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RUSSIA'S WTO ACCESSION: CURRENT STATE OF NEGOTIATIONS, AND FORECASTS OF THE EFFECTS

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Russia applied to the WTO in 1993, although active negotiations and discussions started only about a couple of years ago after President Putin declared WTO accession as one of the goals of his presidency. On June 24-25, CEFIR organized the conference "Negotiating Russia's WTO accession: strategic lessons from multilateral trade liberalization and club enlargement". The conference addressed such topics as the potential accession conditions, the current state of negotiations, as well as potential effects of the accession for Russia. This paper summarizes some of the points raised during the conference.

Accession conditions. Since Russia's accession will take place after the Uruguay round, Russia will have to accept more obligations than countries that acceded earlier. The core requirements that all countries that accede to the WTO after the Uruguay round have to fulfill are as follows:¹ provision of complete information about direct state interventions in the economy, such as state enterprises, including state trading enterprises, and price control; full compliance with WTO requirements on import licensing, customs valuations, customs fees, rule of origin, technical barriers to trade, sanitary and phytosanitary measures; granting MFN regime to member countries; eliminating quotas prohibited by WTO and informing about others; eliminating export subsidies; notifying members concerning trade related investment measures and confirming to agreement on trade-related intellectual property rights. Traditional requirements, such as lowered tariffs on goods, measures aimed at improvements of market access for foreign firms in services, and lowered state support to agriculture, will apply as well. The exact nature of this type of obligations depends on the results of the negotiations.

Current state of negotiations. Russia submitted its first market-access offer in February 1998 and in the spring of 2002 the first draft of the Working Party Report was completed.² This means that Russia is entering the final phase of the accession process, in which it will negotiate its offer

¹ See Richard Self "WTO accession: an analysis of the expectations that WTO members have of Russia and Russia's capacity to meet them", published on CEFIR web-site www.cefir.ru

² See Robert Stern "An Economic Perspectives on Russia's accession to the WTO".

and implement the legislative reforms. However, this final stage may be quite long due to the many disagreements between Russia and other countries.

Russia and other CIS countries provide a rather unusual case for the WTO accession process. Being created as an organization aimed at trade liberalization, the WTO treats accession countries as countries with strong barriers to trade in goods and services. The aim of the accession negotiations is thus to decrease the trade barriers. The Russian case is unusual because when Russia applied to the WTO, its economy had a different structure from traditional non-planned economies. A number of sectors (services) did not exist, and a number of important regulations were not formally legislated. Even now, after 10 years of transition, Russia still lacks legislation in a number of areas. This situation had a direct consequence for the accession process: for several years the Russian side was unable to provide information on regulations, which was required by the other party. This situation has even deeper consequences for the economy and for the accession. Since formal rules were absent, authorities of different levels enjoyed a lot of discretion. The economy was governed by a set of informal rules and when formal rules were introduced, many of them were not enforced. Because of this, a number of member countries have doubts about Russia's ability to fulfill the obligations in the future. Certainly, such doubts make the negotiation process more problematic for Russia.

Another problem with the accession process relates to the fact that, in contrast to many other countries, the Russian WTO accession does not coincide with any major trade liberalization. Russia liberalized its international trade in early-mid 1990s as a part of the IMF stabilization program. Almost all quotas are already eliminated, and most tariffs are set at the level below 20%. Trade liberalization in Russia coincided with a deep economic decline, and a majority of the Russian public believes that trade liberalization was one of the major causes of the decline. The recent economic growth can to a large extent be explained by the devaluation of the ruble, which made Russian industry more competitive. These economic developments have deep consequences for the tightness of negotiations on the Russian tariff offer. Russia now experiences an increase of protectionist movements. A number of strong lobbying groups insist on an increase in tariffs during the accession to the WTO. So, difficulties of external negotiations over tariff rates are combined with increasing difficulties in internal negotiations.

In addition to tariff rates, the issue of price control is an important impediment to Russian accession negotiations. Other countries, mainly in the EU and the US, insist on equalizing prices, which would apply to Russian gas sold internally and externally. In Russia this request confronts very strong opposition since implementation of this measure is expected to ruin Russian manufacturing once again.

Agriculture is another area where there are challenges to Russia's accession. It is well known that other countries insist on decreasing the amount of total support requested by Russia, but this request does not cover all the problems. Russian agriculture is to a large extent still state-owned. It is difficult to translate Russian agricultural support measures into traditional WTO classifications of green, red and yellow subsidies.³ Russia will most likely have to bring its system of government support in line with the WTO Agreement on Agriculture, and eliminate export subsidies before the accession.

The service sector⁴ is the most difficult part of the negotiations . Most of the service sector is new to Russia. For example, no proper financial sector existed under the planned economy. The current position in Russia is largely affected by lobbying groups from this new sector, which use the "infant industry" argument in their defense. Russia insists on limiting foreign presence in a number of service sectors in order to allow domestic sectors to develop. Russia also insists on keeping the state monopoly in some sectors. Newly independent regulation agencies, which do not want to be subjected to international accountability, play an important role in this process.

The current Russian accession offer is very restrictive. In the banking sector, for example, the Russian offer not only set limits on the combined foreign equity share and restricts the mode of operation of foreign banks on Russian territory (branches are prohibited), but it also imposes restrictions on the type of operations foreign banks can conduct in Russia (lending is restricted). The situation is even worse in the insurance sector. Foreign firms are prohibited from participating in the compulsory insurance schemes, which are vital for foreign insurance companies' presence in Russia.

Serious problems still exist in negotiations on market access to telecommunications. The telecommunications sector is nowadays considered a key sector for development of internet-based businesses. New technologies, which appeared in the last 10-15 years, such as mobile phones, broke the former position of this sector as a "natural monopoly". However, the Russian offer is still based on a "natural monopoly" view of the sector. Rostelecom, the incumbent Russian telecommunications firm, is supposed to keep its monopoly on long-distance and international services until 2010. Foreign operators can only provide services on the local level and are not allowed to have more than a 25% equity share when providing resale-based services and 49% when offering facility-based services. This offer looks completely unacceptable for the WTO. They require a shortening of the period for allowing foreign competition and an increase

³ See Self's paper.

⁴ See Self's paper

in the foreign equity share limits. Moreover, the current share of foreign presence in some sectors is higher than the one proposed in the offer (for example in mobile telecommunications), and foreign counterparts require a drop of all foreign equity limits in sectors where foreign providers are already allowed.

Effect of the accession. Major effects of the WTO accession are expected to come after accepting WTO formal rules and procedures, and from increasing market access to the service sector. Effects of liberalization of trade in goods will be rather modest because, as we said before, major trade liberalization has already taken place in Russia, and the expected extent of further trade liberalization is rather small.

As we discussed before, Russia still lacks a number of regulations vital for a properly functioning market economy. WTO accession implies that Russia will have to introduce new regulations or make those regulations that are related to international trade in goods and services more transparent. This will certainly lead to major improvements in the business climate and have positive influences on Russian growth rates. Unfortunately, this will only touch upon a small number of regulations. So, the effect will be modest in comparison to the effect that EU accession will have on the countries of Eastern Europe.

While there are no disagreements in the views on the effect of changing legal procedures according to the WTO requirements, there are different views on the effect of liberalization of trade in goods and services. The Russian decision to become a member of the WTO was mainly political. It was a decision to become a member of an important international club of countries. This decision was not based on a deep understanding of the economic consequences of accession. Now this decision is widely criticized internally by the protectionists, who claim that accession will cause a GDP decline. Some very modest estimates circulated in Russia amounts to a 1% decline of GDP,⁵ although larger numbers also appear. Such forecasts are based on a partial equilibrium view, which does not take into account that the demand for import shall be compensated for by the supply of exports.

General equilibrium models, which are better suited for forecasting the effects of the accession than partial equilibrium computations, predict that the effect of the accession will be positive, and indeed, most of the gains are expected to be the result of liberalization of services. Jensen, Rutherford and Tarr (2002) constructed a CGE model for Russia, which includes 35 sectors of which 11 are services.⁶ Model-based computations show that the total medium run gains of Russian accession to the WTO will amount to 6.8% of Russian consumption (3.2% of GDP),

⁵ See "Russia assesses costs of joining WTO." on pg. 4 of the July 18, 2002 Financial Times.

⁶ Services sectors are: railway transportation, truck transportation, pipeline transportation, maritime transportation, air transportation, other transportation, telecommunications, science and science servicing, public health and sports and social security, education and culture and art, financial services.

while the long run gains could be as high as 54% of consumption or 25% of GDP. Almost 70% of these total gains are due to improved access for foreign investors to the service sector (4.7% of consumption in the short run). Tariff reduction amounts to an additional 25% of total gains (1.7% of consumption). The rest of the gains consist of productivity effects and improved market access for foreign firms in the manufacturing sector.

Results of econometric studies, which use firm level data, provide some additional insights about the productivity effects.⁷ Trade liberalization and particularly increase in inflows of FDI lead to productivity increase of Russian firms both because of restructuring under increased competition pressure, and because of improved quality of imports. There is evidence that entry of FDI in downstream sectors has positive effects on domestic suppliers. This result suggests that an increase of FDI in the trade sector may have positive spillover effects in industrial firms.

Conclusions. Although Russian accession is claimed to have reached its final stage, many problems remain and the process can take much longer than is often declared. Ironically, the most gains from accession will come about due to the liberalization of the service sector, which is the sector Russia is most reluctant to liberalize.

⁷ See Bessonova, Kozlov and Yudaeva “Trade Liberalization, Foreign Direct Investment, and Productivity of Russian Firms”.