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Russia getting closer to WTO membership – what are the practical implications?

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Russia getting closer to WTO membership – what are the practical implications?

Abstract

Russia has cleared an important hurdle in its path to membership of the World Trade Organization (WTO), the signing of the bilateral agreement with the United States. It will still take some months at minimum to finalize Russian membership, and even longer for the effects of membership to be realized. Russia's progress in the WTO negotiations is an important positive sign for international actors of the country's willingness to further integrate with the global economy. Russia has committed to lowering its average import tariff on agricultural and industrial goods by 3 percentage points, but with transition periods. Russia will also liberalize its service sector, but still reserve the right to some restrictions. It is widely believed that WTO membership will have a positive impact on Russia's economic development by enhancing competition and efficiency in the economy and by increasing foreign direct investment (FDI) flows to Russia. Some fears have also been expressed on the ability of domestic companies to survive with the growing competitive pressure. The consequences of future membership will not, however, be dramatic or instantaneous.

Keywords: Russia, WTO, trade policy

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1 Introduction

Russian membership of the World Trade Organization (WTO) is currently on the agenda, as Russia and the United States finally reached agreement on Russian accession in October 2006 after years of negotiations. This is certainly a very important step on Russia's path towards membership of the WTO, albeit not yet the final one. As the bilateral negotiations with the United States have been the hardest Russia has faced in the membership process, it is interesting at this point to review developments thus far and the likely consequences of Russia's future membership.

Within Russia itself there have been mixed feelings over the prospect of WTO membership. Some fear that the obligations related to membership will shrink many domestic sectors both in production and services. On the other hand, internationally oriented market actors, in particular, see it as a natural and obligatory step in Russia's economic development that will benefit the country through increased foreign investment. In reality, the changes brought about by membership are unlikely to be dramatic or instantaneous. Membership will, however, be an important sign of Russia's willingness to be more integrated in the global economy.

The purpose of this paper is to summarize briefly the main aspects of the changes and consequences related to Russia's future WTO membership on the basis of the outcome of Russia's bilateral negotiations with the United States. As the overall negotiation process on Russia's membership is still incomplete, there is only limited information available on the details of the actual accession agreement. Section 2 begins by presenting the overall development of Russia's path towards the WTO. Section 3 reviews the changes related to Russian membership and is compiled on the basis of the official information published so far; it is, however, by no means a comprehensive presentation. Section 4 gathers together and evaluates the results of previous research assessing the impact of Russian WTO membership. Finally, Section 5 presents conclusions.

2 The WTO and Russia's path towards membership

The World Trade Organization (WTO) was established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT) signed by the first members as long ago as 1948. An updated version of GATT is still the umbrella agreement in the WTO for trade in goods. In addition, the WTO has agreements on trade on services (GATS) and on trade-related intellectual property rights (TRIPS). Based on these agreements, the WTO provides the legislative basis for international commerce as well as the dispute settlement process for resolving conflicts in trade issues.

The WTO agreements are based on a number of general principles. Members usually have to apply the principle of most-favoured-nation (MFN) in their foreign trade (this basically concerns trade in both goods and services). The MFN implies that countries cannot have discriminative trade policies, but must apply equal duties and tariffs on imports from any member country. In addition, domestic and imported products and producers should be treated equally after entering the market. WTO negotiations usually also seek to lower import tariffs and reduce non-tariff barriers. Even if not lowered, the maximum level of tariffs can still be bound in order to make the market environment more predictable.

At present, there are 149 members of the WTO. All existing members can participate in the working party for the accession of new candidate countries. The accession process can be roughly divided into four phases. Firstly, the candidate country has to compile a memorandum describing its trade policies and other policies relevant to the WTO. Secondly, the candidate country has to conduct negotiations and sign bilateral agreements with all the participants in the working party. After the working party has examined the trade regime of the candidate country and the bilateral agreements are signed, the final terms of accession and the related schedules are negotiated and determined multilaterally. The candidate is accepted as a member if a two thirds' majority of the members vote in favour of membership.

Russia already filed its application during the time of GATT, the WTO's predecessor, and the working party for Russia's accession was formed in 1993. The first meeting of the working party was held in 1995, and to date 30 meetings have been held. Russia has conducted bilateral negotiations with the countries participating in the working party since the late 1990s. In 2003, the first bilateral agreement was signed with the Kyrgyz Republic. As of November 2005, there were 59 countries in the working party. Of these, 56 had been willing to conduct negotiations with Russia on goods trade, and 27 on the service sector.

According to the Russian Ministry of Economic Development and Trade, Russia has completed its negotiations with all the participants. The latest agreements were signed with Moldova right at the end of 2006, after settlement of the issues of Moldovan import bans and taxation of Russian gas transited through Moldovan territory, and with El Salvador and Costa Rica in January 2007. However, Georgia has required the reopening of negotiations, although the agreement between Georgia and Russia was signed already in 2004. Georgia has raised as the main issue to be renegotiated the illegal customs points in Abkhazia and South Ossetia.

Russia still faces the multilateral round of negotiations before accession can be finally accomplished. In this round, all the specifics of Russia's accession agreement will be finalized. Russia's Trade Minister German Gref stated in his presentation to the State Duma in September 2006 (MEDT 2006b) that one of the most important problems resolved so far in the multilateral negotiations is gas prices. Russian domestic gas prices for industrial users will be lifted to a level that covers production costs, etc. In line with this, the Russian government has already accepted a schedule for a gradual increasing of the domestic gas price for industrial users, implying that the domestic price will equal the export price (excluding duties and transportation costs) by 2011. Gref also noted that Russia will have the right to fully implement nearly all the subsidies it is currently applying, with two exceptions: dual tariffs on the railways and the obligatory domestic content in the automotive industry. According to Gref, the railway tariffs for domestic and foreign trade freights will be harmonized within a transition period of three years and the obligation for foreign car producers to use partly domestic parts will also be removed after a transition period.

Russia's main WTO negotiator, Maxim Medvedkov, has stated (Interfax 2006) that there remain 10–15 serious issues to be agreed in the multilateral negotiations. He named questions surrounding intellectual property rights as one of the most difficult issues. Other significant themes are agricultural issues and customs administration. More minor issues mentioned by Medvedkov include regulation of alcoholic products other than beverages and the practices of state-owned companies.

In relation to intellectual property rights, Russian legislation already largely corresponds to the requirements under the WTO. President Vladimir Putin signed the long-prepared Part IV of the RF Civil Code concerning intellectual property rights in December 2006. It will, however, still take some time to make all the final amendments to regulations, and actual implementation of the new legislation will probably encounter difficulties. In the field of agriculture, the main issue is Russia's agricultural subsidies. Upon accession, Russia has to bind its subsidies to a certain level, from which they will be gradually reduced. Agreement on this level has not yet been reached. In addition, some countries have brought up the question of the distribution of tariff quotas on meat products. In relation to customs administration, Medvedkov has raised the issues of customs fees and customs valuation, especially with regard to the risks of too low valuation.

According to Medvedkov, the multilateral negotiations will continue at the beginning of February in Geneva with discussions on agriculture and phytosanitary measures. Intellectual property rights issues will also be on the table in February, while negotiations on other themes will continue in March–April 2007. Russian officials have stated that under an optimistic scenario the negotiations will be completed by the end of July 2007. In that case Russia would realize its membership already this year and its WTO obligations would probably come into force at the beginning of 2008. On the other hand, the multilateral negotiations could take years, and membership will also require the approval of Russia's State Duma and Federation Council.

3 Changes implied by Russia's WTO membership

The final specifics of Russia's accession agreement have naturally not been laid out yet, but some official information has been provided on the agreed terms. In particular, the Russian Ministry of Economic Development and Trade (MEDT) and the Office of the United States Trade Representative have published some details of the results of negotiations between countries. It should be noted that these documents do not provide a comprehensive record of the agreements; they rather point out certain specifics considered important from a national point of view. However, since this is the only public information currently available, it has to be taken as the basis for any assessment of changes implied by Russia's future WTO membership.

3.1 Goods trade

Perhaps the most commonly mentioned issue related to WTO membership is the lowering of import tariffs. At present, Russia imposes three different kinds of import duty on products imported from non-CIS countries (in imports from CIS countries, no duties are imposed on the majority of products). Firstly, there are pure ad valorem tariffs (ie the duty is a fixed percentage of the value of the imported product). Secondly, there are import duties with a fixed value per unit imported (eg litre, kilogram or item). Finally, there are combination duties. The combination duty has a specified minimum value per unit that has always to be paid as duty, but after the minimum value is exceeded, the products are taxed with a fixed ad valorem duty. (For some footwear, the combination duty is the ad valorem duty *plus* a fixed value per pair.)

The wide majority of the total of over 11,000 tariff lines involve the imposition of a pure ad valorem duty. Russian pure ad valorem import tariffs have the categories 3%, 5%, 10%, 15%, 20% and 100%, the largest being applied only to some spirits. Over 1,300 tariff lines are taxed on the basis of a combination duty. The purpose of the combination duties is to protect the Russian economy especially from the cheapest imports. Finally there are over 300 tariff lines with a fixed value of duty per unit imported. These are mainly imports of some foodstuffs, textiles and footwear, and vehicles. About 1000 tariff lines are subject to no import duties, including mainly products of machinery and mechanical appliances.

According to the MEDT, the average drop in Russia's import tariffs for foodstuffs and industrial products will be about 3 percentage points, but the changes will vary according to sector and specific products. The average level of ad valorem duty in Russia is 11%; it will thus come down to about 8%. The current average Russian tariff is at a medium level compared with other middle-income countries. In 2003–2004, the average tariff was 13% in Brazil, 10% in China and 7% in Ukraine (Tarr et al. 2005). As in other countries, the average Russian duty on industrial products will be a little lower than average, whereas the duties for agricultural products will be somewhat higher. No import duties will be lowered immediately on accession, only following a transition period of 1–7 years, depending on the product. The number of tariff lines based on combination duty will be reduced to about 1,100. The specified minimum value of duty will be calculated annually based on the world market price of the product in the three preceding years.

Table 1 presents the current average minimum import duties in Russia. These must be considered minimum duties, since they are calculated as the simple average over all tariff lines, ignoring the specified minimum values of combination duties and fixed value duties. Thus, the actual duties levied are somewhat higher for eg some cheap foodstuffs.

Table 1 Average minimum import duties in Russia, % (for more details, see Appendix 1).

Product group	Average import duty, %
Agricultural and food products	15
Wood and paper products	13
Textiles, leather, clothing and footwear	12
Vehicles	11
Base metals and metal products	10
Electronic equipment	9
Chemical, rubber and plastic products	7
Mineral products	5
Machinery and mechanical appliances	5

Sources: Customs Tariff of the Russian Federation, author's calculations.

According to the MEDT, Russia has agreed to cut some import tariffs on agricultural and food products, while some will be fixed at their current level. One of the most strictly protected groups is meat products. The current minimum average import duty for these is 32%, but nearly all of the tariff lines are subject to combined duties. There are also import quotas for meat products. The MEDT reports that the current import quotas will remain until 2009, after which Russia will re-evaluate their necessity and conduct new negotiations with its trading partners. Russia will lower the import tariffs for agricultural materials, in which there is not enough domestic production for the needs of the food industry. The import tariffs are also to be lowered for some animal feed and fruits and vegetables that are not produced in Russia (eg oranges, grapes and bananas). The tariffs on spirits will stay at 100%, but duties on wines and some other alcoholic beverages will be lowered within three years.

The MEDT also reports that import duties on paper and paper products and chemical products will be lowered to 5–6% in 3–4 years. Currently, the majority of the different kinds of paper and paperboard are subject to an import tariff of 15%, whereas printed products can mainly be imported without duties. In chemical products, a large number of tariff lines are already subject to 5% duty. Specifically mentioned are the cuts in tariffs on medicines (from 15% to 5–6.5%) and medical substances used in the production of medicines within Russia (to 2–3%). In textiles, leather, clothing and footwear the import tariffs on raw materials for the industry will be lowered or abolished. The tariffs on footwear will be lowered, whereas those on clothes will be practically unchanged. At the moment, the duty on most footwear is at least EUR 1.80 per pair, and the majority of clothing items are taxed at a minimum rate of 20%.

In vehicles, it is reported that within seven years the ad valorem part of the import duty on passenger cars is to be lowered from 25% to 15% and the duty on civil aircraft from 20% to 7.5–12.5%. Within three years, import duties are to be abolished on IT products such as computers and their components, and on medical devices. Many of these products can, however, already be imported duty-free. The MEDT also states that the import tariffs on electronic and electrical products will be lowered to a 'solvent' level in order to reduce the grey importing of these products.

In Russia's case, export duties are also significant, as nearly all the most important Russian export products are subject to export duties. The WTO negotiations, however, mainly concern import tariffs, as these are the trade policy instrument that places domestic and foreign producers in an unequal position in the domestic market contrary to WTO principles. The only concessions reported in the export field are that Russia plans to reduce export duties on ferrous (steel) scrap and eliminate the export duty on copper cathodes (USTR, 2006).

3.2 Service sector

In the area of services, Russia has committed itself to changes in 116 out of the 150 sectors. In 30 of these, the markets are to be liberalized without restrictions. In these sectors, Russia cannot impose any quantitative restrictions on foreign ownership or discriminate against foreign providers of services after admission to the WTO. In other sectors, the markets are to be partially opened. Russia has, however, reserved to itself some concessions regarding unequal treatment of domestic and foreign service producers in all sectors. Firstly, the state will be allowed to discrimination in favour of domestic producers for supplying its own needs. Secondly, Russia will be able to provide subsidies and other state support in any form for domestic service producers. And finally, Russia will have the right to restrict foreign participation in the privatization of state-controlled companies.

Russia's obligations related to WTO membership vary greatly between service sectors. The MEDT (2006a) states that in key service sectors related to extracting, refining and transporting of raw materials Russia has taken on practically no obligations in order to open the markets to foreigners. Thus, in these sectors it will be possible to impose any restrictions on foreign services and their producers (up to total closing of the markets) even after membership.

In the banking sector, direct branches of foreign banks will not be allowed even after WTO membership. Foreign banks can operate in Russian markets through a subsidiary or by buying an existing Russian bank. This means all banks operating in the Russian market are subject to Russian legislation. As at present, foreign investors will be allowed 100% ownership of individual banks. But Russia will still be able to restrict foreign participation in the banking sector as a whole to some degree. The MEDT reports the limit can be set at a 50% share of foreign ownership in the total authorized capital of Russian banks. However, this figure will not include foreign investments made before 1 January 2007 or the assets invested in Russian banks privatized after Russian admission to the WTO.

The insurance sector will also be liberalized. Branches of foreign insurance companies will be allowed to operate in the Russian market (with some restrictions concerning the sphere of their activity) after a transition period of nine years from Russia's accession. The branches will be subject to licensing and capital requirements formulated in Russian legislation. In most non-life insurance companies, 100% foreign ownership will be allowed upon accession, whereas in life insurance, mandatory travel insurance and mandatory automobile insurance there will be a transition period of 5 years before full foreign ownership is allowed. In the insurance sector as a whole, Russia will maintain a quota for foreign participation, but it will be lifted from the current 25% to 50%, and the same exclusions will apply as in the banking sector.

In the sectors of telecommunications, audio-visual services and environmental services, 100% foreign ownership will be allowed. In the distribution sector, Russia has retained the possibility to restrict or block foreign ownership in alcohol wholesaling, and retail trade in eg arms, explosives and some pharmaceuticals; otherwise, foreign ownership will not be restricted.

4 Implications for the Russian economy

There would appear to be fairly broad agreement among researchers that the positive consequences of WTO membership will dominate at least in the long run. Many thorough analyses have concentrated on the implications of the changes in the import tariff regime, although it is mostly recognized that their impact will be limited. The largest benefits are attributed to liberalization of the service sector. A third important positive effect will be improved market access for Russian exporters. The negative effect raised is the contraction of some non-competitive Russian industries when they cease to be protected from foreign competition by import tariffs. Quantitative estimates for the impact of Russian accession have been presented by Rutherford and Tarr (2005, 2006). They have used a general equilibrium model for estimation, and according to their results the medium-term welfare gain for Russia will be about 7–8% of consumption, or over 4% of GDP (ie Russia's GDP will be 4% higher than without membership). The gain is mainly attributed to service sector liberalization, while import tariff reductions and improved market access for Russian exporters account for a more modest gain.

4.1 Goods trade

The lowering of import tariffs is expected to increase imports and competition in Russian markets. In recent years, the volume of imports has already been growing much faster than exports, and forecasts suggest continued robust import growth together with increasing income independent of WTO membership. Lately, prices of oil and other commodities have been so high that Russia has been able to record large surpluses in its foreign trade despite faster growth in imports. If commodity prices come down, Russia's huge export income will shrink, as will the trade surplus. Lower export prices and growing imports will also relieve the continuing pressures for a real strengthening of the rouble as the inflow of currency diminishes.

Previous research has highlighted three main positive effects. Firstly, Russian consumers will benefit from lower prices and a wider variety of choice. Secondly, Russian producers in sectors that have a high import content will be able to get cheaper components for their production. And thirdly, the lowering of import tariffs should bring productivity gains in Russian industry. The productivity gains are argued to come from enhanced access to products containing advanced technologies and from the more efficient allocation of resources brought about by increased competition. In addition, WTO membership will enhance the predictability of the business environment in Russia, as the obligations Russia commits to upon accession will be difficult to change later on.

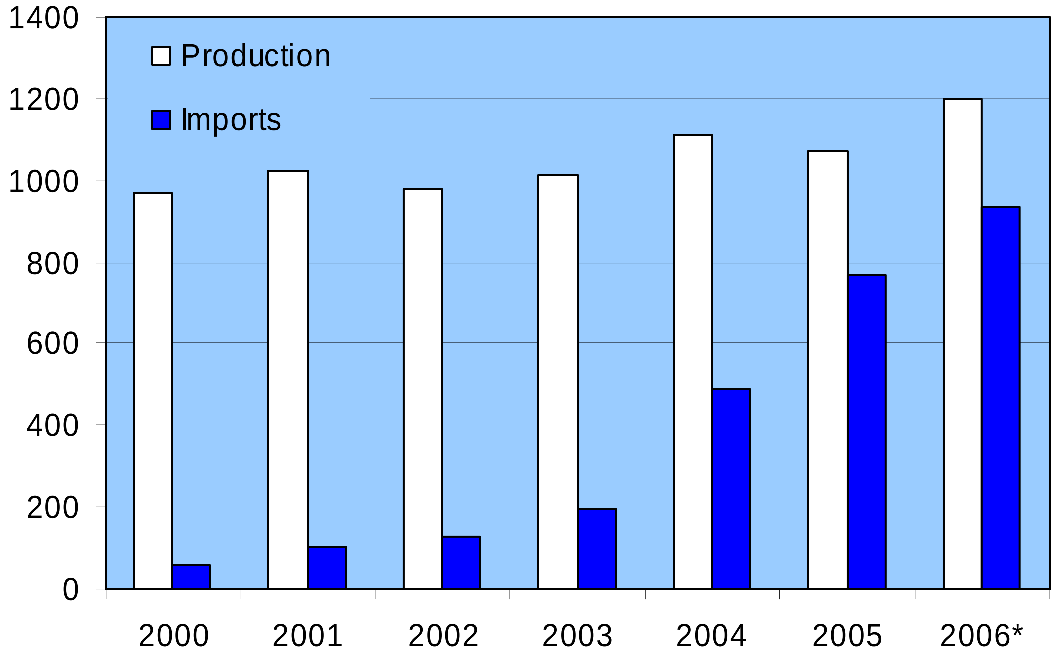
The negative effects will concern foremostly those sectors that are relatively highly protected with import duties and produce mainly for domestic markets. Production and employment in these sectors is expected to contract, as some of the companies operating in them will not survive in a more competitive environment. The most vulnerable sectors are considered to be agriculture and the food industry, light industry, manufacturing of machinery and equipment and manufacturing of construction materials. Some fears have also been expressed that the lowering of tariffs will lead to a reduction in foreign direct investment (FDI) in industrial sectors, as the potential investors will be able to serve the markets through exports instead.

Many researchers do not, however, consider this problem to be very serious in the longer term. The most widely used argument is the expansion of export sectors. Rutherford and Tarr argue that if imports grow, then exports must also grow in order to be able to pay for the higher imports. More currency will be needed to pay for the growing imports, which will lead to depreciation of the rouble's exchange rate. Depreciation of the currency will in turn support export growth, while its impact on imports will be the opposite. Thus, the expanding export sectors will need the labour force freed from contracting sectors. Rutherford and Tarr (2005) state that, altogether, more sectors will expand than contract, and they mention ferrous and non-ferrous metals and chemicals as the sectors that will benefit most. But they also emphasize that the shift of labour force to expanding sectors will take an adjustment period of a couple of years. CEFIR (2001) also suggest the positive effect of exchange rate depreciation will probably exceed the negative effect experienced in the import-competing sector.

It will certainly take some time for many Russian export sectors to expand vigorously. As Russia's exports are strongly dominated by energy products, demand is not so dependent on exchange rate fluctuations. In the first place, Russia's main export product, oil, is priced in dollars. Secondly, the production of Russian energy products seems to be approaching its capacity limits and recent volume growth in energy exports has been modest. Thirdly, the energy sector in Russia currently employs less than 2% of the employed labour force despite the brisk growth in the sector at the beginning of the decade. A fourth reservation is that some Russian export products still lack real competitiveness, as distinct from price competitiveness, and thus will not benefit that much from depreciation of the rouble.

With regard to FDI in the industrial sector, CEFIR (2001) and Yudaeva et al. (2003) state that the possible negative impact will only concern FDI oriented to local production (horizontal FDI), whereas export-oriented (vertical) FDI, and partly also horizontal FDI, will be encouraged by WTO membership. They also argue that most FDI directed to transition countries is of the export-oriented type. It is not always easy to differentiate between the different types of FDI, and in the case of Russia there certainly exists a rationale for both and mixed types. Horizontal investments are encouraged by the vast Russian market, long distances and, until now, the barriers to trade. With WTO membership, the barriers to trade will diminish, but rather modestly and only after a transition period. Although the lower tariffs will reduce protection for producers using Russian components, they will benefit producers using imported components. Incentives for vertical investment in Russia are provided by the country's vast natural resources and (so far) lower production costs. WTO accession will probably have a positive, but modest, impact on vertical FDI, as Russian companies' access to export markets will improve slightly.

Figure 1 Production and imports of passenger cars in Russia 2000–2006, 1000 items.



*) 2006 figure for imports includes only January-November.

Sources: Rosstat, Russian Customs.

The automobile industry is one of the sectors that will experience the largest reduction in import tariffs. As mentioned above, the MEDT has reported that the import tariff for passenger cars will be lowered from the current 25% to 15%. (There is also a specified minimum component in the passenger car tariffs, but the MEDT has not indicated any changes in that.) The passenger car industry is fairly important in Russia, especially as the demand for cars has increased very rapidly. As presented in Figure 1, imports of passenger cars have grown quickly in recent years, whereas the development of domestic production has been sluggish. In 2000, Russia produced 970,000 passenger cars, whereas imports amounted to less than 60,000. In 2005, domestic production had grown by 10% to 1,070,000, while imports had grown more than tenfold to 770,000 cars. As a similar trend has continued this year, protection has so far clearly not prevented a significant growth in import demand for cars. As there will be a transition period of 7 years before the tariffs are lowered, domestic producers will also have time to prepare for the change. In addition, foreign automobile companies have made large investments in production facilities in Russia that are already able to compete with importing foreign producers. Russian car producers have also engaged in cooperation with foreign producers. They will also benefit from WTO membership through better access to imported components. Thus, it is unlikely that automobile production in Russia will contract very much after WTO membership.

Lowering import tariffs will also impact on the budgetary revenues of the Russian Federation. Rutherford and Tarr (2005) estimate that the loss of tariff revenue will equal 0.7% of GDP, but that this will be more than compensated for by growth in the rest of the tax base as the economy expands. During this decade, the share of import tariffs in budget revenues has varied around 6–7%. Export taxes have been much more important in past years. In 2004, export taxes already accounted for three quarters of Russia's total income from taxes on trade, and their share is predicted to increase to over 80% in the approved budgets for 2006 and 2007. Budget income from VAT on imports already exceeds the income from import tariffs.

In addition, the proper duties are at present not always imposed on imports. The share of grey imports to Russia has been evaluated at 20–30% of the value of total imports (see Ollus & Simola 2007). Lower tariffs reduce the incentives for grey imports, as the benefit from illegal actions diminishes. Thus, it is possible that the tariffs will be collected more effectively. The MEDT has also stated that the import tariffs on footwear and electronics will be reduced to such a level that it will help to eradicate grey imports in these product groups.

On the other hand, Russia will gain slightly from improved market access to its export markets. However, Russia already has MFN (most favoured nation) status or more favourable trade agreements with most of its trading partners. In addition, the structure of Russian exports is such that it does not suffer greatly from import duties. For example, the main Russian export sectors, oil and gas, will not gain in market access. According to the MEDT (2006b), the current losses Russia faces due to limitations in foreign market access amount to USD 2.5 billion a year. WTO membership will also give Russian exporters the opportunity to use the dispute settling mechanisms provided by the WTO, eg in anti-dumping cases. Thus, the impact of WTO accession in this respect will be positive, if modest.

As the average reduction in import tariffs is rather low and transition periods will be applied, the changes brought about by WTO membership are unlikely to be dramatic in the goods sector. This is also the main expectation of the managers of Russian companies. According to a survey published by the Russian Development Center in September 2006, about half of the respondents did not expect Russia's WTO accession to change their prices or output, whereas a quarter did not know what to expect. The managers answered similarly when asked about the impact of WTO accession on FDI in Russia, although the share of 'no impact' was somewhat smaller and the share of 'don't knows' larger.

Rutherford and Tarr estimate the medium-term welfare gain from reduced tariffs to be 0.4% of GDP, but they assume a reduction in import tariffs of 50%, which is not going to be realized in light of currently available official information. Russian import growth has been robust recently and is expected to continue to be so regardless of WTO membership. In the longer term, Russian industry is likely to make efficiency gains due to improved resource allocation, increased competition and better access to advanced technological products. It is also likely that WTO membership will have rather a positive effect on FDI in Russia. There will be some negative effects in the shorter term, but the rather modest tariff reductions and transition periods will smooth the adjustment of the economy.

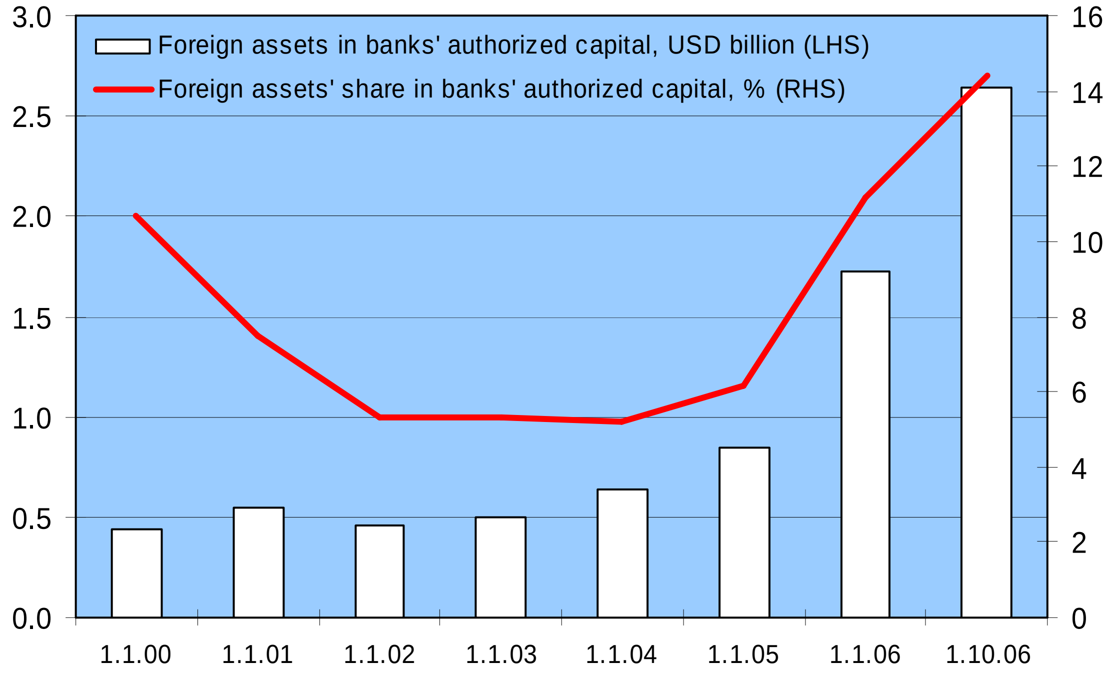
4.2 Service sector

The liberalization of the service sector is expected to increase FDI and the presence of multinational firms in Russia. It is widely seen as the most important aspect of Russia's WTO accession. The impact of service sector liberalization is considered mainly positive for Russia and evaluated as fairly significant economically. Rutherford and Tarr (2005, 2006) estimate the gain in welfare to be 5–7% of consumption or nearly 4% of GDP if the service sector is completely liberalized. They also provide an estimate of welfare gains as 2.4% of GDP for a 50% reduction in barriers to FDI. As official information indicates the financial sector in particular will remain partly protected, the latter estimate might be more realistic.

As a consequence of increased FDI, there will also be increased competition in the Russian services market and the sector will become more efficient. Rutherford and Tarr (2006) argue that the higher number of multinational companies in the service sector will reduce the number of Russian companies, but that this impact will be reduced by common use of joint ventures. They suggest that, as the number of service firms in the market increases, the quality-adjusted price of services will fall, stimulating higher demand. Although some less efficient Russian companies will be forced to exit the market, the released labour force will be absorbed by multinational companies entering the market. CEFIR (2001) notes with particular reference to the financial sector that the presence of international companies in Russian markets is unlikely to increase dramatically in the short term. They state that in the financial sector a more important obstacle to investment than quotas for foreign capital has been the unfavourable investment climate. The investment climate has, naturally, improved since the beginning of the decade, but the financial sector, like many other sectors, is still beset by problems.

One of the most disputed service sectors in Russia's WTO negotiations has been the banking sector. According to the Central Bank of Russia, there were 1,200 banks operating in the Russian banking sector at the beginning of October 2006. The Russian banking sector is, however, still rather concentrated, as the 5 largest banks account for 43% of the total assets of the sector, and the 50 largest for 75% of total assets. Foreign ownership was involved in 150 banks, and the share of banks with foreign ownership in their authorized capital was 14%. As shown in Figure 2, foreign investment in the banking sector has grown very fast lately, clearly exceeding the growth in the total capital of the sector since the beginning of 2005. As the possible quota for foreign capital after WTO membership is 50%, there is still some room for foreign investment in the sector, even if the quota is imposed.

Figure 2 Foreign assets in the Russian banking sector 2000-2006.



Source: Central Bank of Russia.

5 Conclusion

Russia has advanced very close to membership of the WTO, as it has now completed another cornerstone of the membership process; signing the bilateral agreement with the United States. However, there still remains the completion of multilateral negotiations. The main issues to be solved relate to intellectual property rights, agriculture and customs administration. It is anticipated that Russia will actually be able join the WTO at the earliest in summer 2007, but the process could actually take much longer.

The effects of Russia's WTO membership will be neither immediate nor dramatic. The two main issues concerning WTO membership are the lowering of import tariffs and liberalization of the service sector. On average, Russia's imports tariffs are not extremely high at present; the average ad valorem tariff rate is 11%. There are also problems in collecting the duties. The average reduction in import tariffs is announced to be merely 3 percentage points, and the tariffs will be lowered only after a transition period. The Russian service sector will be liberalized, but there will also be transition periods and some restrictions on foreign ownership will remain, especially in energy-related and financial sectors.

Although the effects will not be striking, the advancing process of WTO membership certainly gives a positive political signal. It indicates clear support for a more liberal economic policy despite the expression of protectionist views. Russia has pronounced its endeavour to further integrate with the global economy and to adopt the common practices of international business. But the liberalization of Russian markets will encounter difficulties even after WTO membership. The negotiation results published so far still leave room for manoeuvre for protectionist lobbyists. In Russian markets, there are also other obstacles to the operation of foreign companies than purely protective measures; these include heavy bureaucracy, corruption and inconsistent administrative practices. WTO membership is not a panacea for all the problems in the Russian markets, but it is an important step towards greater efficiency and predictability in the Russian business environment.

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Annex 1. Russian import duties

Table 1 presents the average Russian import duties. They are calculated as the simple average over tariff lines, excluding the lines with a fixed value duty. In product groups where both ad valorem and combination duties are used, the ad valorem part of the combination duty is used for calculating the average. Thus, it should be noted that in these product groups the average import duty is actually the minimum average import duty, as cheaper products are taxed more heavily in relative terms by the fixed value part of the import duty. These product groups are marked grey in Table 1. More detailed calculations and estimations for collected tax rates for 2001–2003 can be found in Tarr, Shepotylo & Koudoyarov (2005).

Table 1 Russia's average minimum import duties by product groups, %

HS-2 title	Average import duty, %
01 Live animals	3.9
02 Meat and edible meat offal	32.4
03 Fish and crustaceans, molluscs and other aquatic invertebrates	10.0
04 Dairy produce; bird's eggs; natural honey; edible products of animal origin n.e.s.	15.1
05 Products of animal origin n.e.s.	8.2
06 Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage	12.9
07 Edible vegetables and certain roots and tubers	14.9
08 Edible fruits and nuts; peel of citrus fruit or melons	7.6
09 Coffee, tea, maté and spices	6.3
10 Cereals	5.0
11 Products of the milling industry; malt; starches; inulin; wheat gluten	10.6
12 Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants, straw and fodder	4.8
13 Lac; gums, resins and other vegetable saps and extracts	5.0
14 Vegetable plaiting materials; vegetable products n.e.s.	13.8
15 Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes	11.3
16 Preparations of meat, fish, crustaceans, molluscs or other aquatic invertebrates	17.8
17 Sugars and sugar confectionery	10.7
18 Cocoa and cocoa preparations	5.0
19 Preparations of cereals, flour, starch or milk; pastry cook's products	14.8
20 Preparations of vegetables, fruits, nuts or other parts of plants	14.0
21 Miscellaneous edible preparations	14.1
22 Beverages, spirits and vinegar	20.2
23 Residues and waste from the food industries; prepared animal fodder	7.6
24 Tobacco and manufactured tobacco substitutes	10.5
25 Salt; sulphur; earths and stone; plastering materials, lime and cement	5.2
26 Ores, slag and ash	4.4
27 Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	5.0
28 Inorganic chemicals; organic or inorganic compounds of precious metals, rare-earth metals, radioactive elements or isotopes	4.9
29 Organic chemicals	5.1
30 Pharmaceutical products	9.2

31 Fertilisers	10.0
32 Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and varnishes; putty and other mastics; inks	4.8
33 Essential oils and resinoids; perfumery, cosmetic or toilet preparations	8.6
34 Soap, organic surface-active agents, washing preparations, lubricating preparations, artificial waxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modelling pastes, dental waxes and dental preparations with a basis of plaster	12.6
35 Albuminoidal substances; modified starches; glues; enzymes	6.3
36 Explosives; pyrotechnic products; matches; pyrophoric alloys; certain combustible preparations	20.0
37 Photographic or cinematographic goods	11.8
38 Miscellaneous chemical products	6.2
39 Plastics and articles thereof	10.9
40 Rubber and articles thereof	8.7
41 Raw hides and skins (other than fur skins) and leather	5.0
42 Articles of leather, saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	18.5
43 Fur skins and artificial fur, manufactures thereof	9.5
44 Wood and articles of wood; wood charcoal	14.9
45 Cork and articles of cork	5.0
46 Manufactures of straw, esparto or other plaiting materials; basket ware and wickerwork	20.0
47 Pulp of wood or other fibrous cellulosic material; recovered (waste and scrap) paper or paperboard	14.6
48 Paper and paperboard; articles of paper pulp, paper or paperboard	13.4
49 Printed books, newspapers, pictures and other products of the printing industry; manuscripts, typescripts and plans	6.1
50 Silk	5.0
51 Wool, fine or coarse animal hair, horsehair yarn and woven fabric	14.7
52 Cotton	11.2
53 Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn	7.4
54 Man-made filaments	10.3
55 Man-made staple fibres	7.6
56 Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof	8.6
57 Carpets and other textile floor coverings	20.0
58 Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery	20.0
59 Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use	6.6
60 Knitted or crocheted fabrics	10.0
61 Articles of apparel and clothing accessories, knitted or crocheted	19.2
62 Articles of apparel and clothing accessories, not knitted or crocheted	8.0
63 Other made-up textile articles; sets; worn clothing and worn textile articles; rags	18.5
64 Footwear, gaiters and the like; parts of such articles	10.4
65 Headgear and parts thereof	20.0
66 Umbrellas, parasols, walking sticks, seat-sticks, whips, riding crops and parts thereof	20.0
67 Prepared feathers and down and articles made of feathers or down; artificial flowers; articles of human hair	20.0
68 Articles of stone, plaster, cement, asbestos, mica or similar	14.9
69 Ceramic products	17.6
70 Glass and glassware	14.0
71 Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coins	19.7
72 Iron and steel	4.9
73 Articles of iron or steel	13.8
74 Copper and articles thereof	5.0

75 Nickel and articles thereof	11.1
76 Aluminium and articles thereof	14.7
78 Lead and articles thereof	5.0
79 Zinc and articles thereof	5.0
80 Tin and articles thereof	5.0
81 Other base metals; cements; articles thereof	14.0
82 Tools, implements, cutlery, spoons and forks made of base metal; parts thereof	9.2
83 Miscellaneous articles of base metal	18.3
84 Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	4.7
85 Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	9.3
86 Railway or tramway locomotives, rolling stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electromechanical) traffic signalling equipment of all kinds	6.7
87 Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	11.0
88 Aircraft, spacecraft, and parts thereof	15.4
89 Ships, boats and floating structures	12.2
90 Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof	6.8
91 Clocks and watches and parts thereof	18.9
92 Musical instruments; parts and accessories of such articles	9.4
93 Arms and ammunition; parts and accessories thereof	20.0
94 Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings n.e.s.; illuminated signs, illuminated nameplates and the like; prefabricated buildings	16.3
95 Toys, games and sports requisites; parts and accessories thereof	13.9
96 Miscellaneous manufactured articles	18.9
97 Works of art, collector's pieces and antiques	0.0

Sources: Customs Tariff of the Russian Federation, author's calculations.