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BEFORE THE IMPORT ADMINISTRATION
U.S. DEPARTMENT OF COMMERCE

INQUIRY INTO THE STATUS OF THE RUSSIAN FEDERATION AS A NON-MARKET ECONOMY COUNTRY UNDER THE ANTIDUMPING AND COUNTERVAILING DUTY LAWS

Comments Filed on Behalf of:

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SUMMARY OF COMMENT

The Department of Commerce should not revoke the Russian Federation's status as non-market economy. Since the collapse of the Soviet Union in 1991, the Russian Federation has made significant strides in becoming a free market economy. Nonetheless, in light of existing rampant corruption, limited rule of law, excessive state intervention in and ownership of several key industries, currency controls, as well as restrictions and practical impediments to foreign investments, substantial additional reform is necessary before revocation of the Russian Federation's non-market economy status would be justified.

I. INTRODUCTION

The government of the Russian Federation ("Russia") has requested that the Department of Commerce ("Department") revoke Russia's status as a non-market economy. The Department initiated its inquiry into Russia's status on October 26, 2001 pursuant to Section 771(18)(C) of the Tariff Act of 1930. *See* 66 Fed. Reg. 54197 (Oct. 26, 2001).

In determining whether to revoke a country's status as a non-market economy, the Department must consider five specific factors, as well as "such other factors as the administering authority considers appropriate." 19 U.S.C. § 1677(18)(B). The five factors which the Department must take into account include:

> (i) the extent to which the currency of the foreign country is convertible into the currency of other countries;
> (ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management;
> (iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country;
> (iv) the extent of government ownership or control of the means of production; {and}
> (v) the extent of government control over the allocation of resources and over price and output decisions of enterprises.

19 U.S.C. § 1677(B).

As discussed in this submission, these factors, when analyzed in the context of the Russian economy, demonstrate that the Department should not revoke Russia's status as a non-market economy at this time. Despite recent reforms and improvements in the Russian economy over the past ten years, significant economic and legal reform is still necessary before Russia's status should be modified. In light of existing rampant corruption, limited rule of law, excessive state intervention in and ownership of several key industries, currency controls, and restrictions and practical impediments to foreign investments, substantial additional reform is necessary before the Department should revoke Russia's non-market economy status. These issues are discussed in the context of the statutory criteria below, but are addressed in order of importance and not the order of the statute.

II. GOVERNMENT OWNERSHIP OVER THE MEANS OF PRODUCTION AND GOVERNMENT INFLUENCE AND EXERCISE OF CONTROL IN THE ECONOMY

After the fall of the Soviet Union in 1991, many formerly state-owned industries were privatized, although often in a controversial manner. Nevertheless, most important for purposes of this inquiry, the Russian government retains extensive control over several important monopolistic industries that preclude Russia's classification as a true market economy. Specifically, the Russian government is significantly involved in the natural gas and electricity monopolies. The government's ownership and involvement in these, and other key industries such as the railroad industry, creates effects that are characteristic of a non-market economy. *See* 19 U.S.C. § 1677(18)(B)(iv), (v).

In the natural gas market, Gazprom, the natural gas monopoly, secures 90 percent of Russian resources and makes up about eight percent of the Russian gross national product. The Russian Federal Energy Commission has announced in the past that it is in favor of independent suppliers to the Russian gas market and unregulated tariffs, but the reform will require adopting such a resolution and introducing amendments to existing legislation, a slow and complicated process.[1] Russia has attempted to demonstrate a more "market-oriented" approach to management of the company and even went as far as to cease delivery of gas to Georgia and Ukraine in the dead of winter last year because of failure of those nations to pay their bills,[2] but the average Russian consumer still pays less than the market value for gas. Finally, recognizing the importance of Gazprom to the Russian economy, the Russian government apparently intends to increase its ownership in Gazprom from its current level of 38 percent to 50 percent.[3]

The Russian government also controls electricity through its 52 percent majority ownership in Unified Energy Systems (UES), the monopoly that represents approximately 70 percent of the electricity production and distribution in Russia.[4] UES is managed to serve the national government objective of low-cost electricity supply notwithstanding that UES is in need of significant funds to modernize and upgrade its infrastructure. Private investment, which would change management to a more market-oriented approach, will not materialize because UES' cash problems are caused by its current low wholesale prices and the fact that UES has difficulty getting consumers to pay for electricity in cash and on time.

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[1] "Federal Energy Commission in favor of unregulated gas tariffs," Interfax (Moscow) (April 12, 2001), attached as Exhibit 1.

[2] Robert McFarlane, "Fueling a Revival," Washington Post (Apr. 10, 2001), attached as Exhibit 2.

[3] "Govt stake in Gazprom unlikely to shrink in near future," Interfax (Moscow) (May 31, 2001), attached as Exhibit 3; Stewart Fleming, "But the Bad Old Ways Are Still Typified By Giant Gazprom," The Evening Standard (Oct. 30, 2001), attached as Exhibit 4.

[4] "Russia: Electricity Sector Reform," attached as Exhibit 5.

Moreover, the receipt of low-priced electricity, which constitutes a major part of the cost of production for some industrial goods such as steel, is tantamount to a subsidy. The current state of the electricity industry in Russia is not representative of a market economy and needs extensive reform and additional privatization before it becomes a self-sustaining industry characteristic of a market economy.

III. FOREIGN INVESTMENT

While the Russian government has expressed an interest in attracting more foreign investment, extensive structural and legal reforms are necessary before foreign investment can increase significantly. The lack of a strong legal system necessary to enforce contracts and property rights, as well as widespread corruption in all areas, have hindered attraction of additional foreign investment. Restrictions on foreign investment in several key industries, coupled with burdensome administrative procedures, further support Russia's continued classification as a non-market economy. *See* 19 U.S.C. § 1677(18)(B)(iii).

While the 1991 Investment Code and the July 1999 Law on Foreign Investment 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.[5] In fact, rather than relaxing barriers to foreign investment, further restrictions on foreign investment are currently envisioned. The Russian administration and the State Duma (the lower house of the Parliament) are discussing additional legislation which would specify areas in which foreign investment should be

[5] United States Department of State, FY 2001 Country Commercial Guide: Russia ("Commercial Guide"), Chap. VII at 44, attached as Exhibit 6.

prohibited or restricted. Currently, such areas are limited in number, but they do exist in important sectors of the economy.

The natural gas industry is one example of an industry with restricted foreign investment. In September 2001, President Putin approved a plan to liberalize trade in Gazprom shares from the 11.5 percent limit, but only up to 20 percent.[6] The goal of President Putin's plan was to gradually implement the liberalization process, eventually uniting the domestic and foreign markets in Gazprom shares, but investment would still be restricted.

Other industries with restricted foreign investment include the aerospace industry, which limits foreign ownership to 25 percent of an enterprise.[7] The insurance industry is also restricted, although companies with foreign majority ownership are allowed to operate in Russia. They are prohibited from selling life or compulsory insurance and overall foreign capital in the insurance industry is limited to 15 percent. A 1998 law limits foreign investment in the electric company UES to 25 percent or less.

Foreign investment in other non-restricted sectors may also prove difficult because of additional registration requirements in place for significant investment of foreign capital exceeding 100 million rubles (approximately $ 3.3 million).[8] Investment in areas requiring

[6] "Putin OKs Gazprom Liberalization," The Oil Daily (Sept. 7, 2001), attached as Exhibit 7.

[7] See Exhibit 6, Commercial Guide, Chap. 7 at 44-45.

[8] Id. at 45.

licensing, such as banking, mining, and telecommunications, can be difficult and expensive because of lengthy and obscure licensing procedures.

Such restrictions on investment, coupled with the corruption which can make it difficult for foreign investors to enjoy profits in the Russian market, do not support the level of openness of investment that is associated with a market economy.

IV. FREE BARGAINING BETWEEN EMPLOYEES AND MANAGEMENT

Labor conditions in Russia are far from ideal. Prior to the recent upturn in the economy, Russian workers faced serious difficulties in even receiving their wages. This injustice continued for years, in some cases.[9] While workers are unionized in Russia, the Federation of Independent Trade Unions (FNPR) dominates the union movement in Russia and does little to represent the rights of the working class. Smaller, more successful, independent trade unions have sprung up in Russia today, but have received much opposition from the FNPR.[10]

As a hold-over from the Soviet era, the FNPR is a vast bureaucracy and does not adequately defend the rank and file workers which constitute its membership. While new unions more actively pursue the rights of the working class, legislation was introduced in the State Duma which would permit only one union to exist at each factory, thereby guaranteeing the

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9 "Russian Workers Stage Protests on May Day," Russia Journal (May 3-9, 1999), attached as Exhibit 8.

10 Id.

FNPR's continued domination.[11] The inability of smaller unions to engage in collective bargaining hinders the rights of the working class and is not indicative of a market economy.

V. CURRENCY CONVERSION

Capital flight, fueled by the ruble's depreciation and escalating inflation, has been a serious problem for the Russian economy. The Russian government has enacted several programs to slow capital flight and require repatriation of profits. These currency restrictions dictate against revoking Russia's status as a non-market economy. *See* 19 U.S.C. § 1677(18)(B)(i).

Official currency transactions in Russia are strictly regulated. Foreign currency transactions are unrestricted only when they involve settlement on import/export contracts within 90 days, loans for terms of less than 180 days, or the payment of interest and dividends.[12] Other laws restricting currency conversions focus on import/export transactions, which have been abused extensively to circumvent currency controls. Other restrictions include mandatory conversion of 75 percent of foreign currency received by residents for the export of goods. Additionally, importers making an advance payment in a foreign currency must deposit an equivalent ruble amount in an authorized bank. The deposit is reimbursed only after the importer receives documents that the imports have entered Russia.

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[11] Fred Weir, "Russia's Bold New Proletariat," Christian Science Monitor (Sept. 6, 2001), attached as Exhibit 9.

[12] See Exhibit 6, Commercial Guide, Chap. 8 at 56.

The existing high level of restrictions on currency conversion are not indicative of a free market. When economic conditions have improved in Russia, capital will be reinvested in the Russian economy and the Government will not be forced to attempt to protect against capital flight. Until such time that these restrictions are on currency conversion are no longer necessary, Russia should continue to be classified as a non-market economy.

VI. OTHER FACTORS

Russia has undoubtedly made significant progress in implementing a capitalist system since the demise of the Soviet Union in 1991.[13] Russia has not experienced, however, the success of some of its neighboring Eastern European neighbors in implementing a market economy.[14] Russia's three major problems have been classified as "the absence of broad-based political support for reform, inability to close the gap between available public resources and government spending, and inability to push forward systematically with structural reforms."[15] Critics overwhelmingly agree that the Russian economy contains much potential due to its immense wealth of natural resources, but reform is necessary for that potential to be realized.

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[13] Robert Cottrell, "The Promise of Capitalism Has Yet To Be Realized," Financial Times (Nov. 30, 2001), attached as Exhibit 10.

[14] The Department has revoked the non-market economy status of Poland, the Czech Republic, and the Slovakia. See Certain Cut-to-Length Carbon Steel Plate from Poland, 58 Fed. Reg. 37205 (July 9, 1993) (Final Determination); Certain Cold-Rolled Flat-Rolled Carbon Quality Steel Products from Slovakia, 65 Fed. Reg. 1110, 1114-15 (Jan. 7, 2000) (Prelim. Determination); Certain Small Diameter Carbon and Alloy Seamless Standard, Line, and Pressure Pipe from the Czech Republic, 65 Fed. Reg. 5599, 5602 (Feb. 4, 2000) (Prelim. Determination).

[15] The 2002 Index of Economic Freedom, the Heritage Foundation, attached as Exhibit 11.

Russia hopes to eventually open its economy more to the world and become a member of the WTO, but the necessary reforms will take several years at a minimum to implement.

The Russian legal system has been referred to as biggest obstacle to doing business in Russia because it does not provide the ability to enforce contractual rights.[16] The courts are often condemned as corrupt and negligent, and even fair rulings are impossible to enforce. Other complaints include the lack of a functional banking system and a legacy of default that left private creditors with little, if any return on their investments after the crisis in 1998.[17]

The Russian economy was recently ranked 131 out of the 161 countries considered in the recent 2002 Index of Economic Freedom published by the Heritage Foundation. That index described the Russian economy as having a "high level of protectionism" in its trade policy, "moderate barriers" to capital flows and foreign investment, a "high level of restrictions" in banking and finance, a "moderate level of intervention" in wages and prices, a "low level of protection" of property rights, and a "high level" of regulation.[18] Based on these descriptors, Russia is not yet at a state of development to merit revocation of its status as a non-market economy.

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[16] Guy Chazan, "Russia Considers Overhaul of Judiciary," Wall Street Journal Europe (Nov. 20, 2001), attached as Exhibit 12. See also George Melloan, "To Win in Texas, Putin Needs to Be a Straight Shooter," Wall Street Journal (Nov. 13, 2001), attached as Exhibit 13.

[17] Editorial, "A Russian Revival," Asian Wall Street Journal (Nov. 13, 2001), attached as Exhibit 14 ("For all that good news, Russia still has far to go to become a genuine tiger economy.").

[18] The 2002 Index of Economic Freedom, the Heritage Foundation, attached as Exhibit 11.

VII. CONCLUSION

For all the reasons listed above, we respectfully request that the Department decline to revoke the Russian Federation's status as a non-market economy.

Respectfully submitted,

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