, bought platinum and palladium (a ton of palladium and a ton of platinum (about 32 000 troy ounces)).[1185] This was done to maintain world prices for these metals, especially palladium, at a high level. Russia ranks first in the world for the sale of palladium (41% of the world market) and therefore may influence world prices. Palladium was purchased from Russian producers, primarily from Norilsk Nickel. Procured palladium and platinum were also intended to be used as collateral for loans of Russian State-owned companies in foreign banks, particularly in China.

12.6 CHAPTER SUMMARY

Russia's strategic priority in the development of the raw materials sector for the long term is the transition from a model of large-scale exports of natural resources to a modern combined model, which is based on an economically reasonable balance between domestic consumption, exports and essential imports of mineral raw materials. To this end, Russia has elaborated several strategic planning documents aimed at stimulating additional domestic production of raw materials, increasing the share of domestic products in total consumption, reducing the cost of capital and facilitation investments, and changing the composition of output towards products with higher value added (Section 12.2). These planning documents not only define the objectives for developing raw materials production but also envisage economic policy instruments that should contribute to the accomplishment of the goals. They are targeted at reducing different types of production costs, stimulating investment in, among others, additional production capacity, as well import substitution.

According to the Ministry of Industry and Trade, more than 600 measures support industrial development in the country at federal and regional levels. These measures are either sector-specific or horizontal (benefiting different sectors of the economy). However, producers of raw materials in Russia can take advantage of both types of support measures, such as (Section 12.3):

- Reduced interest rates on loans for the implementation of investment projects;
- Interest rate subsidies on loans for the replenishment of working capital;
- Concessional loans for up to seven years for import substitution and export-oriented projects;
- An accelerated depreciation coefficient;
- Subsidies on part or the total of the cost of R&D;
- Compensation of part of transportation costs;
- Reduced taxes on profit and property;
- Reduced tax rate on mineral extraction, etc.

[1185] In 2015, Gokhran for the first time bought platinum and palladium into the state fund (*Гохран впервые в 2015 году закупал платину и палладий в госфонд*), available at: https://www.interfax.ru/business/481573, accessed on 14 November 2019.

The Ministry of Industry and Trade states that such support helped enterprises to reduce the costs of production, while increasing their output and, consequently, reducing sales prices for consumers. At the same time, all the above-mentioned measures may have impact on companies down the value chain by lowering input prices for the domestic industry at the expense of foreign competitors.

Russia applies various types of export restrictions in the industrial raw materials sector (Section 12.4). The timber industry, in particular, benefits from almost the whole spectrum of export restrictions (export duties, export quotas, licensing; see Subsection 12.4.1). Wood-based products are subject to such restrictions not only due to their shortage, but also with the aim to increase domestic processing of wood. For example, in December 2017, the Government adopted a Decree on tariff quotas for the export of roundwood depending on its processing volumes. Quotas for the export of raw timber are tied to the volume of investment in processing. For those who will not develop processing capacities, an export duty will grow significantly over a number of years. As to other sectors, after WTO accession, Russia substantially reduced the list of non-ferrous metal goods that are subject to export duties. However, such restrictions still apply to waste and scrap.

13 **LABOUR**

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13.1 INTRODUCTION

This chapter analyses the Russian labour law and its enforcement, compliance with international labour standards, wage setting and minimum wages, collective bargaining of wages between workers and firms, informal labour market and mobility of workers across regions.

The Russian labour market is characterised by a solid macroeconomic performance, verified by the persistently low unemployment rate. The employment rate is above OECD countries' average and the unemployment rate is below the OECD average.[1186] The main structural problems of the Russian labour market appear to be: *(i)* weak role of trade unions and employers' organizations in determining wages, *(ii)* limited mobility of workers across regions, as well as *(iii)* weak enforcement of labour legislation, which is excessively rigid.

13.2 NATIONAL REGULATORY FRAMEWORK

The central piece of labour legislation is the Labour Code ('LC')[1187] which establishes the general framework for labour contracts, and outlines guarantees and rights and the role of trade unions. The LC replaced the Code of Laws on Labour, which had been in force since Soviet times. The main purpose of reforming the labour legislation in Russia was to bring more flexibility to the labour market and to ease the excessive restrictions on employment contracts in order to bring more employment out of informal sector.

In addition to the LC, contracts and industrial relations are further regulated by laws and Government decrees, including:

- The Employment of Population Act, 1991;[1188]
- The Law on Collective Agreements, 1992;[1189]
- The Settlement of Collective Labour Disputes Act;[1190]
- The Trade Union Act;[1191]

[1186] The employment rate was 66% and unemployment rate was 5.2% in 2017, retrieved from Rosstat, *Russian regions; social-economic indicators of 2018*, available at: http://www.gks.ru/bgd/regl/b18_14p/Main.htm and Rosstat, *Labour force survey of 2018*, available at: https://www.gks.ru/storage/mediabank/ors-2018-all.rar, accessed on 23 January 2020.

[1187] Federal Law N.º 197-FZ of 30 December 2001 (as amended), available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102074279, accessed on 6 February 2020.

[1188] Federal Law N.º 1032-1 of 19 April 1991 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_60/, accessed on 6 February 2020.

[1189] Federal Law N.º 2490-1 of 11 March 1992 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_383/, accessed on 6 February 2020.

[1190] Federal Law N.º 175-FZ of 23 November 1995 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_8489/, accessed on 6 February 2020.

[1191] Federal Law N.º 10-FZ, of 12 January 1996 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_8840/, accessed on 6 February 2020.

– The Russian Tripartite Commission on Regulation of Socio-Labour Relations Act;[1192]
– The Fundamentals of Health and Safety Act;[1193]
– The Compulsory Social Insurance Against Occupational Accidents and Diseases Act;[1194]
– The Insolvency (Bankruptcy) Act;[1195]
– The Minimum Wages Act;[1196]
– The Fundamentals of Public Service Act;[1197]
– Presidential May Decree of 2012;[1198]
– Presidential May Decree of 2018.[1199]

13.3 INTERNATIONAL LABOUR STANDARDS

Russia has been a member of the International Labour Organization ('ILO') since 1934.[1200] Russia has ratified 77[1201] ILO Conventions including the eight fundamental conventions and two protocols.[1202] Table 13.1 lists the fundamental conventions together with the date of their ratification by Russia.

[1192] Federal Law N.º 92-FZ of 1 May 1999 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_22938/, accessed on 6 February 2020.
[1193] Federal Law N.º 323-FZ of 21 November 2011 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_121895/, accessed on 6 February 2020.
[1194] Federal Law N.º 125-FZ of 24 July 1998 (ast amended), available at: http://www.consultant.ru/document/cons_doc_LAW_19559/, accessed on 6 February 2020.
[1195] Federal Law N.º 127-FZ of 26 October 2002 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_39331/, accessed on 6 February 2020.
[1196] Federal Law N.º 82-FZ of 19 June 2000 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_27572/3d0cac60971a511280cbba229d9b6329c07731f7/, accessed on 6 February 2020.
[1197] Federal Law N.º 79-FZ of 27 July 2004 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_48601/, accessed on 6 February 2020.
[1198] Presidential Decree N.º 596 of 7 May 2012, available at: http://pravo.gov.ru/proxy/ips/?docbody=&nd=102156330&, accessed on 6 February 2020.
[1199] Presidential Decree N.º 204 of 7 May 2018 (as amended), available at: https://minenergo.gov.ru/view-pdf/11246/84473, accessed on 6 February 2020.
[1200] More specifically, from 1934 to 1940 and then again since April 1954.
[1201] NORMLEX Information System on International Labour Standards, *Ratifications for Russian Federation*, available at: https://www.ilo.org/dyn/normlex/en/f?p=1000:11200:0::NO:11200:P11200_COUNTRY_ID:102884, accessed on 27 February 2020.
[1202] ILO member states are expected to sign all eight fundamental conventions. Member states that have not ratified one or more of the fundamental Conventions are asked each year to report on the status of the relevant rights and principles within their borders, noting impediments to ratification, and areas where assistance may be required. Available at: https://www.ilo.org/declaration/lang--en/index.htm, accessed on 29 October 2019.

Table 13.1: Fundamental ILO Conventions and date of ratification by Russia

Convention	Date of ratification
Forced Labour Convention, 1930 (N 29) P029 - Protocol of 2014 to the Forced Labour Convention, 1930 ratified on 17 Jan 2019 (In Force)	23 June 1956
Freedom of Association and Protection of the Right to Organise Convention, 1948 (N 87)	10 August 1956
Right to Organise and Collective Bargaining Convention, 1949 (N 98)	10 August 1956
Equal Remuneration Convention, 1951 (N 100)	30 April 1956
Abolition of Forced Labour Convention, 1957 (N 105)	2 July 1998
Discrimination (Employment and Occupation) Convention, 1958 (N 111)	4 May 1961
Minimum Age Convention, 1973 (N 138), minimum age specified: 16 years	4 May 1961
Worst Forms of Child Labour Convention, 1999 (N 182)	25 March 2003

Source: ILO, Information System on International Labour Standards.[1203]

There are problems with observance of two ILO fundamental conventions in Russia. The right of workers to strike which is provided by convention N.º 87 on the Freedom of Association is limited in Russia to collective labour disputes, implying for instance that strikes involving issues not included in workplace collective bargaining are not recognised.[1204] For several groups of workers strikes are forbidden (e.g. for railway employees).[1205] The ILO Committee of experts on the application of conventions also noted multiple violations of the Collective bargaining convention N.º 98,[1206] as well as steps taken to address them.[1207] There are cases of suspected anti-union discrimination, interference by employers in trade union internal affairs and refusal to bargain collectively.[1208]

[1203] NORMLEX Information System on International Labour Standards, *Ratifications for Russian Federation*, available at: https://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:11200:0::NO::P11200_COUNTRY_ID:102884, accessed on 29 October 2019.

[1204] Demmou, L. and Wörgötter, A. (2015), *Boosting Productivity in Russia: Skills, Education and Innovation*, OECD Economics Department Working Papers 1189, OECD Publishing, p. 23.

[1205] ILO. (2019a), *Report of the Committee of experts on the application of conventions and recommendations*, Report III (Part 1A), ILO, Geneva, pp. 140-141.

[1206] *Ibidem*, p. 167.

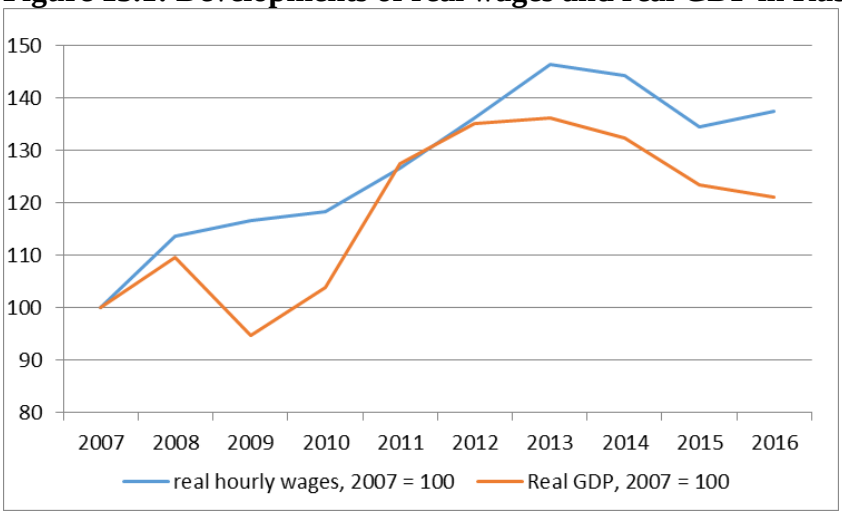
[1207] *Ibidem*, pp. 140-141

[1208] With regard to Collective bargaining convention N.º 98, ILO (2017a, p. 167) lists cases N.º 2758, 2216 and 2251. See for e.g. ILO Freedom of Association Case N.º 2758 (Russian Federation), available at: https://www.ilo.org/dyn/normlex/en/f?p=1000:50001:0::NO:50001:P50001_COMPLAINT_FILE_ID:2897753 , accessed on 29 October 2019.

13.4 WAGES AND WAGE-SETTING

The Russian labour market is characterized by the combination of a rather strong reaction by wages and a relatively weak reaction by employment to production shocks. Between 2007 and 2016, wages were adjusting to the changes in GDP (Figure 13.1). From 2007 real wages were on a rising trend up to 2015 when they started to decline in response to the currency crisis of 2014-2016.

Figure 13.1: Developments of real wages and real GDP in Russia



Source: Internal calculations based on the Rosstat data.[1209]

The main reason for flexible wages is the two-tier wage structure in both the private and public sectors.[1210] The first tier is fixed (basic, tariff-based) and rigidly contracted, while the other one is variable and therefore flexible.[1211] The variable part includes premiums and bonuses that can fluctuate considerably contingent upon general economic conditions, firm performance and regional fiscal capacities. In the private sector the high share of the variable part allows to cut wages during economic slowdowns and to increase wages during the periods of economic growth. In the public sector salary supplements increase when the regional fiscal position is good, and are close to the minimal bound when revenues are scarce.[1212] The variable part amounted to approximately 30% of total wages in the public sector in 2017, and was often higher in the private

[1209] Rosstat. (2017), *Labour and employment in Russia, 2009-2017*, available at: https://www.gks.ru/storage/mediabank/trud_2017.pdf, accessed on 29 December 2018;
Rosstat. (2018a), *Prices in Russia, 2008-2018*, available at: http://www.gks.ru/free_doc/new_site/prices/potr/I_ipc.xlsx, accessed on 29 December 2018;
Rosstat. (2018b), *GDP in Russia, 2007-2017*, available at: http://www.gks.ru/free_doc/new_site/vvp/vvp-god/tab1.htm, accessed on 29 December 2018.

[1210] Wage setting is regulated by Articles 129, 135 and 143 of the LC.

[1211] Gimpelson, V., and Kapeliushnikov, R. (2011), *Labour Market Adjustment: Is Russia Different?, IZA Discussion Paper 5588*, p. 16.

[1212] Gimpelson, V., Lukiyanova, A., and Sharunina, A. (2015), *Estimating the public-private wage gap in Russia: what does quntile regression tell us?, Working papers BRP 104/EC/2015*, p. 5.

sector.[1213] Russian workers employed in the private sector earn, on average, higher wages than the public sector employees do. In 2000-2014, the private sector wages were on average higher than public sector wages by 27%.[1214]

Starting from 2013, the wage gap has decreased by 4-5 p.p. as a result of the May Decree, issued by the President in 2012. One of the goals of the May Decree was to raise public sector wages. The 2012 May Decree fixed wage targets for major occupational groups in the public sector (doctors, teachers, academic researchers, associate professionals in education, healthcare and science sectors, and some junior staff). The targets varied for these occupational groups and were based on percentages of the regional average wage.[1215] Other occupations (mostly low skilled and supporting personnel) were neglected. Financing of the 2012 May Decree is done from the budgets on regional and local levels, with some regions receiving additional transfers.[1216]

In terms of implementation of the 2012 May Decree, average wages of doctors and teachers have increased in real terms only in 2013 as compared to 2012.[1217] Subsequently, in the years 2014-2016 the nominal increases in wages of doctors and teachers were eaten up by the increased inflation, and by 2016 they were only by 2-5% higher than in 2012 in real terms.[1218] However, the increases in public sector salaries led to fiscal strains in the regional budgets, which were responsible for approximately 70% percent of their financing.[1219] Finally in 2018, the President signed a new May decree[1220] setting the national development targets up to 2024 including growth of pensions and real incomes.

Labour taxes are lower in Russia than in most EU countries. The tax wedge on labour amounted to 33% in Russia in 2015,[1221] as compared to the EU-28 average of 38%.[1222] Russia's tax wedge is lower than in Hungary (49%), Czech Republic (40%), Spain (36%), and is similar to Poland

[1213] Gimpelson, V., and Kapelushnikov, R. (eds.) (2017), *Russian labour market: Tendencies, Institutions and Structural Change*, Moscow, HSE Publ. (In Russian), p. 23.

[1214] *Ibidem*, p. 110.

[1215] Gimpelson, Lukiyanova, and Sharunina. (2015), pp. 5-6.

[1216] Chernych, A., et al. (18 November 2014). *It is not May yet: the wages of doctors and teachers do not fit well into 2015 budgets*, Kommersant, in Russian, available at: https://www.kommersant.ru/doc/2613180, accessed on 5 April 2019.

[1217] Internal calculations based on the data from Rosstat (2017) and Rosstat (2018a).

[1218] *Ibidem*.

[1219] Khachaturov, A. (2015), *May decrees pull regions in default*, Novaya gazeta, in Russian, https://www.novayagazeta.ru/articles/2015/06/13/64511-mayskie-ukazy-tyanut-regiony-v-defolt, accessed on 5 April 2019.

[1220] Presidential Decree N.º 204 of 7 May 2018, available at: http://kremlin.ru/acts/bank/43027, accessed on 6 February 2020.

[1221] The tax wedge is calculated as a sum of social security contributions paid by the employer and the employee and the personal income tax expressed as a percentage of total labour cost. Total labour cost is gross wage plus employers' social security contributions. Internal calculations, based on Rosstat data, available at: https://www.gks.ru/storage/mediabank/t01.docx, accessed on 14 January 2020.

[1222] Based on Eurostat data, available at: https://ec.europa.eu/eurostat/statistics-explained/images/4/46/Tax_rate_indicators_on_low_wage_earners%2C_2015_%28%25%29_YB17.png, accessed on 14 January2019.

(33%) and Bulgaria (33%). Employers pay approximately 70% of labour taxes. This bias toward taxing the employer rather than the employee reflects historical legacy and political economy considerations.[1223] Under communism, state-owned enterprises paid social security contributions on behalf of their workers. This pattern has been largely preserved.[1224]

Mandatory minimum wages are the Government's most direct policy tool to influence wage levels. Minimum wages in Russia are regulated by the Minimum Wages Act, as well as by Article 133 of the LC. Minimum wages are reviewed every six months and are established at the federal and regional levels.[1225] In 2017 in 62 (out of 85) Russian regions minimum wages were established at the regional level in addition to the federal minimum wage.[1226]

Since 1991, in Russia the minimum wage was fixed at a low level and was hardly binding for the majority of enterprises.[1227,1228] The commonly used Kaitz index[1229] has amounted to 15-20% in 2010-2016 in Russia whereas in the OECD countries the index ranges from 40 to 60 %. Given large regional differences in wages in Russia, the Kaitz index varies from 11% in Moscow, 15%in Saint Petersburg to 38% in Dagestan and 36% in the Altai region. Real minimum wages in Russia are very low when compared to OECD countries (See Figure 13.2).

[1223] Rutkowski, J. (2007), Taxation of Labour *in* Ch. Grey and A.Vourdakis (eds.), *Fiscal Policy and Economic Growth in ECA*, World Bank, Washington, D.C., p. 290.

[1224] *Ibidem*, p. 290.

[1225] Article 133 LC.

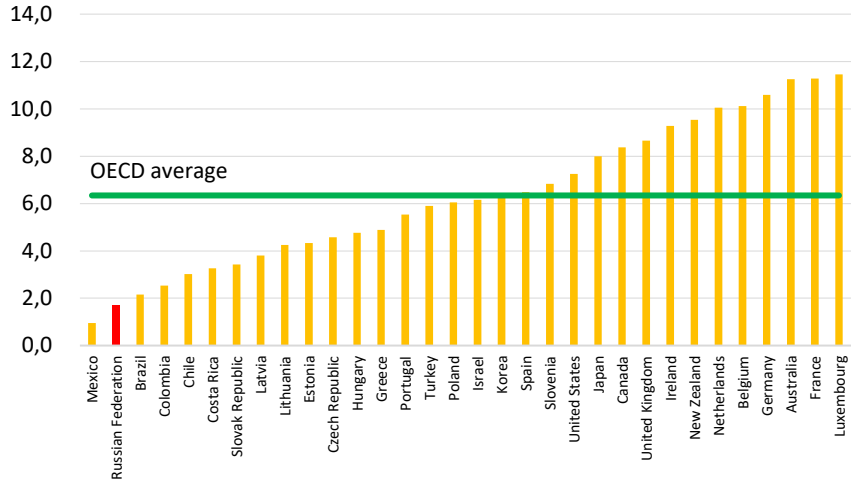
[1226] Gimpelson, and Kapelushnikov, (2017), p. 19.

[1227] Lukiyanova, A., and Vishnevskaya, N. (2016), Decentralisation of the minimum wage setting in Russia: Causes and consequences, *The Economic and Labour Relations Review*, 27(I): 98-117, pp. 102-103.

[1228] If the minimum wage is set too low by the legislation, it is not binding for firms (Boeri, T. and van Ours, J. (2013), *The Economics of Imperfect Labour Markets*, Second Edition, Economics Books, Princeton University Press, p. 51). Employees receive wages that are above the minimum wage even in the absence of the minimum wage.

[1229] The Kaitz index is defined as the ratio of the minimum wage to the average wage for Russia (due to data availability) and as the ratio of the minimum wage to the median wage for the OECD countries.

Figure 13.2: Real hourly minimum wages in 2017, in USD PPP-adjusted



Source: OECD data.[1230]

Given the low level of the minimum wage, it is not surprising that only a small share of the workforce has wages at or below that minimum. In 2017, 1.8% of workers received minimum wages or below.[1231] The minimum wage incidence is significantly lower than in many developed and emerging economies. In the latter, this share often exceeds 5–15%. There are large regional differences, with the lowest shares in the major cities e.g. Moscow (0.3%) and the highest shares in the regions of North Caucasus e.g. Dagestan (11.8%) and Chechnya (10.5%).[1232]

As for the regulatory framework for collective bargaining of wages, the Law on Collective Agreements defines a framework for agreements at different levels.[1233] At the highest level, the General Agreement sets general principles regulating labour relations in Russia. This General Agreement is signed every year by the Russian Tripartite Commission, which includes representatives of the Government, the unions, and employers. The Law on Collective Agreements also provides for tripartite regional, sectoral, and professional agreements. Agreements also can be negotiated at the enterprise level.

Despite the existing regulatory framework at different levels, little real bargaining occurs.[1234] National-level bargaining typically comprises general statements of intent and little real content

1230 OECD. *Statistics on real minimum wages*, available at: https://stats.oecd.org/Index.aspx?DataSetCode=RMW, accessed on 19 December 2018.
1231 See Rosstat (2017).
1232 *Ibidem*.
1233 World Bank (2003), *The Russian Labour Market: Moving from Crisis to Recovery*, International Bank for Reconstruction and Development/World Bank, Washington, p. 88.
1234 Demmou and Wörgötter (2015), p. 23.

relating to wages or working conditions.[1235] Sectoral agreements often just replicate legislative standards, while the content of regional-level agreements varies widely.[1236]

One of the reasons why collective bargaining agreements have generally not been an instrument for bargaining of wages and working conditions is that employer representation is limited. In many instances, agreements are signed between governments and unions with no representative of the employers. For example, more than 50% of the 61 sectoral agreements in 2007 were not signed by any employer organization,[1237] while in 2005 only five out of 57 sectoral agreements were signed by employers.[1238] This lack of representation reflects both a legacy of the previous socio-economic system (where the State was the sole employer) and the weak employers' organizations.[1239]

Another reason for the weak functioning of collective bargaining is a modest role played by trade unions in these agreements. At the time of the planned economy trade unions had almost universal membership.[1240] However, their major role was to provide social services, recreation, housing, consumer goods and sick pay. Collective bargaining over the terms of employment (including wages) did not take place. Currently, union membership is no longer universal, the union density rate of 27% is similar to the rate in the UK, Canada and Austria, much lower than in Sweden and Finland where the rates are approaching 70% and much higher than in Poland and Hungary with rates of about 10%.[1241] Russia's main trade union – the Federation of Independent Trade Unions ('FNPR'), which is a successor to the old communist unions, had 21.1 million members in 2013,[1242] amounting to approximately half of all workers employed in the large and medium-size enterprises. Other independent trade unions established over the transition period are small and make up only 5% of the total union membership.

[1235] Venn, D. (2009), *Legislation, collective bargaining and enforcement: Updating the OECD employment protection indicators*, p. 18, available at: http://www.oecd.org/els/emp/43116624.pdf, accessed on 30 October 2019.

[1236] Company-level agreements are often not adhered to or enforced. In practice, collective agreements mostly provide general recommendations but no binding constraints on firms.

[1237] According to Art. 48 of the LC, if an employer does not submit a rejection in writing within 30 days, the agreement also applies to that employer's enterprise.

[1238] OECD (2011), *OECD Reviews of Labour Market and Social Policies: Russian Federation 2011*, OECD Publishing, p. 101.

[1239] Employers' organisations did not exist in Russia in the Soviet times. The first ones were created during the transition of the early 1990s. Currently many employers' organisations are weak in terms of their influence and membership coverage and are struggling with limited staff and expertise, see ILO: https://www.ilo.org/moscow/areas-of-work/social-dialogue/lang--en/index.htm, accessed on 5 April 2019

[1240] Lehmann, H., and Muravyev, A. (2011), "Labour Markets and Labour Market Institutions in Transition Economies", *IZA Discussion Paper No. 5905*, pp. 7-8.

[1241] ILO (2017b), "Trends in collective bargaining coverage: stability, erosion or decline?", *Issue Brief No. 1* - Labour Relations and Collective Bargaining, p. 5

[1242] FNPR (2015), *FNPR in a changing world, Informational volume*, in Russian.

Although the membership numbers are high, scholars agree that trade unions in Russia play only a limited role.[1243,1244] The union's power is undermined by the restrictions regarding the right to strike.[1245] As was noted in Section 13.3 above, the right of workers to strike is limited in Russia to collective labour disputes. According to Article 398 of the LC, a strike is a voluntary refusal by workers to carry out their assigned jobs in order to resolve a collective labour dispute. Comparing this definition with the position of ILO bodies shows that the right to strike as it is recognized in Russia excludes strikes to express solidarity, strikes to protest against the Government's economic and political policies, strikes to achieve recognition of a trade union, strikes to resolve issues arising from economic and social policy, and strikes to resolve problems arising within an enterprise that directly affect worker interests.[1246] Moreover, the procedure for mounting a collective labour dispute and also the procedures for resolving one impose a multitude of restrictions and formal requirements that are difficult for workers to satisfy.[1247] As a result, many strikes are considered technically illegal on the basis of a missed deadline or not fulfilling some of the requirements.[1248]

According to ILO estimates, for 22% of workers their wage and working conditions are regulated by one or more collective agreements.[1249] This coverage rate is rather low when compared to other countries. Many OECD countries such as Belgium, France and Finland have coverage ratios of more than 80%, with medium-high levels observed in Germany, Switzerland and the Czech Republic.[1250]

As recommended by the experts from the OECD, the Russian authorities should widen the scope for negotiating collective bargaining at the enterprise level and ensure enforcement by following the recommendations made by experts in the context of the OECD review on labour market and the ILO Commissions on Freedom of Association and Collective Bargaining.[1251]

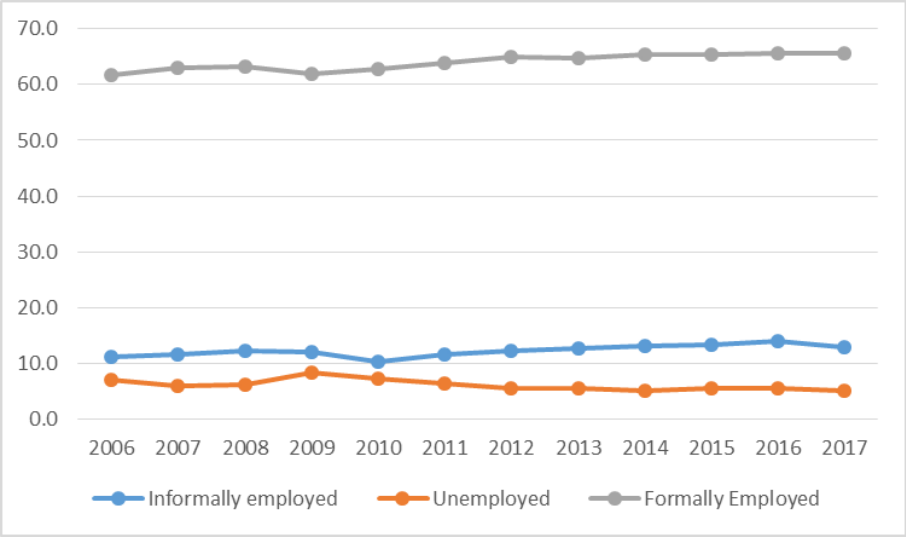
13.5 INFORMAL LABOUR MARKET

According to various estimates, informal jobs account for about 20-30% of employment in Russia.[1252] Rosstat estimated informal workers at 20% of employment in 2017 and the ILO

1243 Gimpelson, and Kapelushnikov. (2017), p. 16.
1244 See Lukiyanova and Vishnevskaya. (2016), p. 102.
1245 See Demmou and Wörgötter. (2015), pp. 22-23.
1246 Gerasimova E. (2017), *Collective Labour Disputes and Strikes in Russia: The Impact of Judicial Precedents and Enforcement*, *Russian Law Journal Volume V*, Issue 2, p. 10.
1247 *Ibidem*.
1248 For instance, a strike was ruled illegal because the employees were not able to prove that their structural subdivision was autonomous enough from the "main" employer's business (Lyutov, 2011, p. 104).
1249 See ILO (2017b), p. 2.
1250 *Ibidem*.
1251 See Demmou and Wörgötter (2015), p. 22.
1252 See e.g. Gimpelson, and Kapelushnikov (2017), p. 71.

estimated it at 24% in 2014.[1253, 1254] In 2006-2017 the rates of informal as well as formal employment were rather stable (See Figure 13.3). Informal workers work mainly in trade, construction and services.[1255]

Figure 3: Developments of labour market status in Russia



Source: Internal calculations, based on Rosstat (2017); informally employed and formally employed are calculated as a ratio of a number of informally/formally employed divided by the working age population (15-72); unemployed is a ratio of a number of unemployed to the labour force.

When compared to other countries, Russia does not stand out in terms of the share of informal workers. Shares of informal employment in other countries varied from 32% in Greece, 27% in Romania, 20% in Poland to much lower levels in Lithuania and Hungary (8 and 12%, correspondingly).[1256]

Studies show low persistence of informal employment in Russia and high mobility from informal to formal sectors.[1257] In the same vein, the likelihood of finding a formal job starting from the informal sector is only a few percentage points lower than when the original state is a formal job. The relatively low persistence of informal employment confirms the idea that the labour market in Russia is competitive and relatively flexible.

[1253] See Rosstat. 2017.

[1254] Rosstat applies 'productive' definition that relies on characteristics of the employer. "*Formal workers*" (in the Rosstat definition) are employed by organizations – legal entities, while "*informal workers*" are those who work outside of them. This definition of informality encompasses all the self-employed, as well as salary workers employed by microbusinesses or by private individuals outside the formal sector, but it largely overlooks informal workers in the formal enterprises (Gimpelson, V., and Kapeliushnikov, R. (2014), *Between Light and Shadow: Informality in the Russian Labour Market, IZA DP No. 8279*, p. 7).

[1255] Gimpelson et al., 2017, p. 77.

[1256] *Ibidem*.

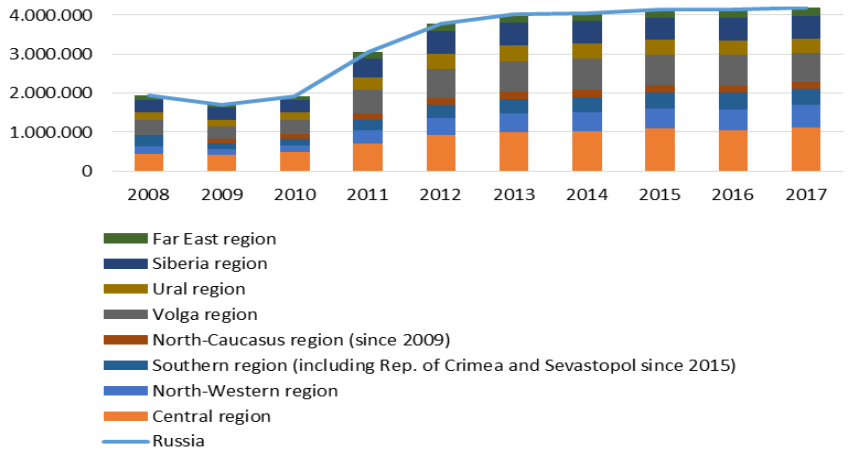
[1257] See e.g. Slonimczyk, F., and Gimpelson, V. (2015), *Informality and Mobility. Economics of Transition 23 (2)*.

13.6 LABOUR MOBILITY AND ITS IMPACT ON WAGES

The Russian labour market is characterised by large barriers to internal geographic mobility. These barriers include poor functioning of the housing market, high transportation and psychological costs of moving and are reinforced by the underdevelopment of financial markets.[1258] Another important feature of the Russian labour market is its high local level concentration of jobs due to the high geographic concentration of industrial production inherited from the Soviet period.[1259,1260]

As a result of those barriers, internal migration flows remain small. In 2017, the annual internal migration amounted to 4.2 million or 2.9% of total population.[1261] The average annual migration rate was at 2.9% of total population also in the time period 2014-2017. Two largest cities – Moscow and St. Petersburg - attract the majority of internal migrants in the central and the north western regions, respectively (Figure 13.4). Migrants tend to go from regions with high unemployment and worse public goods to regions with lower unemployment and better public goods.[1262]

Figure 13.4: Internal migration by Russian regions



Source: Rosstat, 2018c.

Given a small number of internal migrants in Russia, studies usually assume that migration does not affect wages and other socio-economic variables in the destination regions.[1263] The large

[1258] Guriev, S., Vakulenko, E. (2015), *Breaking out of poverty traps: Internal migration and interregional convergence in Russia*, *Journal of Comparative Economics*, Volume 43, Issue 3, August, p. 633.

[1259] This follows from the old Soviet tradition of building one industrial mega-plant in a certain region and a city around it.

[1260] Lazareva, O. (2015), *Russian migrants to Russia: Assimilation and local labour market effects. IZA Journal of Migration*, p. 16.

[1261] Rosstat. (2018c). *Population size and migration of the Russian Federation*, 2009-2018, available at: https://www.gks.ru/storage/mediabank/bul-migr18.rar, accessed on 12 December 2019.

[1262] See Gimpelson and Kapelushnikov, (2017), p. 139.

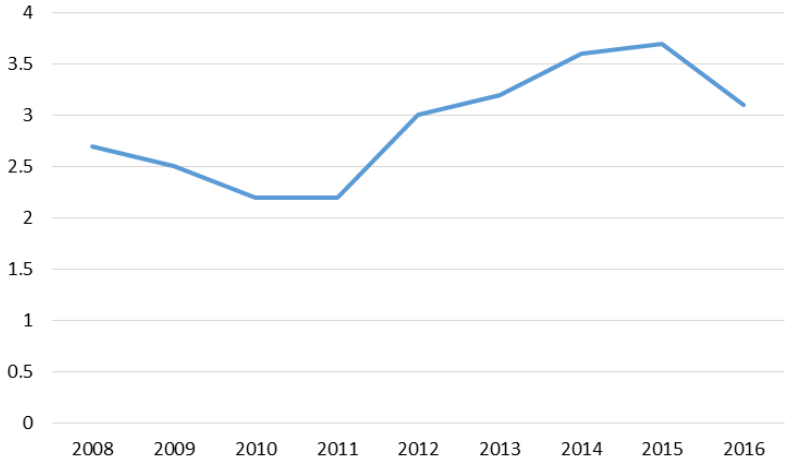
[1263] See e.g. Guriev and Vakulenko, (2015), p. 645.

existing differences in employment indicators across regions confirm this assumption. For instance, the employment rate in 2014 amounted to 65% in the entire country, while it was 81% in Chukotka region in the Far East which is rich in natural resources and only 48% in a less developed Tuva region.[1264]

As a result of low internal mobility, regional labour markets preserve large differences in economic indicators over time. Large regional differences in employment rates, unemployment and wage levels indicate the inefficient allocation of resources across the country, which can be potentially improved and, as a result, the level of wealth in the economy can be increased. The State can pursue more active policies aiming at lowering existing barriers to labour mobility, for example by further developing financial markets. However, the existing inefficiencies cannot be conclusively attributed to the role played by the state authorities, given that the existing barriers are mainly caused by the country's geographical characteristics and the level of economic development.

In addition to internal migration, Russia receives relatively large immigration flows. In 2016, 2.8 million of legal immigrants worked in the country, accounting for 3.1% of the labour force (see Figure 13.5). Experts estimate that illegal immigrants can constitute another 3.2-5.2 million.[1265] Immigrants come to Russia mainly from the countries of Central Asia (Tajikistan, Uzbekistan, Kyrgyz Republic), Ukraine and China.

Figure 13.5: The share of foreign migrant workers in the Russian labour force



Source: Rosstat, 2017.

The legal framework for immigration has gradually improved during the 2000s. The 2002 Federal Law on the legal status of foreign citizens in the Russian Federation precisely defined the legal

[1264] See Gimpelson and Kapelushnikov, (2017), p. 137.
[1265] Lokshin, M., and Chernina, E. (2013), Migrants on the Russian labour market: characteristics and wages, *Economic Journal of Higher School of Economics*, in Russian, p. 44.

status of labour migrants and standardized the registration and issuance of work permits.[1266] In 2010, the procedure of obtaining work permits was simplified and quotas introduced on the number of permits issued to migrants traveling visa free.[1267] Also in 2010, a patent system for citizens of former Soviet countries with visa-free entry was introduced that allowed immigrants to perform domestic work in private households, and was not limited by quota[1268]. Recently, the State has adopted the State Migration Policy Concept[1269] passing the quota reform and abolishing the Federal Migration Service.[1270]

Foreign migrants receive lower wages than Russian workers. The average wage of foreign migrants was on average 40% lower than for Russian workers with the same characteristics.[1271] Most migrant labour into Russia is cheap, unqualified labour, in low-productivity sectors of economy.[1272] Temporal migrant workers had a positive impact on the labour market for Russian nationals during the currency crisis of 2015-2016, as employers were downsizing the number of migrant workers' jobs in the first place, while preserving the jobs of domestic workers. As temporal migrant workers are often not counted in the labour market statistics because they might leave the country after a short period, their presence allowed Russian firms to adjust to the negative labour shock, and as a result constrained the country unemployment rate.

13.7 LABOUR LAW ENFORCEMENT

Russian labour market regulations can be compared to other countries by using different indices. The existing indices suggest that Russian labour market regulations are stringent, i.e. they protect workers. The World Bank's Doing Business 2010 index on the rigidity of employment (rigidity of hiring, firing, and working hours) in Russia stood at 38 against 30 for the OECD on average.[1273,1274]

[1266] Federal Law N.º115-FZ of 25 July 2002 (as amended), available at: http://www.consultant.ru/document/cons_doc_LAW_37868/, accessed on 6 February 2020.

[1267] Government Order N.º 2024-r of 17 November 2010, available at: http://www.pravo.gov.ru/proxy/ips/?doc_itself=&nd=102143378&page=1&rdk=0&intelsearch=%EE+%EA%EE%ED%EE%F0%EE%EB%E5+%E7%E0+%F1%EE%EE%F2%E2%E5%F2%F1%F2%E2%E8%E5%EC+%F0++&link_id=12#I0, accessed on 6 February 2020.

[1268] Federal Law N.º 86-FZ of 19 May 2010, available at: http://pravo.gov.ru/proxy/ips/?docbody=&link_id=0&nd=102138471&intelsearch=&firstDoc=1, accessed on 6 February 2020.

[1269] Presidential Decree N.º 622 2018 of 31 October 2018, available at: https://migrantmedia.ru/novyy-ukaz-o-kontseptsii-gosudarstvennoy-migratsionnoy-politiki-rossiyskoy-federatsii-na-2019-2025-g/, accessed on 14 November 2019; available at: http://kremlin.ru/events/president/news/58986, accessed on 30 October 2019.

[1270] The federal executive body responsible for drafting and implementing national migration policy and for legal regulation of migration. Available at: government.ru/en/department/247/events, accessed on 30 October 2019.

[1271] Vakulenko, E. and Roman, L. (2016), *Are foreign workers discriminated on Russian labour market*, Economic policy, Vol. 11, N. 1, in Russian, p. 121.

[1272] World Bank. (2018), *Russia's Economy: Preserving Stability, Doubling Growth, Halving Poverty – How? 40th issue of the Russia Economic Report*, World Bank, Washington, p. 40.

[1273] World Bank. (2010), *Doing Business 2010*, World Bank, Washington, p. 159.

[1274] This is the latest available data – the World Bank no longer produces this index.

Russia stands even more out against other countries according to other indices, where Russia earns a value of 0.83 against the median value of 0.44.[1275] Another widely used indicator is the OECD index of strictness of employment protection legislations (′EPL′). The OECD EPL index is compiled from 21 items quantifying the costs and procedures involved in dismissing individuals or groups of workers or hiring workers on fixed-term or temporary work agency contracts. The OECD EPL index gives Russia 3.06, while the average for OECD countries stands at 2.08 in 2012.[1276,1277] Only Portugal has a higher index of 3.56 and the indices for the OECD countries tend to decrease over time.

While Russian labour regulations are relatively strict, law enforcement is considered to be poor.[1278] However, only few sources analyse the topic of enforcement of labour regulations[1279] with only one existing detailed analysis on the topic originating from 2009.[1280] This study analyses the activity of Labour Inspectorates, court statistics related to labour disputes and it also carries out a survey of stakeholders.[1281] It found large regional variations in EPL enforcement. In particular, the study found large regional variations in the density of labour inspectors, number of labour inspections, as well as number of detected EPL violations.[1282] The EPL violations are more often reported in the northern territories and in the ethnic republics. Employees in these regions often work in a firm that is a sole employer in the area and therefore employees have only limited outside employment options and prefer litigation as the solution to their labour conflicts. Regions with a more diversified economy and with more competitive labour markets demonstrate lower probability of reporting EPL violations, as workers in these regions are likely to prefer finding a new job instead of costly litigation.[1283] The result of the survey among labour inspectors, judges, trade union leaders and other stakeholders confirm that observance of EPL constitutes a problem, in particular 10-37% of respondents consider non-observance an acute problem.[1284] Numerous restrictions are set by the legislation on the powers of labour inspectors. Moreover, their insufficient and decreasing number do not guarantee effective supervision and sufficient coverage

[1275] Botero, J. C., Djankov, S., Porta, R. L., Lopez-de-Silanes, F., and Shleifer, A. (2004), *The Regulation of Labour*, *The Quarterly Journal of Economics*, 119(4): 1339–1382, p. 39

[1276] OECDa. *OECD Indicators of Employment Protection*, available at: https://stats.oecd.org/Index.aspx?DataSetCode=EPL_CD, accessed on 28 December 2018.

[1277] 2012 is the latest available date for the OECD employment protection indices.

[1278] Demmou and Wörgötter, (2015), p. 37; Gimpelson, V., Kapeliushnikov, R., and Lukiyanova, A. (2009), *Employment Protection Legislation in Russia: Regional Enforcement and Labour Market Outcomes, IZA Discussion Paper No. 4484*, p. 2.

[1279] See also Muravyev, A. (2010), *Evolution of Employment Protection Legislation in the USSR, CIS and Baltic States*, 1985-2009, *IZA Discussion paper No. 5365*.

[1280] Gimpelson, V., Kapeliushnikov, R., and Lukiyanova, A. (2009).

[1281] The data on Labour Inspectorates and court statistics is not readily available. It should be collected and cleaned for the purposes on analysis.

[1282] Violations in Gimpelson et al. (2009) refer to violations on various issues, including unjust dismissals, use of short-term contracts, over-time work, pay and timing of pay, trade union rights.

[1283] *Ibidem*.

[1284] *Ibidem*.

of workplaces by labour inspection visits.[1285] The ILO notes from the statistics provided in the 2016 report of the Russian Federal Service of Labour and Employment that the number of labour inspectors decreased between 2012 and 2016 from 2 680 to 2 102. It also notes from the same source that the number of labour inspectors is considered to be insufficient to achieve sufficient coverage of workplaces by labour inspection visits and that the limited number of staff had significantly affected the results and quality of labour inspection.

In terms of EPL coverage measured as the proportion of covered employees in the total employment Russia scores relatively low. The effective EPL coverage stood at 58% in 2009,[1286] with regional variation ranging from 40% to 74%.[1287] The low effective EPL coverage in Russia has to do with the fact the EPL in full applies to firms in the formal sector only if they are above a particular size.[1288] Therefore, small firms, individual entrepreneurs and self-employed are effectively not covered by the EPL. Most countries had EPL coverage ratios close to 100% in 2010, with the average coverage of 94% in the sample of 93 countries.[1289]

13.8 CHAPTER SUMMARY

The most important piece of labour legislation is the Labour Code, which establishes general framework for labour contracts and outlines the role of trade unions. The LC was adopted in 2002 and further amended in the subsequent years.

Russia has ratified 77 ILO Conventions including the eight fundamental conventions. However, there are problems with observance of fundamental conventions N.º 87 on the Freedom of Association and N.º 98 on the Collective Bargaining. The right of workers to strike is limited in Russia to collective labour disputes, implying for instance that strikes involving issues not included in workplace collective bargaining are not recognised. These legal restirctions undermine the trade union's power. Moreover, there are cases of suspected anti-union discrimination, interference by employers in trade union internal affairs and refusal to bargain collectively.

The wage developments confirm strong reaction of wages to production shocks. Flexible wages are determined by the two-tier wage setting coupled with low levels of mandatory minimum wages. Employers' organizations and trade unions have only limited impact on wage policy and

[1285] ILO, *Report of the Committee of experts on the application of conventions and recommendations*, Report III (Part 1A), 2019, ILO, Geneva, pp. 492-493; ILO, *Report of the Committee of experts on the application of conventions and recommendations*, Report III (Part 1A), 2020, ILO, Geneva, pp. 484-485.

[1286] Gimpelson et al. (2009), p. 15.

[1287] Gimpelson et al. (2009) measure EPL coverage as the proportion of large and medium sized firms i.e. firms with 50+ employees in the total employment. According to Gimpelson et al. (2009), in the Russian context, the proportion of large and medium sized firms can be interpreted as an approximate measure of effective EPL coverage because these firms are more closely monitored by regulatory and tax authorities and are also obliged to fill in monthly statistical reports (*Ibidem*, p. 8).

[1288] *Ibidem*.

[1289] Aleksynska, M., and Eberlein, F. (2016), *Coverage of employment protection legislation*, *IZA Journal of Labour Policy*, 5, pp. 6-7.

working conditions and little real bargaining occurs in practice. Employers' organizations often do not participate in sectoral collective agreements. This lack of representation reflects both a legacy of the previous socio-economic system (where the State was the sole employer) and weak employers' organizations.

The Russian labour market is characterised by low internal mobility and a relatively high number of foreign workers. Internal mobility is low because of existing barriers that include poor functioning of the housing market, high transportation and psychological costs of moving and are reinforced by the underdevelopment of financial markets. However, the existing inefficiencies cannot be conclusively attributed to the role played by the state authorities given that the existing barriers are mainly caused by the country's geographical characteristics and the level of economic development.

Finally, while Russian labour regulations are relatively strict, law enforcement is considered to be poor, notably due to restrictions in the law to the powers of the labour inspectorate and its insufficient staff. Various indices, including the OECD index confirm that labour regulations are relatively strict with respect to firing and the use of fixed-term contracts. However, only limited evidence exists on the topic of labour law enforcement.

14 STEEL

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This chapter provides an overview of the Russian steel sector and discusses the main recent state policies which may be influencing steelmaking production conditions. It starts with key characteristics of the Russian steel sector such as the market structure, production, capacity and trade developments. Subsequently, the main part of the chapter documents and comments on the main state policy measures directed at both the steel industry itself, as well as sectors providing key intermediate inputs into steel production, such as steelmaking raw materials, energy and transportation.

14.1 Overview of Russia's steel sector

14.1.1 The global context

Due to its historical role in industrialisation, strategic nature, high entry and exit costs and strong upstream and downstream linkages to other economic activities, the steel sector occupies a special place in economic policy of many countries. Historically, the sector has been subject to strong market cycles, significant levels of state intervention and major efforts at international co-ordination.[1290] In the last decade, major international commercial frictions surfaced in the sector. Demand for steel products and steel prices decreased considerably in the aftermath of the 2008-09 economic and financial crisis. At the same time, some countries have seen significant capacity expansions. Excess world steelmaking capacity[1291] is estimated to have increased from around 205 million tonnes in 2006 to more than 561 million of metric tonnes (′mmt′) at the end of 2017, or from approximately 14% to more than 25% of installed global capacity.[1292] This coincided with the deterioration of profitability of steelmaking firms and a significant surge in trade policy actions globally.[1293] These disturbances have complex causes, ranging from changes in the demand for and supply of steel products, technology but also state policies towards the sector.[1294]

Steel now accounts for the highest share (26%) of trade remedy measures currently in force globally and for a particularly high share (44%) of countervailing duty measures.[1295]

14.1.2 Market structure and performance: an overview

1290 For example the work of the OECD Steel Committee and, more recently, the G20-led Global Forum on Steel.

1291 Defined as the difference between crude steel production capacity and crude steel production.

1292 OECD (2018), *Recent developments in steelmaking capacity*, OECD, Paris, available at: http://www.oecd.org/industry/ind/recent-developments-steelmaking-capacity-2018.pdf, accessed on 30 October 2019.

1293 See the steel section in OECD (2016), *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?* OECD Publishing, Paris, available at: http://dx.doi.org/10.1787/9789264262096-en, accessed on 30 October 2019.

1294 There is convincing evidence that state policies in some countries have influenced capacity and production of steel. See for example Mattera, G. and Silva, F. (2018), *State enterprises in the steel sector, OECD Science, Technology and Industry Policy Papers*, No. 53, OECD Publishing, Paris, available at: https://doi.org/10.1787/2a8ad9cd-en, accessed on 30 October 2019.

1295 See for instance Kowalski, P. and Rabaioli, D. (2017-05-18), *Bringing together international trade and investment perspectives on state enterprises*, OECD Trade Policy Papers, No. 201, OECD Publishing, Paris, available at: http://dx.doi.org/10.1787/e4019e87-en, accessed on 30 October 2019.

Steel production used to be one of the main industrial activities in the system of centrally planned economy of the FSU. Privatisation of the Russian steel sector was however largely completed in the 1990s and the country's steelmaking is nowadays dominated by privately-owned firms,[1296] with the largest steel producers such as Severstal, [1297] Novolipetsk Steel (′NLMK′), [1298] Magnitogorsk Iron & Steel Works (′MMK′),[1299] Evraz[1300] and TMK[1301] being also publicly listed on Moscow or London stock exchanges.

In terms of turnover, the Russian sector of basic metals accounted in 2017 for some 3.3% of the country's total turnover across all industries,[1302] the sector of mining of metal ores for further 0.07% and manufacture of fabricated metal products (except for machinery and equipment) for an additional 1.4%. No corresponding official employment estimates for the steel industry separately are available. According to the Government 2016 Strategy for Development of the Metallurgical Industry in Russia for the Period till 2030[1303] it is estimated that the whole metallurgical industry accounted for 2.6% of total employment with more than 900 000 employees employed directly at metallurgical enterprises and with an estimated sevenfold employment multiplication factor for other industries. Unofficial estimates suggest that the Russian steel industry itself employs directly approximately 330 000 people while indirect employment accounts for roughly 2.3 million people.[1304] It is also estimated that there are 55 cities centred on activities of metallurgical companies (the so-called metallurgical monocities).[1305]

Steel production is concentrated among a small number of large steelmaking companies which are also significant international players. In 2017, the six largest producers accounted for more than 90% of Russia's production of crude steel and for 4% of global production (see Table 14.1). All of them are vertically integrated, often largely self-sufficient, producers providing a range of steelmaking raw materials (iron ore, coking coal products), as well as a range of semi-finished and finished steel products. However, that integration is often partial: for instance, MMK is integrated

1296 For example, state firms account only for around 0.2% of total basic metals industry output and for 0% of manufacture of coke and refined petroleum products, see: Russian Statistical Yearbook, 2018, Table 16.4, "*Volume of Shipped Own Produced Goods, works performed and services rendered by ownership type in 2017*", available at: https://www.gks.ru/free_doc/doc_2018/year/year18.pdf, accessed on 6 December 2019.

1297 Available at: https://www.severstal.com/, accessed on 12 March 2020.

1298 Available at: https://nlmk.com/ru/, accessed on 12 March 2020.

1299 Available at: http://mmk.ru/, accessed on 12 March 2020.

1300 Available at: https://www.evraz.com/ru/company/, accessed on 12 March 2020.

1301 Available at: https://www.tmk-group.ru/, accessed on 12 March 2020.

1302 Rosstat does not report the GDP broken down by industry but it reports turnover. Based on Russian Statistical Yearbook 2018, Table 16.41 "*Volume of shipped own produced goods, works performed and services rendered by economic activity*", available at: https://www.gks.ru/free_doc/doc_2018/year/year18.pdf, accessed on 6 December 2019.

1303 This is an update of a document with the same title from 2014, available at: https://pandia.ru/text/81/089/58758.php, accessed on 30 October 2019.

1304 This statistic has been provided informally by representatives of the Russian Steel Association.

1305 Strategy for Development of the Metallurgical Industry in Russia for the Period till 2030, available at: https://pandia.ru/text/81/089/58758.php, accessed on 30 October 2019.

in terms of coal sourcing, but not in terms of iron ore sourcing, NLMK and Metalloinvest are integrated in terms of iron ore, but not in coal, and TMK is not integrated in terms of raw materials sourcing. Some of the Russian steelmaking firms, such as for example EVRAZ, MMK, NLMK or Severstal, also generate their own electricity.

The six largest Russian steel companies have been showing strong economic performance, with positive cash flow and high and increasing EBITDA margins.[1306] For example, in 2107, the six largest Russian steel producers recorded EBITDA margins of 24% and higher (Table 14.1), well above the industry's world average and median values estimated by the OECD at, respectively, 12.2% and 7.5%.[1307]

Table 14.1. Russia's largest steel producers

Company name	Crude steel production in 2017 (mmt)	Share of Russia's production (%)	Share of global production (%)	Main products	EBITDA margin* (%), 2017
NLMK	17.08	24%	1.01%	Mining segment: coke, ore, limestone, dolomite. Steel segment: hot-rolled, cold-rolled, semi-finished, rebar, galvanized. Active also in the power generation segment.	26%
Evraz	14.03	20%	0.83%	Mining segment: iron ore, coal, limestone, vanadium. Steel segment: beams, rails, structural shapes, rebar, pipe.	24%
MMK	12.86	18%	0.76%	Mining segment: iron ore, coal, coke.	27%

[1306] This has been the case in the period 2016-18, while earlier, in 2014-2015, the sectors was hit by a financial crisis in the country with a significant drop in steel consumption.

[1307] OECD (2018), *Steel Market Developments Q4 2018*, available at: http://www.oecd.org/sti/ind/steel-market-developments-Q42018.pdf, accessed on 30 October 2019. The average is weighted by total sales.

				Steel segment: semi-finished, hot-rolled, coated, sections, pipe.	
Severstal	11.65	16%	0.69%	Mining segment: iron ore and coking coal. Steel segment: flat products, hot-rolled, cold-rolled, galvanized, pipe.	33%
Metalloinvest Management Company	4.8	7%	0.28%	Mining segment: iron ore. Steel segment: bars; Heavy plate, strips, billets; semi-finished.	34%
Mechel	4.27	6%	0.25%	Mining segment: a range of coal products. Steel segment: flat products, long products, rail products, wire and wire products, forged bars and stampings, ferrosilicon. Active also in the power generation segment.	27%
Total	64.7	91%	3.82%	n.a.	n.a.

Note: *EBITDA margin expressed as EBITDA as percentage of revenue in 2017.

Source: Internal compilation on the basis of the Word Steel Association, company websites and (for EBITDA) Deloitte (2018).

In 2017, 66.9% of Russia's steel production was produced via the blast furnace-basic oxygen furnace (′BF-BOF′) route which uses iron ore, coal, and recycled steel relatively intensely as raw materials. 30.8% was produced via the electric arc furnace (′EAF′) route which uses mainly recycled steel and electricity.[1308] The small rest (2.4%) is produced via the open hearth route, a

[1308] For comparison, the corresponding production technology shares for the EU are around 60% (BF-BOF) and 40% (EAF) according to World Steel Association (2018), *World Steel in Figures 2018*, available at: https://www.worldsteel.org/steel-by-topic/statistics/steel-statistical-yearbook/World-Steel-in-Figures.html, accessed on 30 October 2019. See also Section 14.4.2 for a more detailed discussion of energy sources used in steel production.

relatively outdated technology used according to the World Steel Association otherwise only in Ukraine.[1309] A significant number of open hearths have been closed down in the past years (only two are operational as of writing of this Report) and replaced with EAF capacities in most of the cases. For comparison, in 2000, the corresponding shares were, respectively, 58.1%, 14.6% and 27.4%, illustrating a significant transformation of steelmaking capacity towards more energy-efficient production processes.[1310]

14.1.3 INTERNATIONAL ECONOMIC SIGNIFICANCE

According to the latest World Steel Association statistics, with 71.3 mmt of crude steel produced in 2017, Russia was the world's 5th largest producer (4% of the world total),[1311] the 4th largest steel exporter (31.3 mmt) and, after China and Japan, the 3rd largest net exporter (24.9 mmt) of crude steel products. However, when indirect trade in steel statistics are considered, Russia is also the world's 5th largest net importer of indirectly traded steel products (4.7 mmt, finished steel equivalent) which concerns the steel embodied in steel containing products. With 106.6 mmt production, the country is also the world's 5th largest iron ore producer, the 7th largest iron ore exporter (21 mmt) and the 7th largest exporter of steel scrap (5.2mmt).

A major share of Russian exports is represented by semi-finished steel (slabs and billets) which account for over 50% of Russia's exports. These products are then further rerolled into final steel products at the countries of export. Main export destinations include CIS countries, the EU, Turkey, Egypt, as well as Middle East.

In 2017, Russia accounted for 4% of global steelmaking capacity, down from 6.2% in 2000.[1312] This decrease in the share in global capacity reflected, among other factors, a large expansion of China's capacity in the sector. Russia's 2017 capacity at 88 mmt was down from 95 mmt in the peak year of 1990 but up from the level of 66 mmt in 1997 (Figure 14.2). While this 33% increase seems very modest for an emerging market and when compared to that for China (more than 700% in the same period: from 160 mmt to 1048 mmt), India or even a much more developed South Korea, it contrasts with the decreases in steelmaking capacity in industrialised economies in the same period, such as the triad EU, US and Japan, though the pace of development of these economies is also different from the Russian one.

As was the case in other countries, while production of crude steel in Russia has been hovering around 70 mmt, the excess steelmaking capacity increased in the 2008-17 period. Among the

1309 *Ibidem.*

1310 *Strategy for the Development of the Metallurgical of Russia for the Period till 2030*, available at: https://pandia.ru/text/81/089/58758.php, accessed on 30 October 2019.

1311 Or the sixth if the EU is counted as a whole. World Steel Association (2018), *World Steel in Figures 2018*, p. 9, available at: https://www.worldsteel.org/en/dam/jcr:f9359dff-9546-4d6b-bed0-996201185b12/World+Steel+in+Figures+2018.pdf, accessed on 30 October 2019.

1312 Calculations based on the OECD Steelmaking Capacity Database, available at: https://www.oecd.org/sti/ind/steelcapacity.htm, accessed on 7 February 2020.

world's ten largest crude steel producers, in 2017, Russia however had the third lowest excess capacity of 18.8% of installed capacity (after South Korea and Japan which had excess capacity of respectively 16.9% and 18.4%).[1313] Nevertheless, national data reported by Rosstat suggest that certain downstream segments of the steel industry, such as, for example, stainless steel in ingots or other primary forms and semi-finished products of stainless steel, other alloy steel in ingots or other primary forms and semi-finished products of other alloy steel or tubes, pipes, hollow profiles and related fittings, had much higher shares of unused capacity in 2017 (see Table 14.2).[1314]

Table 14.2 Overcapacity in certain selected segments of the steelmaking industry

Industry segment	Capacity utilisation (in %)
Pig iron and spiegeleisen in pigs, blocks or other primary forms	94.6
Non alloy steel in ingots or other primary forms and semi-finished products of non alloy steel	84.9
Stainless steel in ingots or other primary forms and semi-finished products of stainless steel	22.4
Other alloy steel in ingots or other primary forms and semi-finished products of other alloy steel	43.5
Rolled finished ferrous metals	80.5
Tubes, pipes, hollow profiles and related fittings, of steel[a]	68.0

a Note that this production usually considered to be a separate subsector. Most Russian steel producers (except for Severstal, whose tube production is not significant) do not produce pipe and tube.

Source: Russian Statistical Yearbook 2018; selected items from Table 16.5 "*The level of used of annual average production capacity of organizations producing certain types of products in mining and quarrying and manufacturing in 2017 (in %)*".

14.2 GOVERNMENT POLICIES DIRECTLY INFLUENCING THE STEEL SECTOR

14.2.1 SUPPORT AND DEVELOPMENT POLICIES TOWARDS THE SECTOR

As is the case with several other industrial sectors, the steel sector is covered by Russia's Federal Law on Industrial Policy in the Russian Federation.[1315] Article 9 of Chapter 2 of the Law describes the broad range measures aimed at stimulating activities in the industry. These include financial, information and consulting support, support for scientific and technical activities and innovation activities, support for the development of human potential, support for foreign economic activity, special investment contracts, provision of state and municipal preferences, and other support measures established by the Law, by other federal laws and regulations, as well as laws of the

1313 OECD Steelmaking Capacity Database.

1314 However, there is just one stainless steel producer (Mechel) so the stainless steel case in Table 14.2 is specific to that company.

1315 Federal Law N.º 488-FZ of 31 December 2014 "*On Industrial Policy in the Russian Federation*" (as amended), available at: http://base.garant.ru/70833138/, accessed on 30 October 2019.

constituent entities of Russia, including municipalities. The text of the Law also states that separate federal laws may establish incentive measures in specific industries, taking into account their specific circumstances. However, it should be noted that as of drafting of this report, no separate law that establishes the application of incentive measures for metallurgy has been adopted or drafted.

Until 2014, the State Program on Development of industry and increasing its competitiveness,[1316] and, in particular, its Subprogram 10 Metallurgy, were in force,[1317] covering ferrous and non-ferrous metallurgy (see also Section 12.1). In the new version of the State Program Development of Industry and Increasing its Competitiveness[1318] (′the Program′) there is no separate subprogram for metallurgy, but the Programme states that the industry is to be assisted in accordance with its draft[1319] Sub-program 4 Development of the production of traditional and new materials. One specific sub-task of the Programme is directly relevant to the steel industry:

> *Creation of conditions for the growth of consumption of metallurgical products of Russian production in the Russian market, as well as a competitive rare-earth industry of the full technological cycle to meet the needs of the military-industrial complex, civil industries and access to foreign markets.* [1320]

Another sub-task of the Sub-program concerns composit materials which is an industry competing with the steel industry for the allocation of funds:

> *Forming the basis for the creation and development of the modern industry of composite materials (composites), increasing the production and consumption of high-tech products based on composites in key sectors of the Russian economy.* [1321]

The Sub-program identifies a need to upgrade the Russian metallurgical industry so that it engages in production of more processed and technologically-advanced products which are consumed directly by Russian industry and consumers rather than exporting commodities abroad for further

1316 Government Order N.º 1535-p of 29 August 2013 "*on Approval of the State Program of the Russian Federation Development of Industry and Improvement of its Competitiveness*", available at: http://base.garant.ru/70447194/, accessed on 30 October 2019.

1317 Subprogram 10 Metallurgy, available at: http://base.garant.ru/70447194/2aacfe04592656e6398933b08fd82ddd/#block_10000, accessed on 30 October 2019.

1318 Government Resolution N.º 328 of 15 April 2014 "*on Approval of the State Program of the Russian Federation The Development of Industry and Increase its Competitiveness*", available at: http://base.garant.ru/70643464/c97cd9b59d97ee89f8842c374b081d6f/#block_45, accessed on 30 October 2019. Subsequent changes were made on 31 March 2017, 10 February, 30 March, 1 October and 14 December 2018, as well as 29 March 2019.

1319 Despite the time elapsed since its conception this sub-programme is still a draft that remains to be approved.

1320 Sub-program 4 "*Development of the Production of traditional and new Materials*", available at: http://base.garant.ru/70643464/c97cd9b59d97ee89f8842c374b081d6f/#block_4000, accessed on 30 October 2019.

1321 *Ibidem*.

processing and re-import them subsequently. A reference to rare earths and composite materials suggests an intention to increasingly use rare earths and other materials in steel production to promote the strength and toughness of products. A reference to the military-industrial complex is important in the sense that policies directed at this sector are typically not guided by economic considerations and are subject to different governance and transparency standards. However, military needs of steel in Russia account for a small fraction (estimated less than 1%) of the country's steel demand.

While the Programme provides an extensive list of key performance indicators, expected results and an envisaged budget for all Russian industries, it does not itself elaborate in detail on the instruments that are to be used to achieve them. Some more information on this can be found in specific legal acts and on the website of the Ministry of Industry and Trade which is responsible for the development of the metallurgical industry in line with the Programme and other relevant acts.[1322] The site lists among other the following broadly worded measures:

- Government support to industries which consume metallurgical products and implement infrastructural projects as well as;
- Measures to limit import of metal products;
- Measures stimulating exports of products with high value added;
- Measures aimed at protection of Russian exporters in foreign markets, including prevention of restrictive measures against domestic metal products;
- Measures to reduce the dependence of Russian metallurgical enterprises on the import of raw materials.

The overall budget for the draft Development of the production of traditional and new materials sub-programme in the years 2013-24 is RUB 30.1 billion. The information on allocation of these funds is not detailed enough to identify whether it is envisaged for steel or new materials. Yearly allocations vary from RUB 6.7 billion in the year 2016, which is the year with highest allocation, to RUB 900 million each year in years 2019-2024. To provide a rough indication of the scale of this support, the budget of RUB 6.7 billion for 2016 was equivalent in value to about 0.01% of the combined turnovers of the country's mining, quarrying and manufacturing industries or to the 0.1% of total combined turnover of industries undertaking manufacturing of basic metals and fabricated metal products.

As in the case of other sectors covered by the Programme, the available financial support can take multiple forms, including: R&D subsidies (governed by the Government Decree No. 1312 of 30 December 2013),[1323] subsidies to interest rate payments on investment loans (Government

[1322] Website of the Ministry of Industry and Trade. *Section Current Tasks*, available at: http://minpromtorg.gov.ru/activities/industry/otrasli/metal/, accessed on 30 October 2019.

[1323] Government Decree N.º 1312 of 30 December 2013, "o*n the Approval of the Rules for the Provision of Subsidies from the Federal Budget to Russian Organizations for the Compensation of Part of the Costs of Research and Development in Priority Areas of the Civil Industry as Part of the Implementation of Complex Investment*

Decree No. 3 of 3 January 2014),[1324] subsidies of interest payments on loans whose purpose is to increase working capital (Government Decree No. 214 of 12 March 2015)[1325] or financial support in the form of tax and fees exemptions (Government Decree No. 623 of 24 May 2017).[1326]

In practice, there is a very large number of different central, regional and municipal government regulatory and financial measures and instruments of support, which are available to the steel and other industries. For the convenience of potential beneficiaries, these have been documented in a navigator of support measures prepared and implemented online by Minpromtorg.[1327] Available support measures can be filtered by region, sector, enterprise size and business problems which they are designed to address. There are currently 93 federal and regional regulatory and financial measures for which enterprises from the steel industry, pipe industry and steel structures industry enterprises are eligible.[1328] 82 of these are financial measures and, of the financial measures, 63 are provided at the regional level. 10 are regulatory measures and of these 9 are specified at the regional level.[1329] Therefore, most of the actual support measures concerning the steel industry are applied at the regional level. Table 14.4 lists the main problems which the regional support measures are supposed to address (as per Minpromtorg's navigator classification). They include the lack of available investment lending, necessity of modernization of production to produce competitive products, the high cost of the creation of new industries and their development, the need for R&D and for introduction of new technologies, development of high-tech products, as

Projects by such Organizations", available at: http://ivo.garant.ru/#/document/70555982/paragraph/1509:0, accessed on 30 October 2019.

1324 Government Decree N.º 3 of 3 January 2014, "o*n Approval of the Rules for the Provision of Subsidies from the Federal Budget to Russian Organizations for the Reimbursement of Part of the Cost of paying Interest on Loans received in 2014-2019 in Russian Credit Organizations and State Corporations […]*", available at: http://ivo.garant.ru/#/document/70558574/paragraph/26349/doclist/0/selflink/0/context/%D0%BF%D0%BE%D1%81%D1%82%D0%B0%D0%BD%D0%BE%D0%B2%D0%BB%D0%B5%D0%BD%D0%B8%D0%B5%20%D0%BE%D1%82%203%20%D1%8F%D0%BD%D0%B2%D0%B0%D1%80%D1%8F%202014%20%D0%B3.%20%E2%84%96%203:5, accessed on 30 October 2019.

1325 Government Decree N.º 214 of 12 March 2015, "o*n Approval of the Rules for the Provision of Subsidies from the Federal Budget to Industrial Organizations in 2015-2019 to Reimburse Part of the Costs incurred in 2015-2019 for paying Interest on Loans received from Russian Credit Organizations and the State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank), as well as in International Financial Organizations established in Accordance with International Treaties in which the Russian Federation is involved, to Replenish Working Capital*", available at: http://ivo.garant.ru/#/document/70889986/paragraph/16235/doclist/0/selflink/0/context/214:2, accessed on 30 October 2019.

1326 Government Decree N.º 623 of 24 May 2017 "*on the Procedure for the Formation and Maintenance of a List of Investment Projects, the Implementation of which gives the Right to Subjects of Activity in the Industry to receive Financial Support in the Form of Tax and Levies Benefits until 2025 in Accordance with Tax and Fee Legislation*", available at: http://ivo.garant.ru/#/document/71687260/paragraph/1/doclist/0/selflink/0/context/24%20%D0%BC%D0%B0%D1%8F%202017%20%D0%B3.%20%E2%84%96%20623:2, accessed on 30 October 2019.

1327 Minpromtorg. *Navigator support measures*, available at: https://gisp.gov.ru/support-measures/#s28, accessed on 30 October 2019.

1328 This breakout excludes small enterprises as Russian steel producers relevant to this chapter are medium or large enterprises.

1329 Some measures are specified at both federal and regional level.

well as lack of funds. However, there are no statistics available on the actual use of this regulation by the steel industry.

Table 14.4 Types of problems addressed by regional government support measures for which the steel industry, pipe industry and steel structures companies are eligible

The types of problems	Number of measures	Share* of total regional measures, %
The lack of available investment lending	53	64%
Necessity of modernization of production to produce competitive products	47	57%
The high cost of the creation of new industries and their development	46	55%
The need for R&D, introduction of new technologies, development of high-tech products	38	46%
Lack of funds	37	45%
Access to new export markets	27	33%
Declining domestic demand, competitive import	24	29%
Problems in the company related to operating activities (overdue debt, the gap payment turnover, staff)	24	29%
The high level of taxation	21	25%
Other (Grants, Insurance, Contribution to the authorized capital, the creation of investment funds (provision of support through venture capital funds), Funding, refinancing, mortgage purchase, Consulting/Advisory services)	10	12%

*Note: one measure tends to solve several problems.

Source: Internal compilation based on the Minpromtorg 'navigator' support measures.

At federal level, the IDF was established in 2014 on the initiative of Minpromtorg to support the implementation of the Programme across the different eligible industries. Companies can receive loans from the IDF of between RUB 5 and 750 million at preferential interest rates of 1%, 3% and 5% per annum for up to 7 years, provided on a competitive basis.[1330] The loans, which, as of writing of this report, total RUB 98 billion,[1331] are meant to supplement financing of investment projects aimed at the development of new high-tech products, modernization and creation of

[1330] Industrial Development Foundation. *About the foundation*, available at: http://idfrf.com/, accessed on 30 October 2019.

[1331] Available at: https://frprf.ru/proekty-i-zayavki/, accessed on 30 October 2019.

competitive production processes on the basis of the best available techniques. The IDF is also an operator of SPICs.

The Russian Export Center (′REC′)[1332] group which consists of Eximbank of Russia and Russian Agency for Export Credit and Investment Insurance (′EXIAR′) supports the development of the non-commodity exports industry/sector. It offers a wide range of financial (loan and guarantee support and insurance) and non-financial (consulting and information sharing, promotion to foreign markets, education etc.) support tools to benefit the Russian exporters to explore the foreign markets and build capacity in the global trade and it acts as a focal point for interaction with the relevant domestic ministries and agencies. The work of EXIAR is based on the practice of European export insurance agencies.

In general, across the different instruments and support-providing agencies, there are strict *de jure* rules on the criteria and the process that needs to be followed in order to be eligible for state support. In particular, an extensive set of rules describes the governance and implementation of the process of competition for assistance of actors from across different industrial sectors. Many actors from different sectors are in principle eligible for support and the selection is performed on the basis of general criteria set out in the applicable legislation.[1333] These measures are provided across various industries and are usually related to technology and environment. For example, in the case of Government Decree No. 1321, which governs R&D subsidies, the priority areas are projects whose implementation contributes to: the creation of new cost-effective and environmentally friendly industries; the development of industrial production that increases the output of high-tech products; the growth of labour productivity and the use of advanced technologies and modern equipment as well as creation of high-performance jobs; the creation of conditions for the promotion of innovative Russian products and technologies to global market; increasing energy efficiency and resource saving. In this sense, the Programme and the measures with the help of which it is being implemented are in principle not industry or sector-specific but rather target more general policy goals. Furthermore, the implementation of the Programme in specific sectors is guided by additional Government documents which contain sector-specific directions and targets. As far as the steel industry is concerned, the implementation of the Programme is guided by the Development Strategy of the Steel Industry for 2014-2020 and for the Perspective until 2030[1334] and the Draft Strategy for the Development of the Metallurgical Industry

[1332] Russian Export Center, available at: https://www.exportcenter.ru/en/, accessed on 30 October 2019.

[1333] This suggest an underlying objective of generality rather than sector-specificity.

[1334] Development Strategy of the Steel Industry for 2014-2020 and for the perspective until 2030, approved by the Order of the Ministry of Industry and Trade N.º 839 of 5 May 2014 "*on Approval of the Strategy for the Development of ferrous Metallurgy in Russia for 2014 - 2020 and for the long Term until 2030 and the Strategy for the Development of non-ferrous Metallurgy in Russia for 2014-2020 and for the long Term until 2030*", available at http://www.garant.ru/products/ipo/prime/doc/70595824/, accessed on 30 October 2019.

of Russia for the Period till 2030[1335] (these two documents are referred to jointly as the ′Strategy′ in the remainder of this section).

The order approving the Strategy assigns the competence for its implementation to the Department of Metallurgy, Machine Tool Building and Heavy Engineering of the Minpromtorg.[1336] According to the Strategy, the Russian steel industry represents one of the key players in a competitive global industry, one which is highly dependent on developments in international steel markets. It lays out the Government's long-term forecast for the industry and assumes a continued role of the country in global steel markets in the period of the Strategy's implementation. It also makes refences to several other Russian sectoral, environmental and socio-economic state programmes,[1337] emphasizing the industry's strategic and socio-economic importance. The Strategy also states that, in line with international experience, the development of the industry is possible thanks to '*effective State support, the main tools of which are State financing of infrastructure projects and public-private partnership in the implementation of industrial and infrastructure projects*'.[1338]

The key competitive advantages of the industry, as identified in the Strategy, are its concentration among the few large players,[1339] vertical integration along the steelmaking value chain encompassing own iron ore and fuel and energy bases, and modern smelting of iron, steel and metal production capacities. At the same time, according to the Strategy, the sources of competitive advantage stemming from access to inexpensive natural gas, electricity, rail transportation tariffs and wages as not being any longer sufficient in the global context of increasing competition on the basis not of price but quality and technological sophistication of steel products. Key weaknesses of the Russian industry, as identified in the Strategy, are the persisting shortages of energy and material-efficient technologies, as well as of technologies enabling the production of new types of steel and alloys which would meet the demand of the Russian high-tech manufacturing sectors.

The Strategy considers three development scenarios for the Russian steel industry that depend on different assumptions with respect to the trajectory of the country's economic development, the corresponding trends in domestic consumption of ferrous metals products, and the situation in the international steel markets. The most conservative scenario assumes a stagnation in the development of the Russian fuel and energy industries and an increased reliance on demand for steel products from the construction industry. This scenario is characterized by preservation of the production structure concentrated predominantly in the relatively less processed steel products.

[1335] The latter is a draft update of the 2014 Strategy taking into account consequences of the 2014-2015 crisis. It has not been approved by the Government and as of writing of this report, it remains a proposal by the Ministry.

[1336] The latter can be seen as a way of making the responsible authorities directly responsible for the Strategy implementation.

[1337] These include, for example, programmes on socio-economic development of certain Russian regions, housing and transport priorities throughout the country, and development strategies of many other industries such as coal, gas, oil, automotive and aviation industries and others.

[1338] Internal translation of an excerpt from the final part of Section 2 of the Strategy.

[1339] The strategy refers to Russia's ten largest vertically integrated steel companies, accounting for about 90% of rolled ferrous metals produce in the country in 2014.

The moderately optimistic scenario, on the other hand, assumes exploitation of Russia's advantages in the energy sector and its further development, an increase in the degree of their processing and exports of raw materials, as well as a modernisation of the country's transportation infrastructure. In this scenario, there is a stronger projected demand for more technologically advanced metal products from the energy, commodity and transport sectors, although the production structure is still predicted to be characterised by a significant proportion of lower value-added products. The accelerated development scenario, which is also the scenario preferred by the Government, assumes a breakthrough in the development of Russian high-tech industries, accelerated attraction of foreign investment and a faster development of machine building industry. This scenario is characterised by an accelerated development of domestic demand for high value-added steel products.

The key objectives set out in the Strategy are to:

- Ensure a sustainable development of the industry due to maintaining positions in foreign markets (Task 1);
- Stimulate domestic demand for products of the metallurgical complex (Task 2);
- Promote import substitution of metallurgical products in the Russian market (Task 3),

while meeting the needs of Russian consumers, including in the area of environment.

The main target indicators of a successful implementation of the Strategy are: for Task 1, the volume of exports of metallurgical products; for Task 2, the volume of consumption of metallurgical products; for Task 3, the share of imports in the domestic consumption of metallurgy products. Table 14.5 provides a compilation of the Strategy's target indicators for selected steel production segments through 2030.

Table 14.5 – Ferrous metallurgy - target indicators for the implementation of the Strategy

Products	Actual values in 2014				Target indicators to 2030*				2016 update of the proposed Strategy till 2030*			
	Production, mln. tons	Export, mln. tons	Consumption, mln. tons	Share of import in domestic consumption, %	Production, mln. tons	Export, mln. Tons	Consumption, mln. tons	Share of import in domestic consumption, %	Production, mln. tons	Export, mln. tons	Consumption, mln. Tons	Share of import in domestic consumption, %
Flat products	27.6	8.4	22.4	14	37.9	7.0	32.3	4.2	32.9	8.4	26.7	8.3
Long products	20.3	2.2	19.3	7	32.2	4.5	29.3	5.4	24.6	3.0	22.1	2.3

Pipes	11.3	1.2	10.7	6	16.4	0.8	16.1	1.6	13.8	1.2	12.9	2.3
Semi-finished products (export procure ment)	13.0	13.0	-	-	13.4	13.4	-	-	12.3	12.3	-	-

Note: * - the average value of the three scenarios: conservative, moderately optimistic and accelerated development.
Source: Internal compilation on the basis of the Order of the Ministry of Industry and Trade N.º 839 of 5 May 2014 and the Strategy.

The Strategy provides, inter alia, for the following actions to be taken to deliver on these tasks:

Task 1:

- Promotional activities;
- Development of cooperative ties with foreign countries, including within the framework of the EAEU;
- State assistance for manufacturers being subjects of trade defence investigations provided in the form of governmental participation in these investigations as an interested party;
- Monitoring and defending Russian interests in international discussions on steelmaking capacity at the OECD and in the context of G20 processes;
- Implementing measures aimed at increasing energy efficiency;
- Government support for projects to reduce excess capacity and closure of inefficient production sites.

Task 2

- Assistance with improvements of technical standards; stimulating the development of new materials.

Task 3

- Stimulation of production for high value-added products, including through import substitution measures;
- Regulatory incentives to use Russian products in state and municipal public procurement; stimulating co-operation between enterprises in the military-industrial complex;[1340]
- Application of trade protection measures against unfair imports;
- Programmes directed at development of skills of personnel in the metallurgical industry;
- Implementation of more flexible policies of flexible tariff formation of natural monopolies (e.g. in energy or transportation), taking into account the current situation in the markets of steel products;
- Improving access of Russian companies to scrap, including from imported sources.

[1340] Note that Russia is not a member of the WTO GPA (see Chapter 5).

Information on the actual state support to the steel sector is not provided on a regular basis but various online Government documents and sources may provide an indication of the size and nature of this support. One Government source indicates for example that in 2016, state support for ferrous metallurgy enterprises amounted to RUB 249 million. The total volume of investments projects that benefitted from this state support amounted to RUB 23.2 billion, giving around 1% of state co-financing on average.[1341] However, Government support under the programs of the IDF in 2016 amounted to additional RUB 554.15 million and concerned investments projects of the total value of RUB 1.3 billion, giving a 42% share of state co-financing. For comparison, in the same year, the non-ferrous metallurgy enterprises benefitted from RUB 123.8 million of state support in the context of the total value of RUB 2.7 billion of investment projects carried out in the industry (giving 4.6% of co-financing on average). Financing of non-ferrous metallurgy projects through the IDF amounted to RUB 623 million while the total value of these investment projects amounted to RUB 6.1 billion giving 10% of state co-financing. Rosstat's data on investments in fixed capital by source of financing on the other hand indicate that the share of budget financing in the metallurgical industry was around 0.1%. Expressed as a proportion of the industry's turnover budget financing amounted to 0.01% (see Table 14.6).

Table 14.6 Investments in fixed capital by sources of financing, metallurgical production (RUB billion)

	2015	**2016**	**2017**
own funds	175.5	208.6	221.1
borrowed	54.2	60.6	45.3
including budget funds	0.2	0.3	0.5
Total	**229.7**	**269.2**	**266.4**

Metallurgical production	**2015**	**2016**	**2017**
volume of domestically manufactured shipped goods, bln RUB	4 453	4 460	5 166
cofinancing of investment projects from budget, bln RUB	0.2	0.3	0.5
share of budget financing in industry turnover, %	0.005%	0.006%	0.010%

Source: Rosstat.

Environmental performance upgrading is one of the key goals of the Strategy and Rosstat data allows to calculate the shares own funds of enterprises and other sources (federal, regional, local

[1341] *Metallurgy: some important results and indicators for 2016*, available at: http://government.ru/info/27209/ , accessed on 30 October 2019.

government and special ecological funds) in financing investments in fixed assets aimed at increasing the level of environmental responsibility of steel metallurgical enterprises. Table 14.7 below shows that since 2012, the main source of such upgrading in the steel industry have been the company's own funds while the state and environmental funds did not participate or only marginally participated in such investments. At the same time, the cost of such investments increased by almost 60% in 2018 compared with 2016.

Table 14.7 – Distribution of investments in fixed assets aimed at increasing the level of environmental responsibility of steel enterprises, by source of financing

Source of financing\Year	2012	2013	2014	2015	2016	2018
own funds of enterprises, mln. RUB.	2 814	6 186	7 474	7 969	7 070	11 334
other sources of financing, mln. RUB.	4 240	0	0	12	0	0
total, mln. RUB.	7 053	6 187	7 474	7 981	7 070	11 334
own funds of enterprises share in total, %	39.89	100.00	100.00	99.85	100.00	100.00
Other sources of financing share in total, %	60.11	0.00	0.00	0.15	0.00	0.00

Source: Internal compilation based on Rosstat data.[1342]

14.3 STATE POLICIES IN KEY STEELMAKING INTERMEDIATE INPUTS SECTORS

As indicated in Section 14.2, in 2017, 66.9% of Russian crude steel was produced via the BF-BOF route. Typically, this route uses 1 370 kg iron ore, 780 kg of metallurgical coal, 270 kg of limestone and 125 kg of recycled steel to produce 1000 kg of crude steel.[1343] In terms of the actual breakdown of costs, a notional cost breakdown, based on a representative current input costing information, is provided in Figure 14.1. It shows that in the BF-BOF route typically more than 60% of costs of production are attributed to costs of iron ore and coal, while steel scrap, gas and electricity

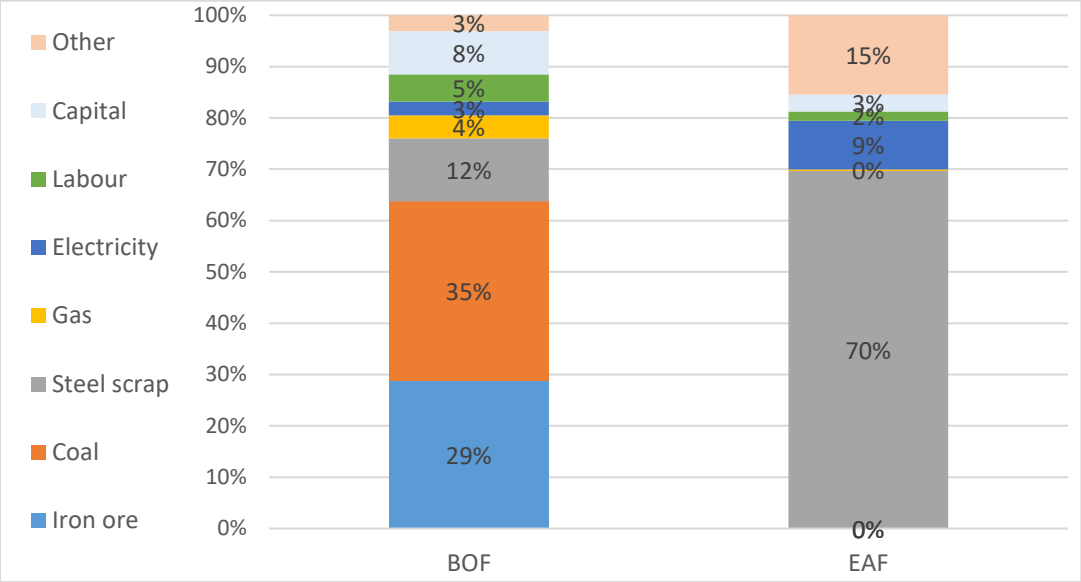
[1342] In official publications of Rosstat, data on investments in fixed assets aimed at increasing the level of environmental responsibility are given either by sectors of the economy (Rosstat (2018), *Environmental protection in Russia, Statistical compilation*, table 2.7, available at: https://www.gks.ru/storage/mediabank/ohrana_2018.pdf, accessed on 7 February 2020) or by sources of funding (Rosstat (2018), *Environmental protection in Russia, Statistical compilation*, table 2.6), but not both. Data by industry and source of funding are available on the Unified Inter-Agency Information and Statistical System portal for the periods 2012-2016, available at: https://fedstat.ru/indicator/36065, accessed on 14 November 2019, and for 2018 avaialbe at: https://fedstat.ru/indicator/5808, accessed on 14 November 2019. As of writing this report, the data for 2017 was not available.

[1343] The exact mix will depend on the type of steel product produces as well as the technology applied. These are world-wide averages provided by the World Steel Association (2019), *Fact Sheet: Steel and Raw Materials*, available at: https://www.worldsteel.org/en/dam/jcr:16ad9bcd-dbf5-449f-b42c-b220952767bf/fact_raw%2520materials_2019.pdf, accessed on 30 October 2019.

constitute another 20%. 30.8% of steel produced in Russia is produced via the EAF route which uses mainly recycled steel and electricity which account for respectively 70 and 9% of costs.

The relative weights of key raw material inputs used in steel production also underscore the importance of transport costs associated with transporting raw materials to steelmaking plants. In Russia, the average transportation distances for steel scrap are estimated at 847 km, for coal at 1 320 km and for finished steel products for export at 1 641 km. For comparison, the average transportation distance of alumina is 3 284 km and the average transportation distance of finished aluminium products is 4 577 km.[1344]

Figure 14.1. Notional breakdown of costs of production of steel by steelmaking route



Source: Internal calculations based on www.steelonthenet.com.

14.3.1 COAL, IRON ORE AND SCRAP

Both coke and iron ore are produced by private enterprises, including in many cases own subsidiaries of the large vertically integrated Russian steelmaking firms. According to Rosstat, in 2017 state and municipal enterprises accounted for only about 0.03% of the value of production in the mining of coal and lignite sectors, for 0.05% in the mining of metal ores sector and for about 0.001% in the manufacture of coke and refined petroleum products.[1345] With USD 17 billion worth of coal exports, the country is the third largest coal exporter accounting for 13.4% of the world export market and, with 106.6 mmt production of iron ore the world's 5th largest iron ore producer and with 21 mmt of exports the 7th largest iron ore exporter (see also Section 10.2.3).

[1344] Draft Strategy for the Development of the Metallurgical of Russia for the Period till 2030 form 2016, available at: https://pandia.ru/text/81/089/58758.php, accessed on 30 October 2019 (which is an update of a document with the same title from 2014).

[1345] Internal calculations based on official Rosstat data: Table 16.4 "*Turnover of organizations by economic activity*".

The Government has instituted a number of measures to support producers of raw materials that are relevant for steel production. One example are tax incentives and other business climate-enhancing, social and environmental policies in certain steelmaking raw materials-producing Russian regions, particularly in the Far East and Baikal regions. The Government considers these regions as being important because other coal basins in Russia face problems of depletion and high risks associated with extraction of the remaining deposits. They are also located relatively close to the Asia-Pacific where demand for natural resources is growing. These regions also face problems with developing raw material processing activities in their largest agglomerations and other areas of advanced economic growth. So far, these activities are highly concentrated in the southern part of this territory. The Government considers that the development of these region requires a broad set of measures, including measures to stimulate the development and implementation of resource and energy saving technologies, relevant engineering industries, transportation, distribution networks, and creation of research and development infrastructure. The Strategy of Socio-economic Development of the Far East and the Baikal region for the period up to 2025 provides broad guidance as to the measures that could be taken.[1346] Assistance is also envisaged to partially reimburse the costs of terminating the activities of unprofitable enterprises and, where economically viable, resettling or facilitating the commuting possibilities of residents of single-industry towns to new production locations. Thera are also a host of other economic, environment and social challenges that the Government intends to address in these regions. The implementation is however mainly in the hands of local authorities who are in charge of devising tax incentives and other incentives and facilitating business climate enhancing policies in accordance with the Tax Code and other sectoral, regional and broad socio-economic policies.

Currently, Russia does not have exports restrictions on key steelmaking raw materials such as coke, coking coal, iron ore, pig iron or limestone.[1347] It does nevertheless have an export tax of on metal waste and scrap products as stipulated in the Government Decree No. 754 of 30 August 2013.[1348] Exports of some thirteen types of products in the category waste and scrap of ferrous metals and ingots of ferrous metals for remelting[1349] are subject to the rate of 5% (but not less than EUR 5 per tonne). This rate has however been progressively decreased from 15% (but not less than EUR 15 per tonne) in the period 2009-2013, to 12.5% (but not less than EUR 12.5 per tonne) in the period 2013-14, 10% (but not less than EUR 7.5 per tonne) in the period 2014-15 and 7.5%

[1346] *Ibidem*.

[1347] OECD. *Inventory of Restrictions on Exports of Industrial Raw Materials*, available at: https://qdd.oecd.org/subject.aspx?Subject=ExportRestrictions_IndustrialRawMaterials, accessed on 30 October 2019.

[1348] Government Decree Nº. 754 of 30 August 2013 "*on Approval of Rates of Export Customs Duties for Goods Exported from the Territory of the Russian Federation and Territory of Member States of the Customs Union*", available at: http://ivo.garant.ru/#/document/70443626/paragraph/1:1, accessed on 30 October 2019.

[1349] Category 7204 of the Commodity Nomenclature for Foreign Economic Activities.

(but not less than EUR 7.5 per tonne) in the period 2015-2017.[1350] This reduction was completed in accordance with Russia's WTO obligations following the accession in 2012 and the tariff schedule agreed upon then. Since 1 January 2018, domestic sales of scrap and waste of ferrous and non-ferrous metals are however subject to VAT,[1351] which was not the case before. Exports of all products are exempt from the VAT.

14.3.2 ELECTRICITY AND NATURAL GAS

It is estimated that generally energy accounts for 20 to 40% of costs of steel production with primary steel production being more energy intensive than secondary production.[1352] In the BF-BOF production method about 89% of energy input comes from coal, 7% form electricity and 3% from natural gas. In the EAF production method, coal accounts for 11%, electricity for 50% and natural gas for 38%. However, these proportions are notional as energy is also used in upstream steelmaking activities (e.g. in mining) and downstream (e.g. transport) and some forms of energy are transformed into others (e.g. generation of electricity from gas).

Being the third largest producer of fossil fuels and having the world's second largest proven reserves of natural gas and third largest reserves of coal, Russia has a natural advantage in energy-intensive industrial activities, including steelmaking. However, as described in more detail in Chapter 10, the country has a host of policies that affect the functioning of the different energy markets, which likely also impact on its steel sector. The Government regulates the prices for electric energy and natural gas in accordance with the Law on Electric Power Industry (see Section 10.6.4) and the Decree on State Regulation of Gas Prices (see Section 10.6.1.1).

Deregulation of Russia's electricity and power sector is more advanced than that of the natural gas sector (see also Section 10.6.4). The country has a two-tier electricity market, wholesale and retail. In the wholesale market, electricity suppliers (generating companies, importers of electricity) supply electricity and power to wholesale buyers (guaranteeing suppliers, sales companies, large consumers, electricity exporters). For the wholesale market the territory of Russia was divided into two zones: price and non-price. In the non-price zone, electricity is supplied at regulated prices. The classification of regions into the non-price zone depends on technical criteria, such as isolation from the unified energy system of Russia, as well as socio-economic objectives of support to

[1350] OECD. *Inventory of Restrictions on Exports of Industrial Raw Materials*, available at: https://qdd.oecd.org/subject.aspx?Subject=ExportRestrictions_IndustrialRawMaterials, accessed on 30 October 2019.

[1351] Federal Law N.º 335-FZ of 27 November 2017 "*on Amendments to Parts One and Two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation*", available at: https://rg.ru/2017/11/30/akciz-dok.html, accessed on 30 October 2019.

[1352] World Steel Association. (2019), *Fact Sheet: Energy use in the steel industry*, available at: https://www.worldsteel.org/en/dam/jcr:f07b864c-908e-4229-9f92-669f1c3abf4c/fact_energy_2019.pdf, accessed on 30 October 2019.

remote regions. In territories that are grouped into price zones, where most Russian steel producers are located, electrical energy is sold at unregulated prices.

Retail tariffs are regulated by the FAS through measures such as price caps.[1353] These are differentiated by categories of end users and are typically the sum of the following components: weighted average generation cost, capacity cost in the wholesale market, cost of ancillary and system services, and retail supply cost (including distribution).[1354] Thus, electricity prices paid by industrial users in the retail market partially reflect regulated retail tariffs and partially the situation in the wholesale market. Retail industrial electricity prices in Russia are estimated to be much lower than in the EU and the US, although in the case of the latter, not by a large margin[1355] and, as documented in Chapter 10, are about 25% lower for mining and processing industries than for agriculture or other economic activities. This suggests that depending on the region of operation and other firm-specific circumstances, relatively low electricity prices might be a source of competitive advantage for the Russian steel makers. Nevertheless, integrated steel mills, being large electricity consumers, buy electrical energy from wholesale market at non-regulated prices. In addition, many large Russian steel makers, such as for example Evraz or Severstal[1356], are substantially self-sufficient as far as electricity is concerned. The largest Russian steel companies Severstal, MMK, NLMK generate more than 60% of electricity needs internally.

As far as natural gas is concerned, close to 70% of natural gas production is concentrated in the hands of the state-owned monopoly Gazprom, which also implements Russia's policy of regulated natural gas prices, including for industrial consumers. The rest is supplied by independent, privately owned gas producers, whose market shares have been progressively rising. Regulated gas prices charged by Gazprom depend on geographical location of consumers and steelmaking companies do not report the prices they are paying for gas. Thus, it is difficult to quantify exactly the advantage steelmaking firms obtain in the form of low gas prices. However, the comparison in Chapter 10 suggests that the domestic wholesale gas prices in 2018 in Russia were several times lower than prices of exports to Europe.

Independent production and exchange of natural gas is developing dynamically in Russia and customers of these gas suppliers, including an increasing share of Russia's largest steelmakers,

[1353] OECD (2019), *Fossil Fuel Country Note: Russia*, available at: http://stats.oecd.org/wbos/fileview2.aspx?IDFile=09aac246-c7ef-4159-898e-2a287deb3341%20%20, accessed on 30 October 2019.

[1354] EBRD, *Russia Country Profile*, available at: https://www.ebrd.com/downloads/legal/irc/countries/russia.pdf, accessed on 30 October 2019.

[1355] See, for example, Table 3-12: *Changes in retail industrial electricity prices compared to EU prices, constant 2017 EUR/MWh* in Trinomics (2019), *Study on Energy Prices, Costs and Subsidies and their Impact on Industry and Households*, available at: https://ec.europa.eu/energy/sites/ener/files/documents/energy_prices_and_costs_-final_report-v12.3.pdf, accessed on 30 October 2019.

[1356] Severstal claims to be substantially self-sufficient in electricity production from natural gas. Severstal. *Annual Report 2018*, available at: https://www.severstal.com/files/23787/Annual_report_2018.pdf, accessed on 30 October 2019.

pay somewhat higher, unregulated, prices.[1357] Still, these prices reflect the role of Gazprom and state policies and thus are not market determined. Policy initiatives such as the amendment of the Gas Directive, as described in Chapter 10 also seem to be going in the direction of deregulation. However, all this suggests that regulated prices of natural gas still have an impact on competition, even if the situation appearss to be evolving in the direction of more market-based mechanisms.

14.3.3 TRANSPORT

Depending on the geographical location of different activities in the steelmaking value chain, costs related to transportation of raw materials (iron ore, coal and scrap) and of steel products can add up to economically significant shares of the cost of steel products. The share of these costs will be smaller the closer the steelmaking plant is located to the coal or iron ore mining sites, or the final consumer of steel products, and they will typically vary by producer and product. As a global benchmark, according to steel industry analysts' estimates,[1358] when the BF-BOF steel production method is used, transportation costs of iron ore account on average for around 3.5% of the total cost of steel (and more than 10% when expressed as percentage of the cost of iron ore). One Russian example for which some information is available is that of Evraz, the vertically integrated steel producer with coal mining, iron ore mining and steel producing facilities in the Urals, western and southwestern Siberia regions and Kazakhstan. According to Evraz's 2018 annual report, transportation accounted for close to 31% of costs in the company's coal segment (production of metallurgical coal) and for 7.3% of the costs of its steel segment.[1359]

Rail transport is a natural mode for transport of bulk commodities such as coal, coke and iron ore but some raw materials used for the steel production and steel products can also be transported using roads. Depending on the source, estimates of relative competitiveness of rail and road modes of transport in Russia suggest that rail freight is generally a more economic mode of transport on distances exceeding 400, 700 or 1 000 kilometres,[1360] meaning that the importance of rail increases with the hauling distance.

[1357] Novatek (2012), available at: http://www.novatek.ru/ru/press/releases/index.php?id_4=580, accessed on 30 October 2019; Severstal (2012), available at: https://www.severstal.com/rus/media/news/document3960.phtml, accessed on 30 October 2019; Forbes (2015), available at: https://www.forbes.ru/news/306737-rosneft-i-evraz-podpisali-soglashenie-na-postavku-gaza, accessed on 26 November 2019; NLMK (2015), available at: https://nlmk.com/ru/media-center/news-groups/nlmk-and-novatek-sign-5-year-contracts-for-supply-of-natural-gas/, accessed on 26 November 2019.

[1358] Steel Industry Portal. *Basic Oxygen Furnace Route Steelmaking Costs 2019: Conversion costs for BOF steelmaking*, available at: https://www.steelonthenet.com/cost-bof.html, accessed on 30 October 2019.

[1359] EVRAZ. *Annual Report 2018*, available at: https://ar2018.evraz.com/en, accessed on 30 October 2019.

[1360] Murray, B (2014), *Russian Railway Reform Programme*, European Bank for Reconstruction and Development estimates this distance at 400 km, available at: http://www.ebrd.com/documents/evaluation/special-study-russian-railway-sector-evaluation-working-paper-1.pdf, accessed on 30 October 2019. Kerney, A.T. (2015), *Russian Rail, Containers and Growth*, estimates this distance at 1000 km, available at: https://www.atkearney.com/documents/20152/434711/Russian_Rail-Containers-and_Growth.pdf/25e9f141-6d5e-52be-9b23-d05bdcd38134?t=1493942304288, accessed on 30 October 2019.

The relative cost competitiveness of the rail mode on longer distance is related to many factors, including the geography of Russia, where many remote locations have access to only very poor alternative shipping options. But the relative cost competitiveness of railway transport is also related to the design of the state-regulated rail tariffs which favour long-distance shipments. It is estimated that in Russia coal and coke have average hauls of around 1 500 kilometres and ferrous metals travel on average 1 900 kilometres, suggesting that rail is on average a preferred mode of transport for these products.[1361] According to Rosstat official transport statistics in 2017 a range of steel-related products accounted for the bulk of country's rail freight: coal 26%, ferrous and manganese ores 8%, ferrous metals including scarp 6.4%, coke 1%. Another testimony of the importance of rail transport for the Russian steel industry is that several of the currently private railway operators which provide wagon services for freight transport have begun their activities as former transport subsidiaries of large Russian steelmaking firms specialising in bulk cargo transport.[1362]

As explained in more detail in Chapter 11, Russian railroads are owned and run by RZD, a company which also essentially has a monopoly on provision of locomotive services.[1363] The rail transportation tariffs are regulated according to the Price List No. 10-01 (see Section 11.3.1). The design of transportation tariffs has a number of features which are relevant in the context of the steel sector. First, the Price List sets the country-wide tariffs for the main component of the cost of freight transport by rail — the payment for infrastructure and locomotive services. This typically accounts for about 85% of total charges.[1364] The remaining 15% are wagon services and this element is partially unregulated.[1365] This means that the bulk of the charges related to rail transport are not set according to competitive pressures and market forces but by state policies. While these tariffs have been increasing continuously in the past years broadly in line with inflation[1366] the

[1361] Pittman, R. (2011), *Blame the Switchman? Russia Railways Restructuring After ten Years*, *Economic Analysis Group Discussion Papers*, U.S. Department of Justice, available at: https://www.justice.gov/sites/default/files/atr/legacy/2011/03/08/267882a.pdf, accessed on 30 October 2019.

[1362] For example, Globaltrans, one of the largest independent Russian operators, is a former transport subsidiary of Severstal which acquired in 2012 Metalloinvesttrans, a transport subsidiary of Metalloinvest, one of Russia's largest iron ore miners and steel producers. Globaltrans. (2012), *Globaltrans to acquire 100% of Metalloinvesttrans for USD 540 million from Metalloinvest*, available at: https://www.globaltrans.com/investors/news/news/article/globaltrans-to-acquire-100-of-metalloinvesttrans-for-usd-540-million-from-metalloinvest/?tx_ttnews%5BbackPid%5D=202&cHash=358563cae45298ff0b1009f02cd96972, accessed on 30 October 2019.
NLMK also sold its transport subsidiary NTK in 2011 to UCL Rail B.V., a subsidiary of Universal Cargo Logistics Holding B.V. (UCL Holding). NLTK. (2011), *NLMK inks NTK divestment deal*, available at: https://www.nlmk.com/en/media-center/news-groups/nlmk-inks-ntk-divestment-deal/, accessed on 30 October 2019.

[1363] Some private operators have a small number of locomotives which are nevertheless used mainly for internal logistical purposes on short distances.

[1364] Murray (2014).

[1365] While RZD is subject to regulated tariff in wagon services, private operators are not and they can and do set this part of the price according to market conditions.

[1366] Murray (2014).

inflation minus approach adopted by the Government in 2017 effectively results in a real lowering of these tariffs after all additional surcharges (see examples below) are eliminated.

Second, the Price List distinguishes between three broad classes of transported products:
- Class 1 covers broadly commodities (including coal and iron ores and concentrates);
- Class 2 includes oil, grain, fertilizers, food, and a broad collection of intermediate goods including iron;
- Class 3 includes finished chemicals and metals, machinery, and most finished manufactured goods, including steel products.[1367]

It is not easy to identify differences in various applicable tariffs given that the tariffs are set on the basis of a number of detailed legislative acts related to this area.[1368] However, it is generally acknowledged in the literature on the Russian railway sector that these tariffs mean that long distance moves of goods of Class 1 are priced below cost, Class 2 cargo is transported at cost, while Class 3 cargo is transported at a premium which compensates for the loss of RZD from the transportation of Class 1.[1369] Class 1 is thus cross-subsidised by the revenues obtained from the transport of goods belonging to Class 3. The RZD itself in its annual report for 2018 seems to confirm this. The report divides the aggregate figures of its handling services into three categories which largely overlap with the three classes. Low margin freight (which includes coals and iron and manganese ores) accounted for 60.2% of RZD's handling in 2016; average margin freight (which contains oils and petroleum products and grains) accounted for 29.4% of freight and high margin freight (which includes ferrous metals and ferrous metal scrap) accounted for 10.4% of overall handling. Recently, however, the RZD proposed to raise tariffs for the transportation of Class 1 cargo for metallurgical enterprises (for instance, the cost of iron ore transportation is to increase as of 2020) and lower it for Class 3 cargo. The impact on steel firms would depend on geographical distribution of ore deposits and distance from production final product markets. The costs of steel producers could actually increase since the reduction of tariffs for the transportation of Class 3 products could be lower compared to the increase in tariffs for the transportation of raw materials (Class 1).[1370]

In addition, several specific executive orders making adjustments to the Price List No. 10-01 also make specific changes to scaling coefficients applied to transport tariffs for specific individual

[1367] Individual tariffs in each category and sometimes for specific products are determined using a declining scale for distance and adjusting for various parameters such as shipment size and charges for loading and unloading.

[1368] These consist of the Federal Tariff Service Resolution N.º 10-01 "*on Approval of the Price List, 'Tariffs for Transportation of Goods and Infrastructure Services performed by Russian Railways*'" and several executive orders, appearing almost every year, adjusting these tariffs in specific circumstances.

[1369] See e.g. Pittman (2011) p. 13 or Murray (2014), p. 35.

[1370] Shtanov, V., & Trifonova, P. (2019). *Russian Railways proposed to change tariffs for metallurgists*, available at: https://www.vedomosti.ru/business/articles/2019/05/28/802674-rzhd-predlozhila-izmenit-tarifi-dlya-metallurgov#galleries%2F140737494463963%2Fnormal%2F1, accessed on 30 October 2019.

steelmaking raw materials and steel products.[1371] Russia also implements policies that provide for compensation of losses that the railways incur due to tariffs applicable for transport of relevant minerals for export to the Far Eastern ports, and to the places of their processing at the enterprises of the Far East and the Baikal region (see also Chapter 12 on raw materials).[1372]

At the same time, the Government has a large discretion in introducing additional charges on top of regular tariffs. For instance, an export surcharge of 8% for all transportation of steel to Russian seaports is in place, putting an additional cost on all steel exports. Furthermore, in 2018 the FAS introduced an additional 2% annual tariff increase for so-called infrastructure development needs.[1373] Some estimate that the resulting railroad tariff increases are thus currently higher than inflation.

The above suggests that the Russian rail transport policy offers possibilities for the Government to influence the competitiveness of various segments of the Russian steel sector by adjusting rail transport tariff rates or by influencing RZD with respect to tariffs it charges for its services for different products.

14.4 CHAPTER SUMMARY

Russia's steel production is concentrated among a small number of large, vertically integrated, steelmaking companies that are also significant international suppliers and investors, making Russia the world's 5th largest producer and 4th largest exporter of crude steel products. Russia's largest steel-making firms are privately-owned and most of them are publicly listed on Moscow or London stock exchanges. They supply both a range of steelmaking raw materials (iron ore, coking coal products) as well as a range of semi-finished and finished steel products. Many of them generate significant shares of their own energy needs. They have been showing strong economic performance in recent years. The country's steelmaking capacity has been increasing since the mid-1990s but compared to other leading steel producers, Russia has relatively high capacity utilisation rates.

A range of Government programmes and instruments envisage financial and regulatory support measures in order to help the steel industry further upgrade its technological capacities, generate higher value added and make the country less reliant on imported processed steel products.

[1371] For example, the order of the Federal Tariff Service N.º 43-t / 3 Moscow of 15 March 2011 "*on Establishing Exclusive Tariffs for the Transportation of Ferrous Scrap by Rail*" established an exceptional coefficient on tariffs for transport of ferrous scrap at 0.50 of the then current tariff, available at: http://www.garant.ru/products/ipo/prime/doc/55071037/, accessed on 7 February 2020. Another example is the order of the Federal Tariff Service N.º 303-t / 3 Moscow of 27 November 2012 "*on Amendments and Additions to the Price List N.º 10-01" Tariffs for the transportation of goods and infrastructure Services performed by Russian railways*" establishing special reduction coefficients for the carriage of iron ores and concentrates at certain distances, available at: http://base.garant.ru/70280464/, accessed on 7 February 2020.

[1372] Strategy of Socio-economic Development of the Far East and the Baikal region for the period up to 2025.

[1373] The Russian Government (2017), available at: http://government.ru/orders/selection/401/30538/, accessed on 30 October 2019; FAS (2017), available at: https://fas.gov.ru/news/23591, accessed on 30 October 2019.

However, the Government financing of these programs represents typically less than 1% of total investments. Many measures relevant to the sector are designed to address broader socio-economic objectives. In general, irrespective of the specific instrument or support-providing agencies, there are criteria and procedures that apply to many sectors and that need to be followed in order to be eligible for state support.

However, the Development Strategy of the Steel Industry for 2014-2020 and for the Perspective until 2030 sets out some sector-specific directions, targets and state support instruments which can affect the competitiveness of the sector. In addition, certain elements of the country's electricity, natural gas and rail transport pricing policies, as well as export restrictions on scrap, may be contributing to lower costs of production and domestic and international delivery of Russian steel products.

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15.1 INTRODUCTION

Several factors affect the international competitiveness of the Russian aluminium sector. These include access to raw materials, semi-products, energy resources, the level of wages, access to domestic and international markets and priorities in the state economic policy.

According to Russian Federal Customs Service data in 2017, export of 3.2 million tons of unwrought aluminium – representing 85% of primary aluminum production in Russia – worth USD 5.464 billion generated 1.52% of Russia's export revenues. At the same time, Russian aluminium producers face growing competition from China and have to deal with problems caused not only by purely economic factors and developments in the global market but also with the consequences of political decisions taken both in Russia and abroad.[1374]

15.2 RUSSIAN PRODUCTION AND EXPORT OF ALUMINIUM

Production of aluminium is a complex process involving several steps, from extraction of aluminium ores, to production of alumina to production of unwrought, primary aluminium used to produce more advanced products such as ingots, fabricated products and various types of finished products. Production of aluminium is very energy intensive, leaves a strong environmental footprint and involves the transport of huge volumes of goods over relatively long distances from bauxite production sites to alumina production sites, to aluminium production sites and on to markets. All these factors affect the production costs incurred by various producers of aluminium operating in the global market.[1375]

Development of the Russian aluminium sector has over the past three decades hinged on two key issues: the situation in the global aluminium market where most of the country's production is

[1374] For instance, the introduction of sanctions targeting owners of UC Rusal by the US administration in 2018 have made Russian authorities consider some measures that were to ease the pressure on this industry and help it survive this political crisis. For further information, Lenta (2018), *Deripaska ponadeyalsya na pomoshch gosudarstva (Deripaska hopes the state will help him)*, available at: https://lenta.ru/news/2018/05/28/benefits/, accessed on 31 October 2019; also Lenta (2018), *Bednyye russkiye. Oligarkhi postradali za Rossiyu.Teper za nikh zaplatyat prostyye ghrazdanie (Poor Russians. Oligarchs have suffered for Russia. Now will ordinary Russians pay the bill)*, available at: https://lenta.ru/articles/2018/05/06/more_money_plz/, accessed on 31 October 2019.

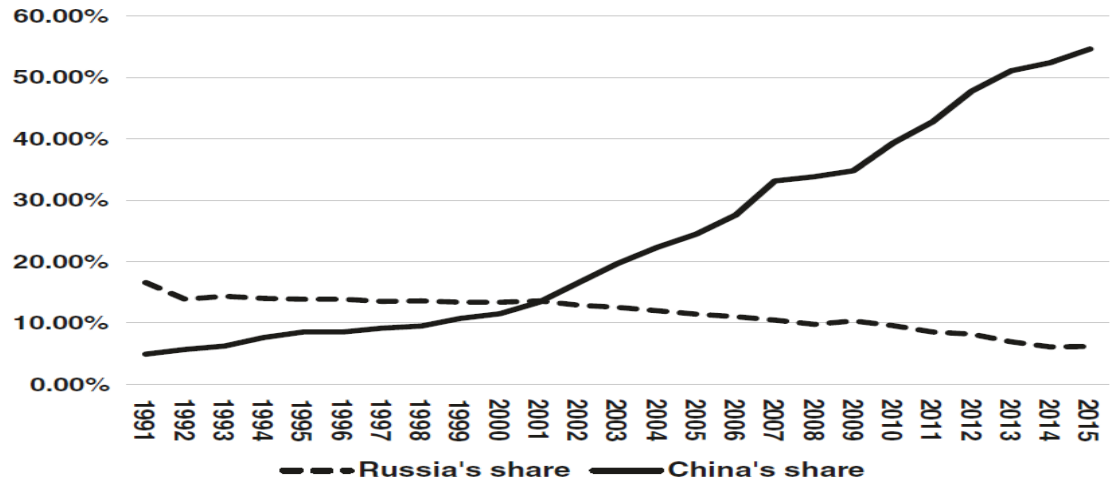
[1375] For a good understanding of the aluminium value chain complexity see for instance OECD (2010), OECD Global Forum on Environment Focusing on Sustainable Materials Management, *Materials Case Study 2: Aluminium*, Paris, available at: https://www.oecd.org/env/waste/46194971.pdf, accessed on 31 October 2019. A simplified description of the complexities of the aluminium value chain and key parameters of the global aluminium market and Russia's changing role in it can be found in Godzimirski, J. M. (2018), *The Political Economy of Russian Aluminium. Between the Dual State and Global Markets*, *in* Shaw, T. (ed.) *International Political Economy*, London, Palgrave Macmillan), Chapter 2. A 2019 OECD study provides a detailed account on what market distortions can be found in various phases of the production and marketing of aluminium. See: *Measuring distortions in international markets: the aluminium value chain*, OECD Trade Policy Papers, No. 218, OECD Publishing, Paris, available at: https://doi.org/10.1787/c82911ab-en, accessed on 4 November 2019.

exported, making Russia one of the leading exporters,[1376] as well as the evolution of relations between the political and economic powers in Russia.[1377]

There are several factors shaping the Russian aluminium sector, such as:

- Access to the domestic and international market for aluminium when domestic demand for aluminium in Russia collapsed after the fall of the Soviet Union and Russian producers had to turn to global markets and face competition from China (see Figure 15.1);
- Access to imported raw materials given that Russia's domestic production of aluminium ores and alumina does not cover industry needs;
- Access to the energy resources needed for production of aluminium which gives Russian producers a strong competitive advantage due to the availability of abundant renewable hydropower resources in Siberia where most of the primary aluminium production sites are located;
- Increased transport-related costs owing to the distances between sites of extraction of raw materials, production facilities and markets;
- The availability of qualified workforce and labour costs.

Figure 15.1. Russia's and China's shares in the global production of aluminium[1378]



Source: data retrieved from U.S. Geological Survey (2016).

[1376] Observatory of Economic Complexity (2017), *Which countries export Raw Aluminium?*, available at: https://atlas.media.mit.edu/en/visualize/tree_map/hs92/export/show/all/7601/2017/, accessed on 4 November 2019.

[1377] Godzimirski, J.M. (2018), *The Political Economy of Russian Aluminium. Between the Dual State and Global Markets*, London, Palgrave Macmillan.

[1378] Source of data: U.S. Geological Survey (2016), *Aluminum. Statistics and Information* (updated 25 October 2016), available at: https://www.usgs.gov/centers/nmic/aluminum-statistics-and-information, accessed on 10 February 2020.

The company UC Rusal which accounts for almost 100% of Russia primary aluminium production, is often referred to as the first privately-owned natural monopoly in Russia and is managed by a group of influential Russian oligarchs. The company was created in 2007, following consolidation of Russian aluminium assets and a political decision to transfer state-owned economic assets to private owners. In the following years the company had to deal with a serious crisis – in 2009, aluminium output was 11% lower than in 2008, alumina production dropped by 36% and bauxite production by 41%.[1379]

In the following years, the industry had to adapt to the post-crisis situation in the Russian domestic and international market by cutting its production and supplies. UC Rusal also had to cope with the effects of the 2015/2016 economic crisis in Russia that resulted, among others, in lower domestic demand for aluminium. Other important challenges were the growing competition from Chinese producers,[1380] and finally, the impact of restrictive measures taken by the EU and US (see Chapter 6) following the Ukraine crisis in 2014 that, by 2018, also targeted the key owners of UC Rusal. The company was forced to adjust its management structures and reduce the role of key owners who, in April 2018, were put on the US blacklist of Russian businessmen suspected of having too close relations with the Russian authorities[1381] (see Section 6.6).

The 2017 United States International Trade Commission ('USITC') report[1382] provides detailed information on the conditions influencing the key global aluminium players, including Russia, in the post-crisis period between 2011 and 2015. According to this report, the global market was characterised by:

– Rising global production of primary aluminium and wrought aluminium (roughly 25% increase in period 2011–15), driven largely by the dramatic growth of China's output and consumption;

[1379] UC Rusal (2010) *Addressing the Challenges. Annual Report 2009*, Moscow, UC Rusal, available at: http://www.rusal.ru/upload/iblock/9f3/Annual_Report_2009_eng.pdf, accessed 20 October 2016.

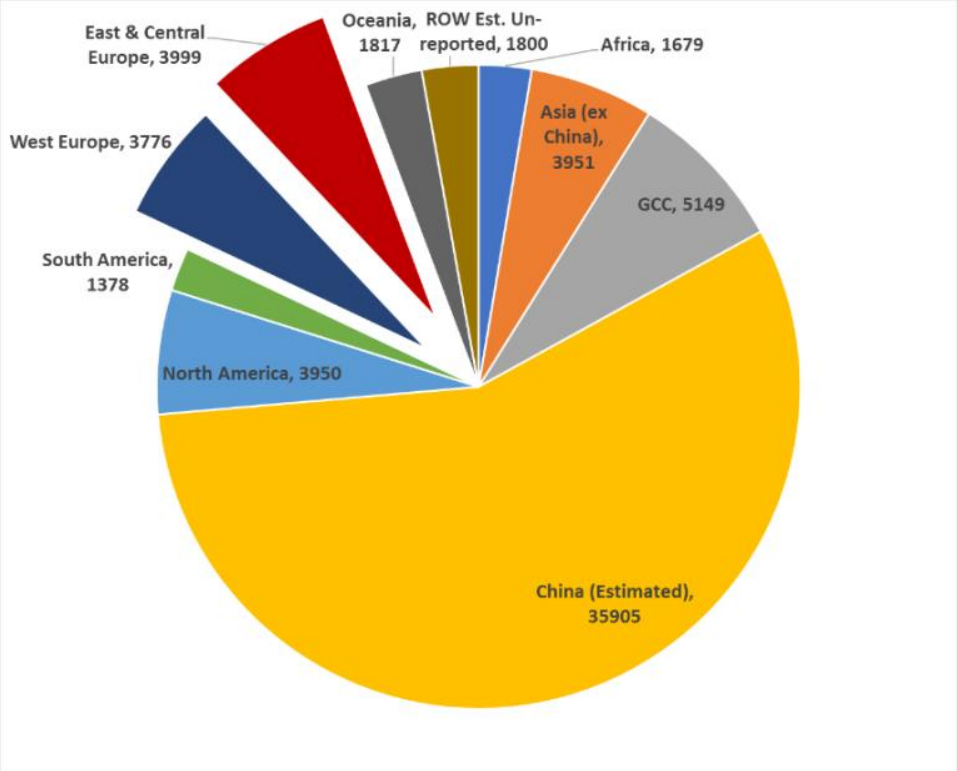
[1380] For more details on this period see Godzimirski, J.M. (2018) *The Political Economy of Russian Aluminium. Between the Dual State and Global Markets*, International Political Economy, London, Palgrave Macmillan, Chapter 5.

[1381] For details, see: U.S. Department of the Treasury (2018), *Ukraine-/Russia-related Designations and Identification Update; Syria Designations; Kingpin Act Designations; Issuance of Ukraine-/Russia-related General Licenses 12 and 13; Publication of New FAQs and Updated FAQ*, available at: https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20180406.aspx, accessed on 14 November 2019 and U.S. Department of the Treasury (2018), *Treasury Designates Russian Oligarchs, Officials, and Entities in Response to Worldwide Malign Activity*, available at: https://home.treasury.gov/news/press-releases/sm0338, accessed on 14 November 2019. The adjustments in UC Rusal's management structures and the subsequent removal of the company from the US Office of Foreign Asset Control's SDN list, had a positive effect on the company's ability to operate on the global aluminium market. See: United Company Rusal Plc (2019), *Removal from OFAC'S SDN List*, available at: https://rusal.ru/upload/iblock/e73/LTN20190128053%20ofac.pdf, accessed on 14 November 2019.

[1382] United States International Trade Commission (2017), *Aluminum: Competitive Conditions Affecting the U.S. Industry*, Washington DC, available at: https://www.usitc.gov/publications/332/pub4703.pdf, accessed on 4 November 2019.

– Continued dominance in the export markets of traditional exporters, such as Russia, Canada, Norway, and Australia, but with China strengthening its position as the world's leading exporter of wrought aluminium, followed by Germany and the US;
– Severe price declines during 2011–15 due to oversupply and falling production costs, which resulted in the US shedding 19% of its primary aluminium capacity between 2011 and 2015 and Europe[1383] losing 11% over this period, while China and the Gulf Cooperation Council countries expanded their capacity by more than 40%.

Figure 15.2. Global aluminium production 2017[1384]



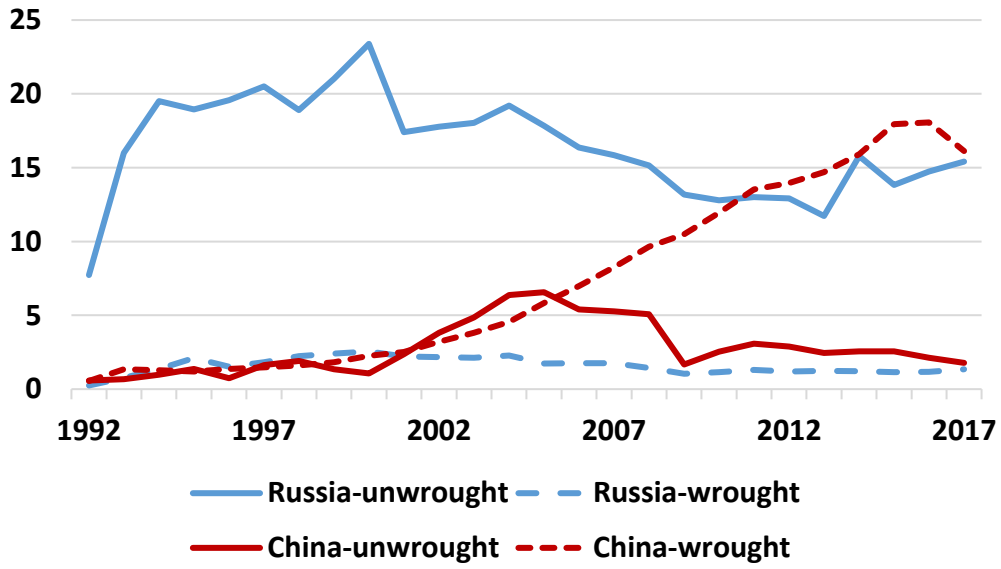
Source: data retrieved from World Aluminium (2019).

According to recent data, the value of aluminium exports represented 1.2% of total Russian exports in 2012 and 2013, 1.1% in 2014, 1.8% in 2015[1385] 1.66% in 2016, 1.52% in 2017 and 1.18% in 2018.[1386] Most of the aluminium exported from Russia is unwrought aluminium and Russia was

[1383] This term covers the EU, as well as Norway, Iceland, Switzerland, Albania, Armenia, Belarus, Bosnia, Georgia, Macedonia, Moldova, Montenegro, Serbia and Ukraine.
[1384] World Aluminium (2019), *Primary Aluminium Production*, available at: http://www.world-aluminium.org/statistics/#data, accessed on 4 November 2019.
[1385] WTO (2016), *2016 WTO Trade Policy Review: Russian Federation*, p.162.
[1386] For 2016, 2017 and 2018 – data of the Russian Customs Service FTS for the respective years is available at: http://www.customs.ru/index.php?option=com_newsfts&view=category&id=53&Itemid=1981, accessed on 4 November 2019.

until 2017 the number one exporter of this product while China has established itself as a major exporter of wrought aluminium. The value of aluminium exports from Russia reached USD 5.841 billion in 2015 and USD 4.682 billion in 2016.[1387]

Figure 15.3. Russia and China – shares of global export of unwrought and wrought aluminium[1388]



Source: data retrieved from COMTRADE.

Between 2014 and 2016, developments in the global aluminium market, where most of the Russian aluminium was sold, were not very encouraging for Russian producers and exporters. According to data provided by the Russian State statistics office, the average global price of aluminium was USD 1 867.4/metric ton (mt) in 2014, USD 1 664.7 in 2015 and USD 1 604.2 in 2016 – which represented respectively 85.9%, 76.6% and 73.8% of the price in 2010.[1389]

However, the situation improved in 2017 with global aluminium demand rising by 6% to 64.2 million tons resulting in the London Metal Exchange's ('LME') aluminium price rising by 22.7% year on year and at one point in January 2018 reaching USD 2 256/mt, almost the highest in six years.

In 2017, UC Rusal produced 3.707 million tons of primary aluminium (0.6% more than in 2016).[1390] According to the Russian Customs Service, exports of unwrought, primary aluminium

[1387] Federal State Statistics Service (2018), *Rossiyskiy statisticheskiy yezhegodnik 2017 (Russian Statistical Yearbook 2017)*, Moscow, FSSS, p. 577, available at: https://www.gks.ru/free_doc/doc_2017/year/year17.pdf, accessed on 10 February 2020.

[1388] Source: COMTRADE, via WITS.

[1389] *Ibidem*, p. 607.

[1390] UC Rusal (2018), *Allow for a Better Future. Annual Report 2017*, Moscow, UC Rusal, available at: https://rusal.ru/upload/iblock/327/LTN20180427141%20ar.pdf, accessed on 4 November 2019.

from Russia in 2017 were 3.208 million tons,[1391] 4.3% lower than in 2016. However, the value increased by 9.5% from USD 4.988 billion in 2016[1392] to USD 5.464 billion in 2017. In 2017, 97.5% of the volume and 97.2% of the value of exports came from trade with countries outside the FSU. This small discrepancy can be attributed to the fact that, according to Russian sources,[1393] the price of aluminium exported to the CIS countries was constantly higher than the price of aluminium exported to the rest of the world.

Table 15.1. Volume and price of aluminium in USD/mt exported to CIS and other countries[1394]

	2000	**2005**	**2010**	**2012**	**2013**	**2014**	**2015**	**2016**
Volume of export of primary aluminium (million tons)	3 203	3 690	3 319	3 417	3 335	2 845	3 380	3 481
CIS	11.2	20.3	50.2	75.9	93.3	70.7	54.1	67.3
Other countries	3 192	3 670	3 269	3 341	3 242	2 774	3 326	3 414
Average export price (USD/mt)	1 298	1 316	1 817	1 819	1 839	1 824	1 741	1 433
CIS	1 757	1 768	2 113	2 160	2 188	2 014	1 957	1 680
Other countries	1 296	1 313	1 813	1 811	1 829	1 819	1 737	1 428
LME average price[1395]	1 550	1 871	2 173	2 023.3	1 846.7	1 867.4	1 664.7	1 604.2

Source: data retrieved from Federal State Statistics Service.

[1391] Avaliable at: http://embedded-cet.customs.ru/attachments/article/26258/%D0%AD%D0%9A%D0%A1%D0%9F%D0%9E%D0%A0%D0%A2.xls, accessed on 10 December 2018.

[1392] Available at: http://technical.customs.ru/attachments/article/24772/%D0%AD%D0%9A%D0%A1%D0%9F%D0%9E%D0%A0%D0%A2.xls, accessed on 2 December 2019.

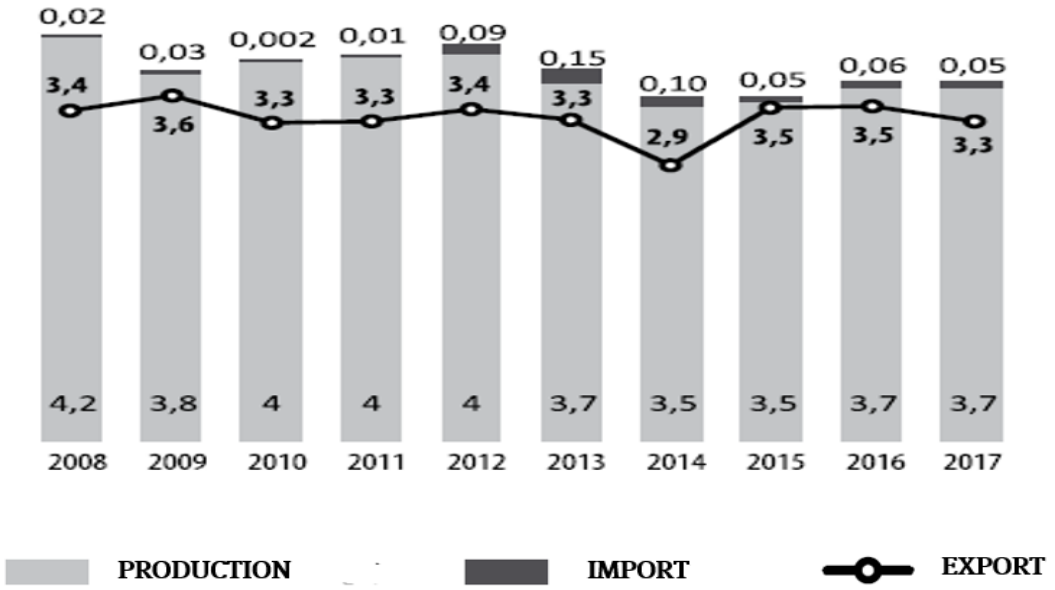
[1393] Federal State Statistics Service (2018) *Rossiyskiy statisticheskiy yezhegodnik 2017 (Russian Statistical Yearbook 2017).*

[1394] *Ibidem*.

[1395] Data from the Institute for the Economy in Transition annual reports on the Russian economy in 2017 and 2007.

During the first six months of 2018, the volume of exports of Russian aluminium increased by 15.4% compared with same period in 2017, while the value increased by 32.1%, reflecting the higher price attained in 2018.[1396]

Figure 15.4. Dynamics of Russia's production, export and import of primary aluminium 2008–2017 in million tonnes.[1397]



Source: data retrieved from *State report on the situation of and exploitation of natural resources in the Russian Federation in 2016 and 2017*.

Due to geological conditions leading to the lack of resources in Russia,[1398] the producers must produce alumina not only from high quality bauxite ores but also from low quality nepheline, as well as importing both bauxite ores and alumina to meet the industry's needs. According to reports on natural resources,[1399] Russia's reserves of bauxite ores represent 3% of global reserves and its

1396 Analytical Centre of Russian Government (2018), *Byulleten' o tekushchikh tendentsiyakh rossiyskoy ekonomiki. Dinamika vneshney torgovli. August, 40, (Information on the current tendencies in the Russian economy. The dynamics of foreign trade*), Moscow, Analytical Centre of the Russian Government, available at: www.ac.gov.ru/files/publication/a/17665.pdf, accessed on 11 February 2020.

1397 Source: *State report on the situation of and exploitation of natural resources in the Russian Federation in 2016 and 2017(Gosudarstvennyy doklad o sostayanii i ispolzovanii mineralno-syrevykh resursov Rossiyskoy Federatsii v 2016 i 2017 godakh),* available at: http://mnr.gov.ru/upload/iblock/902/gosdoklad.pdf, accessed on 4 November 2019.

1398 For an overview of the resource situation in Russia, see the series of reports on natural resources *State report on the situation of and exploitation of natural resources in the Russian Federation (Gosudarstvennyy doklad o sostayanii i ispolzovanii mineralno-syrevykh resursov Rossiyskoy Federatsii),* available at the Ministry of Natural Resources website: http://mnr.gov.ru/docs/gosudarstvennye_doklady/, accessed on 14 November 2019.

1399 *State report on the situation and exploitation of natural resources in the Russian Federation in 2016 and 2017 (Gosudarstvennyy doklad o sostayanii i ispolzovanii mineralno-syrevykh resursov Rossiyskoy Federatsii v 2016 i 2017 godakh),* available at: http://mnr.gov.ru/upload/iblock/902/gosdoklad.pdf, accessed on 14 November 2019.

share in bauxite production is 3% of global production (6 million tons in 2017). In 2016, Russia/UC Rusal produced 2.68 million tons of alumina, which was 2.3% of global alumina production. This met only 34% of the needs of Russian aluminium producers,[1400] hence Russia has to import most of its alumina. In 2015, these imports represented 0.8% of the value of all Russian imports.[1401] The lack of domestic high-quality bauxite needed for the production of alumina is a challenge for Russian aluminium producers. To deal with this and other issues, UC Rusal embarked on building a VIC controlling the whole value chain of aluminium production by acquiring some strategic assets abroad.[1402]

15.3 MAPPING THE COSTS IN THE RUSSIAN ALUMINIUM SECTOR

15.3.1 INTERNATIONAL CONTEXT

According to a 2013 study[1403] examining cost-related issues for the global aluminium industry, Russian/CIS aluminium producers were operating in a highly competitive global environment. The EU, US, Chinese, Australian, Norwegian and Latin American smelters were, at that time, incurring higher costs than those located in Russia. On the other hand, Canadian, Icelandic, African, Asian, Middle Eastern and some EU-located smelters incurred lower costs of production. The production costs per ton incurred by the producers outside Russia ranged from USD 2 041 in the EU to USD 1 402 in the Middle East.

15.3.2 ALUMINIUM PRODUCTION COSTS

According to the USITC 2017 study, the principal input costs for primary aluminium smelters are electricity, alumina, carbon anodes, and labour. Construction of new aluminium production sites is relatively costly; the USICT estimates the cost of construction of a mid-size facility to be USD 4.5 billion.[1404] There are two new aluminium smelters under construction in Russia as of writing of this report, one in Boguchansk[1405] (Capex USD 826 million) and one in Taishet[1406] (planned Capex USD 1.772 billion).

The 2017 USITC study presented more details on the cost structure in the Russian aluminium sector between 2011 and 2015, providing information about costs expressed in USD.[1407]

1400 *Ibidem*, pp. 123–124.
1401 WTO, *2016 WTO Trade Policy Review: Russian Federation*, p.164.
1402 For details on the geography of UC Rusal activity and its global assets, see the overview available at: https://rusal.ru/en/about/geography/, accessed on 5 November 2019.
1403 Centre for European Policy Studies and Economisti Associati (2013), *Assessment of Cumulative Cost Impact for the Steel and the Aluminium Industry. Final Report. Aluminium*, Brussels, available at: https://www.ceps.eu/system/files/final-report-aluminium_en.pdf, accessed on 5 November 2019.
1404 USITC (2017), p. 52.
1405 Funded partly by the State, partly by private investors.
1406 Funded by UC Rusal.
1407 USITC (2017), p. 361 where a) covers bath material, pot relining, smelter fuel, maintenance and other supplies, sustaining capital, and working capital on supplies. b) refers to CRU Group's use of the "*net realization*" cost adjustments to account for variances in product quality impacting production costs but does not include overhead

Table 15.3. USITC/CRU overview: Russia: Primary unwrought aluminium average business costs, 2011–2015 (USD per metric ton of aluminium produced)

Cost component	2011	2012	2013	2014	2015
Alumina	770	713	711	674	604
Electricity	544	515	522	464	408
Labour	108	110	109	87	59
Anode	271	217	180	147	139
Other[a]	222	213	215	195	169
Total liquid metal costs	1 915	1 768	1 737	1 568	1 378
Casthouse	78	76	75	72	62
Net realizations [b]	-31	-274	-324	-290	-219
Average business costs	1 961	1 570	1 488	1 349	1 220
Global average business costs	1 909	1 702	1 589	1 392	1 350
LME cash price (USD/mt) [c]	2 395	2 018	1 845	1 867	1 661

Bauxite and alumina costs are set by the market and producers have a limited ability to influence them, but the fact that UC Rusal is a vertically integrated company controlling the whole aluminium value chain helps it control these costs. However, the costs of energy, transport and labour are defined not only by market but also by policymakers (see also Chapters 10, 11 and 13). Regulation of domestic transport and electricity tariffs is discussed in more detail below (see Sections 15.3.3 and 15.3.4).

UC Rusal presents itself as one of the world's most cost-efficient sustainable producers, due to its high reliance on hydropower.[1408] Data in Table 15.2 are based on UC Rusal's annual reports presented under the heading *Costs of sales* and give a good understanding of the relative importance of various costs incurred in the process of production in Russia.

Table 15.2. Evolution of cost shares (in % of total costs) in aluminium production in Russia in descending order[1409]

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018

costs in overall corporate costs and c) refers to global aluminium prices based on the three-month LME cash costs as reported by CRU Group.

[1408] 95% of UC Rusal's energy came from Siberian hydropower plants. See, UC Rusal (2018) *Allow for a Better Future. Annual Report* 2017, p. 9.

[1409] Data based on UC Rusal's annual reports 2009–2018, position *Cost of sales.* For instance for 2018, available at: https://rusal.ru/upload/iblock/7dc/07.03.2019%20RUSAL_FY2018%20Results.pdf, accessed on 5 November 2019.

Total costs (USD mln)	11 073	6 710	7 495	8 786	9 232	8 429	7 223	6 215	6 070	7 183	7 446
Other raw materials and other costs	38.3	33.6	34.7	35.8	34.1	35.5	36.1	36.2	35.1	36.5	38.1
Energy	18.5	28.0	26.3	28.8	28.1	28.2	26.7	27	25.8	29.9	28.8
Alumina	13.3	14.6	14.9	11.9	14.6	11.9	11.9	11.8	11.8	10.1	11.8
Personnel	9.0	11.5	9.8	9.8	9.9	10	9.8	8.1	8.6	8.1	7.8
Depreciation and amortisation	8.9	8.3	6.3	5.6	5.6	5.8	6	7	7.2	6.6	6.7
Bauxite	6.9	5.6	5.5	5.8	5.7	7	8.4	8.7	7	6.4	6.7
Purchase of primary aluminium from JV									3.8	3.9	4.1
Repairs and maintenance	2.0	1.7	1.9	1.7	1.6	1.1	1	0.9	0.9	1	1.0
Other	3.1	-3.3	0.6	0.6	0.4	0.5	0.1	0.3	-0.2	-2.6	-5.0

15.3.3 ENERGY COSTS

The 2017 USITC study argued that the global aluminium industry is characterised by extensive government policies that affect all segments of the supply chain with the principal aim of lowering production costs for primary unwrought aluminium.[1410] According to this study, the chief determinant of competitiveness for most primary aluminium producers is access to low priced electricity, which may be especially important in the case of Russia where primary aluminium is the main output.

In 2012, production of non-ferrous metals, mostly aluminium, accounted for 2% of all delivered industrial energy consumption in both the OECD and non-OECD regions, and was expected to remain at a similar level in the future.[1411]

The non-ferrous metals sector in Russia consumes 15% of the country's power generation output and it is estimated that production of one ton of aluminium in Russia requires between 15 and 16 000 kWh. With a production level of ca 3.7 million tons of primary aluminium per year, this means annual consumption of between 55.5 and 59.2 TWh of energy by UC Rusal-owned production facilities. This figure corresponds with the data provided by the Analytical Centre of

[1410] USITC (2017).

[1411] U.S. Energy Information Agency. (2016), *International energy outlook 2016*, Washington, DC, available at: http://www.eia.gov/outlooks/ieo/pdf/0484(2016).pdf, accessed on 5 November 2019.

the Government in its study on the economic effects of prices for Russian industry from 2014 which estimated that the non-ferrous sector consumed between 90 and 95 TWh of energy per year and the share of aluminium production in this consumption was close to 67–70%. The study also mentioned that the price for energy paid by aluminium producers in Siberia, where most smelters are located, was much lower – 0.5 rouble per kWh – than the price of energy in the European part of Russia.[1412]

According to the same Government study,[1413] in 2014 the cost of energy represented more than 40% of the cost of aluminium production in the EU and approximately 20% of the cost of aluminium production in the US. By contrast, the energy costs of Russian producers represented between 18.5% and 29.9% of the costs of production over the past decade. In 2015, UC Rusal's electricity costs per metric ton of aluminium produced were lower than the global average – USD 408 per metric ton in Russia and USD 527 globally, but higher than in Canada, Golf Cooperation Council countries, or Norway.[1414]

However, Russian industrial producers – including aluminium producers – face also some energy related challenges due to some political considerations. In the wake of the 2008 reform of the power generation sector, Russian authorities decided to provide lower electricity prices to individual consumers and charge industrial consumers slightly higher prices to shield individual consumers from price shock – and in that way secure greater political stability. This cross-sector subsidising[1415] is still a reality in Russia and can be viewed by Russian industrial energy consumers, including aluminium producers, as a cost-increasing factor. As a result, the price of electricity for industrial consumers was higher in 2017 – 4 Eurocent/kWh – than for individual consumers who, on average, paid 3 Eurocent/kWh.[1416] According to the report by the Ministry of Energy on the situation in the power generation sector, in 2016 individual consumers in Krasnoyarsk region and Irkutsk county (two regions where important aluminium producing facilities are located) paid 1.67 RUB/kWh (Krasnoyarsk region) and 0.67 RUB/kWh (Irkutsk county), while non-individual consumers, including industry, had to pay much higher prices – 1.79 RUB/kWh and 1.55 RUB/kWh, respectively.[1417]

[1412] Analytical Centre of Russian Government (2014), *Energy bulletin, issue 15, Economic effects of energy prices for industry (Energeticheskiy byuleten vypusk 15, Ekonomicheskiye effekty tsen na energiyu dlya promyshlennosti)*, Moscow, Analytical Centre of the Russian Government, pp. 15–16.

[1413] Analytical Centre of Russian Government (2014).

[1414] United States International Trade Commission (2017), p. 110.

[1415] For more on this, I. Ryapin (2013) *Cross-sector subsidising in power generation: result of a fifteen year-long battle (Perekrestnoe subsidirovanie v elektroenergetike: itog pyatnadtsatiletnej borby)*, Moscow, Skolkovo, Energeticheskiy Tsentr Moskovskoy Shkoly Upravleniya Skolkovo.

[1416] Zolotova, I. (2017), *Cross-sector subsidising in power generation sector: empirical analysis, assessment of effectiveness of own power generation (Perekrestnoye subsidiriovaniye v elektroenergetike: empiricheskiy analiz, otsenka effektivnosti sobstvennoy generatsii)*, Moscow, Higher School of Economics.

[1417] Ministry of Energy (2017), *Report on situation in the power generation sector in 2016 (Otchet o funktsionirivaniyu elektroenergetiki za 2016 god)*, Moscow, Ministry of Energy of Russian Federation, p. 88 and 91.

From the point of view of industrial energy consumers – and UC Rusal is one the key consumers – the idea of industrial consumers subsidising private energy consumers had a negative impact on the competitiveness of the industry. UC Rusal pushed for reconsidering the electricity pricing system in 2018 when the introduction of the US sanctions against its owners made its situation more challenging. These questions were even discussed at the round table organised by the Energy Committee of the State Duma in May 2018, where representatives of UC Rusal shared negative opinions on the idea of cross-subsidising.[1418] However, authorities, fearing popular protests, decided not to implement these measures, which again shows that political stability, and not the concern for competitiveness of aluminium sector, was the top priority of political decision makers.[1419]

15.3.4 COSTS OF TRANSPORT

In addition to the energy-related issues, there have been some cost-increases in the Russian transport sector that have impacted negatively on the international competitiveness of Russian aluminium producers. During the Soviet era, the question of transport costs was not very high on the industry agenda due to the autarchic nature of the Soviet economy, and because the main customers were located inside Russia. After the collapse of the Soviet Union, most aluminium production had to be exported abroad due to falling domestic demand (which is still the Russian reality), and imported – or domestically produced – alumina had to be transported long distances.

As a result, transport costs became an economic challenge for Russian producers and an important factor in their costs. For instance, in 2000 UC Rusal paid USD 250 per ton of aluminium in freight costs, which was far more than its international competitors.[1420] The transport costs Russian producers have to cover are still high. In 2018 it was estimated that UC Rusal's transport bill reached RUB 24 billion (or ca. USD 400 million) in 2017 but according to the sources close to RZD this represented only 3% of the company's costs, or USD 70/mt of aluminium.[1421] According to the 2014 strategy for development of the Russian non-ferrous metal industry (see Section 15.4), the share of non-ferrous metallurgy in railway transport in Russia at that time reached a level of 3.8%.[1422] The 2017 USITC study estimated that in 2015 metal delivery costs of aluminium in the case of Russian producers totalled USD 83/mt, representing nearly 7% of the cost of producing a

[1418] A brief report from this round table is available at: http://komitet2-13.km.duma.gov.ru/Novosti-Komiteta/item/16236329, accessed on 5 November 2019. For the opinion on this issue of the representative of En+, the main shareholder of UC Rusal, available at: https://lenta.ru/news/2018/10/25/enplus/, accessed on 5 November 2019.

[1419] In the same vein, see https://www.rbc.ru/economics/16/07/2018/5b4bfc4f9a794712fcd1ded1, accessed on 5 November 2019.

[1420] Skvortsov, A. (2004), *Yest' kuda rasti (There is a room for growth)*, Ekspert Severo-Zapad, (11), available at: http://expert.ru/northwest/2004/11/11no-eprilm_50510/, accessed on 5 November 2019.

[1421] See: https://www.interfax.ru/business/617060, accessed on 5 November 2019.

[1422] Minpromtorg (2014), *Strategy of development of non-ferrous metals sector in Russia in 2014–2020 and with perspectives until 2030 (Strategiya razvitiya tsvetnoi metallurgii Rossii na 2014 - 2020 gody i na perspektivu do 2030 goda)*, Moscow, Ministry of Industry and Trade of the Russian Federation, available at: http://www.garant.ru/products/ipo/prime/doc/70595824/, accessed on 5 November 2019.

metric ton of primary aluminium in Russia and were far higher than the transport costs of the key global competitors.[1423]

The need to deal with the transport burden on Russian aluminium producers was also one of the reasons why the Government considered lowering transport tariffs to cut the costs of operations and make the final product more competitive.[1424] To deal with the relatively high transport costs that in the opinion of UC Rusal's management had a detrimental effect on the company's international competitiveness, the company asked the Government in 2015,[1425] and again in June 2018, to lower rail transportation tariffs for its products.[1426] UC Rusal was at least partly successful in these efforts – in November 2018 when the FAS announced that RZD will be allowed to increase its transport tariffs by 8% from 1 January 2019, the transport of oil and aluminium was exempted from that tariff increase (see also Chapter 11).[1427]

15.3.5 LABOUR COSTS

According to UC Rusal data, the share of labour costs in cost of sales was between 10% in 2013 and 8.1% in 2017. The 2017 USITC report quotes figures showing that hourly wages in Russian aluminium sector were USD 11.77 in 2013 and USD 6.84 in 2015. The fall was attributed to the nearly 50% depreciation of the rouble against the dollar in that period, caused by the collapse of international oil prices and tensions in relations between Russia and the West in the wake of the conflict in Ukraine. This depreciation also explains the drop in labour costs from USD 109/mt of aluminium in 2013 to USD 59 in 2015 noted in the 2017 USITC report.[1428] This was an important issue because companies controlled by the owners of UC Rusal employ, according to some estimates, ca 200 000 people in Russia and abroad – with UC Rusal alone having more than 62 000 people on its payroll.[1429]

15.3.6 OTHER RAW MATERIALS AND OTHER COSTS

This is the largest item in the overview of the cost of UC Rusal's sales, with a 36.5% share in 2017, yet the most difficult to interpret as UC Rusal's report offers no explanation as to what it covers.

1423 USITC 2017, p. 365, and Figure 3.5 on p. 117.

1424 Available at: https://www.rbc.ru/rbcfreenews/5b2367c89a79479a62876ffd, accessed on 6 November 2019.

1425 *RZD considers lowering transport tariffs for Rusal's and Evraz' export products (RZhD obsuzhdayut snizheniye tarifnykh nadbavok na eksportnyye perevozki Rusala i Evraza)*, available at: https://tass.ru/ekonomika/2091310, accessed on 6 November 2019.

1426 *Rusal tries to catch the train. Company asks for lower transport tariffs (Rusal pobezhal za poyezdom. Kompaniya prosit lgot po transportnym tariffam)*, available at: https://www.kommersant.ru/doc/3658152, accessed on 6 November 2019.

1427 *FAS accepted 8 % RZD tariff increase for all goods, except transport of oil and aluminium (FAS utverzhdila 8-protsentnuyu nadbavku k tarifam RZhD dlya vsyekh gruzov, krome nefti i alyuminiya)*, available at: https://trans.ru/news/fas-utverdila-8-protsentnuyu-nadbavku-k-tarifam-rzhd-dlya-vseh-gruzov-krome-nefti-i-alyuminiya, accessed on 6 November 2019

1428 USITC (2017), p. 311.

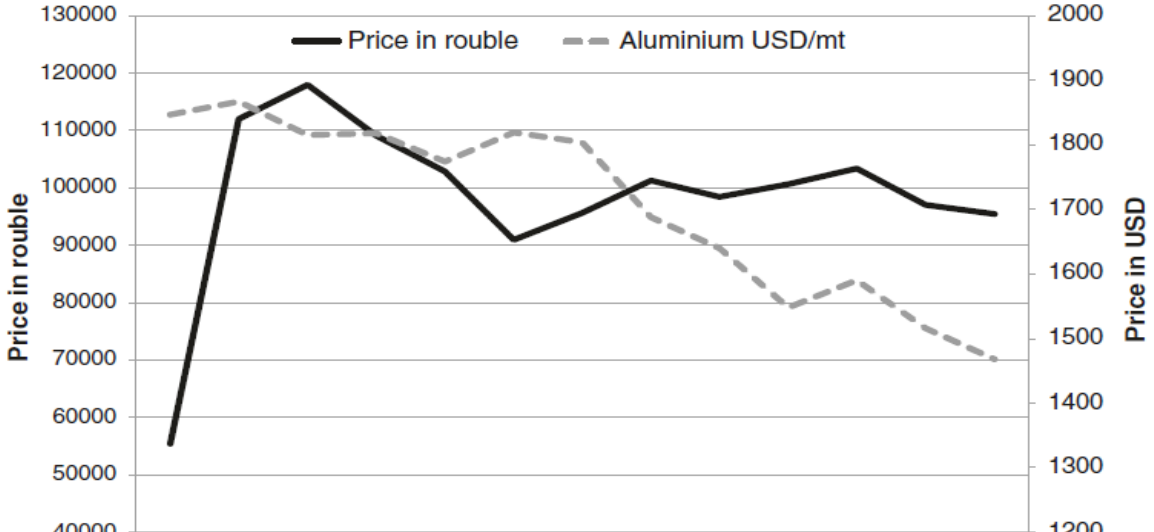
1429 Reuters (2018), *Factbox: Tens of thousands of jobs rely on Deripaska's sprawling empire*, available at: https://www.reuters.com/article/us-usa-sanctions-rusal-workers-total-fac/factbox-tens-of-thousands-of-jobs-rely-on-deripaskas-sprawling-empire-idUSKBN1HV2F7, accessed on 6 November 2019.

It is estimated that these costs most probably include fuel oil, coke, caustic soda, pitch and transport that are not mentioned elsewhere. Other items, such as the cost of unused production capacity, cost of stockpiling and aluminium reserves, and servicing the company's debt, that amounted to USD 16.8 billion in 2009 and down to USD 7.64 billion by 2017, might also be included here.

15.3.7 SUMMING UP OF THE DISCUSSION ON COSTS

In general, the most important element of the Government policy affecting costs for aluminium industry is the policy of increasing tariffs in two areas of crucial importance for the industry – energy and transport. At the same time, however, the policy of allowing the Russian currency to float freely against both the dollar and the euro has had a rather positive effect on the competitiveness of the Russian aluminium sector. The strong depreciation of the Russian rouble after the outbreak of the Ukraine crisis in 2014 helped Russian aluminium producers whose main production facilities for primary aluminium are located in Russia. Most of their costs are incurred in roubles while most of their production is sold on the global market and is paid in dollars. This helped the companies not only to survive but also to improve their financial results. In other words, the rouble depreciation against the dollar from, ca 32 RUB/USD on 30 October 2013 to 78.6 RUB/USD for a brief period in January 2016, to almost 68 RUB/USD on 15 November 2018, allowed the aluminium producers to earn more RUB per ton of aluminium sold on global markets even if the price of aluminium expressed in dollars was going down.

Figure 15.4. Aluminium price development: rouble vs dollar depreciation effect: 2013, 2014 and 2015.



	2013	2014	Jan	Feb	March	Apr	May	June	July	Aug	Sep	Oct	Nov
Price in rouble	55410	112020	117975	109080	102892	90950	95612	101280	98400	100620	103350	97024	95420
Aluminium USD/mt	1847	1867	1815	1818	1774	1819	1804	1688	1640	1548	1590	1516	1468

Source: UC Rusal's annual reports and internal calculations.[1430]

[1430] Source: Godzimirski 2018, p. 108.

15.4 RUSSIAN STATE'S INTERESTS IN THE ALUMINIUM SECTOR

Developments in Russian aluminium sector should be viewed in the context of Russia's industrial policy. Development and implementation of Russia's industrial policy are shaped by decisions taken in the Ministry of Finance, that is responsible for the economic policy of the country and the Ministry of Industry and Trade,[1431] where the long-term economic policy goals and strategies are set for implementation by other state organs. In addition, the Presidential Administration and the CBRF are also involved in the process of policymaking. The strategic goals are often presented publicly by the President, who occupies the top position in the country's formal and informal power structure and is believed to act as an arbiter in conflicts among various actors pursuing their narrow sectoral interests (see also Chapter 2).[1432]

In May 2014, Minpromtorg launched the State Program Development of industry and increasing its competitiveness (see Section 14.2.1). The Program outlines goals and strategies for the country's metal industry and it sets priorities to be reached in two phases, by 2015 and between 2016 and 2020.[1433] The main goals are to ensure supplies coming from domestic and foreign producers can meet the demand for metal products and to increase the competitive advantage of Russian products.[1434] This is to be achieved by:

- Improving the quality and competitiveness of Russian metal products;
- Reducing the resource intensity of production;
- Stimulating domestic demand for metal products;
- Increasing production volumes of metal products, especially those that are in short supply;
- Strengthening Russia's position in the global market;
- Reducing Russia's dependence on the import of metal products and raw materials;

[1431] The department of metallurgy and materials in the Ministry of Industry and Trade is responsible for the planning and implementation of state policy in the area of metallurgy, including the aluminium industry.

[1432] For more details on the organisation of power in Putin's Russia see, for instance, Pavlovskii, G. (2016), *The Russian System: a View From the Inside*, The Russia File, Washington DC, Wilson Centre, available at: https://www.wilsoncenter.org/blog-post/the-russian-system-view-the-inside, accessed on 6 November 2019;

[1433] Minpromtorg (2014), *Russian Federation state programme "Industrial development and improving industry's competitiveness"* (full version) (*Gosudarstvennaya programma Rossiiskoi Federatsii "Razvitie promyshlennosti i povyshenie ee konkurentosposobnosti" (polnaya versiya))*, available at: http://base.garant.ru/70643464/c97cd9b59d97ee89f8842c374b081d6f/#block_45, See also: http://minpromtorg.gov.ru/common/upload/files/docs/Vizualizatsiya_GP-16_polnaya.pdf, accessed on 6 November 2019.

[1434] According to a 2007 study, strategic metals were defined as belonging to the category of sectors that are viewed by Russian policymakers as a top sensitive sector, important both economically and for national security. The fact that the energy sector, including power generation, belongs to the same category of sectors, explains better understand why Russian authorities are showing interest in the development of the aluminium industry. See: Liuhto, K. (2007), *A Future Role of Foreign Firms in Russia's Strategic Industries*, Vol. 4/2007, available at: https://www.researchgate.net/publication/264923339_A_future_role_of_foreign_firms_in_Russia's_strategic_industries/link/53f5ed070cf2fceacc6f7de9/download, accessed on 2 December 2019.

– Developing innovative enrichment technologies for the raw material resources needed.[1435]

Concerning specifically the area of metallurgy, including the aluminium industry, a comprehensive strategy from 2014 launched by the Ministry of Industry and Trade (′2014 Minpromtorg Strategy′),[1436] sets out the state policy for the sector.[1437] The 2014 Minpromtorg Strategy presents a detailed examination of the situation in the Russian and global aluminium industry viewed from the perspective of Russian policymakers and provides ts into how the Government plans to address the key challenges faced by this branch of the Russian economy with very strong connections to global markets.

It is important to bear in mind that the official documents published in Russia often present numerous policy-planning instruments and objectives to be achieved without viable prescriptions on how to achieve these objectives. The result is that relatively often they form the basis for policies that may, or may not, be implemented because of many internal and external factors and actors that intervene changing these policies.

In 2015, in order to improve the level of coordination of state policy in the field of metallurgy, the Ministry of Industry and Trade set up an inter-ministerial working group to reduce the industry's dependence on imports, as well as to discuss problems and the development of the metal industry in Russia. The group comprised representatives of the governmental bodies and industry, including the UC Rusal's director for contacts with state institutions.[1438]

Moreover, on 25 April 2018, Minpromtorg presented the state policy on import substitution in the non-ferrous metal sector in the Order on Approving the Plan of Measures for Import Substitution in the Non-Ferrous Metallurgy Industry of the Russian Federation[1439] (see also Section 12.2.3).

In view of the above, the State has an indirect interest in the country's aluminium sector and an expressed ambition to shape its future. The indirect interest has to do with:

– The reform of the country's power generation sector – including the maintenance and building of new infrastructure – that supplies energy to aluminium producers which is important because

[1435] See Section 10 of the Programme.

[1436] Minpromtorg (2014), *Strategiya razvitiya….*

[1437] Available at: http://minpromtorg.gov.ru/ministry/dep/#!24&click_tab_vp_ind=1, accessed on 6 November 2019.

[1438] Minpromtorg (2015), *Order N.º 2524 "On the Creation of the Inter-Ministerial working Group for Lowering of Industry's Dependence on the Import of metal Products and Development of the metallurgical Industry in the Russian Federation" (Prikaz nr 2524 ob Obrazovanii Mezhvedemstvennoy rabochey gruppy po snizheniyu zavisimosti promyslennosti od importa meallurgicheskoy produktsii i razvitiyu metallurgicheskoy otrasli Rossiyskoy Federatsii),* Moscow, Ministry of Industry and Trade.

[1439] Minpromtorg (2018), *Order N.º 1665 of 25 April 2018 "on Approving the Plan of Measures for Import Substitution in the Non-Ferrous Metallurgy Industry of the Russian Federation" (Prikaz Minpromtorga Rossii ot 25.04.2018 N 1665 Ob utverzhdenii plana meropriyatiy po importozameshcheniyu v otrasli tsvetnoy metallurgii Rossiyskoy Federatsii), a*vailable at: http://minpromtorg.gov.ru/docs/#!43337, accessed on 6 November 2019.

the non-ferrous metals sector of the Russian economy consumes 15% of electricity produced (see also Section 15.3.3);[1440]

- The building and maintenance of transport infrastructure which is needed bearing in mind that, according to Minpromtorg, non-ferrous metallurgy accounts for 3.8% of goods transported on Russian railways (see also Section 15.3.4);[1441]
- The role of the aluminium sector as an employer and player in the Russian labour market – according to recent information, in 2015 Russian primary aluminium production employed approximately 16 000 people (down from ca 21 000 in 2011) but the number seems to increase in 2017 to 18 434 working in aluminium production and more than 21 000 in alumina production (see also Section 15.3.5);[1442]
- The management of the country's natural resources which is important due to the fact that production of alumina and aluminium is energy intensive and requires access to land and various raw materials such as bauxite ores, alunite and nepheline used in Russia for the production of alumina (production of one metric ton of primary aluminium requires four tons of bauxite that is needed to produce two tons of alumina);
- Environmental questions pertaining to the whole aluminium production value chain such as the huge energy footprint or the need to manage large volumes of industrial waste (production of one metric ton of primary aluminium produces 13 tons of industrial waste, including three tons of toxic red mud). The cost of waste handling is most probably relatively high in the case of UC Rusal which produces almost 4 million tons of primary aluminium;[1443]
- Taxation of aluminium production and exports – non-ferrous metallurgy produces 2.3% of the country's GDP and accounts for 3.3% of industrial production, and its turnover in 2013 was ca RUB 1.5 trillion[1444] (the aluminium sector represents ca 22–24% of the non-ferrous metallurgy branch);[1445] more than 80% of the aluminium produced in Russia is exported which makes the question of taxation of aluminium exports and imports important, both from the economic point of view, as these exports can generate revenue for the State, but also as a fiscal instrument positively or negatively influencing the choices of aluminium producers in the country;
- Management of relations between the political and economic power elite in the country;[1446]
- Making economic actors take more responsibility for social issues by embarking on various Corporate Social Responsibility measures to create positive synergies in local communities and

[1440] Minpromtorg. (20 March 2014). *By 2020, imports of non-ferrous metals and products from them will decrease to 58.8% (K 2020 godu import tsvetnykh metallov i produktsii iz nikh snizitsya do 58,8%)*, available at: http://minpromtorg.gov.ru/press-centre/news/#!8502, accessed on 6 November 2019.

[1441] *Ibidem*.

[1442] USITC (2017), pp. 343–344. Data for 2017 from UC Rusal (2018), *Allow for a Better Future. Annual Report 2017*, p. 79.

[1443] According to UC Rusal (2018), *Allow for a Better Future. Annual Report 2017*, Moscow, UC Rusal, p. 87.

[1444] Minpromtorg (2014), *Strategiya razvitiya…*

[1445] Minpromtorg. (20 March 2014). *By 2020, imports of non-ferrous metals and products from them will decrease to 58.8% (K 2020 godu import tsvetnykh metallov i produktsii iz nikh snizitsya do 58,8%)*.

[1446] For more on the position of Russian aluminium oligarchs on Russian maps of informal power see Godzimirski (2018), chapter 9.

in the country in general. This made already in 2004 the then main shareholder of Rusal, Oleg Deripaska, publish a manifesto on social responsibility in which he proposed how Russian business community could contribute to improving the situation in Russian society.[1447]

The State is also interested and financially involved[1448] through one of the biggest private–public partnerships in the history of post-Soviet Russia in the Boguchansk Energy and Metals Complex (′BEMO′) project in which UC Rusal is the main private partner. This project investment, which includes construction of the 3 000 MW Boguchansk hydropower plant and construction of the Boguchansk aluminium smelter, has amounted to USD 2.6 billion[1449] and, according to original plans, was to produce 600 000 tons of aluminium per year.[1450] UC Rusal has benefitted from the State direct engagement in the BEMO project, inasmuch the state involvement reduced the financial risks for UC Rusal. Providing direct investment was also listed as one of the important measures taken by the Government in the 2017 USITC report on the situation in global aluminium.

According to Minpromtorg, about RUB 1.25 trillion (ca. USD 20 billion) are to be invested in the creation and modernisation of the production capacities of non-ferrous metals in Russia between 2014 and 2030. Most of this investment is expected to come from the private owners of the companies who top the lists of the wealthiest Russian entrepreneurs. The Ministry also expects that, by 2020, imports of non-ferrous metals and related products will drop to 58.8%, and by 2030 to 29.4% of the 2013 level. At the same time, the share of products with increased value added will increase in Russia by 2020 by 9.3%, and by 2030 by 21.5%.[1451] This plan should be viewed in the context of the ongoing debate on import substitution in Russia (see Chapter 6) that is to result in the production of more advanced products, also by the country's metal industry.

According to the 2014 Minpromtorg State Program, the characteristic features of the Russian non-ferrous industry, including aluminium, were:

- Strengthening of the position of key producers and their expansion to global markets;
- Post-crisis rebound;
- Diversification of business activities, including acquisition of energy assets;
- High level of import of raw materials (bauxite);
- Relatively high level of import of processed aluminium products;
- Increased energy efficiency and lower environmental footprint of production;
- High share of export and dependence on global market trends;

[1447] The Russian version of this CSR manifesto is available at: https://inosmi.ru/inrussia/20040219/208014.html, accessed on 6 November 2019.

[1448] By means of credit lines made available by VEB since 2010.

[1449] Available at: https://boaz-zavod.ru/en/about/, accessed on 1 August 2019.

[1450] The first stage of the project was launched in 2012 and in 2019 the first line of aluminium production was operational.

[1451] Minpromtorg. (20 March 2014). *By 2020, imports of non-ferrous metals and products from them will decrease to 58.8% (K 2020 godu import tsvetnykh metallov i produktsii iz nikh snizitsya do 58,8%).*

– Transport costs becoming a more important factor affecting the competitiveness of Russian producers;
– Consumers' demand for better quality products.

Accordingly, the most important long-term goals until 2030 in the aluminium sector include:
– Increasing the level of domestic production of higher quality aluminium elements to be used in the construction sector to substitute products currently imported to Russia;
– Increasing the level of consumption of aluminium in Russia per capita by 2.7 times by 2030 in a situation when the current level is three times lower than in US, China or Japan;
– Dealing with technological changes in the aviation industry where the share of aluminium in the construction of aircraft bodies is expected to fall from 80% to 20% due to the use of various composite materials;
– Increasing the share of aluminium produced in Russia for the domestic market from the starting level of 26% of production to more than 50% by 2030;
– Reducing further the level of import of non-ferrous metals, including processed aluminium, to reduce Russia's costs for importing non-ferrous metals and to stimulate production of aluminium products with higher added value in Russia.

In general, Minpromtorg expects that both the production and consumption of aluminium in the global market is going to increase to the levels presented in Table 15.5, which should provide good opportunities for Russian aluminium producers.

Table 15.5. Government forecast of the future of aluminium production and consumption at a global level (in million metric tons)[1452]

Year	**2013**	**2014**	**2015**	**2020**	**2025**	**2030**
Production	49.71	51.50	53.56	63.92	75.54	91.20
Consumption	48.5	49.93	52.67	63.11	75.12	91.1

15.5 GOVERNMENT MEASURES WHICH POTENTIALLY AFFECT THE RUSSIAN ALUMINIUM SECTOR

A 2016 study by the Australian Anti-Dumping Commission on the steel and aluminium industry listed the following measures adopted by governments in Asia that have had distorting effects on trade in these industries.[1453] They were:

[1452] Minpromtorg (2014), *Strategiya razvitiya…*
[1453] Anti-Dumping Commission - Australian Government (2016), *Analysis of Steel and Aluminium Markets: Report to The Commissioner of the Anti-Dumping Commission*, Canberra, Anti-Dumping Commission, Department of Industry, Innovation and Science, Australian Government, available at: https://www.aph.gov.au/~/media/Committees/economics_ctte/estimates/sup_1617/Industry/answers/SI-56_Carr_AttachmentA.pdf, accessed on 6 November 2019.

– Subsidisation of the costs of inputs used in making steel and aluminium products, such as raw materials, power, and land;
– Tax rebates and export taxation arrangements;
– Sustained support for loss-making state-owned enterprises;
– Cheap finance for investments in steel furnaces and aluminium smelters;
– Financial support to maintain large stockpiles, especially of aluminium.

Table 15.6. The USITC 2017 report[1454] on the Russian aluminium sector listed several Government policies impacting directly on the situation of the Russian aluminium industry and their justifications

Policy	Impact	Current situation
Export tariffs on unwrought aluminium	Discourages exports of unwrought aluminium and reduces production costs for wrought aluminium.	Low tariffs on export of unwrought aluminium, 1.25%, were to be lowered in 2017.
Export tariffs on aluminium scrap	Discourages exports of aluminium scrap and reduces production costs for secondary aluminium.	Discussed, but not implemented.
Export licences for bauxite	Discourages exports of bauxite, reduces production costs for primary aluminium.	Not implemented.

[1454] USITC (2017), pp. 357–360.

State aluminium reserves	Increases demand for aluminium.	Discussed but not implemented. However, on 28 November 2018, the Prime Minster ordered the Government to reserve RUB 10 billion (ca. EUR 140 million) to buy and store 50 000 tons of aluminium.[1455]
Aluminium Valley[1456] (Siberia) special economic zones	Increases aluminium production and consumption, helps diversify production and improves quality by the introduction of new technologies to be developed by actors who are expected to start activity in this area that will get support from both the State and from the industry.	The Aluminium valley project was officially launched in Krasnoyarsk in 2016[1457] but was renamed the Krasnoyarsk technological valley in 2017.[1458] By 2017, there were 17 projects launched, 9 of which had a portfolio worth USD 400 million. In addition, plans for a new special economic zone – Yenisieysk Sibir – were presented in March 2019.[1459]
Development plans	Increases demand for aluminium on the domestic market.	Minpromtorg Order No. 1665 of 25 April 2018 [1460] promoting increased domestic consumption and lower level of import of aluminium by introducing a number of indicators and measures to help Russian producers strengthen their position on the domestic market.

[1455] RBK (28 November 2018). *RBK.* Medvedev instructed to allocate up to RUB 10 billion. for the purchase of aluminum (Medvedev poruchil vydelit' do 10 mlrd rub. na zakupku alyuminiya), available at: https://www.rbc.ru/rbcfreenews/5bfe5d019a7947af7f40ccd4#ws , accessed on 6 November 2019.

[1456] Available at: http://www.aluminas.ru/projects/aluminum_valley/, accessed on 6 November 2019.

[1457] Lenta.ru (24 March 2016), *In the Krasnoyarsk Territory will appear Aluminum valley (V Krasnoyarskom kraye poyavitsya Alyuminiyevaya dolina*), available at: https://lenta.ru/news/2016/05/23/aluminiumvalley/, accessed on 6 November 2019.

[1458] Newslab.ru (10 April 2017), *The project 'Aluminum Valley' was renamed 'Krasnoyarsk Technological Valley' (Proyekt 'Alyuminiyevaya dolina' pereimenovali v 'Krasnoyarskuyu tekhnologicheskuyu dolinu'*), available at: http://newslab.ru/news/763955, accessed on 6 November 2019.

[1459] Tabunov, M. (29 March 2019), *In the region they want to create a special economic zone for industrialists (V kraye khotyat sozdat' osobuyu ekonomicheskuyu zonu dlya promyshlennikov).* RBK., available at: https://krsk.rbc.ru/krsk/29/03/2019/5c9d81c69a7947790b6d087b#ws, accessed on 6 November 2019.

[1460] Minpromtorg (25 April 2018), *Order N.º 1665 of 25 April 2018*.

Direct Government investment	Lowers production costs and reduces financial risks for private actors.	State's engagement in BEMO project launched in 2012 (see Section 15.4) represents the best example of this type of involvement.

Source: data retrieved from **USITC 2017 report.**

The long-term goals of the country's aluminium producers were outlined in the State Program Development of industry and increasing its competitiveness.[1461] Sub-programme 10 focused on the plans for the country's metal industry.[1462] It also presented various measures, such as direct and indirect subsidies or support to producers by the State that could be used to stimulate development of the domestic market, production and export of metals (see Section 15.4). This list includes measures such as customs duties and tariffs to protect the domestic market; measures stimulating domestic production of higher quality products, state credit guarantees, reduction of VAT and customs duties for the import of technological solutions not available on the domestic market; participation of VEB (see Chapter 3) in high-priority investment projects; or the use of funds provided by the state investment fund in various infrastructural projects involving public-private partnerships.

The 2014 Minpromtorg State Program was even more specific and listed the following measures by the State to support domestic producers:[1463]

- Creation of a reserve state fund of non-ferrous metals;
- Provision of state guarantees for loans of foreign firms and companies for refinancing of their debts;
- State support for the implementation of investment projects, including the participation of VEB in financing priority investment projects;
- A program to stimulate the restructuring of inefficient capacities and co-financing of the conservation of metallurgical enterprises from federal and regional budgets;
- Long-term approach to the process of formation and regulation of tariffs of natural monopolies operating in Russia, such as railroads, natural gas, transport infrastructure;
- Organisation and facilitation of production of goods with higher added value (like wires and wire rod) in industrial parks to be established in Russia;
- Creation of centres for the development of new technology for the production of cast alloys.

Some examples of how these measures have been implemented include the following:

[1461] Minpromtorg (2014), *Strategiya razvitiya…*
[1462] *Ibidem*.
[1463] *Ibidem.*

- In 2015, UC Rusal received a RUB 500 million loan (EUR 7 million) from the State's Fund for Industrial Development to modernise its plant in Sayanagorsk;[1464]
- In 2016, another UC Rusal plant in Volgograd received a RUB 300 million loan (EUR 4.2 million) from the same source to help it modernise its anodes production.[1465] In both cases, the loans were provided with interest rates that were lower than the market rates and could thus be viewed as being subsidised by the State;
- In addition, and partly in response to the problems faced by UC Rusal, the Government decided to modify its strategy for the development of the aluminium industry and in July 2018 it was announced that a number of measures would be taken to increase domestic consumption of aluminium, reduce its imports and thus help UC Rusal consolidate its position. Out of 140 projects launched, 65 are either directly related to UC Rusal or aimed at increasing the domestic consumption of aluminium;[1466]
- In 2018 and 2019, the Russian authorities decided to impose some restrictions on the import of aluminium wheels from countries not members of the EAEU.[1467] In this context, in September 2018, the Government drafted a Decree on Imposing a Ban on the Admission of Certain Types of Goods Containing Aluminium Originating from Foreign Countries for the Purpose of Procurement for State and Municipal Needs[1468] listing 19 categories of aluminium products from non-EAEU countries that were to be banned in this context. This list included: bars, rods and profiles of aluminium or aluminium alloys, aluminium wire, aluminium plates, sheets, strips and ribbons thicker than 0.2 mm, aluminium foil, aluminium pipes and tubes, and fittings for pipes and tubes, constructions from aluminium and parts of constructions from aluminium, aluminium doors and windows, hinges, fittings, hardware and similar products for aluminum

[1464] FRPRF (7 December 2015), *1.1 billion for oil, medicine and aluminum (1,1 mlrd na neft', meditsinu i alyuminiy*), available at: http://frprf.ru/press-tsentr/novosti/1-1-mlrd-na-neft-meditsinu-i-alyuminiy/, accessed on 6 November 2019.

[1465] *FRPRF* (2016), *JSC 'RUSAL URAL' (AO 'RUSAL URAL'*), available at: http://frprf.ru/proekty-i-zayavki/proekty/42736/?sphrase_id=56678, accessed on 6 November 2019.

[1466] Trifonova, P, Petlevoi, V., Shtanov, V. (2018), *Minpromtorg have found the way to increase domestic consumption of aluminium. This should help UC Rusal increase it sales in Russia 1.5 times (Minpromtorg nashel sposob uvelichit' vnutrennee potreblenie alyuminiya. Eto dolzhno pomoch' UC Rusal podnyat' realizatsiyu v Rossii pochti v 1,5 raza)*, Vedomosti, available at: https://www.vedomosti.ru/business/articles/2018/07/19/775913-uvelichit-potreblenie-alyuminiya, accessed on 6 November 2019.

[1467] Alumina.ru (3 April 2019), *Russia introduces licensing of import of aluminum discs from April 10 to October 9*, available at: http://www.aluminas.ru/media/media-publications/russia_introduces_licensing_of_imports_of_aluminum_wheels_from_10_april_to_9_october/, accessed on 6 November 2019 and Minprom (4 July 2019), *License to import aluminum rims (Litsenziya na import alyuminiyevykh diskov*), available at: https://minprom.ru/licenziya-na-import-alyuminievyx-diskov/, accessed on 6 November 2019.

[1468] Minprom. Draft Government Decree "*on a Ban on the Admission of certain Types of Goods, containing Aluminum originating from foreign Countries, for Procurement Purposes to ensure Public and Municipal Needs*" (*Proyekt postanovleniya Pravitel'stva Rossiyskoy Federatsii 'Ob ustanovlenii zapreta na dopusk otdel'nykh vidov tovarov, soderzhashchikh alyuminiy, proiskhodyashchiy iz inostrannykh gosudarstv, dlya tseley osushchestvleniya zakupok dlya obespecheniya gosudarstvennykhi munitsipal'nykh nuzhd'*), available at: http://regulation.gov.ru/projects#npa=83770, accessed on 6 November 2019.

doors and windows, barrels, drums, cans, boxes and similar aluminium containers for any substances (except gases) with a capacity of not more than 300 liters, aluminium twisted wire without electrical insulation, aluminium ropes without electrical insulation, braided tapes and similar products of aluminium without electrical insulation, table, kitchen and household products from aluminium and their aluminium parts, electric furnaces and other industrial or laboratory chambers not included in other groups, various types of centrifuges, quadricycles and similar means of transportation, two-wheeled bikes without engine, means of transportation not included in other groups;

– Also, the introduction of higher import tariffs for aluminium[1469] was discussed in this context but no decisions have been made.

On 5 December 2018, Minpromtorg announced that it was working on the creation of a full-cycle smelting manufacturing holding, and an engineering centre that will help develop new aluminium casting technologies to meet the needs of the automotive industry. This is being developed in cooperation with the state-owned Central Scientific Research Automobile and Automotive Engines Institute, two leading Russian car producers Avtovaz and Baz and the Volgograd aluminium plant. According to the Aluminium Association – an industry organisation of Russian aluminium producers and users[1470] – the Russian automotive industry needs more than 254 000 tons of aluminium and its alloys per year. At the same time, they estimate the total shortage of aluminium castings for automotive, aircraft and shipbuilding, as well as diesel generation, at 200 000 tons per year.[1471] About 120 000 tons are consumed for the production of automotive components, of which 50% is imported. In other words, this project is aimed at increasing self-sufficiency and could be viewed as an element in the realisation of the State's policy of import substitution (see Chapter 6).

15.6 CHAPTER SUMMARY

The ability of the Russian aluminium producers to compete, on both the international and domestic markets, is shaped by structural macroeconomic factors. These include the balance between demand and supply on the global aluminium market, the pace of the development of the Russian economy, the demand for aluminium products on the domestic market and/or the level of depreciation/appreciation of the Russian currency. These have greater impact than measures taken by Russian policymakers who may be influenced by the most powerful actors operating in the

[1469] *Customs Tariff Of The Russian Federation*, available at: http://www.russian-customs-tariff.com/SectionXV/Chapter76.html, accessed on 6 November 2019.

[1470] Alyuminievaya assotsiatsiya (2015), *Aluminium association established in Russia (V Rossii sozdana Alyuminievaya Assotsiatsiya)*, available at: http://www.aluminas.ru/v-rossii-sozdana-assotsiatsiya-proizvoditeley-postavshhikov-i-potrebiteley-alyuminiya/, accessed on 12 November 2018.

[1471] Minpromtorg (5 December 2018), *Foundry production holding and engineering center may appear in Russia (V Rossii mogut poyavit'sya liteynyy proizvodstvennyy kholding i inzhiniringovyy tsentr*), available at: http://minpromtorg.gov.ru/press-centre/news/#!v_rossii_mogut_poyavitsya_liteynyy_proizvodstvennyy_holding_i_inzhiniringovyy_centr, accessed on 6 November 2019.

country's aluminium sector. The power of the most powerful Russian aluminium actors to shape the framework conditions for the operations of the country's aluminium sector was strongly curbed by the 2018 US sanctions targeting the owners of the most important actor in the Russian aluminium sector, the company UC Rusal (see Section 15.2).

UC Rusal, the main Russian player on the domestic, as well as global aluminium market, is a privately-owned company. It has an important role to play in the Government plans for the future development of the non-ferrous metal sector in the country. The State has taken some measures to strengthen the company's position both domestically and internationally because development of the sector represents a strategic priority for the Russian policy makers, as outlined in several state documents. These include the 2014 Minpromtorg Strategy and the 2014 Minpromtorg programme for improving the competitiveness of the Russian industry (see Section 15.4). These measures have included providing preferential state funding for some strategic aluminium-related projects, promotion of the increased use of wrought aluminium on the domestic market and introducing measures limiting the access of foreign producers of aluminium to that market. The State also provided some funding and helped develop the necessary infrastructure, including in the energy sector, like the BEMO project, the biggest public private partnership project realized in Russia leading to substantial modernisation of the country's aluminium sector, which in turn should make it more competitive on the global stage.[1472]

The measures outlined in the 2014 strategic documents on the future of the sector focus mainly on imposing higher barriers for the import of aluminium and aluminium products to Russia, in order to strengthen the position of domestic producers on the domestic market. This reflects the state driven policy of import substitution (see Section 15.4) in general, and in the non-ferrous/aluminium sectors specifically, as well as the ability of the key aluminium players to lobby for their interests.

Protection of the domestic producers of aluminium from competition coming from external producers represents a measure that does not incur high social costs. It was therefore one of the topics discussed by the Government in 2018. However, the State has not been willing to introduce measures that could result in increased social tensions, such as providing more advantageous conditions to the aluminium producers at the expense of ordinary Russians (see Section 15.3.3.). Also measures that could increase the level of state subsidies to the aluminium sector, such as lowering of electricity or transport tariffs for this group of industrial users, were avoided in a situation when the state budget experienced tensions caused by lower revenues from the energy sector that had previously generated 50% of the state budget revenues.

[1472] Vestifinance (29 March 2019), *RusAl has launched the line Boguchansky aluminum plant (RusAl zapustil ochered' Boguchanskogo alyuminiyevogo zavoda*), available at: https://www.vestifinance.ru/articles/117041, accessed on 6 November 2019.

16 **CHEMICALS**

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16.1 INTRODUCTION

According to the Government, chemical production's share of Russia's GDP in 2017 was 1.34%[1473] (approximately RUB 3.6 trillion[1474] which is equivalent to EUR 54.6 billion[1475]). The sector's output grew by 4.3% year on year in 2017 (with mineral fertilisers recording the largest growth) and by 5.6% annually in 2016, the second-best result among manufacturing industries that year.[1476] The sector consists of some 3 500 companies, which employ approximately 650 000 workers and 100 R&D-oriented organisations.[1477]

16.2 THE STRUCTURE OF THE CHEMICALS SECTOR

Chemical production is found in 44 out of Russia's 85 federal subjects.[1478] The Volga district, with the largest chemicals production, accounts for over 40% of total production. It is host to Technopolis Himgrad, an industrial park specialising in chemicals and located in the Republic of Tatarstan. Other regions with significant chemical production are the Central District (over 24%), the Siberian District (around 11%), and the Southern District (around 10%).[1479] The main chemical clusters, which use hydrocarbons as inputs in production, are located near gas and oil extraction sites as well as near ports.[1480]

Major chemicals companies include (by order of turnover):

– Sibur (active in hydrocarbon processing and the production of plastics and rubbers; present in Tobol'sk and Voronezh; EUR 7.8 billion turnover in 2018);[1481]

[1473] Processing of hydrocarbons, petrochemistry and gas chemistry. Chemical industry: some important decisions and indicators of 6 years' period (2012–2017), available at: http://government.ru/info/32128/, accessed on 6 November 2019.

[1474] The results of the work of the chemical complex in 2017. Ministry of Industry and Trade of Russia (2018), *Key areas of 2018*, available at: http://interplastica.ru/sites/default/files/press2018-07/minpromtorg_rossii.pdf, accessed on 6 November 2019.

[1475] Calculated using ECB's average EUR foreign exchange reference rate in 2017 (EUR 1 = RUB 65.9383), available at: https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/eurofxref-graph-rub.en.html, accessed on 6 November 2019.

[1476] Embassy of the Netherlands to the Russian Federation (2018), *Russian Chemical Sector*, p. 1, available at: https://www.rvo.nl/sites/default/files/2018/09/russian-chemical-sector.pdf, accessed on 6 November 2019.

[1477] Cefic (2018), *Landscape of the European Chemical Industry 2018*, *Russian Federation*, p. 1, available at: https://www.chemlandscape.cefic.org/country/russian-federation/, accessed on 6 November 2019.

[1478] Cefic (2018), p. 2.

[1479] Dyakonov, G., Ziyatdinov, N., Lyzhina, N. (2014), *The Growth of a Chemicals Industry in Russia*, p. 45, available at: https://www.aiche.org/sites/default/files/cep/20141044_2.pdf, accessed on 6 November 2019. According to another classification, there are six main chemicals clusters in Russia: Caspian, East Siberian, Far Eastern, North Western, West Siberian, Volga (Embassy of the Netherlands to the Russian Federation, 2018).

[1480] Embassy of the Netherlands to the Russian Federation (2018), p. 1.

[1481] Avaliable at: https://www.sibur.ru/en/, accessed on 6 November 2019, and Sibur (2018), *FY 2018 Operational and Financial Results*, available at: http://investors.sibur.com/~/media/Files/S/Sibur-IR/Financial-results/2019/SIBUR_FY%202018_Results_Presentation.pdf, accessed on 6 November 2019. Not all local presences are accounted for in the descriptions of the companies. Turnovers of companies calculated using ECB's average EUR foreign exchange reference rates in 2018 (EUR 1 = USD 1.1261 and EUR 1 = RUB 72.9572), available at:

– EuroChem (active in the production of mineral fertilisers; present in Novomoskovsk and Usolye, EUR 5 billion turnover in 2018);[1482]
– PhosAgro (active in the production of phosphate-based fertilisers; present in Apatity and Murmansk; EUR 3.2 billion turnover in 2018);[1483]
– Nizhnekamskneftekhim (active in the production of synthetic rubbers, plastics, and ethylene; present in Nizhnekamsk; EUR 2.7 billion turnover in 2018);[1484]
– Gazprom Neftekhim Salavat (active in hydrocarbon processing, petrochemistry, and the production of mineral fertilisers; present in Salavat; EUR 2.7 billion turnover in 2018).[1485]

Apart from the products mentioned above, the industry's output also includes ammonia, ethylene complexes, finished goods (e.g. paints, inks, detergents and other cleaning agents, herbicides, fungicides and similar products) nitric and sulphuric acid[1486] and other products, with the full list counting around 16 000 products.[1487] In 2017, the main chemicals manufactured in the sector, broken down by value, were basic chemicals, including fertilisers and primary forms of plastics and synthetic rubbers (55.9%), followed by other plastics (21.7%), personal care and household cleaning products (7.1%), and other rubber (5.2%) (Figure 16.1).[1488] In the period January to August 2017,' the product categories with the highest rate of growth compared to the same period of 2016 by production volume were crop protection chemicals (20.8%), mineral fertilisers (9.8%), caustic soda (i.e. soda hydrate; 8%), chemical fibres and threads (5.8%), and paints and coatings (5%).[1489]

https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/eurofxref-graph-usd.en.html, and https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/eurofxref-graph-rub.en.html, respectively, accessed on 6 November 2019.

1482 Available at: http://www.eurochemgroup.com/en/home/, accessed on 6 November 2019, and EuroChem (2019), *FY 2018 Press Release (IFRS Results)*, available at: https://www.eurochemgroup.com/wp-content/uploads/2019/04/2018-q4.pdf, accessed on 6 Novebmer 2019.

1483 Available at: https://www.phosagro.com/, accessed on 6 November 2019, and PJSC "PhosAgro" (2019), *Consolidated Financial Statements for 2018*, available at: https://www.phosagro.com/investors/reports/get/item16935.php, accessed on 6 November 2019.

1484 Avaliable at: https://www.nknh.ru/en/, accessed on 14 November 2019 and Nizhnekamskneftekhim Group (2019), *International Financial Reporting Standards Consolidated Financial Statements and Independent Auditor's Report*. 31 December 2018, available at: https://www.nknh.ru/upload/iblock/b7c/PAO-NIZHNEKAMSKNEFTEKHIM_IFRS_AUDIT-RPRT_2018_eng.pdf, accessed on 6 November 2019.

1485 Available at: http://salavat-neftekhim.gazprom.com/, accessed on 7 November 2019, as well as: http://www.hoovers.com/company-information/cs/company-profile.gazprom_neftekhim_salavat_oao.221ce1af1dbf0a41.html?aka_re=1#financials-anchor, accessed on 7 November 2019.

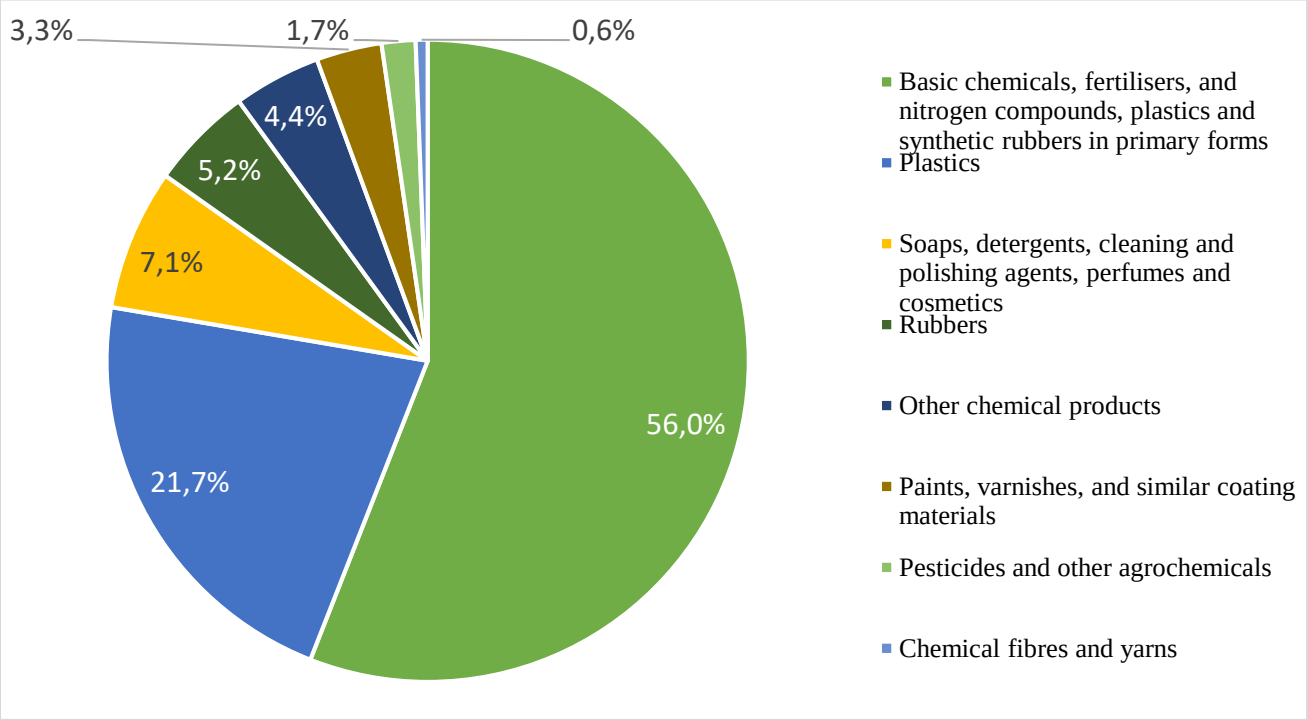
1486 Cefic (2018), p. 2; Dyakonov, G. et al. (2014), p. 48.

1487 Embassy of the Netherlands to the Russian Federation (2018), p. 1.

1488 Bilfinger, Tebodin (2018), *The Russian Chemical Market. Market Study Report*, available at: https://www.pronline.ru/Handlers/ShowRelisesFile.ashx?relizid=6998&num=2, accessed on 2 December 2019.

1489 Embassy of the Netherlands to the Russian Federation (2018), p. 1.

Figure 16.1: The structure of Russian chemicals production by product category (January-August 2017; percentage of total production)



Source: Bilfinger, Tebodin (2018).

16.2.1 COMPETITIVE POSITION OF THE SECTOR

The sector benefits from the abundance of domestically-sourced natural resources. Apart from coal, gas, and oil, these also include minerals (e.g. phosphates), metals (e.g. aluminium, copper, nickel), non-metals (e.g. sulphur), and rare-earth elements.[1490] On the other hand, productivity shows room for improvement, a fact which is mainly related to the technological obsolescence of the industry.[1491] Modernisation of the largely outdated infrastructure is ongoing, with both domestic and foreign capital deployed for this purpose.[1492] Other obstacles are of a geographical nature: climate and large distances.[1493] As an exporter to multiple areas around the world, the industry has to conform to various sets of standards, for example those of the EAEU (see Chapter 6) and of OECD.[1494]

16.2.2 EXPORTS AND IMPORTS OF THE CHEMICALS SECTOR

In 2017, Russia exported a total of EUR 14.1 billion worth of chemical goods, corresponding to 25.7% of the sector's total production in that year (Figure 16.2). By far the most important product

1490 Dyakonov, G. et al. (2014), p. 44.
1491 Cefic (2018), p. 2; Kuzyayeva, A. & Didenko, A. (2014), *Productivity Spillovers in the Russian Federation. The Case of the Chemical Sector*, p. 60.
1492 Dyakonov, G. et al. (2014), pp. 48–49.
1493 *Ibidem*, p. 44.
1494 Cefic (2018), p. 2.

category was fertilisers, which accounted for as much as 47%, or almost EUR 6.6 billion of the sector's total exports. This was followed by organic chemicals (with a share of 20.5% or EUR 2.9 billion), and inorganic chemicals (16.8% or EUR 2.4 billion). The other product categories contributed less than EUR 1 billion each and had single-digit shares (e.g. miscellaneous chemical products, personal care products, and oils). The importance of fertiliser exports to the Russian chemicals sector is confirmed by other sources.[1495]

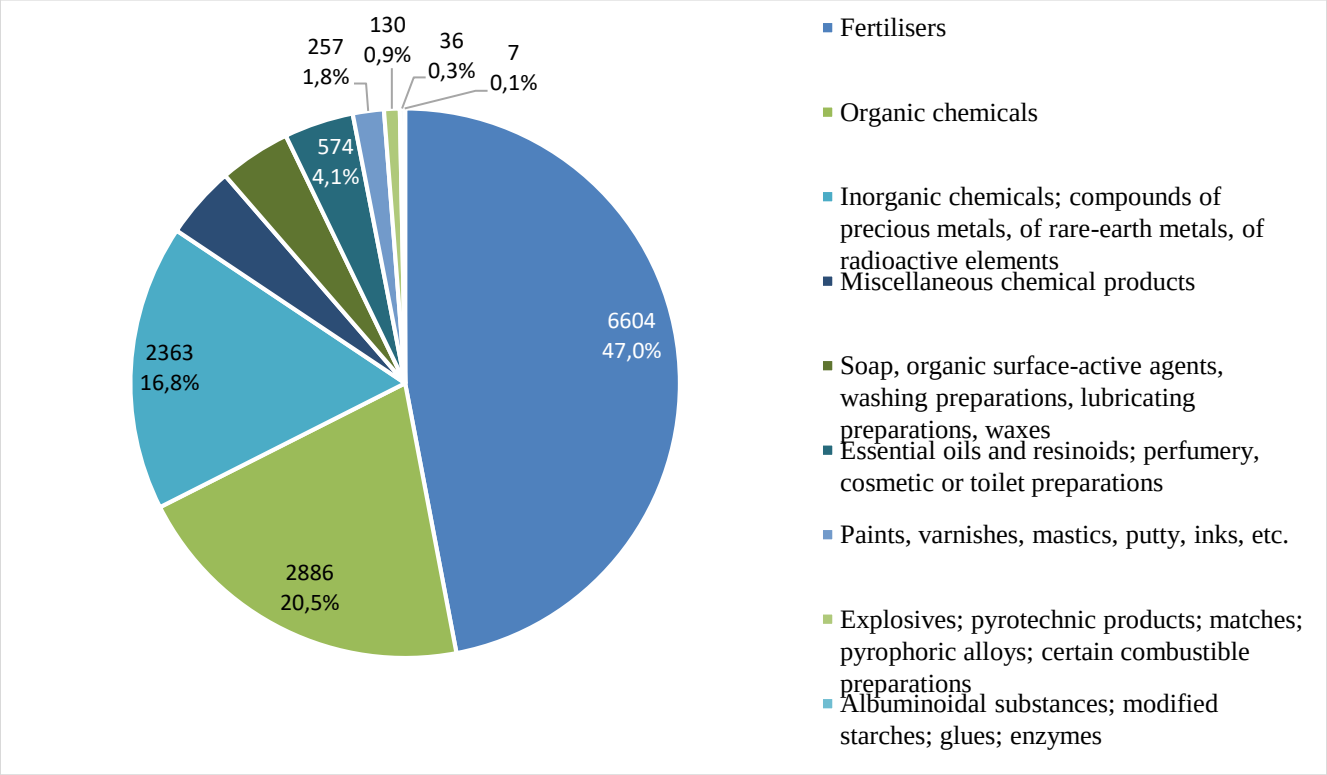
Russia's largest export destination in 2017 was Ukraine (with a share of almost EUR 1.5 billion or 10.1% of total exports), followed by Brazil (EUR 1.3 billion or 9%) and Kazakhstan (EUR 1.1 billion or 7.3%); other important export destinations included China, and Belarus (Figure 16.3).[1496] The most important EU destinations were Finland, Poland, and the Netherlands, with shares of EUR 894 million, EUR 623 million, and EUR 513 million, respectively (accounting for 6.1%, 4.2%, and 3.5% of the total exports). Overall, the chemicals sector accounted for 5.7% of Russia's overall exports in 2017 Q1 and for 6.7% in the previous year.[1497]

[1495] E.g. Dyakonov, G. et al. (2014), Table 3, p. 48. Moreover, according to this source, the main export products of the Russian chemicals sector also include ammonia, methanol, plastics, and synthetic rubbers.

[1496] Ru-Stat (2018a), *Export from Russia. Products of the Chemical or Allied Industries - January 2017–December 2017*, available at: http://en.ru-stat.com/date-M201701-201712/RU/export/world/06, accessed on 7 November 2019.

[1497] Bilfinger, Tebodin (2018), pp. 7–8.

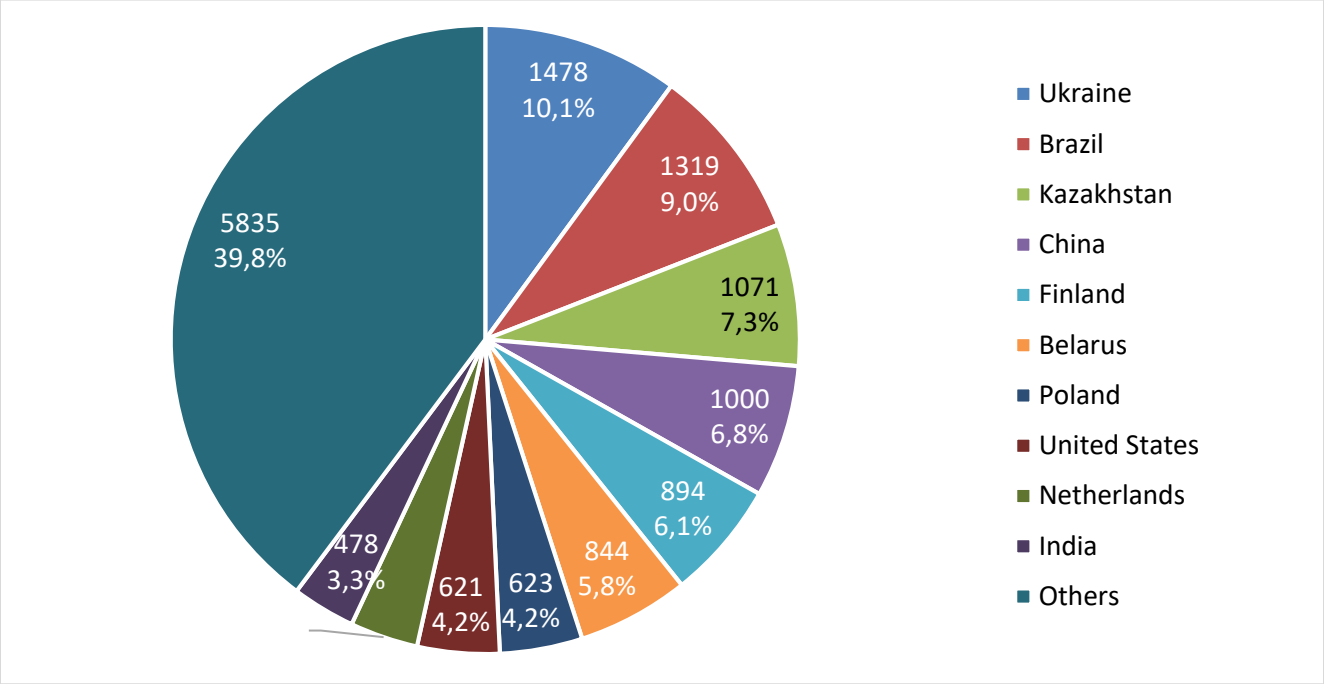
Figure 16.2: The structure of Russian chemicals exports by product category (2017, EUR million and percentage of the total exports) [1498]



Source: Rosstat (2018a).

[1498] Figures 16.2-16.5 use ECB's average EUR foreign exchange rate in 2017 (1 EUR = USD 1.1297), available at: https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/eurofxref-graph-usd.en.html, accessed on 7 November 2019.

Figure 16.3: The structure of Russian chemicals exports by destination (2017, EUR millions and percentage of total exports)

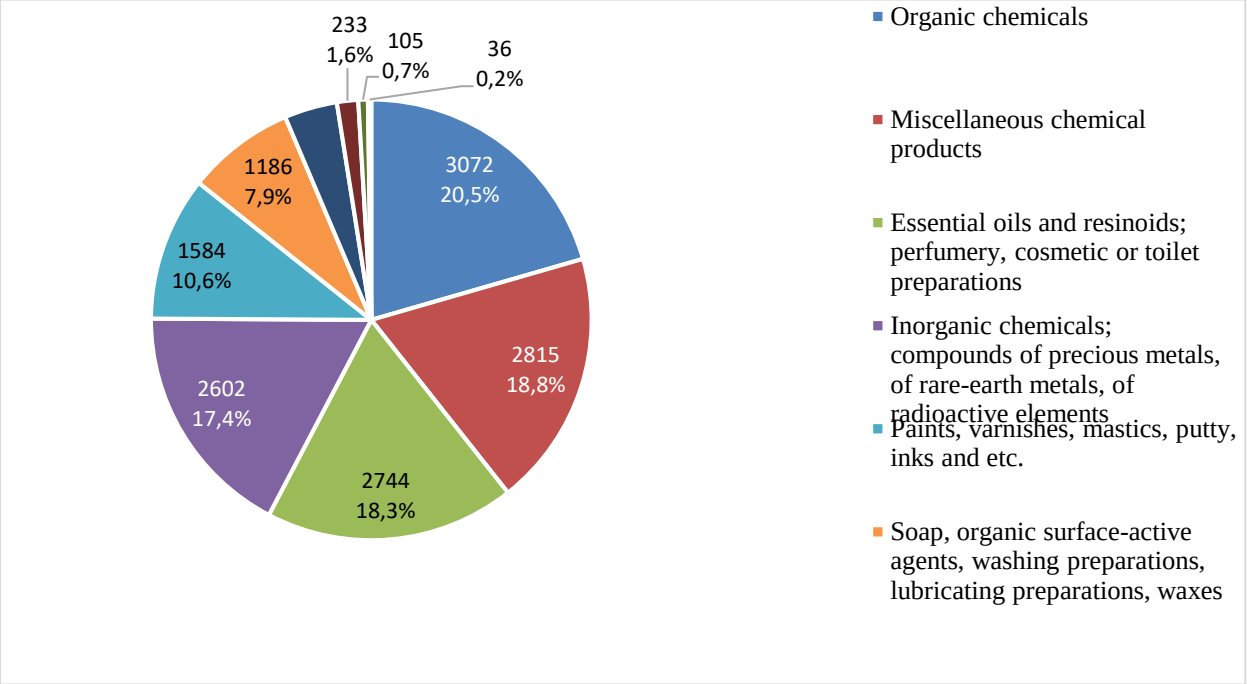


Source: Rosstat (2018a).

In 2017, Russia imported a total of EUR 15 billion (USD 16.9 billion) worth of chemical products. As a result, the country had a small deficit of trade in the chemicals sector in that year of EUR 0.9 billion. The largest product category of imported chemicals was organic chemicals (20.5% or over EUR 3 billion), followed by miscellaneous chemical products (18.8% or EUR 2.8 billion), oils (18.3% or EUR 2.7 billion), and inorganic chemicals (17.4% or EUR 2.6 billion) (Figure 16.4).

Five out of the ten most important import partners of Russia in the chemical sector are EU member states. These are Germany with a share of 16.5% (over EUR 4 billion), France (EUR 2.4 billion or 10%), Italy, United Kingdom, and Belgium. Other important importers are China (over EUR 2 billion or 8.3%), US (EUR 1.4 billion or 5.8%), India (EUR 789 million or 3.2%), Switzerland (EUR 714 million or 2.9%), and Ukraine (EUR 705 million or 2.9%) (Figure 16.5).

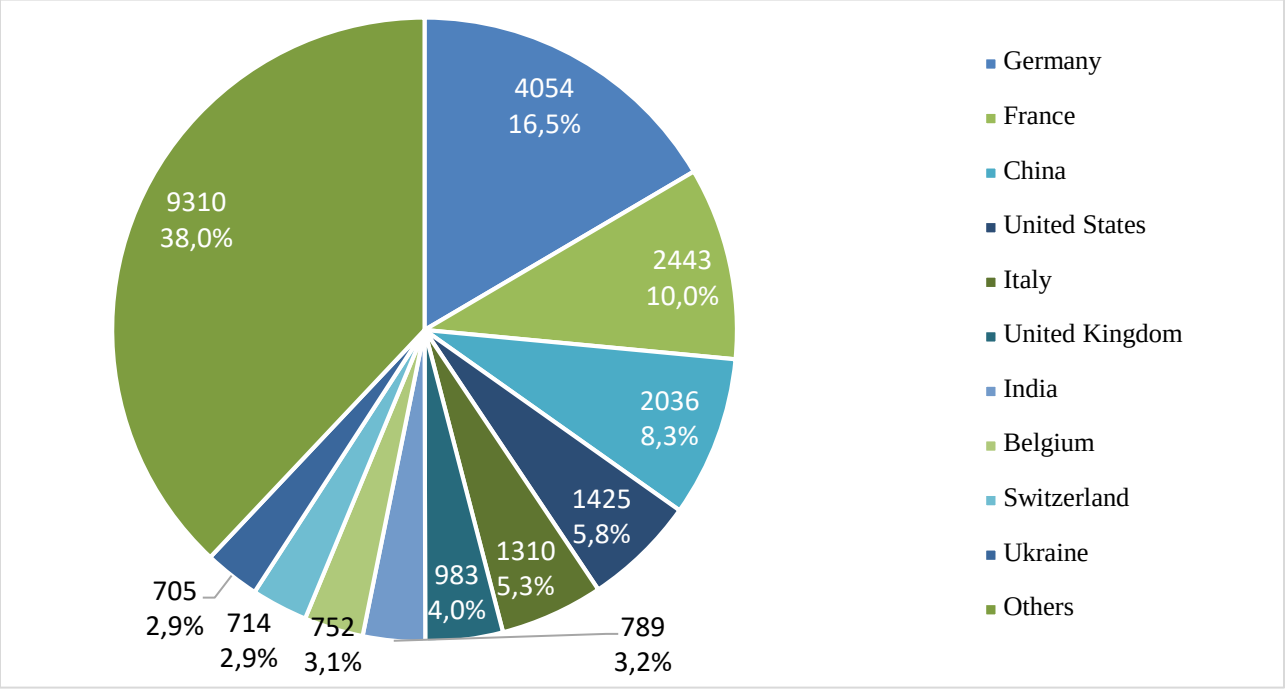
Figure 16.4: The structure of Russian chemicals imports by product category (2017, EUR millions and percentage of total imports)



Source: Rosstat.[1499]

[1499] Rosstat (2018a), *Import to Russia. Products of the Chemical or Allied Industries - January 2017–December 2017*, available at: http://en.ru-stat.com/date-M201701-201712/RU/import/world/06, accessed on 7 November 2019.

Figure 16.5: The structure of Russian chemicals imports by origin (2017, EUR millions and percentage of total imports)



Source: Rosstat.[1500]

16.3 REGULATORY FRAMEWORK

The chemicals industry falls under the responsibility of the Department of Chemical Technology Complex and Bioengineering Technologies of the Ministry of Industry and Trade.[1501]

The main tasks of this department include:

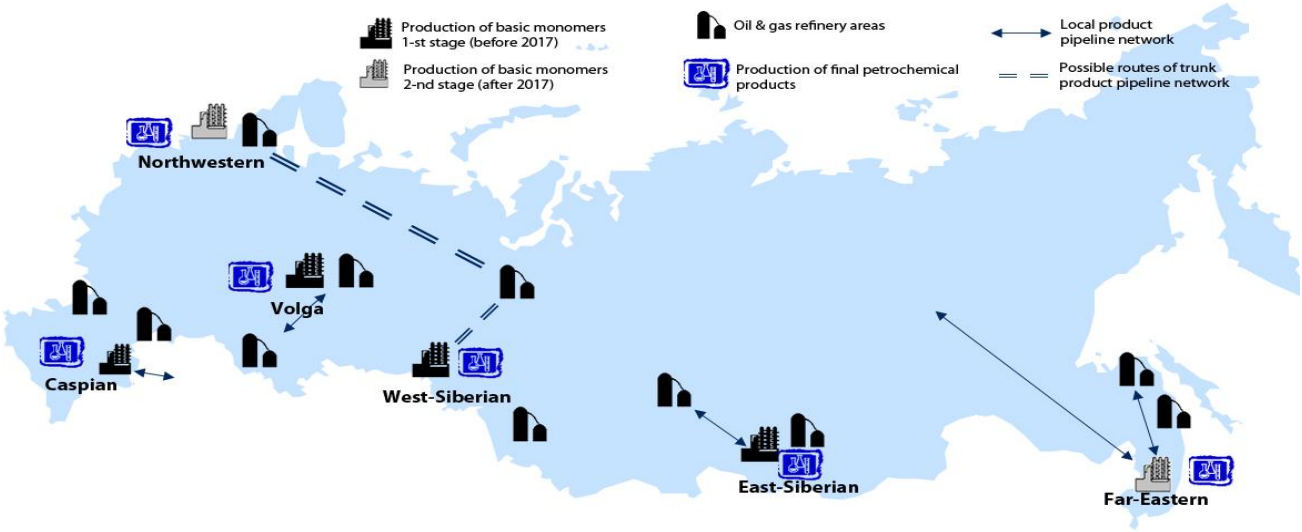
- Preparation of proposals for the formation of state policy and legal regulation in the chemical industry;
- Development of draft strategies, special federal programmes, departmental programmes, and subprogrammes within state programmes for the development of the chemical industry;
- Preparation of proposals for structural transformation and corporate policy in the chemical industry;
- Preparation of proposals for the protection of the economic interests of Russian producers in foreign and domestic markets and measures of state support for the export of competitive chemical industry products.

[1500] Ibidem.
[1501] Ministry of Industry and Trade of Russia, Department of Chemical Technology and Bioengineering Technologies, available at: http://minpromtorg.gov.ru/ministry/dep/#!19&click_tab_vp_ind=1, accessed on 7 November 2019.

The main framework determining the strategy for the development of the chemical industry is the Decree of the Ministry of Industry and Trade and the Ministry of Energy No. 651/172 of 8 April 2014 with the title The development strategy of the chemical and petrochemical complex of Russia until 2030 (′Strategy-2030′).[1502] This strategy was developed in accordance with the instruction of the Government No. DM-P9-47pr (point 2) of 3 July 2013.[1503] The main objective of Strategy-2030 is to increase the competitiveness of the Russian chemical sector and to provide strategic industries with high-quality domestic chemical products. Strategy-2030 focuses mainly on the development of commodity chemical production. The development of fine and specialty chemical products is dealt with by a separate Government resolution (see section 16.4).

According to Strategy-2030, the state support for the development of the chemical industry will be mainly implemented through a managerial mechanism of clustering and a public-private partnerships approach. In that respect, technoparks and chemical industrial parks are a priority to stimulate the development of the chemical industry. Strategy-2030 sets out plans for the creation of six chemical parks within the existing petrochemical clusters: Volga, West Siberian, Caspian, East Siberian, Far Eastern and Northwestern (see Figure 16.6). Moreover, various financial tools and tax incentives are also set to support industry participants.

Figure 16.6: Map of planned chemical parks to be developed within the existing petrochemical clusters in Russia until 2030



Source: Stragegy-2030.

[1502] Ministry of Industry and Trade (2016), *The development strategy of the chemical and petrochemical complex of Russia 2030*, available at: http://minpromtorg.gov.ru/common/upload/files/docs/33-11_sovm.PDF, accessed on 7 November 2019.

[1503] Protocols of Government meetings are not publicly available. The number of this Instruction is mentioned in Strategy-2030, however, the full text is not publicly available.

Within the framework of existing state support and state regulation measures, support should primarily be aimed at stimulating the development of product categories IA[1504] and IB,[1505] in terms of special economic zones and innovation and investment development.

Article 4.3 of Strategy-2030 stipulates that there will be state support through the provision of subsidies from the federal budget to the budgets of federal subjects in order to attract SMEs to work in the technoparks and chemical industrial parks in the petrochemical industry. SMEs who relocate their production to chemical industrial parks will have resident status and be eligible to receive all standard benefits for their production, including products of related areas within the technological chains.

Some quantitative indicators have been set to assess the strategy's effectiveness (see Table 16.1). The responsible authority for reporting and monitoring these indicators is the Ministry of Industry and Trade.

Table 16.1: Goals and targets for the implementation of Strategy-2030

Target	**Index**	**Target value 2014**	**Target value 2015**	**Target value 2020**	**Target value 2025**	**Target value 2030**
The growing importance of the chemical and petrochemical industries in the Russian economy and the development of related industries	The value of goods and services produced in chemical sector (RUB billion)	2,729	2,625	4,482	5,689	6,652
	The growth index of the chemical sector production in % from 2014 (in current prices)	100.0	104.2	178.0	225.9	260.2
	The chemical sector as a share of GDP (%)	1.18**	1.19	1.75	1.96	2.07
	Investments in the development of the chemical sector (RUB billion, in 2014 prices)	291.6	241.0	271.0	192.0	243.0

[1504] IA – products which have stable domestic demand, and the implementation of activities and initiatives in these areas is feasible in a fairly short time.

[1505] IB – products which have a lack of domestic demand, and the implementation of activities and initiatives on these product areas is difficult.

	Average annual growth of investments in the chemical sector (in % from 2014)	100.0	82.6	80.4	101.1	105.2
Increase consumption of chemical and petrochemical	The consumption of chemical products per capita, (kg/person)	223.6	228.7	283.0	355.9	460.0
Increase productivity	Labour productivity in the chemical sector (RUB million/person)		6.0	10.2	14.4	21.1
Transition to an innovative investment development model by increasing the depth of processing	The share of deep processing products in the output structure of the chemical sector, in physical terms (%)	12.5	13.5	15.3	17.4	19.7
	The share of deep processing product import in the structure of consumption (%)	46.7	43.2	36.3	31.2	28.2
	The share of deep processing product export of the chemical sector (%)	21.5	21.0	35.0	39.7	45.1
Realisation of the innovative potential of the chemical complex	The share of investment in R&D in total revenue (%)	0.09	0.11	0.23	0.48	1.00

Source: Strategy-2030.

However, when monitoring the Strategy-2030, a Russian expert pointed out that there were very significant differences in the target and actual indicators of the industry development in 2015–2017, both positive and negative. The expert sharply criticizes the Strategy-2030 and accuses its compilers in lack of professionalism: '*Obviously, the target values are deliberately lowered to demonstrate the positive effects that can be achieved in healthy market competition. The possibilities for a real economic breakthrough in the chemical industry seem to be very limited including the economic sanctions against Russia*'.[1506] Some discrepancies can be found on the

[1506] Aminev, S., (2017), *Strategy 2030 for the development of chemical and petrochemical complex of Russia: goals and realities, Bulletin of the chemical industry*, available at: http://vestkhimprom.ru/posts/strategiya-razvitiya-khimicheskogo-i-neftekhimicheskogo-kompleksa-na-period-do-2030-g-tseli-i-realii, accessed on 7 November 2019.

official website of the Ministry of Industry and Trade.[1507] According to the Ministry, the total value of goods and services produced by the chemical sector in 2015 was RUB 3 014 billion but Strategy-2030, amended in 2016, presents a lower figure of RUB 2 625 billion.[1508]

In addition, the Government adopted resolution No. 2834-p of 15 December 2017 on the Development of the Production of Small-tonnage Chemistry[1509] in the Russian Federation for the Period until 2030.[1510] It is not linked to Strategy-2030 but a separate initiative which provides a kind of roadmap for the development of high purity and high value fine and specialty chemical products in parallel with Strategy-2030. The Resolution provides for the following:

- Improving the mechanisms of state regulation aimed at increasing domestic production and reducing the import of low-tonnage and medium-tonnage chemical products;
- Creating the necessary conditions for the formation and development of modern production that can compete in the domestic and global markets.

According to the Government,[1511] implementating this plan should increase domestic production by USD 1.5 billion by 2030 and reduce the share of imports in the consumption of fine and specialty chemical products by 13%. The main mechanisms to facilitate the growth are:

- Faster development of products and technologies;
- Stimulation of the creation of fine chemicals and specialty chemicals;
- Stimulation of domestic demand;
- Improvement of the standardisation system;
- Export support;
- Monitoring and forecasts.

16.4 GOVERNMENT SUPPORT MEASURES

Government support to chemical producers is divided between financial and non-financial support (regulatory measures). Financial support is provided, among others, through:

- R&D subsidies (Government Decree No. 1312 of 30 December 2013);[1512]

[1507] Ministry of Industry and Trade, Department of Chemical Technology Complex, available at: http://minpromtorg.gov.ru/activities/industry/otrasli/chem/, accessed on 7 November 2019.

[1508] Aminev, S. (2017), *Strategy 2030 for the development of chemical and petrochemical complex of Russia: goals and realities*.

[1509] Small-tonnage chemicals (also known as low-tonnage chemicals) are fine chemicals, i.e. chemicals produced in relatively small tonnages, which are of high purity and high value per unit weight.

[1510] Government Resolution N.º 2834-p. of 15 December 2017, available at: http://static.government.ru/media/files/BXMyJhAEHhaR9pbRmu4rQxY2ZAz7P7GF.pdf, accessed on 7 November 2019.

[1511] *Ibidem.*

[1512] Government Decree N.º 1312 of 30 December 2013, available at: http://static.government.ru/media/files/41d4b3fc59636e3722d2.pdf, accessed on 7 November 2019.

– Partial compensation of the interest rate on investment loans (Government Decree No. 3 of 3 January 2014, [1513] Government Decree No. 5 of 3 January 2014);[1514]
– Subsidies for the replenishment of working capital and (or) financing current production activities (Government Decree No. 214 of 12 March 2015).[1515]

In addition to the above-mentioned activities, some tax exemptions may be provided. However, tax exemptions are only provided to foreign investors who set up new industrial production within the framework SPIC contracts.

Government Decree No. 1312 defines the rules for granting subsidies from the federal budget for partial reimbursement of R&D costs in priority areas of industry. Support for priority industries should contribute to:
– The creation of new cost-effective and environmentally friendly industries;
– The development of industrial production that increases the output of high-tech products;
– The growth of labour productivity through the use of advanced technologies and modern equipment, as well as the creation of high-performance jobs;
– The creation of conditions for the promotion of innovative Russian products and technologies to the global market;
– Increasing energy efficiency and resource saving.

Government Decree No. 3 relates to state support in the form of subsidies to compensate for interest rates on investment loans received for the implementation of new comprehensive investment projects in priority areas of the civil industry. Priority is given to competitive producers who transform the growth of investment into consumer goods production.

Government Decree No. 5 relates to the subsidies granted to Russian chemical companies to reimburse part of the interest rate on loans received from financial institutions and the government-owned development Bank VEB (see Chapter 3) in 2014–2016. These are loans for the implementation of investment projects in the chemical sector under the state program Development of Industry and Improving its Competitiveness (see Section 14.2.1). The total amount of support provided over the three years 2014 - 2016 was RUB 418 million (approximately EUR 6.3 million) broken down as RUB 70 million in 2014 (approximately EUR 1.4 million), RUB 168 million in 2015 (approximately EUR 2.5 million) and RUB 180 million in 2016 (approximately EUR 2.4 million). The support was limited specifically to those three years.

While both decrees are linked to the State Program Development of Industry and Improving its competitiveness, Decree No. 5 is specifically dedicated to companies in the chemical sector while

[1513] Government Decree N.º 3 of 3 January 2014, available at: http://static.government.ru/media/files/41d4b3fd4ca7e8fbf341.pdf, accessed on 7 November 2019.
[1514] Government Decree N.º 5 of 3 January 2014, available at: http://static.government.ru/media/files/41d4b3fbae3ca0be1b75.pdf, accessed on 7 November 2019.
[1515] Government Decree N.º 214 of 12 March 2015, available at: http://static.government.ru/media/files/zlJfNg6AOEY.pdf, accessed on 7 November 2019.

Decree No. 3 does not highlight any specific sector. Nevertheless, under both decrees, Government subsidies can be granted.

Government Decree No. 214 defines the rules for granting subsidies to reimburse part of the cost of loans raised by industrial enterprises to replenish working capital and/or to finance production activities. Under this decree, RUB 20 billion (approximately EUR 303 million) has been paid out during 2015–2017. The scope of this decree is not limited to the chemical sector. Therefore, there is a lack of information about the amount that has been paid out to the chemical sector only. The following are the requirements for such a subsidy:

- Loan agreement should be concluded after 16 December 2014;
- The loan should be received in national currency;
- The purpose of the loan should be replenishment of working capital and/or financing of the current production activities of the organisation;
- The producer must conclude an agreement with the Ministry of Industry and Trade and provide any necessary documents (i.e. tax declaration etc.).

According to the up-to-date information of the Ministry of Industry and Trade, under Government Decree No. 214, subsidies were provided to 35 enterprises in the amount of RUB 1.3 billion (approximately EUR 19 million) in 2015. Under Government Decree No. 5, financial support was also provided in 2014 to another four plastic producing companies to the amount of RUB 151 million (approximately EUR 3 million).[1516] In both cases, the subsidies were provided for expense reimbursement and loan interest rate payment purposes. However, public information about the recipient enterprises is not available.

Strategy-2030 covers 199 projects, including 95 in organic and inorganic chemical products, 35 in mineral fertilisers, 33 in paint and coatings, 15 in rubbers and tyres, and 13 in plastics, with a total amount of public investment of over RUB 1 trillion (approximately EUR 14.3 billion).[1517]

Some additional Government support measures for the development of the chemical and petrochemical sectors within the framework of Strategy-2030 include:

- Support of market demand and import substitution (regulation of import duties, subsidisation of research and development for homologation);
- Support for the formation of chemical parks within petrochemical clusters (infrastructure development co-financing, support for management companies).[1518]

[1516] *Ibidem.*

[1517] Evtukhov, V., (2018), *Development of high processing production is one of the most important tasks of the chemical complex of Russia*, available at: https://finance.rambler.ru/other/40953999-razvitie-proizvodstva-vysokih-peredelov-produktsii-odna-iz-vazhneyshih-zadach-himicheskogo-kompleksa-rossii/, accessed on 7 November 2019.

[1518] Ministry of Industry and Trade of Russia (2016), *The development strategy of the chemical and petrochemical complex of Russia 2030*, available at: http://minpromtorg.gov.ru/common/upload/files/docs/33-11_sovm.PDF, accessed on 7 November 2019.

Government support measures are also provided to exporters of chemicals and chemical products to foreign markets. Government Resolution No. 1473-p of 12 July 2017 approves a list of products that should have priority support from federal executive authorities.[1519] Chemicals and chemical products are included in the priority list (except mineral fertilisers, polymers and monomers in primary forms). The type of support is not specified in the document; however, it can be presumed that financial, organisational or other types of support can be provided.

16.5 IMPACT OF ENERGY PRICES ON CHEMICAL PRODUCTION

According to the Academy of Industrial Market Studies,[1520] a Russian consulting firm, producers of nitrogen fertilisers (including ammonia-nitrate) achieve competitiveness in the global market due to the low price of Russian natural gas, which is an essential factor of the production cost. Russian ammonia producers consume about 1 200 m^3 of gas on average for the production of one ton, which is one third higher than the average European level. However, due to the gas price difference, the direct costs of Russian ammonia and carbamide per ton are 2–3 times lower than in Europe. Therefore, the profitability of the chemical industry in Russia is mainly achieved by contractual domestic prices of natural gas that are significantly lower than world prices. The cost of electricity in Russia is also lower than in the world market, because the main components of power generation (such as coal, black oil (mazut), natural gas and uranium) are all produced in Russia and mainly belong to state-owned corporations and because energy resource prices are regulated by the Government monopolies to maintain competitiveness and stimulate domestic production[1521] (see also Chapter 10). At the same time, Figure 16.6 demonstrates that the chemical producers are located near to oil and gas refinery areas which naturally lowers the transportation and transaction costs.

16.6 CHAPTER SUMMARY

The Russian chemical sector mainly produces commodity chemicals, which are competitive domestically but less so in the global market. The sector fully meets the commodity chemicals needs of the domestic market and can partly cover the needs for specialty chemicals, but it cannot cover the demand for fine chemical (for example, active ingredients of pharmaceutical drugs, paint coatings etc.). In this context, the Government is making efforts to develop the segments producing fine chemicals (i.e. small-tonnage chemicals), typically by providing certain subsidies. These efforts should be seen in the context of the forecasted increase in the consumption of chemicals,

[1519] Government Resolution N.º 1473-p of 12 July 2017, available at: http://static.government.ru/media/files/fAALdOWVLx2dbCd77k0hlAua5NJ2RnlX.pdf, accessed on 7 November 2019.

[1520] Academy of Industrial Market Studies - New Chemistry (2011), *Nitrogen fertilisers: about competitiveness of domestic producers*, available at: http://newchemistry.ru/letter.php?n_id=6778, accessed on 7 November 2019.

[1521] Volkova, A. (2017), *Mineral fertilisers market*, National Research University - Higher School of Economics, available at: https://dcenter.hse.ru/data/2017/07/26/1173626734/Рынок минеральных удобрений I 2017.pdf, accessed on 7 November 2019.

from 228 kg/person in 2015 to up to 460 kg/person in 2030. At the same time, the development of the chemical industry is also a part of the state programme of import substitution (see Chapter 6).

The regional competitiveness of commodity chemical productions is mainly the consequence of low domestic energy prices. Current domestic demand for fine chemicals is largely met by imports. More than 50% of the fine chemical components come from abroad, and in many cases, the share reaches up to 100%. Trends envisaged in Strategy-2030 indicate that the consumption share of imported processed products is expected to be gradually reduced, from 43% in 2015 to 28% in 2030. This suggests that the Government is not aiming to fully substitute imports with domestic production but that it is taking measures to gradually reduce the dependence on imports.