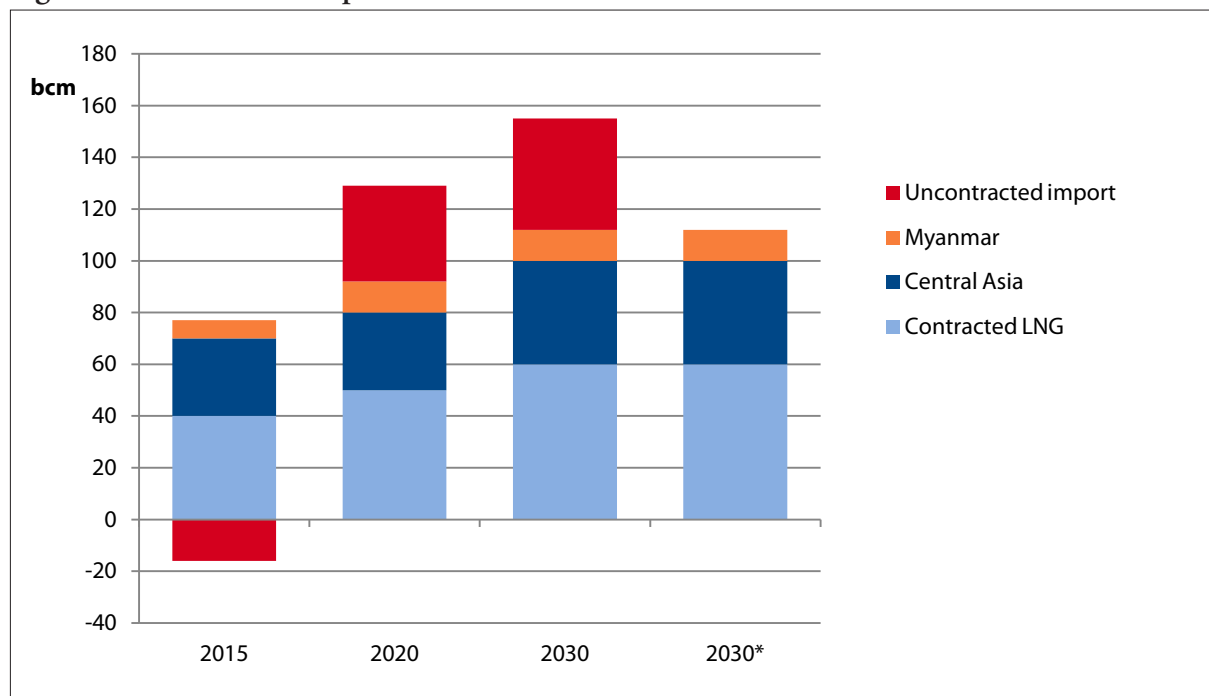


Figure 4: Chinese Gas Import Structure



\* shale gas scenario

Source: author's estimates

## ANALYSIS

### WTO Accession: Implications for Russia

By Viacheslav Evseev and Ross Wilson, Washington and Moscow

#### Abstract

Accession to the World Trade Organization will have a variety of positive and negative impacts on the Russian economy. This article provides a guide of what to expect.

#### Introduction

The eighth World Trade Organization (WTO) Ministerial conference held Dec. 15–17, 2011 in Geneva approved Russia's accession after 18 years of difficult negotiations. The decision was historic—Russia had been the largest economy in the world outside the WTO system after China's accession in September 2001.

Russian and Western policymakers, trade professionals, companies and experts now are evaluating Russia's WTO accession and what will come next. Discussions in Russia are focused on the following issues:

- How successfully have Russia and the world trade community negotiated the terms of accession?

- Has Moscow managed to successfully defend the domestic market? Or, will Russia become wide open for foreign companies?
- How will it be possible to protect the domestic market against unfair trade practices in the new legal environment?

Western commentary has looked at other issues:

- How will Russia comply with its commitments?
- What role will Moscow play in global trade talks, including the Doha Development Round?
- How will accession impact market liberalization and the reinforcement of market economic values and thinking?

- How will WTO membership enhance the rule of law and good, stable and predictable governance?

This article analyzes the implications of Russia's economic and social development in the wake of its accession to the WTO, outlines three possible post-WTO scenarios for economic development and presents recommendations for the Russian government and its key trading partners.

## Impact Of WTO Accession on Russia's Economic and Social Development

### *Russia's Foreign Trade Regime: from Protectionism to Liberalism*

After the fall of the Soviet Union, Russia took steps to liberalize and integrate its economy into the world system. Starting from the Decree of the President of the Russian Federation—"On liberalization of foreign trade activities in the RSFSR", issued Nov. 15, 1991—that cancelled the state monopoly on foreign trade, the authorities implemented steps to conform the country's trade regime to international standards. Russia has significantly decreased tariff barriers and quantitative restrictions on imports and exports, progressively reduced licensing requirements, cancelled the system of specially authorized exporters (*spetzexporter*), modernized currency regulation and implemented many other steps. As a result, the number of independent companies involved in foreign trade has dramatically grown since 1991, and the share of foreign trade as a percentage of Russia's GDP was 43.8% in 2010.<sup>1</sup>

But the country's economy remained well-protected. In 2010, Russia still extensively used trade-restrictive measures.<sup>2</sup> According to the European Commission's "Seventh Report on Potentially Trade Restrictive Measures" (issued in October 2010), Russia had implemented 73 potentially trade-restrictive measures during that year—more than any other country the EC assessed.

This practice is about to change. By acceding to the WTO and agreeing to comply with its multilateral rules that prohibit the arbitrary use of protective, discriminatory, and other trade distorting measures, Moscow has signaled that it intends to move away from protectionism toward a more liberal model in foreign trade. It has accepted the critical free-trade values that lie at the foundation of the GATT/WTO system. These include open-

ness, transparency, freedom of competition and consistency of economic policy. WTO accession will reduce significantly Russian authorities' ability to act as they have before. The extensive set of binding commitments they have undertaken reflect—and/or will require—a dramatically different approach to trade policymaking and economic policy decision-making.

### *Russian Economy: New Challenges to and Opportunities for Growth and Diversification*

Western policymakers by and large accept that Russia's accession to the WTO likely will have an important and positive impact on the country's economic development and its integration into international trade. Ordinary Russians, however, do not have a clear position with respect to WTO membership. According to a November 2011 Levada Center survey, 38% believe WTO membership is in the country's interests, while 28% have an opposite opinion, and 24% are undecided.<sup>3</sup>

Nevertheless, a World Bank report estimates Russia's GDP should grow by about 3.3% per year (or about \$49 billion per year, based on 2010 GDP at market exchange rates) over the 10 years following WTO accession. Over the long term, when the positive impact on the investment climate is incorporated, the gains should increase to about 11% per year (or about \$162 billion per year at 2010 market exchange rates).<sup>4</sup>

Analyses by international organizations, government authorities, trade associations and experts, and business community representatives point to several possible implications of WTO accession for the Russian economy.

## Positive Gains

### *FDI Increases in the Services Sectors*

Russia attracted a fairly low level of foreign direct investments (FDI) in the post-Soviet period. At the end of 2010, accumulated FDI amounted to only around \$300 billion.<sup>5</sup> In comparison, FDI in 2010 alone reached \$236.2 billion in the United States and \$185.1 billion in China.<sup>6</sup>

According to World Bank estimates, rising FDI in

1 Federal State Statistics Service of the Russian Federation. Available from: [http://www.gks.ru/bgd/regl/b11\\_11/IssWWW.exe/Stg/d2/26-02.htm](http://www.gks.ru/bgd/regl/b11_11/IssWWW.exe/Stg/d2/26-02.htm) (accessed on March 28, 2012).

2 Trade-restrictive measures are measures undertaken by governments that have negative effects on international trade, i.e. import or export duty increases, licensing, local content requirements, import prohibitions, etc.

3 Levada Center, "Country in the system of international relations", Jan. 12, 2011, Moscow. Available from: <http://www.levada.ru/01-12-2011/strana-v-sisteme-mezhdunarodnykh-otnoshenii> (accessed on March 15, 2012).

4 World Bank, "Moderating Risks, Bolstering Growth: Russian Economic Report 27", p.37. Available from: <http://www.worldbank.org/content/dam/Worldbank/document/rer-27-march2012-eng.pdf> (Accessed on March 27, 2012).

5 Federal State Statistics Service of the Russian Federation. Available from: [www.gks.ru](http://www.gks.ru) (accessed on March 15, 2012).

6 Greyhill Advisors, FDI by country. Available from: <http://greyhill.com/fdi-by-country/> (accessed on March 26, 2012).

the service sectors may become the most significant outcome of Russia's WTO accession. This is primarily due to Moscow's commitments to open services to foreign investment, i.e., banking and insurance, telecommunications and transportation.<sup>7</sup> WTO membership sends a strong signal to foreign investors that the country complies with international rules and standards. An increase in the transparency and consistency of policymaking also will be critical factors in attracting foreign investors.

#### *Technological modernization and increased productivity*

The Russian economy is in dire need of more productive technology. The reduction of tariffs and improvements in intellectual property rights protection likely will lead to an increase in the importing of new equipment, which will help to modernize Russian industry. This assertion is supported by the Center for Customs Tariff and Non-Tariff Regulation. The Center conducted a survey in 2011 among leading Russian industrial companies and found that 19% of the respondents pointed to the reduction of customs duties on new technology as the most significant advantage of WTO membership.

#### *Small- and Medium-Size Business Development*

Unlike big companies in the industrial sectors, many small- and medium-size enterprises (SMEs) are expected to gain from Russia's entry into the WTO. Historically, Russian SMEs are concentrated in the areas of retail, logistics and transportation, IT, tourism, accounting and consulting services. These sectors most likely will grow as a result of increased trade and investment flow to Russia after accession. They also will have better access to new information, other technologies and better quality equipment. This assertion is supported by a survey conducted in 2003 among representatives of SMEs and relevant public authorities and trade experts: 41.3% predict the retail sector will benefit from Russia's WTO membership; 27.5% predicted gains in auditing and consulting services, 25% in telecommunications and 18.8% in transportation.<sup>8</sup> However, SMEs in the goods sector of the economy likely will experience difficulties due to the inflow of competing foreign products. According to the same survey, 63.6% expect negative repercussions for manufacturers of consumer goods; 53.4% expect losses in machine tool and equipment manufacturing, 50% in agriculture and 27.3% in banking.

7 David G. Tarr, "Russian WTO accession: Achievements, impacts, challenges," OECD, 2008. Available from: <http://www.oecd.org/dataoecd/28/4/40747249.pdf> (accessed on March 10, 2012).

8 Information and Consulting Center, Business-Thesaurus, Research, "Examination of small business' problems related to accession of the Russian Federation to the WTO", p.88, Moscow, 2003.

#### *Exporting Sectors Will Benefit from Improved Market Access*

The WTO system is comprised of multiple rules and agreements that are designed to protect companies in foreign markets, decrease discrimination and remove trade barriers. However, even prior to WTO accession, Russia obtained either bilateral most favored nation (MFN) treatment<sup>9</sup> or preferential status from almost all of its trading partners, including the European Union, China and most of the former Soviet states. For its part, Russia granted MFN status to 130 countries.<sup>10</sup>

Therefore, WTO accession will not improve access significantly for Russian goods and services in other markets. However, sectors that are subject to anti-dumping or other trade-restrictive measures, such as steel, chemical and fertilizer manufacturers, will benefit because the government will be able to use the WTO dispute settlement system to challenge unfair trade restrictions.

#### *Greater competition in Russia's domestic market*

Competition is a critical element of the open-market economy model, but remains low in Russia, despite policies implemented in the 2000s to promote it. The Global Competitiveness Index 2011–2012 ranks Russia 66<sup>th</sup> out of 142 countries.<sup>11</sup> GATT and GATS, as well as other WTO rules designed to promote fair trade, open markets and the removal of trade barriers, will enhance competition in many ways, primarily through the increase of foreign and joint-venture companies and the greater availability of foreign goods and services. The ability to challenge arbitrary policy decisions through the WTO dispute settlement system also will be extremely beneficial and will contribute to the improvement of Russia's overall economic situation.

#### *Promotion of Pro-Free Trade Government Policies*

In order to keep up with new challenges and operate in a transparent environment, Russian authorities will have to improve the way they govern. A highly competitive environment will require a competent and non-corrupt government bureaucracy. Increased pressure from the private sector, the necessity of increased international involvement and the required notification of WTO members regarding domestic trade policy will

9 Most-favoured-nation (MFN) treatment (GATT Article I, GATS Article II and TRIPS Article 4), the principle of not discriminating between one's trading partners (source [www.wto.org](http://www.wto.org)).

10 The Ministry of Economic Development of the Russian Federation, VED regulation website. Available from: <http://www.ved.gov.ru> (accessed on March 26, 2012).

11 World Economic Forum, "The Global Competitiveness Index 2011–2012 rankings", 2011. Available from: [www.weforum.org/gcr](http://www.weforum.org/gcr) (accessed on April 6, 2012).

constitute powerful incentives for the government to undertake reforms and increase its efficiency.

By engaging high-level policymakers in international trade-related talks, WTO membership will promote free-trade values among the leadership and necessitate further liberal reforms. Senior policymakers traditionally have held the interests of Russia's overall economy in mind, while lower-level officials from sector ministries may allow interest groups to strongly influence their decision making. Moscow's experience during the WTO negotiations proved that political leadership and intervention is critical to the effective implementation of reforms in slow-moving sector ministries.

### Negative or Ambivalent Effects

#### *Tariff Reduction Will Not Become a Major Source Of Gains from WTO Membership*

Russia committed to set its final legally binding tariff ceiling at, on average, 7.8%, compared with a 2011 average of 10%.<sup>12</sup> This reduction is not large, since Russia progressively has been liberalizing its tariffs since the 1990s. Therefore, market-access commitments on tariffs will not be a major source of gains for the Russian economy, although it will be important in certain areas. For example, final tariffs will be bound at zero for cotton and information technology products that currently face an applied rate of 5.4%. The average tariff for wood and paper will decrease to 8% from the current rate of 13.4%.

#### *Certain Traditional High Value-Added Sectors of the Russian Economy May Be Threatened*<sup>13</sup>

The reduction of tariff barriers also may have an immediate, negative impact on certain traditional high value-added sectors of the Russian economy. Affected areas may include: a) agricultural machinery (the duty on combine harvester-threshers, which was issued three or more years ago, will decrease from 15% to 5% at the time of accession; b) truck manufacturing (the duty on motor vehicles used for transport that exceed a gross weight

of five tons will decrease from 25 to 15% by 2017); and c) airline manufacturers (the duty on wide body commercial airplanes that seat fewer than 50 passengers will decline from 20% to 7.5% by 2016).

It is not surprising that 24% of Russia's industrial companies believe accession to the WTO will lead to a decrease in domestic producers' share of the internal market.<sup>14</sup> Trade experts in each sector and the authorities believe that areas under the greatest threat include the automotive sector, aviation, agricultural machinery, agriculture and wood processing.

### For Russian Citizens: an Increase in Living Standards or Unemployment?

WTO membership also will have an impact on ordinary citizens, including:

#### *Increased Household Income*

According to the World Bank, WTO membership will generate gains in income for 99.9% of households in Russia between 2–25%.<sup>15</sup> Poor households likely will gain slightly more than the wealthy. Skilled labor and urban households should gain relatively more than average due to the increase in foreign direct investment in the skill-intensive business service sector.

#### *Increased Availability of High-Quality Goods and Services at Lower Prices*

High tariffs mean high prices. WTO accession and the consequent lowering of tariff and non-tariff barriers for foreign products likely are to result in a slight decrease or at least a slowdown of annual price increases on imported goods and services. This will enhance the availability of foreign goods and services to many Russian citizens in the medium and long term.

In the short term, it is likely that foreign producers, dealers and retail chains will benefit more than households.

#### *Risk of Potential Unemployment*

As mentioned previously, certain sectors in the Russian economy will be at a greater risk of decreased production or even collapse after Russia joins the WTO. Despite significant gains for households during the transitional period following the accession, many workers may lose their jobs in firms that fail to compete in the new environment.

12 WTO, "Working Party seals the deal on Russia's membership negotiations", Geneva, Nov. 10, 2011. Available from: [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) (accessed on March 13, 2012).

13 High value-added sectors refers to industries where an initial product or material is transformed from its initial state into another. For example, aviation, high tech, IT and so on, are high value-added sectors, as opposed to industries that only produce raw materials, which are considered low value-added sectors. By transforming the initial raw materials into goods, such as cars, airplanes, etc., the producers transform raw materials into products that serve a greater function, thereby adding "value" to these goods.

14 Center for Customs Tariff and Non-tariff Regulation Research, Survey, "Instruments of protection in foreign trade in the framework of WTO accession", Moscow, 2011.

15 World Bank, "Moderating Risks, Bolstering Growth: Russian Economic Report 27", p.37. Available from: <http://www.worldbank.org/content/dam/Worldbank/document/rer-27-march2012-eng.pdf>. (accessed on March 27, 2012).

## Possible Outcomes Of WTO Membership in the Short To Medium Term: Three Scenarios

WTO accession is both a serious challenge and a unique opportunity for the Russian economy. According to World Bank reports and viewpoints expressed by experts in international trade, Russia likely will benefit from WTO membership in the medium and longer term, while some setbacks are likely in the short term—specifically industries that do not use raw materials. In addition, medium- and longer-term benefits from the WTO system won't come automatically. The private and public sectors will need to adapt and learn how to operate in an increasingly open, transparent and multilateral trade system.

There are three possible outcomes of WTO membership for the Russian economy in the short to medium term:

### *Increased Dependence on the Export of Raw Materials*

Widespread opinion in public and professional circles in Russia holds that WTO accession will have no positive impact on the economy and the existing economic model, which is based on the export of raw materials, will be reinforced. In this scenario, the weakening of tariff and non-tariff barriers and the increased penetration of foreign producers into Russia's domestic market will seriously damage the domestic design and production of high value-added products and eventually lower, or even wipe out, the growth potential in the automotive sector, ship building, aviation, space technology and several other areas.

As a result, Russia's role as a supplier of raw materials may become magnified further, as will its dependence on imported technology and high-quality products.

### *Enhanced Modernization and Hi-Tech Growth*

WTO membership and the consequent liberalization of market access for new technologies, know-how and spare parts will allow Russian companies to modernize at an accelerated rate. Accession will provide businesses with new opportunities to integrate into international production chains and establish new alliances. As a result, the technological sector will develop and eventually reshape the structure of the economy.

### *Encouraged Modernization Accompanied by Adjustment Difficulties*

For the short and medium term, WTO membership will result in the progressive development of the technological sectors of the Russian economy, together with the continuing domination of sectors that produce or use raw materials.

This scenario is the most likely. WTO membership will encourage technological modernization and innovation, but will not bring significant, immediate changes to the structure of the economy. Rather, WTO membership will create incentives for consistent and positive changes in the business environment and development of competition in the domestic market.

## Policy Recommendations for the Russian Government and Its Key Trading Partners

Russia's accession to the WTO should be considered as a next, major step toward integration into the multilateral trade system. The inclination toward protectionism is still strong, and this attitude will not disappear overnight. It may become stronger after accession once Russian companies realize their share of the domestic market is decreasing. Domestic producers who advocate for protectionist measures often have greater political influence than those who advocate for lower tariffs. In this challenging environment, the government, along with the country's major trading partners, will need to develop strategies to reduce the risk of potential non-compliance with Russia's WTO commitments and overcome any negative effects of WTO membership.

### *Recommendations for the Russian Government*

- Conduct an education campaign among Russian companies and trade associations to improve their understanding of the WTO system and its legal framework;
- Develop and implement a safety net and assist in the reintegration of workers who may lose their jobs due to structural change (i.e., retraining, migration policy and additional education);
- Provide assistance to those sectors of the economy that experience significant setbacks, in compliance with WTO regulations;
- Initiate safeguards and anti-dumping investigations in order to confront any unfair trade practices or serious injury, in compliance with WTO regulations;
- Develop a consultative mechanism that involves the private sector and interested civil society organizations in trade policymaking; and
- Promote the development of trade-related educational programs in universities.

### *Recommendations for Russia's Key Trading Partners*

- Encourage Russia to consistently shift from a protectionist to a liberal model in foreign trade by educating decision makers, business leaders and experts and by including Moscow in major trade-related talks;
- Assist Russian trade associations and government authorities at the federal and regional levels in build-

ing capacity to make effective use of the multilateral trading system; and  
Avoid, in the medium term, the prospective use of trade disputes against Russia to provide the country the time needed to adjust domestic policies to meet new WTO commitments.

### Conclusion

WTO accession is an important step in the Russia's economic development. It is a two-way street, reflecting rights and commitments on the part of both Russia and others. In order to achieve its economic goals and find an adequate place in an increasingly open global economy, it is clear that Russia needs to accede. Today's leading world economies need to be competitive in foreign markets, but they also need to open their domestic markets to foreign competition. Diversification, modernization and the growth of the economy will improve if the country's WTO accession is complemented by an improvement in the business climate in Russia.

Accession will create new opportunities and challenges. It is likely the economy will experience many positive changes such as the growth of FDI in the service sector, development of competition, expansion of SMEs, technological modernization and higher productivity. Increases in household income also are likely, as well as improved access to high-quality goods and services at lower prices for Russian citizens. Russia's estimated economic growth after joining the WTO is predicted to increase by about 3.3% per year. However, setbacks also are possible, including a negative impact on traditional high value-added sectors and the risk of unemployment.

Benefits from the WTO system won't come automatically. The Russian private and public sectors will need to adapt and learn how to operate in an increasingly open, transparent and multilateral trade system in order to experience the lasting, positive impact of WTO membership.

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