

Russian WTO Membership

BY PETER AVEN

To join or not to join, that is the question...

Entry into the World Trade Organization is clearly in Russia's best long-term economic interests. The removal of some existing trade restrictions on Russian exports plus an expected increase in inward investment flows would add about \$5 billion¹ to the trade balance in the first year alone. Meanwhile, momentum toward entry would accelerate the pace of much-needed reforms and would benefit Russian industry and consumers as much as its foreign trade partners.

However, the real obstacle to advancing economic reforms and achieving the objective of a more broadly based economy with higher sustained growth is not the absence of WTO membership, but the fact that Russia is only a little more than two years into an economic restructuring program. Membership in the WTO and the need to comply with its entry requirements will eventually act as a strong framework for advancing these reforms. However, some basic changes, such as banking reform, do need to be put in place as a more immediate priority.

There is a danger that pushing for membership at too early a stage, and particularly entry under the wrong conditions, could pose risks for support of the fledgling reform process.

Entry to the WTO will not be as quick as was suggested only six months ago, and certainly not until after the next presidential election in March 2004. Entry at an earlier date does imply that the government will have to clearly set forth an agenda for tariff reform in the utilities sector. In a country where a recent study showed that 37 percent of the population is still struggling below the basic subsistence level, this would be seen as an unwise move ahead of the Duma and presidential elections.

CONCERNS

Right now, most ordinary Russians could not care less whether their country joins the WTO or not. Equally, many business managers are suspicious of pressure they believe is being placed on Russia to

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join. These individuals see membership as a ploy by Western interests to prevent them from being able to properly develop export markets. Alternatively, membership is seen

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as a sort of “Trojan Horse” that would allow foreign businesses to enter the Russian economy precisely at a time when confidence is growing that basic reforms initiated by the government might work.

In reality, of course, it is quite clear that an economy cannot hope to grow at rates and under conditions set forth in the government’s current economic development plan while remaining outside the WTO. To grow at these rates, Russia needs to see a substantial increase in foreign direct investment and the return of Russian capital. Investors’ perceptions of Russia are different from those of, say, China. For one thing, the Russian economy is perceived as too narrowly based on commodities, and the framework for economic advances provided by the WTO (e.g., pushing improvements in transparency and legal protections) will be important in helping persuade that capital to return home.

It is not a question of whether Russia should join or not. Rather, it is a question of educating people that distrust of WTO entry is misplaced, and that striking a balance on the conditions of entry would establish a consensus for membership. At this stage, these are much more important factors than the timing of entry.

WTO VERSUS REFORMS

It is generally accepted that membership in the WTO has proved highly beneficial for economies that are efficient and competitive, neither of which description can be applied to Russia at the present time. Moreover, it is unreasonable to expect Russia to move very quickly to allow such broad unrestricted competition, such as would occur with WTO entry, until industry is ready to compete. Membership, when it eventually occurs, will certainly force industry to become more competitive.

However, given that many of the more vulnerable sectors such as banking and services are still undergoing

basic restructuring, it is unlikely that the government will be keen to push membership until these reforms are in place. Today, the sectors best able to compete internationally (i.e., commodities) are the very ones that increase Russia’s economic vulnerability. The danger is that premature entry to the WTO on the wrong terms would only condemn Russia to an equally vulnerable future.

PROBLEM AREAS

A major part of concern about WTO entry arises from the belief that membership would allow unrestrained entry by foreign companies into Russia’s service sectors while exposing Russian industry to unfair competition from foreign enterprises and not allowing full access for Russian exports to their markets. The fact that both the United States and the European Union routinely use their economic muscle to impose seemingly arbitrary quotas and tariffs on selected imports whenever their domestic industries ask for protection does nothing to reduce these suspicions. The danger is that the WTO is seen as a mechanism for large economies to expand their dominance into newer economies while not fully allowing reciprocal access.

Agriculture. The fear is that Russia will be forced to drop import tariffs that many see as aimed at protecting domestic producers from dumping. In other words, if “dumping” does occur, this would prevent the proper development of Russia’s agricultural sector and make the

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country perpetually dependent on imports. Many countries that are current WTO members, particularly those in the important EU market, have high import tariffs on agricultural products. If these tariffs remain while Russia is forced to drop its protections, such fears may well be realized.

Finance. The banking sector is only just showing signs of recovery from the 1998 crisis and still undergoing major reforms. One example is the bank deposit insurance scheme, which is designed to help boost customer confidence. If foreign banks are allowed to enter on equal terms before Russian banks have been allowed to benefit from

industry restructuring, the possibility exists that Russian and foreign banking customers will simply choose the safe “foreign bank” option.

Similarly, both the insurance and asset management sectors, partly thanks to reform of the pension industry, are taking the first steps towards becoming important components of the economy. Large international institutions could easily dominate if allowed early and unrestricted access.

Industry. Major infrastructural industries, such as aviation, complain that they would face severe competition from strong global brands if protections were removed before they have a chance to restructure and become more competitive. Actually, any tariffs that are in place now do not restrict such import competition. This is clear in the automotive sector; customers buy imported cars at higher prices due to the lack of competitive domestic alternatives. As the economy continues to grow, domestic manufacturers face a race to become as competitive as foreign competitors, in quality and service as much as price, if they are to acquire future market share.

Telecoms. This is an obvious area of concern as a result of globalization of the telecommunications industry.

Energy. This is a very contentious area, as the implications of required domestic tariff changes affect all Russian citizens, and not just industry and commerce. For this reason, we are unlikely to see much progress, or even much debate on these changes, until after the election period is over in early 2004. Russians pay a lot less for energy than international price averages. For example, they pay about one-third of the EU price for gas and enjoy a domestic oil price that last winter was only one-quarter of the export price, even though the discount is usually about 25 percent. In total, Russians pay about \$20 billion less for energy per year than WTO membership would eventually require, and about one-third of this is a straight subsidy to industry.

INTERNATIONAL CONCERNS

Of course, the issue of Russia’s membership is not just a one-way street. While Russians have concerns and suspicions about WTO entry, the enthusiasm often shown by national governments and agencies to have Russia join

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on a fast-track basis is not shared universally by those who will have to compete in Russia.

Major problem areas that Russia will have to address as part of its entry requirements will include:

Protection of intellectual property. A very substantial amount of copyright violation takes place on a daily basis in Russia, ranging from the entertainment

industry output to industrial products. While impossible to eliminate in any economy, Russia will have to become much more active in combating this area of abuse.

Customs. There is little point in signing an agreement that encourages free trade if bureaucratic, corrupt, and inefficient practices are allowed to continue across large sections of the customs service. Reducing bureaucracy and streamlining areas such as customs and licensing is a major part of the government’s objective to establish an “investment climate” in the country. This is clearly going to be a slow process.

Currency restrictions. Foreign currency restrictions are incompatible with free trade, and they will eventually have to be removed. This liberalization is already on the government’s declared agenda, but progress will only be allowed in conjunction with other “investment climate” improvements. Otherwise, the risk is simply that legal capital flight will grow larger rather than reverse direction, as it now needs to do.

COMPROMISE

The one word that has been used most to refer to the policies and strategies of the current government is “pragmatic.” This pragmatism is expected to allow for a compromise solution on entry terms that offers a balance of benefits and risks. In the meantime, educating industry and the public about the long-term benefits of membership and the negative consequences of remaining outside the organization will also help smooth eventual entry. ◆

Notes

1. According to a report by the Ministry of Economic Development and Trade.