European Union **Organisation for Economic Co-operation and Development** **North-West Investment Agency**

OECD WORKSHOP
INVESTMENT AND BUSINESS CLIMATE IN THE RUSSIAN FEDERATION: A REGIONAL PERSPECTIVE

ST. PETERSBURG, 9-10 NOVEMBER 2005

SUMMARY OF DISCUSSIONS

Introduction

The workshop was organised under the aegis of the Investment Committee and the Working Group on Bribery in collaboration with the Russian North-West Investment Development Agency as a part of the OECD-Russia project, financed by the European Commission. The objective of the meeting was to address the role and responsibilities of Russian regions in shaping a competitive investment and business environment ("investment module") and in enhancing business integrity and engaging in private-public interaction in the fight against corruption ("business integrity module"). (For further information see Annex 1: Programme of the meeting and Annex 2: Agenda and issues for discussion).

Some 70 participants attended the meeting: OECD countries were represented by officials mainly posted in St. Petersburg and Moscow, business associations (Japan, Finland, US) and foreign investors (e.g. timber, construction, law firms and banking). Russian participants included officials from the federal and regional governments, business associations and Russian businessmen representing foreign firms. In addition to the expected strong presence of the North-West region, several other Russian regions were represented including Astrakhan and Bashkortostan (see Annex 3: List of participants).

Improving business and investment climate in Russian regions – Assessment and policy options

The discussions on the role of the regions in investment policy have been very timely given that growing property and labour costs in Moscow have offered a real opportunity for other Russian regions to compete for foreign investment and provided further impetus for reform at the regional level. The OECD investor survey and three regional investment studies (on the Astrakhan region, Bashkortostan and the North-West region) showed certain progress in reducing investment barriers achieved both at the federal and regional levels, including in some formerly criticised aspects such as foreign exchange and customs regulations. However, several other areas often within regions' competences are of growing concern, in particular long delays for granting work and construction permits and uncertainty regarding titles to real estate ownership.

Participants recognised that better coordination and coherence between federal government and regional administrations in designing and implementing investment policy remain critical to realise the regions' investment potential. Regional officials pointed out that their actions in favour of foreign investment have been hindered by the lack of long-term strategy on the role of foreign investment in Russian economy in general and in specific sectors in particular, and by insufficient predictability in federal legislation, especially in tax-related matters. At the same time, the co-ordination between federal and regional authorities also implies a more pro-active attitude of the regions such as timely transmission of relevant information to federal instances and rapid responses to their initiatives. The lack of consultations between the authorities and the business community prior to changes in laws and regulations continues to be a problem. Such consultations should become routine practice also at the regional level in order to achieve both better predictability and effective regulatory reform.

Several other recurrent themes appeared during the discussions. Although administrative barriers remain an important issue, competition for investment projects focuses increasingly on availability of infrastructures and an adequate skill structure of labour force. In both these areas, Russian regions can and should be more active and develop modern infrastructures, including within the framework of the new law on concessions, and improve vocational training adapted to new technological needs. Similarly, investment promotion by the regions should not be based on tax incentives, which are not a driving force for investment, but should rather concentrate on long term policy predictability and transparency. It was also noted that current emphasis on large investment projects is not sufficient and has to be supplemented by programmes encouraging development and investment of small and medium-sized enterprises following some successful experiences pursued in OECD countries such as Finland.

Participants agreed that the recent adoption of new legislation on special economic zones constitutes a positive signal to foreign investors, but that its impact will very much depend on concrete implementation and respect of transparency and other recognised international standards. Some other national investment policies have, however, adversely influenced the investment climate, in particular uncertainties concerning the future level of foreign equity limitations in strategic sectors. Participants recommended that the planned legislation should enhance predictability, add no new restrictions and improve transparency, including through a negative list approach to existing limitations to foreign participation.

Based on the results of the OECD investor survey, the three regional investment studies and discussions during the first session of the workshop, the participants proposed several policy recommendations to improve transparency and coherence of Russia's investment policy at the federal and regional levels:

a) The federal authorities have primary responsibility in ensuring a sound economic and legal environment and defining clear policy orientations. They should lead by example and provide the transparent and predictable legal and regulatory framework for investment and guarantee its uniform implementation. In this respect, the application of the recent law on special economic zones and the planned legislation on foreign equity limitations in strategic sectors represent an important test of governmental intentions and implementation capacities.

b) Regional and local authorities have also a considerable role to play to guarantee stable and business-friendly climate for investors. Despite certain progress in reducing investment barriers, much more can be done by regions to avoid overlapping or additional administrative barriers on businesses and to simplify existing requirements.

c) Transparency is a key condition for favourable business climate. Regions should continue to improve access to information relevant for business and select right channels for transmitting it to investors, including in co-operation with business and industry associations. They should also develop adequate consultation mechanism and maintain a regular dialogue with the business community to discuss planned regulatory changes and explore the possibilities to further facilitate establishment and operations of investors.

d) Fiscal and other incentives currently provided so far by the regions have not had a decisive impact on attracting investment. The federal and regional authorities should therefore carefully assess costs and benefits of tax incentives, especially in relations within the future implementation of special economic zones on their territories. The regions should also evaluate transparency of their incentive schemes and seek to minimise possible market distortions.

Overall, the discussions benefited from and confirmed the robustness of Investment Committee's existing guidelines and other tools such as the Policy Framework for Investment to identify and encourage transparency-enhancing measures, make informed assessment of the cost-effectiveness of targeted tax and other incentives for attracting FDI, and to build public support for reform and a climate of mutual trust between investors and the communities in which they operate. There was a broad agreement that Russia thus should take full advantage of experience of OECD and other countries' efforts towards more transparent and coherent investment policy implementation. Russia is also in a position to contribute and benefit from other OECD Investment Committee's ongoing work on balanced policy options for successful international investor participation in infrastructure development. Furthermore, it was noted that Russia could draw benefits from bringing its policies closer to the standards embodied in the Declaration on International Investment and Multinational Enterprises, including the Guidelines for Multinational Enterprises and its National Treatment Instrument. As in other investment outreach activities, the unique role of the OECD as a convenor of dialogue between government entities, businesses and other domestic actors was found useful by participants.

The results of the workshop will serve as an input into the Investment Committee's 2005-2006 project with Russia on transparent and coherent investment policy implementation, which will be a part of Russia's Investment Policy Review to be discussed at the meeting of the Investment Committee in April 2006.

Business integrity and private-public inter-action in the fight against corruption – Assessment and policy options

The session on business integrity and private-public interaction in the fight against corruption aimed at highlighting the benefits of engaging in public-private relations to fighting corruption and at illustrating how the private sector can positively contribute and complement public sector anti-corruption actions. The Russian Federation and its regions are challenged to establishing an enabling business environment with a view to improving opportunities for economic growth, investment and job creation. Business integrity is an essential component in creating a competitive economic environment.

The sessions were addressed by OECD and Russian representatives both from the public sector and the private sector. Ambassador Nygren (Sweden) and Mr. Vincke (Chairman, Anti-corruption Commission of the International Chamber of Commerce) notably confronted their experiences with the current practices of the Russian regions, as essentially outlined in the integrity study commissioned by the OECD on two regions of the Russian North-West – Novgorod and Tver. They recalled that globalisation and competitive challenges have resulted in the application of new rules and regulations in international business transactions. A number of legally binding as well as non-binding government and non-government instruments have been developed at regional and international levels to improve trade and investment and promote integrity. They stressed the need for governments to adapt the regulatory environment and ensure that their institutional framework is adequate to grant enforcement of these commitments. Though, government actions are insufficient and consequently, complementary and mutually supportive, voluntary actions by the business community and civil society actors are equally important.

Discussions highlighted that the fight against corruption remains mostly a declared intent in the Russian Federation. Indeed, participants reported that the problem of corruption worsened over recent years and that bribery payments increased. Participants from the private sector operating in Russia described numerous situations where their relations with federal or regional public administration officials had reached a stand still and could only be set in motion again by bribe payments. It further became clear that public-private relations are mostly informal and that the Russian private sector has so far had very limited exposure to notions such as corporate social responsibility, business integrity, corporate codes of conduct and corporate compliance programmes.

Participants noted that implementation and enforcement of recently developed international anti-corruption standards have a major impact on international investors and international financial institutions. Several OECD participants stressed the benefits of a business environment free of corruption. In particular the economic benefits in the medium and long term were underlined. It was noted that business from OECD countries will increasingly be reluctant to engage in relations with companies originating from countries that do not implement and enforce such standards. Also financial institutions increasingly consider countries commitments to fighting corruption in their overall risks assessments and international loan policy.

To remedy the current situation and enhance the fight against corruption in Russia, participants recommended different actions by the federal and regional governments as well as by business and civil society at large:

a) The Federal government should enact effective legal and regulatory provisions to detect, prosecute and sanction corruption and enforce such provisions. This means in particular and transposition of standards as defined in main international anti-corruption instruments (OECD Convention and related instruments, UNCAC) into clear and straightforward anti-corruption rules and regulations as well as the ratification of the UNCAC (United Nations Convention against Corruption).

b) Participants recommended the strengthening and the promotion of the rule of law as well as the establishment of a central body to investigate and prosecute corruption crimes. In addition, they called on the federal and regional governments to take effective steps against all public officials that solicit bribery.

c) Federal and regional governments should increase transparency and engage in information sharing with a view to ensuring that companies and professionals concerned be aware of the applicable relevant domestic legislation, and the applicable sanctions in case of breach of such provisions.

d) Participants encouraged the Russian Federation and its regions to adopt and put into effect preventive anti-corruption measures as part of the wider good governance and integrity concern.

e) Simplification of administrative procedures and reduction of red tape for investors as well as streamlining of business licensing was advocated since this encompasses risks of discretionary action by public officials and enhances corruption.

f) Develop better communication within the public service, in particular also between the regional and the federal administrations.

g) Clarify and simplify the roles of the various administrative agencies to facilitate the exchange of information and experience on national, regional and international anti-corruption initiatives.

h) Foreign investors called upon domestic companies to make a meaningful contribution to the fight against corruption in taking wide-ranging, voluntary self-regulatory integrity measures. Companies were confident that they can be more pro-active in fighting corruption; they were encouraged to consider taking collective steps either at regional or at the sectoral level. Collective actions were in particular recommended as an effective approach for small or medium sized business.

i) Formal consultations between public administrations and the business community were identified as an appropriate tool to exchange information both on the anti-corruption policies and programmes of the federal and regional governments and on the private sector's implementation of anti-bribery laws and regulation.

j) Finally, it was recalled that civil society at large (including trade unions and the media) can and should play an active role in developing the regulatory environment and define societal expectations regarding business integrity.