

Russia and the WTO: are we there yet?

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Summary

- Russia's negotiation to join the WTO has been the longest multilateral negotiation in modern history. After 18 years it is poised to join if the Russian Duma ratifies the protocol in July. In principle this is good news for both investors in Russia and firms that import and export there.
- However, it is still not certain that this will happen. Russia's long road to the WTO has been a mirror of its post-Soviet politics. It has tracked its shifting attitudes to market liberalisation, state capitalism and its status and strategy as a hydrocarbon power. Those attitudes shaped its journey into the WTO and they will shape its conduct inside it.
- China's long WTO negotiation between 1986 and 2001 was part of an internal power struggle for dominance of China's economic agenda, and the same has been true of Russia. The difference is that in Russia's political economy it is hard to find a well-connected constituency with a serious and consistent vested interest in Russia joining the WTO.
- The risk for Russia and for Russian investors is that the protracted process of WTO negotiation and the instincts of the Russian leadership are such that some of the key potential benefits of WTO membership are lost in the ambiguous messages from Moscow.
- Even if Russia does ultimately join the WTO in 2012, EU and US officials privately expect the first few years of Russian membership to be difficult. Nobody seems to expect Russia to be particularly constructive or instinctively compliant as a WTO member, probably with good reason.

It has been the longest single negotiation in the history of multilateral diplomacy, and we still cannot be sure it is decisively concluded. Russia's eighteen year-long road to the WTO has been a mirror of its post-Soviet politics. It has tracked its shifting attitudes to market liberalisation, state capitalism and its status and strategy as a hydrocarbon power. Since China's accession to the WTO in 2001, Russia has been the only significant economy in the world outside of the WTO.

In principle, the conclusion of negotiations in Geneva in December last year marked the end of the multilateral process, subject to ratification in the Russian Duma. Last week's petition by 130

Communist and Just Russia Duma Deputies to overturn the WTO protocol on constitutional grounds provides President Vladimir Putin with the pretext to stall the process yet again, should he be so inclined.

China's long WTO negotiation between 1986 and 2001 was part of an internal power struggle for dominance of China's economic agenda, and the same has been true of Russia. Understanding why Russian reformers have repeatedly come so close to losing that fight, and why the victory is likely to be an ambiguous one, tells us a lot about modern Russia. This Global Counsel Insight looks at the

politics of free trade in Russia, and what Russia's membership is likely to mean for the WTO

The political costs of WTO membership

It began with the request for observer status in the GATT in 1986 - a move blocked by the United States on the grounds that the Soviet Union did not believe in the principle of free trade that defined the GATT. After the fall of the Soviet Union, Russia applied to join the GATT in 1993, when the current negotiations commenced. The fortunes of the negotiations waxed and waned with Russian internal politics and wider geopolitics. The US signed off on Russian WTO membership in 2006 amid a sharp deterioration in Russia's relations with Georgia and as an incentive for constructive Russian policy on Iran. The EU held out a lot longer, looking for satisfactory commitments to reduce export tariffs on trade in timber and for changes to the conduct of Russia's food import safety authorities.

The agreement that Russia ultimately signed in Geneva includes commitments to reduce most of Russia's external tariffs. It will leave Russia with one of the lowest tariff landscapes among the emerging economies, especially relative to Brazil and India, which entered the GATT earlier and on politically less onerous terms than Russia and especially China. The tariff reductions are generally by around 30-50% and over the course of around three years. The significance of these reductions for importers depends heavily on the existing level of protection. Russia has also committed to reducing, removing or freezing a large number of export tariffs.

Russia has also committed to new conditions of market entry for services export firms, including 100% ownership of most forms of financial services suppliers. These are, however, subject to local subsidiarisation requirements, and overall caps on the level of foreign participation in the banking sector at 50%. Foreign ownership caps in the telecoms sector will also be removed after four years. Conditions for establishing retail, engineering, computing and environmental services firms have also in principle been improved and set in stone.

But the real significance of WTO membership for Russia lies less in these changes to its tariff levels than in what it means for the conduct of Russian trade policy in general. WTO membership transforms the international legal framework in which Russia conducts trade policy. It will act as a considerable check on Russia's ability to alter or limit unilaterally the terms on which goods and services enter the Russian market. Russia's trading partners will now be able to use the WTO dispute settlement system to pursue judgments on Russia's conduct of trade policy. Russia will in principle accept the obligation to halve its \$9bn annually farm subsidy bill by 2018 and to reform its industrial subsidy programs to eliminate trade distortions.

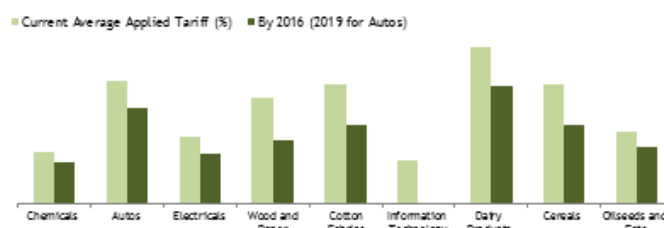


Fig1: Average current Russian applied tariffs and reductions by 2016 (%)

Source: Russian WTO protocol

Russia has also committed to standardising its application and enforcement of health and safety standards for imports, an area of persistent tension with the EU and criticism of arbitrary and protectionist behaviour on the part of Russian authorities. Except in cases of serious risks to animal or human health, Rosselkhozadzor will no longer be able to suspend imports without allowing the exporting country an opportunity to implement corrective measures. All suspensions or refusals of import permits for meat or other foodstuffs will have to comply with the WTO Sanitary and Phytosanitary Agreement and international standards.

The value of these constraints to Russia lies in the fact that they also apply to Russia's WTO partners. Russia is in theory exchanging opacity and autonomy for transparency and predictability. Most of the evidence suggests that this will be good for Russia and for Russian businesses in the

long run. The problem is that it also flies in the face of a system that does not place any particular value on transparency and has been built for the last decade or more around the personal political autonomy of one man. Vladimir Putin's personal involvement as President in trade disputes such as the long-running tension with Poland and the EU over meat exports seemed to suggest a preference for retaining trade and trade policy as political and diplomatic leverage.

The uses of WTO membership

The comparison of Russia's WTO negotiation with China in the 1990s is telling. China's bid for WTO membership was part of a profound internal power struggle over China's economic agenda. In the face of conservative resistance, leaders like Zhu Rongji saw greater foreign competition as a necessary discipline of China's large state owned enterprise sector, as well as an important signal of China's economic modernisation. China's export-driven growth model also provided a strong incentive to reduce the tariffs paid on Chinese exports. The growing western dependence on Chinese manufacturers as part of long global supply chains meant that there were strong American and European domestic constituencies in manufacturing and retail for opening up trade with China.

Russia of course also has an export-driven growth model, but one based on hydrocarbons that are not subject to import duties. While Russia's economy earns more than 70% of its export income from the fuels and mining sectors, the headline economic benefits of WTO membership are inevitably limited. Russia imports large volumes of manufactured goods, but control over the tariffs for these has provided a useful source of political leverage and the prospect of their manipulation for import substitution policy.

The limited strength of the domestic Russian manufacturing sector, has typically made it defensive about international competition. Indeed, a delegation of Russian manufacturing businesses has already privately petitioned the Russian Industry Ministry for a set of political countermeasures to the loss of tariff protection

they will experience over the next three years. They complain that the Russian state has not taken adequate action to protect domestic industry and advocate enhanced use of WTO 'anti-dumping' rules to provide a secondary line of protection against imports. These corporate leaders reflect a sizeable constituency among the Russian business elite who saw the WTO negotiations as a symbol of a never-ending dialogue rather than a set of new protocols.

An ambiguous message from Moscow

This points to the basic problem in Russia on WTO membership. In Russia's political economy it is hard to find a well-connected constituency with a serious consistent vested interest in Russia joining the WTO. Russian reformers have generally taken the same view of WTO membership as their Chinese equivalents in the last half of the 1990s. They see WTO membership as a necessary discipline on the domestic Russian manufacturing and agricultural sectors and an incentive to diversification. But even more importantly they regard it as an important symbol of Russia's economic modernisation and transparency and as such as a key method of mitigating soaring levels of investor scepticism about Russia risk.

They are probably right to see WTO membership in these terms. The anecdotal experience of both China and Vietnam, the last two economies of any size to join the WTO, is that investors responded with a greater willingness to invest in joint ventures and to establish locally. The need to attract FDI to Russia outside of the hydrocarbon sector made this investor confidence argument the key potential benefit for many reformers. The trouble is that unlike China, where Rongji and his reformist allies were pushing for WTO entry from a position of considerable power in the Politburo, Russian reformers have had patronage from the top that has been uneven, to put it mildly. Vladimir Putin has never been a consistent advocate of membership, although his remarks last Thursday at the St Petersburg Economic Forum and his body-language with business leaders in private suggest that he may be warming to the benefits of WTO membership - especially encouraging new

inward capital investment (and perhaps slowing Russian capital flight).

The risk is that the protracted process of WTO negotiation and the instincts of the Russian leadership are such that much of this potential benefit is lost in the ambiguous messages from Moscow. Even now it is not clear that Russia will actually join the WTO in July. The resistance in the Duma provides the necessary pretext for a reversal if the Kremlin wants one, and ministers have been heard grumbling in public about the impact of lost tariff revenues on the Russian budget (which in reality are negligible, even once most tariffs cuts kick in after 2015). A cynic might be tempted to believe that the ground is being prepared for yet another derailing of the slowest train in multilateral diplomacy.

Trouble may also be brewing however in the US as Congress has come under pressure from the Obama administration to repeal the Cold War era Jackson-Vanik amendment which allows trade restrictions between the two nations. It is not clear that the maintenance of the Amendment after Russia's WTO accession would have substantive effects on US-Russia trade relations, as the WTO imposes Most Favoured Nation status and supersedes previous arrangements - the political fallout of a failure to repeal the amendment however could be damaging. The upcoming US election has stiffened rhetoric in the US as the Obama administration has come under pressure to link the repeal of the Jackson-Vanik amendment to the passage of the proposed 'Magnitsky bill', a bill which would freeze assets and deny visas to those accused of human rights abuses in Russia - a move which would inevitably play very badly in Moscow. Further complications have also arisen from recent deterioration in US-Russian relations over Russia's perceived failure to act on Syria and Putin's non-attendance at the May G8 summit in the US. These high profile disputes will only provide further incentives and excuses for the Duma, and maybe even the Kremlin, to drag its feet on ratification.

Even if Russia does ultimately join in 2012, EU and US officials privately expect the first few years of Russian membership to be difficult. The EU's 2012

Annual Protectionism Review published in June 2012 made it clear that it had concerns about Russia's border protection, licensing systems and industrial development programmes. Russia is not, it concluded, "currently fully living up to its future obligations". In much the same way that the US and EU have used a succession of WTO dispute cases since 2006 to apply pressure to the machinery of Chinese state capitalism, the EU in particular can be expected to see Russia in court on a range of unresolved problems. Nobody seems to expect Russia to be particularly constructive or instinctively compliant as a WTO member, probably with good reason.

This is not particularly good news for the WTO. The challenge for the WTO of assimilating the BRIC economies has always been strained by the BRICs' suspicion of a system of trade rules overseen for five decades by the EU and the US. China's positive desire to join the organisation and its relatively constructive - or at least not positively disruptive - conduct over the last decade is probably the single most important determinant of the organisation's continued relevance for global trade in the twenty first century. Russia does not join the WTO with the same instinctive interest in the rules-based system it aspires to preserve or the same basic desire to keep a low profile. It has a general sense that its status as a major power requires a seat at the WTO table. But beyond that, the people at the top of the Russian system seem unsure of why, or if, they want to be there at all.

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