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THE ECONOMIC STRUCTURE OF RUSSIAN FEDERATION

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INTRODUCTION

The present working paper provides an extended overview and a thorough analysis of the fundamental institutional and political dimensions about the contemporary ‘investment regime’ in Russian Federation. The main objective of the empirical and theoretical approach is to develop a broad understanding of the largely particular Russian investment framework, primarily in the light of the relatively low levels of foreign direct investment (F.D.I). Indeed, it is somewhat paradoxical the poor performance of Russian Federation in the international competition for foreign direct investment inflows relative to its high potentials.

Despite the unquestionable progress so far, the investment climate in Russia still remains unstable and risky for foreign investors. The fairly unattractive investment environment can be attributed to the extensive structural distortions, market inefficiencies and institutional weaknesses in those crucial sectors that heavily determine F.D.Is. For instance, the insufficient establishment of the rule of law and the ineffective protection of property rights, the uncertainties over economic policy, the huge and sluggish bureaucracy, the widespread corruption and the malfunction of state institutions erect hard obstacles and impediments to foreign investors. In that sense, the fundamental priority of the modern policymakers’ agenda is the rapid implementation of widespread institutional and structural reforms in a clear - cut, market - oriented policy pattern.

Within this context, the paper is organized as follows: in the first four sections there is an analytical - theoretical and empirical - approach of the basic structure and the reform activity of significant institutions and public policies, that is, the judiciary, the banking system, the taxation and the corporate law respectively. The fifth section presents the main features of an important investment domain, the real estate. In the next four sections there is an extensive analysis and a broad description of the economic and institutional framework relative to F.D.I flows in Russia. In addition, the tenth section is devoted to the privatization - denationalization experience while the next one outlines Russia’s relations with international organizations. Finally, the last section highlights the state interventionism and the sociopolitical realities in Russian Federation as the crucial factors for competition distortion and market inefficiencies as well as the fundamental impediment to foreign investments.

1. THE JUDICIARY

1.1 Introduction

The Ministry of Justice administers Russia's judicial system[1]. The ministry's responsibilities include the establishment of courts and the appointment of judges at levels below the federal district courts. The ministry also gathers forensic statistics and conducts sociological research and educational programs applicable to crime prevention.

Many Western observers consider the judicial and legal systems weak links in Russia's reform efforts, stymieing privatization, the fight against crime and corruption, the protection of civil and human rights, and the general ascendancy of the rule of law. Many judges appointed by the regimes of Leonid I. Brezhnev (in office 1964-82) and Yuriy V. Andropov (in office 1982-84) remained in place in the mid-1990s. Such arbiters were trained in "socialist law" and had become accustomed to basing their verdicts on telephone calls from local CPSU bosses rather than on the legal merits of cases.

For court infrastructure and financial support, judges must depend on the Ministry of Justice, and for housing they must depend on local authorities in the jurisdiction where they sit. In 1995 the average salary for a judge was US$160 per month, substantially less than the earnings associated with more menial positions in Russian society. These circumstances combined with irregularities in the appointment process and the continued strong position of the procurators, deprived judges in the lower jurisdictions of independent authority.

1.2 Judicial reform

In 1992 a new Law on the Status of Judges was passed. The law was intended to confer greater status on the judicial profession by raising salaries and benefits. The 1993 constitution provides for some degree of judicial reform by establishing an independent judiciary and specifying that justices may only be removed or their powers curtailed or terminated in accordance with the law. Sitting justices also enjoy immunity from prosecution. However, judicial reform has moved slowly despite those two legislative developments, and in 1996 the judiciary remained subject to the influence of security

[1] www.countrystudies.us/russia/.

agencies and politicians. A large case backlog, trial delays, and lengthy pretrial detention also remain problems.

According to a provision approved in 1994, trial by jury may take place in specific types of cases, including those involving the death penalty. This reform supersedes in part the older system of trial by judges and lay "people's assessors" who usually acceded to the judges' verdicts. In practice, trial by jury has made little headway in the hidebound court system. In 1995 jury trials were only available in nine of the eighty-nine subnational jurisdictions, although other jurisdictions sought permission to introduce them.

In the mid-1990s, a total of about 14,000 judges were active in approximately 2,500 courts at all judicial levels. To be eligible for appointment as a judge, an individual must be at least twenty-five years of age, have a higher education in law, and have at least five years of experience in the legal profession.

In the reform it is also planned the expansion of participation of juries into the whole judicial system, since till today they have been used at pilot basis.

1.3 Structure of the Judiciary

The twenty-three-member Supreme Court is Russia's highest court of origination and of appeals for consideration of criminal, civil, and administrative cases. Its chairman in 1996, Vyacheslav Lebedev, had been a judge in Leningrad and Moscow for nineteen years before his appointment in 1989. The Superior Court of Arbitration, which is headed by a board of one chairman and four deputy chairmen, is the highest court for the resolution of economic disputes. Courts of arbitration also exist at lower jurisdictional levels. The nineteen-member Constitutional Court decides whether federal laws, presidential and federal decrees and directives, and local constitutions, charters, and laws comply with the federal constitution. Treaties between the national government and a regional jurisdiction and between regional jurisdictions are subject to the same oversight. The Constitutional Court also resolves jurisdictional disputes between federal or local organs of power, and it also may be asked to interpret the federal constitution. The Constitutional Court temporarily ceased to exist after Yeltsin dissolved the parliament in October 1993. Although prescribed in the new constitution, the court remained moribund in 1994 because no new law was passed governing its procedures and composition. In 1995 the Federation Council finally approved appointments to the Constitutional Court, and it resumed operation that year.

Under the constitution, judges of the three highest courts serve for life and are appointed by the Federation Council after nomination by the president. The president appoints judges at the next level, the federal district courts. The minister of justice is responsible for appointing judges to regional and city courts. However, in practice many appointments below the national level still are made by the chief executives of subnational jurisdictions, a practice that has perpetuated local political influence on judges' decisions.

1.4 Conclusion

Despite the latest steps to make judges more amendable and responsible for their acts and more independent the judiciary is still plagued by corruption and incompetence to take action. In fact, due to the existence influence of the local rulers on the judges, many companies are forced to create bonds with the local authorities and “voluntary” bring in respectful amounts to the local budget in many regions and, thus, confront the massive corruption. In addition, the plethora of local laws, ukases, federal laws etc. that are contrary to the constitution and remain to force due to the lack of control from the judiciary are politically and legally dangerous to the normal function of the society. Therefore, it is advisable for foreign investors not to solve their differences with potential local adverse parties through national arbitrary courts. Instead, they should choose the legal settlement of the International Arbitration, where the parts can agree to the applicable law, the arbitrators and other matters. Most important advantage of this method is that the decision taken can be recognized and uphold in the countries of the parts.

2. THE BANKING SYSTEM

2.1 General description of the Banking System

The Russian banking industry is regulated by a number of legislative acts, including:

- The Federal Law "On Banks and Banking," No. 395-1 dated December 2, 1990.
- The Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)," No. 86-FZ dated July 10, 2002.
- The Federal Law "On Insolvency (Bankruptcy) of Lending Institutions," No. 40-FZ dated February 25, 1999.

The Russian banking sector has been rapidly developing since the break-up of the Soviet Union. Russian commercial banks enjoyed a period of remarkable growth between 1995 and 1998. However, the decision dated August 17, 1998, to restructure Russia's foreign debt, as well as its debt on Russian treasury bills ("GKOs"), led to a near collapse of the national banking system. The financial consequences of August 17, 1998, known as the "Russian financial crisis," have had a profound impact on the Russian banking industry and have left it in a much weakened state. Currently, the banking sector in Russia is steadily developing and is tending towards a reduction in the quantity of banks through mergers, while the quality of banking services is improving and the amount of accumulated funds is growing. Furthermore, the standards established for Russian lending institutions by the Central Bank of the Russian Federation are more and more in compliance with international banking standards.

Russia's banking system consists of the Central Bank of the Russian Federation[2], lending institutions, and branches and subsidiaries of foreign banks (i.e. institutions deemed as banks under the laws of the corresponding foreign states). Lending institutions include banks and non-banking lending institutions. The main difference between the two is the kind of banking operations they are permitted to perform. Banks are authorized to

[2] The Central Bank of the Russian Federation, 2007, Banking supervision report 2006, pp. 5-11, available at www.cbr.ru.

carry out a full complex of operations: from attracting funds from individuals and legal entities, placing such funds in its own name and on its behalf under terms of repayment, serviceability and maturity, to opening and maintaining bank accounts for individuals and legal entities. Conversely, the scope of banking operations performed by non-banking lending institutions is limited.

2.2 Introduction to the Banking Sector in Russia

The Russian Banking sector has known three development periods[3]. Till 1995, the banking sector was too profitable and was notably developed within a period of economic crisis, since the tree digit inflation was in favor of these growth rates. The macroeconomic stabilization was considered as a shock cure for the banking system since it deprived it of easy profits, but without generating the conditions which would enable the traditional lending or investing functions. The economic crisis of 1998 had as a result the bankruptcy of the whole of the banking system. During the second semester between 1995 and 1998, the number of commercial banks was decreased from 2.600 to less than 1.600 and the banks of Moscow during this period increased their profits also due to the high interest rates of the promissory notes of Russia’s debt. Among the 20 greatest banks, early in 1998, only 3 of them survived under the old form. There are currently about 1,300 commercial banks in Russia. However, this number hides the strong concentration of the banking sector and the dominance of a few state banks. Leading place hold Sberbank, the former soviet savings bank, and Vneshtorgbank, the old bank of foreign trade. Also, there is a small number of private banks with sufficient funds. The rest are small banks with insufficient funds which play the role of de facto safes of either rich entrepreneurs or large companies or they just facilitate the capital flight abroad. The assets of the 50 largest banks account for more than 75% of total banking assets, but the Russian banking sector is tiny compared to that of the European Union, the United States, Canada, Japan and other countries where banking is central to the operation of the economy and where a larger proportion of the population have bank accounts and make widespread use of the banking system. Russia needs banks to be more involved with intermediation and to serve the needs

[3] Embassy of Greece in Moscow-Russia, Office of Economic and Commercial Affairs, Institutional – Investing Framework in Russia, p. 53, 2007, available at www.agora.mfa.gr/russia.

of the economy, consumers and investors in order for Russia to reach the desired levels of sustained economic growth.

The year 2004 represents the beginning of the third development phase of the sector by putting into practice the new legislation about the deposits guarantee at the end of 2003. This was the main measure for the restraint of Sberbank's omnipotence, which until then was the only bank that provided state deposit guarantee and thus, concentrated over 70% of the total deposit amount. The total amount of banking assets reached 45% of the GDP in 2005, 15 times more than in 1997. The progress of the funds was speeded up in 2005 with a 31% increase. In addition, the total deposits gained a 37,5% at real prices. In 2006, the Duma adopted an amendment of the banking law setting the minimum obligatory capital at 5 million Euro from 1.1.2007. Finally, the adoption of the international accounting standards (IAS) in the banking sector and the implementation of the laws (IFRS) – for instance the improvement of the mergers and acquisitions system (M&As) - were put into force at the beginning of 2007.

Despite the fact that the allowances to the private sector were increased at 40% annually from 2005 till 2006, the value Allowances/GDP remains at 30%[4]. In fact, banks are only financing the 10% of private investments in comparison to the 50% in developed economies. The reasons are following:

a) lack of corporate transparency

b) the legal framework that is in favor of the loaner against the borrower

c) the insufficient capital stock of banks.

2.3 Strengthening confidence in the Russian banking system

Banks in Russia do not have the confidence of the Russian population[5]. Capital flight remains a serious problem as huge sums of money continue to leave Russia by various means for a perceived safer haven outside Russia where the source of the money is not investigated too thoroughly. Individuals prefer to keep their surplus funds in cash at home or, if they are prepared to trust the banking sector at all, to put their money either in an account with a foreign bank or in an account with the State savings bank where the

[4] Alexei Vedev, 2003.

[5] PricewaterhouseCoopers at www.pwc.com/prodev.

Government has given an undertaking that the savings of small scale depositors will not be lost. The 1998 default on Russian government debt, the subsequent bankruptcy of some prominent Russian banks and a series of other scandals and allegations of impropriety by some Russian banks have all added to the perception of mistrust in the Russian banking system.

The Central Bank of Russian is the regulator and supervisor of the Russian banking system. The new management team at the Central Bank, which took office in 2002, is taking firm action to strengthen confidence in the banking sector by improving the supervision of banks.

The main pillars for effective banking supervision are already in place: the legal foundation is well developed; the Central Bank has the necessary infrastructure and staffing in place for supervising banks; prudential requirements are already developed that compare well with international requirements. However, significant events are taking place concurrently that impact on the way the banks report to the Central Bank and the way the Central Bank must assess the information it receives from the banks: the banks are in the process of adapting their accounting and reporting systems to meet the requirements of International Financial Reporting Standards (IFRS); the Central Bank is adapting its supervisory techniques to take account of developments in international Central Bank supervisory practices and the recommendations of the Basle Committee on Banking Supervision; a deposit insurance law has recently been approved, the implementation of which will place further demands on banks' supervisors in assessing and monitoring individual banks.

The Russian Federation covers a huge territory spanning nine time zones. Developments in computerized information and reporting systems can address the challenges of supervising banks across such a wide geographic area, but the Central Bank must take the initiative in adapting its own data collection systems and organization by developing technical solutions that interface efficiently with the information systems of a diverse range of banks.

2.4 Foreign participation in the Russian banking sector

The Federal Law "On Banks and Banking Activities," No. 395-I dated December 2, 1990, sets forth additional requirements for the foundation and commercial activities of credit institutions with foreign investments and branches of foreign banks in the Russian Federation.

Pursuant to Article 18 of the mentioned Federal Law, the admissible share of foreign capital in the banking system of the Russian Federation shall be established in accordance with a legislative procedure. The admissible share of foreign capital in the banking system of the Russian Federation is calculated as a ratio of the total amount of stakes belonging to foreign investors in the share capitals of credit institutions and the amount of stakes belonging to foreign banks to the total amount of capital of all credit institutions registered in the territory of the Russian Federation. However, to date the federal law that sets forth the share of foreign capital in the banking system of the Russian Federation has not been adopted.

The transfer of shares or ownership interest in the share capitals of credit institutions in favor of foreign investors is performed by their owners on the basis of prior approval from the Central Bank of the Russian Federation. Moreover, such approval from the Central Bank is required in the event a credit institution plans to increase capital through contributions from non-residents or alienate its shares or ownership interest in favor of foreign investors. The Central Bank is entitled to prohibit share capital increases or transfers of title to shares and ownership interest in the share capitals of credit institutions, if such actions result in exceeding the admissible share of foreign capital in the banking system of the Russian Federation.

The interest of the *foreign bank invasion* into domestic market was until recently assessed as low. The main restrictions were the prohibition of foreign bank participation over 12% of the total assets of the banking sector as well as the obligation to set up a new company when they want to open branches. So far, the presence of foreign banks is mainly located in Moscow and in St. Petersburg. The foreign bank possibility of entering into the Russian market through the founding of a branch remains the main demand of the USA in order to consent with the accession of Russia into the WTO. The Russian authorities do not agree with this demand because then foreign banks will go through the control of the supervisory office in their seat and they will not have separate economic presence in Russia. Instead they will be based on the assets of the parent company. As a result, there would be impossible for the Russian banks to compete them.

Some foreign banks have already invaded the Russian market by usually merging of a Russian bank. However, according to the facts of the Central Bank they do not control over 15% of the total bank assets.

In 2007, it is estimated that the foreign banks increased their share possessed in the Russian market at 5% to 6% and thus reaching the 18%. The interest of foreign bank remains as one can conclude from the recent acquisitions movements. As for the Greek bank presence in Russia, representative offices in Moscow have ALPHA BANK (belongs to its Cyprian subsidiary) and HELLENIC BANK. On October 2007, Bank of Cyprus, which occupied a representative office in Moscow since 1998, has started its operation in Russian market by opening a branch in Moscow, while the opening of more branches in the future is expected[6].

2.5 Present conditions of the banking system in Russia

In 2006, the favorable trends in the Russian banking sector gathered strength: most of the banking sector performance indicators grew faster than in the previous years and their ratio to GDP increased. The banking sector becomes considerably important for the domestic economy.

The Russian banking services market continued to expand as competition in the banking sector intensified and the progressive growth of foreign capital in Russian credit institutions is now becoming an ever more substantial factor of this competition. Competition increased especially in the household lending sector. It leads to the improved quality of banking services and to new banking products coming out on the market, makes credit institutions more transparent, encourages the use of new information technologies and outsourcing and stimulates the spread of the banking business to the Russian regions.

Overall, 2006 was the year when the top Russian banks were busy preparing to make initial public offerings (IPOs) on the stock market. Some banks are expected to make IPOs in 2007 and this will become a landmark event in the development of the Russian banking sector and the domestic economy as a whole.

At the same time, as the banking business grew more sophisticated and expanded to new spheres of activity, including consumer lending, risks accumulated. This aspect of

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[6] Hellenic-Russian Chamber of Commerce at www.hrcc.gr.

banking sector development is in the focus of the Bank of Russia supervisory attention. Its main tasks are to help credit institutions improve the quality of management and internal controls and ensure that it operates as an efficient regulator and supervisor.

Last but not least, the International Valuation Offices Standards & Poors'"Fitch", valued the borrowing capability of Russian from BB+ to BBB+ in July 2006.

2.6 Conclusions

The Russian economy has demonstrated the steady positive growth rates during the last five years. In the basis of such developments there are such factors, as sharp ruble devaluation, the favorable external conditions and the state control on the prices for the natural monopoly products. As the key threats for the future Russian economic developments appear the high dependency on the external factors (mainly from the oil prices and the physical demand on the raw materials from the economic developed countries).

The key problem will be the condition of the national financial sphere – in context of its availability to resist the external shocks and to support the positive production rates. The main problems of the financial sphere are the weakness of the banking system and inefficiency of the financial markets as well as the absence of the controlled the interest rates for the purposes of the macroeconomic regulations.

The main disposable resources of the national banking system will be the households' savings. The size of this resource is significant, characterized as the low cost and can be distributed by the banks on the different purposes – to the financing domestic debt, the investments to the real sector or on the financial markets. The prospects of the accumulation such resources will depend on the monetary policy and on the conditions of the banking system, including relatively high inflation rates, the monopoly position of Sberbank RF on the individuals deposit market, the high risks of the other commercial banks and others.

The potential of the self-recovering banking system scenario is over. The accumulated losses of banking system had been covered only in the middle of 2002, but only due to the financial position of the Sbebank of RF. Excluding the financial results of this state owned bank the commercial banks are still in crisis (including the great volume of the accumulated losses). The key problems of the private commercial banks are the high cost of the liabilities, the tough regulation of the banking activity from the CBR and government of RF, the high risk of the providing loans to the enterprises and of the shortages of the existing financial instruments.

The possible invasion of the foreign financial institution on the domestic market can accompany only under the positive development of the Russian real sector and banking system and realized due to the reasons listed below:

- ✓ the increase of the thrust to the banking system from the households and enterprises;
- ✓ the expansion the set of the banking services on the financial market;
- ✓ the increase of the efficiency of the banking top- and medium-level management;
- ✓ the increase of the transparency of the banking operations, which is important for the cut of the capital outflow and for the tax payments growth;
- ✓ the growth of the aggregate banking capital.

Now the increase of the attendance of the foreign banks on the Russian domestic market is limited by the high risks (connected with the socio-political instability, the indefinite of the world conjuncture and others) and by low profitability of the banking business.

In general now the national banking system is on the eve of the strategic choice of the future development. Such choice is determined by the political aspects (the political stability and the ability/inability of the Russian monetary authorities to create and to realize the banking reform), by the external factors (the world oil prices and the world demand on the fuel and energy products) and by the set of the internal factors (mainly, the parameters of the fiscal and monetary policies). The listed above factors affect the possible future development of the national banking system, but the crucial point will be the governmental strategy of the Russian economic development, where the banking system should play the key role.

3. TAXATION

3.1 Introduction

The tax reform program initiated in 1998 by the Russian government is still ongoing today. These reforms are aimed at codifying the tax statutes, consistently developing and adopting the parts of the Russian Federation Tax Code that regulate taxation, as well as repealing laws passed in Russia at the beginning of the economic reform of the early 90s[7].

The major goals of the ongoing tax reforms are as follows:

- Establishing unified taxation rules applicable to all taxpayers.
- Clarifying the rights and obligations of taxpayers and tax authorities.
- Protecting taxpayers from arbitrary decisions and enforcement by taxation controlling authorities.
- Differentiating taxation powers among federal, regional, and local (municipal) authorities.
- Making investing in the Russian Federation more attractive.
- Decreasing the black market economy, and creating more favorable conditions for companies interested in conducting legal business in the Russian Federation.
- Considering international experience in the taxation sphere.

3.2 Taxes concerning the foreign investment presence in RF

- **24%** (from a prior 35%) – on the profit of Russian and foreign companies whose activities do not create a permanent establishment in Russia (6.5% to the federal budget, 17.5% to the regional budget).

[7] Beiten Burkhardt, Investments in Russia, pp. 60-70, Edition 2006–2007 at www.beitenburkhardt.com.

- **18% VAT** (from a prior 20%), and it is expected to gradually reach the 13%.
- **Not more than 2,2%** - of the depreciated value of the taxable property value.
- **5%** turnover tax.
- **10%** (unless international treaties provide otherwise) – on income of foreign companies gained by freight of vessels, aircraft, and other mobile transportation means and containers (including trailers and ancillary freight equipment), provided that the activities of the foreign company do not create a permanent establishment in Russia.
- **15%** (unless international treaties provide otherwise) – on income in the form of dividends paid among Russian and foreign companies.
- **20%** (unless international treaties provide otherwise) – on types of income, other than those above, of foreign companies from sources in Russia, provided that the activities of the foreign company do not create a permanent establishment in Russia.
- **15%** – on income from state and municipal securities (with some exceptions).
- **From 2 to 26%** (from a prior 35,6%) unified social tax, which is regressive and depends on the amount of taxable income, which means that the higher the annual salary of the employee, the lower the unified social tax rate.
- **13%** - on individuals' income is for "tax residents," i.e. individuals who spend no less than 183 days in Russia during a calendar year. For foreigners the rate stands at **30%**.

3.3 Particularities of Taxation of Foreign Companies

One of the particularities of taxation of foreign companies is the fact that the income of such companies may be taxed at different rates depending on the types of activities carried out by the particular foreign company in Russia, the types of income gained, and the country in which the company is based.

According to Russian Federation tax legislation, a permanent establishment of a foreign company is the place of performance of entrepreneurial activities in the territory of Russia.

If a foreign company's activities create a permanent establishment in Russia, its profit gained through such permanent establishment may be taxed in Russia according to the rules applied to Russian organizations. If a foreign company's activities do not create a permanent establishment, its income derived from Russian sources may also be taxed. If a Double Taxation Treaty exists between the particular foreign company's country of residence and the Russian Federation (in case of Greece, there is a DTT signed between Greece and Russia), certain rates may be reduced or may not apply at all. Income tax at the source in the Russian Federation is usually withheld by the Russian counterparty (payer) of the foreign company and transferred directly to the Russian budget.

3.4 Special Economic Zones – some of the advantages

Legal Grounds: Federal Law "For the SEZ in the Russian Federation" from 22.07.2005.

1) SEZ are tax free. The tax status of the industrial production SEZ and the technological-innovatory SEZ does not differ.
2) The residents of all SEZ are for five years after settlement free of paying property tax and estate tax.
3) For the residents in technological-innovatory SEZ mounts the reduced Unified Social Tax at only 14% unlike the general tax rate of 26%.
4) Losses of Residents of an industrial SEZ are unconditionally till 100% valid.
5) The profit tax rate of 24% is basically for all residents of a SEZ valid. However, the regional legislator can reduce his share on the profit tax from 17,5% up to 4% at 13,5%. The six so far existent Federation's subjects have all make use of this opportunity, so that the profits tax rate actually stands at 20%.

3.5 Existing drawbacks of the Russian tax system

It is necessary to separately consider the drawbacks of the Russian tax system.

Tax administration. The Russian tax authorities are not well organized and many employees lack legal competence. This creates serious difficulties for taxpayers dealing with the tax authorities and their staff.

Emphasis on companies. The Russian tax system is more focused on the taxation of companies than on the taxation of individuals, as tax revenue from individuals has been insignificant up until now.

Differs from western systems. The Russian tax system significantly differs from the Western-European and North American systems. Among the most conspicuous distinctions is the impossibility of consolidating profits / losses, for taxation purposes, of companies operating under a corporate umbrella. Another significant difference is that the Russian tax system uses Russian accounting standards, which do not always coincide with IFRS or GAAP.

Tax reforms. Although the reformation of the Russian tax system is a positive factor in the economic development of the country, it may well create a temporary destabilization of the tax system during its implementation. As a result, a period of uncertainty in the methods and practices for solving various issues can be expected.

Generally low level of legal culture. This problem is not exclusive to legal tax relations. In dealings in Russia, foreign businesspeople often find that their Russian counterparts, or the Russian authorities, tend to solve arising issues without considering, or even completely ignoring, the existing rules of law. It should be noted that there is a recent trend towards improving the legal culture in Russia.

4. CORPORATE LAW

4.1 Forms of commercial activities in Russia

According to the standing legislation, foreign natural or legal persons can commercially enter in Russia:

- by exporting/importing commodities or services without permanent presence in Russia
- by opening a new company (by choosing one of the legal entities established under the laws of Russia)
- by joining in the capital of an already existent company
- by acquiring a stock share of an already existent company
- through an affiliate-branch
- through a representative office.

Foreign companies are obliged to comply with the laws of Russia and to have equal rights and obligations with the local investors (national treatment), unless the law foresees differently.

Russia's legislation about companies defines that one should previously examine the type of the company plan and the development strategy of the parent company (if it is about a subsidiary).

In any case, before starting up a company in Russia foreign investors should cooperate with specialized legal offices and accountants in order to inform about the procedures needed and to choose the legal entity that suits best to their business plans.

One should note that the representative office and branches are not considered to be legal persons according to Russian law, but subdivisions of the parent company. The parent company is responsible for the activities of its representative office or branch in Russia. In particular, the representative office is a subdivision of the parent company that represents its interests in Russia and it is not allowed to have commercial activities. By contrast, the branch is allowed to be commercially active.

The opening of a legal entity in Russia, namely a Russian law company, legally independent from the parent company, is the most advanced way of a foreign legal person's installment in Russia.

Finally, the registration and the founding cost of a company in Russia is lower than the founding cost for a representative office or a branch.

4.2 Legal entities of a foreign activity in Russia

The following organizational and legal forms of commercial legal entities referred to as commercial organizations are at the disposal of foreign investors who want to engage in Russia:

- **unlimited partnership –** an association whose members are fully liable for its obligations
- **limited partnership –** a partnership within which several partners have full liability and at least one partner has limited liability to the extent of such partner's contribution
- **limited liability company (OOO) –** an association in which the liability of each participant is limited to the extent of such participant's contribution
- **additional liability company –** a company in which the participants are, in addition to the extent of their contributions, equally liable in accordance with a multiple applicable to all their contributions
- **closed joint-stock company (ZAO)**

The most popular legal forms for a foreign activity are the OOO and ZAO. As mentioned, the so called joint ventures as well as franchising, especially for commodities, are also preferred among foreign investors.

4.3 Conclusions

Due to the minimized business risk and the flexibility in the decision making process and in the structure, the limited liability company and the closed joint-stock company are the corporate forms that foreign investors usually prefer.

In particular, if a foreign investor wishes to open a 100% affiliate he should choose the OOO, which has the simplest structure, since its norms are optional and it takes one month earlier than the ZAO to be founded. If a foreign investor wishes to collaborate with a Russian partner (joint venture) then it is advisable to turn to the ZAO, which represents a more stable corporate form. In this case, the foreign investor must test all the assets of the company as well as all the legal aspects in order to detect any possible economic and legal risks. This procedure is the so called "Due Diligence" and is extremely important for every investor who wants to minimize the risks of an investment in a foreign and unknown market. In addition, the foreign investor should pay attention to the participation shares, namely high participations percentages (i.e. 50% to 50%) should not be acceptable. Despite the fact that foreign companies are treated equal to national ones, laws are mostly in favor of the national companies. That is one of the advantages of a joint venture as they are enjoying the benefits of Russian companies.

Last but not least, due to the boom of franchising firms one should mention that the risk of product copying is extremely high in Russia. This trend influences lots of foreign products. For these products that the literary property is violated the products' copies represent the 65% of the total (i.e. CDs), the 90% for software products and the 75% for films. As for the trademark products, cosmetics, perfumes and clothes copying is particularly notable, while in medications copying holds the 12-15% of the total. Although Russia is a member of the International Organization for the protection of the industrial property, the protection of trademark is the main concern for foreign companies. Russia – as well as Greece – is member of the "Madrid system" for the international registration of brand and trademark of products, which is regulated by the Madrid Agreement of 14.04.1891 and the Madrid Protocol of 26.6.1989. This system provides the opportunity of obtaining the title of an international brand protection certificate in many countries. However, Russia obliges each applicant that already possesses this international certificate to make a special request at ROSPATENT through a representative “agent” recognized by it. Finally, each registration is renewable. As a result, in order to avoid a trademark copying (i.e. case of IKEA in Russia) it is advisable to re-register and re-patent the trademark in Russia.

5. REAL ESTATE

5.1 General provisions for foreigners

The natural foreign and legal persons can buy or lease from the State land (taking into consideration the existent exceptions). From the possibility of purchasing are excluded:

1. the borderlands
2. and territories that are protected according to the new real estate code and the federal laws.

The norms for the agricultural land differ since foreign subjects do not have the right to purchase land but only to lease for a renewable period of usually 49 years. In addition, Russian legal entities in the capital of which foreign participation does not overcome the 50% do not have the right of agricultural landholding.

Each foreign natural and legal person can become the owner of a real estate through purchasing or/and through construction.

6. FOREIGN DIRECT INVESTMENTS

6.1 Introduction

First of all, foreign investment is defined as a capital deposition to a commercial activity in Russia by a non permanent resident. The law suggests an unlimited catalogue of possible investment forms: cash deposition, deposition to real estate, to currency or rubles etc.

6.2 The basic legislative frame

The legislation about foreign direct investments consists of the Federal Law "About Foreign Investments" which has been in force since 14.07.1999 and was designed to enhance FDI.

The basic guarantees are:

- The foreign investors have equal rights to the Russians.
- Any restrictions on rights of foreign investors may be imposed only by federal laws and only to the extent necessary for the protection of the fundamentals of the constitutional regime, morals, health, rights and lawful interests of other persons, and for the provision of national defense and security.
- The foreign investors are granted the right to reimbursement for losses inflicted by unlawful actions (or omissions) of state or local authorities.
- The clean business profits are disposable and free to get repatriated.
- The foreign business fund is allowed to participate in the procedure of privatization of Russian economy.
- The foreign investors have the right to posses and use land, real estate and natural sources.

In addition to the guarantees above:

- The fifth article of the Law mentions the superiority of international treaties compared to the national law
- The Law confirms the guarantees offered by the Constitution and the Civil Code
- The Law “About Foreign Investments” emphasizes the cases when a foreign enterprise holds at least 10% of the share- capital, when the investments are laid on firm capital in a foreign company’s subsidiary and when leasing activities are taking place by a foreign investor.
- The foreign investments which take place in banks, credit institutions, insurance companies and non- commercial organizations, are being adjusted by other regulations.
- The ninth Article of the Law refers to some special tax facilities, such as no further increase of the import duties and federal taxes for a period. These facilities are applied to (a) Russian enterprises in which the foreign capital exceeds the 25% of the share- capital (b) foreign investments or Russian enterprises with any percentage of foreign participation, only when the business plan belongs to the category of “priority plans”
- As we see, the law makes out the “priority investments” amongst the direct investments. These are :
    - Foreign investments which exceed the amount of 1 billion Rubles (or equivalent amount to foreign currency)
    - Participation of the foreign investor in the share- capital of commercial companies with investment which exceeds the amount of 100 Rubles
    - In any case though, the business plan must be included in an catalogue of plans which are approved by the Russian Authorities
- Finally, the taxpayer who lives in Russia and has also paid tax to a foreign country due to profit by business abroad is entitled to reduced taxation in Russia.

6.3 Motives for foreign investments in Russia

There are some propitious motives which a company can take advantage of during its establishment in Russia:

- The relatively low tax factor which is imposed to enterprises' profits and runs to 24%.
- Every foreign investor who invests in the equipment of a company in Russia is excluded by tariff duties and VAT. According to the government edict 883 of July 23rd 1996, the equipment stuff is excluded by tariffs when: (a) it is not amenable to special consumption taxes (vehicles are excluded) (b) when it's considered as real estate (c) it's considered as industrial equipment (d) it's imported temporarily (e) its total worth is lower than the share- capital of the company (f) it is used directly for the object of an activity, according to the articles of association.
- Motives at the special economic zones: the law about the foreign investors of 1999 creates some special free economic zones in Russia offering various motives in investments' benefit. These motives can be propitious taxation, privileged tariff regime, simplification of procedures etc. Yet, the regime of these special zones is not considered to be working effectively. Among the almost 20 special economic zones, only the one of Kaliningrad works at a satisfying level.
- Motives to foreign investments are also offered to some districts: some districts (Novosibirsk, Nizhniy Novgorod, Tararstan, Yekaterinburg, Rostov, Samara, and Kazan) offer more motives to attract foreign investments, such as decreased taxation factor for the business profits by 4%. The policy of attracting foreign investments can also get the pattern of support to new technologies and in that case, new technologies parks are running in order to sustain the small and medium enterprises and to provide them with the motives in order that they can rent spaces and borrow money in supported rates of interest.

6.4 <u>Access to the Russian market</u>

The Greek and communal enterprises are facing difficulties while trying to access the Russian market, due to its particularities[8]:

- The labor legislation and the employment policy are obsolete.
- The property regime is vague.
- The investing framework for large size enterprises is unstable.
- Compound regulations as well as practices of evaluation and inspection of credit institutions are not applied.
- The public authorities reveal bureaucratic inflexibility while operating.
- The regime of intellectual and industrial property is also vague.
- There are difficulties in editing permissions for raw materials and food imports.
- The legislation which rules the commercial and investing policy in Russia falls short of transparency.
- The Russian government imposes measurements in an unpredictable and unwarned way.
- The Russian patterns are not fully aligned with the international ones. Besides, the entrance of Russia to WTO is still pending.
- The internal waters of the country are closed to foreign ships until 2008 at least. Russia adduces in its defense the bad condition of its rivers' and lakes' navigation net, which ambushes dangers for the transportations.

- Although the are many difficulties for a foreign company to enter the Russian market, a successful business requires a specific and well studied plan, a cooperator who speaks the Russian language and

[8] Embassy of Greece in Moscow-Russia, Office of Economic and Commercial Affairs, Institutional – Investing Framework in Russia, p. 45-51, 2007 at www.agora.mfa.gr/russia.

last but not least, investment in time and money. Due to the flexible character of the institutional framework and the market's conditions (for instance, commercial centers and department stores change the structure and the pattern of the distribution nets), the factors mentioned above are very important for successful activities in the market of Russia.

- Another thing which import and investing enterprises should keep in mind is the fact that the available income of Russian consumers has increased and over- consumption is their characteristic.

As a conclusion, although the Russian market is particular, all international offices of evaluation of business risk estimate that the condition of the Russian market has been improved the latest years since : (1) Russia doesn't face problems with external debts anymore because the government has already used the incomes from oil exports in order to pay out the biggest part of the debt in advance (the country has returned all the loans to the Parisian Club since August 2006) (2) the level of gross national product is highly raised due to oil exports and internal consumption (3) the middle class earns a constant ongoing income especially in Moscow and other big cities (4) the Russian industries are being updated and (5) the International Office of Evaluation "Standards & Poor's' Fitch" lifted up the borrowing ability of Russia from BB+ to BBB+ in July 2006.

6.5 Institutions and enterprises which support FDI

- A "Department for Attracting FDI" is operating within the Russian Ministry of Financial Development and Trade in order to coordinate polices for attracting FDI and to provide with essential information.
- The local authorities supply with additional motives the foreign investors quite often.

7. THE EVOLVEMENT OF FDI IN RUSSIA

The FDI in Russia were anemic during the ‘90s in comparison to the possibilities of the country. The most significant reasons for this situation were the political and economic uncertainty, the widespread corruption and also the taxation and regulative environment, which aggravated the business conditions. The total amount of FDI is estimated around $20 bill for the whole decade.

That condition is different today. The FDI are increased rapidly, since their total amount was $60 bill the triennium 2003- 2006. It is obvious that not even the Yukos case affected much the upward drift of the FDI in Russia. Yet, the investing level is still low in Russia if we compare it to other countries with the same rate of development[9].

YEAR	% GDP
2003	16,5
2004	16,1
2005	16.4

[9] Embassy of Greece in Moscow-Russia, Office of Economic and Commercial Affairs, Russia: Economical and Commercial Developments, Moscow, August 2007, pp. 37-39, at www.agora.mfa.gr/russia.

According to official data the FDI represent 18% ($26,3bill) of the Russian gross national project in 2006, while the same percentage runs into 25% for other countries which are also in the same developing process. The main obstacle for foreign investments in the Russian market is bureaucracy: the procedure for editing a residence license and visa, corruption and controversial legislation. Indeed, according to the research of Transparency International Institution in 2005, the level of corruption has risen up in Russia the latest four years and the country is enlisted at the same level with Albania, Nigeria and Sierra- Leone. The main cause is referred to be the lack of measurements taken by the government in order that the problem is confronted. The fact that the condition of corruption has worsen, indicates the distance between the public statements of the Russian government and reality. Moreover, the results of the research may be related not only to the fact that transparency is reduced within the Russian government but also to the fact that independent organizations and media are restricted. A special Russian state service was founded in 2003, but apparently didn't bring out the desirable results. Besides, its manager was fired in 2004, facing himself corruption accusations.

Still, there is high eagerness for reinvestment of profits and actually, the 91% of the foreign investments are interested in reinvesting their gains in the Russian market. This fact shows that foreign investments are beginning to trust the Russian economy and that business condition is improved. The reasons why the investments in Russia are increased are briefly the evolvement in credit system and the instituted tax motives which simplify the reapportionment of profits made by the big export companies, attracting in this way new FDI in the fields of industry and technology transformation, both in levels of production and organization.

As a conclusion, the Russian government confronted initially the problem of capital leak, was aware of the small amount of FDI and created motives (as mentioned above) for attracting them. The point is that there are still some problems which must be confronted so that the amount of FDI is representative to the possibilities of the country: corruption, simplification of the tax system, access to WTO etc.

8. MAIN INVESTORS AND FOREIGN INVESTMENTS IN RUSSIA PER SECTION AND AREA

First of all, the first investor in Russia for 2006 according to ROSSTAT is E.U. which holds the 76% of the total FDI. Among the European commercial associates, the most important are Germany, Great Britain, France and Italy. On the other hand, USA holds the smallest percentage (5%)[10].

The 55% of FDI in 2006 came from Holland, Cyprus and Luxembourg, since these three countries are known receivers of Russian capital which leaks abroad and there are many companies in their land which belong to Russians. So, it is a safe estimation that a big part of the funds coming from these countries comprises repatriated capital.

FOREIGN INVESTMENTS IN RUSSIA ($ MIL)

ORIGIN COUNTRY	**PERCENTAGE**	**2005**	**2006**
CYPRUS	27%	8.431	6.173
LUXEMBURG	22%	5.473	4.903
GREAT BRITAIN	20%	6.988	4.520
HOLLAND	9%	5.107	2.056

[10] Embassy of Greece in Moscow-Russia, Office of Economic and Commercial Affairs, Institutional – Investing Framework in Russia, pp. 48-50, 2007 at www.agora.mfa.gr/russia.

VIRGIN ISLANDS	7%	805	1.565
GERMANY	4%	1.733	952.9
FRANCE	2%	2.332	408.7
SWITZERLAND	2%	1.558	435.8
AUSTRIA	1%	811	-
USA	1%	1.850	201.6
TOTAL	100%	15.500	26.277

Between the countries of Commonwealth, Russia has strengthened its commercial ties within the framework of EVRAZES (Eurasian Economic Association) which besides Russia includes Belarus, Kazakhstan, Uzbekistan and Tajikistan as well. Ukraine and Belarus remain the main commercial associates of Russia within the Commonwealth of Independent Countries.

As far as the FDI per geographic area, Moscow and the district of Moscow hold nearly 50% of the total FDI, Saint Petersburg follows but it doesn't attract big investments, while the big centers which produce petroleum products and natural gas, such as the Urals department (Tioumen) and the Sakhaine island, hold bigger percentage. Besides, there are some industrial districts which attract very important FDI by offering motives which protect the investors. (See annex for more details, table 1)

As far as the FDI per section is concerned, the sections which attract significant FDI are excavation of petroleum products, industry and the field of updating petrochemical establishments. Moreover, the chain stores and trade in general, the field of natural gas distribution and electricity are raising their participation constantly. (See annex for more details, table 2)

9. THE GREEK INVESTMENTS IN RUSSIA

While studying the data of Greek investments in Russia and the Russian investments in Greece, we notice that both activities fall short of the vigor that characterizes the two countries. Yet, new possibilities for expanding the accessory investments are coming along, since the two countries preserve political, religious and economic relations traditionally[11].

COMMERCIAL RELATIONSHIPS BETWEEN RUSSIA AND GREECE (MIL. EUROS)

	2003	**2004**	**2005**	**2006**
TRADE VOLUME	2.663	2.565	3.665	4.018
GREEK EXPORTS	285.0	262.0	275.7	441.1
GREEK IMPORTS	2.378	2.303	3.389	3.577
TRADE BALANCE	-2.092	-2.041	-3.113	-3.135

Source: National Statistical Office of Greece

In 2006 the total trade volume is 10% increased and reached 4.018 mil Euros. The Greek investments in Russia run into 2, 5 bill Euros in invested capital and the

[11] Embassy of Greece in Moscow-Russia, Office of Economic and Commercial Affairs, Institutional – Investing Framework in Russia, pp. 50-52, 2007, available at www.agora.mfa.gr/russia.

main fields which the Greek companies take action in are trade (mostly fur, clothes, food and fruit), tourism and transportation.

- The biggest Greek investment in Russia belongs to the Greek Bottling Company 3E which comprises almost the half of the total investments. The company keeps the rights on Coca Cola's trademark for the dominion through the subsidiary Coca Cola HBC Eurasia. It owns 11 bottling factories and it accomplished the biggest foreign investment in Russia (apart from the energy field) in 2004: it took over the juice company Multon (second most important company for juice production in Russian market) in common with the Coca Cola Inc of USA.
- The Frigoglass company (subsidiary of 3E) has an important presence in the Russian market too and keeps a factory in Orel city (south of Moscow). This company provides 3E with professional refrigerators, so that the latter company can dispose its products throughout Russia.
- The Chipita company preserves a productive unit as well in Saint Petersburg through which it channels its products (confectionery) into a very large number of selling spots. It also performs exports.
- Other important presences of Greek companies in Russia are PLASTICA CRETES, which took over a company of colors' raw material in Saint Petersburg, SARANTIS which deals with import and distribution of cosmetics in the attractive market of Russia, MECHANIKI, GEK and AKTOR which have taken on the constructing and exploitation of the sites at MKAD- the external circuital road of Russia, PROMETEI which keeps a factory of cement production, Media Strom, Intracom- Intralot and many more.

The mixed Greek-Russian companies are estimated around 71 and according to the Special Chamber of Registration in Russia, their activities take place mostly in trade, agriculture, industry, services supply, tourism, construction, energy, transportation and technology.

According to the Greek offices, there are business collaborations of about 500 Greek and Russian companies which work on the sections of telecommunications, tourism, navigation, trade, industry, processing food and small and medium enterprises with consuming supplies.

Moreover, the Burgas – Alexandroupolis agreement on the homonymous pipeline, the agreement on the pipeline of natural gas “North Stream” and other prospective settlements on the energy section, indicate willingness by both sides for reinforcing their cooperation.

Russia and Greece have also singed a bipartite Arrangement on Investors Protection which has been in force since 23/2/1997. This agreement adopts the principle of no discrimination. In the meantime this very principle is also adopted by the agreement signed between EU and Russia (article 28) on June 24^{th} of 1994.

Finally, Russia is also member of the Multilateral Guarantee of Investments Office, called MIGA.

Any foreign businessman, who attempts to access the Russian market, should keep in mind a very important factor: the changes in the business scene and the conditions of the market are also changing the facts. For instance, the foundation of big commercial centers and the operation of department stores alter the structure and form of the distributive nets. Therefore, the success of Greek and foreign businessmen generally depends on three consequences: the choice of a well studied project, finding a cooperator who speaks the Russian language and of course, time and money investment. Of course, the products offered to the Russian market should be of good quality. Another fact that the exporting and investing companies interested in the Russian market should look into, is that the dispensable income of the Russian consumers has risen and that their new characteristic is over- consumption.

10. PRIVATIZATION – DENATIONALIZATIONS

Law order[12]

Foreign investors are allowed to posses the maximum of 15% of the total shares as far as the most significant enterprises of strategic importance are concerned. Special limitations are enforced in the financial field as well.

In 1997, the foreign participation in the 100 largest companies of the country ascended to 12%.

Privatization process

A' Privatization phase (1992-1994): the government started to offer to public bonds and shares of governmental enterprises, meaning in reality that due to the property scattering, the undergoing management kept on having the control of the companies. However, 15.000 companies had been privatized in this way.

B' Privatization phase (1995- onwards): the main focus was on the property gathering. Nevertheless, the sale of precious property – usually in an opaque manner and in low price – privileged certain economic circles close to the government. In the essence, that is when the "economic oligarchy" took shape, which actually still dominates in the country's economy. The base line aimed at the loaning of Yeltsin's 1996 pre-election campaign, with shares of governmental enterprises as guarantee. Afterwards, the state didn't manage to pay off those loans and the oligarchy banks sold up the shares in very low price through auctions. The competition processes are considered to be improved only after 1998.

[12] Embassy of Greece in Moscow-Russia, Office of Economic and Commercial Affairs, Institutional – Investing Framework in Russia, pp. 38-39, 2007 at www.agora.mfa.gr/russia.

PM Putin set the target of the oligarchy abolishment, so that a new transparent economy will rise and operate according to the power of the market and not of political connections. However, the handling of the oligarchy proved to be a selective process. For example, in 2003 Kremlin moved against Michael Khodorkovsky, owner of Yukos oil among others. The case was closed in 2005-2006 with the re-nationalization of Yukos and the sentence of Khodorkovsky into 8 years imprisonment. In any case, the "nationalization" of Yuganskneftegaz Company – Yukos' subsidiary – through opaque process questions government's intentions. Yuganskneftegaz holds 17% of the official Russian oil reserve.

New Privatization Law of April 2002: introduced new privatization methods, such as sale of shares in the stock market, and limited older methods i.e. sale of shares to employees.

Main characteristic of the government from 2005 is its noticeable presence in the economy and not in the privatizations. The plenty of capital prevents from privatization of public companies or even their management improvement.

Additionally, the structural changes that are immediate necessary for the country show huge delays. The reformation of power market is behind schedule, the managerial reformation has been halted and the restructuring of gas market never started. Alike, the tax reformation stopped at the 2nd phase out of the totally 3 phases, under the fear of social reaction. The failure to reform the gas market complicates the efforts of restructuring the power production and delivery. Moreover, it restricts the possibility of the enlargement of the gas market that could have been achieved through some corrective steps. Since the governmental monopoly of the gas network (Transneft) is being maintained, the rest investors do not make any investments resulting in low magnitude investments[13].

[13] Embassy of Greece in Moscow-Russia, Office of Economic and Commercial Affairs, Russia: Economical and Commercial Developments, Moscow, August 2007, p. 23, at www.agora.mfa.gr/russia.

Nowadays, the main de-nationalization program in progress concerns the field of electric energy, where the target is the creation of wholesale market. It is certain that the delivery network will remain under state's control.

Criticism: despite the fact that PM Putin set as main goal the restriction of the government's role in the economy and the fight against bureaucracy, still he persists on giving directions of nationalization of strategic fields of the economy, especially of the energy field (the monopoly of government's Transneft gas network has been maintained), where the foreign investors are allowed to possess 15% of the total shares the most. In this way, despite of the privatization of the petroleum and natural gas fields, the state's interference has been enforced, while the foreign investors turned into the privatizations through the Moscow's stock house and especially the purchase of large Russian enterprises' shares. Therefore, it's not clear yet whether the government's intentions move towards liberation of the markets which are still under state's control or preserving significant fields of economy under suffocative control. The statements of Putin's government do not align with the showed intentions and actions taken.

11. RUSSIA AND INTERNATIONAL ORGANIZATIONS

Since 1990 many international organizations have expressed their interest in including Russia among their members, something that really helped the country to its political, social and mostly financial and investing development[14].

European Union: Russia's membership in EU begins in 1990 with a support program for USSR which included food provision and certified trust for food imports. It also contained a program of technical help aiming at reformation of the economy. Later on, in 1997, the agreement on Corporative Relation and Cooperation between Russia and EU got in force and a Common Strategy of EU towards Russia was adopted in 1999. Russia expanded the latter agreement to the new members of EU in 2004. In the meantime, the regime of effective market for Russia was adopted by the Summit Council of E.U - Russia in 2002, giving the ability to Russia to avoid the antidumping procedure through the communal policy. The 15th Summit Council decided in 2005 the construction of a pipeline in North Europe between E.U. and Russia.

EBRD – European Bank of Reformation and Development: Russia has been a member since 1992 and the country comprises the main destination of EBRD's help (over the ¼ of the organization's investments). Six sections which need support were defined in 2004- 2007 : modernization and infrastructure projects, reinforcement of the private sector, efficient governance, reinforcement of the energy section, development of credit constitutions. EBRD suggested in 2006 the development of hotel infrastructures and announced its intention to invest 24 mil euros therefore.

World Bank: Russia became member of the four Organizations of the World Bank, BIRD, IFC, AID and AGIM in 1991 and took advantage of $50 mil initially. However, the WB announced in 2006 that the minimum annual help for Russia would be between $230- $600 and its strategy towards Russia for the period 2003- 2007 would

[14] www.agora.mfa.gr/russia.

have three priorities: improvement of the business conditions, support of competition and modernization of public section.

Word Trade Organization (WTO): USSR was participating in WTO as an observer and Russia as the successor state, took on all of the rights and obligations of USSR in 1992. Russia has been in negotiations with WTO since 1995. However, the European Union agreed on Russia’s accession to WTO quid pro quo joining Russia the Kyoto Agreement. China is also disposed positively to Russia’s entrance to WTO, but the potential of accession is still far. The object of research is the cutback of Russian import duties and of the non- tariff restraints (quota, checks etc), as well as of the opening of Russian service section (financial, telecommunications, transportations etc).

The issue of Russia’s entrance to WTO is of sublime importance for Russia itself, E.U. and Greece which supports Russia actively. Greece believes that this drift would contribute to strengthening the international trade system and would minimize the chances of a commercial conflict.

12. COMPETITION DISTORTIONS AND MARKET INEFFICIENCIES: STATE INTERVENTIONISM AND SOCIOPOLITICAL INFLUENCE IN RUSSIAN FEDERATION

12.1 The economic framework: market transformation and reform challenges in Russia

The empirical analysis of market transformation and structural reform process in post- communist era indicates two distinct political periods: B. Yeltsin's and V. Putin's presidency respectively. Though easily perceptible in terms of political dominance, this methodological approach relies mostly on crucial differences in economic policy objectives and priorities of each period.

In the early '90s, the reform process took place in the midst of a severe economic crisis (**transition shock**) setting therefore a strict policy framework. In that sense, the main priorities were macroeconomic stabilization, state reconstruction and marketisation. The early stage of transition from a central - planned economy to a market one was marked by the set of fundamental market foundations such as the implementation of *price and trade liberalization* as well as large - scale *privatization*.

However, political realities imposed limits on the speed and the width of market reforms. For instance, price liberalization proceeded relatively slowly, as many regional authorities feared the popular response to any rapid elimination of price controls on basic necessities, while the federal government considered the impact on industry of liberalizing energy prices[15]. Furthermore, selective trade liberalization and non - transparent privatization methods were the socioeconomic outcomes of extensive and efficient political influence of powerful interest groups and certain domestic constituencies[16]. Apart from the political constraints generated by influential 'insiders', the reform process of Yeltsin's era was further hindered by the external

[15] Ahrend R. and W. Tompson, Fifteen years of economic reform in Russia: What has been achieved? What remains to be done?, Economics Department Working Paper No 430, OECD, 2005.

[16] Farby N. and S. Zeghni, Foreign Direct Investment in Russia: how the investment climate matters, Communist and Post - Communist Studies, 2002, p. 289-303.

shock that hit Russian economy (the 'Asian' crisis, 1998) and the subsequent unflattering economic conditions.

The significant point that differentiates the two periods is the substantial change in the macroeconomic context. In stark contrast to Yeltsin's era, when the macroeconomic crisis management was on the top of economic policy agenda, Putin's accession concurred with a largely unexpected economic recovery, shifting thus policymakers' priorities from macroeconomics to essential micro - level reforms[17]. Undoubtedly, the propitious circumstance in international energy markets contributed a lot to a steady economic boost and therefore to a dramatic economic upturn. Since late 90's Russia maintains strong GDP figures and rather stable macroeconomic conditions. Indeed, the favorable economic environment in Putin's years created an unprecedented 'window of opportunity' for widespread institutional and structural reforms. Thereby, the new reform process' orientation was *to strengthen the basic institutions and framework conditions for a modern market economy.*

Despite the unquestionable progress so far, deep and extensive institutional and structural weaknesses still remain a critical factor of economic inefficiencies. The outstanding economic growth depends heavily on energy (high oil prices), otherwise it is particularly one - sided and relatively circumstantial. Hence, the consolidation of long - term determinants of growth is the ultimate policy goal of the contemporary reform agenda. Consequently, Russia's long - term growth prospects depend to a great extend on its progress in establishing the rule of law and the security of property rights, strengthening open and fair competition, enhancing the transparency and accountability of state institutions, eliminating corruption and bureaucracy and boosting foreign and domestic investment.

12.2 Theoretical aspects on competition policy and foreign investment prospects in transition economies

The role of competition policy in advanced market economies is to establish the essential framework conditions for *open and fair competition*. Unhindered and fair

[17] Tompson W., Putin's Challenge: The Politics of Structural Reform in Russia, Europe - Asia Studies, Vol. 54, No 6, 2002, p. 933-957.

competition implies the elimination of explicit and implicit state protectionism, otherwise that all economic sectors are open to foreign investment and operate in a truly transparent and unbiased policy framework.

However, totally open and free competition regimes are extremely difficult to be achieved, even more in developing market economies since economic policy is subjected to inevitable *sociopolitical constraints*. **Formal governmental ideology**[18] *and* **the influential role of lobby groups** in decision making process often induce the consolidation of preferential and discriminatory competition frameworks[19]. Moreover, systematic and persistent violation of free competition rules and non - transparent practices undermine the smooth market procedures, distort economic incentives, diminish long - term productivity and growth prospects and thus create a hostile economic environment for foreign investors. For instance, unwarranted state intrusions to market functions such as preferential agreements and discriminatory subsidy policies to powerful domestic lobbies, uneven law enforcement at the expense of foreigners and arbitrary institutional regulations that set restrictions to international capital flows restrain investment inflows and hinder economic modernization.

Furthermore, in transition economies the preferential competition policy is strongly related to the politically **selected privatization methods** and the system of corporate governance. The non - competitive privatization methods, widely known as the methods of “insider privatizations”, were implemented under the excessive socioeconomic pressure produced by the transition shock period[20]. The extremely high social risk and the distrust of foreign funds obliged policymakers to transfer the ownership of state enterprises to the ‘insiders’, that is, the managers and the employees of the firms. Such a method of privatization directly excluded international funds from participating in the newly privatized enterprises but also created a favorable political climate for powerful domestic lobbying. In addition, ‘insider privatization’ contributed

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[18] The ideology of ‘economic patriotism’: governments consider specific economic sectors as strategic and therefore raise official and unofficial barriers impeding foreign investment.

[19] Skotiniotis A., Why has Russia failed to attract F.D.I?, 2007, Dissertation paper available at www.cere.gr.

[20] Earl J. S. and S. Estrin, Privatization Versus Competition: Changing Enterprise Behavior in Russia, 1996, IIASA Working Paper 049, available at www.iisa.ac.at.

a lot to the poor performance of the former state firms, as they were transformed into more opportunistic and rent - seeking institutions than modern market - oriented enterprises.

12.3 Competition distortions and political constraints in Russian Federation

The extensive violation of open and fair competition is the fundamental obstacle that depresses domestic business initiatives but also the major constraint to foreign direct investments. Using a statistical index to illustrate the magnitude of this phenomenon, the Russian 'investment freedom' indicator is only 30% (100% equals the most free) in 2007, far below the world average[21]. The closed and unattractive investment environment is the normal outcome of several official and unofficial barriers that impede foreign investments. Officially, Russia restricts inter alia investments in aerospace, natural gas, large - scale construction projects, electric power and natural resources, that is, the strategic economic sectors, while uncontrolled corruption and malfunction of state institutions are important informal impediments to F.D.Is.

The state interventionism and the extended economic protectionism can be attributed to three main factors: **governmental policy priorities**, **powerful vested interests** and **political culture**. The political culture is related to strong and prevailing beliefs and policy concepts among a significant number of Russian statesmen regarding international political economy and foreign investments. Russia's political and social history, even before the Soviet period, has been one of isolation from the West and distrust of the 'outside' world. Since ideological and cultural attitudes change relatively slowly, many members of Duma and policymakers distrust international investors and perceive foreigners' motivations as untrustworthy and exploiting[22]. In that sense, the widespread, albeit obsolete, ideas of internal development and independent economic growth suggest a remarkable political opposition to foreign business activities.

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[21] 2007 Index of Economic Freedom at www.heritage.org.

[22] Ogotcu M., Attracting foreign direct investment for Russia's modernization, Battling against the odds, OECD - Russia Investment Roundtable, 2002, Saint Petersburg, Russia.

Furthermore, formal state ideology and competition policy practices indicate the governmental deep consideration on the key role of state control over strategic (e.g. energy) economic sectors. This ideological orientation partly interprets the modest achievements in the contemporary structural reform political agenda, especially in reforming state monopolies and enhancing competition. Actually, while market - oriented reforms have been de-emphasized somewhat, the government has undertaken a number of initiatives aimed at defining a rather more active state role in economic development[23]. Indeed, there has been an explicit policy trend towards expanding state ownership and direct intervention in all strategic economic sectors.

The persistent maintenance of public or semi - private monopolies in vital economic sectors and the direct exclusion of foreign investors inevitably lead to the strong concentration under the state control of crucial 'heavy' industries. Such market distortions, weaken the competitive efficiency of state enterprises and undermine the long - term productivity and growth prospects. A clear - cut example, is the ominous predictions about the ability of the state - owned gas monopolist Gazprom in meeting its supply commitments by the end of the decade due to lack of efficient investment[24].

Consequently, the expansion of state ownership (overconcentration) and the direct state interference in the operations of 'strategic' enterprises distort both the development of such firms and the markets in which they operate. The trend towards greater state ownership contributes to more rent - seeking, less efficiency and increased corruption, that is, creates a totally unattractive market environment for investment and foreign participation[25].

The formal violation of 'open competition' in the strategic economic sectors is accompanied by informal impediments to those markets where competition is officially open (open competition does not always mean fair competition). Illegal or indirect preferential treatments and tacit agreements to domestic enterprises from the governmental or the administrative authorities is a common phenomenon in Russia.

[23] OECD, Economic survey of the Russian Federation, November 2006.

[24] Andrianopoulos A., Competition, Growth and the prospects of the Russian economy, 2007, available at www.andrianopoulos.gr .

[25] World Bank, From transition to development, A country economic memorandum for the Russian Federation, 2005, Moscow.

For instance, taxation avoidance, direct or indirect subsidization, illegal bureaucratic facilitations and severe purposeful inconveniences to foreigners by state agencies are particular methods of unfair treatment and competition distortion.

It is general wisdom that the unfair competition practices result from the extensive activity and the political power of special interest economic groups, widely known as the 'oligarchs'. Undoubtedly, during V. Putin's administration the political influence of those powerful lobby groups has been diminished comparatively to B. Yeltin's era. Nevertheless, the role of such groups in the decision making process still remains important and to a great extend is responsible for foreigners' reluctance to invest in Russia. Internationally compared, Russia acquires the fourth place among 21 countries regarding the power concentration of vested interest groups[26].

The source of vested interests' power is the strong and well - developed networks with state and public bureaucracy. The overwhelming 'clientelism' and the politicization of public administration emerged from the Soviet and post - Soviet state building strategies. The Soviet institutional legacy, particularly the inseparable political and administrative spheres and the lack of autonomy of the administrative bureaucracy, originated the framework conditions for the state penetration and institutional 'capture' by the ruling parties and the resurgent pressure groups[27].

In that sense, the political and administrative corruption strengthens the consolidation of power of pressure groups at the expense of other economic agents (e.g. foreign investors). For instance, even in non - protected sectors, domestic powerful lobby groups are still often favored towards foreigners through indirect (and illegal) governmental and administrative preferential treatments. However, the major success of the most powerful lobbyists (the oligarchs) was to maintain their sectors protected erecting unrivalled barriers to foreign investments, undermining thus market competition and the social interests. Not accidentally, the great majority of

[26] Skotiniotis A., 2007, p. 28.

[27] Tompson W., From 'clientelism' to a 'client -centred' orientation? The challenge of public administration reform in Russia., Economics Department Working Paper No 536, OECD, 2007.

international researches for the investment climate in Russian Federation indicates corruption and 'lobbying' as the fundamental obstacles to F.D.Is[28].

Apart from the manipulation of state administration and the above mentioned methods of privatizations, the prominent role and the influential political activities of several interest groups are facilitated by the political and institutional structure. Unlike mature west democracies where developed institutional and political systems of 'check and balances' exist, the over - presidential Russian political system and the insufficient democratic institutions contribute to the lack of effective political scrutiny of governmental power. In this political and institutional framework, the Russian politicians are more vulnerable to external pressures from vested interests as well as to illegal attitudes (corruption).

12.4 Trends and prospects of Russian economy after Putin's re- election

The outstanding victory of President Putin's party 'United Russia' has been warmly admitted by international markets. Foreign investors and market observers consider political stability as a prerequisite for the sustainability of Russia's economy booming pace. Relative to this viewpoint, recent publications and economic reports highlight stability as a key variable to economic development. By all accounts, the remarkable victory of 'United Russia' will further reduce the perception of political risk among investors consolidating a favourable environment for international and domestic investments. Moreover, Putin's political ascendancy can be partly interpreted by the wide public acceptance of his overall economic policy.

As far as the economy is concerned, Russia maintains strong GDP figures, estimated at around 7,2 % for this year (see table 1. below). Undoubtedly, Russia's economic boost depends a lot on the propitious energy environment as it is marked by the historically high oil prices. According to Central Bank's estimates, in 2007 oil and gas incomes are going to reach 220$ billion, thus offering a wide range of economic policy opportunities (public investments, social security expenses and wage policy

[28] OECD, Oecd Investment Policy Reviews, Russian Federation, Enhancing Policy Transparency, 2006.

etc)[29]. However, the mass inflow of 'petrodollars' stimulates the national currency putting pressure on the general level of prices. A high inflation rate combined with a 'hard'ruble could inevitably work as a source of destabilization.

Nevertheless, the consolidation of long - term determinants of economic stability and growth is still a matter of uncertainty. Indeed, the extensive and deep structural problems of Russian economy, despite the unquestionable progress so far, call for widespread institutional and structural reforms. In that sense, the main priorities of the new government are the following: establishing the rule of law and the security of property rights, promoting open and fair competition, enhancing the transparency and accountability of state institutions and combating corruption.

Table 1: Economic and Financial Indicators (Data Source: The Economist)

GDP (2007 estimation)	Industrial Production (latest)	Consumer Prices (latest)	Unemployment rate	Trade Balance, $bn (latest year)	Budget Balance (% of GDP, 2007 estimation)	Interest Rates (3 -month latest)
+ 7.2	+ 6.1 Oct	+ 9.5 Sep	5.8 Oct	+121.5 Sep	4.0	10.00

[29] Ria Novosti, http://en.rian.ru.

CONCLUSION

One can infer that despite the latest steps to make judges more amendable and responsible for their acts and more independent, the judiciary is still plagued by corruption and incompetence to take action. In fact, the cliental relations are flourishing in order to reap benefits in the future. In addition, the large number of local laws, ukases, federal laws etc. that are contrary to the constitution and remain to force due to the lack of control from the judiciary are politically and legally dangerous to the normal function of the society. Thus, foreign investors should avoid solving their differences with potential local adverse parties through national arbitrary courts. Instead, they should choose the legal settlement of the International Arbitration, where the parts can agree to the applicable law, the arbitrators and other matters. Most important advantage of this method is that the decision taken can be recognized and uphold in the countries of the parts.

The main problems of the financial sphere are the weakness of the banking system and inefficiency of the financial markets as well as the absence of the controlled the interest rates for the purposes of the macroeconomic regulations.

The main disposable resources of the national banking system will be the households' savings. The size of this resource is significant, characterized as the low cost and can be distributed by the banks on the different purposes – to the financing domestic debt, the investments to the real sector or on the financial markets. The prospects of the accumulation of such resources will depend on the monetary policy and on the conditions of the banking system, including relatively high inflation rates, the monopoly position of Sberbank RF on the individuals deposit market, the high risks of the other commercial banks and others.

Moreover, the latest taxation reform has created financial incentives for foreign investors. On the other hand, the bureaucratic measures remain a major obstacle for a foreign invasion into the Russian market.

As far as the FDI are concerned, Russia has made a lot of improvement as we examine their course from the '90s till today mostly due to government stability that characterizes Russia the latest years. The international organizations in which the country participates have also played a great role therefore. However, there are still many improvements that need to be accomplished so that the value of total FDI images the vigor and capabilities of this developing country.

The main factors that guarantee a spectacular rising of FDI briefly are: fighting off bureaucracy, progress in administrative decentralization, acceleration of privatization, reformation of financial sections and tariff facilitation and of course measurements by the Russian government so that the FDI legislation is actually practiced.

Generally, the financial development of Russia has been impressive however its main problem is that it keeps on depending on the production and export of raw materials. As a consequence, the coincidence of high international prices of oil that characterize our era, do not guarantee the high rates of financial development. However the short- term advantages of this situation is superfluous state budget, high rate of financial development and superfluous trade balance.

Finally, we cannot think of Russian market as fully open and liberal, as state protectionism is still intense. As a result of the privatizations of the period 1992- 1994, 70% of the financial activity has passed to private individuals. However, very important industries (telecommunications, transportation, energy, banks) remain under state control since globalization generates insecurity as far national security, sovereignty and sufficiency are concerned.

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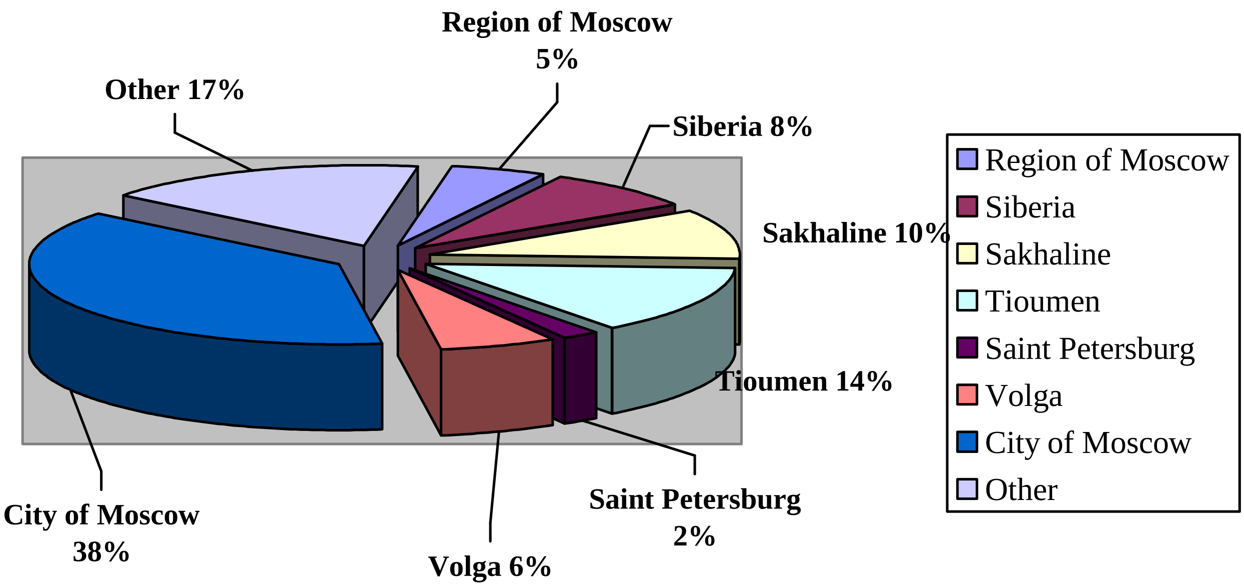
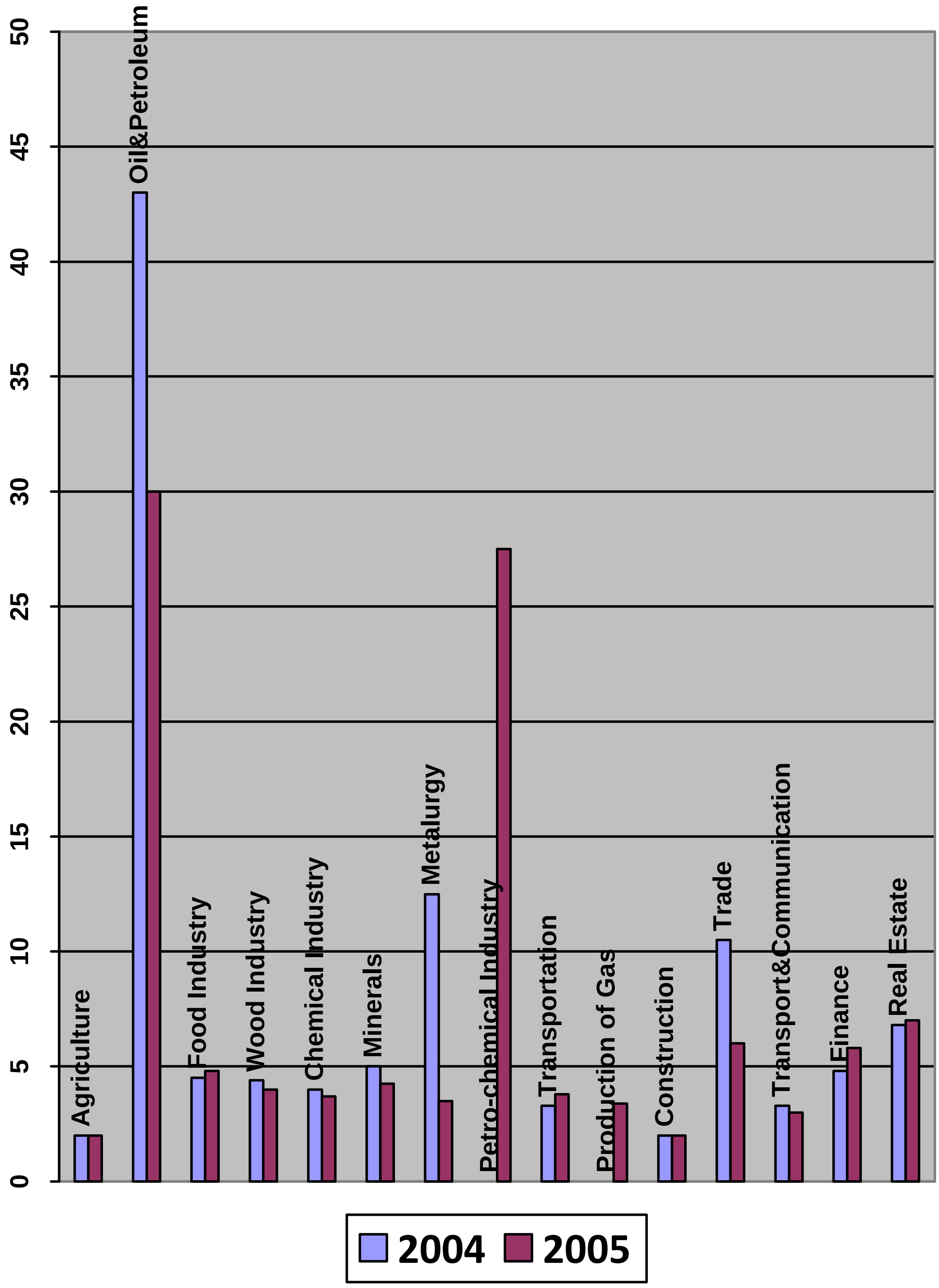
Annex

Table 1: Main destinations of foreign investment in Russia



Source: Embassy of Greece in Moscow

Table 2: Investment in Russia by sectors



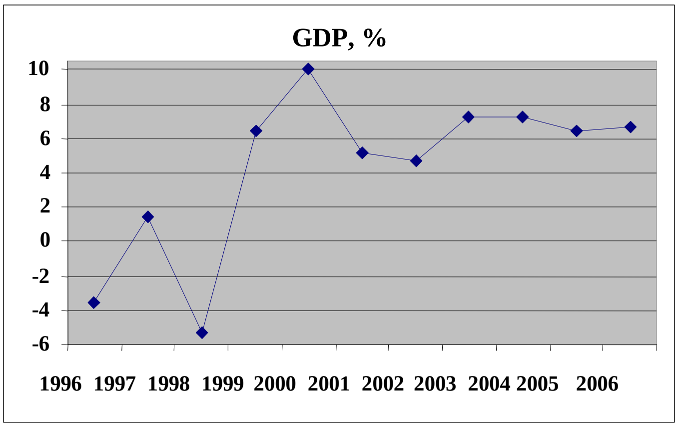
Source: Embassy of Greece in Moscow

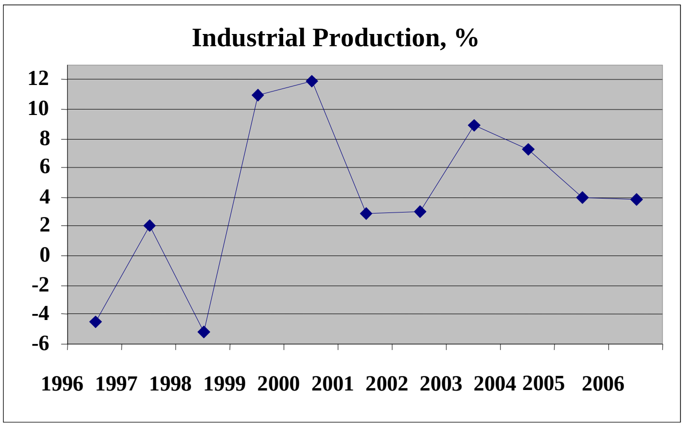
Table 3: Russia's most profitable companies (Rank for 2006)

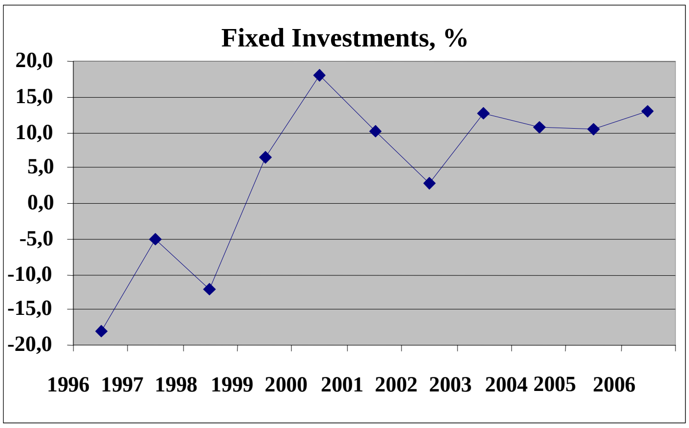
Rank	Companies/Sector	Sectors	Profit 2005 in Mill. Ruble	Profit 2006 in Mill. Ruble	Profit 2006 in Mill. US$
1	Gazprom	Raw Materials (natural gas)	1.383,5	2.152,1	79,2
2	Lukoil	Raw Materials (natural oil)	1.309,4	1.482,9	54,5
3	RAO EES Rossij	Energy	764,7	894,9	32,9
4	Rossijskije Schelesnye Dorogi	Railroad Transportation	748,7	848,9	31,2
5	TNK-BP	Raw Materials (natural oil)	unknown	602,7	22,2
6	Rosneft	Raw Materials (natural oil)	489,8	588,1	21,6
7	Surgutneftegas	Raw Materials (natural oil)	446,3	526,6	19,4
8	Sberbank	Banks	302,1	389,0	14,3
9	Sewerstal	Metallurgy (iron, steel)	295,1	337,8	12,4
10	Tatneft	Raw Materials (natural oil)	300,4	318,3	11,7
11	Norilskij Nikel	Metallurgy (nickel)	194,3	300,9	11,1

12	AFK Sistema	Telecommunications	214,8	295,4	10,9
13	Ewras-Group	Metallurgy	184,1	225,5	8,3
14	Rusal	Metallurgy (Aluminum)	188,1	222,4	8,2
15	Swjasinwest	Telecommunications	193,2	218,3	8,0
16	Transneft	Raw Materials Transport (Pipelines)	179,7	202,4	7,4
17	UGMK-Holding	Metallurgy	unknown	197,0	7,2
18	Slawneft	Raw Materials (natural oil)	186,0	179,0	6,6
19	Magnitogorskij metallurgitscheskij kombinat	Metallurgy	152,2	174,7	6,4
20	Nowolipezkij Metallurgitscheskij Kombinat	Metallurgy	123,8	164,4	6,0

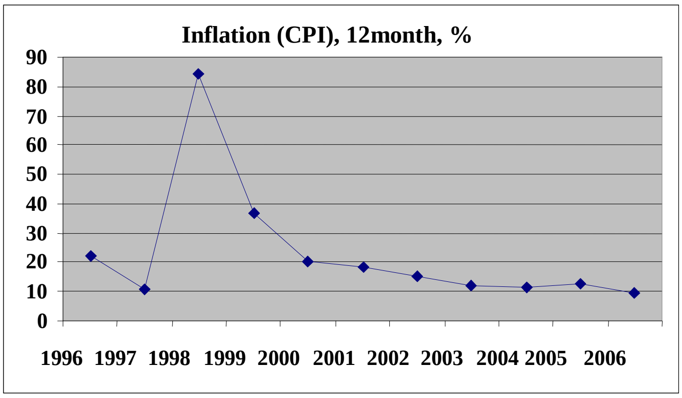
Source: Rating – Expert 400 (published October 2007)



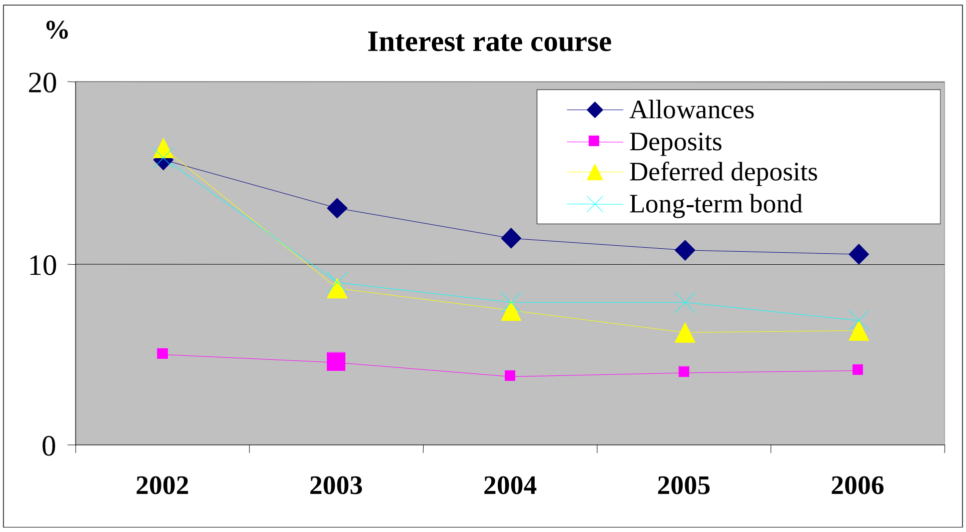




Source: Embassy of Greece in Moscow



Source: Embassy of Greece in Moscow



Source: Embassy of Greece in Moscow

Structure of foreign trade (mill.$)

	2002	2003	2004	2005	2006
Exports fob:					
Oil, fuels, natural gas	56,264	70,190	99,130	154,114	196,804
Metals	14,923	17,432	28,667	34,252	41,835
Mechanical gear	10,048	10,763	12,268	13,521	17,512
Chemicals	7,365	8,426	10,871	14,347	16,916
Total of exports	*107,302*	*135,930*	*183,209*	243,572	304,519
Imports cif :					
Mechanical gear	16,654	19,447	28,752	43,379	65,554
Food & agricultural products	10,341	11,158	12,813	17,403	21,591
Chemicals	7,677	9,103	11,435	16,245	21,579
Metals	2,915	3,614	5,144	6,801	9,615
Total of imports	*67,064*	*80,781*	*75,590*	98,505	128,142

Source: Statistical Service, Customs Service