

Analysis

Russia and the WTO: One Step Forward, One Step Back

By Peter Rutland, Montreal

Abstract

Most likely Russia's entry into the World Trade Organization will be delayed for a year or more. Russia faces a variety of obstacles from Georgia, Poland, and the broader anti-Russian sentiment in Europe. Optimists point out that Russia has one of the world's biggest economies and that it does not make sense for it to remain outside the trading organization. Pessimists note, however, that election year politics may make any immediate action unlikely.

Close to an Agreement

In November 2006 it looked like Russia's 13-year quest to enter the World Trade Organization had cleared its final hurdle. On the sidelines of an international summit in Hanoi, President George W. Bush signed a bilateral agreement with President Vladimir Putin signifying US approval of Russia's entry to the WTO. Russia has now signed bilateral agreements with 58 trading partners and only a handful of countries are still waiting to sign agreements. Among them are Vietnam, Cambodia, and Saudi Arabia.

The US agreement came as something of a surprise, since the failure to strike a deal at the July 2006 G8 summit in St. Petersburg had led many to conclude that Russia had no real intention of joining the WTO. In the end, it turned out to be a case of diplomatic brinkmanship, with each side holding out for the best possible deal. Moscow accepted a compromise over the question of Russian inspection of American pork and poultry exporters, and the US accepted the Russian government's package of legal and administrative measures to tighten sanctions on CD and DVD piracy.

Entry by 2007 Unlikely

Since then, however, the optimism that a new era of pragmatism had entered Russia's relations with its Western partners has slowly unraveled. It is now looking increasingly unlikely that Russia will complete the process for WTO entry by the end of 2007. Russia has been unable to schedule any formal accession talks at the WTO's Geneva headquarters in over a year. The loss of momentum in negotiations has redoubled the voices of skeptics both inside Russia and in the West who question whether Moscow really intends to join the WTO club at all.

The immediate challenge to Russia's entry bid came from three directions. First, Georgia, which had signed off on a bilateral deal approving Russia's

WTO entry in 2004, withdrew its agreement in July 2006, in the wake of Russia's March ban on the import of Georgia's wines. Moscow introduced the ban after claiming that Georgian exports included falsely-labeled wines that were not in fact from vintage vineyards. An additional complication was Russia's October 2006 decision to suspend direct flights between the two countries, citing an unpaid airline debt. Georgia subsequently added a demand that Russia assist Tbilisi in placing Georgian customs controllers on the border with Russia in South Ossetia and Abkhazia, regions over which Georgia had lost control 15 years previously. Russian-Georgian negotiations on May 31, 2007, ended without result, with Moscow insisting that the customs issue is unrelated to WTO entry.

Second, Poland retaliated against Russia's year-old ban on Polish meat imports by vetoing the European Union's plans to sign a new Partnership and Cooperation Agreement (PCA) with Russia to replace the 1994 PCA that is due to expire in 2007. The European Union (EU) had signed off on Russian WTO entry in 2004, in what was seen as a quid pro quo for Russian acceptance of the Kyoto accord on global warming. The EU-Russia summit that took place in Samara on May 17-18 was a deep disappointment, resulting in no progress on virtually any front. In the wake of that meeting, Economics and Trade Minister German Gref told a meeting of the European Bank for Reconstruction and Development in Kazan that Moscow would not renegotiate the PCA with the EU until Russia secures entry to the WTO.

Third, Russia's WTO bid came to be used as a political football in a broader current of anti-Russian sentiment, particularly in Europe. EU Trade Commissioner Peter Mandelson said on April 20 at an energy forum in Bologna that that mistrust between the EU and Russia has reached "a level not seen since the Cold War." The lead issues were the dispute with Estonia over the moving of a Soviet war memorial in

April 2007, and European fears over energy security revived by the interruption of oil and gas supplies to Belarus and Ukraine respectively in January 2006 and January 2007. The meeting of a new Gas Exporter Countries Forum in Qatar at beginning of April also produced a degree of anxiety in energy-importing countries. Although Russian actions in battling the Chechen insurgency, a major focus of criticism for Moscow in the past, have quieted down in the past few years, other issues came along to cast a shadow over Russia's image as a self-proclaimed member of the democratic community. Western observers criticized the sinister assassination of Aleksandr Litvinenko in 2006 and the forcible dispersal of opposition protesters in several Russian cities in 2007.

Although most of the foot-dragging on WTO is now coming from Europe, the US position has also been somewhat equivocal. US Trade Representative Susan Schwab stated at trade negotiations in Washington on April 9 that the US Congress is not ready to repeal the Jackson-Vanik amendment and that the WTO was "not yet" ready to accept Russia. But, the previous week at talks in Moscow, Commerce Secretary Carlos Gutierrez told his hosts that Washington hopes to see Russia join the WTO by the end of this year.

Reasons for Optimism

Optimists will argue that these are but temporary glitches in what is now an unstoppable trend towards Russian membership in the WTO. There are several grounds for the argument that Russia will enter the WTO at some point in the not-too-distant future.

First, there is the simple fact that Russia is the world's tenth largest economy and seventeenth largest trading nation. It is simply anomalous that it has remained outside the ranks of WTO members, which now number 149 countries, for so long. The fact that Russia is still outside the WTO makes it more difficult for countries such as Ukraine and Kazakhstan to join, given that Russia is their leading trading partner. It is also another factor holding up the conclusion of agreements to tighten Russian economic integration with its Commonwealth of Independent State (CIS) partners, something which is a priority for Moscow. This issue came up at the CIS summit in Yalta on May 24.

Second, doubters who point to the evidence of weakness of rule of law and non-market barriers to foreign entry in Russia should acknowledge that existing WTO members face similar problems. Russia's tariff barriers, which currently average 11.7 percent, are modest by international standards. Even so, Russia plans to cut the average weighted customs tariff rate to 9.9 percent by 2010. As part of the deal with the US,

over the next seven years, Russia will reduce import tariffs on foreign-made aircraft from 20 percent to 7.5 percent, which will increase the competitive pressures on Russia aircraft manufacturers. The country's limits on foreign banks and insurers are similar to those of China – which joined the WTO in 2001. Foreign firms currently account for an estimated 18 percent of Russia's banking and 5 percent of Russia's insurance market. Both are subject to a 25 percent ceiling, though the foreign bank ceiling will rise to 50 percent after WTO entry, with Russia reserving the right to intervene in individual cases. Take for example the question of CD and DVD piracy, which cost Hollywood an estimated \$1.7 billion in lost sales in Russia in 2005. Indeed it is a problem, but Russia is only third in the world league table of DVD pirates – after China and Mexico, who are both already WTO members.

Third, compromise had been reached on most of the laundry list of items that had concerned the US in the summer of 2006. Russia has indeed been slow to implement some of the changes that it promised – for example, it has not yet waived the overflight fees for aircraft transiting from Europe to Asia, which generate \$300 million a year. The EU also wants Russia to stop charging higher railway fees for foreign train freight than for domestic loads. On the other hand, at the International Economic Forum in St. Petersburg in June, Aeroflot agreed to buy 22 Boeing 787 Dreamliners, a deal which had been allowed to lapse in October 2006 – just before the US agreed to accept a compromise deal on Russian WTO entry. Also at the St. Petersburg Economic Forum, the Russian Union of Industrialists and Entrepreneurs, Troika Dialog Investment, and the American Chamber of Commerce announced the formation of a Russian-American private sector working group to support Russian entry to the WTO.

Fourth, there is substantial evidence that Russia has made WTO entry a centerpiece of its economic development strategy. Russia's official goals in joining the WTO are: non-discriminatory treatment for Russian exporters; access to WTO dispute settlement procedures; a better climate for incoming foreign investment and opportunities for outgoing Russian investment; to improve domestic competitiveness; to be a full participant in international trade negotiations; and to improve Russia's image.

Reasons for Pessimism

The pessimists also have some good arguments, however. First, Russian WTO entry is a focal point for political mobilization. Critics of Russia can use it to send

a signal to Putin about their unhappiness about some of his policies – as is the case with Georgia and Poland. But Russian nationalists can also use WTO to send a message to Western critics. As both Russia and the US will be electing new presidents in 2008, there is a high probability that no substantial progress in WTO entry will be attempted next year, to avoid providing additional scope for such political opportunism.

Second, there is the argument that Russia actually stands to make only modest gains from WTO entry. The fact that the Russian economy is so heavily dependent on oil and gas exports means that one cannot really extrapolate from the efficiency effects and investment boom that have accompanied WTO entry in other economies. International organizations such as the World Bank claim that Russia will see a 3 percent boost in GDP from WTO entry, but it is not at all clear that these studies take into account the specificities of Russia's resource-dependent economy.

Third, WTO entry is clearly a bone of contention between the liberal and security (*siloviki*) wings of the presidential administration. A new draft law on regulating foreign investment was approved at a government meeting on January 31, 2007. Any foreign company will need permission to exceed a 50 percent stake in a firm on a list of restricted sectors, and any firm controlled by a foreign government or international organization would require approval for a 25 percent stake. Deputy Industry and Energy Minister Ivan Materov told a meeting of the Consultative Council on Foreign Investment that "The Federal Security Service is insisting on including some lines of business in this list while the (Economic Development

and Trade Ministry) does not wish to see them there because this would run against the rules of the WTO." The restricted list includes alloys, aerospace, arms and mineral resources.

Federation Council Speaker Sergei Mironov warned "If anyone believes that joining the WTO is the greatest ambition of everyone in Russia, they are deeply mistaken." Alexander Shokhin, president of the Russian Union of Industrialists and Entrepreneurs, told a conference of foreign investors that "It's time to stop seeking WTO membership, we should wait for them to ask us to join," noting that "the balance of advantages and disadvantages of joining this organization is not obvious for Russia." Even Putin himself seems to have become more skeptical about the benefits of WTO entry. For example, on June 12 he said: "Old methods of decision making often don't work. That is well seen both with the WTO and with the Doha Round, which goes, to say the least, with big difficulties."

Russia's WTO entry seems trapped between two bureaucratic machines that are both fractious and sluggish, and that find it very difficult to come up with definitive policies: the European Union on one side and the Russia government on the other. The Kremlin elite is anxiously preparing for the ultimate test of a presidential power succession, while the 27-headed hydra of Brussels is absorbed with struggle to draft a new union treaty. It looks increasingly likely that the complex bargaining around Russia's accession to the WTO club will fall between the cracks, and will be delayed for a year or more.

About the author:

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Recommended Reading:

Stephen E. Hanson, Philip Hanson, Juliet Johnson, Stephen K. Wegren, and Peter Rutland, *Russia and the WTO: A Progress Report*, National Bureau of Asian Research Special Report, no. 12, March 2007, <http://www.nbr.org/publications/specialreport/pdf/SR12.pdf>