Trade Barriers in Russia

U.S. Commercial Service Russia

In general, U.S. companies face a number of tariff and non-tariff trade barriers when exporting to Russia. A complaint frequently voiced by U.S. companies is Russia’s complex system of standardization. As explained in detail in the “Standards” section below, Russia’s regime remains extremely complex due to its lack of clarity and transparency, and overall redundancy. While the system has improved somewhat, U.S. companies are encouraged to obtain appropriate legal advice or assistance from experienced distributors or consultants, as well as the U.S. Commercial Service.

Discrimination against foreign providers of non-financial services is, in most cases, not the result of federal law, but stems from abuse of power, sub-national regulations and practices that may violate Russian law. For example, a few foreign service providers have noted that they are forced to pay a range of fees to obtain licenses from local authorities, fees that domestic companies allegedly bypass via bribes.

The 1996 federal law “On Banks and Banking Activity” permits foreign banks to establish subsidiaries in Russia. However, Russia does not allow foreign banks to establish branches in Russia. In November 2006, Russia and the U.S. signed their WTO (World Trade Organization) Bilateral Agreement, a major step in Russia’s accession to the WTO. As part of this Agreement, Russia pledged to allow foreign ownership to account for as much as 70% of the country’s total banking sector equity. Previously, Russia had the prerogative to legislate the limit on foreign capital to 50% of total equity. However, at the time the bilateral agreement was signed, foreign equity accounted for 20% of the total. Russia’s pledge essentially “grandfathered” in that 20% and provided new foreign equity the potential to absorb/account for an additional 50% of total banking sector equity.

The Central Bank has required new foreign bank subsidiaries to have a minimum of €5 million in capital (the same requirement is applied to domestic banks) and that at least 75% of the bank’s employees and 50% of the bank’s management board be of Russian nationality if the chairman is not a Russian citizen. Heads of foreign banks' Russian offices are required to be proficient in the Russian language.
In the insurance sector, foreign insurance firms are subject to a 49% equity restriction. Foreign firms that were active in Russia when this requirement came into effect, however, were grandfathered and are not subject to the foreign equity limit. Russia also has more generous operating provisions for insurance companies from the European Union, and has been permitting multinational companies to benefit from this more generous treatment provided they conduct their Russian investments via their EU-based offices. Once Russia becomes a WTO member and the United States grants permanent normal trade relations status, U.S. insurance companies will be allowed to operate through subsidiaries, including 100% foreign-owned non-life insurance companies, and will be able to open direct branches at the end of a nine-year transition period. However, as in the banking sector, Russia maintains the discretion to limit foreign sourced charter capital in the insurance sector and if the ratio of foreign sourced to total charter capital in the insurance sector ever exceeds the 50% cap, Russia’s regulators will have the discretion to take certain actions specified in Russia’s WTO commitments.

Until Russia’s accession, EU firms will continue to enjoy an advantage over their counterparts from the United States and elsewhere, since they can offer life and mandatory forms of insurance in Russia directly, without the requirement to work through a majority Russian-owned partner. Russian law currently requires that chief executives and chief accountants of foreign insurers operating in Russia be Russian citizens.

In the telecommunications sector, the 2004 Law on Communications was amended in July 2006 by the law “on Information, Information Technologies and Information Protection.” The latter law’s impact on competitive alternative telecommunications operators, many of which enjoy large foreign investment, has been substantial, since these companies now fall under tight government regulation. In particular, regulations on interconnection—the process by which alternative operators connect their networks to the Russian public telephone network—place interconnection contracts and fees under the regulatory authority of the Ministry for Information Technologies and Communications. Alternative operators fear that these fees will be raised to subsidize network upgrades of government-owned and ministry-controlled local and long distance operators.

There are significant barriers in the provision of satellite telecommunications services in Russia. In particular, satellite regulation is not transparent. The legal requirements and administrative responsibilities associated with the provision of these services appear to be discriminatory, with the Russian government demonstrating a preference for Russian satellite communications systems, which puts competing satellite systems at a disadvantage. Current Russian legislation restricts foreign investment in the aerospace industry to less than 25% of an enterprise.

The Land Code that was passed in 2001 allows equal treatment of domestic and foreign entities to buy land and buildings, although purchase of agricultural land by foreigners is still prohibited. Discussion on specific land policy continues, including legislation on transfer of use, but a
conclusion has not yet been reached. Foreign entities are restricted from buying land close to federal borders and in areas that the President determines critical to national security.

The government enacted the Strategic Sectors Law (SSL) in May 2008. The SSL introduces a list of 42 “strategic” sectors in which purchases of “controlling interests” by foreign investors must be pre-approved by the Russian government. The list of restricted sectors includes: enterprises in the nuclear industry or involved in handling radioactive materials; enterprises involved in work on infectious diseases; arms, munitions, and military equipment production, maintenance, or repair; the aviation and space industries; certain data-transmission (radio, television, telecommunications) infrastructure; production and distribution of encryption technologies and equipment; production and sales of goods and providing services under conditions of a “natural monopoly” (e.g., activities such as operating certain gas networks); newspapers with a circulation of more than one million; and natural resource extraction. Many observers, while welcoming more precision about the rules of the game, have criticized the SSL for being overly broad in the number of sectors it covers, and raised concerns that the approval process will prove to be non-transparent and burdensome.

The SSL approval process involves two steps. Initially, the foreign investment must be vetted by the Federal Anti-Monopoly Service (FAS). The FAS must determine whether the proposed investment is subject to the SSL and then recommend to the Government Commission on Control of Foreign Investment in the Russian Federation (“Commission”) whether the investment should be approved. The head of the FAS is appointed by the Prime Minister. The Commission is headed by the Prime Minister and is comprised of Cabinet Ministers with jurisdiction over most of the restricted sectors, as well as the Director of the Federal Security Service (FSB).

To date, only two foreign companies have received approval under the SSL: DeBeers (diamond mining) and Alenia Aeronautica (development of Sukhoi Superjet 100). These approvals provide little guidance regarding implementation of the SSL. Both investments were pre-approved by Prime Minister Putin when he was still President and no information about the process was publicized by government authorities.

In conjunction with the SSL, amendments to the sub-soil legislation were also passed requiring governmental approval for foreign investment in excess of 10% in companies operating a “strategic” deposit, which includes major oil, gas, and other mineral deposits. Foreign oil and gas companies are concerned about the potential application of these provisions, including how and when the government may declare a given field strategic and what compensation a field licensee may be given under such declarations. The Russian government continues its policy of not entering into any further Production Sharing Agreements (PSAs - designed for energy projects that require high capital expenditures and a long period before profits or significant tax revenues are generated).
In July 2008, RAO UES, the electricity holding company that controlled all of Russia’s power assets, with the exception of those connected to nuclear energy, completed its corporate reorganization and ceased to exist. It has been succeeded by 24 companies: six wholesale private generation companies (“OGK’s”) and 14 “territorial” generation companies (“TGK’s”), the hydroelectric giant RusHydro; a Federal Grid; and a number of distribution operators. Although the unbundling and privatization of RAO UES was initially hailed as a huge success, concerns are growing.

As a condition to the generating companies’ spinoffs, investors in the OGK’s and TGK’s agreed to implement plans to modernize and expand their respective electricity infrastructure. These plans were premised on the assumptions of robust economic growth and demand, and access to affordable credit. In light of slowing Russian economic growth and tight financial conditions, these investment obligations have become very expensive. Consequently, a number of investors are backing out of acquisition deals or seeking to renegotiate the terms of their acquisitions with the Russian government. It seems unlikely that modernization and expansion of the sector’s infrastructure – a major purpose of the reorganization – will occur in the near future. Because the restructuring was only completed in July 2008, it is still unclear to what degree the electricity generation market will ultimately be deregulated, and whether it will operate in a transparent and non-discriminatory manner.

In aviation, many of the Russian-flagged carriers have aging fleets and use outmoded avionics and engines, but several are seriously considering significant purchases or wet-leases of foreign aircraft in an attempt to be more competitive with Western airlines. Domestic aircraft manufacturers only produce ten planes per year on average and therefore cannot keep up with Russian airlines’ projected demand for 1,500 additional planes in the next twenty years. The airlines hope that Russia's commitment to reduce aircraft tariffs as part of its WTO accession will help them purchase the modern, fuel-efficient aircraft they need to remain competitive with foreign airlines. Current Russian law stipulates preferential treatment (tax holidays, guarantees on investment) for Russian and foreign investors in aviation-related research and manufacturing ventures. However, it limits the share of foreign capital in aviation enterprises to less than 25% and requires that board members and senior management staff be Russian citizens. There is speculation that the 25% limit could be raised or eliminated to make way for further investment. Some observers, however, doubt that recent proposals to raise the limit to 49% would be sufficient to attract foreign capital for Russia’s aircraft industry.

The signed bilateral agreement on Russia's accession to the WTO and the corresponding side letter on leased aircraft could yield significant market access opportunities. The side letter on leased aircraft has been in force since November 19, 2006, with narrow body leased aircraft enjoying immediate tariff reductions. Tariffs on wide body aircraft will be reduced from 20% to 7.5% over four years following accession. Tariffs on civil aircraft parts, including engines, will be reduced to an average of 5%. As long as the lease is signed before January 1, 2011, aircraft with less than 50 seats will be charged only 8% and those with 115-160 seats will be charged 10%.
The Russian government eliminated the import tariff on small aircraft with up to 19 seats for a period of nine months as of July 16, 2008. According to the Ministry of Transportation, the measure will be extended after nine months. In September 2008, the government announced that the import tariff for aircraft with up to 50 seats would be cancelled as of January 1, 2009, and that import tariffs for aircraft with 115-160 seating capacity would also be temporarily canceled, so long as the aircraft were not more than ten 10 years old and were imported into Russia prior to 2011 under leasing contracts for no longer than five years. Neither of the decrees finalizing these proposals has yet been issued.

The import tariff on foreign aircraft with over 300 seats was eliminated for a period of nine months beginning in February 2008. In September 2008, the Russian government recommended permanent cancellation of import duties on aircraft seating more than 300 passengers, but no date has been set yet for this permanent tariff reduction measure to come into effect. U.S. industry reports that illegal logging accounts for as much as 20% to 30% of Russia’s timber harvest. Illegal wood supplies have begun to appear in China, hurting U.S. exports to that market. Illegal logging continues to increase, particularly in the Far East due to its proximity to China. According to World Wildlife Fund data, the share of unregistered wood to total volume of timber consumption is 53% in the Chita region, 34% in Primorskiy Kray, 33% in Khabarovsk Kray, 17% in Vologda region, and 10% in Krasnoyarsk Kray.

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