

## RUSSIA

### TRADE SUMMARY

In 2002, the United States had a trade deficit with Russia of nearly \$4.4 billion, an increase of \$878 million from the 2001 deficit of \$3.5 billion. U.S. goods exports to Russia totaled \$2.4 billion in 2002, a decrease of 11.7 percent from the previous year. Russia was the United States' 39th largest export market in 2002. U.S. imports from Russia totaled approximately \$6.8 billion in 2002, an increase of 9 percent from 2001 levels. The flow of U.S. foreign direct investment into Russia in 2001 was \$231 million, down from \$602 million in 2000. The 1991 United States-Union of Soviet Socialist Republics (USSR) Trade Agreement provides for normal trade relations between the United States and Russia and governs other aspects of the bilateral trade relationship. The USSR signed the agreement in June 1990, and it was approved by the U.S. Congress in November 1991. The agreement, however, was not ratified during the existence of the USSR, and the United States offered the agreement (with minor technical changes) to Russia and each of the other emerging states of the former Soviet Union. Russia's parliament approved the agreement, making it possible for the United States to extend Most-Favored-Nation (now Normal Trade Relations or NTR) status to Russia on June 17, 1992.

Russia is in the process of negotiating terms of accession to the World Trade Organization (WTO). By the end of 2002, the Government of Russia had met fifteen times with WTO members in formal Working Party meetings and many more times in informal Working Party sessions, plurilaterals, and bilaterally. Russia tabled its initial goods and services market access offers in February 1998 and October 1999, respectively. Russia has subsequently revised its goods and services offers and is currently actively engaged in negotiations with Working Party members on those offers.

### IMPORT POLICIES

Frequent and unpredictable changes in Russian customs regulations and erratic customs enforcement traditionally have created problems for foreign and domestic trade and investment. In addition, a burdensome import licensing regime, including quotas for alcohol, has depressed imports of some products, including

products containing alcohol (e.g., some toiletries).

In March 2002, Russia announced a ban on poultry exports from the United States, citing, among other things, concerns with avian influenza. On March 31, 2002, the United States and Russia concluded a protocol that established a framework for closer cooperation between U.S. and Russian veterinary officials and provided for improved certification and testing procedures and led to the resumption of trade flows. Following the negotiation of this protocol, the United States began intensive negotiations with Russia on a new veterinary certificate for U.S. poultry exports which was finalized in August 2002. As part of the implementation of this new veterinary certificate, Russian veterinarians will conduct reinspections of U.S. processing and cold storage facilities, and discussions are currently underway to establish the criteria for these reinspections. In January 2003, the Russian Government announced the imposition of a quota for poultry and tariff-rate quotas for pork and beef, all of which will become effective in April 2003. U.S. poultry exports to Russia declined by 35 percent in volume and 44 percent in value from 2001 to 2002.

Depressed purchasing power, which had been the most important factor restraining U.S. exports in recent years, has ameliorated gradually, allowing U.S. export levels to rise back to pre-1998 levels in 2001 and 2002. While purchasing power shortfalls account for part of the depressed level of imports, Russian companies' expanded market share at the expense of imports, particularly in the food processing and light manufacturing sectors, also accounts for the continuing low levels of imports from the United States.

Specific barriers to textile and apparel imports have not been observed in Russia, although Russia is not a major customer of U.S. textile goods at present. Customs authorities continue to assess duties on the royalty value of imported audiovisual materials, such as TV master tapes and DVD masters, rather than basing these duties on the physical value of the material.

Since 1995, Russian import tariffs have generally ranged from five percent to 30 percent, with a trade-weighted average in the range of 11.5 percent to 15 percent. In addition,

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value-added taxes (VAT) are applied to virtually all imports and excise taxes are applied to a small selection of goods. The VAT, which is applied to the price of the imported good plus its tariff, is currently 20 percent. Although pharmaceuticals and printed matter have been exempt from the VAT and some food products and items for children (e.g., diapers) were taxed at a lower VAT rate of 10 percent, the Government of Russia took steps to eliminate such special provisions in January 2002.

Import tariffs have declined in importance as a revenue source in recent years, but they remain significant, accounting for 5.5 percent of total government budget revenue. A major revision of the Russian tariff system took effect January 1, 2001. Under this tariff unification, tariffs were consolidated into major product groups (raw materials, semi-finished goods, foodstuffs and finished products) with tariffs ranging from five percent to 20 percent for nearly all tariff categories. However, many rates are accompanied by alternative minimum rates, making the actual applied rate less transparent. The tariff unification resulted in an overall lowering of tariff rates—the Russian Government states that in 2001 trade-weighted average tariff rates dropped from 11.4 percent to 10.7 percent. In addition, there are limited exceptions to the rate scheme, including higher rates for raw sugar (30 percent), poultry meat and automobiles (both 25 percent), and minor additional adjustments have been made. The Russian Government proceeded with the tariff unification to help combat customs fraud and improve customs collections, and while there have been some improvements in this regard, the overall weakness of Russian customs administration still leads to many abuses.

Other Russian import tariffs that are notable as particular hindrances to U.S. exports to Russia include those on automobiles, where combined tariffs and engine displacement-weighted excise duties can raise import prices of larger U.S.-made passenger cars and sport utility vehicles by over 70 percent. In addition, the government recently passed a new law increasing tariffs on imported second-hand cars. The existing tariff rates for 3-7 year-old cars imported by private individuals and by companies would be subjected to a tariff increase of between 10 percent and 17 percent, depending on engine displacement.

The Duma continues its work on the adoption of a new Customs code. A second reading is expected early in 2003. Tax code revisions setting new Customs valuations (tax chapter 25.1) are being prepared by the Russian Government for submission to the Duma. Both pieces of legislation are a part of Russia's WTO accession bid.

The government continued tight controls on alcohol production, including strict licensing requirements, import quotas on all distilled spirits except cognac and brandy, export duties, and increased excise taxes. Many of these controls are intended to increase budget revenues. Import licenses are required for various other goods, including color TVs; sugar; combat and sporting weapons; self-defense articles; explosives; military and ciphering equipment; encryption software and related equipment; radioactive materials and waste including uranium; strong poisons and narcotics; raw and processed sugar; and precious metals, alloys and stones. Most import licenses are issued by the Russian Ministry of Economic Development and Trade or its regional branches and are controlled by the State Customs Committee. Import licenses for sporting weapons and self-defense articles are issued by the Ministry of Internal Affairs. In early 2002, the Russian Government submitted to the Duma draft legislation to simplify trade licensing procedures.

Pharmaceutical products are included on reimbursement lists without any objective and verifiable criteria. Reimbursement lists and state purchases do not adequately consider the quality and safety of the products, and, as a result higher-priced imports are often discouraged.

### **STANDARDS, TESTING, LABELING AND CERTIFICATION**

U.S. companies report that Russian standards and procedures for certifying imported products and equipment are non-transparent, expensive, time-consuming, and beset by redundancies. Russian regulatory bodies are reluctant to accept foreign testing centers' data or certificates. U.S. firms active in Russia have complained of the limited opportunity to comment on proposed changes in standards or certification requirements before the changes are implemented. Occasional jurisdictional overlap and disputes between different regulatory bodies

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compound certification problems.

On July 31, 1998, amendments to Russia's Law on Certification of Products and Services went into effect which Russia claims generally meet the requirements of the WTO. The law allows a manufacturer to submit a declaration of conformity in the certification procedure for a limited number of products. The Government of Russia has established a list of 200 products eligible for this procedure. Approximately 30 percent of the 22,000 Russian standards now conform to international norms.

At the end of December 2002, the Duma passed in its third reading an "umbrella" law on standards (technical regulations and SPS) which is intended to bring Russia's standards regime into closer compliance with WTO norms and streamline the adoption of standards and the certification process for imported goods. Under the provisions of this law, many currently mandatory standards will become voluntary. The passage of this law will result in multiple revisions of product-specific regulations.

The current Russian product certification regime makes it difficult to introduce products into the Russian market. Manufacturers of telecommunications equipment, construction materials and equipment, and oil and gas equipment have reported serious difficulties in obtaining product approvals. Certification is particularly costly and prolonged for telecommunications equipment, which is tested for compliance with standards established by both the State Standards Committee (Gosstandart) and the Ministry of Communications and Information. This process has been known to take as long as 12 months to 18 months. Self-certification in this area is currently not possible. Russian sanitary and phytosanitary (SPS) measures are burdensome and sometimes of questionable scientific or food safety value. As Russia continues its efforts to join the WTO, a more transparent, science-based and WTO-consistent SPS system will need to be developed. Bioengineered food products are likely to attract regulatory attention from Russian authorities in the coming year.

In December 2002, the Russian Ministry of Health put in place a mandatory conformity assessment requirement for pharmaceuticals. This certification requirement is duplicative of other certification requirements for

pharmaceuticals and could lead to delays in the marketing of medicines.

### GOVERNMENT PROCUREMENT

Russian ministries and government agencies are frequent purchasers of equipment, goods and services for their own needs or for the needs of various domestic organizations or groups (i.e., the military, regional health organizations, or population centers located in remote areas). In April 1997, the Russian Government established procedures for public tenders for some government procurement, but this process needs improvement and clearer guidelines. A government procurement bill, that incorporates international government procurement standards (model UNCITRAL law on procurement of goods, works and services) is before the Duma, but has yet to be adopted. Domestic suppliers currently are not accorded many official advantages or privileges in competing for government procurement. Nonetheless, the Russian government's strong political bias toward supporting domestic industries may work in favor of Russian suppliers.

Manufacturers of telecommunications equipment, construction materials and equipment, and oil and gas equipment have reported serious difficulties in obtaining product approvals. On January 13, 1999, an amendment to the Federal Law on Communications went into effect, which appears to encourage government agencies purchasing communications equipment to give priority to systems using Russian-produced equipment. This has motivated some major U.S. suppliers to begin production in Russia.

### EXPORT SUBSIDIES

The Russian government's industrial policy guidelines emphasize export promotion and import substitution. In practice, there has been limited budgetary funding for such initiatives. In December 1999, then-acting President Putin proposed the establishment of a Russian export credit guarantee agency, but no action has been taken to date to implement this proposal. Russia has no explicit export subsidies on agricultural products, although it has suggested in WTO accession talks that it would like to reserve the option to use agricultural export subsidies in the future.

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### INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

According to industry sources, estimated losses to U.S. copyright industries due to intellectual property piracy (films, videos, sound recordings, books and computer software) exceeded \$755 million in 2002. Of special concern in 2002 were the large increases in illegal DVD production far in excess of Russian demand, with pirated products apparently intended not only for domestic consumption but also for export. The film industry estimates that over 80 percent of all DVDs on the Russian market are counterfeit. Piracy of motion pictures is estimated at approximately 80 percent of sales, piracy of music at approximately 66 percent of sales, and software piracy at approximately 88 percent of sales, all of which remained high in 2002. Although the Russian Government established an interagency task force to combat piracy, headed by Prime Minister Kasyanov, in the fall of 2002, Russia remains a major destination and transshipment point for pirated optical media products.

With the exception of protection for pre-existing copyrighted works and sound recordings, the Russian government has made considerable progress in constructing a legal framework to bring Russia up to world standards in its protection of intellectual property (IP). Since 1992, Russia has enacted generally acceptable laws on trademarks and appellations of origin, patents, protection of layout designs for integrated circuits, and copyrights, including protection for computer software.

Russia is a member of the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Geneva Phonograms Convention, the Universal Copyright Convention and other major multilateral intellectual property conventions. The U.S.-Russia bilateral trade agreement also requires Russia to provide protection for intellectual property. As part of Russia's accession to the WTO, Russia will be required to fully meet obligations under the WTO's Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement) upon accession. The Russian Patent and Trademark Agency (Rospatent) drafted amendments to five existing laws covering the various forms of intellectual property that should

bring Russia's legislation largely in line with TRIPS standards. This legislation was submitted to the Duma in June 2001, and the Duma has taken steps to bring the legislation into force, including the passage and signature of amendments to the Trademark Law in December 2002, the passage and the passage of amendments to laws covering integrated circuits and plant varieties and computer software and databases, and the first reading of amendments to the Copyright Law in November 2002.

There are some marginal improvements in anti-piracy actions by Russian law enforcement agencies, including an increased number of raids by police, but overall enforcement of IPR remains inadequate. Enforcement actions depend on proactive initiatives by rights holders to investigate violations and then refer investigations to law enforcement agencies. Strengthened criminal penalties for IPR infringement went into effect on January 1, 1997, and even stronger penalties have been proposed by the Russian Government in draft legislation. But, while the Russian Government has begun to pay more attention to enforcement, there are still few cases in which existing penalties have been applied, and even when violators have received jail sentences, the sentences are often suspended or general amnesties are issued, and imprisonment does not actually occur. In addition, goods seized during enforcement actions are rarely destroyed and consequently may return to the stream of commerce.

As the copyright industries' estimated losses attest, piracy of U.S. videocassettes, films, music recordings, books, and computer software is extensive in Russia. The Russian Government's Licensing Law, adopted in August 2001, did retain licensing for optical media producers, but U.S. copyright industries believe that this provision is inadequate to control optical media piracy.

Some U.S. companies have had difficulty registering well-known trademarks in Russia, although recently approved legislation will improve protection for well-known marks. U.S. and multinational companies continue to report counterfeiting as a serious problem, especially for consumer goods and pharmaceuticals. Recognizing that counterfeit pharmaceuticals are a serious concern, in 2001 the Ministry of Health set up an interagency working group to

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address this problem at the urging of international industry groups.

Administrative and judicial review bodies are only beginning to become active in protecting IP in Russia, and the number of police and judges with relevant expertise is still small but is expanding. U.S. copyright industries believe that at the prosecutorial and judicial levels, officials often do not consider IP infringements to be serious offenses compared to other crimes, although an increasing number of prosecutors are willing to file cases related to copyright piracy.

U.S. investors also consider the Russian court system to be ill-prepared to handle sophisticated patent cases. However, a specialized higher patent chamber has been established at the Russian Patent and Trademark Agency, which should bring greater expertise and efficiency to resolution of trademark and patent disputes.

### SERVICES BARRIERS

Discrimination against foreign providers of non-financial services are in most cases not the result of federal law, but can stem from the abuse of power, sub-national regulations, and practices that may violate Russian law. For example, a few foreign providers of services have sometimes noted discrimination in obtaining licenses from local authorities. Foreign providers are forced to pay a range of fees that domestic companies allegedly bypass via bribes. The federal law on "Banks and Banking Activity of 1996" permits foreign banks to establish subsidiaries in Russia. The law allows the Central Bank to impose a ceiling on the total amount of foreign bank capital calculated as a percentage of the total bank capital in Russia. The percentage ceiling is currently set at 12 percent, although it is unclear whether the 12 percent limit is operative. (The current percentage of foreign capital is approximately percent.) Russia has been asked to clarify the situation and remove any limits as part of its WTO accession. The Central Bank has indicated it does not want this limit to dissuade foreign banks from operating in Russia. Since 1997 the Central Bank has required foreign banks to have a minimum of Euro 10 million in capital (same as for domestic banks) and to have at least 75 percent of the bank's employees and 50 percent of the bank's management board be of Russian nationality.

Heads of foreign banks' Russian offices are required to be proficient in the Russian language. In the WTO talks, the U.S. has urged the Russian side to allow branches, as well as subsidiaries, to allow complete liberalization.

In the insurance sector, a law took effect in October 1999 which implicitly allows majority-owned non-life insurance companies to operate in Russia for the first time (life insurance companies remain subject to a 49 percent equity restriction) but restricts the total market capitalization for both life- and non-life insurance companies and prohibits them from selling life insurance or obligatory types of insurance. The law contains a "grandfather clause" exempting the four foreign companies currently licensed in Russia from these restrictions. Insurance companies with a minority foreign participation (49 percent or less) are not subject to these restrictions. Differential treatment is also potentially available to the benefit of EU insurance companies under the Partnership and Cooperation Agreement with the EU.

The Ministry of Communications and Information is reviewing the operations of alternative telecommunications carriers, which in many cases have foreign investment. Digital overlay companies spun-off from slower-growing, under-capitalized traditional operators and providing modern, alternative networks to high-margin business customers have raised concerns at the Ministry of Communications. The Ministry is currently drafting changes and amendments to the Communications Law. Included in the new draft Communications Law are proposals to streamline the licensing procedure to make it easier for small- and medium-sized businesses to enter the telecommunications market. Operators in Russia cite the excessive number of regulatory authorities and ensuing regulatory acts governing activities in the telecommunications sector as a source of market instability and difficulty in adhering to applicable law and regulation. Operators also continue to complain about the Russian Government's lack of transparency in licensing and have criticized the five- to ten-year terms of the licenses, which they argue do not allow them sufficient time to recoup their investment.

Russian entities with over 50 percent foreign ownership are prohibited from sponsoring

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television or video programs, or establishing television organizations capable of being received in more than 50 percent of Russia's territory or by more than 50 percent of the population. The Ministry of Communications announced on September 5, 2000 its intention to confiscate valuable frequency bands from two existing cellular providers for possible transfer to a new entrant. Minister of Communications Reyman, after receiving a wide range of criticism, rescinded the order, offering instead to investigate opportunities to convert military frequencies to civilian use.

Central Bank regulation 721-U requires that purchases of foreign currency of greater than \$10,000 for a limited number of imported services, mainly in the hospitality and tourism sector, must receive advance permission from the Ministry of Finance. While intended to combat capital flight, this measure has the potential to delay financial transactions and impede the participation of foreign firms in this sector. A new currency control law, which is currently under discussion within the government, may eliminate the need for licenses, but would require CBR notification in most circumstances unless specifically noted in the law, with all currency controls lifted by 2007. Tax preferences formerly provided to Russian film producers were abolished effective January 1, 2002.

### INVESTMENT BARRIERS

A Bilateral Investment Treaty (BIT) was signed between the United States and Russia in June 1992. The treaty was approved by the U.S. Senate in October of the same year, but it cannot enter into force until ratified by the Russian Duma. The Duma did not actively consider ratification of the BIT in 2002. The Russian government has proposed a number of changes to the BIT, and the two governments are engaged in discussions of these proposals. Despite the passage of a new law regulating foreign investment in June 1999, Russian foreign investment regulations and notification requirements can be confusing and contradictory. The law on foreign investment provides that a single agency (still undesignated) will register foreign investments and that all branches of foreign firms must be registered. The law does codify the principles of national treatment for foreign investors, including the right to purchase securities, transfer property

rights, protect rights in Russian courts, repatriate funds abroad after payment of duties and taxes, and receive compensation for nationalizations or illegal acts of Russian government bodies. However, the law goes on to state that federal law may provide for a number of exceptions, including, where necessary, for "the protection of the constitution, public morals and health, and the rights and lawful interest of other persons and the defense of the state." The potentially large number of exceptions thus gives considerable discretion to the Russian government.

The law also provides a "grandfather clause" that existing "priority" foreign investment projects with foreign participation over 25 percent be protected from unforeseeable changes in the tax regime or new limitations on foreign investment. The law defines "priority" projects as projects with a foreign charter capital of over \$4.1 million and with a total investment of over \$41 million. However, the lack of corresponding tax and customs regulations means that any protection afforded investors by this clause is only theoretical.

The new Land Code that was passed in 2001 allows equal treatment of domestic and foreign entities to buy land and buildings, although purchase of agricultural land by foreigners is still prohibited. Foreign entities are restricted from buying land close to federal borders and in areas that the President determines are critical to national security.

Current Russian legislation restricts foreign investment in the aerospace industry to less than 25 percent of an enterprise. Foreign investment in the natural gas monopoly, Gazprom, is formally limited to 20 percent and in the electrical power giant, Unified Energy Systems, to 25 percent. In practice, these limits have been exceeded, and there is discussion of whether to eliminate or raise the limits. Foreign investment in Russian spirits concerns is limited to 49 percent. In 2001, the Duma rejected draft legislation which would have prohibited and/or allowed restriction of foreign investment in a wide range of sectors in the economy.

A major tax reform law that became effective January 1, 2001, reduced tax-related investment barriers. It substantially amends the value-added tax (VAT), excise taxes, personal income tax and unified social tax. These reforms will

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reduce the nominal tax burden from 41 percent of GDP (only 37 percent actually collected) to 39 percent in 2001. The Government of Russia has stated recently that it plans to implement another round of tax reduction, possibly on the unified social tax and VAT, to reduce the tax burden to 31 percent of GDP by January 2005. The amendments established a flat income tax rate for residents and a 30 percent income tax rate for non-residents as of January 1, 2001. In addition, six taxes were abolished entirely: the 1.5 percent social and housing turnover tax; the Employment Fund tax; the state border clearance fee; the vehicle tax; the vehicle acquisition tax; and the oil and lubricant product sales tax. The road users turnover tax, reduced from 2.5 percent to 1 percent of turnover, was abolished entirely in January 2003. Regions and municipalities received authority to grant exemptions to the regional portion of profits taxes. Some regions received specific regional exemptions, particularly the Leningrad oblast. However, regions will no longer be able to grant individual tax exemptions.

Notable VAT tax changes since 2000 include VAT tax relief for small businesses; considerable clarification to deductibility rules; reduction of import VAT exemptions; and an attempt to provide a zero VAT tax on exports, although the VAT refund system still does not function well. Companies report that VAT refunds due to an exporter, which should be provided within three months after a claim is submitted, often do not occur on time, with a number of burdensome additional requirements for refund applied by customs and tax authorities. In addition, input VAT is often not refunded for a number of reasons, forcing exporters to avail themselves of the court system.

Excise duties on oil and gas have been adjusted several times over the past few years, being raised or lowered as oil and gas prices fluctuate so as to capture "windfall profits." The new law expands the list of dutiable activities and objects, but several additional transactions became exempt, including exportation when conducted by the producer of the goods (except oil).

In addition, another amendment to the tax code enacted in 2001 lowered the corporate profit tax to 24 percent from 35 percent came into effect on January 1, 2002.

Crime and corruption in commercial transactions and problems with the implementation of customs regulations also inhibit investment. Russian trade and investment would benefit, for example, from improved dispute resolution mechanisms, the systematic protection of minority stockholders rights, conversion to international accounting standards, and the adoption and adherence by companies to business codes of conduct. Initiatives are underway to address these shortcomings, either through regulation or government-sponsored voluntary codes of conduct. More transparent implementation of customs and taxation regulations is also necessary.

Adequate conforming legislation and implementing regulations (known as "normative acts") for Production Sharing Agreements (PSAs) continue to be necessary in order for the PSA regime in the oil and gas sector to be complete. However, movement on an adequate PSA regime has been slow. After a long delay, new PSA legislation was adopted at the beginning of 1999 when the State Duma finally approved remaining necessary legislative components of Russia's PSA framework.

Nationalists (including some Russian oil companies) object to the "special treatment" for foreign companies that they believe PSAs grant. The Russian government has submitted to the Duma legislation to amend the tax code to allow PSAs to function, but the legislation was still awaiting its second reading at the end of 2002. Meanwhile, opponents of PSA were seeking amendments to the existing PSA law that would greatly inhibit opportunities for the development of PSAs. International oil companies insist that PSA legislation, while not sufficient in itself, is a precondition for investment in certain major energy projects in Russia. Over \$1 billion invested to date in the Sakhalin II consortium and ExxonMobil's announcement that it is proceeding with a \$12 billion development plan for Sakhalin I, both "grandfathered" PSA projects, demonstrate the tangible benefits to Russia of foreign energy investment on PSA terms.

Elsewhere in the energy sector, the \$2.6 billion Caspian Pipeline Consortium (CPC) project, inaugurated in 2001, shows the vulnerability of projects to efforts to violate contracts and/or founding agreements. In 2002, the CPC had to resist designation as a "natural monopoly" even

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though its founding agreements explicitly exempt it from application of the Law on Natural Monopolies. In addition, local officials continue to insist that CPC pay port fees, despite the fact that its founding agreements explicitly exempt it from such fees. Elsewhere, non-transparent environmental regulations concerning environmental permitting and pipeline access remain of concern to potential U.S. investors. Central Bank restrictions on medium-term loans (more than 180 days) of hard currency for the purchase of imported inputs have also presented an obstacle to foreign investment projects in Russia's energy sector. Existing PSA legislation retains a 70 percent local content requirement for equipment and requires 80 percent local labor. There is no reference to the period in which these targets must be achieved, and U.S. companies believe they will be manageable provided that the Russian government develops appropriately flexible regulations. A separate PSA amendment limits the total amount of foreign investment to 30 percent of Russia's "strategic" oil reserves. The precise meaning and significance of this restriction remains unclear.

Russia has assumed obligations under Article VIII of the IMF Articles of Agreement to permit free payment of current transactions, but the Central Bank continues to maintain controls on capital flows, despite several new currency control amendments enacted in 2001. The only major change was to lower from 75 percent to 50 percent the mandatory requirement to surrender hard currency by exporters, without reducing the 100 percent repatriation requirement. The proposed law on currency control under current government review would lower the surrender requirements to 30 percent, and completely abolish them by 2007. Russia continues to maintain restrictions on profit repatriation with respect to investments in restructured Russian sovereign domestic debt (S accounts), although now investors can repatriate coupon payments on government and corporate bonds and invest in other bonds. However, licenses are still required for most transactions transferring money into or out of Russia, with exporters incurring exchange fees and substantial compliance expenses. The proposed law would eliminate the licensing requirement in favor of simple notification, but it is not clear what ultimately will be approved.

Of potential concern to some investors are

export tariffs imposed since 1999 by the Russian Federation, which have become a very significant revenue source for the government. Export tariffs are levied on a range of goods, including oil, gas, forest products, ferrous and non-ferrous metals and scrap, hides and skins. Export tariff rates for oil and gas, like excise rates, have been raised and lowered in parallel with changes in oil price levels. A presidential decree signed in early 1998 provides investment incentives for large investments in the automobile industry that meet local content requirements. Although the decree is technically still in place, the Government of Russia has stated that no new contracts will be concluded under the law and that the law itself will be abolished in the near future. In practice, U.S. investors in this sector have faced difficulty in obtaining relief promised by the Russian Government from local content requirements and for special customs treatment.

The Ministry of Communications and Information's Order No. 8 mandates that certain types of telecommunications switching equipment be manufactured only in Russia. This has motivated some U.S. telecommunications suppliers to set up manufacturing operations or joint ventures in Russia, rather than import the equipment.

### Aircraft

With more than 70 percent of Russia's civil aviation fleet over 10 years old and suffering from outmoded avionics and engines, replenishment of the fleet is a priority. Aircraft replacement, however, has not been proceeding because of the difficulties faced by Russian aircraft manufacturers, including the financing of aircraft. In 1994, the government provided protection to the ailing industry by raising tariffs on imported aircraft from 15 percent to 50 percent. Subsequently, tariffs were lowered to the still prohibitive level of 30 percent in 1995, and then to 20 percent in 1999.

Current law stipulates preferential treatment (tax holidays, guarantees on investment) for Russian and foreign investors in aviation-related research and manufacturing ventures. It also limits the share of foreign capital in aviation enterprises to less than 25 percent and requires that board members and senior management staff be Russian citizens. The government, however, is looking to reorganize and revitalize Russia's



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aircraft industry in the context of a larger restructuring plan for Russia's defense industry. Specifically, the government is considering large-scale consolidation of the aircraft industry through mergers and the provision of state guarantees on leases of domestically manufactured aircraft. Moreover, to support leasing of Russian-manufactured aircraft, the government in August 2001 concluded a deal with Ilyushin Finance and Finance Leasing Company (FLC) to take a controlling interest in their aircraft leasing operations in exchange for an \$80 million infusion of government money in Ilyushin's IL-96 project and \$25 million in FLC's TU-214 project. In 1996, the United States and Russia concluded a Joint Memorandum of Understanding (MOU) that addresses U.S. concerns about barriers to the Russian civil aircraft market and the application of international trade rules to the Russian aircraft sector. The MOU states that U.S. aircraft manufacturers will be able to participate in the Russian market and share in its growth. The MOU also makes clear that the Russian aircraft industry will become fully integrated into the international economy over time. Russia pledged to eventually undertake the same international trade principles in the aircraft sector as the United States and many others have done as embodied in the WTO Agreement on Trade in Civil Aircraft, although thus far Russia has refused to make this commitment in its WTO accession negotiations. In the interim, before Russia accepts its full international trade obligations, the MOU commits Russia to take steps, such as the granting of tariff waivers, to enable Russian airlines to meet their needs for non-Russian aircraft on a non-discriminatory basis. In 2002, Russia announced a decision to reallocate existing tariff waivers in favor of Airbus Industries. We continue to press the Russian Government to join the WTO Agreement on Trade in Civil Aircraft as soon as possible and to take immediately other steps, including increasing the limited number of tariff-waivers currently available, to facilitate increased market access for U.S. aircraft.

On July 7, 1998, the Russian government issued Resolution 716 which required Russian airlines to commit to the purchase or lease of Russian-made aircraft in order to receive duty reductions and exemptions for foreign aircraft acquisitions. In August 2001, the Prime Minister approved a decree that, among other things, canceled Resolution 716 and instructed

the Russian Aerospace Agency and the Ministry of Transport to review the 20 percent customs duty currently levied on all aerospace imports with the goal of reducing tariffs. The proposal for tariff reductions, pursuant to this review, is pending government approval. While it recommends significant tariff reductions on aerospace items not produced in Russia, it does not recommend tariff reductions on aircraft.

### ELECTRONIC COMMERCE

Russian law does not currently provide identical legislative protection for both electronic and paper documents. Settlement issues need to be considered in conjunction with applicable currency control provisions. Registered trademarks are not recognized as entailing rights to the equivalent domain names and the property rights which trademarks secure for their registered owners are currently not protected for the purposes of Internet advertising and commerce through web sites. Tax implications from electronic commerce are unclear.

Electronic Russia (E-Russia) 2001-2010 is a \$2.6 billion, nine-year plan announced by President Putin in July 2001 to boost information technologies and Internet usage in Russia. It includes proposals to improve the telecommunications infrastructure of the country and to implement legislation to facilitate electronic commerce. The Ministry of Communications and Information's 2001-2006 draft program on electronic commerce may be integrated into the E-Russia program. A law on electronic digital signatures was approved by the Duma in December 2001 and was signed into law by President Putin in January 2002. The law defines electronic signatures strictly, making public-key technology the sole acceptable digital signature technology. The law also requires certification of hardware and software, and the establishment of digital signature authentication centers. An electronic commerce bill is also under consideration. This bill, while closely following an International Chamber of Commerce model bill, nevertheless has problems, including the fact that it limits electronic transactions to the sale and purchase of moveable goods, services agreements, and shipments. The adoption of the new WIPO Copyright Treaty and the WIPO Treaty on Performers and Performances Treaty also would promote the development of electronic commerce in Russia.

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The Supreme Court of the Russian Federation on September 25, 2000 struck down a provision of a Ministry of Communications order that required certain communications service providers in Russia to install special eavesdropping equipment on behalf of the Federal Security Service (FSB). The intercept scheme, known as the System of Operative and Investigative Procedures (SORM), allows the Government to intercept voice and data, e.g., email transmissions, supposedly for reasons related to law enforcement. The ultimate impact of the court's ruling is still disputed, and for the time being operators have left the installed intercept systems in place.