

BRIEFING NOTE

10 November 2008

INDUSTRIALISTS' ROUND TABLE PANEL ON FOREIGN INVESTMENT, STRATEGIC INDUSTRIES AND PROTECTIONISM 13 NOVEMBER 2008

BRIEFING NOTE FOR ERNEST-ANTOINE SEILLIÈRE, PRESIDENT OF BUSINESSEUROPE

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Speakers

- Victor Borisovich Khristenko, Minister for Industry and Energy of the Russian Federation
- Catherine Ashton, European Commissioner for Trade
- Alexander Shokhin, President, Russian Union of Industrialists and Entrepreneurs
- Ernest Antoine Seillière, President, BUSINESSEUROPE

Economic situation in Russia

The financial crisis and volatile commodity prices are having a destabilizing effect on the Russian economy. Over the past weeks, there has been a 70% decrease in Russian stock markets and a steep fall in Russian reserves. In addition, prices of oil and other commodities have fallen drastically. The Russian government downgraded its economic growth forecast for this year from 7.8 percent to 7.3 percent, but most economists argue this is too optimistic. Russian companies are already asking the Russian government for support through a number of measures, such as stricter regulation of raw materials' prices. Prime Minister Putin wants to increase import duties and give Russian companies with better access to credit.

Over the medium term, Russia remains an attractive investment market for EU companies thanks to high growth rates, vast natural resource wealth and a big potential for industrial and services development. The EU is Russia's biggest investor, with up to 75% of investments coming from EU Member States. European companies invest foremost in **industrial sectors** (e.g. the chemical sector, the automotive sector, appliances and food). EU investments in **commodities** (e.g. oil, gas) are much lower and require setting up joint ventures with Russian companies.

There is a discrepancy between Russia's rhetoric of commitment to rules-based trade and investment and its policies aimed at strengthening domestic industries (economic nationalism). For instance, Russia tries to accede to the WTO and the OECD, but also aims to decrease imports to help domestic industries to move up the value chain.

Main concerns of European companies in Russia

1) Absence of a transparent legal framework

The absence of stable and clear legal framework creates major obstacles for European investors. One example of the 'unclear' Russian legal framework is the **Law on Foreign Investment in Strategic Sectors**, which was passed on 12 April 2008. The law has been criticised for reaching far beyond its legitimate purpose to protect certain industries from foreign influence. One of the major challenges regarding this strategic sector policy is that it lacks clarity and that the definition of 'strategic' could be ever-expanding. Another example of this concern is the **opaque legal rights for shareholders**, especially in the case of minority shareholders.

2) Discriminatory application of Russian regulations

On several occasions, Russian regulations have not been applied equally to European investors and Russian companies. The risk of **discriminatory treatment** by Russian authorities is a major problem of European investors. Examples of discriminatory treatment include: (1) issuing of work visa's; (2) application of environmental standards; (3) tax investigations and (4) food safety measures.

3) Difficult environment for industrial investment

In addition to such discriminatory treatment and the absence of a transparent legal framework, European investors are also faced with a **difficult environment for industrial investment**.

- European companies are faced with **red tape** (e.g. inefficient bureaucracy, lengthy customs procedures) and a high degree of **corruption**.
- The Russian government upholds high local content requirement for industrial production, whereas the **Russian market for supplies is largely ineffective**. This is due to the absence of reliable high quality suppliers, difficulties surrounding the import of supplies and insufficient infrastructure. The automotive sector faces numerous problems in this respect with Russian authorities promoting local assembly of cars.

Main concerns of Russian companies

1) EU energy policy

Russian companies are worried about decreasing European demand for energy resulting from **EU energy policy** (i.e. setting high renewable energy targets and energy efficiency targets, Nabucco pipeline). In addition, Russian companies are concerned about **EU proposals to restrict foreign investment** in electricity and gas transmission. This would mean that the EU imposes stricter competition rules on investment from Russia.

2) Investment restrictions at national level

Russian companies are faced with barriers to investing in the EU due to **restrictive investment laws in EU Member States**. Investment laws in Germany and France are often cited examples. In reality these laws have a limited impact, since the Single Market provides various means to circumvent these restrictions.

3) Research and technology

Russia wants to increase European investment in technology. In addition, Russian companies want access to EU research programs. BUSINESSEUROPE thinks that access to R&D programmes should be based on reciprocity.

BUSINESSEUROPE recommendations to improve cross-border investment

1) **Russia's WTO accession**

European business needs a clear signal that the Russian government remains committed to rules-based international trade and investment. WTO accession is considered to be a first major step toward rules-based economic integration between the EU and Russia. WTO accession would also involve a chapter on trade facilitation, which would help overcome many of the current concerns over customs.

2) **EU-Russia trade and investment agreement**

European companies need a comprehensive bilateral free trade & investment agreement with Russia which includes a strong dispute settlement system, a mediation mechanism and chapters on research, energy and environment.

The Commission decided to postpone negotiations of the New EU-Russia Agreement after the war in Georgia. Over the past week, the Commission has been pushing for the resumption of the negotiations on the New Agreement with Russia in spite of the declared opposition of some member states (Lithuania and Poland, for example).

3) Fair and equitable treatment of EU investment

In sectors where there is a risk of discriminatory treatment, the EU should seek very clear rules on non-discrimination. Russian laws, for example the law on strategic sectors, should not be used to protect uncompetitive Russian industries. The negotiation of the New EU-Russia Agreement will provide an excellent opportunity for the EU and Russia to agree on a definition of strategic sectors. This would clarify which sectors are open for European investors to buy Russian companies.

4) Investment agency

Russia should develop an effective investment agency at federal level or strengthen existing investment promotion agencies which aim to attract high quality investment from European companies and create a favourable environment for potential investors.

Key questions

1. The EU and Russian economic structures are complimentary and would benefit from open markets for trade and investment. What should be done to make a systematic proceeding to an EU-Russia common business area possible?
 - *WTO accession: European investors need a clear signal that the Russian government remains committed to rules-based international trade and investment.*
 - *A comprehensive EU-Russia bilateral free trade & investment agreement which includes a strong dispute settlement system, a mediation mechanism, chapters on research, energy and environment.*
2. The economic crisis has affected most countries in the world and in some of them could also lead to changes in economic legislation. In this context will Russia and/or the EU impose protectionist measures for investments? Will the so-called strategic sectors of economy be the main 'victim' of the financial crisis?
 - *Especially in light of the financial crisis and a global economic slowdown, it is important that governments do not resort to protectionist measures. Foreign investment, one of the main driving forces of economic growth, should not be restricted. Instead, markets for investment should maintain open and based on predictable and transparent rules.*
 - *The EU and Russia should agree on a definition of strategic sectors.*
3. Although legal restrictions are limited, there are often populist reactions against foreign investment into the EU. How does the Commission ensure that the EU remains open to foreign including Russian investment?
 - *Single Market rules limit what national governments can do to restrict investment. The Commission must enforce these rules.*

4. Stock market declines were affected mainly by the financial crisis. Will the stock market disruption in Russia lead to the decline of direct foreign investments? What steps will the Russian Government take to increase the attractiveness of the country for foreign investments? Will the existing administrative barriers be reduced to make Russia more competitive in attracting foreign investment?
 - *Russia should increase its attractiveness for high quality investment by reducing administrative barriers and ensuring national treatment under Russian laws for EU companies.*
 - *Russia should look into setting up a specialized investment promotion agency which aims to create a favourable regulatory environment for potential investors.*

5. One of the main challenges in the EU-Russia relationship is how to implement competition rules. Some might argue that there is not enough competition in Russia and that both the Russian and EU countries might be reluctant to further steps in opening their markets for free competition. Is this true and does it not hinder economic development?
 - *There is not enough competition in Russia. There are few SMEs and the few that exist are sometimes subject to unfair competition and abusive practices by big companies.*
 - *Over the medium term, Russia and the EU will need to work out an understanding on competition policy. Russian companies operating on the EU market, including energy giants, must abide by EU rules. Similarly, EU companies in Russia will need to follow the rules of the Russian Federation. Why not move towards convergence or cooperation?*

6. The Bretton-Woods institutions appear unable to resolve the economic crisis. And Russia seems to lose interest in WTO accession negotiations. Does Russia still believe that multilateral organizations are the only way to address global challenges? Or will Russia focus on CIS countries as a priority over the next few years.
 - *The financial crisis and global economic slowdown should not lead us down the path of protectionism. The EU should support calls for the resumption of the Doha Round.*
 - *The Russian government should remain committed to rules-based international trade and investment. Many hurdles have yet been overcome in Russia's route to WTO accession.*
 - *Consistent approaches to safeguard financial systems should be further promoted at the international level. The IMF plays a crucial role and should be provided with sufficient means and flexibility to help countries affected by short-term financing difficulties, particularly emerging economies.*