

PUBLIC DOCUMENT

BEFORE THE
INTERNATIONAL TRADE ADMINISTRATION
UNITED STATES DEPARTMENT OF COMMERCE

In the matter of:)
)
)
THE STATUS OF THE RUSSIAN)
FEDERATION AS A NON-MARKET)
ECONOMY COUNTRY UNDER THE)
ANTIDUMPING AND COUNTERVAILING)
DUTY LAWS)
_____)

Case No. A-821-816
Number of Pages: 931

**THIS DOCUMENT CONTAINS NO
PROPRIETARY INFORMATION**

**REBUTTAL BRIEF OF JSC SEVERSTAL, NOVOLIPETSK IRON & STEEL
CORPORATION, AND JSC MAGNITOGORSK IRON AND STEEL WORKS***

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*Also supported by the Ministry of Economic Development and Trade of the Russian Federation

Dated: February 7, 2002

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I. INTRODUCTION

On October 26, 2001, the Department of Commerce ("DOC") opened an inquiry into the status of the Russian Federation as a market economy under the antidumping and countervailing duty laws of the United States.¹ As part of its inquiry, the DOC solicited comments on the appropriateness of revoking the Russian Federation's designation as a non-market economy ("NME") under the U.S. antidumping and countervailing duty laws.

Comments supporting revocation were submitted by the Government of the Russian Federation and by counsel for, JSC Severstal, Novolipetsk Iron & Steel Corporation, and JSC Magnitogorsk Iron and Steel Works ("the Russian Steel Producers").² The two submissions set out succinctly the reasons why revocation of the Russian Federation's NME designation is appropriate and timely.

The DOC also received comments from representatives of certain domestic firms opposing revocation (the "Opposing Parties"), which alleged that the Russian Federation did not meet the statutory criteria for revocation and contending that such revocation would not be appropriate. The Opposing Parties' submissions contain both broad arguments asserting generally the inappropriateness of revocation and highly specific arguments addressing specific revocation criteria. These submissions contend the Russian Federation is not eligible for revocation.

¹ Notice of Initiation of Inquiry into the Status of the Russian Federation as a Non-market Economy under the Antidumping and Countervailing Duty Laws, 66 FR 54197-98 (Oct. 26, 2001).

² Submission on behalf of JSC Severstal, Novolipetsk Iron & Steel Corporation, and JSC Magnitogorsk Iron and Steel Works ("Russian Steel Producers"), filed by Powell, Goldstein, Frazer & Murphy, LLP, December 10, 2001 ("Russian Steel Producers Brief").

The arguments in the Opposing Parties' submissions suffer from a number of shortcomings. Frequently they depart from the statutory criteria to raise factual arguments that, even if they were true, have no relevance to the DOC's focused examination of the Russian Federation's economy in light of the six enumerated criteria in the Trade Act of 1930 (as amended).³ For example, one Opposing Party opposes revocation on the ground that there is "an epidemic of violations" of workers' rights.⁴ Another argues against revocation on the ground of supposed inadequacies in the Russian Federation's "democratic political reform."⁵ Such polemically inflamed rhetoric does a disservice to the objective, focused inquiry that the DOC is required by statute to conduct.⁶

Even where they have directly addressed the relevant criteria, the Opposing Parties' submissions are marred by frequent and pervasive factual inaccuracy. In some cases, the source of this inaccuracy is outdated information. Since President Putin was elected to office on March 26, 2000, his administration has moved with increasing rapidity to reform the Russian Federation's legal system, its judiciary, and its economy. The Opposing Parties have failed to take account many of these dramatic and far-reaching reforms, with the result that their submissions are frequently misinformed and misleading.

³ 19 U.S.C. § 1677(B).

⁴ Submission on behalf of Nucor Corporation and the Committee for Fair Beam Imports and its members, filed by Wiley Rein & Fielding LLP, December 10, 2001 ("Wiley, Rein & Fielding Brief"), at 8.

⁵ Submission on behalf of Elkem Metals Company and Globe Metallurgical Inc., filed by Verner, Liipfert, Bernhard, McPherson and Hand, December 10, 2001 ("Verner Liipfert Brief"), Comment III.

⁶ Similarly troubling is the heavy reliance of certain Opposing Parties on studies produced by organizations with a sharp anti-Russian ideological bias like Freedom House and the Heritage Foundation.

Elsewhere, the inaccuracies arise from an Opposing Party's fundamental misunderstanding of a particular issue. Finally, the Opposing Parties assert a number of facts in opposition to revocation that, while accurate, are taken out of context. Once they are placed in their proper context — as the present submission does — it becomes immediately apparent that these facts *support* revocation, rather than the contrary.

Leaving aside the multitude of particular errors in these submissions, the Opposing Parties' overall thesis — that NME revocation is inappropriate — is profoundly and fundamentally flawed.

The present submission, which has been prepared on behalf of the “Russian Steel Producers,” rebuts and corrects the errors in the submissions of the Opposing Parties. Its rebuttal is structured as follows. It addresses in turn each of the six statutory criteria. Each discussion is divided into three parts:

- First (following the summary of the section), a rebuttal of specific errors found in the portions of the Opposing Parties' submissions devoted to that criterion.
- Second, a detailed discussion of the treaties, laws, and regulations of the Russian Federation relevant to that criterion.
- Finally, since certain of the Opposing Parties have disputed the efficacy of such rules, the third part of each discussion is a detailed exposition of the economic data demonstrating that the relevant legal rules are in full force and are having their intended effects within the Russian economy.

Because of the many, repetitive, scattershot objections to revocation raised by the Opposing Parties, the Russian Steel Producers have felt it imperative to provide the DOC with a comprehensive, and highly detailed, discussion of the present state of Russia's economy.

Anything less than a broadly comprehensive discussion of the relevant laws and economic indicators would have fallen short of addressing the Opposing Parties' blanket assertions that revocation — as a general matter divorced from particular facts — is inappropriate.

Submission of a comprehensive study of the status of Russia's economy is also appropriate because the DOC has never conducted an inquiry such as the present one and has only once before — nearly six years ago — made an express determination concerning the status of the Russian Federation's economy.⁷ Instead, it has continued to treat the Russian Federation as though nothing had changed since independence in 1990.

The Opposing Parties have framed the revocation issue in a legalistic, hypertechnical manner. The Opposing Parties have stated in various ways that evidence that a country "has made significant progress towards creating a market economy" is not sufficient for revocation.⁸ Instead, they point out — correctly — that the DOC must determine that the economy "operate{s} on market principles of cost or pricing structures, so that sales of merchandise in such country . . . reflect the fair value of the merchandise."⁹ The Opposing Parties have interpreted this language in a hypertechnical manner such that the slightest indication of government intervention in the economy is seized on as evidence that the Russian Federation has not yet achieved market economy designation.

This approach to the revocation issue is misleading and disingenuous, and a reality check is in order. Governments in every country — including the United States and the other six members of the Group of Seven — intervene to a greater or lesser degree in their economies, such that there is no such thing as a pure market economy. The DOC has stated the proper understanding of this issue with particular clarity: "{E}ach of the six statutory factors

⁷ Pure Magnesium and Alloy Magnesium from the Russian Federation, 60 FR 16440, 16443 (final det.) (March 3, 1995).

⁸ See, e.g., Verner Liipfert Brief Comment I.

⁹ 19 U.S.C.A. § 1677(18)(A).

discussed is framed in terms of the *extent* of government intervention, and not in terms of absolutes . . . complete *laissez faire* or a perfectly competitive market economy is not the applicable standard."¹⁰

An example will suffice to show the sterility of the Opposing Party's logic. Price regulation is often viewed as one of the most intrusive forms of government intervention. Yet, the U.S. government broadly regulates prices in the energy sector, the insurance sector, and the defense sector. Only a few short years ago, it also regulated prices in the airline industry and the telecommunications sector. By the Opposing Parties' logic, the United States would not meet the statutory criteria for designation as a market economy. Such a view of the revocation issue is purblind and self-defeating. The Russian government, like that of every other country in the world, and like those of all five countries whose NME status has been revoked, intervenes in certain highly discrete areas of the Russian economy. Yet a recitation of these discrete instances of intervention does not lead to the conclusion that Russia is a non-market economy.

¹⁰ Antidumping Investigation of Certain Steel Concrete Reinforcing Bars from Latvia, Memorandum to Troy Cribb re Request for Market Economy Status (Jan. 10, 2001), at 20 (emphasis in original) ("Latvia NME Analysis Memorandum").

II. **CRITERION 1: THE EXTENT TO WHICH THE CURRENCY OF THE FOREIGN COUNTRY IS CONVERTIBLE INTO THE CURRENCY OF OTHER COUNTRIES**

Summary of Comment

In arguing that the ruble is not sufficiently convertible into the currency of other countries to permit revocation of the Russian Federation’s NME status, the parties opposing revocation (the “Opposing Parties”) have misstated key facts about the nature and extent of Russia’s exchange controls. Section A corrects these misstatements, while Section B provides a detailed discussion of Russia’s exchange controls, which shows that the ruble is freely convertible for most purposes and that Russia maintains fewer exchange controls than did the other five countries that have achieved revocation. Section C sets out the economic data — particularly data regarding international currency flows — that demonstrate that the ruble is freely convertible and widely used in international commercial transactions.

A. The parties opposing revocation misstate key facts concerning the convertibility of the ruble.

The Opposing Parties have painted a picture of Russia’s exchange controls that is factually inaccurate, lacking in context, and based on badly outdated information. For example, three Opposing Parties state erroneously that the surrender requirement requires surrender of 75 percent of foreign currency export earnings.¹¹ None gives the true figure – presently 50 percent;¹² and none mentions that the requirement does not apply to non-resident legal entities.

¹¹ The surrender requirement is the mandatory conversion of hard currency profits earned abroad into the home currency.

¹² See Federal Law # 130-FZ of August 8, 2001.

Nor do any of the Opposing Parties mention that the requirement is scheduled for full revocation.¹³

One of these same Opposing Parties also states that "non-resident persons may use rubles to purchase foreign exchange only with balances held in so-called I accounts. . . . Ruble balances held on T account are also subject to conversion restrictions."¹⁴ In fact, ruble I and T accounts no longer exist in Russia and have been replaced with K ("conversion") and N ("non-conversion") accounts with a different regime representing the further liberalization of currency restriction.¹⁵ We discuss below the fact that the mandatory use of these accounts does not, as a practical matter, limit the ability of non-residents to repatriate earnings.

Another Opposing Party asserts "foreign currency transactions are unrestricted only when they involve settlement on import and export contracts within 90 days, and loans with terms of less than 180 days."¹⁶ In fact, the recent amendments to the Russian currency legislation significantly expand the list of unrestricted import and export operations. Moreover, the licensing requirement for long-term loans was abolished, and no restrictions currently exist for loan arrangements, whatever their duration.¹⁷

¹³ Submission on behalf of Gallatin Steel Company, IPSCO Steel Inc., Nucor Corporation, Steel Dynamics, Inc., and Weirton Steel Corporation, filed by Schagrin Associates, December 10, 2001 ("Schagrin Associates Brief"), at 8; Submission on behalf Bethlehem Steel Corporation, LTV Steel Company, Inc., National Steel Corp, and U.S. Steel LLC, filed by Skadden, Arps LLP, and Dewey Ballantine LLP, December 10, 2001 ("Skadden-Dewey Brief"), at 9; and Submission on behalf of The Ad Hoc Committee of Domestic Nitrogen Producers, filed by The Ad Hoc Committee of Domestic Nitrogen Producers, December 10, 2001 ("Ad Hoc Committee Brief"), at 2.

¹⁴ Skadden-Dewey Brief at 10.

¹⁵ See Russian Central Bank Regulation # 93-I of October 12, 2000).

¹⁶ Schagrin Associates Brief at 8.

¹⁷ See Russian Central Bank Resolution #1030-U of September 10, 2001.

One Opposing Party states that Russian "citizens are not free to make portfolio investments abroad."¹⁸ This is simply false. An amendment last year to the 1992 currency control law¹⁹ permits residents to make portfolio investments in the amount of USD 75,000 per annum without restrictions.²⁰ Investments in excess of the indicated amount are also possible with permission of the Russian Central Bank.

Certain of the Opposing Parties also misrepresent the facts. For example, one Party, attempting to draw an unfavorable comparison between Russia and Latvia, argues that "[i]n a recent affirmative determination, the Department found that . . . there were no restrictions on *foreign exchange transactions*. . . when deeming that a currency was convertible."²¹ What the Department actually said about Latvia — and its implication for Russia — is crucially different: "[s]ince 1994, the *lat* has been fully convertible on all *current account* transactions"²² This misstatement is highly misleading, since all countries – including Latvia and Russia -- adopting the IMF Articles of Agreement have committed to impose no restrictions on *current account* transactions. The Articles of Agreement, however, make no similar requirement with respect to *capital account* transactions, and both Latvia and Russia impose certain exchange controls on capital account transactions.

Another Opposing Party simply fails to understand the facts, and its fundamental misunderstanding of the most basic facts taints the conclusions it reaches. This Opposing Party

¹⁸ Skadden-Dewey Brief at 9.

¹⁹ See Federal Law # 3615-1 of October 9, 1992 "On Currency Regulation and Currency Control," art. 6(2).

²⁰ Federal Law #72-FZ of May 31, 2001 "On Amendments and additions" to the Federal Law "On Currency Regulation and Currency Control."

²¹ Skadden-Dewey Brief at 9.

begins its discussion of convertibility by announcing that "the convertibility of the country's currency for current account purposes" is "[o]f particular significance."²³ The Party then asserts that the ruble is not fully convertible, as evidence of which it complains that "unrestricted foreign currency transactions are permitted *only for short-term import/export contracts (within 90 days) and loans for terms of less than 180 days.*"²⁴ Yet these are precisely the current account transactions that the Opposing Party rightly believes are "[o]f particular significance."

This same Opposing Party further asserts that "exporters must sell their hard currency at specially authorized exchanges only, which prevents them from seeking the most favorable exchange rate available at commercial banks."²⁵ In fact, exchange transactions may be conducted by both resident and non-resident legal entities at any of the 998 commercial banks licensed by the CBR to carry out such transactions.²⁶ This creates a competitive environment, providing the best conditions for traders to carry out international operations.

One Opposing Party asserts that "the Ministry of Finance and the Ministry of Economic Development and Trade were jointly tasked with preparing legislation to liberalize currency regulation but that the initiative died, bringing efforts to reform the currency control laws to a dead stop."²⁷ This is incorrect. In November 2001, the Ministry of Finance, the Ministry of Economic Development and Trade, and the Central Bank of Russia forwarded currency control legislation to the government that bridged the differences among the three

²² Latvia NME Analysis Memorandum at 6.

²³ Ad Hoc Committee Brief at 1.

²⁴ Ad Hoc Committee Brief at 1 (emphasis added).

²⁵ Ad Hoc Committee Brief at 2.

²⁶ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 63.

agencies on how, and how soon, reform should occur. Included in this bill are plans to reduce the mandatory surrender of hard currency earnings by Russian companies from 50 percent to 35 percent in 2003 and completely remove the requirement in three years. Indeed there is pressure from the Central Bank of Russia and the Ministry of Economic Development and Trade to move even more quickly.²⁸

Another Opposing Party points to the “instability” of the ruble as being a main factor in why Russia should not be designated as a market economy.²⁹ This same party goes on to assert that the Russian Federation is compelled to restrict international transfers of capital for its residents in order to maintain Russia’s economic stability.³⁰ Russia does not need to restrict capital transfers to maintain a healthy economy. Between 1998 and 2001, restrictions on international transfers of capital were significantly *reduced* (see discussion below). During the same period, the ruble has remained stable, exhibiting total fluctuation of just 6.3 percent over the last 2 years.³¹ Furthermore, the Russian GDP grew by 5.4 percent in 1999, 8.3 percent in 2000 and 4.9 percent through the first quarter of 2001. Unemployment fell from 13.7 percent in 1999 to 8.3 percent through July of 2001. Inflation decreased from 36.5 percent per year in 1999

²⁷ Skadden-Dewey Brief at 10.

²⁸ Interfax News Agency, Business Law Review, “Bill On Currency Regulation Submitted To Government,” December 4, 2001.

²⁹ Wiley, Rein & Fielding Brief at 5.

³⁰ Wiley, Rein & Fielding Brief at 6.

³¹ The Central Bank of the Russian Federation, “Bulletin of Banking Statistics,” No. 11(99), Moscow 2001 at 33-35.

to 20.8 percent through August of 2001, and the current account recorded a surplus in each of the last 3 years.³²

In response to the inaccuracies and misconceptions contained in the various submissions made by the Opposing Parties, we set forth below an analysis of the legal and regulatory framework in Russia as it relates to currency convertibility, followed by empirical evidence supporting the conclusion that the economy has responded to these liberalization initiatives. This analysis, together with the supporting economic data, demonstrates that the ruble is convertible for most purposes, that its degree of convertibility equals or exceeds that of the currencies of Latvia, Slovakia, the Czech Republic, Hungary, and Poland at the time the NME status of each was revoked, and, as such, that the Russian Federation meets the requirements of Criterion 1.

B. The legal and regulatory framework of Russia’s foreign exchange policy ensures the free convertibility of the ruble.

1. Pursuant to Russia’s obligations under Article VIII of the International Monetary Fund’s Articles of Agreement, the ruble is freely convertible for current account transactions.

In 1996, Russia assumed important commitments concerning the free convertibility of the ruble under Article VIII of the International Monetary Fund’s (“IMF”) Articles of Agreement. Chief among these is the commitment to avoid “impos[ing] restrictions on the making of payments and transfers for current international transactions.”³³ Because

³² Russian-European Centre for Economic Policy, “Russian Economic Trends Monthly,” September 17, 2001 at 2.

³³ International Monetary Fund, Articles of Agreement, Article VIII, Section 2: “Avoidance of Restrictions on Current Payments”:

international treaty obligations entered into by the Russian Federation (or its predecessor, the Soviet Union) are self-executing, Russia's commitments under Article VIII are automatically incorporated into — and take precedence over any contrary provisions of — Russia's domestic law.³⁴

The DOC has repeatedly pointed to a country's adoption of the commitments imposed by IMF Article VIII as favorable evidence of the free convertibility of its currency.³⁵ In the cases of Hungary, Slovakia, and the Czech Republic, the DOC held that, upon adherence to the provisions of IMF Article VIII, each currency "became fully convertible for current account purposes."³⁶

Subject to the provisions of Article VII, Section 3(b) and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

³⁴ 1993 Constitution of the Russian Federation, art. 15(4) ("[I]nternational treaties of the Russian Federation shall be a component part of its legal system. If an international treaty or agreement of the Russian Federation fixes other rules than those envisaged by law, the rules of the international treaty shall be applied"); 1995 Federal Law on International Treaties, art. 5; Civil Code of the Russian Federation (First and Second Parts) (amended on February 20 and August 12, 1996, on October 24, 1997, on July 8, 1999), art. 7 ("If the rules stipulated in the international treaty of the Russian Federation differ from those stipulated by the civil legislation, the rules of the international treaty shall apply.")

³⁵ Antidumping Administrative Review of Tapered Roller Bearings from Hungary; Memorandum to R. LaRussa re Market vs. Non-Market Economy Analysis (Feb. 23, 2000) at 6 ("Hungary NME Analysis Memorandum"); Antidumping Investigation of Cold-rolled Carbon-Quality Steel Products from the Slovakia, Memorandum to R. LaRussa re Market vs. Non-Market Economy Analysis (Oct. 13, 1999) ("Slovakia NME Analysis Memorandum") at 4; Antidumping Investigation of Certain Small Diameter Carbon and Allow Seamless Standard Line and Pressure Pipe from the Czech Republic, Memorandum to R. LaRussa re Non-Market Economy Country Status (Nov. 29, 1999) ("Czech Republic NME Analysis Memorandum") at 5.

³⁶ See, e.g., Hungary NME Analysis Memorandum at 6.

2. Market forces freely determine the official exchange rate of the ruble.

Like the Czech and Slovak koruna at the time that these countries were designated as market economies, the ruble floats independently.³⁷ This means that rather than being artificially fixed at some particular level relative to other world currencies, market forces set the official exchange rate at which the Central Bank of Russia (CBR) buys and sells rubles.³⁸

The ruble's situation contrasts favorably with the limited convertibility of the Hungarian forint and the Latvian lat, whose exchange rates were pegged directly to other currencies at the time of NME revocation.³⁹ And the ruble's situation is radically different from that of the zloty, which "[could] not be freely exchanged outside Poland for foreign investment goods" at the time of Poland's NME revocation.⁴⁰

Moreover, Russia's floating exchange rate policy, which was painfully maintained throughout the difficult days of the 1998 financial crisis, will remain in place for the foreseeable future. The CBR has submitted to the Duma a draft monetary and credit policy plan for 2002 based on the principle of a freely floating exchange rate: "[t]he main principle of

³⁷ Slovakia NME Analysis Memorandum at 5; Czech Republic NME Analysis Memorandum at 5.

³⁸ The official exchange rate of ruble is established by the Central Bank of the Russian Federation, being calculated on the basis of average-weighted exchange rates determined by various market forces.

³⁹ Hungary NME Analysis Memorandum at 6 (pegged to euro and dollar); Latvia NME Analysis Memorandum at 6 (pegged to IMF's Special Drawing Rights, a basket of major trading country currencies).

⁴⁰ Department of Commerce, Memorandum to the file from Albert Hsu, Office of Policy, re Respondent's request for revocation of Poland's NME Status (June 21, 1993) ("Poland NME Analysis Memorandum") at 10. At the time, the DOC decided that "[f]ull convertibility is not . . . necessary to link Poland's economy to world markets." It concluded that while "[i]t certainly is true that the zloty is not fully convertible (on both current and capital accounts) . . . [,] [t]he lack of full convertibility *certainly does not disqualify Poland as a market economy.* . . ." *Id.* at 33 (emphasis added).

exchange rate policy in 2002 will remain rate-setting by the market using the regime of a floating rate for the ruble against foreign currencies.”⁴¹

3. The ruble is freely convertible for virtually all types of transactions.

As noted above, consistent with IMF Article VIII the ruble has been freely and fully convertible for current account transactions since 1996.⁴² Indeed, Russian law expands considerably on the basic convertibility principle of Article VIII, providing expressly that:

- Resident legal entities have the right to buy foreign currency, without limits, for the purpose of making payments and transfers for current account transactions and to make such payments and transfers;⁴³
- Resident legal entities have the right to receive payment, without limits, in foreign currency in payment for the provision of delivery of goods, works, and services in the current account transactions, although, as discussed below, they are required to convert a certain portion of such foreign exchange earnings to rubles;
- Non-resident legal entities have the right to buy and to use, without limits, legally obtained currency of the Russian Federation for purposes of making payments for goods, works, and services in connection with current international transactions;⁴⁴
- Non-resident legal entities have the right to accept payments in the currency of the Russian Federation from resident legal entities for delivery of goods, works, and services in connection with current account transactions; to convert such rubles into foreign currency at the domestic currency market of the Russian Federation at the market rate; and to repatriate such foreign exchange.⁴⁵

⁴¹ Interfax News Agency, "Central Bank to Continue to Float Ruble" (October 4, 2001).

⁴² Current account transactions include, but are not limited to, settlements under import/export contracts within 90 days, financial credits, the payment of interest and dividends, non-trade settlements (such as salary, business trips allowances, pensions, etc.)

⁴³ Instructions of the Russian Central Bank #7 of June 29, 1992, point 24: " Russian Resident legal entities have the right to buy foreign currency for rubles through the authorized banks of the Russian Federation at the internal currency market . . . or execution of current account transactions."

⁴⁴ Instructions of the Russian Central Bank #93-I of October 12, 2000, point 3.4: "Non-residents are allowed to execute operations from their ruble bank account in accordance with the list pointed out in attachment 1 to the Instructions"; attachment 1, line 203: "payments for goods sold by the residents," line 206: "payments for services and works performed by the residents."

⁴⁵ The Instructions of the Russian Central Bank #93-I of October 12, 2000, attachment 1, line 202: "Non-residents are allowed to receive payments from resident legal entities for goods," line 205:

In sum, non-resident legal entities, may send foreign currency into Russia, convert it into rubles, invest in local equities and debt, and eventually convert and repatriate foreign currency proceeds out of Russia. In short, convertibility of the ruble for use in connection with current account transactions is, in the word of the U.S. Commercial Service, “unrestricted.”⁴⁶

Convertibility of the ruble for use in connection with capital account transactions is subject to certain limited restrictions,⁴⁷ and, unlike current account transactions, certain capital account transactions must be licensed by the CBR.⁴⁸ Examples of such licensing requirements include a requirement that non-resident legal entities willing to make an initial investment in a Russian company *in rubles* register the investment with the Central Bank of Russia and apply to invest via a ruble-denominated account. If the investment is made in *foreign currency*, however, registration is *not* required. In addition, registration is required of Russian resident legal entities that wish to invest in offshore companies. Such licensing requirements are in the nature of registration or notification requirement, depending on the type of the capital account transaction;

"non-residents are allowed to receive payments from resident legal entities for services and works performed by non-residents," point 3.7: "Operations on purchase of foreign currency from ruble accounts of non-residents are executed without limits." In addition, certain types of investments are allowed to be made in foreign currency, *e.g.* contributions to charter capitals of Russian companies, joint activity agreements, etc. (Central Bank Directive #660-U, October 18, 1999).

⁴⁶ U.S. Commercial Service, *Country Commercial Guide Russia, Fiscal Year 2002*, "Foreign Exchange Controls," p. 80 ("Unrestricted foreign currency transactions may be completed on settlements under import/export contracts within 90 days, loans for terms of less than 180 days, and the payment of interest and dividends.")

⁴⁷ Capital account transactions include settlements under import/export contracts beyond 90 days, loans for terms of more than 180 days, and investments.

⁴⁸ U.S. Commercial Service, *Country Commercial Guide Russia, Fiscal Year 2002*, "Conversion and Transfer Policies," p. 63-64.

They are not prohibitions. Moreover, the government has issued a list of capital account transactions that may be settled without a license.⁴⁹

4. Resident and non-resident legal entities may maintain accounts in Russian banks in either rubles or foreign currency.

Resident and non-resident legal entities can hold ruble or foreign currency accounts in any bank that is a resident legal entity of Russia.⁵⁰ Resident and non-resident legal entities can carry out foreign exchange transactions in any of the 1,319 banks and non-bank credit organizations that are authorized to conduct such transactions. Non-residents without a subsidiary or representative office in Russia may settle accounts in rubles for export-import transactions through the correspondent accounts of non-resident banks with authorized Russian banks.⁵¹

Presently, non-resident legal entities must hold rubles (if in Russia) either in a “K” (conversion) or an “N” (non-conversion) account. “K” accounts are designed for the receipt and disbursement of rubles for transactions that would, if they involved foreign currency as opposed to rubles, constitute current account transactions (*i.e.*, settlements under import/export contracts within 90 days, financial credits, the payment of interest and dividends, and non-trade settlements such as salary, business trips allowances, and pensions). “N” accounts are designed for the receipt and disbursement of rubles for transactions that would, if they involved foreign

⁴⁹ Regulation #39 approved by the Central Bank Order #02-94 of April 24, 1996.

⁵⁰ Federal Law # 3615-1 of October 9, 1992 "On Currency Regulation and Currency Control," art. 5 point 1: "Residents are allowed to open and operate with foreign currency bank accounts in the authorized banks of the Russian Federation," art. 7 point 1: "Non-residents are entitled to have foreign currency bank accounts and ruble bank accounts in the authorized banks of the Russian Federation."

⁵¹ The Economist Intelligence Unit, *Country Commerce, Russia*, p. 38, November 2001.

currency, constitute capital account transactions (*i.e.*, settlements under import/export contracts beyond 90 days and investments).

While a non-resident legal entity may use funds maintained in a “K” account for the purchase of hard currency without limitation, it may convert rubles held in an “N” account to hard currency only after a one-year waiting period. Moreover, funds held in an “N” account cannot be transferred to a “K” account. The requirement that capital-account-type ruble transactions flow through an “N” account, with its waiting period for conversion of rubles to foreign currency, is a necessary adjunct to Russia’s exchange controls on capital account transactions. Without the corresponding controls on rubles entering and leaving “N” accounts, the exchange controls on capital account transactions would be ineffective. As such, the restrictions regarding “N” accounts do not impose additional currency controls on non-residents. Instead, they merely effectuate the limited existing currency controls.

In practice, the restrictions regarding “N” accounts affect only a very small number of transactions, since it is lawful to structure most investment transactions in ways that avoid the restrictions regarding “N” accounts.

For example, transactions between non-residents involving property interests (*i.e.*, including tangible, intangible, and real property interests) in Russia can lawfully be conducted entirely in hard currency. As such, they are entirely exempt from Russia’s exchange controls. In addition, transactions between a non-resident and a resident involving real property interests in Russia can be conducted entirely in hard currency with the permission of the CBR, permission that is typically forthcoming, although the processing time is about three months. Most of the other transactions involving property interests in Russia (other than real estate and portfolio

investments) between residents and non-residents are current account transactions and can be performed freely in foreign currency or in rubles through “K” account.

Under Russian law certain types of earnings from investments are treated as current-account-type transactions that can be repatriated without restriction through a “K” account, if in rubles, and through foreign currency accounts of non-residents in Russia or abroad, if in foreign currency. Specifically, non-resident investors may found, or invest in an existing, Russian legal entity (*i.e.*, a *resident* legal entity) by contributing to the charter capital of the entity. Permission from the Russian Central Bank for such contributions is not required.⁵² The non-resident investor may then freely convert into hard currency and repatriate payments in rubles of interest, dividends, and other income gained out of contributions, since such revenues constitute current-account-type transactions.⁵³

Finally, following a recent change in the CBR’s exchange controls, non-residents may lawfully avoid the restrictions regarding “N” accounts by structuring direct investment as a loan to a resident entity. Under a recently adopted CBR rule,⁵⁴ residents can now receive not only short-term loans but also long-term loans (*i.e.*, in which the repayment period exceeds 180 days) without a license or other restrictions and can repay the non-resident lender, again without restrictions. In addition, interest payable for loan facilities constitutes a current-account type transaction under the Federal Law “On Currency Regulation and Currency Control” and can be settled without restrictions through payment into a “K” account. Hence, foreign investors may

⁵² The Russian Central Bank Resolution # 660-U dated October 8, 1999.

⁵³ Federal Law # 3615-1 of October 9, 1992, “On Currency Regulation and Currency Control.”

⁵⁴ The Russian Central Bank Resolution # 1030-U dated September 10, 2001.

freely repatriate their earnings if those earnings are structured as the repayment of a loan or as interest on a loan.

In sum, the restrictions regarding “N” accounts have little practical effect on non-residents doing business in Russia.

5. The minimal exchange controls that Russia maintains on certain types of exchange transactions are not evidence that Russia is not a market economy.

Like many countries, Russia imposes certain controls on foreign exchange in order to maintain the stability of the ruble and to monitor illegal currency flows. Contrary to assertions made by the Opposing Parties, such controls are entirely consistent with Russia’s obligations under IMF Article VIII, with the full convertibility of the ruble, and with the practice of other countries at the time of NME revocation.⁵⁵

Currency controls are, of course, widely used in market economies and are not, in themselves, evidence that an economy does not operate on market principles. For example, the DOC noted at the time of Poland’s revocation in 1993 that France and Italy, members of the G7 and two of the world’s most robust market economies, maintained exchange controls on their currencies.⁵⁶

⁵⁵ As an additional confirmation, it can be noted that the Russian courts cite to the provisions of IMF Article VIII in making their judgements. In particular, see Resolution of the Federal Arbitration Court of North-West Region #A56-17224/98 of December 17, 1998; Resolution of the Federal Arbitration Court of North-West Region #A13-829/98-15 of September 15, 1998.

⁵⁶ Poland NME Analysis Memorandum at 10 n.1, 33 (“France and Italy do not have fully (externally and internally) convertible currencies, due to restrictions on capital account transactions.”)

a. Market-based economies routinely use currency controls.

Many countries with market economies maintain currency controls. These include several of the group of emerging economies known as the "Asian Tigers;" two of the world's largest emerging economies, Brazil and India; and Australia, a western-style first-world market economy.⁵⁷

Australia, for example, requires prior approval for the most significant types of foreign direct investment. Prior authorization is required for:

- Acquisitions by foreign investors of a substantial interest in an Australian business with total assets of more than \$A 50 million or where the proposal values the business over that amount (a substantial interest is seen as one that would result in the shareholding of 15 percent or more by a single foreign interest or association or 40 percent or more by two or more unrelated foreign interests in an Australian corporation);
- All investments in the banking, civil aviation, airports, shipping, media, telecommunication, and real estate sectors, including those below the \$A 50 million threshold, which are subject to special restrictions; and
- Proposals to establish new businesses where the total amount of investment is \$A 10 million or more.⁵⁸

India also maintains extensive currency controls on both current and capital account transactions, a fact of particular significance given that the DOC routinely uses India as a market economy surrogate in anti-dumping cases.⁵⁹ For example, the rupee is not freely

⁵⁷ "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 440-443 (Indonesia), p. 570-574 (Malaysia), p. 734-738 (Philippines), p. 824-826 (Singapore), p. 498-502 (South Korea), p. 917-921 (Thailand), p. 136-143 (Brazil), p. 430-436 (India), p.50 (Australia).

⁵⁸ "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 50.

⁵⁹ Certain Folding Gift Boxes From the People's Republic of China, 66 FR 58115 (final det.) (Nov. 20, 2001); Honey From the People's Republic of China, 66 FR 50608 (final det.) (Oct. 4, 2001); Certain

convertible even for current account transactions and there are "11 items related to public sector expenses and other items listed" that are not freely convertible.⁶⁰ As regards capital account transactions, capital securities, money market instruments and collective investment securities all face restrictions and approval by the Reserve Bank of India.⁶¹ Finally, *like Russia, India requires 100 percent of export proceeds to be repatriated and at least 50 percent to be exchanged for local currency.*⁶²

b. Other countries whose NME status was revoked had similar currency controls.

The DOC has expressly recognized that the mere existence of exchange controls is not evidence that an economy operates on non-market principles. The DOC revoked its NME designations of Latvia, Hungary, Slovakia, and the Czech Republic each country maintained significant exchange controls at the time. Hungary required forced repatriation of foreign exchange earnings and prohibited resident legal entities holding accounts in non-resident banks.⁶³ The DOC found that Hungary's exchange controls were not objectionable because they were intended "to reduce short-term pressures on and undue (destabilizing) fluctuations in the exchange rate."⁶⁴ Latvia maintained controls on resident legal entities' portfolio and on direct

Hot-Rolled Carbon Steel Flat Products From the People's Republic of China, 66 FR 49618 (final det.) (Sept. 28, 2001); Pure Magnesium in Granular Form From the People's Republic of China, 66 FR 49345 (final det.) (Sept. 27, 2001).

⁶⁰ "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 429-430.

⁶¹ "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 431-432.

⁶² "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 429.

⁶³ Hungary NME Analysis Memorandum at 6.

⁶⁴ Hungary NME Analysis Memorandum at 6.

investments abroad.⁶⁵ Slovakia and the Czech Republic also maintained significant exchange controls in place at the time their NME designations were revoked.

In Slovakia, residents were required to repatriate all export profits no later than 30 days from acquisition. This requirement also applied to invisible transactions and current transfers.⁶⁶ A permit was required for a variety of capital transactions, including purchases of capital market securities, bonds, and other debt securities and money market instruments.⁶⁷ In the Czech Republic, permits were required for the issuance of debt and mortgage securities and money market instruments.⁶⁸ In fact, only Poland had no currency controls, and that is simply because the zloty was not convertible at the time of revocation.⁶⁹

c. Russia's limited exchange controls were instituted to address capital flight.

The most stringent of Russia's exchange controls were instituted in 1998 to stabilize the ruble and protect the Russian economy during the financial crisis caused by instability in Asian financial markets and by record low prices for Russia's single most important export product – crude oil and associated hydrocarbons.⁷⁰ The purpose of these controls was no different from those imposed in Hungary and Latvia. As the CBR noted in 1999, their purpose

⁶⁵ Latvia NME Analysis Memorandum at 6.

⁶⁶ "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 778-779.

⁶⁷ "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 779-780.

⁶⁸ "Annual Report on Exchange Arrangements and Exchange Restrictions," International Monetary Fund, 2001, p. 269.

⁶⁹ Poland NME Analysis Memorandum at 10, 33.

⁷⁰ Russia's exports of oil and gas accounted for 58% of total exports in 2000. The Economist Intelligence Unit, EIU Viewswire, "Russia: Energy Provision," July 16, 2001. available at <http://www.viewswire.com>.

was "restoring public and corporate confidence in the ruble, which was considerably undermined by its abrupt devaluation" and "maintaining the official foreign exchange reserves at the level ensuring stability of the Russian monetary and financial system."⁷¹

Specifically, the principal purposes of the remaining exchange controls are to control capital flight, which plagued Russia throughout most of the 1990s, and to crack down on corruption by monitoring suspicious transactions. This latter is an initiative that has been urged on Russia by Western nations – chief among them the United States -- attempting to control money laundering and illicit currency flows.⁷² In fact, the reporting requirements implemented by the CBR to monitor suspicious transactions⁷³ – far from being evidence that Russia is not a

⁷¹ Central Bank of the Russian Federation, "The Objectives, Tasks and Instruments of the Exchange Rate Policy" (Feb. 24, 1999), available at http://www.cbr.ru/eng/analytics/money_market.

⁷² For example, authorized banks are required to report certain types transactions to the CBR. These include:

Any transaction by a resident with a non-resident located in a listed "offshore zone" ;

Contracts without penalties for non-payment or non-compliance by non-resident legal entities (*i.e.*, because there is a presumption that such a deal is a sham and non-resident counterpart has no intention of completing transaction);

Transactions that involve more than 30 percent pre-payment of the purchase price of imported goods to non-resident legal entities (*i.e.*, to prevent sham transactions to transfer foreign currency out of the country), or where total prepayment exceeds USD 100,000;

Transactions that have resident legal entities paying non-resident legal entities at interest rates exceeding 20 percent per year (again to prevent sham transactions); and

Where the actual recipient of goods or services imported or exported are not parties to the agreement. Deals concluded by resident legal entities registered less than three months.

The U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, "Special Rules for Suspicious Transactions," p.65-66.

⁷³ This is the purpose of the requirement that an importer who has paid in advance in foreign currency for imported goods deposit 100% of the value of an import transaction with an approved bank until he can present proof that the goods have actually cleared customs. This is to control sham transactions aimed at sending foreign currency abroad illegally.

market economy — are patterned on those recommended by the OECD's Financial Action Task-Force on Money-Laundering.⁷⁴

The actions taken by the CBR worked. "[C]apital flight has declined rapidly since late 2000,"⁷⁵ and today, Russia is swiftly phasing out the most stringent of its remaining exchange controls. Moreover, the Putin administration has been acting recently to reduce the few remaining restrictions on the convertibility of currency in capital transactions and further open Russia to foreign investment.

As a result, the U.S. Commercial Service notes, "many [currency] controls are presently in the process of revision."⁷⁶ For example, in 2001 a rule was revoked that had prevented non-resident legal entities from converting ruble earnings from direct investments into foreign currency during one calendar year consequent to the investment execution.⁷⁷

d. Russia's surrender requirements are scheduled for full revocation by 2004 at the latest.

The requirement most frequently cited by Opposing Parties in discussions of Russia's exchange controls is the ruble surrender requirement. This provision requires Russian

⁷⁴ The Economist Intelligence Unit, "Country Commerce, Russia," p. 37, November 2001.

⁷⁵ The Economist Intelligence Unit, "Country Commerce, Russia," p. 36, November 2001.

⁷⁶ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, "Conversion and Transfer Policies," p. 63-64.

⁷⁷ Prime-TASS, "The CB Lifts Restrictions on Repatriation of Revenues," Kommersant, October 24, 2001, p.7. See Russian Central Bank Regulation #154-P of October 12, 2001.

companies – *but not non-resident legal entities* -- that earn revenues in foreign currencies to convert a part of these earnings to rubles.⁷⁸

While the requirement had existed prior to the financial crisis of October 1998, its reach was broadened in response to that crisis and in December 1998, the CBR raised the ruble surrender requirement from 50 percent to 75 percent.⁷⁹ As Russia has emerged from the 1998 crisis, this requirement has been scaled back significantly and is presently scheduled for full revocation. In early 2001 business leaders lobbied President Putin for a relaxation of this requirement. Rapid action was taken, and in August the surrender requirement was reduced to 50 percent.⁸⁰ The government plans to reduce this figure to 25 percent by 2003 and to zero by 2004.⁸¹

Viewed narrowly, the surrender requirement, like Russia's other exchange controls, limits certain types of currency transactions by *residents*. In a broader perspective, however, the overall effect of this requirement, which was instrumental in stemming capital flight in the wake of the 1998 financial crisis, has been to promote the stability of the ruble, stimulating foreign investment and *increasing capital flows and their associated currency exchange transactions*. As economists at the Hoover Institute recently noted with approval: "The Russian economy improved in 2000 due to a dissipation or slower accumulation of

⁷⁸ It should be stressed that this restriction applies only to resident legal entities. Non-resident legal entities such as foreign entities with branch offices or commercial offices are not required to convert a portion of their export earnings into rubles.

⁷⁹ The Economist Intelligence Unit, "Russia; Regulations: Foreign exchange," December 14, 2001.

⁸⁰ See Federal Law # 130-FZ of August 10, 2001, "On Changes Introduced into Certain Legislative Acts Affecting Foreign-Exchange Regulation."

⁸¹ The U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, "Foreign Currency Liberalization," p.10.

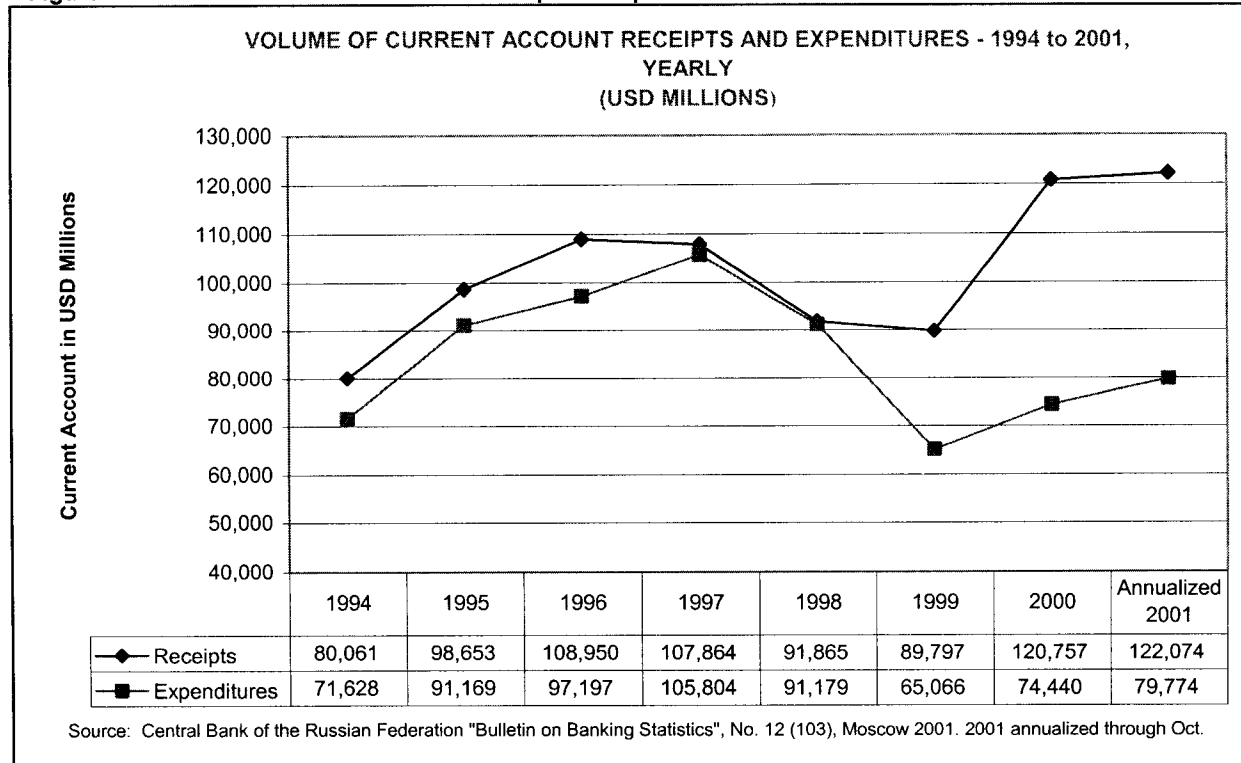
payment arrears relative to the money stock. It was the 75 percent rule that brought additional dollars to Russia and facilitated payments after their conversion."⁸²

C. Economic data confirm the free convertibility of the ruble.

1. The volume of the Russian economy's current account transactions shows a steady increase from 1997 to annualized 2001.

As the degree of economic freedom has increased in Russia, the volume of current account transactions as shown through expenditures and receipts has increased over 30% and the ruble has become accepted in international transactions. The current account is a concept in international finance that portrays the flow of international trade over a period of time. The current account measures "visible" trade such as goods and merchandise, as well as "invisible" trade such as services and dividends. Over the past several years as the Russian economy has expanded and increased its transactions with countries around the world, and the government has liberalized its economic policies the volume of current account transactions has increased significantly. The private businesses that now exist in Russia due to the shift to a market-based economy are increasing their interactions and trade with foreign entities, a trend which would be expected to continue as the Russian economy continues its economic liberalization. None of this increase in current account transactions would be possible without the free convertibility of the ruble. The legal reforms regarding convertibility discussed above have manifested themselves in increasing international trade between Russia and the rest of the world.

⁸² Hoover Institution Public Policy Inquiry, The Russian Economy, "The 100% Repatriation Rule: An Option for Russia," January 25, 2001.

Figure 1 - Volume of Current Accounts Receipts & Expenditures

2. The volume of capital and financial account transactions has also increased in tandem with the increase in volume of current account transactions.

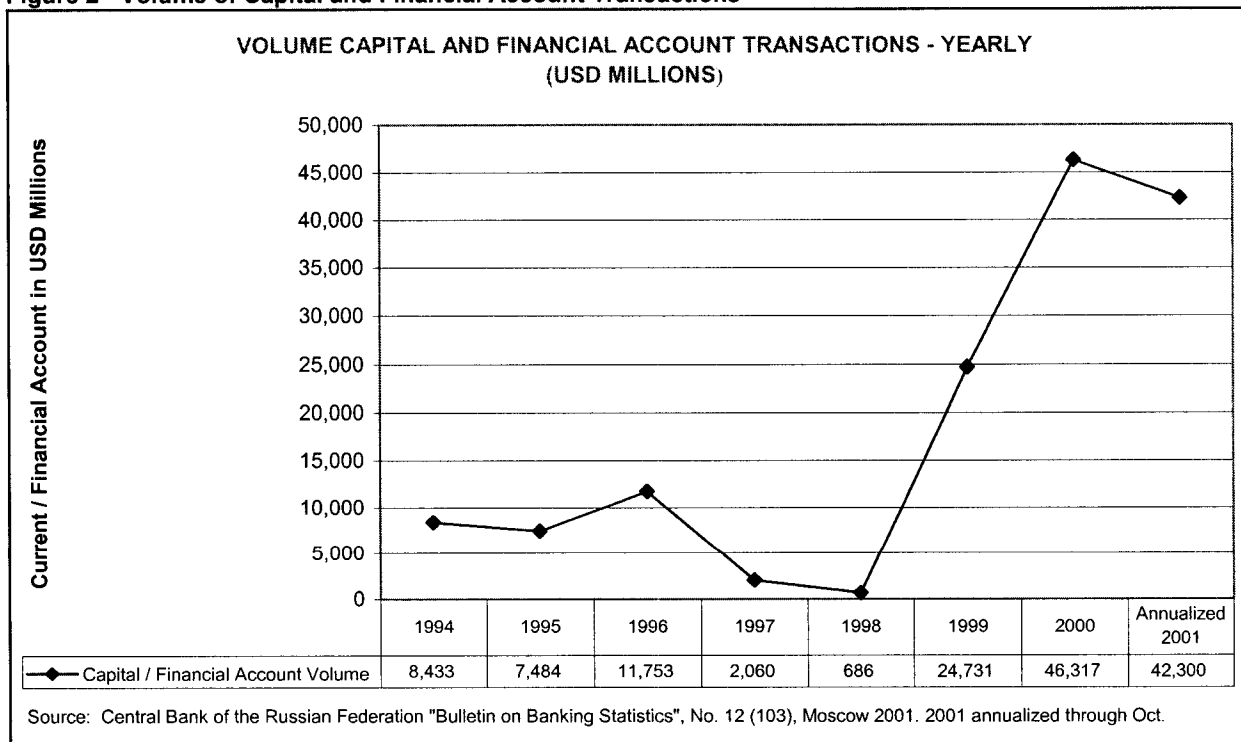
The capital and financial accounts of a nation's balance of payments accounts record the purchase and sale of assets across international borders, as well as the flow of capital and investment. The assets could take the form of traditional fixed assets such as buildings or factories, or could take the form of financial assets such as stocks or bonds. The capital and financial accounts can be thought of as financing the transactions of the current account.

As the Russian economy has moved to a market-based system, Russian businesses and individuals have participated more and more fully in international transactions, as evidenced by an increase in the volume of current, capital, and financial account transactions. However, since capital and financial account transactions are reported on a net basis, the volume of

transactions reported in national financial statistics are not the full volume of transactions, but rather the amounts needed to finance a nation’s current account surplus or deficit.

Over the last several years, Russia has enjoyed a current account surplus, meaning that the Russian economy has exported more goods and services than were imported. Extensive energy exports and strong world prices for oil and gas have contributed significantly to this surplus, but the growth in exports of other goods has been strong as well. The size of the surplus has increased over the past several years, in correlation with Russia’s increasing involvement in the world economy and the increasing convertibility of its currency.

Figure 2 - Volume of Capital and Financial Account Transactions



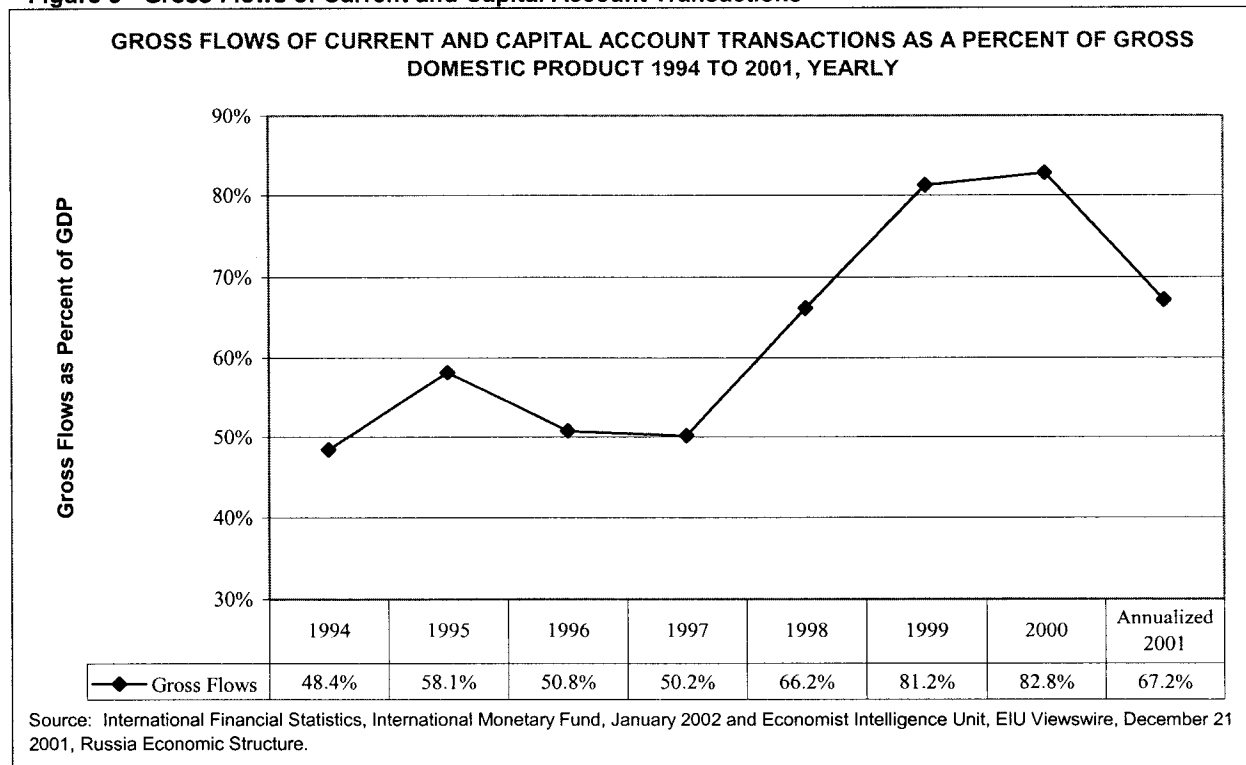
3. Gross flows of capital have increased and remain at a high level.

As the global economy expands and becomes more and more integrated, international trade between nations becomes more and more important. One empirical method to capture the significance of international trade to a national economy is the measurement of gross

flows of goods and capital as a percentage of gross domestic product.⁸³ The gross flow of goods and capital as a percent of gross domestic product is a more accurate measure of the importance of international trade to an economy, since the measurement of gross flows would capture the total value of all international transactions.

Since 1994, the volume of current and capital account transactions has steadily increased over time and as compared to gross national product, has also been increasing. The integration of Russia into the international marketplace has become complete.

Figure 3 - Gross Flows of Current and Capital Account Transactions

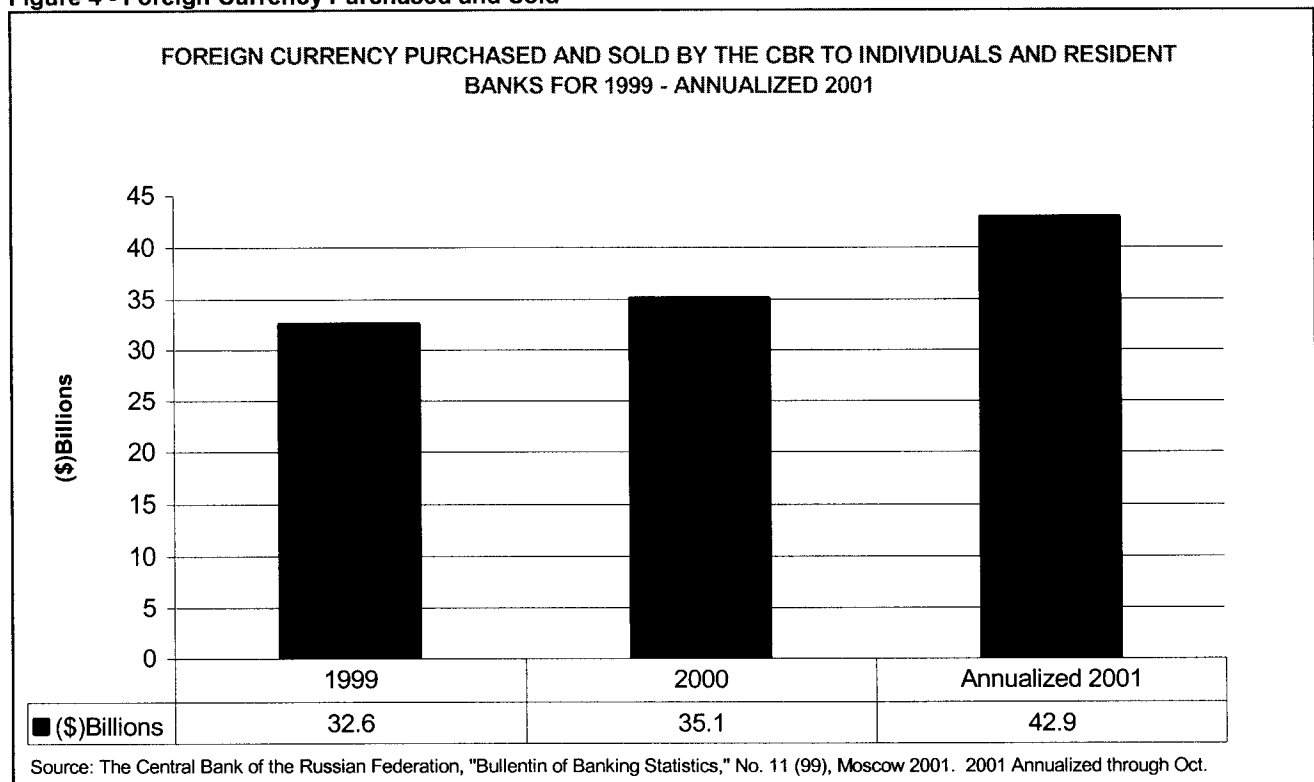


⁸³ In the reporting of balance of payments, flows are often reported on a *net* basis. However, the flow of goods into and out of a country is offset by the flow of capital, yielding a comparison where *net* transactions cancel each other out. Hence, this comparison is based on *gross* flows. The above chart, however, reflects the entire volume of both current and capital account transactions.

4. Large volumes of foreign currency are bought by and sold to Russian individuals and resident banks.

Russia's liberalized policies on exchange controls have taken root and are also reflected in the amount of foreign cash purchased and sold each year by individuals and resident banks in Russia. From 1999 to annualized 2001 (through Oct.), foreign currency transactions increased by 31.6 percent, as shown in the table below.

Figure 4 - Foreign Currency Purchased and Sold

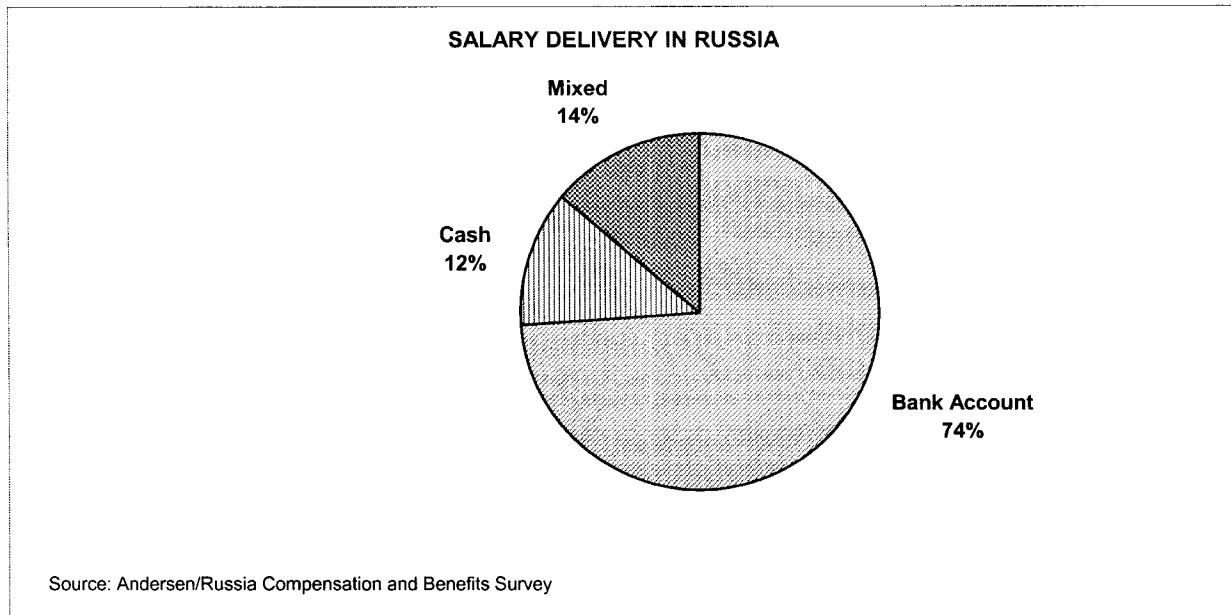


5. Increasingly, Russian employees are electing to receive their salary as a bank deposit rather than in cash.

Confidence in the stability of the ruble and banking sector continues to grow in Russia as non-monetary payments continue to decline. In a recent compensation and benefits survey in Russia, more than 80 percent of employers reported they pay their employees' salaries directly into bank accounts, an indicator that confidence in the banking sector continues to

grow.⁸⁴ Retail banking by Russian and international banks is also on the increase, with firms such as ABN/Amro, Citibank, and Bank Austria expanding in Russia.

Figure 5 - Salary Delivery In Russia



6. The ruble is stable and capital flight has been mitigated.

The 1998 financial crisis that hit Russian financial markets developed gradually. Budget expenditures continued to exceed revenues prior to 1998 and the government's use of non-inflationary sources of financing the budget deficit led to significant growth in government debt. Additionally,

East Asian financial markets crisis in 1998 compelled many foreign investors to review their investment strategy with regard to the transitional economies and emerging markets. As a result, the inflow of foreign investment to the Russian government debt market dwindled, while the government debt-servicing expenditures grew considerably. Decrease in the world prices of oil and some other key Russian exports led to the reduction of Russia's balance of trade surplus

⁸⁴ Arthur Andersen LLP, "Russia, Compensation and Benefits Survey" (October 2001) at 21 attached as Exhibit 3, (the "Russia, Compensation and Benefits Survey").

and eventually in the first half of 1998 the current account of the balance of payments slipped into negative ground.⁸⁵

As the situation continued to deteriorate, capital flight became a significant factor in weakening the economy and public confidence in the ruble. The decline in confidence in the ruble was reflected in the exchange rate between the US dollar and the Russian ruble rose from 5.96 to 20.65 rubles to the dollar, or 3.46 times. To restore the domestic foreign exchange market, ensure the return of export earnings to Russia, and create conditions for replenishment of the official foreign exchange reserves, the CBR in September 1998 began to implement a series of measures to tighten foreign exchange regulation and foreign exchange control, as addressed above.⁸⁶

The following graph illustrates the effects the financial crisis of 1998 had on ruble exchange rate dynamics with the U.S. dollar, and the subsequent stabilization of the ruble since the second half of 1999.⁸⁷ By the end of 1999, the exchange rate of rubles to U.S. dollars was 28.57 and by October of 2001, it was 29.50 representing a decrease in value of just 3 percent over nearly 2 years. The total fluctuation during this same time period was just 6.3 percent.⁸⁸

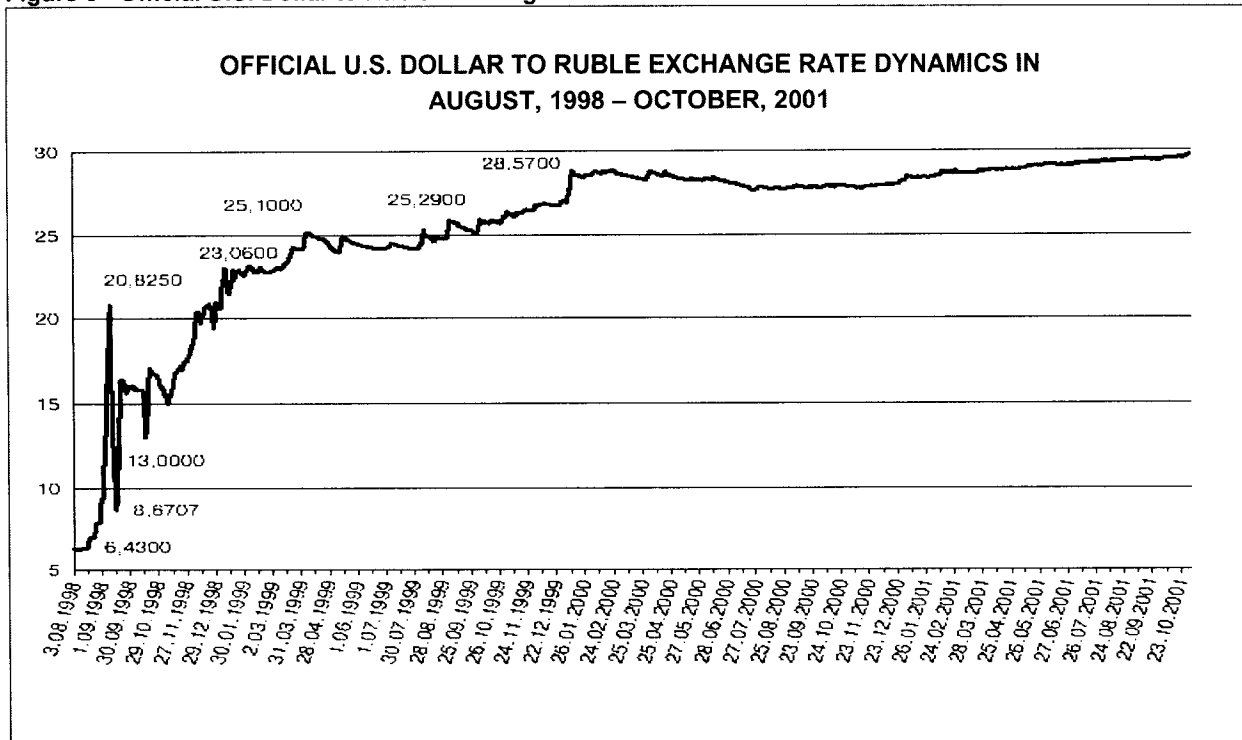
⁸⁵ Central Bank of the Russian Federation, "Foreign Exchange Policy in 1998 and the Bank of Russia Policy Response to the Financial Crisis," February 25, 1999, available at http://www.cbr.ru/eng/analytics/money_market/print.asp?file=pvk_e.htm.

⁸⁶ Central Bank of the Russian Federation, "Foreign Exchange Policy in 1998 and the Bank of Russia Policy Response to the Financial Crisis," February 25, 1999, available at http://www.cbr.ru/eng/analytics/money_market/print.asp?file=pvk_e.htm.

⁸⁷ Central Bank of the Russian Federation, "Bulletin of Banking Statistics," No. 11(99), Moscow 2001, available at http://www.cbr.ru/eng/BBS/bank_bulletin.asp.

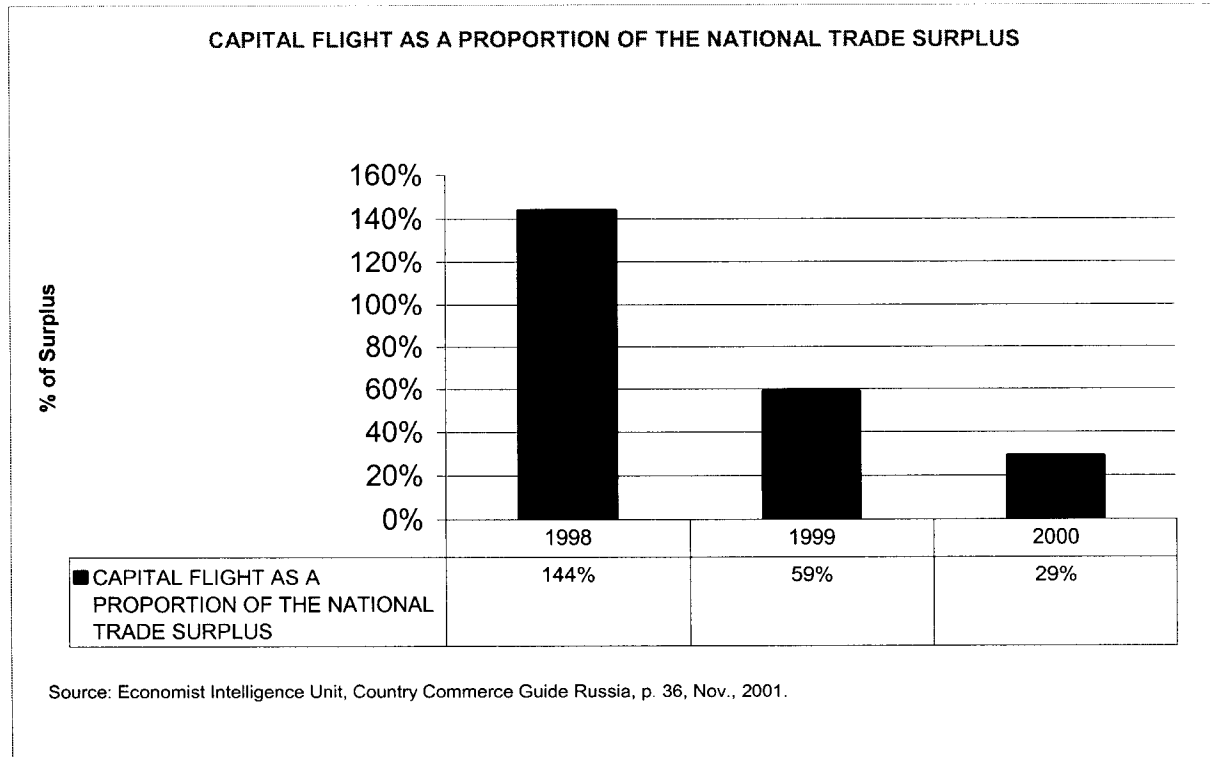
⁸⁸ Based upon exchange rate data from The Central Bank of the Russian Federation, "Bulletin of Banking Statistics," No. 11(99), Moscow 2001, available at http://www.cbr.ru/eng/BBS/bank_bulletin.asp.

Figure 6 - Official U.S. Dollar to Ruble Exchange



Source: The Central Bank of the Russian Federation, Bulletin of Banking Statistics, No. 11(99), Moscow 2001 at 35.

This new confidence, bred by the stabilization of the ruble, has led to substantial decreases in capital flight from Russia. As a proportion of the national trade surplus, capital flight has decreased since 1998, as shown in Figure 7 below.

Figure 7 - Capital Flight As A Proportion Of the National Trade Surplus

III. CRITERION 2: THE EXTENT TO WHICH WAGE RATES IN THE RUSSIAN FEDERATION ARE DETERMINED BY FREE BARGAINING BETWEEN LABOR AND MANAGEMENT

Summary of Comment

The Opposing Parties have also misstated key facts in arguing that wage rates in the Russian Federation are not determined by free bargaining between labor and management. Section A corrects these misstatements, while Section B provides a detailed discussion of the legal regime governing how wages are set in Russia. Section C provides economic data demonstrating that free bargaining between labor and management sets wages.

A. The parties opposing revocation misstate key facts concerning the extent to which wage rates in the Russian Federation are determined by free bargaining between labor and management.

One Opposing Party, using badly outdated data, has asserted that "Russian wages are extremely low, with the current monthly minimum wage at 200 rubles, or USD 7. . . . The Russian Duma postponed passage of a new labor code."⁸⁹ On the second point, the new Labor Code, which replaces the outdated former code, was adopted in December 2001 and will enter into force as of February 1, 2002. Among other things, the new Labor Code establishes a minimum monthly wage at the official subsistence level – currently RUR 1,658 (\$56) per month or eight times the amount stated by the Opposing Party. It must be emphasized that the monthly minimum wage was not an actual wage level, was and is still used as a multiplier for benefits such as pensions, salaries for government workers, tax penalties, and registration fees. For example, a person found to have violated the tax code would incur a penalty of 10 times the monthly minimum wage.

Most misleading, however, is the first point, with its implication that the outdated \$7 minimum wage figure is an accurate indicator of wage levels generally in Russia. While wage levels in Russia are low by U.S. standards, they are many times higher than the \$7 figure cited above — an average of \$118/month as of late 2001.⁹⁰ What is more, they are rising rapidly, far faster, in fact, than in the United States. In the first seven months of 2001, *real* wages in Russia grew by 16-17 percent.⁹¹

One Opposing Party contends "workers are commonly paid late or with goods rather than money, underscoring their lack of bargaining power."⁹² While it is true that these practices occur, there are now legal penalties in place for late payment, including the right of employees to suspend work until paid.⁹³ As to payment in kind, the new Labor Code, which becomes effective on February 1, 2002, will greatly reduce this practice by limiting the maximum percentage of employee's salary that may be paid in non-monetary form at 20 percent.⁹⁴

One Opposing Party erroneously states, "worker's freedom of movement is severely restricted by the *propiska* registration system."⁹⁵ This is incorrect. The 1993 Constitution guarantees all persons freedom of movement and the right to choose where to live.⁹⁶

⁸⁹ Wiley Rein & Fielding Brief, at 6.

⁹⁰ The Economist Intelligence Unit, "Country Commerce, Russia," p. 54, November 2001.

⁹¹ The Economist Intelligence Unit, "Country Commerce, Russia," p. 54, November 2001.

⁹² Skadden-Dewey Brief at p. 15.

⁹³ Federal Law #197-FZ of December 30, 2001, "Labor Code of the Russian Federation," art. 142, (the "New Labor Code").

⁹⁴ New Labor Code, art. 131.

⁹⁵ Skadden-Dewey Brief, at 12, 14.

⁹⁶ 1993 Constitution, art. 27.

In construing this constitutional provision, the Constitutional Court has ruled that the existing registration mechanism may not be used to require citizens to obtain permission to change location or place of residence. In other words, the existing registration mechanism cannot limit any rights granted by the Constitution.⁹⁷ The federal law that provides for registration explicitly states that:

Registration or non-registration may not serve as a ground or condition for the implementation of the rights and freedoms of citizens, provided for by the Constitution of the Russian Federation, the laws of the Russian Federation, the Constitutions and laws of the Republics within the Russian Federation.⁹⁸

While various laws in addition to the federal law cited above require natural persons to register their place of residence,⁹⁹ these registration rules require only that when a person changes his/her residence, he/she must provide local authorities with a passport or other documents for the purposes of registration. The Federal Law spells out the limited, exclusive list of areas where citizens' rights to move freely or to reside may be restricted:

The right of citizens of the Russian Federation to the freedom of movement, the choice of a place of sojourn or residence within the Russian Federation may be restricted according to the laws of the Russian Federation:

- In a border area;
- In closed cantonments;
- In closed administrative-territorial formations;
- In zones of ecological disaster;

⁹⁷ Constitutional Court Resolution # 4-P of February 2, 1998; see also Constitutional Court Resolution # 3-P dated April 25, 1995.

⁹⁸ Federal Law # 5242-1 of June 25, 1993, "On The Right Of Citizens Of The Russian Federation To The Freedom Of Movement, The Choice Of A Place Of Stay And Residence Within The Russian Federation," art. 3.

⁹⁹ *See, e.g.*, Russian Government Resolution # 713 of July 17, 1995; the Moscow and Moscow Region Governments Resolution # 241-28 of March 30, 1999.

- In separate territories or populated localities where special conditions and regimes of living and economic activity have been introduced in case of danger of infections and mass non-infections diseases and poisoning; and
- In territories where a state of emergency exists.¹⁰⁰

In sum, Russia's registration requirement is merely a notification requirement.

One does not apply for the right to register and then wait for "permission" to be granted.

Registration is automatic and occurs immediately (article 6 of the federal law requires registration to be completed within three days). Registration is a mere administrative formality that cannot — and does not— serve as a pre-condition for employment.

B. The legal and regulatory regime governing Russia's labor markets ensures that wage rates in the Russian Federation are determined by free bargaining between labor and management.

Market forces can operate to set wages freely only in an economy where neither the government, employers, nor workers have the power to oppose or circumvent such forces. In the case of the government, the power to oppose or circumvent market forces would be the power to set wages by fiat. In the case of employers, it would be the power to set wages for a captive work force that did not have the ability to withhold their services. In the case of workers, it would be total protection against dismissal. In other words, market forces can operate freely only in an economy where the government does not dictate wages and where employers and employees each hold significant bargaining power because employers are free to dismiss workers in response to changing economic conditions and because employees are able to strike and to move freely within the labor market. The following section analyzes how Russia's laws balance

¹⁰⁰ Federal Law # 5242-1 of June 25, 1993, ("Grounds for Restricting the Right of Citizens of the Russian Federation to the Freedom of Movement, the Choice of a Sojourn or Residence"), art. 8.

these competing interests and limit each of these three parties from interfering with the operation of market forces in setting wages.

1. The Russian government does not intervene to dictate wage rates.

Like the U.S. government, the Russian government establishes a minimum monthly wage for workers.¹⁰¹ This is, however, the only constraint on the freedom to set wages that the state imposes upon management and labor. The Labor Code states that no limitation shall be placed on the maximum amount of payment each worker shall receive.¹⁰²

This absence of government intervention in the setting of wages contrasts starkly with the situation in the other countries that have been granted market economy status. Every country except Latvia imposed wage controls in the years preceding revocation of its NME status.

- Hungary imposed wage caps on public sector jobs.¹⁰³ Indeed, so forceful was the Hungarian government's insistence on wage discipline that the private sector conformed to the government's wage cap even though it was not legally bound to do so.¹⁰⁴
- The Czech Republic imposed wage controls on all sectors of the economy for a period of three years between 1991 and 1994; in 1997, it revived wage controls, freezing wages in the public sector and imploring private sector to exercise wage restraint.¹⁰⁵

¹⁰¹ See Labor Code, art. 78 (art. 133 of the New Labor Code).

¹⁰² See art. 77 ("Payment for labour of each worker shall depend upon his personal labour contribution and the quality of labour, and *the maximum amount shall not be limited*") (emphasis added).

¹⁰³ Hungary NME Analysis Memorandum at 8 (wage caps imposed beginning in 1995).

¹⁰⁴ Hungary NME Analysis Memorandum at 8.

¹⁰⁵ Czech Republic NME Analysis Memorandum at 7 (wages frozen from 1991-1994 and again beginning in 1997).

- Poland constrained wages in the public sector through a different mechanism — a tax on excessive wage increases.¹⁰⁶
- And Slovakia imposed wage controls *on both public and private-sector workers* in the two years immediately preceding revocation of its NME designation.¹⁰⁷

In Russia, no law permits the state to act directly to set the upper level of wages.

It goes without saying, of course, that state authorities in Russia, as in all other countries, exercise indirect control of the wages through, for example, the tax system.¹⁰⁸ Such control, however, is not aimed to limit the upper level of wages.

The Russian Government does not participate directly in wage negotiations between workers and employees. There are, however, state, regional and local tripartite organizations that bring together representatives of employers, employees, and the state/municipal authorities to coordinate and reconcile the various groups' interests.

The regional laws "On social partnership" provide for general principles of collaboration of employers (in the person of the heads of legal entities), employees (in the person of the representatives of trade unions), and the state authorities for coordination of various interests. Such laws provide the framework for the participants of labor relationship to influence labor politics in the region and take part in the creation of labor and social legislation in the region. Specially, the laws provide for foundation of the Regional Tripartite Commission for regulation of labor and social relationships, which is empowered to present legislative initiatives to the Regional State authorities, participate in elaboration of municipal and professional tariff agreements, and debate drafts of regional laws in the fields of social and labor relationships.

¹⁰⁶ Poland NME Analysis Memorandum at 7 (wage tax imposed).

¹⁰⁷ Slovakia NME Analysis Memorandum at 8 (wage controls imposed in 1997-1998),

¹⁰⁸ Russian Tax Code, art. 86.1.

The Federal Law "On the Russian Federation Tripartite Commission for regulation of social and labor relationship"¹⁰⁹ determines the legal platform for formation and work of the Commission. The Commission consists of the representatives of all-Russia unions of trade unions, all-Russia unions of employers and the Government of the Russian Federation. The main functions of the Commission are preparation of draft General Agreement to be concluded between the parties and facilitation of social and labor regulation on the Federal level. The Commission is empowered to consult Federal authorities in relation to the social-economic politics and draw up legislative initiatives and other normative acts for presentation to the Federal authorities.

At least four of the countries whose NME designation was revoked used a tripartite system of wage negotiation at the time of their graduation. In Hungary, wages for the public and private sector were set using a tripartite arrangement known as the Interest Resolution Council (IRC). The IRC made decisions on a consensus basis and was comprised of representatives from trade unions, employer associations, and the government.¹¹⁰ Latvia relied on a tripartite arrangement between trade unions, employer organizations and the government, referred to as The National Trilateral Co-operation Council, to negotiate changes in the minimum wage and other conditions of employment, including job protection.¹¹¹ Slovakia relied on collective bargaining among the government, trade unions and employer associations to

¹⁰⁹ Federal Law #92-FZ of May 1, 1999.

¹¹⁰ Hungary NME Analysis Memorandum at 7.

¹¹¹ Latvia NME Analysis Memorandum at 7.

determine wage rates,¹¹² and the Czech Republic also was found to rely on a tripartite agreement between the government, trade unions and employer associations to determine wage rates.¹¹³

2. Employers have the ability to adjust the size and composition of their workforces in response to changing economic conditions.

Unless an employer has the ability to tailor the size and composition of its workforce in response to changing economic conditions, the wages it pays are artificially inflated rather than being set by market forces. While Russia, like all the major market economies of Western Europe, grants workers significant protections against termination, it also gives employers the right to adjust their workforce through termination.

The Labor Code enumerates the reasons pursuant to which an employee who has completed a probationary period of employment may be terminated. From the point of view of an employer adjusting his workforce to changing economic conditions, the most important ground for termination, and the most frequently applied, is redundancy. In other words, an employer may terminate a worker whose services are no longer required. While the employer must provide the employee with paid notice and severance pay, this provision provides the employer with the means to reduce its workforce in response to reduced demand for the enterprise's goods or services. Notwithstanding its paid notice and severance pay provisions, this law has been used very effectively by companies to downsize during periods of economic contraction. For example, in the year following the financial crisis of August 1998, foreign companies in Moscow and St. Petersburg reduced their staff on average by 30-50 percent.¹¹⁴

¹¹² Slovakia NME Analysis Memorandum at 6.

¹¹³ Czech Republic NME Analysis Memorandum at 5.

¹¹⁴ The Economist Intelligence Unit, "Country Commerce, Russia," p. 51, November 2001.

The Labor Code also permits termination for cause, another important ground for termination from the point of view of the employer's economic interests. The Labor Code expressly recognizes inadequate performance as a ground for termination.¹¹⁵ This provision permits an employer to eliminate unproductive workers from its workforce and to replace them with more productive workers. This enhances the enterprise's productivity and, thus, its profitability, thereby giving the employer the ability to raise wages in response to changing conditions in the labor market.

The President signed a new labor code on 31 December 2001. The new code, which became effective 1 February 2002, represents a significant step forward in reforming Russia's Soviet-era Labor Code by establishing greater flexibility in defining labor relations while retaining certain basic guarantees for workers. A relevant provision of the New Labor Code provides private employers the right to dismiss employees in case of a general cutback in staff without prior approval of the relevant trade union (although consultation with the trade union is still required), a significant step in permitting employers to set, and to adjust, the size of their work force based on need.¹¹⁶ These legal rights provide employers with the ability to maintain and improve the productivity of their enterprises, give employers greater bargaining power in negotiating wages, and ensure that wage levels respond to market forces.

¹¹⁵ Federal Law # 197-FZ of December 30, 2001, "Labor Code of the Russian Federation", (the "New Labor Code"), art. 40, section 2.

¹¹⁶ The New Labor Code, art. 82.

3. Russia’s domestic legislation guarantees fundamental rights to workers, thereby ensuring them adequate bargaining power in negotiating wages.

Russian law provides fundamental legal protections to Russian workers. These include the right to bargain freely for wages, the right to strike, and the right to form and to participate in trade unions. It also guarantees workers the right to move freely, permitting workers to change jobs without hindrance, and it provides a safety net for unemployed workers. These rights, protections, and entitlements collectively provide workers with the ability to withhold their labor and, hence, with the bargaining power to negotiate freely for wages with their employers.

a. Russia’s domestic legislation guarantees workers the right to bargain freely for wages.

The laws that permit and protect free bargaining between labor and management are explicit and comprehensive. They include the 1993 Constitution of the Russian Federation,¹¹⁷ the Labor Code,¹¹⁸ the Federal Law “On Employment,”¹¹⁹ the Federal Law “On Collective Contracts and Agreements,” and the Federal Law “On Trade Unions, Their Rights and Guarantees of their Activities.”¹²⁰

¹¹⁷ 1993 Russian Constitution, art. 34 point 1.

¹¹⁸ New Labor Code, art. 129.

¹¹⁹ Federal Law #36-FZ of April 20, 1996, art 1, 8.

¹²⁰ Federal Law #10-FZ of January 12, 1996, "On Trade Unions, Their Rights and Guarantees for Their Activity," (“Federal Law on Trade Unions”).

b. Russian law protects workers' right to strike.

The 1993 Constitution of the Russian Federation guarantees the right to individual and collective labor disputes including the right to strike.¹²¹ As the Constitution has the supreme legal force and direct effect, no regional or municipal law or normative act can abridge the rights granted by the Constitution and restrict the right to strike. Indeed, Russian workers have exercised this right regularly, with strike activity rising in bad economic times and declining as the economy improves.

It is important to recognize, however, that frequent strikes are not necessarily a sign that market forces are operating vigorously. Often, strikes are a sign of economic turmoil and an indication that the economy is functioning imperfectly. The DOC has recognized this fact, noting that while the right to strike is constitutionally protected in Slovakia, the country was "largely free of strikes" for seven of the ten years preceding NME revocation.¹²² The DOC found the same to be true of the Czech Republic, where "significant labor unrest remains rare."¹²³

Unlike Russia, where the right to strike is unqualified, this right was partial at best in the Czech Republic at the time of revocation. In the Czech Republic, workers could exercise

¹²¹ Art. 37 provides:

Everyone shall have the right to labor conditions meeting the safety and hygienic requirements, for labor remuneration without any discrimination whatsoever and not lower than minimum wages and salaries established by the federal law, as well as the right to protection against unemployment.

Recognition shall be given to the right to individual and collective labor disputes with the use of methods of their adjustment fixed by the federal law, including the right to strike.

¹²² Slovakia NME Analysis Memorandum at 6.

¹²³ Czech Republic NME Analysis Memorandum at 6.

their right to strike only after mediation efforts had been exhausted, and workers in sensitive positions had no right whatsoever to strike.¹²⁴

c. Russian law protects workers' right to form and participate in trade unions.

As Russia has shifted from a command to a market economy in the last decade, and as the government has ceased to exercise control over wages, union membership has declined. During the Soviet period, labor unions were monolithic bureaucracies that worked in concert with the central government to set wages at the level required by the needs of the command economy. In the post-Soviet era, the state-owned enterprises where the old-style labor unions were based are increasingly being transformed through privatization. As this occurs, the old-style labor unions are withering.¹²⁵ Many of the workers who once belonged to the old-style unions have moved to the private sector, where they now work in non-unionized start-up enterprises or in newly formed Western-style unions. Hence, declining union membership is not an indication that workers are losing wage negotiating power but rather a sign of a profound change that has transformed the entire Russian economy, giving workers autonomy and bargaining power that they never enjoyed as members of the old-style unions. Nevertheless, their right to form and to participate in trade unions enjoys the full protection of domestic law.

¹²⁴ Czech Republic NME Analysis Memorandum at 6.

¹²⁵ The Economist Intelligence Unit, "Country Commerce, Russia," p. 53, November 2001 ("Union membership in Russia has fallen dramatically in the last few years, especially in retail trade, banking and finance, and personal and business services. As enterprises are privatized and restructured, many workers have withdrawn from the relevant trade unions.")

The 1993 Constitution of the Russian Federation guarantees the right to form trade unions and simultaneously provides that no one may be forced to join a trade union.¹²⁶

The Federal Law "On Trade Unions, Their Rights and Guarantees for Their Activity"¹²⁷ guarantees and protects workers' fundamental rights regarding the formation and activities of trade unions. Specifically, the law

- Guarantees workers the right to join trade unions;¹²⁸
- Prohibits the state from interfering with or restricting the rights of trade unions;¹²⁹
- Prohibits discrimination against individuals affiliated or not affiliated with a trade union,¹³⁰ and
- Guarantees the right of trade unions and organizations to hold collective negotiations, to conclude agreements and collective agreements, and to exert control over their execution.¹³¹

New trade unions have begun to make significant strides in defending their members' interests. In an effort to wield more influence on national legislation and government decisions, several national and regional trade union structures formed the Russian Confederation of Labor (KTR) and the All-Russian Confederation of Labor (VKT) in 1995. In November

¹²⁶ 1993 Constitution, art. 30 provides:

Everyone shall have the right to association, including the right to create trade unions for the protection of his or her interests. The freedom of activity of public association shall be guaranteed.

No one may be compelled to join any association and remain in it.

¹²⁷ Federal Law on Trade Unions.

¹²⁸ Federal Law on Trade Unions, art. 2.

¹²⁹ Federal Law on Trade Unions, art. 5.

¹³⁰ Federal Law on Trade Unions, art. 9.

¹³¹ Federal Law on Trade Unions, art. 13.

2000, the International Confederation of Free Trade Unions (ICFTU) accepted as members the KTR, VKT, and the Federation of Independent Trade Unions (FNPR).¹³²

d. Russia is a party to the International Labor Organization, which requires its members to provide workers with certain fundamental rights — including the right to bargain freely and the right to strike.

The Russian Federation has been a member of the International Labor Organization (ILO) since 1954. The right to bargain freely is guaranteed by ILO Convention 98, “The Right to Organize and Bargain Collectively.” This convention guarantees the right to organize and bargain collectively, and protects against anti-union discrimination and employer interference.¹³³ The right to strike is protected in ILO Convention 105, “Abolition of Forced Labor.” This convention prohibits punishment for participation in strikes. It also prohibits the use of any form of forced or compulsory labor as a means of political coercion or education; punishment for the expression of political or ideological views; and discrimination.¹³⁴

e. Russian law guarantees labor mobility.

It is noteworthy that the DOC has not found worker mobility a crucial indicator of market economy status in the past. In revoking Latvia’s NME designation, the DOC remarked that while, in theory, “there is unrestricted labor mobility in Latvia, regional labor mobility is actually very low.”¹³⁵ As discussed above in section III.D., the 1993 Russian Constitution

¹³² The U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, “Labor” p.74-75.

¹³³ ILO Convention 98, “The Right to Organize and Bargain Collectively.” International Labour Organization, available at <http://www.ilo.org>.

¹³⁴ ILO Convention 105, “Abolition of Forced Labor.” International Labour Organization, available at <http://www.ilo.org>.

¹³⁵ Latvia NME Analysis Memorandum at 8.

guarantees all persons freedom of movement and the right to choose where to live,¹³⁶ and the existing registration mechanism cannot limit any rights granted by the Constitution. In part, Russia's registration requirement is merely a notification requirement: One does not apply for the right to register and then wait for "permission" to be granted. Registration is automatic and occurs within three days. Registration cannot -- and does not -- serve as a precondition for employment.

f. Russian labor laws provide support for terminated workers.

Workers' bargaining power flows directly from their ability to withhold their labor — either by striking, by quitting, or by refusing to accept a position offering unacceptable wages or other conditions of employment. Workers who cannot afford to lose their jobs have little real bargaining power. Hence, measures that provide unemployment compensation, retraining, and assistance in finding new employment — that make it possible for workers to accept the consequence of withholding their labor — contribute ultimately to the ability of workers to exercise their bargaining power in wage negotiations.

Russian law grants workers the right to such assistance, including modest regular unemployment indemnities to those out of work, professional orientation, retraining, and information on job opportunities.¹³⁷ The state Employment Exchange provides unemployed workers with information on job opportunities and with appropriate retraining.

¹³⁶ See art. 27.

¹³⁷ Federal Law #36-FZ "On the Introduction of Amendments and Addenda into the Law of the Russian Federation On the Employment of the Population in the Russian Federation," of April 20, 1996, arts. 9, 12.

C. Economic evidence confirms that wage rates in the Russian Federation are determined by free bargaining between labor and management.

The controlled economy of the Soviet era was characterized by low employee turnover rates ("employment for life"). Job terminations, voluntary or involuntary, were rare. Indeed, in the Soviet period the government denied the very existence of unemployment in the Soviet Union, as the right to work was a constitutional right. Since the dissolution of the Soviet Union, the labor market in Russia reflects the ebb and flow of the economy and the differing strengths of different employment sectors.

1. Wage rates are determined by market forces, not by the government.

Regional differences in pay across a country reflect market differences among particular regions. Within Russia, pay scales vary widely from region to region. Moscow usually attracts the highest compensation levels, while wage levels in St. Petersburg are about 20 percent lower. Overall, pay levels in Central Russia are consistently the lowest, ranging from 20 percent to 50 percent of Moscow levels. Central Russian pay levels are typically 50 percent less than Moscow rates for office-based jobs, including administration, IT, and finance. However, pay levels for production and technical jobs reach 120 percent to 150 percent of Moscow levels, predominantly due to demand from oil companies.¹³⁸

The results of a recent compensation survey in Russia show that virtually all responding employers use an element of short-term variable pay within their organization, demonstrating a strong relationship between market dynamics and pay scales.¹³⁹ The focus is very much on performance-related variable pay, with less than a quarter of employers stating

¹³⁸ Arthur Andersen LLP, "Russia, Compensation and Benefits Survey" at 19.

¹³⁹ Arthur Andersen LLP, "Russia, Compensation and Benefits Survey" at 19.

they pay "guaranteed" bonuses. Bonuses in Russia are typically annual, or annual with quarterly advances. In nearly all plans, company performance was a factor. The most "incentivised" jobs are: Sales Executives (average pay 30 percent to 40 percent of base); Senior Managers (15 percent to 30 percent); and Middle Management in Sales (15 percent to 30 percent).¹⁴⁰

Over half of employers already have a long-term incentive plan (LTIP) and a further 26 percent are considering implementing such a scheme. This is primarily a result of the increasing demand for skilled labor at an executive level, at whom LTIP's are more normally directed, requiring retention-based compensation structuring. Like the incentive bonus system, tying salaries to LTIP demonstrates a strong relationship between market forces and wage rates in the Russian economy. Wage raises are also market driven, with 91 percent of employers indicating that increases in base salaries are dominated by merit.¹⁴¹

The following table demonstrates the variance in pay within various professions in Russia. Additionally, regional differences in pay, within those same professions, are shown in Exhibit 3 for Moscow and St. Petersburg to illustrate how market forces of a specific region affect wage rates.¹⁴²

¹⁴⁰ Russia, Compensation and Benefits Survey at 19.

¹⁴¹ Russia, Compensation and Benefits Survey at 21.

¹⁴² Russia, Compensation and Benefits Survey at 79-93.

Figure 8 –Gross Annual Base Salary and Annual Total Pay in USD – Russia

		Lower decile	First quartile	Median	Third quartile	Upper decile	Average
ADMINISTRATION DEPARTMENT							
AD01	Administration Director	17,124	30,722	38,222	45,892	60,649	38,393
AD04	Assistant/Secretary	5,117	7,200	9,935	13,543	16,424	10,519
AD07	Health & Safety Inspector	2,059	3,284	7,363	11,686	14,934	8,630
CORPORATE AFFAIRS							
CA01	Corporate Affairs Director	-	-	-	-	-	-
CA02	Corporate Affairs Manager	13,920	28,119	38,135	66,903	75,062	45,246
CA03	Corporate Affairs Specialist/Public Relations	14,434	18,040	30,005	36,000	36,680	27,742
CUSTOMER SERVICE DEPARTMENT							
CS01	Customer Service Director	-	39,004	47,265	68,625	-	54,188
CS02	Customer Service Manager	18,778	21,850	25,522	33,187	45,089	27,728
CS04	Service Engineer	9,413	10,812	13,668	21,624	25,440	16,349
FINANCE DEPARTMENT							
FD01	Financial Director	36,480	45,245	60,764	74,250	99,996	75,013
FD03	Finance Analyst	7,250	12,555	19,505	27,456	36,885	20,719
FD06	Junior Accountant	5,160	7,881	9,907	13,234	17,101	10,723
GENERAL MANAGEMENT							
GM01	General Manager	53,840	89,750	118,493	134,631	209,349	134,169
GM02	Division Manager	30,330	41,585	50,673	66,153	316,320	127,798
GM04	Project Manager	22,402	23,340	27,048	41,618	50,791	32,218
HUMAN RESOURCES DEPARTMENT							
HR01	Human Resources Director	28,687	42,000	62,515	83,827	90,807	62,912
HR03	Human Resources Generalist	10,176	11,814	19,200	24,480	32,165	19,864
HR05	Human Resources Assistant	6,500	7,018	10,392	13,200	14,601	10,415
IT DEPARTMENT							
IT01	IT Director	22,354	26,300	34,159	83,975	96,000	52,543
IT04	System Analyst	8,789	15,020	19,466	26,574	31,788	20,375
IT07	Programmer	2,670	4,511	6,864	16,200	21,100	10,903
LEGAL DEPARTMENT							
LE01	Senior Legal Advisor	7,861	25,511	41,280	99,225	123,015	61,566
LE02	Legal Advisor	3,003	13,637	20,958	43,897	57,596	30,651
LE03	Research Assistant	10,058	11,564	13,424	14,787	17,829	13,811
LOGISTICS DEPARTMENT							
LS01	Supply Chain Director	34,451	38,096	41,692	49,906	63,571	46,801
LS05	Purchasing Manager	4,666	10,856	19,063	26,026	45,464	22,074
LS09	Warehouse Operator	1,072	2,336	2,452	4,954	6,130	3,286

MARKETING DEPARTMENT							
MA01	Marketing Director	37,361	51,404	69,574	77,689	80,132	64,849
MA03	Product/Brand Manager	15,672	22,420	26,220	38,371	48,215	29,233
MA05	Marketing Assistant	6,710	7,452	10,159	14,208	17,415	11,250
PRODUCTION DEPARTMENT							
PD01	Production Director	-	36,000	36,000	39,011	-	33,596
PD04	Shift Foreman	2,246	3,300	7,946	13,089	23,053	10,181
PD06	Production Operator	1,495	2,336	2,802	4,728	6,747	3,844
RESEARCH & DEVELOPMENT DEPARTMENT							
RD01	Research & Development Director	-	-	-	-	-	-
RD02	Research & Development Manager	-	10,812	17,448	21,837	-	21,290
RD04	Laboratory Specialist	-	1,417	1,635	2,023	-	1,668
SALES DEPARTMENT							
SA01	Sales & Marketing Director	27,936	34,179	56,000	77,550	99,591	60,183
SA06	Area/Territory Sales Manager	7,430	13,312	17,747	21,901	27,032	18,610
SA10	Merchandiser	3,302	6,500	7,150	8,900	9,466	7,179
TECHNICAL DEPARTMENT							
TL01	Technical Director	23,906	36,783	44,754	66,080	77,983	50,436
TL05	Chief Technologist	-	23,419	35,918	41,433	-	33,578
TL10	Quality Assurance Technician	-	-	-	-	-	-

2. Market forces in Russia have resulted in expanding wage rate variances.

The amount of variance in wages paid to employees among the major industries is indicative of how freely the market operates. As economies transition from command to free market economies, the laws of supply and demand in the labor market replace state control over wage setting. Labor and management become free to negotiate wage remuneration, and competition among both employers and employees is heightened. Additionally, workers' remuneration becomes more dependent upon productivity, which, in turn, is dependent on factors such as education, experience, and occupation type.¹⁴³ This is known as the Human Capital Theory.

¹⁴³ Jin Xiao, "Determinants of Salary Growth in Shenzhen, China," Chinese University of Hong Kong, June 6, 2001, available at http://www.tc.edu/centers/coce/pdf_files/d4.pdf.

The end result is an increase in the amount of variance in wage rates paid between various industries within the economy. This phenomenon stands in stark contrast to the situation in typical command economies, in which government determines the wage rates, and various industries across the economy exhibit less variance.

The year 1992 marked the beginning of this transition for Russia. A comparison of the average monthly nominal accrued wages of employees of enterprises and organizations by industry in 1992 and 2000 reveals characteristics of a labor market that has successfully transitioned from government wage setting to the practice of free bargaining. The amount of variance in wages paid across major industries that make up the Russian GDP increased by 25 percent from 1992 to 2000.¹⁴⁴

3. Data on employee turnover demonstrates a high degree of freedom, on the part of both employers and employees, in Russia's labor market.

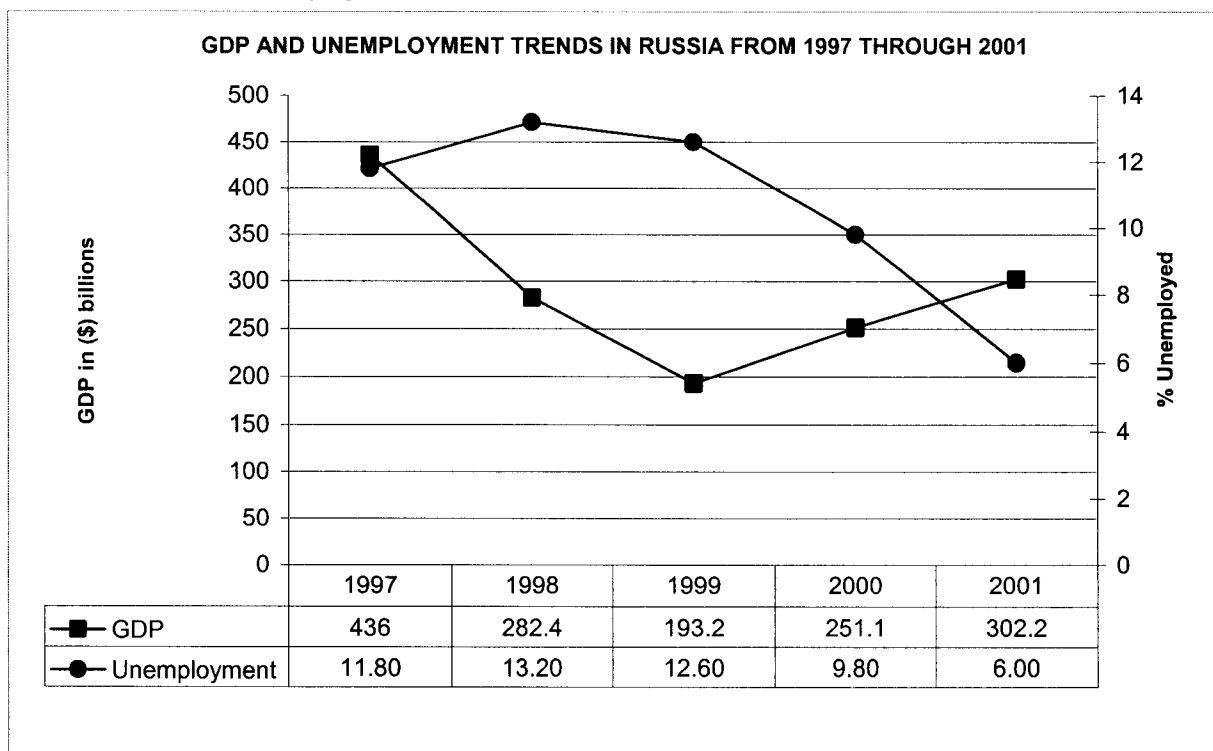
One indicator of the market forces prevalent in Russia's labor market is Russia's unemployment rate. In any market economy, there exists an inverse correlation between GDP and unemployment. As a nation's market economy grows and prospers as reflected in GDP, unemployment decreases. This is the direct result of employers hiring greater numbers of employees to keep up with demand during prosperous times, and having the freedom to terminate employees when demand falls and the employers needs change. Following independence, Russia's unemployment rate rose, reaching thirteen percent in 1998. Since then, unemployment in Russia has fallen as its economy has experienced relatively high growth rates.

¹⁴⁴ Based on data from "Statistics of Russia," compiled by the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat), available at <http://www.gks.ru/eng/>.

These trends are evidence of the operation of market forces, as shown in the chart below entitled “GDP and Unemployment Rates in Russia from 1997 through 2001.”¹⁴⁵

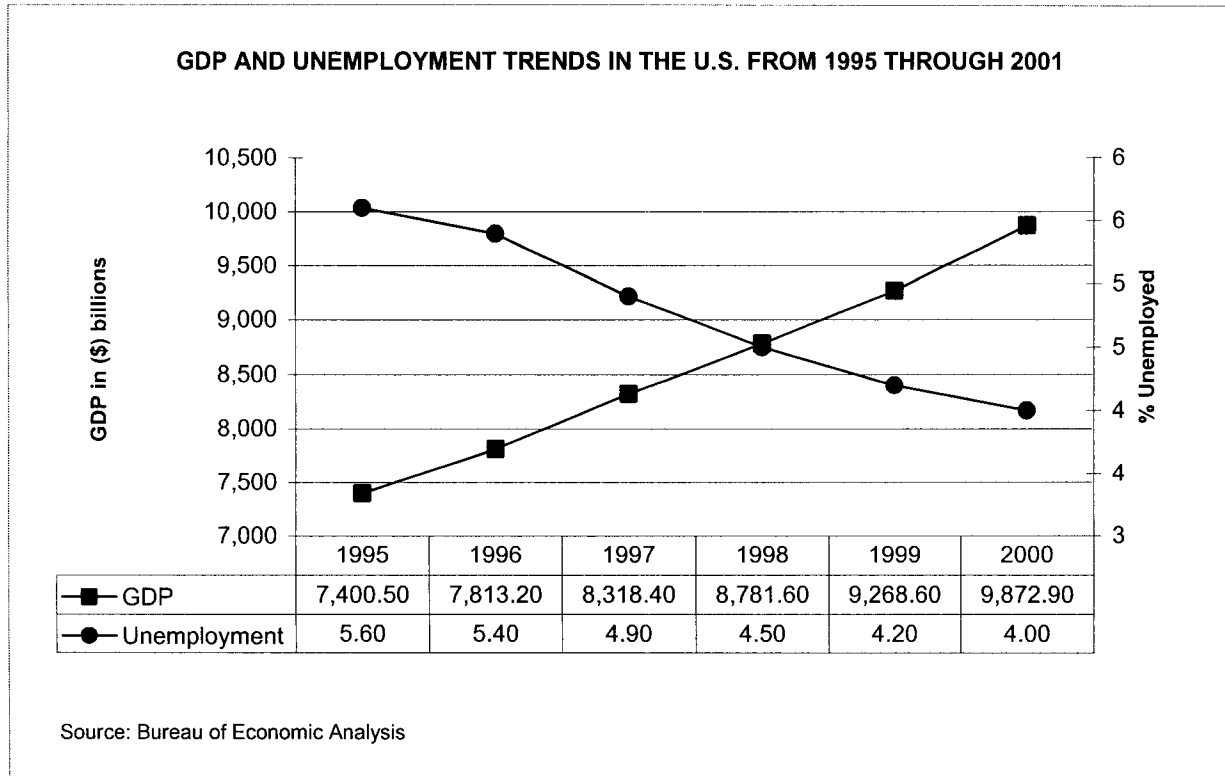
The relationship between GDP and unemployment is the same in Russia as in the United States. In both countries, the unemployment falls as GDP rises, indicating that the market forces that drive unemployment in Russia are the same market forces driving unemployment in the United States. See Figures 9 and 10 below.

Figure 9 - GDP And Unemployment Trends in Russia

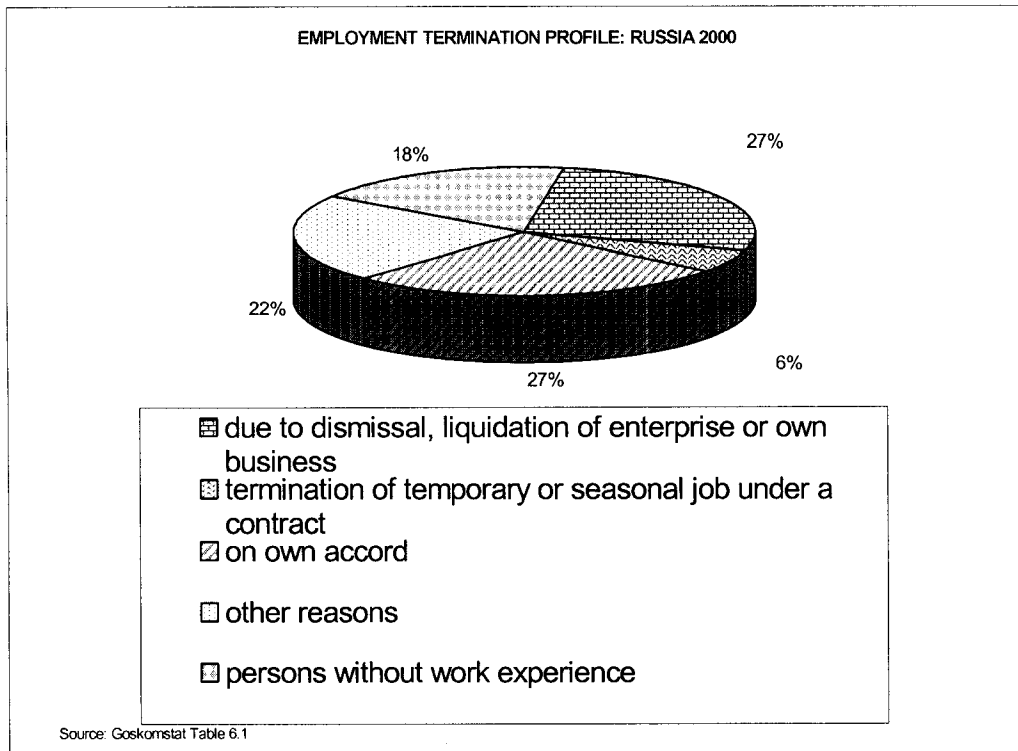


¹⁴⁵ Sources of data include: "Statistics of Russia," compiled by the Main Regional State Committee of the Russian Federation on Statistics ([Goskomstat](http://www.gks.ru/eng/)), available at <http://www.gks.ru/eng/>, Table 6.1; U.S. Commercial Service Country Commercial Guide to Russia at 90-91, Appendix B Domestic Economy, 2002 (2001, preliminary estimate); The Economist Intelligence Unit, Viewswire, Country Background Russia, Economic Structure, available at http://www.viewswire.com/index.asp?layout=display_article&doc_id=172584&showarchive=true.

Figure 10 - GDP and Unemployment Trends In the U.S.



Data on voluntary and involuntary employee termination demonstrate that a dynamic labor market providing unprecedented flexibility to both employers and employees has replaced the restrictive labor market of the Soviet era, where employers could not fire employees and where employees could not move freely from job to job. Employers had the ability to adjust their labor forces to meet market conditions and, as shown below in Figure 11, more than a quarter of total terminations in 2000 were of this type. Employees had sufficient confidence in the strength of the labor market to leave their employers in search of more gainful employment, and another quarter of terminations in 2000 were of this type. International placement firms such as Korn/Ferry and Antal International are active in the Russian marketplace and mostly use Russian candidates to fill openings.

Figure 11 - Employment Termination Profile

4. Russia's market-based labor market has generated a surge in the demand for higher education.

As in all market economies, terms of employment and the negotiation for wages and other benefits between management and the labor force are driven by education, merit and expertise, and not on political considerations based on nepotism and corruption. A change from a controlled to a free market economy provides incentives to the labor force to pursue improvement, such as formal education and training. This is currently the case in Russia as evidenced by the educational statistical data contained in the table below. The number of students admitted to institutions of higher education has steadily increased by 148 percent since 1992. Likewise the number of graduates has increased by nearly 50 percent and the number of non-public educational institutions has grown from 0 in 1992 to 358 in 2001.

Figure 12 – Higher Education Statistics

Higher Education Statistics		
	1992-1993	2000-2001
Number of admitted students	521,000	1,292,000
Number of graduates	425,000	635,000
Number of graduates per 10,000 population	29	44
Non-public educational institutions	0	358

Source: Goskomstat, Table 8.7, 8.8.

Human capital theory predicts that, in unregulated labor markets, workers' remuneration depends on their individual productivity, which is itself partially a function of education. This is a reality in Russia today and the Russian workforce is very aware of this phenomenon as evidenced by the markedly high increase in higher education students, graduates and institutions. It should be further noted that "the previous system of education was mostly directed to the training of narrow-skilled specialists for particular industries. As a result workers were less mobile and highly attached to one job and occupation during their lifetime horizon. Although the general level of schooling was relatively high, this narrow education did not provide the skills and knowledge now demanded by the market economy."¹⁴⁶ This explains the high levels of unemployment experienced in Russia during the early stages of their transition. There was a glut of highly, yet narrowly trained people among the workforce who found themselves ill equipped to compete in a newly evolving free labor market. Unemployment in Russia is now decreasing at a time when unprecedented numbers of Russians are seeking higher education in order to adjust to the newly evolved demands on the labor force in Russia's market economy.

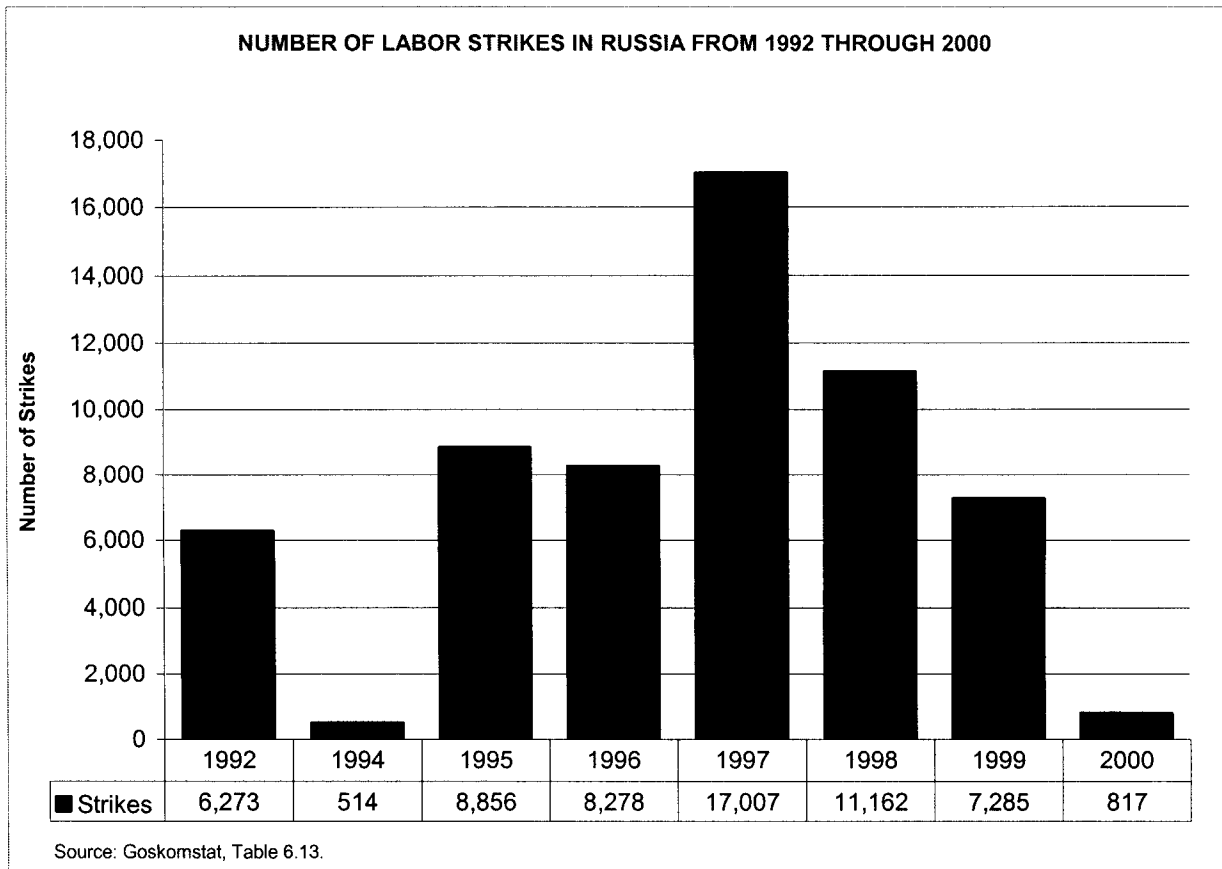
¹⁴⁶ Daria V. Nesterova and Klara Z. Sabirianova, "Investment in Human Capital Under Economic Transformation in Russia," Economic Education and Research Consortium, Working Paper No. 99/04, December 1998.

5. Labor strikes have decreased with a reduction in wage arrears.

Labor unions in Russia exercise the right to strike freely. In 1997 there were over 17,000 strikes in Russia. More recently, the number of strikes has decreased. This is due largely to an improving economy and a reduction in wage arrears. "Wage arrears were the main cause of strikes during the years of economic reform. President Putin identified the full payment of the state's social debts as a key priority in 2000, and disputes have declined since."¹⁴⁷ From January to July of 2000 190,000 man-days were lost due to some form of industrial action, while in that same period for 2001, only 24,000 man-days were lost.¹⁴⁸

¹⁴⁷ The Economist Intelligence Unit, "Country Commerce Russia," November 2001 at 53.

¹⁴⁸ The Economist Intelligence Unit, "Country Commerce Russia," November 2001 at 53.

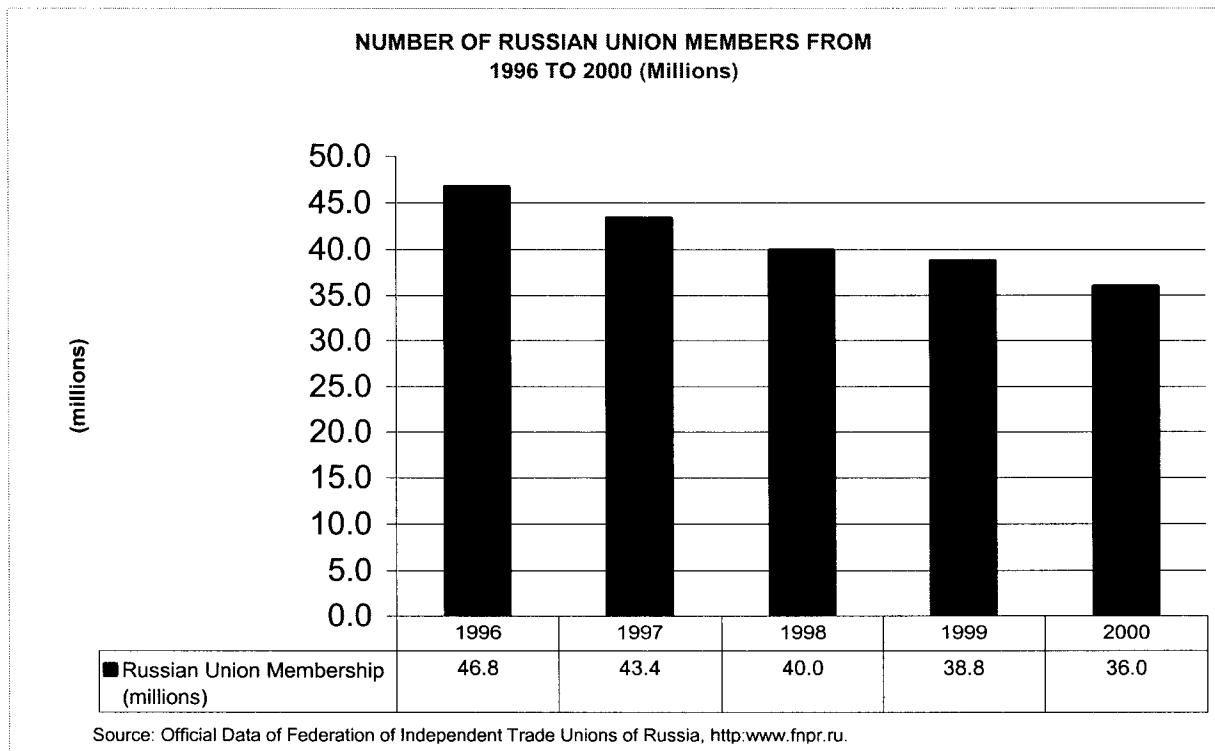
Figure 13 - Number of Labor Strikes in Russia

6. Union membership has fallen as enterprises are privatized and restructured.

Since the early stages of Russia's transition to a market economy, labor unions have served as important and valuable vehicles for workers to negotiate compensation with employers. While these unions continue to play an integral role in this free negotiation, the labor union landscape has changed in recent times, due to Russia's successful transition to a working market economy. Membership in labor unions is beginning to contract and some unions are banding together in response. In 2000, the International Confederation of Free Trade Unions united three of the largest trade unions in Russia. These three are the Federation of Independent Trade Unions consisting of 35 million members, the All-Russian Confederation of Labor uniting 1.27 million workers, and the Russian Confederation of Labor having 1.25 million members.

Additionally, there are many smaller, independent unions the largest of which is the Association of Social Trade Unions, consisting of a few hundred thousand workers.¹⁴⁹ Membership, however, in Russia's unions is decreasing as workers are finding gainful employment in smaller private organizations, born of the free market economy. "Union membership in Russia has fallen dramatically in the last few years, especially in retail trade, banking and finance, and personal and business services. As enterprises are privatized and restructured, many workers have withdrawn from the relevant trade unions."¹⁵⁰

Figure 14 - Number of Russian Union Members



¹⁴⁹ The Economist Intelligence Unit, "Country Commerce Russia," November 2001 at 53.

¹⁵⁰ The Economist Intelligence Unit, "Country Commerce Russia," November 2001 at 53.

7. The shift from public to private employment and the increase in the number of small enterprises have increased workers' bargaining power in Russia's labor market.

The flexibility of the Russian labor market is a direct result of two factors: the increase in the percentage of workers employed by the private sector versus the public sector and the growth of small businesses.

The table below represents the percentages of the Russian labor force employed in enterprises by type of ownership.¹⁵¹ Employment in state and municipal enterprises decreased by 45 percent from 1992 to 2000. During this same period, employment in privately-owned enterprises increased by 131 percent, and employment in wholly-owned foreign and joint Russian-foreign private enterprises increased by 567 percent. The creation and growth of these private enterprises serves to increase labor force mobility in Russia by providing new opportunities to the Russian worker.

Figure 15 - Employment by Type of Ownership Structure

EMPLOYMENT BY TYPE OF OWNERSHIP STRUCTURE			
	1992	2000	Change
Publicly owned (state and municipal)	68.9%	38.1%	-45%
Privately owned (Russian ownership)	19.5%	45.0%	131%
Privately owned (joint Russian-foreign ownership or wholly foreign-owned)	0.3%	2.0%	567%
Mixed Public-Private (Russian Ownership)	10.5%	14.1%	34.3%
Public and Religious Associations	0.8%	0.8%	0%

Source: Goskomstat, Table 6.2.

¹⁵¹ "Statistics of Russia," compiled by the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat), available at <http://www.gks.ru/eng/>, Table 6.2.

The job turnover rate data compiled by the Russian government show that the new entrants rate is lower than the job terminations rate.¹⁵² This means that people are losing or leaving jobs at a greater rate than people are being hired into new jobs. These data, however, are based only on job turnover in large and medium-sized enterprises.¹⁵³ Between 1999 and 2000, job terminations in large and medium-sized enterprises increased while overall unemployment decreased as shown in Figure 16. The explanation, of course, is that the number of small enterprises has grown rapidly, absorbing those who left employment in large and medium-sized enterprises.

The shift from public to private employment and the increase in the number of small enterprises have added a dramatic new dimension of flexibility to Russia's labor market, providing employment alternatives that did not exist during the Soviet era. Where more employment alternatives exist, employees throughout the labor market have greater flexibility to withhold their labor, greater flexibility to change employment, and, hence, greater bargaining power in negotiating wages. Moreover, the more fluid a labor market, the more perfectly prices in that market will be determined by the laws of supply and demand.

¹⁵² "Statistics of Russia," compiled by the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat), available at <http://www.gks.ru/eng/>.

¹⁵³ See explanatory note to Table 6.12 in "Statistics of Russia," compiled by the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat), available at <http://www.gks.ru/eng/>.

Figure 16 - Labor Force Turnover by Industries

LABOR FORCE TURNOVER BY INDUSTRIES								
	New entrants to labor force during year				Job leavers during year			
	Persons (thou.)		Percentage of the average payroll		Persons (thou.)		Percentage of the average payroll	
	1999	2000	1999	2000	1999	2000	1999	2000
Total in economy	10128.3	11235.9	24.2	26.9	10273.8	11616.2	24.5	27.8
Industry	3199.6	3581.8	27.4	30.1	3151.6	3503.5	27.0	29.5
Agriculture	954.2	997.9	18.3	20.3	1138.9	1295.6	21.8	26.3
Forestry	888.0	91.5	34.8	36.1	83.8	92.7	33.2	36.6
Construction	838.3	970.5	40.3	47.7	890.5	992.5	42.8	48.8
Transport	644.4	732.4	21.3	24.2	683.0	785.4	22.5	26.0
Communications	207.9	239.4	27.0	31.0	220.2	241.4	28.6	31.3
Wholesale and retail trade, catering	639.6	711.2	33.7	39.0	679.7	739.8	35.8	40.5
Housing and public utilities; non-production everyday services rendered to population	936.6	1040.8	37.2	41.4	916.8	1059.3	36.4	42.1
Public health, physical culture and social security	775.7	829.0	19.5	20.8	756.7	876.5	19.1	22.0
Education	873.5	908.1	16.0	16.6	839.8	977.5	15.4	17.9
Culture and art	234.0	232.6	25.2	24.5	188.6	216.8	20.3	22.8
Science and scientific service	139.4	172.7	14.2	17.0	153.1	172.9	15.6	17.1
Finances, credits and insurance	108.9	126.5	17.3	20.5	133.0	131.1	21.1	21.3
Administration	237.6	263.9	13.9	15.1	199.5	231.6	11.6	13.2

Source: Goskomstat, Table 6.12

IV. CRITERION 3: THE ABSENCE OF CONSTRAINTS ON JOINT VENTURES WITH A FOREIGN JOINT VENTURE PARTNER AND ON FOREIGN INVESTMENTS

Summary of Comment

The Opposing Parties have also misstated key facts in arguing that foreign investors face significant constraints in investing in the Russian Federation. Section A corrects these misstatements, while Section B provides a detailed discussion of the legal regime governing foreign investment, both inbound and outbound, in Russia. Section C provides economic data confirming that foreign investors face no significant constraints in investing in the Russian Federation.

A. The Opposing Parties misstate key facts concerning any constraints on joint ventures with a foreign joint venture partner and on foreign investments.

The Opposing Parties have raised a fog of objections to the foreign investment regime in Russia. Many of these objections are based on outdated information. Others are simply inaccurate. And others are lacking in context and raise objections to practices that are routine in market economy countries. In fact, Russia's foreign direct investment regime is highly favorable to foreign investors and provides full protection of their rights. Some of the Opposing Party's erroneous assertions are discussed immediately below. The rest of this section is devoted to a description of Russia's foreign direct investment regime that sets out the extensive body of rights granted to foreign investors and the mechanisms by which those rights are protected.

One Opposing Party erroneously asserts that "although the Putin government has promised several reforms of laws related to investors, joint stock companies, bankruptcy, insider

trading, and the securities market, these draft laws have been stalled in the Duma."¹⁵⁴ In fact, the new laws "On Foreign Investments"¹⁵⁵ and "On Joint Stock Companies"¹⁵⁶ are in force already. New versions of laws "On Securities Market" and "On Bankruptcy" are expected to be enacted shortly. In addition, the new Tax Code,¹⁵⁷ the package of laws on judicial reform,¹⁵⁸ and the new Land Code¹⁵⁹ have been adopted and are presently in force.

The same Opposing Party contends erroneously that "under Russian corporate law, ownership of 28 percent is necessary to exercise a veto."¹⁶⁰ In fact, ownership of a majority of the shares is required for the majority of decisions.¹⁶¹ For certain important corporate decisions the blocking amount is 25%+1 share.¹⁶² In fact, a veto requirement of 28 percent has never been in place in the Civil Code or the Joint Stock Companies Law (1996).

The same Party alleges that "under current law, the Russian Securities Commission's only recourse against a company that has violated investors rights or securities laws is a maximum fine of USD 10,000 and the right to deny new share issues."¹⁶³ In fact, since 1999 the Federal Law "On Protection of Investors Rights on Securities Market"¹⁶⁴ has provided

¹⁵⁴ Skadden-Dewey Brief at Page 19.

¹⁵⁵ Federal Law #160-FZ of July 9, 1999 "On foreign investments in the Russian Federation."

¹⁵⁶ Federal Law #120-FZ of August 7, 2001 "On amendments and additions to the Federal Law On Joint Stock Companies."

¹⁵⁷ The Federal Tax Code #146-FZ of July 31, 1998.

¹⁵⁸ These are discussed and cited below.

¹⁵⁹ The Federal Land Code #136-FZ of October 25, 2001.

¹⁶⁰ Skadden-Dewey Brief at Page 17.

¹⁶¹ Federal Law #208-FZ of December 26, 1995 "On Joint Stock Companies," art. 78.

¹⁶² Federal Law #208-FZ of December 26, 1995 "On Joint Stock Companies," art. 79.

¹⁶³ Skadden-Dewey Brief at Page 20.

¹⁶⁴ Federal Law #46-FZ of March 5, 1999.

for a fine in the amount of more than USD 30,000 at the current exchange rate. In addition, the recently adopted Administrative Code,¹⁶⁵ contains 15 enforcement mechanisms on the Federal Securities Commission's authority to sanction violators of securities law. Standing behind these rules is the 1993 Constitution, which guarantees private right of action for any violation, including restitution of rights and compensation of damages.¹⁶⁶

The same Opposing Party also asserts in error "the new law also retains a provision stating that companies are also subject to state registration by judicial bodies."¹⁶⁷ In fact, the new law, which accelerates the registration time to a few days from the present period of about one month, does not subject companies to additional state registration by judicial bodies.¹⁶⁸

Another Opposing Party writes, "while the 1991 Investment Code and the July 1999 Law on Foreign Investments purported to provide foreign investors rights equal to those of Russian investors, the laws have not been put into effect because they lack implementing regulations."¹⁶⁹ In fact, both laws are in force. Under Russian law and existing practice, the absence of implementing regulations does not prevent investors from exercising the rights granted by the Investment Code and the Law on Foreign Investments.¹⁷⁰

This same Opposing Party opines that "foreign investment in other non-restricted sectors may also prove difficult because of additional registration requirements in place for

¹⁶⁵ The Russian Code on Administrative Violations of June 20, 1984 (The New RF Code on Administrative Violations #195-FZ of December 31, 2001).

¹⁶⁶ 1993 Constitution, art.s 46-48.

¹⁶⁷ Skadden-Dewey Brief at 21.

¹⁶⁸ Federal Law #129-FZ of August 8, 2001 "On official registration of legal entities."

¹⁶⁹ Schagrin and Associates Brief at p. 5.

¹⁷⁰ See Letter of the Supreme Arbitration Court # 58 of January 18, 2001.

significant investment of foreign capital exceeding 100 million rubles.”¹⁷¹ This is not an additional registration requirement. Rather, a separate body is responsible for keeping the register of companies with foreign investment. Most important, however, is the fact that under the new law on registration of legal entities, effective as of July 2002, there is no difference between the registration requirements for companies receiving investment capital from within Russia and from abroad.¹⁷²

This Opposing Party also asserts that “[i]nvestment in areas requiring licensing, such as banking, mining, and telecommunications, can be difficult and expensive because of lengthy and obscure licensing procedures.”¹⁷³ In fact, the Federal Law “On Licensing”¹⁷⁴ provides that as a general rule the maximum term for consideration of a license application may not exceed 30 days, while the maximum fee for issuing the license is approximately USD 30 at the current exchange rate.

The statement of a third Opposing Party that “a package of judicial reform proposals is still under consideration” is outdated.¹⁷⁵ In fact, the judicial reform laws were adopted late in 2001. These include the Federal Law “On Judicial System,”¹⁷⁶ the Federal Law “On the Status of Judges,”¹⁷⁷ and the Criminal Procedural Code.¹⁷⁸

¹⁷¹ Schagrin and Associates Brief at p. 6.

¹⁷² Federal Law # 129-FZ of August 8, 2001, “On Official Registration of Legal Entities.”

¹⁷³ Schagrin and Associates Brief at p. 6-7.

¹⁷⁴ Federal Law #158-FZ of September 25, 1998.

¹⁷⁵ Ad Hoc Committee of Domestic Nitrogen Producers Brief at p. 12.

¹⁷⁶ Federal Law #5-FZ of December 15, 2001.

¹⁷⁷ Federal Law #169-FZ of December 15, 2001.

¹⁷⁸ Federal Law #174-FZ of December 18, 2001.

This Opposing Party also contends that "a CBR regulation mandates advance permission for payments for imported services in excess of USD 10,000, and foreign providers of services have been subject to discrimination by regional authorities."¹⁷⁹ In fact, the permission is required *not* for payment for services but rather for the purchase of foreign currency for settling the payment. Since such permission is automatically forthcoming, this is not a meaningful restriction. In addition, the Russian Steel Producers, with their extensive experience in business in Russia, know of no cases in which this requirement was a major issue for investors.

¹⁷⁹ Ad Hoc Committee of Domestic Nitrogen Producers Brief at p. 12.

B. Russia's laws governing foreign investment do not impose significant constraints on joint ventures with a foreign joint venture partner or on foreign investments.

The climate favoring foreign investment in Russia is stronger than it has ever been. According to the U.S. Commercial Service, "President Putin's government has shown a strong interest in attracting foreign investment and has promised to enact structural changes that would improve the environment for investors."¹⁸⁰ Moreover, "Russia has been the darling of international investors this year [*i.e.*, 2001]. Its stock market is by far the best performer in 2001, having nearly doubled in value since the start of the year."¹⁸¹

For these reasons, Russia continues to attract ever-increasing amounts of new foreign direct investment through a variety of business structures.

1. Foreign companies have flexibility in establishing different forms of business organization.

There are several forms through which a foreign company can undertake business activities in the Russian Federation:

- through a separate Russian entity recognized under Russian law;
- through a representative office;
- through participation in a joint activity agreement; or
- through a combination of the above.

¹⁸⁰ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 59.

¹⁸¹ Economist Intelligence Unit Viewswire, December 19, 2001, "Currency consensus forecast."

Each of these forms is briefly described below.

a. Foreign investment through a separate Russian entity recognized under Russian law.

In accordance with the Civil Code of the Russian Federation, there are several types of Russian entities that can be established by a foreign company. The most important are:

- joint stock companies;
- limited liability companies;
- full partnerships; and
- limited or mixed partnerships.

Joint stock companies ("JSC") fall into two categories – "closed" and "open." The shares of an open JSC are freely transferable. In a closed JSC, share transfers are restricted with the other shareholders generally having pre-emption rights. The minimum capital requirement for incorporation of a JSC is equivalent to USD 30,000 in the case of an open JSC and USD 300 in the case of a closed JSC. The maximum number of shareholders is unlimited for an open JSC but cannot exceed 50 for a closed JSC. A JSC cannot be established and/or owned by a single shareholder if the latter, in turn, has only one shareholder/participant. The governing bodies of a JSC are the General Shareholders' Meeting and Board of Directors. In a JSC with fewer than 50 eligible shareholders, it is not necessary to have a Board of Directors. A Managing Board and/or General Director regulate the day-to-day activities of a JSC.

The minimum capital requirement for the formation of a limited liability company ("LLC") is approximately USD 300. An LLC has participatory rights rather than shares, although with the exception of certain securities tax issues, the differences for practical purposes are limited. The number of "participants" in an LLC cannot exceed 50. An LLC cannot be

established and/or owned by a single shareholder if the latter, in turn, has only one shareholder/participant. The statutory documents of an LLC can contain certain restrictions about the transfer of a participant's rights, such as a prohibition of sale to third parties. A participant in an LLC does however have the right to withdraw from the LLC without requiring the consent of other participants; in such case the participant should be repaid the actual value of his/her participation in the LLC.

The principal features of a partnership are the personal contribution by participants to the partnership's business activity and the unlimited liability of at least some of the partners. Some partners in a limited partnership enjoy limited liability. Both full and limited partnerships must file separate tax returns and pay taxes in respect of the activity of the partnership.

b. Foreign investment through a representative office or a branch.

Foreign companies may also operate in Russia without creating a new entity by establishing a representative office or a branch. A representative office is generally understood to be a subdivision of a foreign legal entity that represents the company's interests in a foreign country. Although in most countries representative offices are not allowed to undertake commercial activity, in practice representative offices in Russia are able to do so. A "branch" of a foreign company has been very rare in Russia, both for historic reasons and also because the basis of taxation of such an entity has historically been unclear. In summary, the advantages of operating through a representative office compared with a JSC or LLC are that a representative office

- has fewer administrative, tax and accounting obligations;
- is considered to be non-resident for currency control purposes; and

- may be able to benefit from the contents of a relevant double tax treaty.
 - c. ***Foreign investment through participation in a joint activity agreement.***

Investors can also enter into a joint activity agreement with a Russian company to carry out business in Russia. In this case a foreign company usually contributes funds, property or know-how in the form of tangible or intangible assets to the joint activity and, in accordance with the agreement, is entitled to a share of the profit derived by the joint activity.

Participation and sharing of profits in a joint activity are contractually determined on the basis of the joint activity agreement and need not be pro rata. The joint activity is taxed at the level of its participants (with the exceptions of value-added tax ("VAT") and turnover taxes). One participant is obliged to maintain separate books for the joint activity. When entering into a joint activity agreement, a foreign company does not need to have any presence in Russia. In such case, income derived through a joint activity is subject to Russian withholding tax, as reduced by any applicable double taxation treaty.

2. Russia has both a trade and an investment treaty with the United States.

The U.S.-Russia Trade Agreement of June 17, 1992 allows the United States to extend Most Favored Nation (MFN) status to Russia.¹⁸² MFN status is important to the international community because it is a policy of nondiscrimination in trade policy that provides all trading partners the same customs and tariff treatment given to the so-called most favored nation. The MFN status causes the contracting governments to confer upon each other all of the most favorable trade concessions that either may grant to any other country subsequent to the signing of the agreement.

The Trade Agreement between the United States and Russia affects customs duties and charges of any kind relating to imports and exports, methods of payment for imports and exports, rules and formalities in relation to imports and exports (for example, those relating to customs clearance, transit, warehousing, and transshipment), taxes and other charges on imported products, and rules concerning the sale, purchase, transport, distribution, storage and use of products in the domestic market.¹⁸³

The trade agreement also has detailed provisions relating to intellectual property. It guarantees copyright protection for computer programs and data bases; provides protection for sound recordings; provides product and process patent protections for all areas of technology (except those relating to atomic weapons) for a term of at least 20 years from the filing of an application or at least 17 years from the granting of a patent; and strengthens the protection of trade secrets.¹⁸⁴

Another treaty signed between the United States and Russia is the OPIC Investment Incentive Agreement. This treaty allows the Overseas Private Investment Corporation to insure U.S. foreign investments in Russia.¹⁸⁵ The treaty allows OPIC to provide financing of investment projects through direct loans and loan guarantees, insure investment projects against a broad range of political risks, and provide a variety of investor services, including investment missions, conferences and business roundtables.¹⁸⁶

¹⁸² U.S. Department of State, Foreign Trade Barriers – Russia, 2001.

¹⁸³ Agreement on Trade Relations, U.S. – Russia, June 17, 1992, T.I.A.S.

¹⁸⁴ Agreement on Trade Relations, U.S. – Russia, June 17, 1992, T.I.A.S.

¹⁸⁵ OPIC Investment Incentive Agreement, U.S. – Russia, June 17, 1992, T.I.A.S.

¹⁸⁶ OPIC Investment Incentive Agreement, U.S. – Russia, June 17, 1992, T.I.A.S.

Each of these treaties is vital to foreign direct investment into Russia because the treaties provide assurance and protection for U.S. entities to enter the Russian market place.

3. Russia is a party to numerous bilateral and multilateral treaties promoting foreign direct investment and protecting investors' rights.

Russia is a party to bilateral investment treaties ("BITs") with 34 countries, including the largest economies in the European Union — the United Kingdom, France, Germany, and Italy; as well as with some of the world's largest economies — Canada, China, India, Japan, and Korea. Russia is also a party to BITs with Austria, Greece, Cuba, Romania, Denmark, Slovakia, Czech Republic, Vietnam, Kuwait, Hungary, Albania, Norway, Yugoslavia, Lebanon, Macedonia, the Philippines, Egypt, South Africa, Moldova, the Netherlands, Spain, Belgium, Luxembourg, Finland, and Switzerland.¹⁸⁷ These BITs define and protect the rights of foreign investors in Russia.

There are two bilateral treaties signed between the Russian Federation and the United States of America: the agreement between the Government of the Russian Federation and the Government of the United States of America on investment incentives of April 3, 1992, which was ratified by Resolution of the Supreme Soviet of the Russian Federation of June 4, 1992.¹⁸⁸ The Agreement between the Russian Federation and the United States of America on stimulation and mutual protection of investments of June 17, 1992 is signed by both parties, duly ratified in the USA and is to be ratified by the Russian Parliament.

The Partnership and Co-operation Agreement with the European Union of 1994 superseded the Agreement on trade and commercial and economic co-operation of 1989 signed

¹⁸⁷ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 50.

¹⁸⁸ Investment Incentive Agreement, U.S. – Russia, June 17, 1992, T.I.A.S. 11471.

by the Soviet Union. The Agreement establishes firm and comprehensive economic and political partnership ties between the Russian Federation and the European Union covering trade in goods, works, services, political dialogue, investments, intellectual property and collaboration in various fields. The Agreement is made for development of mutual investment and trade relationship and to guarantee observation of international commonly accepted rules by the Russian Federation as a basis for co-operation between the Russian Federation and the European Union.

The Agreement provides for:

- Regular annual meetings between the state executives of Russia and the European Union;
- The Russian Federation to grant the national treatment to the companies of the European Union investing into Russia;
- Elimination of trade quotas.

Russia is also a member of the International Center for the Settlement of Investment Disputes and accepts binding international arbitration.¹⁸⁹ Foreign investors have access to the Russian judicial system for resolution of investment disputes. In addition to the national and local courts, these include tribunals specializing in commercial arbitration: the Arbitration Court of the Russian Federation, the International Commercial Arbitration Court at the Russian Chamber of Commerce and Industry, and a similar arbitration court in St. Petersburg.¹⁹⁰ As the Department of Commerce has recently stated, "the trend towards a more

¹⁸⁹ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 59.

¹⁹⁰ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 59.

independent, transparent and impartial judicial system is generally positive. . ."191 The reform of Russia's judicial institutions culminated with the enactment in December 2001 of a package of reform legislation described above. Further more, decisions rendered in such tribunals are enforceable in Russia. A 1997 law now allows foreign arbitration awards to be enforced in Russia, even if there is no reciprocal treaty between Russia and the country where the order was issued.¹⁹²

4. Russia's domestic legislation provides broad rights and far-reaching protections for foreign investors.

Since 1998, the Russian government has enacted a series of laws dramatically expanding the rights and protections afforded to foreign investors. The foundation for the rights and protections of foreign investors is the Federal Law on Foreign Investment in the Russian Federation ("the Foreign Investment Law"),¹⁹³ which was enacted in 1999. The Foreign Investment Law, which expands the rights and protections afforded by the 1991 Investment Code,¹⁹⁴ provides the basic guarantees of the rights of foreign investors to invest directly in the Russian Federation and to enjoy unfettered rights to the earnings gained from such investments. The purpose of the law is to ensure that the legal treatment of foreign investments complies with Russia's obligations under international law and international practices of investment cooperation.¹⁹⁵

Specifically, the Foreign Investment Law:

¹⁹¹ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, Chap. 2, "Judicial Reform."

¹⁹² U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 59.

¹⁹³ Federal Law #. 160-FZ (July 9, 1999).

¹⁹⁴ Federal Law of July 4, 1991, "On foreign investments in Russia."

- Guarantees national treatment to foreign investors;¹⁹⁶
- Provides that foreign investors may establish or invest in any type of business venture not prohibited to investors generally by Russian law, including making investments in private and government equities;¹⁹⁷
- Prohibits nationalization or expropriation of foreign investors' assets except as provided for by federal law or international treaties to which Russia is a party, and guarantees full compensation in case of any nationalization or expropriation.¹⁹⁸ (The federal law governing nationalization and expropriation, the 1991 Investment Code, prohibits the nationalization or expropriation of foreign investments except following legislative action, requires that such action be in the national interest, provides for judicial appeal of such action, and requires prompt, adequate and effective compensation.);¹⁹⁹
- Provides protection for certain large foreign investments against unfavorable changes in Russian laws affecting investors' interests for a period of seven years (e.g., customs laws, tax laws);²⁰⁰
- Guarantees foreign investors access to dispute resolution mechanisms for resolution of investment disputes;²⁰¹ and
- Guarantees that foreign investors may reinvest their profits or may repatriate them in foreign currency.²⁰²

Finally, the Duma is expected to approve a new "Corporate Governance Code" in early 2002. In a closely related development, on February 4, 2002 the chairman of Russia's Federal Securities Commission unveiled the Commission's proposed corporate code of conduct in an address to the World Economic Forum in New York. The code, which would parallel the

¹⁹⁵ See Preamble, art. 3(1), art. 5(1).

¹⁹⁶ Art. 4(1).

¹⁹⁷ Art. 6, art. 13.

¹⁹⁸ Art. 8.

¹⁹⁹ The 1993 Constitution, art. 35, point 3; Federal law # 160-FZ of July 9, 1999 "On foreign investments in the Russian Federation," art. 8.

²⁰⁰ Art. 9.

²⁰¹ Art. 10.

pending “Corporate Governance Code” legislation, covers all areas of corporate conduct and contains strong rules promoting transparency, safeguarding shareholder’s rights, and prohibiting insider trading. In this regard, the chairman stated, “For me the key issue is to protect the domestic investor because if we protect the domestic investor, foreigners will benefit as well.” Among the new provisions are a requirement that at least 25 percent of a company’s board be comprised of independent directors and a requirement that, following a corporate reorganization, Independent assessors be utilized to determine the value of the reorganized company’s shares.²⁰³

With limited exceptions for certain sensitive industrial sectors, Russia permits foreign investment in all sectors of its economy. In late 2000, a draft law that would have specified sectors where foreign investment either would be prohibited or could be restricted failed in the Duma and is now effectively dead.²⁰⁴ Moreover, the Russian government continues to take steps to liberalize the remaining rules restricting investment in particular sectors of the economy. While foreign investment in certain sectors (e.g. banking, mining and telecommunications) requires licensing, the government has submitted to the Duma legislation that would greatly simplify business registration procedures, and sharply reduce the number of sectors subject to licensing.²⁰⁵

²⁰² Art. 11.

²⁰³ “FSC Unveils Corporate Ethics Code,” Daniel Bases, Reuters Newswire, February 5, 2002.

²⁰⁴ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 73-74.

²⁰⁵ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 74.

5. The Putin administration has championed tax reform as an important means to improve the investment climate in Russia.

During President Putin's tenure, Russia has strongly stressed attracting foreign direct investment, particularly through structural reforms including a reform of the tax system.²⁰⁶

Historically, the Russian tax system has been characterized by a large number of taxes and levies, many based on business turnover rather than economic profit. The tax laws were complex and poorly drafted, and interpretive regulations and instructions were often open to conflicting application by the tax authorities. Tax reform in Russia has taken the form of the adoption of a comprehensive Tax Code that replaces numerous individual laws governing particular taxes.²⁰⁷

Part I of the Tax Code was adopted in the summer of 1998 and entered into force on 1 January 1999.²⁰⁸ Part I mainly covers administrative and procedural matters as well as establishing principles for introduction of new taxes, protection of "rights" of taxpayers and avoidance of tax discrimination. Part I places the burden of proof on the tax authorities (unlike the case in many jurisdictions) and provides that in cases of ambiguity of a tax law the interpretation most favorable to the taxpayer should apply. Placing the burden of proof on the tax authority instead of the taxpayer is a much more liberal approach than that used by many countries, such as the United States, Germany, and the United Kingdom. Russia's established procedures are a model of due process in the tax environment with respect to other countries. It

²⁰⁶ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 60; The Economist Intelligence Unit, "Country Commerce, Russia," p. 10, November 2001.

²⁰⁷ Federal Law # 1992-I of December 6, 1991, "On Value Added Tax;" Federal Law # 2116-I of December 27, 1991, "On profits tax on enterprises;" Federal Law # 1998-I of December 7, 1991, "On individual Income tax;" Federal Law of December 6, 1991 "On excises," etc.

²⁰⁸ The Federal Tax Code, Part I, #146-FZ of July 31, 1998.

also entirely abolished six taxes and reduced the nominal tax burden from 41 percent of GDP to 39 percent in 2001.

The most significant tax reforms were enacted in 2000 and 2001. Four chapters of Part II of the Tax Code covering VAT, excise tax, individual income tax and social tax were adopted and entered into force on 1 January 2001.²⁰⁹ The Individual Income Tax and the Social Tax were revised to encourage further foreign direct investment.

The Individual Income Tax Chapter of the New Russian Tax Code (effective as of January 1, 2001) moved to a flat income tax rate of 13 percent for residents and 30 percent for non-residents from the burdensome bracket structure previously used.²¹⁰ It also created a variety of new deductions to taxable income that residents and non-residents may use to lower their nominal tax burden.²¹¹ Foreign persons can establish residency in Russia after 183 days and under the U.S.-Russia tax treaty, U.S. citizens doing business in Russia would pay no Russian taxes during the six-month period necessary to establish residency provided they have no Russian-sourced income (e.g. income paid by the Russian legal entities, income paid for works performed in the territory of the Russian Federation, etc.)

The chapter on Profits Tax was adopted in August 2001 and entered into force 1 January 2002.²¹² The implementation law for the chapter on profits tax was adopted effective

²⁰⁹ Federal Tax Code Part II #117-FZ of August 5, 2000.

²¹⁰ The Economist Intelligence Unit, "Country Commerce, Russia," p. 47-49, November 2001.

²¹¹ The Economist Intelligence Unit, "Country Commerce, Russia," p. 47-49, November 2001.

²¹² Federal Law #110-FZ of August 6, 2001 "On amendments and additions to the Federal Tax Code."

1 January 2002, which introduces transitional provisions from the old rules for certain aspects of the new profits tax regime.²¹³

With the adoption of the Profits Tax chapter, Russian tax reform is substantially complete from a legislation standpoint. This, in conjunction with earlier made progress through reductions in turnover taxes, personal income and employee social taxes, and abolition of numerous minor taxes, considerably relieves the overall tax burden for Russian and foreign businesses and makes Russia's tax regime comparable to those of other major market economies. Tax litigation is Russia's single biggest "tax reform" success. The option of litigation by Russian and Western companies has become increasingly popular and successful. Statistically almost half of all the commercial arbitration cases involved tax disputes against the tax authorities. Over 60% of such cases are determined in the taxpayer's favor. Judges have applied the law (rather than tax authority letters and instructional guidance) and have acted independently in reaching their decisions. The system itself is also highly efficient in that the entire case process can be completed in anywhere from two to five months as compared to years in other nations.

6. Russia's remaining limitations on the ownership of land by foreign investors are far less restrictive than those of other countries whose NME designation has been revoked.

The legal status of land ownership by foreigners in Russia is evolving. The 1993 Constitution establishes the principle of private ownership of land²¹⁴ and contains the general provisions that govern land ownership.

²¹³ Federal Law # 110-FZ of August 6, 2001 "On amendments and additions to the Federal Tax Code," art. 2.

²¹⁴ See art. 9.

A 1993 presidential decree²¹⁵ establishes the right to sell, rent, give as security or otherwise dispose of land sets out the procedure for the direct purchase of land. The decree does not expressly allow foreign citizens or enterprises to purchase land outright, *though it does allow Russian companies with foreign investment to do so.*²¹⁶

A second presidential decree, issued in late 1993, repealed the provisions of the then-existing Land Code that prohibited foreign ownership of land.²¹⁷ Since 1993, ownership rights in land can be acquired during the privatization of state companies, which came with the right to buy the land they occupy.²¹⁸ In 1994, a privatization decree permitted foreign owners of privatized companies to receive title to enterprise land. A 1997 decree provided for a pre-emptive right of the owners of privatized buildings and structures to purchase land beneath them.²¹⁹ Under another 1997 presidential decree, non-residents as well as residents can buy or lease specific land plots, although this must be accomplished through a tender.²²⁰

The New Land Code, effective as of October 29, 2001, imposes no restrictions on the purchase by foreign individuals and companies of non-agricultural land plots — except for certain sensitive areas near Russia's national borders in accordance with the list to be drawn up

²¹⁵ Decree 1767 of October 27, 1993 "On the Regulation of Land Relations and the Development of Agricultural Reform in Russia

²¹⁶ The Economist Intelligence Unit, "Country Commerce, Russia," p. 17, November 2001.

²¹⁷ Presidential Decree 2287, of December 24, 1993.

²¹⁸ Presidential Decree 301 of March 1992 "On the Sale of Land Sites to Individuals and Legal Entities in the Course of Privatization of State and Municipal Enterprises."

²¹⁹ Decree 485 of May 16, 1997.

²²⁰ Decree 1263 of November 26, 1997.

by the Russian President.²²¹ The government plans to follow this law at a later date with a code for agricultural land sales, a more politically-sensitive issue.²²²

In sum, the situation as regards to the right of foreigners to own land in Russia, while still in flux, compares very favorably with that in the other countries whose NME designation has been revoked. Three of these countries prohibited all, or virtually all, direct ownership of land by foreign investors. In the Czech Republic, foreign business and persons could not directly own real estate.²²³ The same was true in Slovakia, with insignificant exceptions.²²⁴ Latvia permitted ownership of land only by majority-owned persons or enterprises from Latvia or from countries with which Latvia had a mutual investment protection agreement.²²⁵

7. The limited restrictions that presently exist are significantly narrower than those imposed by the other five countries whose NME designation has been revoked.

a. Defense sector

At the time of their NME revocation, Hungary prohibited *all* foreign ownership in its defense-related industries,²²⁶ while Slovakia prohibited *all* foreign investment in its armaments industry.²²⁷ In sharp contrast, Russia permits foreign investment in defense industries

²²¹ Federal Law #137-FZ of October 25, 2001 "On introduction of the Land Code of the Russian Federation."

²²² U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 59.

²²³ Czech Republic NME Analysis Memorandum at 7.

²²⁴ Slovakia NME Analysis Memorandum at 7.

²²⁵ Latvia NME Analysis Memorandum at 10.

²²⁶ Hungary NME Analysis Memorandum at 8

²²⁷ Slovakia NME Analysis Memorandum at 7.

with prior approval, although such approval is not guaranteed.²²⁸ Foreign ownership is permitted in Russia's aerospace industry up to 25 percent of an enterprise.²²⁹

b. Natural monopolies

Slovakia prohibited foreign ownership in the gas and electricity sectors at the time its NME status was revoked,²³⁰ while Latvia prohibited FDI in its timber sector.²³¹ In contrast, Russia has opened its natural monopolies to foreign investment, with the petroleum/natural gas and electricity sectors leading the way. Russia, which is the second-largest petroleum producer in the world, is taking bold and dramatic steps to open its petroleum/natural gas sector to foreign direct investment. "Changes in the ownership structure of the Russian oil industry have resulted in new, more market-oriented partners for U.S. firms seeking to invest in Russia and with them abroad."²³² This will effectively increase the amount of foreign direct investment in the industry.

The state Duma, in 2001, approved remaining necessary legislation components of Russia's Production Sharing Agreement (PSA) framework.²³³ This was generally considered a precondition for major Western energy investment in Russia and was a major factor in the decision of ExxonMobil to develop offshore drilling rigs discussed below.²³⁴

²²⁸ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 60.

²²⁹ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 60.

²³⁰ Slovakia NME Analysis Memorandum at 7.

²³¹ Latvia NME Analysis Memorandum at 9.

²³² U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 62.

²³³ Economist Intelligence Unit Viewswire, "Russia: Investment Regulations," p. 1. available at http://www.viewswire.com/index.asp?layout=display_art.&doc_id=171420.

²³⁴ Economist Intelligence Unit Viewswire, "Russia: Investment Regulations," p. 1-available at http://www.viewswire.com/index.asp?layout=display_article&doc_id=171420.

Moreover, limitations on foreign ownership in the natural monopolies sector have been severely reduced. For example

- The November 4, 1997 presidential decree, No. 1148, removed the 15 percent investment ceiling for non-resident owners of oil and gas companies to allow them to bid for oil companies earmarked for privatization.²³⁵ "Foreigners have participated in subsequent oil and gas sector privatization auctions."²³⁶
- "Foreign ownership in the natural gas monopoly Gazprom is technically limited to eleven percent but use of joint ventures to purchase additional shares has allowed Gazprom to pursue its strategic partnership with the German company Ruhrgas without legal problems."²³⁷
- Foreign ownership in Unified Energy Systems, the national power utility, which is theoretically capped at 25 percent, presently stands at 30 percent, prompting a call by the utility for revocation of the rule limiting foreign ownership.²³⁸

As a consequence of these developments, Russia's oil and gas sector in particular has received massive foreign investment.

- Over USD 1 billion has been invested to date in the Sakhalin II consortium, a project that began production in mid-1999.
- USD 2.6 billion has been invested in the Caspian Pipeline Consortium project.²³⁹
- Exxon struck a deal with Russia, in October of 2001, worth an estimated \$4 billion over five years to develop offshore oil and gas fields according to the New York Times. The project is said to be worth \$12 billion over its life. Glenn Waller, director of external affairs for ExxonMobil in Russia, said, "This is the green light, we've been encouraged by progress on structural reforms. The bilateral relationship and improvements in that area have not been lost on this project. The broader context has given us confidence."²⁴⁰

²³⁵ Slovakia NME Analysis Memorandum at 7.

²³⁶ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 60.

²³⁷ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 60.

²³⁸ The Economist Intelligence Unit, "Country Commerce, Russia," November 2001, p.15.

²³⁹ U.S. Commercial Service, Country Commercial Guide Russia, Fiscal Year 2002, p. 59.

²⁴⁰ "Exxon Says Way is Cleared for Development in Russia," The New York Times, pg. 1, October 30, 2001.

c. Communications

With the exception of the television industry, where the foreign ownership of stations and programs is prohibited, there are no restrictions on FDI in the Russian communications sector.²⁴¹ At the same time, Slovakia prohibited all foreign ownership in the telecommunications sector,²⁴² while Latvia prohibited FDI in the radio and television sectors.²⁴³

d. *The difficulties faced by foreign investors in Russia are no greater – and in most instances far more minor – than those faced by foreign investors of the other countries whose NME designation has been revoked.*

The DOC revoked the Czech Republic's NME designation in spite of the fact that — as the DOC pointed out — foreign investors faced a host of thorny problems. The DOC cited specific problems with:

- inadequate information on the ownership and financial condition of target companies;
- insufficient recourse to the court system;
- inadequate enforcement of their intellectual property rights;
- non-transparent bidding processes;
- inefficiencies in the government administrative process;
- high corporate and employment taxes;
- and changes in the external tariff regime that favored EU goods.²⁴⁴

²⁴¹ The Economist Intelligence Unit, "Country Commerce, Russia," p. 16, November 2001.

²⁴² Slovakia NME Analysis Memorandum at 7.

²⁴³ Latvia NME Analysis Memorandum at 9.

²⁴⁴ Antidumping Investigation of Certain Small Diameter Carbon and Alloy Seamless Standard Line and Pressure Pipe from the Czech Republic; Memorandum to R. LaRussa re Market vs. Non-Market Economy Analysis (Nov. 29, 1999) at 8.

In revoking Hungary's designation, the DOC noted that foreign investors commonly complained of the lack of legal and regulatory transparency.²⁴⁵

In Slovakia the DOC cited concerns over macroeconomic and political instability and a lack of transparency, consistency and predictability in the implementation of investment related laws and regulations.²⁴⁶

In Latvia, the DOC found even more extensive problems, including the following:

- effective enforcement of the foreign investment law and associated rules and regulations was hampered by the unavailability of official translations of laws, rules, and regulations;
- an inefficient judicial system effectively precluded timely resolutions of disputes;
- an inadequate number of officials knowledgeable about market concepts and business practices and experienced in resolving complex legal and commercial disputes; and
- corruption undermined business confidence and the rule of law.²⁴⁷

In Poland, the DOC found problems stemming from

- the underdeveloped nature of Poland's banking, financial and communications systems;
- the scarcity of domestic personnel knowledgeable in foreign languages and skilled in Western management and business techniques;
- the large and increasing number of new laws and regulations;
- uncertainty about the privatization program and property rights; and
- labor unrest.²⁴⁸

²⁴⁵ Hungary NME Analysis Memorandum at 9.

²⁴⁶ Slovakia NME Analysis Memorandum at 8.

²⁴⁷ Latvia NME Analysis Memorandum at 10.

²⁴⁸ Poland NME Analysis Memorandum at 15.

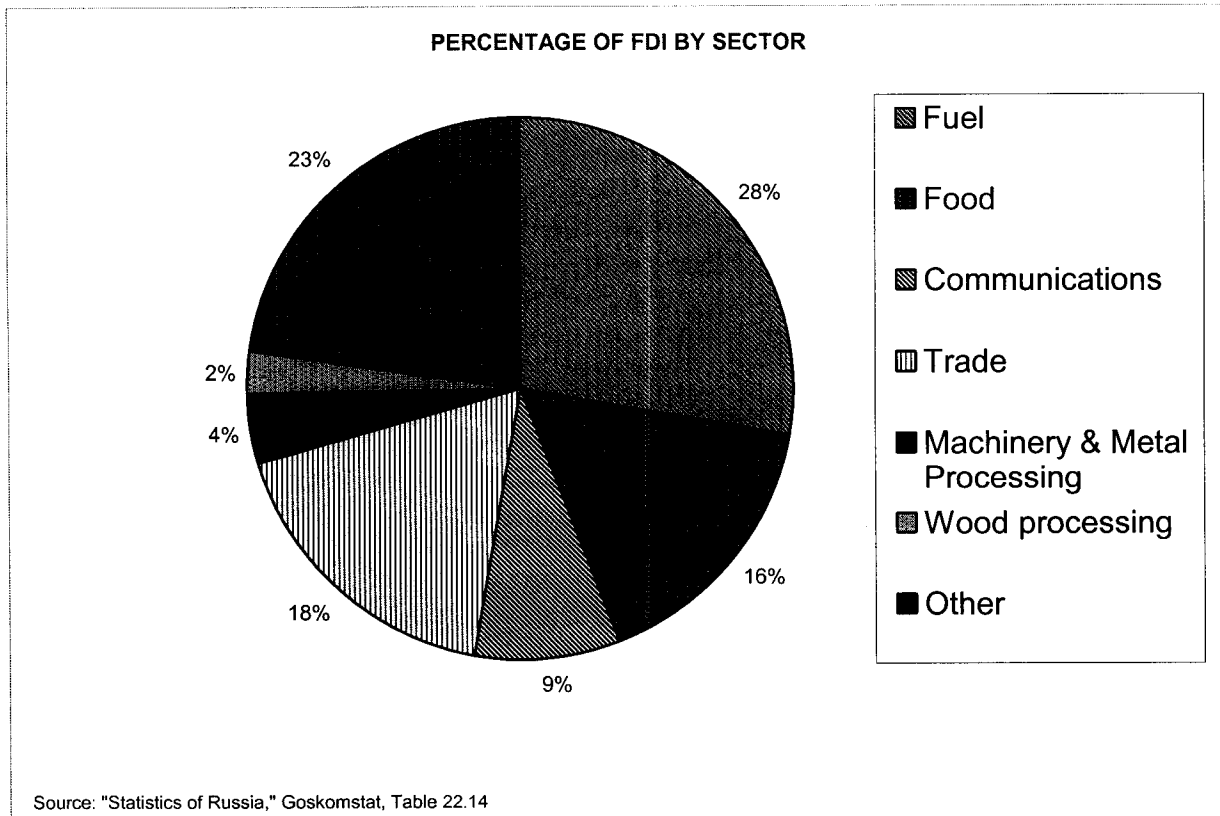
In short, the DOC determined that in each case barriers to investment were present. Examples of legal transparency, inadequate investment infrastructure, corruption, political uncertainty, economic instability, poorly defined property rights, an inadequate judicial system, an inadequate and problematic privatization regime, a punitive tax regime, inadequate protection of intellectual property, a discriminatory trade regime, a failure to implement existing investor laws, and uncertain or biased investor dispute resolution mechanism can be found in some of the countries who have gained the market economy designation. Yet each was found to be a market economy despite having some of these problems.

C. Economic data confirm the absence of any significant constraints on joint ventures with a foreign joint venture partner and on foreign investments.

1. Structural reforms have encouraged wide-spread foreign direct investment.

As a result of structural reforms undertaken by Russia, a wide variety of industries are receiving FDI. During 2000, Russia's fuel industry received 27.9 percent of all foreign direct investment and 17.7 percent of the total cumulative foreign investment for the year. Other sectors of the economy attracting significant foreign investments were trade, retail and catering, food processing, communications, machinery and metal processing, and the wood, pulp, and paper industry.

Figure 17 - Percentage of FDI By Sector



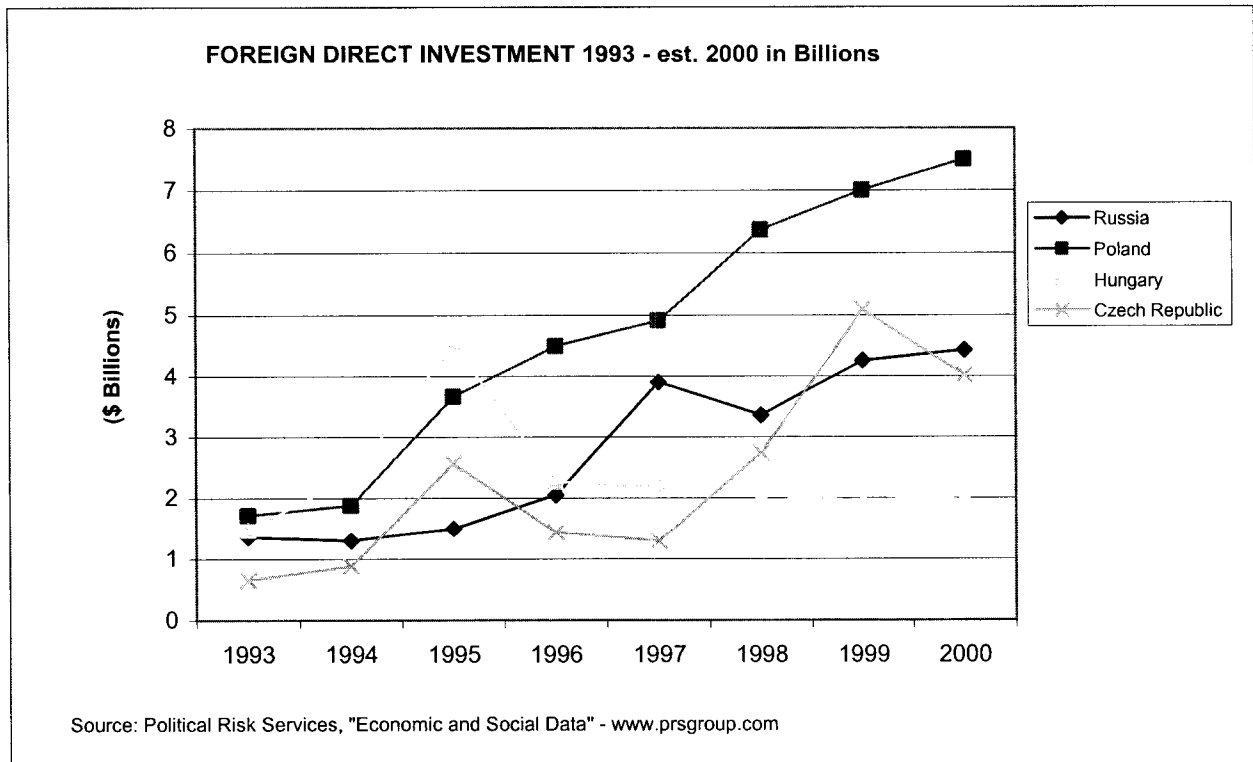
Foreign direct investment in the Russian economy has steadily increased in the past several years. The levels of investment in Russia are commensurate with foreign investment levels in other central and eastern European countries, particularly those who have been granted market economy status with the DOC.

In 1999, total foreign direct investment in Russia amounted to \$4.26 billion (45 percent of the total investments). Other investments, mainly trade credits and foreign loans, reached \$5.27 billion (55 percent). In the following year, the amount of foreign direct investment increased by 4 percent, when it reached a level of \$4.43 billion (40.4 percent of the total investments), while other investments rose 20 percent and reached \$6.35 billion (58.3 percent of the total). Cumulative foreign investment increased in 2000 over 1999 by 14.6 percent to \$10.96

billion.²⁴⁹ The trend in recent years continues to echo the patterns developed in the early 1990's with the total percentage increase in foreign direct investment from 1993 to 2000 amounting to over 225 percent. This large increase demonstrates the increasing confidence foreign investors have with the Russian economic system.

Similar trends in foreign direct investment can be seen in other Central and East European countries. The average percentage change in foreign direct investment levels from 1993 to 2000 for Poland, Hungary and the Czech Republic was 297 percent. This is similar to the change in investment levels in Russia over the same time period.²⁵⁰

Figure 18 - Foreign Direct Investment

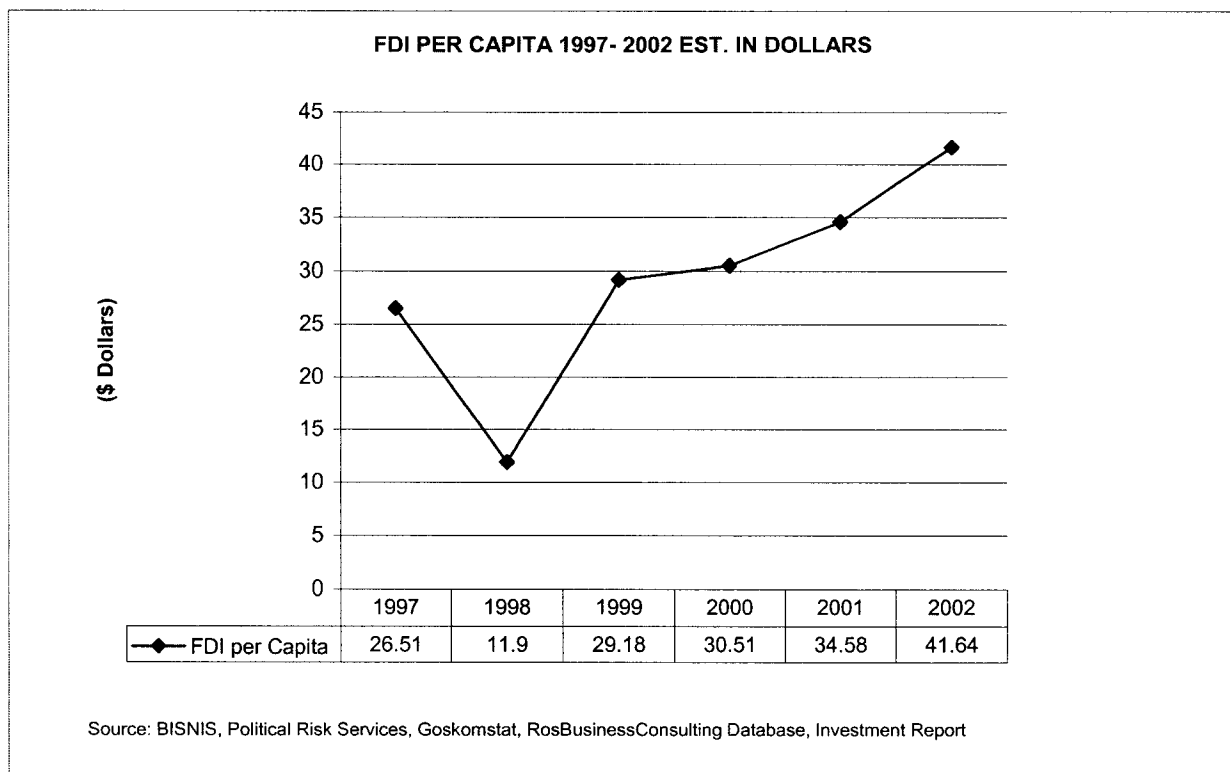


²⁴⁹ Bisnis, Russia Fact Sheet, p. 2.

²⁵⁰ Political Risk Services, "Economic and Social Data for Poland, Hungary, Czech Republic & Russia," Jan. 1, 2001, March 1, 2001 and May 1, 2001 available at <http://www.prsgroup.com>.

The volume of foreign investments in the Russian economy is projected to increase steadily each year, approaching a level 25 percent higher than the current level by the year 2004, according to Russia's Ministry of Economic Development and Trade.²⁵¹ In addition to the liberalization of the legal structure pertaining to foreign investment in Russia, the increased political ties Russia has formed with its western counterparts in the wake of the September 11th terrorist attacks are also likely to fuel increasing investment levels.

Figure 19 - FDI Per Capita

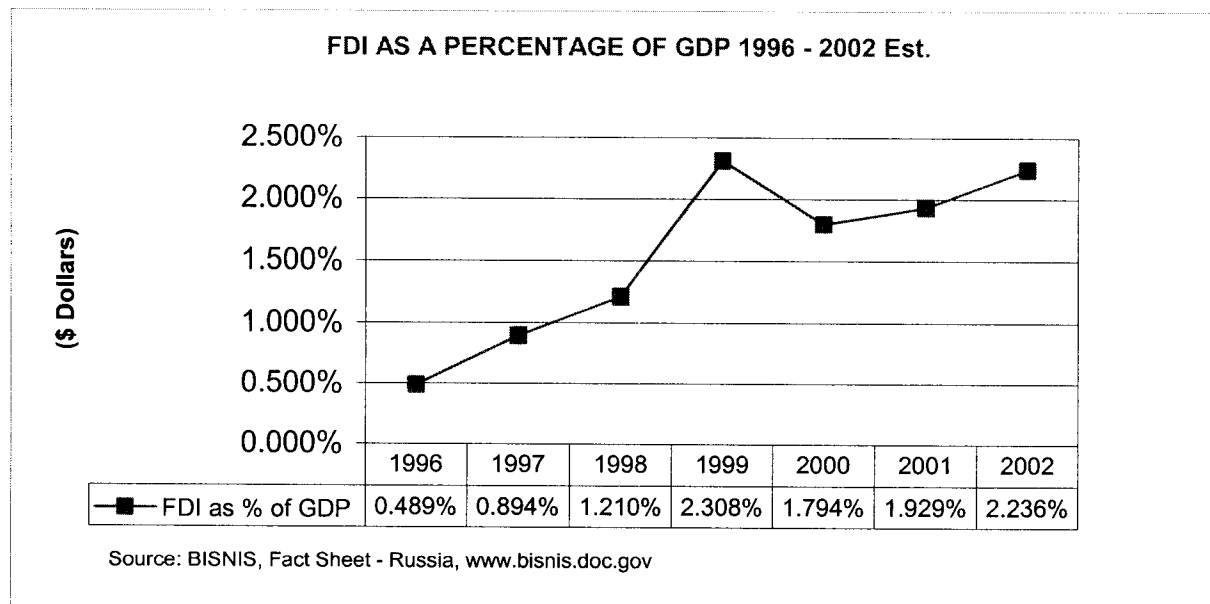


Foreign direct investment per capita has increased every year since 1998. The rate of growth in foreign direct investment per capita has steadily increased by 4.5 percent per year for the past four years. This growth trend shows that the confidence of foreign investors in

²⁵¹ Investment Opportunities in Russia, Weekly Brief No. 40, November 2-8, 2001, pg. 1.

the Russian economy has grown. Foreign investment in Russia continues to increase and the pace is likely to increase in light of the new legislation brought before the Duma as discussed in Section IV. B. above. The pace of foreign direct investment per capita is forecast to increase significantly, with year-by-year increases in 2001 and 2002 forecast to be 13 and 20 percent, respectively.²⁵² This increase in the amount of investment shows investor confidence in the Russian system and the increased availability of new sources of funding within the economy.

Figure 20 - FDI As A Percentage of GDP



As seen in Figure 20, the same increasing trends that existed with respect to foreign direct investment measured on a per capita basis also exist with respect to foreign direct investment measured on a gross domestic product basis. Foreign direct investment as a

²⁵² "Volume of Foreign Direct Investments in Russia's Economy Growing," RosBusinessConsulting Database, December 6, 2001, available on Lexis.

percentage of GDP grew from 1996 to 2000 by 267%, with continued increases forecast for 2001 and 2002.²⁵³ The rate of foreign direct investment is increasing more quickly than GDP, demonstrating that investor confidence is higher and additional new investments are being made each year.

2. Large multinational corporations continue to invest heavily in Russia.

ExxonMobil reached an agreement with the Russian government in October of 2001 worth an estimated \$4 billion over five years to develop offshore oil and gas fields. The project is said to be worth \$12 billion over its life. Within the diverse Russian economy, the most attractive sector for foreign investment, partially due to the Profit Sharing Agreement (PSA) regime, is the fuel industry.

Many governments use PSA's to define their relationships with oil companies wishing to explore for hydrocarbons. The concept behind such agreements outlines that the hydrocarbons within a state's territory belong to the state. If the state wishes to explore and exploit them it either does so itself or contracts with others to do so on its behalf. But the costs of exploration and production and the risks of failing to find commercial quantities of hydrocarbons are quite high. Despite advances in technology, it is still not possible to know whether oil and gas fields exist below the earth's surface without drilling expensive exploration wells. When those wells are successful, the costs of development and production, especially when the fields are under the sea, can be immense. For these reasons, states often decide to

²⁵³ Based on FDI data from Bisnis, Russia Fact Sheet, p. 2. Projections for 2001 & 2002 arrived at through author calculations using FDI projections from "Volume of Foreign Investments in Russia's Growing Economy," RosBusinessConsulting Database, December 6, 2001, available on Lexis and GDP projections from "GDP Forecast to Grow 3.8% - 4.4% in 2002 -2004," Investment Report, August 24, 2001, available on Lexis.

contract via PSAs with international oil companies that will bear the risks and the costs in return for a share of production if hydrocarbons are found and produced.

Similar investments have been made by Sakhalin and BP Amoco. These agreements were also made under the PSA regime and are currently working. Sakhalin-1 and Sakhalin-2, oil and gas producers, are consortiums of U.S. and Japanese companies with a total investment of \$1.3 billion. BP Amoco, an oil and gas producer based in the United States and the UK invested \$1 billion in Russia.

In terms of a geographical breakdown of foreign investors, US companies are by far the most prevalent, leading in terms of cumulative investment (\$5.49 billion as of the end of 2000), and also in concentration of investment. Many large investment projects (as of February 1, 2000) involve US companies. Examples are as follows:

- RJ Reynolds, US, \$0.450 billion.
- Philip Morris, US, \$0.360 billion.
- Mars Inc., US, \$0.160 billion.
- International Paper, US, \$300 million.
- Ford Motor Company, US, \$150 million.

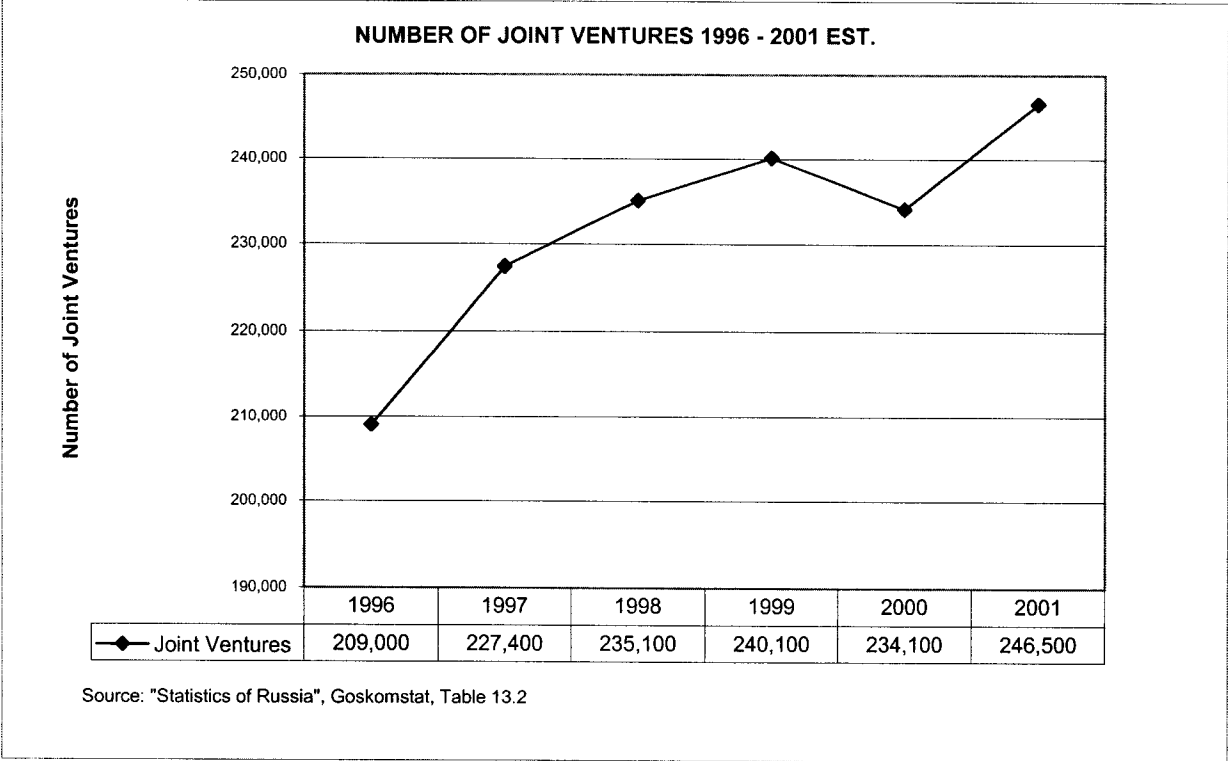
Besides the United States, other important investing nations are Germany (\$1.468 billion in cumulative investment by the end of 2000), the Netherlands (\$1.231 billion), the United Kingdom (\$0.599 billion), and Sweden (\$0.308 billion).²⁵⁴

²⁵⁴ "Statistics of Russia" affiliated with the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat) available at <http://www.gks.ru/eng/>, Table 22.15.

3. Joint ventures between Russian and foreign companies have expanded.

Since 1996, the number of Russian ventures with overseas firms has increased almost 20 percent. As the joint venture laws and governance have improved, this form of business entity has served as a major conduit of foreign direct investment and funds.

Figure 21 - Number of Joint Ventures



V. CRITERION 4: THE EXTENT OF GOVERNMENT OWNERSHIP OR CONTROL OF THE MEANS OF PRODUCTION

Summary of Comment

The Opposing Parties have also misstated key facts concerning the extent and rate of privatization in the Russian Federation. Section A corrects these misstatements, while Section B provides a detailed discussion of the legal regime governing land ownership and privatization in Russia. Section C provides economic data demonstrating that the government does not exercise significant ownership or control of the means of production.

A. The parties opposing revocation misstate key facts concerning the extent of the Russian government’s ownership or control of the means of production.

Russia has privatized the majority of its industries, although as in every other country, there are certain sectors in the Russian economy that are of the utmost national importance and, therefore, cannot be privatized. These include national defense, social welfare, securities market, regulation and some parts of the aerospace industry.

Several of the Opposing Parties argue that one factor weighing against market economy status is the fact that the Government of the Russian Federation maintains an ownership interest and supervisory control over the activities of certain natural monopolies – in particular, in the energy and transportation fields.²⁵⁵ One Opposing Party is “particularly concerned about the continuing involvement of the Russian Government in the natural

²⁵⁵ See, e.g., Ad Hoc Committee Brief at 19-23; Schagrin Associates Brief at 3-5.

monopolies, and especially energy”²⁵⁶ This argument, however, should be disregarded by the Department as inapposite, as well as factually distorted.

The argument is inapposite to the Department’s market economy determination because government involvement in or ownership of natural resources, and particularly energy resources such as oil and natural gas, has not been considered contrary to the existence of a market economy. To the contrary, the governments of a broad range of market economy countries hold ownership shares or are heavily involved in the activities of the energy sectors within their boundaries. For example, the governments of many, if not all, Persian Gulf states – including major oil producing countries like Saudi Arabia, Iran, Kuwait, and the United Arab Emirates – hold majority shares in their oil production companies. This is true as well for other major oil and natural gas producing countries, such as Mexico, Venezuela, Norway, Nigeria, and Libya. The United States itself retains ownership of the extensive oil and gas reserves found on federal lands, including all reserves on the United States’ continental shelf. It should not be surprising that the governments of many countries holding abundant energy resources should maintain ownership interests in the entities that recover and distribute those resources. Energy resources, at least since the 1970s, have been considered so fundamentally a part of a nation’s patrimony, and their recovery and use so important to a nation’s well-being, that many nation-states envisage the development of those energy resources as an integral aspect of the role of government in their societies.

Thus, it would be absurd to argue that the countries listed above are non-market economies because of their governments’ ownership of the oil and natural gas reserves or

²⁵⁶ Ad Hoc Committee Brief at 19.

production entities, and there is no reason to treat Russia differently because of the continuing interest of its government in the production and distribution of its energy resources. Although the Ad Hoc Committee may ascribe its concern to the Russian Government's "continuing involvement" in the country's energy sector, its real concern is with the sheer existence of competitors with access to abundant, inexpensive natural gas supplies. That fact, however, has nothing to do with whether Russia is a market economy country, and the Russian Steel Producers submit that it would be inappropriate for the Department to be distracted from the appropriate analysis of the issue at hand by the Ad Hoc Committee's concern.

At least as dubious is the assertion by some of the Opposing Parties that evidence of Russia's continuing NME status is provided by the Russian Government's continuing ownership over the country's transportation (in particular, rail) system.²⁵⁷ The governments of many market economy countries own the rail transport systems within their jurisdictions, because it is seen as a "public good" whose delivery to the citizenry is recognized as an inherently governmental function, and because rail transport often operates under economic conditions of natural monopoly, requiring either heavy government regulation or ownership. The involvement of the U.S. federal government in the ownership of Amtrak is a prime example of such government supervision, and other examples exist in recent past and/or continuing government ownership of rail transport systems in most Western European countries, Japan, etc. Whether or not an economic theoretician might assert that a preferable state of affairs would be the private ownership of a country's rail system (which is not clear), it would be ridiculous to

²⁵⁷ See Verner Liipfert Brief at 2; Ad Hoc Committee Brief at 18-19; Schagrin Brief at 3; Wiley, Rein & Fielding Brief at 20; Skadden-Dewey Brief at 31-32.

conclude therefore that the countries whose governments own their transport systems are non-market economies. Again, there is no good reason to treat Russia differently on this score.

B. The laws and regulations governing privatization in Russia prevent the government from exercising significant control over the means of production.

In order to determine whether Russia's economy operates on market principles of cost and pricing such that sales of merchandise in Russia reflect their fair value, the statute further instructs the DOC to consider "the extent of government ownership or control of the means of production."²⁵⁸ The DOC has consistently interpreted this provision as an instruction to investigate the progress in a country's land reform and the privatization of its state-owned enterprises.²⁵⁹

After the collapse of the Soviet Union and the declaration of independence of Russia in 1990, the country adopted a policy of transition to a market economy. Among the main elements of this policy were

- the recognition of private property;
- the adoption of legislation governing issues related to private property; and
- the adoption and implementation of a privatization program aimed at reducing the share of state ownership in the economy.

These principles govern the privatization process as discussed below.

²⁵⁸ 19 U.S.C.A. §§ 1677(18)(B)(iv).

²⁵⁹ *See, e.g.*, Hungary NME Analysis Memorandum at 10-13.

1. Laws governing issues related to private property.

As discussed above in the discussion of Criterion 3 (*see* Section IV.C.2.d above), private ownership of land is recognized and permitted in the Russian Federation. This is a right guaranteed by the 1993 Constitution of the Russian Federation. The 1993 Constitution establishes that land and other natural resources may be in private, state, municipal or other forms of ownership.²⁶⁰ It further guarantees that private property is recognized and protected in Russia to the same extent as state property.²⁶¹ The right of private property is protected by law; individuals and legal entities are entitled to own, possess, use and dispose of property and nobody can be deprived of his property except as by a court decision.²⁶²

Pursuant to the 1993 presidential decree that laid the groundwork for the transfer of ownership of agricultural land,²⁶³ citizens and legal entities owning plots of land are entitled to sell, hand down, give as a present, pledge, exchange, and transfer the land plot as a contribution to authorized capital funds of joint-stock companies, associations and cooperatives — *including those with foreign participation*. This decree guarantees the protection of private property on land as well as protection of landowner's rights while effecting of transactions with the land.²⁶⁴

In 1996-1998 a unified state system of title registration was created all over the Russian Federation using the West-European pattern. Today, the Civil Code and the newly

²⁶⁰ 1993 Constitution, art. 9.

²⁶¹ 1993 Constitution, art. 8.

²⁶² 1993 Constitution, art. 35.

²⁶³ *See* Decree of the President of the Russian Federation #. 1767 of October 27, 1993, "On regulation of land relationships and development of agricultural reform in Russia."

²⁶⁴ Decree of the President of the Russian Federation # 1767 of October 27, 1993, "On regulation of land relationships and development of agricultural reform in Russia."

enacted Land Code²⁶⁵ provide a reliable legal base for land privatization and circulation of land parcels on the secondary Russian market.

Urban lands (the lands of the cities, towns and urban settlements) comprise less than 2 percent of the Russian territory (note that denominator includes forest and agricultural land). Under a 1994 presidential decree,²⁶⁶ owners of non-residential buildings and premises are entitled to privatize land plots attached to such buildings and premises. The new Land Code of 2001 confirms this right and removes any doubt that not only urban but also agricultural land can now be privately owned.

Previously, there had been a serious question as to whether the federal government, or the cities, had the "ownership" authority over city land, including the power to privatize. This issue has been resolved by the passage last year of the Federal Law "On the Delineation of State Land Property,"²⁶⁷ which sets out the main principles for allocating control of the state urban lands among the federal, regional and local authorities.

It is important to note that the newly enacted Land Code has no restrictions for foreigners purchasing and selling urban lands, except for the frontier land plots under the special list to be approved by the Russian President.

2. Privatization of state-owned enterprises.

The first law governing privatization, the Federal Law "On the Privatization of State-Owned and Municipal Enterprises in the Russian Federation" (the "1991 Federal Law on

²⁶⁵ Federal Law #137-FZ of October 25, 2001 "On introduction of the Land Code of the Russian Federation."

²⁶⁶ Decree of the Russian President # 1535 of July 22, 1994.

²⁶⁷ Federal Law #101-FZ of July 17, 2001.

Privatization"), was enacted in 1991.²⁶⁸ The 1991 Federal Law on Privatization provided the legal basis for the transfer of ownership of the property and the means of production that were identified in a presidential decree issued on the following year.²⁶⁹

The 1991 law was superseded in 1997 by a new privatization law, the Federal Law "On the Privatization of the State Property and on the Principals of Privatization of the Municipal Property in the Russian Federation" (the "1997 Federal Law on Privatization"),²⁷⁰ which is now the basic legal act regulating issues of privatization in Russia although, as discussed below, it has been amended in significant ways by new privatization legislation enacted. The 1997 law extends the list of available instruments of privatization,²⁷¹ increases possibilities for control of the privatization process, and cancels investment tender, which was found to be an ineffective method of privatization.

a. The adoption and implementation of a privatization program.

In 1992, the State Program of Privatization of State and Municipal enterprises in the Russian Federation was created to implement the 1991 Federal Law "On Privatization."²⁷² This program of privatization is updated each year and submitted for approval to the Duma with the federal budget. The program identified four possible methods of privatization:

- auction;

²⁶⁸ Federal Law # 1531-1 of July 30, 1991.

²⁶⁹ Decree of the President of the Russian Federation No. 721 of July 1, 1992, "On the Organizational Measures to turn State-Owned Enterprises and Voluntary Association of State-Managed Enterprises into Joint Stock Companies."

²⁷⁰ Federal Law # 123-FZ of July 21, 1997.

²⁷¹ Federal Law # 123-FZ, art. 16.

²⁷² See Federal Law # 1531-1, art. 3.

- commercial tender;
- leasing with a right for redemption; and
- creation of shareholdings with subsequent sale of shares.

The program provided for two stages in the implementation of the privatization policy: the voucher stage and the monetary stage. The time limits for the implementation of the stages were as follows: for the voucher stage – from June of 1992 until July 1, 1994, and for the monetary stage - from July 1, 1994.

b. The voucher stage of privatization

The main objectives of the voucher stage of privatization were:

- The mass transition of state property to private owners, redistribution and securing of private property rights in Russian society with a minimal number of social conflicts;
- The creation of wide groups of private property owners in order to facilitate the transition to a market economy;
- The provision and securing of conditions for an increase in operating efficiency of Russian enterprises;
- The establishment of legislative and organizational conditions and mechanisms required for the transition of property rights from one owner to other;
- The facilitation of the process of financial stabilization in Russia;
- The creation of a competitive environment and the provision of conditions for demopolization of the Russian economy; and
- The widening of the investment base for Russian enterprises and the attraction of foreign investments to the Russian economy.

In the voucher stage, privatization vouchers were used as the main instrument of privatization. The vouchers were given to all Russian citizens, regardless of sex, age, place of residence, or occupation. The population of Russia was given 146,046 million privatization vouchers. A voucher owner could use his/her shares in any of four ways:

- To purchase closed subscription to shares of the company by which he/she was employed (as a result of such subscription around 26 million vouchers were used);
- To participate in a voucher auction;
- To buy shares of a check investment fund – special funds created for accumulation of vouchers for investment in enterprises - (640 check investment funds were established and they collected more than 60 million privatization vouchers); and
- To sell (approximately 25 percent of all vouchers were sold).

During the voucher stage of privatization, forty million citizens of the Russian Federation became shareholders of joint stock companies and check investment funds established through privatization. Shares of 16,462 enterprises with total authorized capital of 1,421 billion rubles were offered at check auctions and shares of total nominal value of 285 billion rubles (around 20 percent) were sold. Practically the whole Russian population was involved in the first stage of the privatization.

The voucher stage of privatization produced fundamental and far-reaching changes in the structure of property in the Russian economy and brought about the denationalization of the economy. The majority of small privatization enterprises passed into the hands of private owners, so that more than 85,000 shops, cafés, consumer services enterprises and 21,900 joint stock companies were created from small, medium and large state enterprises by the middle of 1994. By the end of 1999 the number of privatized enterprises reached 110,000 and at the end of 2000 the number had risen again to 112,274.

c. The monetary stage of privatization

The main purpose of the monetary stage of privatization, which officially started from July 1, 1994, was to transfer the property rights for privatized state property to responsible

and effective owners. Implementation of the monetary stage of privatization was to achieve the following two strategic tasks:

- the creation of groups of investors possessing large blocks of shares interested in long-term investments into the enterprises; and
- the provision of privatized enterprises with cash funds necessary for their structural reorganization.

The monetary stage of privatization targeted three types of property:

- state blocks of shares in privatized companies;
- land plots of privatized companies; and
- real estate.

As a result of the monetary stage of privatization, a significant part of property that had continued to be state owned after the end of the voucher stage of privatization was taken out of the direct state ownership and control and turned over to the market.

d. The present status of privatization in the Russian Federation.

In last two years the priorities in privatization policy have changed, and the emphasis is presently on the restructuring of enterprises, especially liquid ones, and on the sale of their shares. A recent government directive²⁷³ identified the list of state-controlled companies and state blocks of shares of which are subject to privatization. The list includes such companies as "Svyazinvest," "Rosneft," "Slavneft," and "Lukoil" Currently the Government of Russia is planning the restructuring and privatization of "Gazprom" and "RAO EES."

²⁷³ Resolution of the Ministry of State Property of the Russian Federation, "On Implementation of the Priority of the Federal Property Privatization in 1999-2000."

Last Year witnessed significant advances in Russia's privatization initiatives, particularly in the transportation, natural resources and military areas. By year-end,

- 80% of the enterprises in the marine, river and air transportation sectors were privatized;
- Privatization of the oil and gas industry was nearly complete, with 326 out of 332 ex-state owned oil companies and 64 out of 64 ex-state owned gas companies transformed into joint stock companies;
- 70% of total Russian coal production was mined by privatized enterprises;
- 60% of enterprises in the military-industrial complex were privatized;
- in the nuclear related industry, 230 out of 389 enterprises were privatized, and only three major enterprises were still owned 100% by the state; and
- in the aviation industry some of the largest enterprises had been fully privatized or were in the process of privatization, including OAO Tupolev, AVPK, Suhoi, RSK, and MIG.²⁷⁴

On February 4, 2002, the 2002 Privatization Program was announced. The main priorities of the program include:

- continuing the structural reforms of the Russian economy;
- maintaining the revenues from privatization at the level planned in the federal budget for 2002;
- maximizing profits from privatization;
- limiting spending on managing the state property;
- attracting investments, including foreign investments; and
- attracting small businesses lacking start-up capital to take part in privatization.

²⁷⁴ These statistics are taken from the publicly available Report by the Russian Ministry of State Properties for 2001-2002, which was prepared for the Russian Government Meeting of February 7, 2002 and which was generously provided to the Russian Steel Producers by the Moscow-based legal firm of GGPU.

The main principles of the 2002 Privatization program include auctioning state stakes in large joint stock companies, looking at the individual privatization prospects taking into account the financial position and market conditions, selling state property via public offerings and privatizing the state companies along with the plots of land they occupy. In 2002, the Russian government is planning to privatize 152 state enterprises and 365 open joint stock companies. The effect of these privatizations will be a 4 percent decline in the share of the economy owned by the government. By the end of 2002, it is expected that the oil & gas, telecommunications, timber, pharmaceuticals and chemicals industries will all be more than 90 percent privatized. It is clear that the laws passed by the Duma are being put into action and are having their intended effect.

On January 26, 2002, the Duma passed a new privatization law, which makes significant changes to existing privatization policy.²⁷⁵ The most significant change modifies the old law, under which the government prepared a list of enterprises to be privatized and presented the list to the Duma for approval. In this way, the government was able to limit the number of enterprises eligible for privatization. The new law strips the government of the power to limit the enterprises eligible for privatization except in the case of natural monopolies and strategic enterprises. All other fully or partly owned state enterprises will become eligible for privatization under the terms of the new law.²⁷⁶

²⁷⁵ Federal Law # 178-FZ of December 27, 2001, "On Privatization of State and Municipal Property" (effective date: April 27, 2002).

²⁷⁶ Ekaterina Larina, "We are working gradually toward an ideal law," *Russia Journal*, November 30 – December 6, 2001.

C. Economic evidence confirms that the Russian government does not exercise significant control over the means of production.

As a result of Russia's privatization initiative since the beginning of 1990s, a private sector has emerged in Russia that today produces approximately 75 percent of the Russian GDP. This figure compares favorably with the ratios in the other countries at the time of NME revocation: "half, maybe more" for Poland,²⁷⁷ 65 percent for Latvia,²⁷⁸ 75 percent for the Czech Republic,²⁷⁹ 75 percent for the Slovakia,²⁸⁰ and 85 percent for Hungary.²⁸¹

1. A significant portion of Russia's economy has been privatized, and the government is no longer playing a significant role in the economy.

Since the start of the economic reforms in January 1992, Russia has made significant steps forward in the privatization process. The number of private enterprises and organizations is continuously increasing from year to year. The quantity of privatized companies in the Russian Federation in 2001 was more than 2.5 million, which formed 75% of all Russian legal entities.²⁸²

²⁷⁷ Poland NME Analysis Memorandum at 22.

²⁷⁸ Latvia NME Analysis Memorandum at 12.

²⁷⁹ Czech Republic NME Analysis Memorandum at 10.

²⁸⁰ Slovakia NME Analysis Memorandum at 10.

²⁸¹ Hungary NME Analysis Memorandum at 12.

²⁸² "Statistics of Russia," compiled by the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat), available at <http://www.gks.ru/eng/>, Table 13.2.

Figure 22 - Allocation of Enterprises & Organizations

ENTERPRISES AND ORGANIZATIONS BY TYPES OF OWNERSHIP						
	1996	1997	1998	1999	2000	2001
	Number of enterprises and organizations, thou.					
Total	2249.5	2504.5	2727.1	2901.2	3106.4	3346.5
Of which by the types of ownership:						
State property	322.2	232.8	142.5	147.9	149.6	150.8
Municipal property	197.8	184.4	177.6	183.3	197.7	216.6
Private property	1425.5	1730.5	2014.1	2146.8	2311.9	2509.6
Property of public and religious organizations (associations)	95.0	129.5	157.8	183.1	213.1	223.0
Other property types including mixed Russian property, foreign, joint Russian and foreign	209.0	227.4	235.1	240.1	234.1	246.5
	Percentage of the total					
Total	100	100	100	100	100	100
Of which by the types of ownership:						
State property	14.3	9.3	5.4	5.1	4.8	4.5
Municipal property	8.8	7.4	6.5	6.3	6.4	6.5
Private property	63.4	69.1	73.9	74.0	74.4	75.0
Property of public and religious organizations (associations)	4.2	5.2	5.8	6.3	6.9	6.7
Other property types including mixed Russian property, foreign, joint Russian and foreign	9.3	9.0	8.6	8.3	7.5	7.3

The share of goods and services produced by private enterprises in 2000 in Russia constituted 74.4 percent of Russian GDP. Since 1997, Russia's private sector has created no less than 70 percent of the country's GDP.²⁸³ The remaining state property is concentrated in the defense, education, health and public utilities sectors.

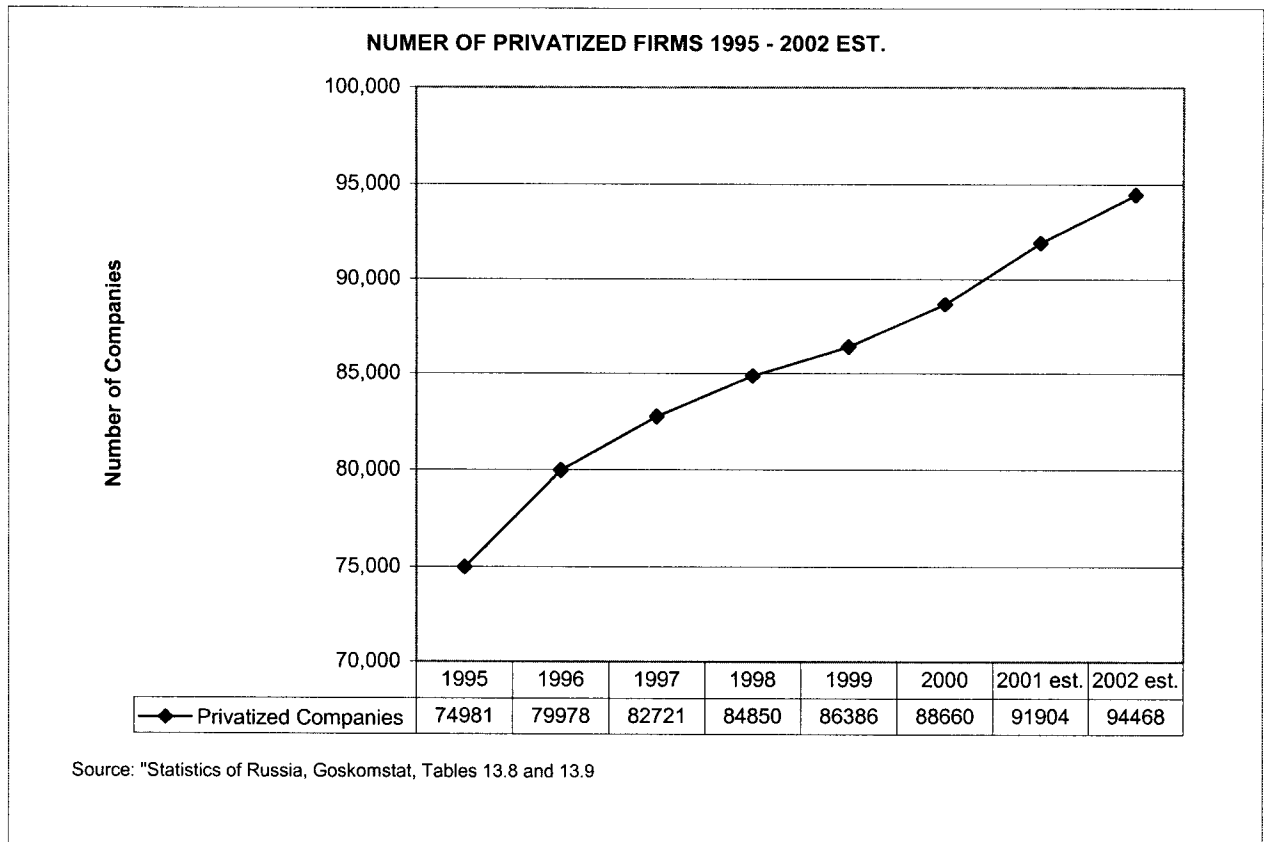
Moreover, in the past two years the priorities of the Russian government's privatization efforts have accelerated. The restructuring of enterprises, especially liquid ones, and sale of their shares are regarded as key factors in the current atmosphere of privatization. The resolution of the Ministry of State Property of the Russian Federation "On Implementation

²⁸³ Aslund, Anders, "Think Again:Russia," August 2001, available at http://www.foreignpolicy.com/issue_julyaug_2001/Tajulyaug.html p. 2

of the Priority of the Federal Property Privatization in 1999-2000” identified the list of state-controlled companies and state blocks of shares of which are subject to privatization.

In addition, the total number of firms that have been privatized has increased steadily since 1995, as shown in Figure 23, with the pace of privatization expected to increase by 6.5 percent per year for the next several years.²⁸⁴

Figure 23 - Number of Privatized Firms



²⁸⁴ "Statistics of Russia" affiliated with the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat) available at <http://www.gks.ru/eng/>, Table 13.1.

2. Russia has made significant strides in privatization in all major sectors of its economy.

a. Steel

The Russian iron and steel industry is dominated by nine companies: JSC Severstal (“Severstal”), Zapadno-Sibirsky Iron & Steel Works, Novolipetsk Iron & Steel Works (“Novolipetsk”), Kuznetsky Iron & Steel Works, Nizhnetagilsky Iron & Steel Works, Mechel, Oskolsky Electrical Steel Works, NOSTA, and JSC Magnitogorski Iron & Steel Works (“Magnitogorski”). The three largest are Severstal, Magnitogorski, and Novolipetsk.

All nine companies have been privatized. Privatization was carried out in compliance with the Russian Federation’s “Privatization Program of the State-Owned and Municipal Enterprises in the Russian Federation” of 1992, which was adopted by a Decree of the Supreme Council of the Russian Federation of June 11, 1992. Nizhnetagilsky Iron & Steel Works and NOSTA were privatized in early 1990s, Mechel was privatized in 1993, and the privatization of Oskolsky Electrical Steel Works was completed in 1995. While the Russian state owns stakes in some of these companies, the controlling shares of all nine companies are in private hands. A description of the privatizations of Severstal and Novolipetsk are instructive in illustrating the progress of privatization efforts in the steel industry since 1990.

Severstal was created as a result of the privatization of the Cherepovets Iron and Steel Works in 1992 by presidential decree.²⁸⁵ The issuance and sale of shares that implemented the privatization process was carried out by the Vologda Region Asset Management Committee, which, under the privatization law, was entrusted with the transformation of the state-owned

²⁸⁵ Presidential Decree # 721 of July 1, 1992, “On the Measures concerning the Transformation of State-Owned Companies and Voluntary Unions of State-Owned Companies into Joint Stock Companies.”

company into a private joint stock company. In the first stage of privatization, the employees of Severstal were permitted to purchase 48% of the company's shares. Between 1994 and 1998, additional shares were issued and, in a series of sales, were sold at auction. Separately, company employees were also issued additional shares of stock. By the end of 1998, the Committee had completely divested itself of any ownership of Severstal, completing the full privatization of Severstal.

The Novolipetsk Iron & Steel Company, a joint-stock company, was formed in 1993 to privatize the state-owned Novolipetsk Iron & Steel Company. Initially, Novolipetsk's privatization plan contained the provision granting the state a so-called "golden share right." The "golden share right" gave the state the ability to veto any decision of the company's management. The "golden share" provision was rescinded in 1999. As of 2001, more than 95% of Novolipetsk's shares were held by two private shareholders.

The only one of the nine steel companies in which the state still holds a significant interest is Magnitogorski, where the Russian Ministry of State Property holds a 17.82% minority ownership share.

b. Oil and gas

When President Yeltsin signed a decree on Russian vertically integrated companies was signed, Russia's oil and gas industry went through a speedy and often turbulent privatization process. As a result, a dozen oil companies emerged as vertically integrated entities.

Major investments are being undertaken by the Russian oil companies Lukoil, Surgutneftegaz, Yukos, TNK, Rosneft and Tatneft. Each is spending hundreds of millions of dollars in a variety of both upstream and downstream modernization projects and equipment

upgrades, thus offering significant opportunities to U.S. equipment and engineering service providers. Gazprom and Lukoil also have ADRs listed on the New York Stock Exchange.

The following are the most recent and important developments in the energy industries:

YUKOS - YUKOS incorporated Tomskneft and the Achinsk refinery. This year it secured control over Angarsk refinery and plans to incorporate the Eastern Siberian Oil Company (VSNK) where it owns 68%. Plans exist to acquire a blocking share in Sakhaneftegaz. In addition, YUKOS recently acquired the engineering arm of Kvaerner, a Norwegian industrial conglomerate, illustrating the freedom that firms have to trust overseas.

TNK - TNK currently controls 43% of Sidanko and has also declared its desire to acquire Slavneft (it owns 12.6% of Slavneft's shares, including almost 50% in YaroslavlNefteOrgSyntez, Slavneft's major refinery). TNK also acquired 84% of Orenburggeologiya shares, paying some \$84 million. This would enable TNK to get access to 17 fields in the Orenburg Region as well as Western Siberia and increase its output by 650 thousand metric tons in 2002. The next logical step for TNK will be to absorb Orenburg-based ONAKO.²⁸⁶

NORSI - The last independent refinery NORSI has just been acquired by Lukoil. Russian majors are becoming increasingly active in that respect, eyeing additional downstream capacities and retail networks in Europe. As a result, a globally competitive oil production market is being established in Russia.

Lukoil - Breaking new ground, Lukoil signed a strategic alliance with Gazprom in 1998, but they have not yet started any joint gas development projects. Another alliance followed in 2000 when a joint venture between Gazprom, Lukoil and Yukos was formed to develop fields in the Russian sector of the Caspian. This April Gazprom and Yukos agreed on partnering in developing fields in Eastern Siberia and the Far East.²⁸⁷ In the meantime Lukoil took over Komineft and Arkhangelskgeodobycha thus increasing its output to 1.44 million bpd.²⁸⁸

Gazprom - After the withdrawal of Germany's Wintershall from the Prirazlomnoye project, Gazprom and Rosneft struck a strategic deal to jointly develop oil and gas fields in Yamal-Nenets Autonomous District and in the Barents Sea shelf. Western participants in the consortium, includes Conoco (US), Fortum (Finland), Norsk Hydro (Norway) and TotalFinaElf (France).

²⁸⁶ Available at <http://www.bisnis.doc.gov/bisnis/isa/011101rsoil.htm>.

²⁸⁷ Available at <http://www.bisnis.doc.gov/bisnis/isa/011101rsoil.htm>.

²⁸⁸ Available at <http://www.bisnis.doc.gov/bisnis/isa/011101rsoil.htm>.

c. Electricity

The Russian government plans to substantially restructure RAO UES Rossii (“UES”), which dominates the sector, to improve efficiency and attract necessary investment prior to ultimate privatization.²⁸⁹ The goals of achieving real competition and market-based pricing require that UES be unbundled into viable, competing generation and supply companies and that control of those companies be privatized as soon as practicable. Privatization in the electric power industry as a whole has been increasing by 4.5 percent a year on average as shown in Figure 24.

Figure 24 - Power Firms

Number of Privatized Electric Power Firms					
1995	1996	1997	1998	1999	2000
101	112	116	116	119	128

d. Communications

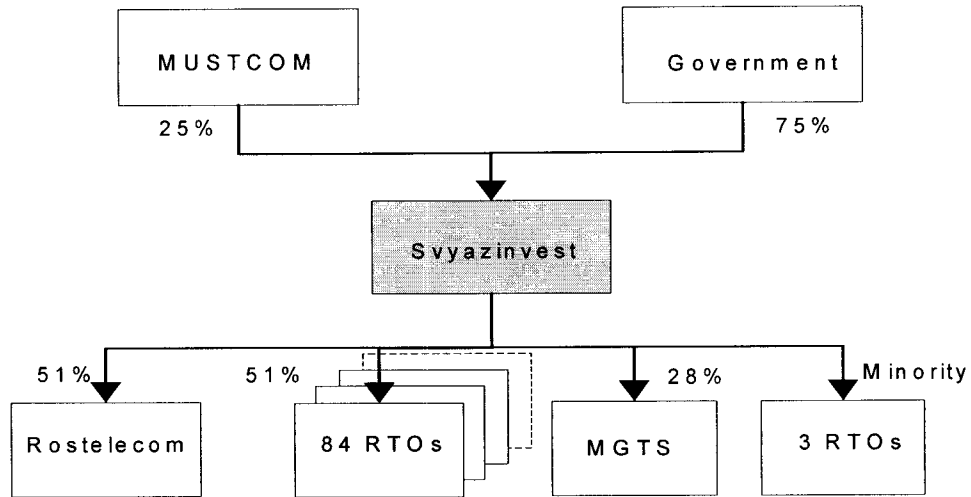
Russia has one of the largest telephone networks in the world: in 2000 total fixed access lines nationwide stood at 31.2 million with a relatively low teledensity of around 21.3%. The Russian telecommunications sector has an increasingly privatized structure.

First, in 1992, the 89 regional fixed-line operators were partly privatized: the state kept 51% of common shares and 22% were sold by regional property funds. In 1994 the government formed Svyazinvest, the state holding company that holds controlling stakes in regional fixed-line operators and in incumbent long-distance operator Rostelecom.

²⁸⁹ Russian Electricity Reform: Recommendations Report by Andersen Moscow, 2001.

In 1997 the government sold 25% plus one share in Svyazinvest to Mustcom, a Cyprus consortium including Uneximbank, Renaissance Capital, Deutsche Morgan Grenfell, Morgan Stanley Asset Management and the Quantum Fund. The sale raised US \$1.875 billion. The ownership structure of Russian fixed-line telecom sector after this transaction is illustrated below. Currently the Government is preparing to complete the privatization of Svyazinvest and is restructuring the 76 regional companies into seven larger and better-managed interregional companies to increase their value before the sale, including both regional telecommunications operators (RTOs) and the Moscow regional telecom operator (MGTS).

Figure 25 - Ownership Structure of Russian Fixed-Line Telecom Sector



In addition to traditional telephony operators, numerous cellular, Internet, data and other value-added telecoms service providers exist throughout Russia. These businesses are either owned directly by the private sector or through joint venture consortiums affiliated to the fixed line public network operators. From the late 1980s onward private sector interests have entered into most telecommunications lines of business (fixed line, cellular, satellite, etc.) either directly as licensed operators, financial investors and/or joint venture participants.

The revenue of private telecom operators in 1999 amounted to \$2.4 bln. and accounted for more than half of the industry revenue. In early 2000, alternative operators controlled 95% of wireless and 80% of data transmission markets and had a 20% share in local and long-distance telephony.²⁹⁰ The largest Russian telecom companies have ADRs listed on NYSE (MTC, Vimpelcom, Rostelecom, and several fixed-line local operators, e.g., Kuban Electrosvyaz, Chelyabinsk Electrosvyaz) and a majority of local fixed-line operators are listed

²⁹⁰ European Bank for Reconstruction and Development, "Russian Federation Investment Profile," 2001 available at <http://www.ebrd.com/english/pubs/index.htm>.

and traded on the Russian stock market. Overall, privatization in the communications industry has been increasing by 16 percent a year on average as shown in Figure 26.²⁹¹

Figure 26 – Number of Private Communications Firms

Number of Private Communications Firms					
1995	1996	1997	1998	1999	2000
43	56	68	74	79	85

e. Transportation

At the moment, the railway system of the Russian Federation is comprised of 2,960 state unitarian enterprises, *i.e.* totally owned by the state. The “Program of Structural Reform on the Railway Transport”²⁹² has already been adopted as of May 18, 2001. The program contains plans for reformation and privatization of the industry for 2001-2010 in three stages.

The first stage (2001-2002) includes, in particular:

- Development of legislation base substantiating the structural reform in the railway industry,²⁹³
- Separation of functions of the state regulation and economic board, creation of public corporation (joint-stock companies) “Russian Railways”;²⁹⁴ and
- Continuation of the privatization process and separation of independent enterprises not involved in organization of transportation directly from the structure of railway transport system.

The second stage (2003-2005) plan includes, specifically:

²⁹¹ "Statistics of Russia" affiliated with the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat) <http://www.gks.ru/eng/>, Table 13.14.

²⁹² The RF Government Resolution #384 of May 18, 2001 “On the Program of Structural Reform on Railway Transport,” (“Resolution on Structural Reform on Railway Transport”).

²⁹³ Resolution on Structural Reform on Railway Transport, point 4 (b).

²⁹⁴ Resolution on Structural Reform on Railway Transport, point 4 (g).

- Reorganization of joint-stock company “Russian Railways” by means of separation of independent structural subdivisions executing certain kinds of transportation (long-distance passenger transportation, specialized cargo transportation, maintenance services, etc.) to daughter joint-stock companies;²⁹⁵
- Formation of conditions for development of competition in the market of cargo and passenger railway transportation;²⁹⁶
- Transfer to free market pricing in competing sectors;²⁹⁷
- Arrangement of conditions for acquisition of main-line locomotive by operating companies;²⁹⁸ and
- Attracting investments for development of railway transportation.²⁹⁹

In the third stage (2006-2010), Russia anticipates attracting investment into the railway industry by means of sales blocks of shares of daughter enterprises of joint-stock company “Russian Railways.”³⁰⁰ At the end of the third stage more than 60% of the locomotive fleet is proposed to be transferred to private ownership. Overall, privatization in the transportation industry has been increasing by 2.8 percent a year on average as shown in Figure 27.³⁰¹

²⁹⁵ Resolution on Structural Reform on Railway Transport, point 5 (a)

²⁹⁶ Resolution on Structural Reform on Railway Transport, point 5 (c).

²⁹⁷ Resolution on Structural Reform on Railway Transport, point 5 (d).

²⁹⁸ Resolution on Structural Reform on Railway Transport, point 5 (e).

²⁹⁹ Resolution on Structural Reform on Railway Transport, point 5 (f).

³⁰⁰ Resolution on Structural Reform on Railway Transport, point 6.

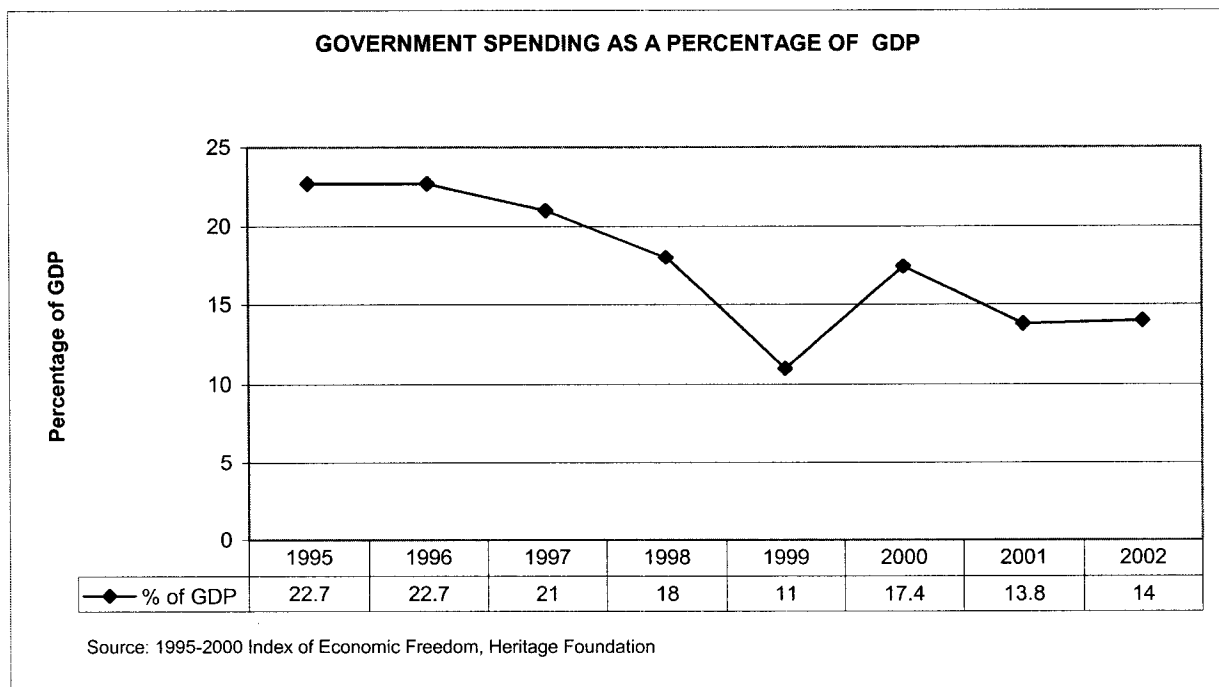
³⁰¹ "Statistics of Russia" affiliated with the Main Regional State Committee of the Russian Federation on Statistics (Goskomstat) <http://www.gks.ru/eng/>, Table 13.14.

Figure 27 – Number of Privatized Transportation Firms

Number of Privatized Transportation Firms					
1995	1996	1997	1998	1999	2000
1830	1993	2039	2085	2116	2144

3. Government spending as a percentage of GDP has decreased steadily.

Since the mid-1990's government spending as a percentage of gross domestic product has been steadily decreasing, in conjunction with the liberalization of the economic system. As the Russian economy moved from a planned economy model to one based on market principles, the expectation would be a decrease in government expenditures. As the data below demonstrate, this has been the case. As the number of privatized firms increased, these firms began to perform many of the functions previously delegated to the government, leading to greater autonomy for private industry and less influence over the economy by governmental organizations.

Figure 28 - Government Spending As a Percentage of GDP

VI. CRITERION 5: THE EXTENT OF GOVERNMENT CONTROL OVER THE ALLOCATION OF RESOURCES AND OVER THE PRICE AND OUTPUT DECISIONS OF ENTERPRISES

Summary of Comment

The Opposing Parties have also misstated key facts in arguing that the Russian government intervenes in the allocation of resources and in the price and output decisions of Russian enterprises. Section A corrects these misstatements, while Section B provides a detailed discussion of the legal regime governing resource allocation and the freedom to set prices and output. Section C provides economic data demonstrating that the government does not intervene in the allocation of resources or in setting the prices or output of enterprises.

A. The Opposing Parties misstate key facts concerning the extent of the Russian government’s control over the allocation of resources and over the price and output decisions of enterprises.

According to one Opposing Party, “the [Russian] government controls prices under guise of antimonopoly policy.”³⁰² Further, with reference to the Ministry of Anti-monopoly Policy (“MAP”) 1999 Annual Report, the same Opposing Party pointed to the fact that “in 1999, there were 215 [natural monopolies] in the transportation sector . . . and 200 in the communications field. Such enterprises must have at least one government official on the governing board,” and for each enterprise “the principal competence of the Board is to determine the prices (tariffs) charged.”³⁰³ The above statement is outdated and misleading. First, since the beginning of this year, MAP has not had direct responsibilities for regulating prices in relation to “natural monopolies” in the transportation sector. Secondly, the above statement has confused

³⁰² Skadden-Dewey Brief at 34.

³⁰³ Skadden-Dewey Brief at 33.

“the Board of MAP,” whose members are appointed and dismissed by the Russian Government and which has the authority to determine the prices in strict compliance with economically sound principles,³⁰⁴ with boards governing each of the Russian natural monopolies.

To support the claim that MAP “substitutes agreements on pricing for action against structural dominance by large enterprises,”³⁰⁵ the Opposing Party refers to “2,100 cases of suspected pricing abuse by large Russian firms” reported by MAP in its 1999 Annual Report. In fact, the 1999 report says that in MAP considered “2,100 cases (both on the basis of the complaints and on their own authority), involving violations of article 5 [abuse of dominant position]of the Federal law “On competition.” The report says nothing as to whether these were “price violations.” In fact, the Russian version of the MAP 1997-1999 Annual Report³⁰⁶ makes it absolutely clear that, as in 2000, the most common types of abuses by large Russian firms were refusal to supply and imposition of unfair contractual terms, not pricing abuses.³⁰⁷

Arguing that MAP is subject to “political influences,” the same Opposing Party makes reference to the World Bank setting goals in the fields of competition policy in July 1999, which included the adoption of legislation to ensure that MAP is governed by its own board. The Opposing Party was apparently unaware, however, that the MAP Charter adopted by the Russian Government Decree in 1999 provides that MAP’s board makes the most important

³⁰⁴ See, for example, the RF Government Regulation of 13 October 1999 “On securing the observation of economically based principles of setting prices (tariff) by natural monopolies.”

³⁰⁵ Skadden-Dewey Brief at 35.

³⁰⁶ The MAP 1997-1999 Report available at <http://www.maprus.ru>.

³⁰⁷ *Id.* at 14.

decisions regarding “natural monopolies” by a simple majority vote.³⁰⁸ This provides a safeguard against potentially “politically influenced” decisions by the Minister himself.

Russia’s anti-monopoly and competition policies are not limited to “price controls.” The major thrust of MAPs work is combating the most common types of abuses by monopolies -- refusal to supply and imposition of unfair contractual terms, not pricing abuses.³⁰⁹ These two types of abuses are not corrected by setting prices but rather by enjoining anti-competitive practices.

The price constraints imposed by the Russian anti-monopoly authorities as a condition for approving mergers and acquisitions are not the main conditions set by the regulator. In fact, MAP normally agrees to accept a proposed merger subject to such other conditions as maintaining production and supply levels. Further, the low percentage of rejected merger applications in Russia is in line with international experience.

In addition, MAP takes an active part in reforms currently being undertaken by the Russian Government in the electricity, railways and gas sectors. In particular, MAP is assisting in:

- determining the competitive sectors of Russian natural monopolies and working out their transformation from natural monopoly status into competitive markets;
- ensuring non-discriminatory access to services provided by natural monopolies; and
- ensuring that natural monopolies acquire raw materials and other resources on a competitive basis.

³⁰⁸ RF Government Regulation # 793 of 12 July 1999

³⁰⁹ Presentation by MAP prepared for the Russian Government Meeting in July 2001. The above Presentation is based on the year 2000 figures. The results are similar for 1997-1999 (See the 1997-1999 report at 14.)

B. Russian law ensures that enterprises make decisions affecting costs, prices, and allocation of resources autonomously and without state intervention.

The extent of state regulation and control over the economy has greatly decreased as a result of privatization, the liberalization of prices, and the recognition of freedom of entrepreneurship in Russia. The centralized economy in which the state identified and regulated all economic relationships and decisions of enterprises, including decisions on volumes of output, prices, allocation of resources, etc., ceased to exist at the beginning of the 1990s. Currently, the state does not control the economic decisions of enterprises in Russia.

The 1993 Constitution contains the following provisions that are relevant to whether the state intervenes in decisions made by enterprises affecting costs, prices, and allocation of resources:

- a guarantee of freedom of economic activity;³¹⁰
- a guarantee that everyone (including both individuals and legal entities) has the right freely to use his or her abilities and property for entrepreneurial activity;³¹¹ and
- a guarantee that each person is entitled to own and possess property, and to use and dispose of it both individually and together with others.³¹²

³¹⁰ 1993 Constitution, art. 8, "In the Russian Federation guarantees shall be provided for the integrity of economic space, a free flow of goods, services and financial resources, support for competition, and the freedom of economic activity. In the Russian Federation recognition and equal protection shall be given to the private, state, municipal and other forms of ownership."

³¹¹ 1993 Constitution, art. 34, "Everyone shall have the right to a free use of his abilities and property for entrepreneurial and economic activities not prohibited by law. The economic activity aimed at monopolization and unfair competition shall not be allowed."

³¹² 1993 Constitution, art. 35.

Russian law prohibits the arbitrary interference of the state in the private affairs of entrepreneurs, and guarantees freedom of contract, the right of private ownership and the equality of entrepreneurs and the state in civil relationships.³¹³

In accordance with the rights afforded by this legislation, enterprises make decisions with respect to investments, labor, output, sales, costs and expenses, and all other aspects of their business operations independently and without governmental intervention. Economic activity is exercised in accordance with and under the influence of supply and demand for goods, services, capital, and labor. According to the 1999 Index of Economic Freedom, in Russia, "Free enterprise sets some 90 percent of all prices. The government fixes another 5 percent; and government limits on the amount of profitability determine the remaining 5 percent."³¹⁴

1. Economic relationships are governed by contracts freely entered into by economic actors, not by government mandate.

Relationships between economic agents are regulated by contract. In accordance with the Civil Code of the Russian Federation, citizens and legal entities are free to enter into contracts.³¹⁵ Terms of contracts are determined at the discretion of the contracting parties. In other words, enterprises have the right to identify the conditions on which they participate in deals independently and without intervention from the state.

³¹³ Civil Code of the Russian Federation, art. 1, "Chief Principles of the Civil Legislation."

³¹⁴ "1999 Index of Economic Freedom," The Heritage Foundation, p. 332, available on Lexis.

³¹⁵ Civil Code of the Russian Federation, art. 421, "The citizens and the legal entities shall be free to conclude contracts. Compulsion to conclude contracts shall be inadmissible, with the exception of the cases, when the duty to conclude the contract has been stipulated by the present Code, by the law or by a voluntarily assumed obligation. The parties shall have the right to conclude a contract, both stipulated and unstipulated by the law or by the other legal acts."

As a general rule for all sales contracts, payments for goods and services are effected at prices established by contract or other agreement of parties. Thus businesses set prices for their products independently of government intervention.³¹⁶ There are transfer pricing rules in place in Russia that are established by law and require that market prices are used in transactions between entities. If the tax authorities discover that market prices were not used and the firms were attempting to avoid taxes, penalties may result.³¹⁷

2. The Russian government imposes limited controls on prices in a very few sensitive sectors.

The state regulates the prices of a small number of products and services in accordance with a 1995 presidential decree.³¹⁸ The Decree, which stresses the necessity of further price liberalization,³¹⁹ covers the products and services of:

- natural monopolies (gas, electric and heat energy, transshipment of oil through pipelines, services of railroad transport, port services and so on);
- the defense industry; and
- certain socially important goods and services (such as ritual services, some types of drugs, prosthetics and orthopedic appliance).

³¹⁶ Civil Code of the Russian Federation, art. 424, "The performance of the contract shall be paid by the price, fixed by an agreement between the parties. In the law-stipulated cases, the prices (the tariffs, estimates, rates, etc.) shall be applied, fixed or regulated by the specially authorized state bodies."

³¹⁷ Tax Code, art. 40, Part 1, effective January 1, 1999.

³¹⁸ Decree of the President of the Russian Federation No. 221 of February 28, 1995, "On Measures to Improve the State Adjustment of Prices (Tariffs)."

³¹⁹ "To recognize as essential the further liberalization of prices (tariffs). The state adjustment of prices (tariffs) shall be effected only with regard to the products of natural monopolies."

A contemporaneous government decision sets out the exclusive list of goods and services to which price regulations apply.³²⁰ State price regulations may not be imposed except with respect to goods and services included in this exclusive list.³²¹

3. Russian law requires that in regulating prices in the natural monopolies sector the state must set prices based on actual production costs.

State price regulation is largely confined to the regulation of prices of natural monopolies. Regulation of natural monopolies' activities, including price regulation, is aimed at achieving a balance between the interests of consumers and those of economic agents working in the spheres where natural monopolies exist.³²² The main purpose of the state regulation of prices on products and services of natural monopolies is to prevent the natural monopolies from using their dominant position to set monopolistic prices.

When regulating prices for natural monopolies, Russian law requires that authorities must base the regulated price on the actual cost of producing the regulated good or service.³²³ Hence, the prices for products and services of natural monopolies, including gas and electricity, reflect their actual cost of production or provision, determined by the operating conditions of the specific enterprise. For example, the difference between tariffs for electricity in

³²⁰ Decision of the Government of the Russian Federation # 239 of March 7, 1995, "On Measures to Streamline the State Regulation of Prices (Tariffs)."

³²¹ Decision of the Government of the Russian Federation # 239 of March 7, 1995, "On measures to improve state regulation of prices (tariffs)."

³²² Federal Law # 147-FZ of August 17, 1995 "On Natural Monopolies," art. 1.

³²³ Decision of the Government of the Russian Federation # 1158 of October 13, 1999, "On ensuring of economically viable principles of formation of prices on products and services of natural monopolies." Specifically, the regulating agency must take into account the cost of production and provision of goods and services, taxes and other payments, the value of basic production funds, investments required for reproduction, depreciation charges, forecasted profit, remoteness of

various regions is the result of a difference in the cost of electricity distribution and production for that region.

A case in point is the Department of Natural Monopolies' Regulation, which sets prices in the telecommunications industry. The law strictly dictates the methodology that it must follow in setting prices. These rules require the Department to decide on the appropriate level of prices based on:

- The cost of production per each product (service) in accordance with Russian accounting standards;
- Projected demand for each product (service) based on marketing reports prepared by the Ministry of Anti-Monopoly Policy and external sources; and
- Projected investment requirements and prospects for further growth based on internal calculations and external sources.³²⁴

This regulation system is similar to that in the United States, where natural monopolies are regulated by the government. The Federal Energy Regulatory Commission ("FERC") regulates natural gas, oil and electricity in the United States.³²⁵ According to the FERC website, in the area of natural gas, "Under the NGA, the Commission regulates both the construction of pipeline facilities and the transportation of natural gas in interstate commerce." Companies providing services and constructing and operating interstate pipelines must first obtain Commission certificates of public convenience and necessity. In the area of electricity,

different groups of consumers from the place of the production, compliance of the goods and services to the quality requirements of consumers.

³²⁴ Russian Government Regulation # 715 of October 10, 2001.

³²⁵ Regulates the transmission and sale of natural gas for resale in interstate commerce; regulates the transmission of oil by pipeline in interstate commerce; regulates the transmission and wholesale sales of electricity in interstate commerce; licenses and inspects private, municipal and state hydro electric projects; oversees environmental matters related to natural gas, oil, electricity and hydroelectric projects; administers accounting and financial reporting regulations and conduct of jurisdictional

the FERC website points out, "The Commission approves rates for wholesale electric sales of electricity and transmission in interstate commerce for private utilities, power marketers, power pools, power exchanges and independent system operators."³²⁶ While deregulation of the electricity industry has occurred in the last 5 years, prior to that the industry in the U.S. was fully regulated.³²⁷ The regulation of the oil industry is much the same.³²⁸ Regulation of the telecommunications industry is the work of the Federal Communications Commission, which regulates radio, television, wire, satellite and cable. Each of these is regulated in the sense that the FCC regulates the fees and taxes to be charged for each of these services.³²⁹ The natural monopoly controls in Russia are no more than those that currently exist in the United States.

companies, and; approves site choices as well as abandonment of interstate pipeline facilities., available at <http://www.ferc.fed.us/about/about.htm>.

³²⁶ Available at www.ferc.fed.us.

³²⁷ In 1978, Congress passed the Public Utility Regulatory Policies Act which laid the groundwork for deregulation and competition by opening wholesale power markets to nonutility producers of electricity. Congress voted to promote greater competition in the bulk power market with the passage of the Energy Policy Act of 1992. The Federal Energy Regulatory Commission (FERC) implemented the intent of the Act in 1996 with Orders 888 and 889, with the stated objective to "remove impediments to competition in wholesale trade and to bring more efficient, lower cost power to the Nation's electricity customers." The FERC orders required open and equal access to jurisdictional utilities' transmission lines for all electricity producers, thus facilitating the States' restructuring of the electric power industry to allow customers direct access to retail power generation., available at http://www.eia.doe.gov/cneaf/electricity/page/fact_sheets/restructuring.html.

³²⁸ Available at www.ferc.fed.us, The objective is to establish just and reasonable rates to encourage maximum use of oil pipelines--a relatively inexpensive means of bringing oil to market--while protecting shippers and consumers from unjustified costs. The Commission does not oversee the construction of oil pipelines or regulate the supply and price of oil or oil products. Rather, it helps to assure shippers equal access to pipeline transportation, equal service conditions on a pipeline, and reasonable rates for moving petroleum and petroleum products by pipeline.

³²⁹ Available at www.fcc.gov/ccb.

4. Russia has vigorous bankruptcy laws that prevent unproductive enterprises from remaining in business and ensure the efficient allocation of capital resources across the economy.

Russian enterprises exercise their entrepreneurial activity independently and are responsible for their own activities. In the event of their insolvency, enterprises could be subject to bankruptcy procedures. Bankruptcy laws are important because they provide an exit strategy for enterprises that are not economically viable and a redistribution of capital to economically viable enterprises. The first Russian Law on Insolvency³³⁰ was adopted in 1992. The major deficiency of this law was that the procedure of insolvency was initiated based on the formal criteria if the balance assets of enterprise including its receivables were lower than its debts. Therefore, a company, which had more bad debts than trade liabilities, was not treated as bankrupt although it could not actually pay its debts. Such situation made insolvency procedure difficult and ineffective for the purpose of improvement of the economy by withdrawal of bankrupt entities from the market.

The second Law on Insolvency was introduced as of January 8, 1998³³¹ (the “1998 Bankruptcy Law”) and is currently effective. The 1998 Bankruptcy Law establishes grounds for adjudication of bankruptcy, measures of prevention of bankruptcy, procedures of insolvency, including restoring of financial capacity of debtor, supervision of debtor, external management of debtor, proceedings in bankruptcy and amicable agreement between the debtor and his creditors. Further the law establishes special insolvency procedures for the particular categories of debtors including security

³³⁰ Federal Law # 3929-I of November 19, 1992 “On Insolvency (Bankruptcy) of enterprises.”

³³¹ Federal Law #6-FZ of January 8, 1998 “On Insolvency (Bankruptcy).”

traders, banks, insurers, etc. The law for the first time establishes procedures for insolvency of individuals including sole traders.

Besides the 1998 Bankruptcy Law, Russian bankruptcy legislation includes also the Law “On Insolvency of Credit Institutions of 1999,”³³² and the Law “On Insolvency of Enterprises of Fuel-and-Power Sector of 1999.”³³³ These laws regulate insolvency of the particular kinds of entities and are supplemental to the 1998 Law. A number of other federal laws (for example Civil Code, Arbitrage Procedure Code etc.) also include some insolvency provisions.

Russia is a signatory to a number of international, European, and regional treaties (e.g., the Convention on Jurisdiction and Enforcement of Courts Decisions on Civil and Commercial Cases of 1988,³³⁴ Moscow Convention on Protection of Investor’s Rights of 1997³³⁵) regulating the insolvency procedures. According to Russian Constitution international treaties and conventions have supreme force and direct effect.

One of the intentions of the Russian insolvency law is to balance the interests of debtor and its creditors and to protect rights of the debtor’s employees. This adjustment of interests should be reached in a special trial under control of the federal court, which plays the role of mediator in this procedure. This position was repeatedly supported by the Constitutional Court of the Russian Federation in a number of cases concerning the 1998 Bankruptcy Law. Therefore, Russian insolvency legislation protects

³³² Federal Law #40-FZ of February 25, 1999 “On Insolvency (Bankruptcy) of Credit Institutions.”

³³³ Federal Law #122-FZ of June 24, 1999 “On Peculiarities of Insolvency (Bankruptcy) of Subjects of Natural Monopolies of Fuel-and-Power Sector.”

³³⁴ Convention on Jurisdiction and Enforcement of the Courts Decisions on Civil and Commercial Cases of September 16, 1988, Lugano.

markets and their participants from continuous non-payments and, therefore, make economic relations stable and less risky.

The 1998 Bankruptcy Law has introduced a new approach to definition and features of insolvency of legal entity. The particular enterprise is subject to bankruptcy procedure if it had not paid its debts exceeding approximately USD 1,670 for more than three months, notwithstanding the amount of the respective assets or receivables. The law establishes a procedure of pre-trial readjustment of insolvent debtor as a preventive measure for avoidance of bankruptcy trial. In case such measures are not efficient, the procedure of insolvency should be held under control of the respective court (federal court for commercial disputes). The bankruptcy trial can be initiated by the debtor (in some cases it is the debtor's obligation to initiate the proceedings), by creditors and in a limited number of cases by the state authorities.

The insolvency procedure consists of three stages, two of which are readjustment procedures, and the last one is dissolution of the debtor entity with the purpose of satisfaction of its creditors. In every stage of insolvency procedure the debtor and its creditors can enter into amicable agreement to settle the dispute by means of agreement on reduction of debt, deferral of debtor payments for creditors, etc.

All stages of the bankruptcy procedure are conducted under control of special external professional managers appointed by the court on decision of the committee of creditors. In the first stage of bankruptcy procedure (so-called "supervision") the debtor takes measures for adjustment of his financial capacity under the supervision of the manager (so-called "temporary manager"). If the debtor is unable

³³⁵ Convention on Protection of Investor Rights of March 28, 1997, Moscow.

to restore his ability to pay, the court initiates the external management procedure, where the manager directs the debtor in accordance with a readjustment plan adopted by the committee of creditors and approved by the court. In case of failure of this plan the final stage (so-called “proceedings in bankruptcy”) begins. In this stage the manager should arrange for disposition of debtor’s property for settlement of his liabilities. After sales of debtor’s property and satisfaction of creditors in accordance with the special order established in the Law of 1998 and so-called “queue of creditors” the debtor entity is liquidated and all of its unsatisfied liabilities should be considered to be settled.

In 1993, fewer than 100 corporate bankruptcy cases were filed in Russian courts. In 1998, the year Russia’s new bankruptcy law was promulgated, Russian courts received more than 10,000 bankruptcy petitions.³³⁶ In contrast, at the time of revocation Slovakia did not have an effective bankruptcy regime. “[B]ankruptcy [was] not yet a sufficiently real threat that would harden budget constraints or improve corporate governance” and the failure of companies to cease operations and enter bankruptcy “interfer[red] with efficient resource allocation and use.”³³⁷

5. The other countries whose NME designation was revoked maintained similar — or more extensive — price controls at the time of revocation.

At the time of their respective NME revocations, Slovakia, the Czech Republic, Poland, Hungary, and Latvia imposed price controls that were at least as extensive as those currently maintained by Russia.

³³⁶ "Globalist Factsheet: Our Top Facts on Russia," November 12, 2001, www.theglobalist.com/nor/factsheets/2000/03-27-00.shtml.

³³⁷ Slovakia NME Analysis Memorandum at 13.

- Slovakia maintained price controls "on a limited number of goods and services, primarily for household consumption, covering such items as energy products, utilities, rents, and some public services."³³⁸ The Slovakian government also controlled the prices of water, gas, and household electricity.³³⁹
- Similarly, the Czech Republic regulated the prices of "a limited number of goods and services, primarily for household consumption, covering energy products, utilities, rents, and some public services."³⁴⁰ Specifically, the Czech Republic controlled water and sewer rates, bus fares, housing rents, and the price of electricity and natural gas.³⁴¹
- In Poland, residential rents and the prices of gas and electricity, milk, domestic heating and hot water supplies, basic medicines, and public transportation were regulated by the government.³⁴²
- Hungary maintained price controls on household electricity and gas, public transportation, and natural monopolies, including telecommunications and gas and electricity distribution.³⁴³
- Latvia, where fully 20 percent of the consumer price index was comprised of regulated prices, maintained price controls on public transportation; water and sewerage; residential and industrial electricity, gas, and steam; and housing.³⁴⁴

³³⁸ Slovakia NME Analysis Memorandum at 12.

³³⁹ Slovakia NME Analysis Memorandum at 12.

³⁴⁰ Czech Republic NME Analysis Memorandum at 12.

³⁴¹ Czech Republic NME Analysis Memorandum at 12.

³⁴² Poland NME Analysis Memorandum at 22.

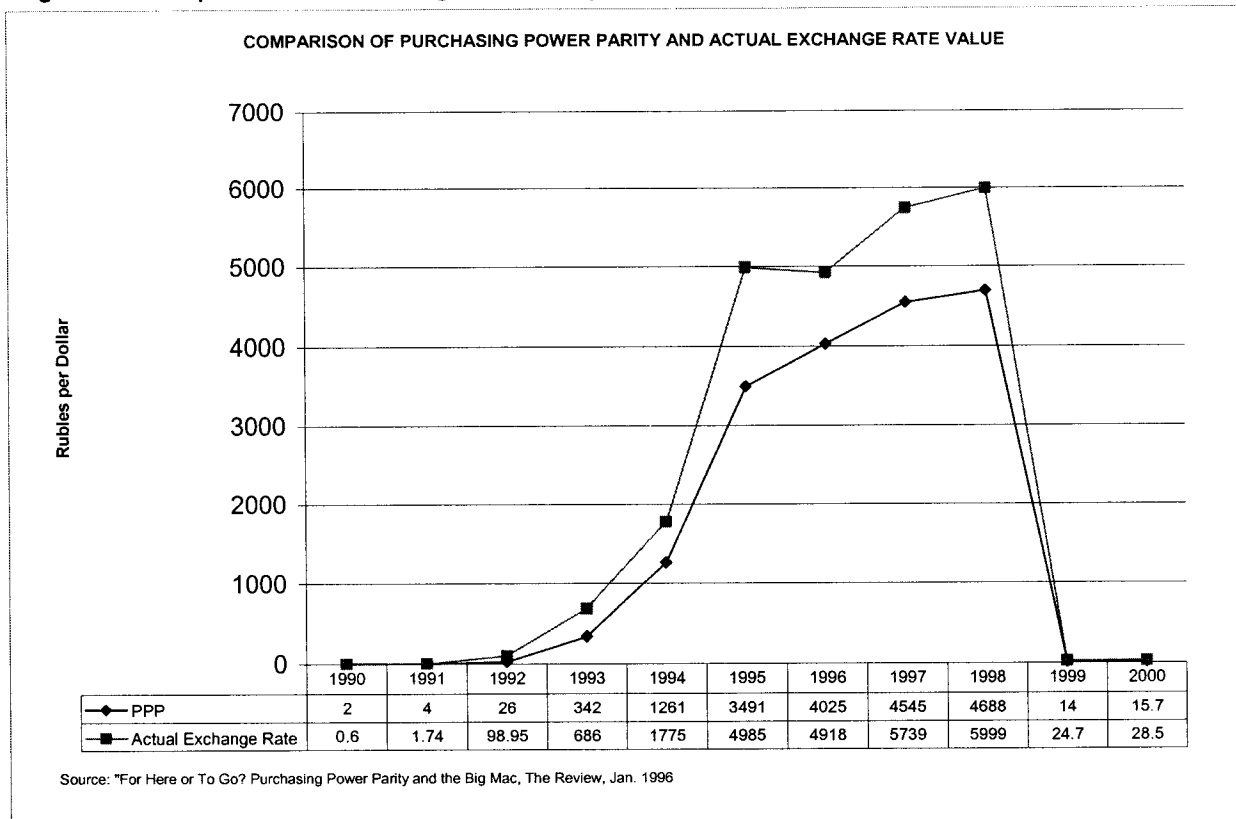
³⁴³ Hungary NME Analysis Memorandum at 14.

³⁴⁴ Latvia NME Analysis Memorandum at 15.

C. Economic evidence confirms that enterprises in Russia make decisions affecting costs, prices, and allocation of resources autonomously and without state intervention.

- 1. Purchasing power parity is a vehicle for evaluating the degree to which one country's prices correlate with others and therefore whether prices are set by market forces.**

Figure 29 - Comparison of Purchasing Power Parity



According to the theory of purchasing power parity, given perfect information the prices of the same goods in two different countries when expressed in the same currency should equalize. Russia's prices over time fluctuate with its purchasing power parity, which is what would be expected in a market economy. A comparison of the prices of goods between countries will rarely if ever be exactly the same because of the lack of perfect information. The trends shown above, however, indicate that prices are fluctuating within Russia in response to market forces. As seen in Figure 29, Russia's current exchange rate and purchasing power parity are

converging. This indicates that the prices charged in Russia are equivalent to prices charged in the rest of the world, which further supports the conclusion that they are determined freely by the market.

2. Oil price levels in Russia fluctuate with world oil prices.

The fuel industry in Russia is one of the largest industries of the Russian economy. Oil prices in Russia fluctuate in reaction to market forces and move in tandem with oil price levels in other parts of the world. As can be seen from Figure 30 below, market forces set oil prices in Russia and those prices mirror prices in the United States.

Figure 30 - Russian Vs. U.S. Oil Prices

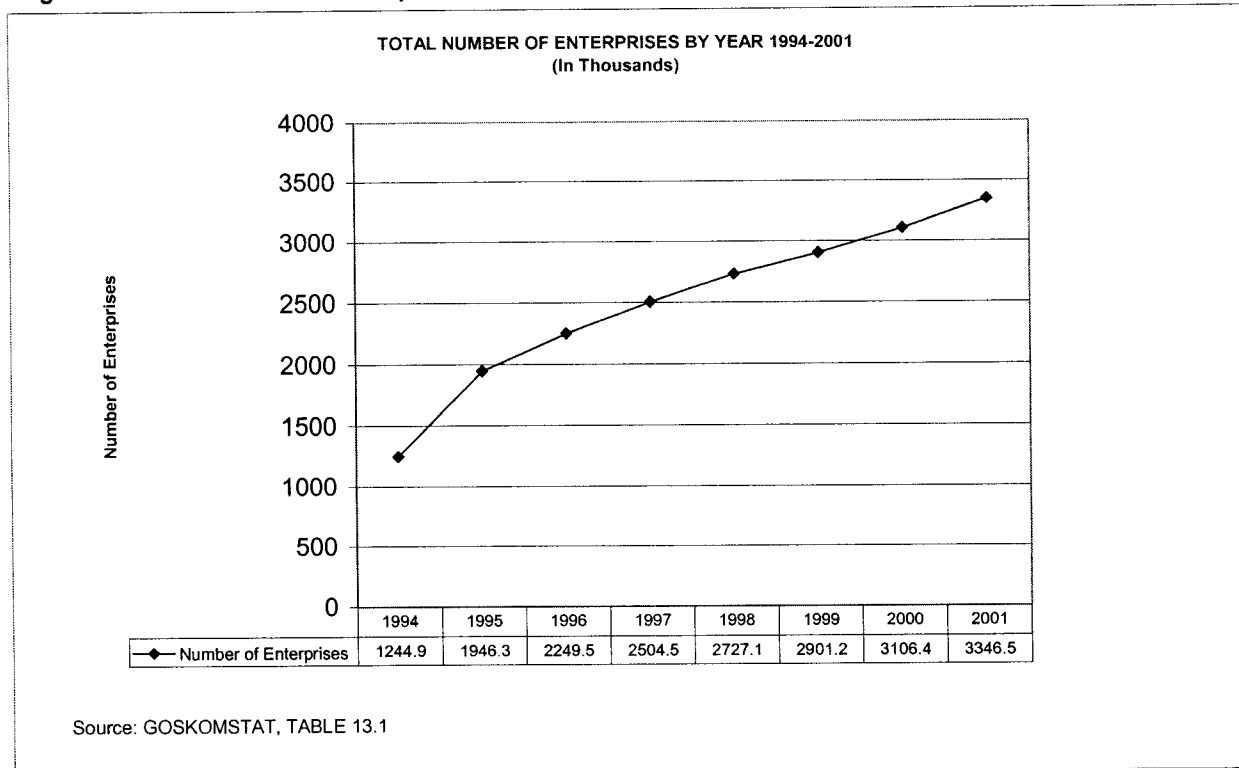


3. The number of firms entering the market is increasing, as is the number of bankruptcy cases filed.

The number of private enterprises in the Russian Federation has steadily increased from 1994 to 2001 and this is due to the market demand for smaller local businesses and service

providers. See Figure 31 below. Parallel with the number of new businesses, the number of exits from the market is also increasing. As discussed above, the number of bankruptcy cases filed increased from 100 in 1993 to 10,000 in 1998.³⁴⁵

Figure 31 - Total Number of Enterprises



4. Commodities and stock markets exist in Russia.

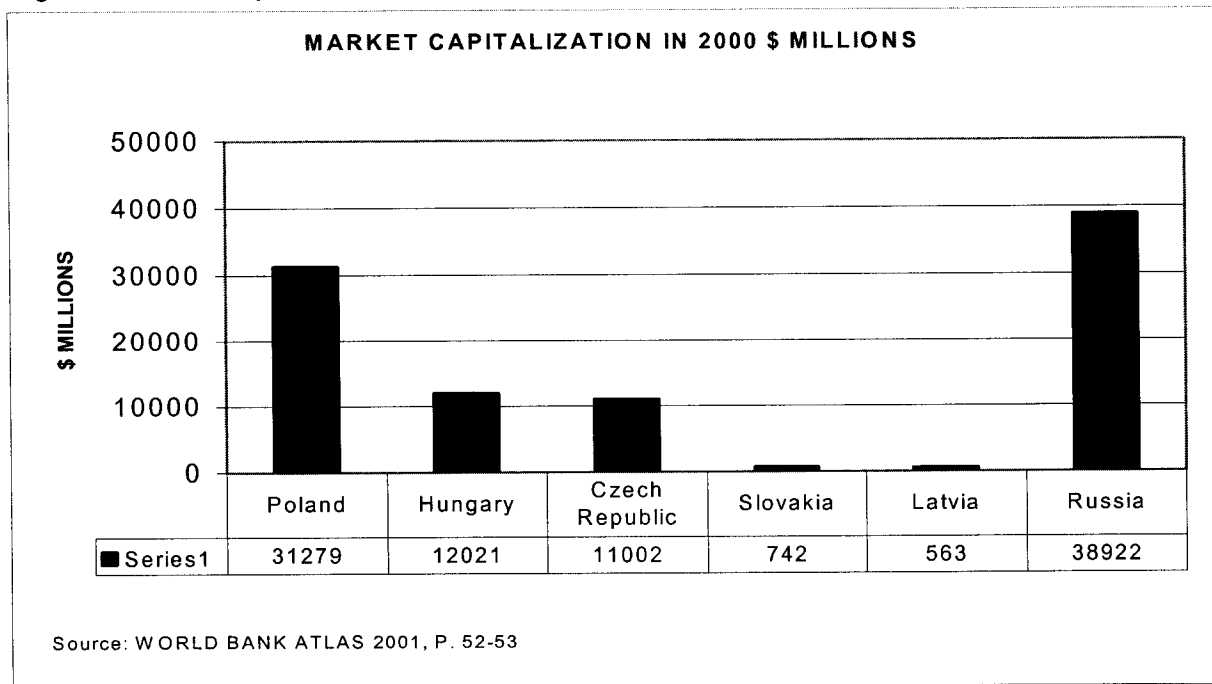
The Russian commodities market was formed in the early 1990s on the basis of the law "On Commodities."³⁴⁶ The exchanges are in major cities and facilitate the process of exchange of goods. The Russian Trading System – the first electronic trading floor in Russia –

³⁴⁵ "Globalist Factsheet," March 20, 2000 – <http://www.theglobalist.com/nor/factsheets/2000/03-27-00.shtml>.

³⁴⁶ Federal Law #2383-I of February 20, 1992 "On commodity exchanges and commodity exchange trade."

was introduced to the market in mid-1995.³⁴⁷ In the few years it has been operating, it has been able to generate \$23.7 million in average daily funds traded.³⁴⁸ The RTS Stock Exchange was established in January 1997 by leading dealer-broker companies. Its mission is to consolidate independent regional securities markets into an organized securities industry and regulate OTC trading in Russia. The market capitalization of the Russian stock market is 18 percent of GDP. As shown in Figure 32, the market capitalization of firms on the Russian stock exchange far exceeds the other five graduate countries in absolute terms.

Figure 32 - Market Capitalization



As the stock market continues to grow, international companies are beginning to include stock options and stock purchase plans in their salary packages.³⁴⁹ See Figure 33 below.

³⁴⁷ "About the Exchange," RTS web site - <http://www.rts.ru/eng/rts/about.htm>

³⁴⁸ "Annual Report of the RTS Stock Exchange," December 31, 2000.

³⁴⁹ Russia, Compensation & Benefits Survey at 43.

This is clear evidence of domestic confidence in the stock market and its ability to increase the wealth of the participants. It is also evidence of capital allocation by the markets independent of governmental interaction.

Figure 33 – Incentive Plans

Type of Existing Program	% of Companies
Stock Options/Stock Purchase Plans ³⁵⁰	21 %
Phantom Stock / SAR's ³⁵¹	16%
Anniversary/Length of Service Payments	14%
Other	19%

³⁵⁰ Stock Options/stock purchase – are plans where employees are rewarded with company’s shares granted either free or at a discount to the fair market value.

³⁵¹ Phantom stock/SAR’s – are plans where employees are rewarded with case that is linked to the company’s share price growth.

VII. CRITERION 6: SUCH OTHER FACTORS AS THE ADMINISTERING AUTHORITY CONSIDERS APPROPRIATE

Summary of Comment

The Opposing Parties have asserted certain arguments, concerning the level of corruption in the Russian Federation, arguments that are irrelevant to the statutory criteria governing NME revocation. Section A challenges the relevance of these arguments, while Sections B discuss additional factors and economic data that are directly relevant to revocation.

A. The Opposing Parties raise irrelevant arguments concerning the level of corruption in the Russian Federation.

One of the more ill-considered arguments presented by some of the Opposing Parties is their attempt to link corruption in the Russian Federation – or, as one party alleges in an extreme manner, the “criminalization of the Russian economy”³⁵² – to the country’s allegedly continuing status as a NME. We note also that one of these parties recently raised the same issue in challenging the status of Kazakhstan as a market economy country in a currently pending investigation.³⁵³ The Russian Steel Producers submit that this argument is inapposite both because it is utterly irrelevant to the market economy issue that the Department is attempting to resolve and because it is a blatant effort on the part of certain parties to prejudice the Department’s decision-making, which demeans this entire inquiry.

³⁵² See, e.g., Skadden-Dewey brief at 42, 63-64; see also Wiley, Rein & Fielding Brief at 20-21.

³⁵³ See Letter from Verner, Liipfert, Bernhard, McPherson and Hand, Counsel for Petitioners, to the Honorable Donald L. Evans, Secretary of Commerce, at 14-22 (August 29, 2001); Letter from Verner, Liipfert, Bernhard, McPherson and Hand, Counsel for Petitioners, to the Honorable Donald L. Evans, Secretary of Commerce, at 3, 24-27 (July 30, 2001).

The existence of corruption, while unfortunate, is not an exclusive feature of non-market economy countries. It is painfully obvious that throughout history up to the very present time, many countries have lived under conditions of corruption. Indeed, the studies cited in the Wiley Rein brief cite the existence of high levels of corruption in other countries (such as Pakistan, Indonesia, and Ecuador) that the Department routinely considers to be market economies.³⁵⁴ And the tales of corruption in the Central Bank of Russia and in the regulation of Russia's foreign trade, detailed by one Opposing Party,³⁵⁵ while regrettable, are no worse than those that have plagued market economy countries since time immemorial. If their argument were to be taken seriously, the United States in the Grant Administration or during the Teapot Dome scandal of the 1920s was a NME.

The Russian Steel Producers strongly urge that the DOC disregard this irrelevant and inflammatory argument by the Opposing Parties in reaching its determination on this important issue.

B. The Russian economy has strengthened and stabilized since 1998.

The Russian economy experienced significant growing pains during the early years of its transition to a free market economy. Inflation and unemployment became serious problems in the early 1990s and the ruble devalued significantly through the 1990's. Since that time, however, the difficult structural reforms have finally taken root, and the economy has not only stabilized but is strengthening. This is reflected in the Russian GDP, unemployment, and

³⁵⁴ See Transparency International Global Corruption Report, available at http://www.globalcorruptionreport.org/download/data_and_research.pdf; Heritage Foundation 2002 Index of Economic Freedom, available at <http://cf.heritage.org/index/indexoffreedom.cfm>.

³⁵⁵ See Skadden-Dewey brief at 42-43, 45, 63-65.

inflation indicators, resulting in a solid and stable foundation for Russia's market economy. See Figures 34 and 35. The Economist describes Russia's economy today as follows:

While the world economy has slowed precipitously this year, Russia's has gone from strength to strength. Real GDP grew by 5 percent year on year in the first half of 2001, and the Economist Intelligence Unit now expects full-year growth of 4.7 percent. Although this is slower than the 8.3 percent recorded in 2000 as a whole, it is still a striking achievement by Russian standards. In the first five years after the end of central planning, Russian GDP contracted by roughly 40 percent and the return to growth in 1997 was accompanied by dangerous macro-economic imbalances, including an unsustainable hole in the state budget, an overvalued exchange rate and a current account that was heading for a deficit.

The situation could hardly be more different in 2001, the third consecutive year of growth since the 1998 financial crisis. The federal budget is in surplus, inflation is more or less under control, the ruble is stable, and the current account recorded a surplus of almost USD 30 billion in January-September. Much of this is the result of the after-effects of the sharp 1998 devaluation -- which has given an unprecedented boost to Russian industry -- and the very high international oil prices in 2000-01. Meanwhile, the government of President Putin has been pushing through long-overdue structural reforms that should help to boost Russia's economy in the medium- to long-term.³⁵⁶

Figure 34 – Key Indicators of the Russian Economy

KEY INDICATORS OF THE RUSSIAN ECONOMY (YEAR ON YEAR % GROWTH UNLESS OTHERWISE NOTED)							
	1996	1997	1998	1999	2000	2001	
GDP	-3.4	0.9	-4.9	5.4	8.3	4.9	Q1
Industrial Production	-4.5	2.0	-5.2	11.0	11.9	4.5	July
Inflation	21.8	11.0	84.4	36.5	20.2	20.8	August
Unemployment (ILO,%)	9.6	10.8	11.9	13.7	10.5	8.3	July
Fed. Budget Balance (% to GDP)	-7.9	-6.7	-4.9	-1.7	2.5	4.4	Q1
Current Acct. (% to GDP)	3.0	0.5	0.3	13.5	18.5	17.8	Q1

(Source: Goskomstat, CBR, Ministrv of Finance)

³⁵⁶ Economist Intelligence Unit, Viewswire, "Weak foundations for catch-up growth?," October 29, 2001. http://www.viewswire.com/index.asp?layout=display_article&doc_id=165395.

These trends are expected to continue. Russia's GDP is expected to continue to grow at a healthy pace, inflation is expected to remain relatively low, and unemployment rates are expected to remain constant.

Figure 35 – Key Future Indicators of the Russian Economy

KEY FUTURE INDICATORS OF THE RUSSIAN ECONOMY (2002 – 2004 Projections)			
	2002	2003	2004
GDP	3.5	4.0	4.3
Unemployment	8.8	8.5	8.4
Inflation	15.5	13.0	11.0
Current Acct. (% to GDP)	5.8	5.8	4.5

(Source: Goskomstat, CBR, Ministry of Finance)

VIII. CONCLUSION

For the reasons set out above, the DOC should find that the Russian Federation meets all the statutory criteria for revocation of its NME designation and should revoke that designation.