

## Journey's End: Russia Joins the WTO

By Peter Rutland, Middletown

### Abstract

Russia originally applied to join the World Trade Organization (WTO) in 1993. Many years and many rounds of fruitless negotiations later, the WTO's ministerial meeting on December 16, 2011 finally granted entry. Russia will formally join 30 days after the State Duma ratifies the treaty, which must occur by July 2012. It was embarrassing that Russia, the world's sixth-largest economy and 15<sup>th</sup>-largest trading nation, was the only G20 country left outside the 153-member WTO. Countries not notably more transparent than Russia have been allowed in—from China in 2001 to Saudi Arabia in 2005 and nearby Ukraine in 2008. Why did this long-running saga finally come to an end, and what are the implications for Russia's development prospects?<sup>1</sup>

### The Path to Agreement

At several points during the odyssey it looked like Russian membership was imminent. Most of the principal barriers to Russian entry had been resolved by 2006, with the outstanding issues being intellectual property rights, financial market liberalization and meat imports. After six years of negotiations, Russia signed a bilateral protocol securing EU approval for entry in May 2004 and with the US in November 2006.

However, it is a WTO convention that all existing members must agree to a new entrant. Georgia revoked its consent for Russia's candidacy in 2006 in response to a ban on its wine and mineral water exports, and withdrew from the talks in May 2008 in protest of Russia's policy regarding the break-away regions of Abkhazia and South Ossetia. The August 2008 war led to the complete severing of diplomatic relations between the two countries.

This last obstacle fell in late October 2011 when Georgia agreed to a compromise over monitoring trade across the border between Russia and Abkhazia and South Ossetia. At the suggestion of Swiss mediators Tbilisi agreed to allow a third party, a private company, to monitor the transactions, rather than Georgian customs officials. Georgia was the last of the 153 member countries required to approve Russian entry.

The EU Commission's top diplomat for Russia and Central Asia, Gunnar Wiegand, visited Tbilisi on October 25 and reportedly threatened to go around the Georgia veto with a majority vote. This is possible under WTO rules, but it would have been unprecedented, and controversial.<sup>2</sup> The US also pressured Tbilisi to compromise. Many assume that President Mikheil Saakashvili's visit to the White House in January 2012—and the promise of a free trade agreement with the US—was a reward for his flexibility.

Another factor pushing the process forward was signs that Moscow was introducing protectionist measures. In January 2011 Russia introduced tougher rules for foreign automakers planning new plants inside Russia. The new rules raised the local component requirement from 30% to 60%, set a \$500 million minimum investment, and raised the production threshold from 25,000 to 300,000 vehicles. Several foreign car makers signed off on these terms—which allow them to import auto parts at a preferential 5% tariff. In October 2011 WTO negotiators agreed to allow the new rules to stand, but they will end in 2018.<sup>3</sup>

Another complication was the fact that in 2009 Russia, Kazakhstan and Belarus formed a Customs Union (renamed the Eurasian Economic Space from January 2012), and stated their intention to join the WTO as a group. This step threatened to further delay Russia's entry to the WTO, since there was no precedent for three countries joining as a bloc, and no other WTO member is in a customs union with non-WTO members. Once Russia joins the WTO, all WTO rules will become obligatory for the other Customs Union members.<sup>4</sup> On October 4, 2011, the State Duma passed an amendment to the Customs Union establishing that WTO rules would have priority over Customs Union regulations. The solution to this anomalous situation is for Belarus and Kazakhstan to join the WTO as soon as possible—but this process will take at least a couple of years. It is a particular challenge for Kazakhstan since that country had already negotiated some conditions with the WTO more liberal than those granted to Russia.

### The Terms of Entry

The terms of Russian entry were approved by the Working Group on November 10, 2011: the 31<sup>st</sup> meeting since

1 Thanks to Mike Nelson for comments.

2 John Miller, "EU presses Georgia to let Russia join WTO," *Wall Street Journal*, 26 October 2011. The next day the paper ran a correction retracting this specific claim.

3 Egor Popov, "Avtokomponenty razlozhili po kvotam," *Kommer-sant*, 14 November 2012; First Deputy Prime Minister Igor Shuvalov, *PRIME-TASS*, 20 January, 2012.

4 Tat'yana Edovina, "Kazakhstan podkinet Rossii svobody," *Kom-mersant*, 1 February 2012.

it first convened in 1995.<sup>5</sup> The most significant aspect of the agreement is that it serves to limit the policy discretion of the Russian government.<sup>6</sup> The document lays down in some detail how the WTO understands certain Russian rules to operate, and the Russian government pledges to bring all the specified rules in line with WTO practice in the future.<sup>7</sup> It's an old Russian business maxim that serious negotiations begin *after* the contract has been signed. But in the case of the WTO such practices will not work: the whole purpose of the organization is to set the rules of the game and limit the scope for deviation from them.

Apart from harmonizing trade rules, WTO entry also requires the lowering of direct and indirect trade barriers. Some of the most heated negotiations involved the reduction of import tariffs—which will benefit Russian consumers, but will expose Russian producers to foreign competition. In Russia's case, the aggregate tariff level was already quite low, some 10%, a result of the trade liberalization of the early 1990s. Under the new rules Russia's legally binding ceiling on import tariffs will be lowered to an average of 7.8%.

Most of the arguments revolved around protection for specific sectors. The tariff limit for agriculture products will be 10.8%, down from the previous 13.2%, while that for manufactured goods will be 7.3%, down from 9.5%. Dairy products will fall from 19.8% to 14.9%, alcohol from 20% to 12.5%, automobiles from 15.5% to 12%, and medicines from 15% to 5%. IT products will go from 5.4% to zero. One third of these lower tariffs will be implemented on the day of accession, with others phased in over several years—the longest transitions being seven years for cars and aircraft and eight years for pork. Quotas will be preserved for beef, pork and poultry, with higher tariffs for above-quota deliveries (55, 65 and 80% respectively, compared to in-quota tariffs of 15, 0 and 25%).

As for services, the 49% limit on foreign equity in telecom firms will be eliminated four years after accession. Russia will allow 100% foreign ownership of retail and wholesale businesses—and foreign universities will be allowed to set up branches. Presently foreign banks

can open subsidiaries, but not branches, and this will remain unchanged. In the future foreigners will be allowed to take ownership in Russian banks subject to an overall limit of 50% of all the capital in the Russian banking system (up from the current 15%). Russia does not have any immediate plans to join the WTO Government Procurement Agreement, which opens public procurement to foreign competition.<sup>8</sup> The maximum customs clearance fees will fall from \$3,000 to \$1,000. Last year Russia collected \$1 billion in such fees.<sup>9</sup>

Russia has already rewritten part IV of its Civil Code to address intellectual property issues. By July 2013 a new court will be created exclusively for IP issues with 30 specially recruited judges. Piracy remains a serious problem in Russia, but presumably the leading US IT and entertainment corporations concluded that henceforth it would be easier to tackle the problem with Russia inside the WTO. A new law passed in October 2010 obliges Russian producers of generic drugs to negotiate agreement with the patent holders with regard to use of clinical trial data.<sup>10</sup>

Russia agreed to eliminate all export-distorting industrial subsidies, and imported goods will be charged the same rail freight rates as domestic goods—an important concession, given the monopolistic position of Russian Railways and the distances involved in reaching Russian markets. Russia is allowed to continue subsidizing natural gas utility prices to households, but not to commercial customers. (Still, good luck to Russia's competitors who might seek to challenge Gazprom's hall-of-mirrors pricing system.) Russia will also have to lower tariffs on exports of Russian products, such as semi-processed metals. This will benefit the metals industry, but push up prices for Russian domestic manufacturers who buy those goods (such as auto producers).

One of the most important advantages for Russia from WTO entry is that existing members will no longer be able to impose unilateral restrictions on Russian exports. Russian exporters of chemicals and metals are currently subject to more than 100 anti-dumping quotas and tariffs. In the future such measures can be challenged through the WTO Dispute Settlement Mechanism.<sup>11</sup> EU anti-dumping law currently uses European gas prices for calculating product costs. That will change once Russia joins the WTO: the EU will have to accept

5 Ambassador Stefán Jóhannesson (Iceland) headed the 58 member Working Group. "Working Party seals the deal on Russia's membership," [http://www.wto.org/english/news\\_e/news11\\_e/acc\\_rus\\_10nov11\\_e.htm](http://www.wto.org/english/news_e/news11_e/acc_rus_10nov11_e.htm); "Dostatochno sil'ny dlya VTO," *Ekspert*, 21 November 2011. <http://expert.ru/expert/2011/46/dostatochno-silnyi-dlya-vto/>

6 The newspaper *Kommersant* obtained a copy of the unpublished protocol that was signed on December 16, a complex document with 1,452 clauses. Dmitrii Butrin, "Obyazatel'stva dlitel'nogo sroka khraneniya," *Kommersant*, 20 December 2012.

7 Dmitry Butrin, "Obyazatel'stva dlitel'nogo sroka khraneniya," *Kommersant*, 20 December 2011.

8 39 WTO members have joined this protocol. Tat'yana Edovina, "Goszakupkam otkroyut granitsy," *Kommersant-Gazeta*, 25 January 2012.

9 *RIA Novosti*, 9 February 2012.

10 Aygul Zhumanova, "Impact of WTO accession on IP regulation," *Moscow Times*, 20 December 2011.

11 Ali Aliev, "Ostorozhno, rynek otkryvaetsya," *Ekspert*, 17 November 2011. <http://expert.ru/2011/11/15/ostorozhno-rynok-otkryvaetsya/>

Russia's domestic prices, which are one third those of the EU.<sup>12</sup>

Agriculture is perhaps the most sensitive sector. Although Russia is a leading exporter of grains, its livestock farmers are vulnerable to cheaper imports of meat and dairy products. As part of WTO accession Russia agreed to cut the maximum allowed agricultural support from \$9 billion in 2012 to \$4.4 billion in 2018. These limits do not really constrain Russia's scope for subsidizing farmers, since actual subsidy spending in 2011 was only \$5.6 billion.<sup>13</sup> Moreover these limits only apply to direct subsidies (the "amber box" in WTO terminology) and not to general spending on roads, housing, irrigation, education etc. (the "green box"), nor to spending in depressed regions. Other sectors that are vulnerable include medicines and textiles—which already have 70% and 82% import penetration respectively.<sup>14</sup>

## Reactions

The announcement of Russia's WTO entry received a muted reaction in the Russian press, in contrast to previous years, when discussions of WTO would trigger vigorous protests from Communist, nationalists and economic interests threatened by trade liberalization.<sup>15</sup> Presumably such groups were more engaged with the political protests following the December elections, or were simply worn down by 18 years of debates over WTO entry. The leading figure in the opposition is Konstantin Babkin, head of the Rostselmash farm machinery company. In 2010 he founded the Action Party, drawing on former members of the Agrarian Party, which had merged into United Russia in 2008.<sup>16</sup> The Communist Party and Just Russia still oppose WTO entry, but United Russia has enough votes to push the measure through the Duma.

Aleksei Portanskii, the head of the Information Bureau for Russia's entry to the WTO, noted that there are some public fears that WTO entry might cause a spike in inflation.<sup>17</sup> But he argues that on the contrary consumers should benefit from falling prices for some goods, such as medicines and cars. Chief WTO negoti-

ator Maksim Medvedkov said that the negative impacts "will be within the range of statistical error."<sup>18</sup>

Farmers are lobbying for 400 billion rubles (\$13 bn) compensation—with support from the Russian Union of Industrialists and Entrepreneurs (RSPP) and the State Duma agriculture committee.<sup>19</sup> In 2011 the sector received 125 billion rubles (\$4 bn) in subsidies, and according to the RSPP's Aleksandr Shokin this turned the rate of return from negative 5.4% to positive 8.3%.<sup>20</sup> Shokhin called for cancellation of some of the farm sector's debts (which total 1.6 trillion rubles or \$50 bn) and an extension of the zero tax rate on farm profits, currently set to expire in 2013. Some of these steps might have to be taken *before* ratification of WTO entry, so we can expect to see a flurry of activity in the next few months. But the agrarian lobby is divided. The president of the Russian Grain Union Arkady Zlochevskii disagreed with the RSPP stance, saying that debt cancellation would merely reward inefficient farms, though the head of the National Union of Pork Producers head Yurii Kovalev supported the proposal. MGU economist Sergey Kiselev notes that currently only half of Russian farm subsidies are in the "green box," while in the EU that proportion is 80%—which leaves the Russian state a lot of room to expand indirect subsidies.<sup>21</sup>

Liberal economists see WTO entry as giving a new impetus to faltering efforts to modernize and diversify the Russian economy. Economic Development Minister Elvira Nabiullina said that accession was "not a finishing line but a starting point" for Russia.<sup>22</sup> Evgenii Yasin told a meeting at the Higher Economics School that it opens the door to "real modernization" and may help the economy escape from its oil dependency.<sup>23</sup> At the same gathering former finance minister Aleksei Kudrin said it will generate an extra 3–4% growth over ten years. Severstal director Aleksei Mordashev, who headed the RSPP working group for WTO entry, argued that the very process of preparing for WTO has been beneficial for the Russian economy, from devising strategies to improve the competitiveness of lagging sectors, to rewriting the Customs Code.

On February 10 Putin instructed Economics Minister Nabiullina to organize workshops to help companies prepare for WTO entry. According to a December

12 Maxim Medvedkov, the head of Russia's delegation in the WTO negotiations, speaking at the US Chamber of Commerce. *RAPSI*, 24 January, 2012.

13 Yelena Skrynnik, Minister of Agriculture, report to the State Duma, 8 February 2012. <http://www.mcx.ru/news/news/show/5270.78.htm>

14 Ekaterina Petukhova, "Pyat' mifov," *Forbes.ru*, 14 February 2012.

15 The "Stop WTO" opponents have a website: <http://stop-wto.ru/>

16 See his interview with Mikhail Delyagin, "Put' k gosudarstvennomu perevorotu lezhit cherez VTO?," 14 February 2012, <http://forum-msk.org/material/politic/8330509.html>

17 Alexei Portanskii, "Rossiya plavaet v basseine bez vody," *Argumenty & Fakty*, 15 February, 2012.

18 Ekaterina Shokhina, "VTO stoit dorogo," *Ekspert*, 17 November 2011. <http://expert.ru/2011/11/17/vto-stoit-dorogo/>

19 "Ne zabud'te truzhenikov sela," *Ekspert*, 20 February 2012. <http://expert.ru/2012/02/20/ne-zabudte-truzhenikov-sela/>

20 Evgeniya Pis'mennaya, "Agrarniki ekspluatiruyt strakh pered VTO," *Vedomosti*, 17 February 2012.

21 *RIA Novosti*, 7 February 2012.

22 [http://www.wto.org/english/news\\_e/news11\\_e/acc\\_rus\\_16dec11\\_e.htm](http://www.wto.org/english/news_e/news11_e/acc_rus_16dec11_e.htm)

23 Oleg Nikiforov, "Doping dlya Rossii," *Nezavisimaya gazeta*, 14 February, 2012.

2011 survey of businessmen, 52% thought WTO entry would have a positive impact for Russia, and 32% a negative impact. As for the impact on their own business, 48% saw it as positive and 46% as negative. Still, only 6% had a plan worked out for their own company.<sup>24</sup>

The economic gains from WTO are likely to be quite modest. Economist Sergei Aleksashenko concluded that “Russia’s accession to the WTO will not have any substantial impact on its economic landscape.”<sup>25</sup> This is because Russia had already liberalized many features of its international trade in the early 1990s. Also, oil and gas are the main drivers of Russian growth, and these commodities are not affected by WTO entry. Most current estimates of the impact on Russia’s annual GDP growth range from 1 to 3%. In one widely cited study, David Tarr and Natalya Volchkova estimated that entry would boost Russia’s GDP by 3.3 per cent a year, and possibly as much as 11 per cent.<sup>26</sup> But the bulk of these gains would come from the putative effects of more competition rather than increased exports, and the prognoses are therefore highly speculative. The unique features of the Russian economy—its size, its dependence on oil and gas, and the prominent role of the state—make it hard to extrapolate from the experience of other economies after they joined the WTO.

On the diplomatic front, WTO entry is an important signal of Russia’s acceptance by the international community. It is also a sign of *Russia’s* acceptance of the international rules of the game, and a desire to play a role in shaping those rules. Now all five BRICS countries are in the WTO, and it will be interesting to see whether Russia’s entry changes the dynamics of the WTO itself. The ongoing Doha Round of talks has been

deadlocked since 2008 over the question of agricultural trade. In February 2012 Putin welcomed WTO entry as an important step forward, of more than merely symbolic importance. He noted that “Russia is still learning how to systematically and consistently promote its economic interests in the world.”<sup>27</sup> Putin also acknowledged that “the Obama administration and the leaders of some major European states made a significant contribution to achieving the final accords.”

Securing Russian entry to the WTO has been a priority for successive US presidents, and Barack Obama was presumably hoping that this signal achievement would clear the air and refresh the stalled “reset” in US–Russia relations. Alas, this was not to be. In politics, timing is everything. WTO approval came in the midst of unprecedented popular protests in the wake of the rigged December 4 State Duma elections—protests which Vladimir Putin promptly attributed to US meddling. Relations deteriorated further with Russia’s veto of the UN resolution on Syria on February 4. As with the economic benefits of WTO entry, the political benefits will only come in the long term.

A further item of unfinished business is Section 401, Article 4 of the 1974 Trade Act, better known as the Jackson Vanik amendment. Under this act the US cannot grant Permanent Normal Trade Relations to any country that restricts emigration, and the president is required to report to Congress every year on Russia’s compliance with the legislation. Russian Foreign Minister Sergei Lavrov has threatened to suspend application of WTO rules for the US until the Jackson-Vanik amendment is repealed.<sup>28</sup>

#### *About the Author*

Peter Rutland is professor of government at Wesleyan University.

24 Aleksei Shapovalov, ‘Chinovniki raz’yasnyat pravila igry v VTO,’ *Kommersant*, 14 February 2012.

25 Sergei Aleksashenko, “Russia in the WTO,” Carnegie Endowment, 7 December 2011. <http://carnegieendowment.org/2011/12/07/russia-in-wto/8knk>

26 David Tarr and Natalya Volchkova, “Russian trade and foreign direct investment policy at the crossroads,” Policy Research Working Paper Series 5255, The World Bank, 2010. <http://ideas.repec.org/p/wbk/wbrwps/5255.html>

27 Vladimir Putin, “Russia and the changing world,” *Moskovskie novosti*, 27 February 2012. <http://premier.gov.ru/eng/events/news/18252/>

28 Interfax, 18 January 2012.