

RUSSIA AND THE WTO: DEAL, OR NO DEAL?

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“Staying outside this organization, outside this process, is dangerous and stupid.”
(Vladimir Putin, June 2002)

Thirteen years after Russia first expressed interest in joining the World Trade Organization, the Kafkaesque saga now seems to be entering its final act. The surprise November 10 announcement that the US government would approve Russian entry seemed to clear the last remaining hurdle.¹ The deal was signed on November 18, when President George W. Bush and President Vladimir Putin of Russia were in Hanoi for an Asian Pacific Economic Cooperation meeting.

However, some important questions remain. Why did this breakthrough occur now? Is it for real – that is, will Russia actually enter the WTO anytime soon? And, if it does join, what will be the impact on the Russian economy?

This article argues that the primary value of WTO entry to Russia is political rather than economic: her continued exclusion is seen as a diplomatic snub. Despite that, Russia’s hard bargaining over issues such as veterinary inspections combined with a lack of firm commitment on the US side to delay the reaching of an agreement. The economic benefits of WTO entry are relatively modest, given Russia’s trajectory as an energy-driven economy. The political fall-out from WTO entry is causing some anxiety in the Kremlin as the 2007-08 election round draws near. So it would be in the interests of both Russia and the United States to bring the final round of multilateral negotiations to a speedy conclusion – before the political winds change direction in Moscow.

Why now?

With each passing year, the failure of Russia to join the 149 countries that make up the WTO became more and more of an anomaly. With the world’s tenth largest economy, Russia is already better qualified for entry than many existing WTO members. Thanks to the economic liberalization of the 1990s, a process that continued under President Vladimir Putin, trade already accounts for one third of GDP, and average tariff levels have been cut to 11%. Moscow looked on as China joined the WTO under very favorable terms in 2001, not to mention places like Saudi Arabia who joined in 2005.

Increasingly, Russia’s exclusion as the negotiations ground on seemed to be an act of political vindictiveness.² Moscow could point to the US failure to revoke the 1974 Jackson-Vanik Amendment, which ties Russia’s trade status to its emigration policy. Russia was also exasperated by American arguments that the persistence of intellectual property violations in China proved that new members should be forced to make firmer commitments to enforcement of

¹ For details, see the US Trade Representative Factsheet on US-Russia WTO Bilateral Market Access Agreement, November 10, 2006. www.ustr.gov

² The 67-country Working Party held its 30th meeting on 30 March 2006. www.wto.ru

anti-piracy laws. The Russians argue that this is unfair: the standards are being raised for late-comers (“WTO plus”), giving an unfair advantage to the developed countries that locked in their own peculiarities (such as farm subsidies) at the start of the process.

Still, the negotiations were inching forward. A major development was the European Union’s May 2004 agreement to back Russian entry and abandon its demand that Russia raise domestic natural gas prices. (It is widely assumed that the EU made this concession in return for Russia’s acceptance of the Kyoto Accords.) That left the United States as the main hold out. America takes only 2.6% of Russian exports and provides just 4.6% of her imports. Those numbers suggest that the issue is of mainly of symbolic interest for the US. In contrast Russia provides 30% of EU energy imports and 44% of her gas imports.

Russia was hopeful that the US would sign off on a deal at the St Petersburg G8 summit in June 2006, but those hopes were dashed.³ Agreement had been reached on some crucial issues. For example, the US abandoned its demand for foreign banks to be allowed to establish branches in Russia, while Russia agreed to permit this for foreign insurance companies.⁴ Knowing that a deal was close, both sides engaged in some last-minute brinkmanship – and miscalculated the obstinacy of the rival team. The sticking point for Russia appears to have been the application of “national standards” for veterinarian inspection of meat imports on the Russia side; while the US was demanding firmer commitments to action on trade-related intellectual property rights (TRIPs).⁵ In response, the Russian government did submit a new intellectual property rights bill to the State Duma in August, and it was passed on second reading on November 9, the day before the US announcement.

After the G8 summit, top Russian officials began signaling that they intended to give up on WTO entry altogether. This was more than just a negotiating ploy. WTO entry has considerable value as a political symbol for Russia, but its political capital had steadily eroded over the years of negotiations. Further humiliating concessions could infringe on Russia’s “national sovereignty” – the central concept of Putin’s political ideology. Moscow’s pessimism was presumably exacerbated by the failure of the general Doha round of talks, and a feeling that the WTO as a whole had reaching the limits of its utility.⁶

German Gref, the liberal Minister of Economic Development and Trade, publicly threatened to cut the generous quotas for imports of American pork and chicken, agreed back in 2003.⁷ In September 2006 the Russian Veterinary Service (VPSS) placed a ban on chicken imports from Maryland and Pennsylvania, citing avian flu fears. At the end of October Aeroflot failed to take up an option to buy 22 Boeing 787s, worth \$3 billion.⁸ At the same time the state-owned Vneshekonombank spent \$1 billion acquiring a 5% stake in EADS, the European manufacturer of the rival Airbus.

³ Natalya Portyakova at al, “A dry remnant: US Russian Strategic partnership is over,” *Kommersant*, August 7, 2006.

⁴ Boris Grozovsky, “Win-win,” *Vedomosti*, November 13, 2006.

⁵ The US is being somewhat disingenuous over intellectual property rights: the US only signed the 1896 Berne Convention in 1989; and TRIPs was only hitched to trade liberalization in the 1994 Uruguay round.

⁶ Yekaterina Mereminskaya, “Russia is not hurrying into WTO.” *gazeta.ru*, 31 July 2006.

⁷ By 2005, 1 million tons of US chicken was exported to Russia, out of total US exports of 2.3 million tons. Ivan Nikol’skii, “Russia bargained its way into the WTO,” *gazeta.ru*, 13 November 2006.

⁸ Elmar Murtazaev, “How much per bullet,” *Kommersant*, November 9, 2006.

Meanwhile, tensions were increasing in the general US-Russian relationship. Venezuelan President Hugo Chavez made a high-profile visit to Moscow on July 27. On August 4 the US announced sanctions on the arms exporter Rosoboronexport and the state-owned aircraft manufacturer Sukhoi, because of their dealings with Iran, presumably triggered by the late July announcement of a contract to modernize 30 Su-24 bombers. And on August 22 Secretary of State Condoleezza Rice was in Moscow for some hard bargaining over the nuclear weapons programs in Iran and North Korea.

On October 9 came a surprising announcement from Gazprom, rejecting all five Western suitors for the giant Shtokman field. (A shortlist of approved bids had been released as recently as September 19.) Moreover, plans to build a liquefied natural gas plant were cancelled – instead the gas will to Europe by pipeline. (The building of an LNG plant would have allowed gas deliveries to the US.) At their October 21 meeting in Geneva, Putin reportedly told Rice that Russia would withdraw from the WTO talks absent some serious breakthrough.⁹ On October 24 14 leading American businesses sent a letter to Bush and Putin urging them to conclude the WTO deal.¹⁰

Russia was playing hardball, and the US had to act to rescue the process before Russia irrevocably withdrew, costing American manufacturers and farmers billions of dollars in lost contracts.

Will the deal unravel?

Several factors could yet derail Russia's bid during the final round of multi-lateral negotiations, which usually takes 12-18 months. One anonymous WTO official intoned: "Nothing is finalized until everything is finalized."¹¹

The US may yet hold out for firmer commitments on issues such as TRIPs. The 2008 presidential election is approaching, and Russia provides plenty of opportunities for the now-Democrat controlled Congress to criticize the Bush Administration. The US president will have a hard job persuading Congress to lift Jackson-Vanik and offer permanent normal trading partner status to Russia.¹² For example, on October 31 Senators Thad Cochran (R-MS) and Blanche Lincoln (D-AR) sent a letter to US Trade Representative Susan Schwab complaining that low natural gas prices in Russia are a subsidy for fertilizer exporters. The Democrats have a tougher position on human rights issues; they are closer to Hollywood (with its TRIPs concerns) and less connected to the oil companies that have an interest in closer ties with Russia.

The US entertainment industry lobby, the International Intellectual Property Alliance, estimates that Russian piracy of CDs and DVDs cost US industries \$1.7 billion in 2005.¹³ A surge of Western newspaper stories turned Allofmp3.com, which sells album downloads for \$2, into the

⁹ *Kommersant*, October 26, 2006.

¹⁰ The signatories were Alcoa, Boeing, Cargill, Chevron, Citigroup, ConocoPhillips, Dow Chemical, Ford Motors, General Electric, General Motors, International Paper, Procter & Gamble, Wrigley and the American Chamber of Commerce in Moscow. *Kommersant*, October 30, 2006.

¹¹ Quoted in *Izvestiya*, November 8, 2006.

¹² Russia could join WTO even without Congressional action on Jackson-Vanik, the US would be suspending application of WTO rules to Russia.

¹³ Sherman Katz and Matthew Ocheltree, "Intellectual Property Rights as a key obstacle to Russia's WTO accession," Carnegie Paper no. 73, October 2006.

poster-child of Russian piracy. The US is calling for an overhaul of Russian laws (allowing for class action lawsuits, and longer prison sentences) and even a public re-education campaign to tackle erroneous but “deeply rooted cultural assumptions” and cultivate “the idea that one should pay extra money for creative works, which used to belong to everyone collectively.”¹⁴ Even if the \$1.7 billion number is accurate, that is still less than the money the US makes from selling pork and chicken to Russia, and less than half the suspended Boeing deal.

It is also possible that the process could be sabotaged by some of Russia’s anxious neighbors. At the EU summit in Riga in November, Poland vetoed discussion of a new partnership agreement with Russia in retaliation for a Russian ban on Polish meat imports. On November 2, 2006 Georgia’s Foreign Minister Gela Bezhuashvili said his country would respond to Russia embargo on wine imports by revoking its approval of WTO membership for Russia, granted in a May 2004 – though this was later repudiated by President Mikheil Saakashvili. Realistically, however, if the EU and US want the deal to go ahead, these countries can be expected to fall into line.

How will WTO entry impact the Russian economy?

German Gref, Economic Development and Trade Minister, estimates that WTO entry would boost Russian GDP growth by 2% a year.¹⁵ However, the benefits will be concentrated in commodity export sectors and in gateway regions that will see an influx of foreign investment. Exporters of metals and fertilizers will find more Western markets open to them, and will have access to WTO arbitration procedures to challenge market restrictions. However, the beneficiaries are outnumbered by sectors likely to lose from WTO entry. Farmers and light manufacturers will face even more Western imports.

Rutherford and Tarr estimate that entry would boost Russian consumption by 7.8% (and GDP by 4.3%), ranging from a low of 6.2% in the Urals region to a high of 11.2% in the Northwest.¹⁶ They estimate that 85% of the impact would come from foreign investment in services and imports of manufacturing machinery (6.7%) as opposed to tariff reduction (0.7%) and market access (0.3%). Lissovolic and Lissovolic conclude on the basis of 1995-2002 data that lack of membership may have cut Russian exports by 30-50%.¹⁷ As of 2001 Russia faced 120 dumping actions, a fourfold increase on 1997. 50% of the dumping cases affect ferrous metals, 15% chemicals, and 7% fertilizer. However, they concede that a substantial boost in Russian exports would require an equally substantial investment in capacity. Martin Shakkum, head of the State Duma industry committee, estimated that WTO entry would result in the lifting of 35-40% of the dumping suits for metals, worth \$2.3 billion a year.¹⁸ If Russian mills went to full load from their current 70% capacity the maximum revenue increase could be as much as \$15 billion.

But it is important to remember that 60% of Russia’s export revenues comes from oil and gas, which are bringing in \$100 billion a year and which would be unaffected by WTO entry, since countries do not typically impose discriminatory tariffs or restrictions on energy imports. (Though there should be increased opportunity for US exports of mining equipment.) About half

¹⁴ *Ibid.*

¹⁵ Interfax, 8 December 2006.

¹⁶ Thomas Rutherford and David Tarr, “Regional impacts of Russia’s accession to WTO,” World Bank, 23 June 2006.

¹⁷ Bohdan Lissovolic and Yaroslav Lissovolic, “Russia and the WTO: the ‘gravity’ of outsider status,” IMF August 2004, p. 17.

¹⁸ Aleksandr Koksharov and Maksim Rubchenko, “Hold on to your share,” *Ekspert*, November 6, 2006.

of Russia's growth since 1998 has come from oil and gas, and that trend is likely to continue into the future. But none of the Western models seem to take due account of petro-earnings.¹⁹

Russia's extreme oil-dependency means that the two main economic challenges it faces are (1) to prevent the Dutch disease – that is, appreciation of the exchange rate making Russian manufacturing and farming unable to compete with imports; and (2) to mitigate the sharp increase in regional and social inequality that has accompanied its oil-fired growth over the past decade. The inequality effect will likely exceed the growth effect, both in terms of economic welfare and political visibility. Wary of the regional impact, since 2001 the Ministry of Economic Development and Trade has held more than 130 meetings with regional business leaders to prepare them for WTO entry.

Russian tariffs are already low, so the tariff impact will be insignificant. The average import duty is now 12%; it may actually rise to 13.2% on WTO entry, then fall to 8.8% in four years.²⁰ During the transition period import duties for manufactured goods is expected to decrease from 10.2% to 6.9%, and for agricultural goods from 21.5% to 18.9%. Russia has negotiated a \$16 billion ceiling for agricultural subsidies, and is currently spending a small fraction of that sum. Russia plans to cut tariffs on imports of machinery for the pulp and paper and oil industries, and exports of scrap aluminum, but may raise them for timber exports. The toughest negotiations were over the tariffs on imports of autos and aircraft (current tariffs are 25% and 20% respectively – while WTO-member China still maintains a 48% auto import tariff). The new aircraft tariff will be 7.5% – but in any case, Russia's long-haul jets are 1980s vintage technology, so inefficient in fuel economy that they cannot compete with Boeing and Airbus.²¹

Although the financial sector loomed large in the negotiations, it seems clear that the actual impact will be modest. Foreign insurers will be allowed to set up branches – but only after a nine year transition period, which will leave Russia plenty of time to come up with bureaucratic and legal barriers to their operations.²² The same is likely to be true for banking (where direct branches will not be allowed).²³ Although Russia agreed to raise the limit on the total share of foreign capital in the bank sectors from the current 25% to 50%, Russia will reserve the right to intervene in individual cases. (At the start of 2006, 11% of bank capital was foreign-owned.) Note that in November 2006 – five years after joining the WTO – China introduced new rules insisting on local incorporation before foreign banks can take yuan deposits.

When all is said and done, is it really in Russia's interests to join the WTO? Aleksandr Koksharov and Maksim Rubchenko argue that “Despite nearly 20 years of negotiations, there has not been and is not a clear understanding of the economic costs and benefits of entry for Russia.”²⁴ Moscow Mayor Yuri Luzhkov has been outspoken against WTO entry, saying 90% of Russian companies would suffer.²⁵ The political vulnerability of the government on this score should not be overlooked: 2008 will be an election year in Russia, too.

¹⁹ Rutherford and Tarr assume that the import influx will cause the ruble to depreciate, leading to a boom in exports. (*op. cit.*, p. 19) This seems to discount the tremendous upward pressure on the ruble from oil earnings.

²⁰ Interview with Vitaly Gudim, deputy director of the department of state regulation of foreign trade at the Economic Development and Trade Ministry, Prime Tass, October 27, 2006.

²¹ Dmitri Litovkin, “Russia's aviation industry after the WTO,” *Izvestiya*, December 6, 2006.

²² Anna Kaledina, “Insurance against the WTO,” *Izvestiya*, December 13, 2006.

²³ *Rossiiskie Vesti*, no. 27-28, July 2006.

²⁴ Aleksandr Koksharov and Maksim Rubchenko, *op. cit.*

²⁵ Itar-Tass, October 20, 2006.