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Abdur Chowdhury

WTO accession: What's in it for Russia?

Bank of Finland  
Institute for Economies in Transition, BOFIT

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Bank of Finland  
Institute for Economies in Transition (BOFIT)

PO Box 160  
FIN-00101 Helsinki  
Phone: +358 9 183 2268  
Fax: +358 9 183 2294  
bofit@bof.fi  
www.bof.fi/bofit

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Abdur Chowdhury

## WTO accession: What's in it for Russia?

### Abstract

Prospects for Russia's membership in the WTO now look better than any point since accession negotiations began almost a decade ago. Good progress with economic and legal reforms within Russia has left the country's economy better prepared for membership. Nevertheless, the economy still suffers from various weaknesses including, but not limited to, pervasive subsidies for different sectors, lack of liberalization and foreign participation especially in the service sector, inefficiency in custom administration, lack of enforcement of intellectual property rights, etc. For all their sensitivity, the negotiations on the import tariff levels and access to the service sectors are the least of the problems. Much more difficult will be non-tariff barriers and the general trade-related legislative framework. Resolving the remaining weaknesses would be a complex process. However, given the importance of WTO-related measures for the overall domestic structural reform, any delay in accession would be at least marginally negative for investor perceptions of country risk.

**Key words:** Russia, WTO, tariff, reform

**JEL classification:** F1, P2

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Abdur R. Chowdhury, Institute for Economies in Transition, Bank of Finland, Helsinki 00101 Finland  
abdur.chowdhury@bof.fi

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# 1 Introduction

Russia applied to the World Trade Organization's (WTO) predecessor, the General Agreement on Trade and Tariff (GATT), in June 1993 hoping to join the organization before the end of the decade. However, a lack of initiative during the early years – which can be attributed to a government that is relatively new and, in many areas, still in the midst of formulating a legal and regulatory framework to meet a completely different political and economic environment – led the entire process to run out of steam. Following the 1998 financial crisis, when Russia devalued the rouble and defaulted on its debt, efforts to keep the economy afloat left the authorities with little time to press ahead with WTO preparations.

Active negotiations and discussions started again only after President Putin declared WTO accession as one of the goals of his presidency. His declaration generated a genuine political commitment that has enabled Russia to tackle a number of contentious accession issues. In May 2001, Russia presented a report on 'Review of the Russian Trade Policies' that will serve as the basis for the Protocol of Accession. In Spring 2002, WTO's Working Party on Russia's accession reviewed the first draft of the report [Stern (2002)]. This means that Russia has entered the final phase of the accession process, in which it will negotiate the conditions of entry and implement the required legislative reforms. However, because of the many disagreements between Russia and the other countries, this final stage could take some time to complete [Yudaeva (2002a)].<sup>1</sup>

The aim of this paper is to discuss the potential accession conditions, the current state of negotiations, as well as potential effects of the accession for Russia. An analysis of Russia's accession process is interesting for at least three reasons. First, the Russian Federation is one of around 30 countries which are currently seeking accession to the WTO. Being one of the largest economies among the applicant countries, its accession has great potential to increase trade that would benefit current WTO members as well as Russia itself. On the other hand, its relative size and importance within the former Soviet Union countries (CIS), many of whom are also in the WTO accession process, mean that Russia's entry terms would have important implications for other countries [Hare (2002)]. In fact, there is already indication of this happening.

Second, when Russia initially applied to the WTO, its economy had a different structure from traditional non-planned economies. A number of sectors (e.g., financial services) did not exist, and a number of important regulations were not formally legislated. Even now, after a decade of transition, formally legislated laws are not fully implemented and enforced. This has a direct consequence for the economy and for the accession. Since in many cases formal rules are absent and the economy is governed by a set of informal rules, authorities at different levels enjoy substantial discretion. Consequently, a number of WTO members have doubts about Russia's ability to fulfill the obligations in the near future.

Third, the fact that, like many of the other applicants, Russia is in the midst of a process of economic reform and transition towards a market economy also makes the accession process more complicated than it would be for an already well established market economy.

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<sup>1</sup> Unless all unsolved issues are settled by the summer of 2003, Russia may not be able to join the WTO over the next 2-3 years, in which case she might face some additional hurdles as new requirements concerning anti-dumping measures and exports of labor force emerging from the Doha Round are likely to be presented later.

The paper begins with a discussion of the composition and direction of Russia's foreign trade in Section 2. Section 3 provides a description of the negotiation process. The benefits and hurdles on the way to WTO membership are presented in Sections 4 and 5, respectively. Empirical results analyzing the effect of WTO accession for the Russian economy are reported in Section 6. The paper ends with concluding remarks.

## 2 Composition and Direction of Trade

In order to set the stage for discussion, this section presents some salient features of the commodity and geographic composition of Russia's foreign trade. In recent years, Russia has experienced surplus in both merchandise trade and current account. Merchandise surpluses have been huge, culminating in a surplus of \$60 billion in 2000, \$48 billion in 2001, \$46 billion in 2002, and about \$15 billion in the first three months of 2003 (Table 1). Crude oil, petroleum products, natural gas, and metal are Russia's main exports, accounting for about two-thirds of the export earnings in 2002 (Table 2). Russia's current account has also shown record surplus – about \$33 billion or 10.5 percent of GDP in 2002 (Table 1).

As shown in Table 2, Russia's merchandise exports in 2002 totaled \$100 billion.<sup>2</sup> Europe was the leading destination of Russian exports with 56 percent followed by Asia (including China and Japan) at 18 percent and CIS at 15 percent (Table 3). Only about 4 percent of Russian exports went to the United States.

Russia's total merchandise imports in 2002, exclusive of barter and shuttle trade, was \$42 billion (Table 4). Again, Europe was the major source of imports (49. percent) followed by the CIS countries (22. percent). Asia (including China and Japan) accounted for about 15 percent while the USA's share was slightly higher than 6 percent (Table 5). In terms of commodity composition, machines (equipment and instruments) and chemicals (including pharmaceuticals and rubber) account for a combined 53 percent of total imports while food and agricultural products account for 23 percent [Stern (2002)].

An analysis of these figures will show that Russia's exports and imports are concentrated geographically with the EU, CIS, and Central and Eastern Europe. It enjoys a comparative advantage in raw materials and low value added products including oil, gas, metals, timber and artificial fertiliser; while its comparative disadvantage is in certain types of industrial products and, to a lesser degree, in services and agricultural products [Stern (2002), Yasin (2002)].

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<sup>2</sup> This figure does not include barter and what has come to be known as 'shuttle trade' where individuals or groups frequently travel abroad and buy items including clothing, used cars, etc. to bring them to Russia for resale.

### 3 The Negotiation Process<sup>3</sup>

Pursuant to the established procedure, a Working Party (WP) on accession, consisting of representatives of interested GATT countries, was formed in June, 1993. The mandate of the Working Party (transformed into the Working Party on Russia's WTO accession after the WTO's establishment) was to study the trade regime in Russia and negotiate the requirements for Russia's participation in the WTO. As of June 2003, there are 67 member countries in the Working Party.

Negotiations on Russia's accession to WTO started in 1995. The WP has met on numerous occasions. Until April 2003, nineteen meetings of the WP have been held to examine the accession application and eventually submit recommendations, which may include the draft Protocol of accession, to the General Council.<sup>4</sup>

Initially, the WP focused on a detail study of the economic mechanisms, trade and political regime in Russia at multilateral level in terms of their conformity with the WTO rules and regulations. During 1998-99, Russia presented its preliminary proposals on tariffs (the list of the maximum admissible import customs duties), agriculture (measures to support national agricultural production and subsidize exports of agricultural products and food), and provision of free access to the national services market (the list of obligations to provide free access and the list of exceptions from the most-favored nation clause).

Russia has also initiated a series of bilateral negotiations with all the interested members of the WP on the terms and conditions of Russia's membership in WTO. The negotiations are in the areas of agriculture, the customs system (and customs union and other trade arrangements with CIS States), excise taxation and national treatment, import licensing, industrial subsidies, national treatment, Agreement on Technical Barriers to Trade (TBT), Trade Related Intellectual Property Rights (TRIPS) and services.

The latest round of talks included multilateral discussions on sanitary measures, access of services to the Russian market, import tariff quotas and agriculture, as well as bilateral talks on access of goods and services to the Russian market. The first bilateral agreement on access of goods to the Russian market has been signed. Russian legislations are also being brought in line with the norms and rules of the key WTO Agreements. The government has also submitted to the Duma the last draft law included in its WTO package. However, the most controversial issues still lie ahead, e.g., agricultural subsidies; EU demands that Russian domestic energy prices be better aligned with world market prices; access to Russian markets for telecommunications, finance, and transportation services markets; and demands that Russia accede to a voluntary agreement governing trade in civil aircraft (BOFIT, 2003).

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<sup>3</sup> For a discussion of the main procedural aspects of accession to the WTO, see the WTO website [www.wto.org](http://www.wto.org).

<sup>4</sup> The minutes of each of these meetings are available at the website ([www.wto.ru](http://www.wto.ru)) maintained by the Ministry of Economic Development and Trade of the Russian Federation.

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Key concerns in these negotiations include:<sup>5</sup>

- subsidization of agriculture – in particular, Russia's claims to enter the WTO with subsidies above levels utilised in recent years;
- customs formalities and administration, including customs valuation – Russia is still to introduce a new Customs Code ensuring that all aspects of customs policy are compatible with WTO rules;
- standards and conformity assessment – introduction of legislation ensuring the compliance of technical standards with WTO disciplines;
- import licensing and other non-tariff barriers – WTO members are challenging the WTO-consistency of Russian measures in this area;
- fees and charges on imports – commitment that fees and charges on imports (other than tariffs) do not afford protection to domestic production and any fees and formalities associated with import reflect the approximate cost of the services involved;
- intellectual property protection – effective enforcement by Russia of intellectual property protection;
- judicial review of administrative decisions – greater clarification as to administrative and legal bodies in Russia for reviewing administrative decisions impacting on trade;
- consistency of sub-federal measures with the WTO – commitment from Russia that trade-related measures will be enforced consistently throughout the country and in a manner that does not result in unjustifiable restrictions on trade;
- bilateral negotiations are placing particular emphasis on securing Russia's agreement to:
  - commit to tariffs at low levels on products of current or prospective export interest to these countries – at present a number of proposed tariff rates are well above those currently applied to imports into Russia;
  - improve market access and reform policies in the services sector – a number of countries are seeking commitments from Russia to guarantee levels of access to a number of sectors such as mining-related services, education, financial, legal and telecommunications.
  - commit to removal of tariff quotas imposed on imports of meat; and
  - remove non-tariff measures of concern to foreign industry, such as measures affecting the importation into Russia of food products.

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<sup>5</sup> For a more detail discussion on these concerns, see the website [www.dfat.gov.au/trade/negotiations/accession/wto\\_russia.html](http://www.dfat.gov.au/trade/negotiations/accession/wto_russia.html) maintained by the Australian Department of Foreign Affairs and Trade.



## 4 Benefits of Membership

Russia's primary objectives in a bid to join the WTO is to obtain new trade advantages; gain access to foreign markets and provision of non-discriminatory treatment for Russian exporters; access to the international dispute settlement mechanism;<sup>6</sup> creation of a more favorable climate for foreign investments; creation of conditions for growth of domestic production' quality and competitiveness as a result of increased flows of foreign goods, services and investments and; expansion of opportunities for Russian investors in the WTO-member countries.<sup>7</sup>

WTO membership would bring clear economic benefits for Russia. Foreign trade has become increasingly important for the Russian economy, with exports rising from less than 20 percent of GDP in early 1990s to around 40 percent in 2002. In the first quarter of 2003, crude oil, fuel, gas and metal made up more than 75 percent of total exports, which leaves the country overly dependent on unstable international commodities markets. In order to achieve sustainable economic growth, Russia will have to diversify its exports into higher-value added goods.

However, being outside the WTO framework has made it unnecessarily complicated for Russian producers to find new markets as it allows for a more rigorous interpretation of anti-dumping rules. According to the Russian Ministry of Foreign Trade, some 120 anti-dumping actions are currently in place against Russian products, costing the country up to US\$ 4 billion a year. Russia views many of these to be WTO non-compatible. Recent decisions by the United States and the European Union to classify Russia as a market economy under antidumping and countervailing duty regimes may not fully alleviate this problem As it would make Russian subsidies on such public services as gas and electricity more susceptible to anti-dumping and/or countervailing duty actions.<sup>8</sup> Although WTO membership does not render a country immune to protective action against the producers, it does provide access to the WTO's dispute settlement mechanism.

WTO membership would also mean a further liberalization of Russia's domestic market. Import penetration is already relatively high, at 24 percent of GDP (compared with, say, 15 percent in the US). Nevertheless, competitions are severely restricted in a number of areas and quasi-monopolies often exist on a sectoral and regional basis. International competition would help to weed out some inefficient producers and create a level playing field for more dynamic small and medium-sized enterprises. Russia's economy would also benefit from the implementation of WTO rules in areas such as investment regulations, trade in services and intellectual property. A more transparent business environment would help to attract much needed foreign investment. In short, the most tangible benefit of acceding to the WTO would be the improvement of the business environment.

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<sup>6</sup> The importance of this is illustrated by a recent bilateral trade dispute, during which Russia banned US chicken imports. This prompted threats from the US administration that it might withdraw political support for Russia's WTO application.

<sup>7</sup> The list is based on various documents prepared by the Ministry of Economic Development and Trade of the Russian Federation. See also the website [www.wto.ru](http://www.wto.ru)

<sup>8</sup> The EU formally recognized Russia as a market economy on May 29, 2002. Similar recognition were given by the U.S. on June 6, 2002.

## 5 Obstacles to Membership

Since the completion of the Uruguay Round, countries acceding to the WTO have been held to a higher standard than those that joined in previous years. These include greater disciplines in tariff levels and agriculture supports; new obligations in rules and commitments covered by the General Agreement on Trade in Services (GATS), TRIPS, and the Agreement on Agriculture; and assuming obligations to a number of agreements, such as, TBT, customs valuation rules, and the Agreement on Subsidies and Countervailing Duties.<sup>9</sup> The exact nature of this type of obligations, which require the enactment of new laws and regulations to meet WTO obligations, depends on the results of the negotiations.

The main areas of remaining dispute relate to tariff and non-tariff barriers and a number of trade-related distortions. These can be summarized under the following headings:

### 5.1 Tariff Structure

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- and mid-1990s as a part of the IMF stabilization program. Hence the effect of further trade liberalization will be rather modest [Yudaeva (2002a, 2002b)]. The country's foreign trade regime has been characterized by a very complex import tariff structure including both ad valorem and specific tariffs, a variety of licensing requirements and other qualitative restrictions as well as export duties payable on exports of gas and oil.<sup>10</sup> In the late 1990s, the weighted average import tariff in Russia was about 13.6 percent with a range from 0 to 30 percent for most commodities [Michalopoulos and Tarr (1997)]. However, the effective rate was close to 10 percent given the exemptions and pervasive noncollection [Hare (2002)].<sup>11</sup> Table 6 shows the weighted average tariff rates (across all categories of imported goods) and the actual collection of import duties. The divergence between the official and actual tariff rate can be attributed to low administrative capacities and corruption practices.

In early 2001, Russia undertook a major effort to reduce the number of rates in use and lower the average rate. Currently commodities are divided into four major subgroups – raw materials, semi-finished goods, food stuffs, and finished products - with marginal tariff rates of 5, 10, 15, and 20 percent, respectively. Although there are major exemptions [spirits (100 percent), cigarettes (30 percent), sugar (30 percent) and cars (25 percent)], these changes have brought the average tariff rate down from 11.4 percent to 10.7 percent [Stamps (2001)].

Russia is experiencing a strong domestic protectionist movement as a number of strong lobbying groups are insisting on an increase in tariffs during the accession to WTO. An example in point would be the auto industry. Russian automakers have proposed to retain high import duties on foreign cars after WTO accession for a transitional period of

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<sup>9</sup> See Self (2002) for a more detail discussion of the core requirements that all countries that accede to the WTO after the Uruguay round have to satisfy.

<sup>10</sup> Brenton *et al* (1997) presents the official Russian trade-weighted tariffs for 1994 by major commodity groups.

<sup>11</sup> This was much higher than the average external tariff of EU, but not very high by international standards.

up to ten years. Bowing to the domestic pressure, in its WTO negotiations, Russia is proposing initial tariff bindings at levels well above current effective rates while the final bound rates - after the expiration of 5-7 years of transition period – will be close to the current effective tariff level [Hare (2002)]. For example, the proposed final bound rate for agricultural produce and food products are 25 percent as compared to a current tariff of 15 percent. As countries usually lower the tariff rates on accession to the WTO, Russia's offer may not be acceptable to the other countries. However, the existing low level of tariff protection in Russia means that this would not be a source of major concern during the accession negotiations.

## 5.2 Energy Prices

Another area of contention is the issue of state control over energy prices. According to OECD (2002) estimates, industrial subsidies in the form of cheap energy amounted to the equivalent of about 5 percent of GDP in 2000, thus potentially giving the Russian producers a comparative advantage over their foreign competitors. The EU and US are insisting that Russia's domestic prices for energy resources must be closer to the world price and that significant reform should be carried out in the energy sector. Russia contends that lower energy prices are due to its comparative advantage and raising the domestic price of energy to the world-market levels would make Russian manufacturing uncompetitive. This proposal is also facing strong opposition from various lobbying groups within Russia.

## 5.3 Agriculture

During the early 1990s, Russian agriculture didn't perform well. However, significant investment in recent years in large farms run by Russian companies coupled with favorable weather conditions has enabled food grain production to increase substantially [Tekoniemi (2003)]. Special WTO regulations allow countries to employ some non-tariff measures, such as import quotas and subsidies in agriculture. Such subsidies is quite prevalent in many countries (e.g., USA and the EU). By these standards, levels of subsidies to the Russian agriculture during the last few years has been relatively low creating a peculiar problem for the Russian position at the WTO negotiations.<sup>12</sup> Countries belonging to the Cairns Group (Australia, New Zealand and others) want the late 1990s to be used as a reference point such that the upper limit to the subsidy levels that Russia should commit would be low. Russia, on the other hand, want to use the late 1980s as the reference point when applied subsidies were much higher than at present.

Further, given the large scale state-ownership in agriculture, translating Russian agricultural support measures into traditional WTO classifications of red, yellow and green light subsidies is difficult.<sup>13</sup> Agriculture related issues are currently being discussed in the Doha Round of multilateral negotiations. So the final conditions for accession are still fluid.

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<sup>12</sup> Subsidy-like measures provided by the regional governments, for example, barter schemes that allow the exchange of fuel and fertilizers for agricultural crops, are quite common [Amelina (2000)]. However, these schemes are often not transparent making it difficult to measure the size of the transaction.

<sup>13</sup> See Self (2002) for a discussion of the red, yellow, and green subsidies.

## 5.4 Trade in Services

Most WTO members would like to see a significant opening of the Russian service sectors to foreign-owned business and capital. Most of the service sector, e.g., financial sector, is either new to the Russian economy or performed a different role during the Soviet period.<sup>14</sup> The current negotiating position of Russia is influenced by domestic lobbying groups who use the infant industry argument in their defense. Russia insists on limiting foreign presence in a number of service sectors including banking and insurance in order to allow domestic producers to flourish, and also to retain state monopoly in some areas, e.g., telecommunications

Much work also need to be done in the area of intellectual property rights. Copyright piracy in Russia is rampant and often run by organized crime syndicates. Laws for protecting intellectual property are weak, lack strong criminal sanctions and are not well enforced. Hence active steps have to be taken by the state to draw up new laws and implement and enforce both the new and existing laws before acceding to the WTO.

## 6 Empirical Estimates of the Effect of WTO Accession<sup>15</sup>

As discussed in the earlier sections, the major impact of WTO accession will occur through an improvement in the business environment as it becomes more transparent, accessible, and less riskier with a better protection of property rights. A number of studies have tried to empirically estimate the economic impact of accession on the Russian economy. In the following sections, the results from various studies are briefly summarized.

Jensen *et al* (2002) have used a computable general equilibrium (CGE) model to show that gains to Russia from WTO accession derive from at least four key effects: (i) improved access to the markets of non-CIS countries in selected products; (ii) improved domestic resource allocation since tariff reduction induces the country to shift production to sectors where production is valued more highly based on import prices closer to world market prices; (iii) higher Russian factor productivity due to availability of better imported technologies and techniques from multinational firms that increase their foreign direct investment; and (iv) positive effects on the growth rate from increases in the rate of return to capital.

Using the CGE model, they estimate the gains to Russia from WTO accession to be about 8 percent of Russian consumption (or about 4 percent of GDP) in the medium run, and as high as 69 percent of Russian consumption (29 percent of GDP) in the long run. Almost 70 percent of this total gains are due to improved access for foreign investors to the service sector (around 5 percent of consumption in the short-run). Tariff reduction amounts to an additional 25 percent of total gains (2 percent of consumption). The rest of the gains are attributed to productivity effects and improved market access for foreign firms in the manufacturing sector.<sup>16</sup>

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<sup>14</sup> The service sector includes transportation, telecommunication, education, financial services, culture and art, public health, sports, science, etc.

<sup>15</sup> I would like to thank Ksenia Yudaeva for suggesting the empirical studies published in the Russian language.

<sup>16</sup> A number of econometric studies using firm-level data have shown that the entry of foreign direct investment in downstream sectors has positive effects on domestic suppliers. See Yudaeva (2002b) for additional insights on the productivity effects.

In terms of the sectoral impact, the paper predicts that sectors that currently export or have little protection, such as, ferrous and non-ferrous metals, chemical and timber, wood pulp and paper products, will expand while business services will record significant contraction. However, sectors that are expected to expand are mostly energy-sensitive. So any reform in the energy sector could significantly affect the paper's prediction.

Using a model similar to Jensen *et al* (2002), Zemnitsky (2002) analyzes the impact of liberalizing the access of foreign firms to the financial sector on labor demand. Given the rigidity in labor movement in this sector, he shows that labor will gain from liberalization only if it is mobile. Consequently, he proposes that foreign firms should be required to employ Russian labor.

Ustenko (2002) uses survey results to investigate the impact on the aluminium industry of an increase in energy prices following prospective WTO accession. The Russian primary aluminium producers will gain from accession because of better access to the world market and higher employment. On the other hand, the expected decrease in import tariffs will increase competition in the secondary aluminium products market driving some producers away from the market and increasing unemployment. Domestic consumers will gain with a decrease in price and increase in quality for secondary aluminium products. Overall, the findings of the study support the country's accession to the WTO.

The Higher School of Economics (2002) uses a macroeconomic model to forecast the effects of WTO accession. The study compares a base scenario (where Russia does not enter the WTO) with four different variations of Russia's 2002 tariff offer. The results indicate that any of the four WTO accession scenarios would lead to a 0.4 percent higher GDP growth than the base scenario between 2002 and 2010. The difference in effects under the four separate scenarios is minimal.

CEFIR (2002) published a collection of several studies analyzing different aspects of the accession process. First, using firm-level panel data, the paper estimates tariff elasticities of employment of Russian firms. The results show that food and light industry and machine building are the most sensitive to changes in tariff. At the regional level, a uniform 1 percentage point decrease in the tariff rates would lead to a more than 1 percentage point decline in industrial employment in four regions – Evreiskaya, Ivanovskaya and Kurganskaya oblasts and Adygeya. The remaining regions would experience a less than proportional decline.

Second, the paper finds inconclusive results on the effect of an increase in competition with imports on the level of productivity of Russian firms. While demonstration and incentive effects may have a positive impact, pure competition effect will be negative. Third, the paper estimates that a decline in tariff rates to 5 percent in several categories of durable goods - clothing, construction materials, fabrics, furniture, household electronic appliances, shoes, and transports – would lower average per capita household expenditures by 540 rubles, measured in 2000 prices. The rate of decline varies from a low of 2.7 percent in construction materials to a high of 22.4 percent in household electronic appliances.

Fourth, using a gravity model, the paper shows that WTO accession will increase foreign direct investment in Russia by up to US \$4 billion. Finally, the paper argues that liberalization of the entry of foreign banks and trans-border banking activities will encourage economic growth. In particular, a doubling of the number of foreign banks operating in Russia will increase economic growth rate by about 1 percentage point, while a doubling of trans-border credits to non-banking Russian institutions will increase growth rate by 1.6 percent.

A study sponsored by the National Investment Council (2002) employ an econometric model (Russian Inter-Industry Model) to measure the impacts of WTO

accession on a number of sectors and regions. Two scenarios of accession are considered: a 'moderate' scenario allowing for gradual transition and the phased removal of protectionist barriers, and a 'worst-case' scenario implying faster tariff reductions than Russia is currently proposing. Interestingly, the study finds little difference in the impacts between fast and phased convergence. Overall, the study did not find any major negative impact on the national economy. In the worst case scenario, the adverse effect on GNP would be held to less than one percentage point.

However, impacts within specific sectors and regions could be significantly more dramatic. Russia stands to benefit from WTO membership through integration into the international legal framework, which could contribute strongly to Russia's development of a coherent system of laws and regulations. This would have a positive impact on the country's investment climate. Certain sectors including telecommunications, metallurgy, footwear, garments, electronics, strong alcoholic beverages, etc. stands to benefit from accession to WTO. On the other hand, increased competition can be expected in a number of sectors including, but not limited to, pharmaceuticals, furniture, insurance industry, retail, and certain parts of the chemical industry.

Finally, the paper tries to identify the regions which are most sensitive to changes in the tariff policy. Estimations reveal that the following nine regions, with a high import share of consumption and a high share of industries that are affected by tariff changes, are most sensitive – Irkutskaya oblast, Kaluzhskaya oblast, Leningradskaya oblast, Moskovskaya oblast, Moscow, Primorsky kray, Republic of Karelia, St. Petersburg and Yaroslavlskaya oblast. Using Russia's 2002 offer as the WTO accession scenario, the paper predicts an increase in GDP from 0.13 percent to 0.67 percent depending on the region, and an increase in employment from 320 to about 10,000 individuals.

To summarize, the overall results from the empirical studies show a positive effect on the domestic economy. A number of specific conclusions can also be derived. First, as the current tariff rate in Russia is already relatively low, a further decline in rates after WTO accession will not have a significant impact on the economy. On the other hand, a decrease in non-tariff barriers would have a positive impact. Second, reform in the services sector is expected to generate significant positive externalities. Third, natural resource extracting sectors and producers of metals and chemicals are likely to gain the most from accession, while labor intensive sectors, such as, food and light industries, and machine building industries would experience the most adverse effect.

## 7 Concluding Remarks

Prospects for Russia's membership in the WTO now look better than any point since accession negotiations began almost a decade ago. Good progress with economic and legal reforms within Russia has left the country's economy better prepared for membership.

Nevertheless, the economy still suffers from various weaknesses including, but not limited to, pervasive subsidies for various sectors through, for example, low energy prices; absence of a uniform tariff structure; inefficiency in customs administration; lack of liberalization and foreign participation especially in the service sector; lack of enforcement of intellectual property rights, etc.

The original timetable for an entry to the WTO by 2003 has slipped. This means that Russia would not be able to become a full participant in the current 'Doha Round' of multilateral trade talks where new regulations on sensitive trade areas, such as, textiles and agriculture will be discussed.

But this timescale always looked ambitious, and all the more so after the last few rounds of tough negotiations on reducing tariffs in key sectors such as autos, aerospace and pharmaceuticals, or on lifting restrictions on foreign entry into the domestic financial market. The necessary Russian concessions on some or all of these matters would mean overcoming some powerful vested interests at home.

For all their sensitivity, the negotiations on the import tariff levels and access to its service sectors are the least of the problems, since the negotiating parties can quickly come to an agreement provided there is sufficient political will on both sides. Delays here will be mainly due to negotiating tactics.

Much more difficult will be non-tariff barriers, and the general trade-related legislative framework. Here, the key issues are Russia's low regulated energy tariffs and agricultural subsidies. On the legislative front, the Duma has to address relevant legislations for WTO accession including the Customs Code, the liberalization of currency and controls and, in the area of non-tariff barriers, the law of technical regulations.

The large number of outstanding issues may well cause further delays in accession. Resolving the weaknesses would be a complex and painful process. However, given the importance of WTO-related measures for the overall domestic structural reform, any delay would be at least marginally negative for investor perceptions of country risk.

Ultimately the advantages of membership outweigh the disadvantages. As pointed out by many analysts, the disadvantages are mostly tactical, short-term and immediate; while the advantages are strategic. By joining the WTO following necessary reforms, Russia can still reap the full benefits of more free trade. It would be a logical continuation of Russia's advance towards a full market economy.

## Tables

Table 1. Main Indicators of the Russian Economy

### Macroeconomic indicators

	1996	1997	1998	1999	2000	2001	2002	2003	as of
GDP, %	-3.6	1.4	-5.3	6.4	10.0	5.0	4.3		
Industrial production, %	-4.5	2.0	-5.2	11.0	11.9	4.9	3.7	6.3	1-4/03
Fixed investments, %	-18.0	-5.0	-12.0	5.3	17.4	8.7	2.6	10.9	1-4/03
Unemployment, % (end of period)	9.3	9.0	11.8	11.7	10.2	9.0	7.1	8.9	4/03
Exports, \$ billion	89.7	86.9	74.4	75.6	105.0	101.9	107.2	29.9	Q1/03
Imports, \$ billion	68.1	72.0	58.0	39.5	44.9	53.8	61.0	15.3	Q1/03
Current account, \$ billion	10.8	-0.1	0.2	24.6	46.8	35.0	32.8	11.9	Q1/03

Source: Goskomstat, CBR.

### Fiscal indicators for federal government

(% of GDP, unless otherwise indicated; end-year figures for debt)

	1996	1997	1998	1999	2000	2001	2002	2003	as of	2003 budget
Revenues <sup>1</sup>	12.5	12.3	11.0	12.6	15.5	17.6	20.3	20.6	Q1/03	18.5
Expenditures <sup>1</sup>	20.9	19.4	16.9	13.9	14.3	14.7	18.8	17.4	Q1/03	18.0
Balance	-8.4	-7.1	-5.9	-1.4	1.2	2.9	1.4	3.2	Q1/03	0.6
Foreign currency debt	31.6	30.2	50.1	87.7	55.3	44.4	36.2			
Foreign currency debt, \$ bln	136.1	134.6	158.2	154.6	143.4	133.1	123.5			

<sup>1</sup> Since 2002 social tax is included in the federal budget.

Source: Budget: IMF 1995-1998, Economic Expert Group 1999-2003.

Debt: IMF 1995-1999, Minfin 2000-2003.

### Monetary indicators

	1995	1996	1997	1998	1999	2000	2001	2002	2003	as of
Inflation (CPI), 12-month, %	131	22	11.0	84.4	36.5	20.2	18.6	15.1	13.6	5/03
M2, 12-month growth, %	113	30	29.5	36.3	57.2	62.4	40.1	32.3	42.6	4/03
Average wage, \$ (period average, except last)	104	154	164	108	62	79	111	142	161	4/03
Deposit interest rate, % (period average)	102	55	16.8	17.1	13.7	6.5	4.9	5.0	4.3	3/03
Lending interest rate, % (period average)	320	147	32.0	41.8	39.7	24.4	17.9	15.7	13.4	3/03
Forex reserves, \$ bln (incl. gold)	17.2	15.3	17.8	12.2	12.5	27.9	36.6	47.8	59.8	4/03
RUB/USD (end of period)	4640	5560	5960	20.65	27.00	28.16	30.14	31.78	30.71	5/03

Source: Goskomstat, CBR.



Table 2. Russian Federation: Composition of Merchandise Exports, 2002

	<u>Value (\$ m.)</u>	<u>In Percent of Total Exports</u>
Total exports (f.o.b.)	100,312	
Food beverage, and agr. products	2,173	2.2
Stone and ore	580	0.6
Fuel products	55,737	55.6
Oil and oil products	38,585	38.5
Crude	27,445	27.4
Oil products	11,140	11.1
Gas	15,359	15.3
Coal	1,151	1.1
Other	643	0.6
Chemicals (inc. Pharmaceuticals)	6,775	6.8
Leather	186	0.2
Wood and paper products	4,692	4.7
Textiles and clothing	654	0.7
Gems and precious metals	4,760	4.7
Metals	14,166	14.1
Machines, equipment, instruments	9,164	9.1
Other, including ceramics and glass	1,425	1.4

Note: Total trade excludes shuttle trade. Data from Belarus is also excluded.

Source: IMF (2003, Table 31)

Table 3. Russian Federation: Destination of Exports, 2002

	<u>Total Exports (\$ m.)</u>	<u>In Percent of Total Exports</u>
Total exports	106,154	
CIS	15,609	14.7
Belarus	5,843	5.5
Kazakhstan	2,413	2.3
Ukraine	5,853	5.5
Other	1,501	1.4
Non-CIS	90,545	85.3
Europe	59,272	55.8
Czech Republic	1,509	1.4
Finland	2,925	2.8
France	2,649	2.5
Germany	8,035	7.6
Hungary	2,167	2.0
Ireland	260	0.2
Italy	7,432	7.0
Netherlands	7,267	6.8
Poland	3,719	3.5
Slovak Republic	2,032	1.9
Switzerland	5,367	5.1
UK	3,774	3.6
Other	12,136	11.4
Asia	19,043	17.9
China	6,819	6.4
Japan	1,803	1.7
Other	10,420	9.8
Western Hemisphere	7,447	7.0
US	3,983	3.8
Other	3,464	3.3
Middle East and Africa	4,722	4.4
Other	61	0.1

Note: Based on exports according to the Direction of Trade Statistics, which differ somewhat from those compiled by the Central Bank of Russia and given in Table 2.

Source: IMF (2003, Table 30)

Table 4 Russian Federation: Composition of Merchandise Imports, 2002

	<u>Value (\$ m.)</u>	<u>In Percent of Total Imports</u>
Total imports (c.i.f.)	42,103	
Food, beverage, agr. products	9,816	23.3
Stone and ore	667	1.6
Fuel products	1,001	2.4
Chemicals (inc. Pharmaceuticals)	7,305	17.3
Leather	170	0.4
Wood and paper products	1,758	4.2
Textiles and clothing	1,899	4.5
Gems and precious metals	40	0.0
Metals	2,591	6.2
Machines, equipment, instruments	15,180	36.1
Other, inc. Ceramics and glass	1,676	4.0

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Note: Excludes shuttle trade; also excludes data from Belarus.

Source: IMF (2003, Table 33)

Table 5. Russian Federation: Origin of Imports, 2002

	<u>Total Imports (\$ m.)</u>	<u>In Percent of Total Exports</u>
Total exports	46,156	
CIS	10,233	22.2
Belarus	4,054	8.8
Kazakhstan	1,945	4.2
Ukraine	3,226	7.0
Other	1,008	2.2
Non-CIS	35,923	77.8
Europe	22,720	49.2
Czech Republic	560	1.2
Finland	1,515	3.3
France	1,892	4.1
Germany	6,586	14.3
Hungary	512	1.1
Ireland	199	0.4
Italy	2,222	4.8
Netherlands	2,222	2.3
Poland	1,297	2.8
Slovak Republic	158	0.3
Switzerland	417	0.9
UK	1,117	2.4
Other	5,189	11.2
Asia	6,792	14.7
China	2,395	5.2
Japan	979	2.1
Other	3,418	7.4
Western Hemisphere	5,491	11.9
US	2,972	6.4
Other	2,519	5.5
Middle East and Africa	757	1.6
Other	164	0.4

Note: Based on imports according to the Direction of Trade Statistics, which differ somewhat from those compiled by the Central Bank of Russia and given in Table 4.

Source: IMF (2003, Table 32)

Table 6. Russia's Import Tariff Rate (in percent)

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	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Nominal weighted average tariff rate	14	14	12	8
Effective tariff rate (actual duty collected/import)	4	7	7	5

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Source: Gorban *et al* (2001)

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