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## Russia and the WTO: On the Finishing Stretch

Julien Vercueil

► **To cite this version:**

| Julien Vercueil. Russia and the WTO: On the Finishing Stretch. Russie.Nei.Visions, 2007. <halshs-01419849>

**HAL Id: halshs-01419849**

**<https://shs.hal.science/halshs-01419849v1>**

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## Russia and the WTO: On the Finishing Stretch

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**Julien Vercueil**

*February 2007*

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ISBN

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### ***Last published:***

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- Tatiana Kastueva-Jean, "The 'Greatness and Misery' of Higher Education in Russia", *Russie.Nei.Visions*, n.14, September 2006;
- Vladimir Milov, "The EU-Russia Energy Dialogue: Competition Versus Monopolies", *Russie.Nei.Visions*, n.13, September 2006.

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## Summary

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Russia is now in the final negotiation phase regarding its accession to the World Trade Organization (WTO). Discussions have been held over the past fourteen years and have contributed indisputably to the transformation of the Russian economy and the modernization of its legislature. If there are still unanswered questions at the start of 2007, the unbalanced nature of the negotiations runs the risk of Russia having to make further concessions to its partners in order to speed up the agreement's conclusion. In the longer term, the main challenge faced by Russian authorities is to ensure that documents that are already in force are transposed.

# Introduction

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*"The WTO is an instrument. Whoever knows how to make use of it will become stronger."*

Vladimir Putin\*

Russia applied to join the General Agreement on Tariffs and Trade (GATT) in 1993. Fourteen years on, the Russian economy has changed fundamentally. Its recent trajectory has given rise to a very different economy to the one Russia had when negotiations began: market processes—albeit manifested variously in different fields—have made an indelible mark. In this time, moreover, GATT has been replaced by the World Trade Organization (WTO); the Uruguay Round has given way to the Doha Round; conditions for accession have become more complex; and the number of member states has risen from 113 to 150,<sup>1</sup> altering the very nature of the negotiations.

What can be expected from 2007? Will Russia finally be able to join the WTO, after having seemingly been condemned to run after it for all eternity, like Achilles in Zeno's parable of the tortoise? If so, under what conditions?

Even if no one actually doubts the positive outcome of the process, the "China example" should tame the impatient: it took fifteen years to conclude negotiations between the last major power under Communist rule and the members of an international organization emblematic of Western capitalism. The current state of negotiations between Russia and the member states gives cause for optimism, however: the remaining obstacles appear less difficult than those already overcome. The negotiators already have the most bitter discussions under their belts: an agreement was

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Translated from French by Nicola Bigwood.

\* Annual Address to the Federal Assembly of the Russian Federation, 18 April 2002.

<sup>1</sup> In January 2007, Vietnam became the 150<sup>th</sup> member of the WTO.

reached during bilateral discussions with the United States (US) in November 2006, and the impending end of Vladimir Putin's second term in office should accelerate the process from the Russian side—the dossier being considered a priority by the President.

However, the negotiations come in the backdrop of acute political controversy, particularly in Russia. The setbacks faced by political transition in the 1990s, where international financial organizations played a prominent role, still weigh heavily on people's minds. Some people thus believe that membership of the WTO would constitute yet another concession to the advocates of Anglo-Saxon liberal dogma,<sup>2</sup> made all the worse since Russia's main economic assets on the international stage—energy and mineral resources—do not even figure fully in the organization's sphere of competence. Others, however, simply believe that Russia cannot remain outside the WTO for long, as it risks being gradually sidelined from international decision-making circles, only exacerbating its marginalization vis-à-vis global business flows.<sup>3</sup>

This background is a major cause for negotiations being so irregular, with faster phases (1996-1998, 2001-2003) alternating with tenses phases (1998-2001, 2004-2005). This rhythm has caused a certain amount of harm to the credibility of analysts and key players who venture to make forecasts, soon outdated by the process.

This essay assesses the situation at the beginning of 2007. After a brief reminder of the structural parameters needed to incorporate the Russian economy into the global economy, it aims to evaluate the benefits and risks entailed in the accession of the Russian economy to the WTO. The main negotiation stages that are underway will then be examined, as well as the stumbling blocks encountered in these discussions. The conclusion will focus on observations concerning the final phase of the discussions, currently underway.

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<sup>2</sup> This argument masks the fear certain Russian industrialists have (such as those whose interests lie in the car industry, for example) of their domestic market opening more to foreign competition, thus threatening their position.

<sup>3</sup> This is the opinion held by the Russian executive in particular.

# Russia's Position in the Global Economy and its Effect on Negotiations

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Officially, Russia's economy is open to the rest of the world: in 2005, foreign trade accounted for 56 percent of gross domestic product (GDP). This openness goes hand in hand with very comfortable amounts of cashflow from the rest of the world. In recent years, trade surplus has reached record values (120 billion dollars in 2005, that is almost 16 percent of GDP). However, the facts will not go away: year on year, despite repeated declarations from successive governments on the need to diversify the economy, Russia continues to maintain the same specialization profile in its economic structure and foreign trade relations, namely raw materials, and particularly in the energy sector. This industry could be considered a godsend to the economy, as it accounts for 25 percent of national GDP, 40 percent of the revenue side of the state budget, and 60 percent of exports. It constitutes the lion's share of current trade surpluses; it also largely enabled the state to reduce its foreign debt from 88 to 10 percent of GDP between 1999 and 2006, paving the way for a significant improvement in international agencies' rating of the country. On the other hand, Russia's intra-industry trade as measured by common indices<sup>4</sup> is still one of the weakest in Europe<sup>5</sup> and reflects how deeply the national productive fabric is embedded in the international division of labor. Sectoral data on foreign direct investments (FDI) in Russia indicates that a reversal of the current trend cannot be expected in the mid-term.<sup>6</sup>

Thus the integration of the Russian economy into the global economy is not dissimilar to the approach taken for a "petrostate". The rise in global energy prices since 1999 has forced this sector's importance in the economy to increase. At the very most, Putin's two presidential terms will have brought part of the sector back under state control, after Boris Yelstin's administration nearly lost it entirely in this sector. If Russia's comparative advantages still lie in the raw material sector as before, and if added value

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<sup>4</sup> The Grubel-Lloyd index in particular.

<sup>5</sup> B. Algieri, "Trade Specialisation Patterns: The Case of Russia", *Bofit discussion papers*, No. 19, 2004.

<sup>6</sup> J. Vercueil, "L'ouverture aux IDE : cadre institutionnel, politiques et stratégies" [Opening up to FDI: The institutional, political and strategic framework], in P. Koleva, N. Rodet-Kroichvili, and J. Vercueil (dir.), *Nouvelles Europes. Stratégies et enjeux économiques* [New Europe. Economic strategies and stakes], Belfort: Presse de l'UTBM, 2007.

industries are still excluded from its specialization profile, this is mainly because no serious attempts have been made to alter the situation since 1992.

Taking this into account, some Russian observers—and not only representatives of national industrial interests—continue to ask whether Russia is really interested in joining the WTO.<sup>7</sup> In fact, accession to the WTO would mean greater competition for Russian manufacturing industries. While it is difficult to accurately judge the effect this may have on employment, it is certainly not negligible, particularly in traditional industrial sectors and the regions associated with them in Russia. If, on the other hand, there are no guarantees of any advantages in gaining access to the main consumer markets for raw materials, as this is outside the WTO's control, then wherein lies the attraction for Russia to join the organization?

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<sup>7</sup> One of the politicians opposed to WTO membership is the former Duma MP Constantin Remchukov.

# The Benefits of Successfully Integrating Russia into the WTO

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Aside from the expected benefits of trade liberalization presented by traditional literature, the following list of arguments is usually put forward to justify Russia's accession to the WTO:

- *The benefit of WTO institutions:* accession would allow Russia to benefit from the organization's multilateral agreements (most-favored nation clause, anti-dumping practices, reduction in tariff barriers, and abolition of non-tariff barriers). In the mid-term, Russia would be offered more favorable trade conditions by its partners if it joined the WTO.
- *A Russian voice in international bodies:* joining a powerful arena of multilateral negotiation would enable Russian authorities to assert their country's position in future negotiation rounds and thus have a say in their outcome.
- *The defense of Russian interests on an independent platform:* accession to the WTO would open the door to the Dispute Settlement Body (DSB), which makes independent decisions on trade disputes. Even if it is not summoned, the DSB exerts influence on member states' conduct, forcing them to seek compromises. This has been demonstrated by several recent disputes involving the US.
- *An end to discriminatory practices in trade matters:* by joining the WTO, Russia hopes to abolish unilateral anti-dumping duties imposed on it by several trade partners (European Union, US, etc.), which cost it between 2 billion and 4 billion US dollars a year.<sup>8</sup>
- *The benefit of mandatory external management for internal reforms:* the structural reforms demanded of Russia as part of the accession negotiations aim at improving and stabilizing the legal system for economic activities and guarantee its effective application in Russia. The direct and indirect consequences of such institutional stabilization are crucial to Russia's development in the mid-term, especially as regards the effect on the investment climate. On average, over the last twenty years, economies that have acceded to the WTO have seen a rapid

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<sup>8</sup> These estimates come from Russia's Ministry of Economic Development and Trade. The most affected sectors are metalworks, the chemical industry, manufacturing, and fertilizers. Cf. B. Lissovlik, and Ya. Lissovlik, "Russia and the WTO: The 'Gravity' of an Outsider's Status", *IMF Working Paper* 04/159, August 2004.

growth in foreign direct investments to the tune of 4 billion US dollars a year.<sup>9</sup>

- *The development of Russia's international trade relations*: greater access to foreign markets should provide more opportunities for Russian exporters; at the same time, competition increasing pressure on the Russian economy is likely to lower prices, improve product and service quality, and, more generally, the allocation of resources. Some people believe that only the spur of international competition can induce the necessary alterations to the Russian economy.<sup>10</sup>
- *Assistance in guiding Russia toward a knowledge-based economy*: with the protection of intellectual property rights that it demands, membership of the WTO should enable Russia to establish a legal framework that helps develop research- and development-intensive sectors, and to maintain a qualified workforce and scientific potential within Russia.<sup>11</sup>

A number of quantitative estimates on the expected benefits of accession have been put forward. Tested models have shown the effects of improving access to foreign markets and of allocating economic resources more effectively; and the effects of incoming capital and foreign technology on the productivity of industry and services, and the increase in returns on investments. The results differ, varying from annual growth of 0.4 to 4 points in the mid-term.<sup>12</sup> In the long term, consumption could be boosted by 7 percent per year, owing to the reduction in customs tariffs and, in particular, improved access to the service sector for foreign investors.<sup>13</sup>

Estimates on the effect accession will have on employment are just as varied.<sup>14</sup> In theory, the re-allocation of resources as the market opens should result in jobs being created in the most competitive sectors, and jobs being cut in sectors that are less competitive. Yet works by Akhmedov *et al.*,<sup>15</sup> which observe a fairly poor intersectoral flows of labor resources, bring to light a certain inertia in the production structure response to relative price changes likely to occur in the event of accession to the WTO. On the whole,

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<sup>9</sup> K. Yudaeva, "Joining the WTO: Is a Political Decision the Only Hope?" *Post-Soviet Economies in Transition Briefing Paper*, vol. 5, No. 6, June 2003.

<sup>10</sup> E. Bessonova, K. Kozlov, and K. Yudaeva, "Trade Liberalization, Foreign Direct Investment, and Productivity of Russian Firms", paper at CEFIR meeting *Negotiating Russia's WTO Accession: Strategic Lessons from Multilateral Trade Liberalization and Club Enlargement*, Moscow, September 2003.

<sup>11</sup> K. Yudaeva, 2003, *op.cit.*

<sup>12</sup> Vysshaya Shkola, "Development of forecasts of socio-economic consequences of Russia's WTO accession", *Report for the Ministry of Economic Development and Trade*, Moscow, 2002; J. Jensen, Th. Rutherford, and D. Tarr, *Economy-Wide and Sector Effects of Russia's Accession to the WTO*, Mimeo, 2004, available at <[www.worldbank.org/russia-wto](http://www.worldbank.org/russia-wto)>.

<sup>13</sup> Th. Rutherford, D. Tarr, and O. Shepotylo, "The Impact on Russia of WTO Accession and the Doha Agenda: The Importance of Liberalization of Barriers Against Foreign Direct Investment in Services for Growth and Poverty Reduction", in Th. Hertel, A. Winters (eds), *Poverty and the WTO: Impacts of the Doha Development Agenda*, London: The World Bank/Palgrave MacMillan, 2006.

<sup>14</sup> The official unemployment rate in Russia is 7.6 percent, <[www.worldbank.org](http://www.worldbank.org)>.

<sup>15</sup> A. Akhmedov *et al.* "WTO Accession and the Labor Market: Estimations for Russia", *CEFIR Working Paper*, October 2003.

these authors believe that no more than 0.5 to 1 percent of all industrial jobs should be affected by accession. These results are largely confirmed by other studies on this issue.<sup>16</sup>

As a whole, quantitative analyses of the consequences of Russia acceding to the WTO indicate positive results. Even if the reduction in customs tariffs does not bring about any considerable changes, the effects of suppressing non-tariff limits and the liberalization of the service sector on the efficiency of the economy should be more significant. Sectors relating to the use of natural resources should benefit most from the liberalization of foreign market access, whereas labor-intensive sectors, such as light industry and the agri-food industry, could face stiffer competition.

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<sup>16</sup> A. Chowdhury, "WTO accession: What's in it for Russia?", *Bofit Online*, No. 10, 2003, <[www.bof.fi](http://www.bof.fi)>.

# The Influence of Negotiations on Russian Reforms

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Attempting to identify which reforms undertaken by Russia since 1994 are specifically related to the accession negotiations would be impossible. The intensification of negotiations since 2001, however, does enable reforms affecting areas covered by more recent accession negotiations to be identified.

## *Foreign trade*

After the initial opening up of Russia's economy, a complex, incoherent and inefficient customs system was set up, undermined by corruption. The reform to foreign trade regulation mainly served to simplify it. On 1 January 2001, the number of customs duties was reduced from seven to four.<sup>17</sup> Subsequently, the average tariff was reduced from 13 to less than 10 percent. A new classification system for foreign trade goods came into force, which was more in line with international standards than the preceding one. The long anticipated Customs Code was announced on 1 January 2004;<sup>18</sup> and customs administration was restructured with the assistance of the World Bank. After fifteen years of partially troubled existence, it numbered 60,000 civil servants, contributing to more than 40 percent of the state's budget, compared with 10 percent in 1991.<sup>19</sup> Other regulatory measures for foreign trade have also been simplified: a single taxation system for exports of crude oil has been set up, and some taxes on exports

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<sup>17</sup> Tariffs now range between zero and 20 percent. The main tariffs are 5, 10, 15 and 20 percent, and apply to 3,500 products out of the 10,000 regulated by Russian customs classification. Tariffs for some sub-categories were merged to avoid false declarations; exceptions include cars (taxed at 25 percent), refined sugar, ethyl alcohol (any over 80 percent volume are taxed at 100 percent), and tobacco. The current tariff structure is available at <[www.russian-customs-tariffs.com](http://www.russian-customs-tariffs.com)>.

<sup>18</sup> Russia's Customs Code is available at <[www.russian-customs-code.com](http://www.russian-customs-code.com)>.

<sup>19</sup> "Russian customs is 15 years," 25 October 2006, available at <[www.customs.ru](http://www.customs.ru)>.

of raw materials have been abolished.<sup>20</sup> In 2006, the exchange control for revenue from exports was abandoned completely.

## ***The competition regulation and corporate governance***

The Russian authorities had committed themselves to modifying the law on bankruptcy of 1998, which contained inconsistencies that greatly impaired court sentences. In the autumn of 2002, a modified version of the law was voted upon. Its objective was to correct the deficiencies of the original text by making the power balance between creditors and debtors more equal. Recently, amendments have toughened up penalties incurred by managers guilty of misinformation or deliberate bankruptcy.<sup>21</sup> Amendments clarifying the law on competition and the prerogatives of the Council for Competition were voted upon in September 2002. The main issues still to be resolved in this area concern the application of laws and the Russian judicial system's capacity for action.

In September 2002, in collaboration with the World Bank, the European Bank for Reconstruction and Development (EBRD) and the Organization for Economic Co-operation and Development (OECD), the Russian government also instigated an overhaul of the legislation on corporate governance, which began with the creation of a "Corporate Governance Code" and has since been amended several times. The latest modifications to the legislation aim to grant more rights to minor shareholders.<sup>22</sup> The accounts of major Russian companies are now starting to be presented in line with international standards.

## ***The banking and services sector***

The Russian authorities began reforming the Central Bank of Russia (CBR) in October 2000, as well as other public financial institutions (such as the

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<sup>20</sup> Taxes on exports of gold, non-transformed goods from the timber industry, and several categories of paper (1 March 2002).

<sup>21</sup> EBRD, *Commercial Laws of the Russian Federation. An Assessment by the EBRD*, The European Bank for Reconstruction and Development, August 2006.

<sup>22</sup> An amendment that came into force in July 2006 requires that each buyer with more than 30 percent of the voting rights in a public company make a bid for the remainder. In addition, any holder of more than 95 percent of the voting rights in a public company can force minority shareholders to sell them the remainder (EBRD, 2006, *op.cit.*).

*Vneshekonombank* and *Vneshtorgbank* banks, for example). The authority of Russia's National Banking Council, which is in charge of supervising the CBR's activities, was extended in order to improve the transparency of banking operations.

It took time for the restructuring of the banking system to take shape, despite constant pressure from international organizations. The influence of *Sberbank*, a public savings bank with an unrivaled network and a state guarantee on its accounts, is still predominant (*Sberbank* holds more than 55 percent of private accounts in Russia) and gives rival private banks cause for complaint. Measures undertaken to restructure the sector have primarily affected the reform of the state guarantee on accounts, the minimum level of capital required for commercial banks' approval with the CBR, and restrictions on foreign banks' access to the Russian market. In November 2002, the ceiling imposed on foreign stakes in Russian banks' capital was abolished. Moreover, two laws suppressing money laundering were voted upon in July 2001 and September 2002, enabling the Russian authorities to show their willingness to conform to the standards of the Financial Action Task Force on Money Laundering (FATF)<sup>23</sup> and Russia's name to be removed from the "black list" of non-cooperative countries. The banking sector's recently increased role in financing consumption and investments is indicative of the sector's progressive maturation; the sale of the *Impexbank* (with assets of 1.8 billion US dollars) to a foreign establishment in February 2006 was a symbolic step.<sup>24</sup> Yet the restructuring of the sector is far from being finished: private banks are still under-funded; the three major public banks—*Sberbank*, *Vneshtorgbank* and *Gazprombank*—still hold 36 percent of the sector's assets, 45 percent of private loans, and 33 percent of corporate loans;<sup>25</sup> and foreign banks only control 10 percent of the country's banking assets, compared with 70 percent on average in Central European countries.

The banking sector issue is emblematic of the more general issue of opening up the service sector, for which Russia would like to maintain a level of protection suitable for the poor development of national companies (particularly for the insurance and telecommunications sectors), while allowing the inflow of foreign capital needed for consolidation and modernization.

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<sup>23</sup> The OECD's Financial Action Task Force on Money Laundering, responsible for monitoring international money laundering activities.

<sup>24</sup> The Austrian bank Raiffeisenbank (*Bofit Russia review*, No. 5, 2006).

<sup>25</sup> *Bofit Russia Review*, No.3, 2006.

## ***State-corporate relations***

From 2000, a plan to reform the railway, electricity, telecommunications and gas sectors was put forward, aiming to bring these sectors under the sole supervision of the state. This plan was presented to a working group of the WTO on the opening of telecommunications companies' capital to foreign investors in February 2001. From 2001 to 2003, privatizations were carried out with more transparency than before.<sup>26</sup> The restructuring programs of the main natural monopolies (such as *RAO UES*, an electricity producer) progressed according to models recommended by international organizations.

However, from 2004, the pace of reform slowed in regard to state-corporate relations, reflecting a change in the doctrine of power on the matter. The de facto re-nationalization of *Yukos* dampened the investment climate. In 2004, the planned restructuring of *RAO UES* did not happen; only a plan for partial privatization was drawn up. Privatization continued in 2005, but at a pace considered too slow even by the government. In December 2005, the State Duma voted in an amendment that further opened the capital of *Gazprom*, the world's leading gas producer, to foreign investors. Yet at the end of 2006, it was officially granted the monopoly on gas exports by presidential decree, a gesture clearly designed to serve as a reminder of the political control held over the sector. The same privilege was then granted to *Rosoboronexport* regarding arms exports. After several hesitant years, the privatization of *Svyazinvest*, a predominant holding company for national fixed telephone networks, was finally postponed until after 2007.

## ***The legal and fiscal system***

The legal system's transformation is pursuing the standards required for WTO accession. Between 2003 and 2005, twelve legislative texts with direct reference to accession negotiations were promulgated. Yet, as this is the Russian case in question, a degree of uncertainty remains in regard to how effectively laws are applied. Have governmental agencies and local authorities the capacity and the will to implement legislation issued by a central power? The measures taken by President Putin since he came to power have shown the new administration's willingness to re-establish the "vertical of power." In order to reduce any risks of corruption, the number of trade activities under license has been reduced from approximately 450 to

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<sup>26</sup> An example of this improvement is the privatization of 85 percent of the oil company *Onako* that generated 1.1 billion US dollars in revenue for the state. Foreign observers regarded this sum to be reasonable.

120; administrative registration procedures have been simplified; and companies now have more rights during inspections. In reality, corruption has not ceased to spread, according to regular studies conducted in Russia by international organizations and non-governmental organizations (NGOs such as the World Bank, Transparency International).<sup>27</sup> Moreover, the separation of powers and the independence of the judicial system vis-à-vis the government in particular are still regularly being reappraised in Russia, which makes combating corruption even more problematic.<sup>28</sup>

The fiscal code and the financing of social security were reconsidered from the summer of 2000. Taxation on revenue was simplified by adopting a single rate of 13 percent; social security contributions were merged into one single contribution; value added tax (VAT) rates were fixed at 10 and 20 percent; and the tax base for companies (TBC) was reviewed to conform to Western practices. In July 2001, the TBC rate was reduced to 24 percent and a simpler fiscal regime was applied to small and medium-sized companies from 1 January 2003.

In terms of international recognition, the primary results from Russia's reform of its economic legislation were the granting of market economy status by the European Union,<sup>29</sup> and then by the US in the spring of 2002. Its full involvement in the G8 was made official at the start of the summer of 2002.

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<sup>27</sup> See, for example, World Bank, "Administrative and Regulatory Reform in Russia. Addressing Potential Sources of Corruption," *World Bank Policy Note*, 36157-RU, October 2006, for an overview of the development in corruption indicators for Russia over the last decade.

<sup>28</sup> Readers interested in the independence of judicial power can consult, for example, the study by A. Politkovskaya, *La Russie selon Poutine* [Russia according to Putin], Paris, Gallimard, 2006.

<sup>29</sup> The decision was announced at the Russo-European summit in May 2002 and came into effect in November 2002. Since then, investigations into anti-dumping have used the cost of input from Russian companies and input from other countries which have already been accorded the status of a market economy as reference points (*Bofit Weekly Review*, No. 47, 2002).

# The State of Negotiations

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In 1995, Russia submitted a "Memorandum on Foreign Trade" to the working group for its accession to the WTO, describing its policy on foreign trade and on related areas. The working group submitted questions in writing based on the Memorandum, to which Russia was required to respond. This back-and-forth process was developed as part of official multilateral meetings; at the same time, bilateral discussions are held with group members to determine specific conditions for accession (30 meetings have been held to date since negotiations began), resulting in several important bilateral agreements and the drawing up of the working group's report. This will be submitted for approval by all member states, constituting the protocol for Russia's accession to the WTO.

The main difficulties in the final phase now underway concern energy costs, intellectual property, sanitary and phytosanitary regulations, and politically-sensitive industries.

## ***The issue concerning the price of gas***

Russia's system for billing gas supplies relies on *Gazprom's* de facto monopoly granted by the state for production and distribution. A legacy from the Soviet era, this monopoly<sup>30</sup> enables a dual system to be maintained for billing, differentiating between domestic and export prices. Table 1 shows the current difference between prices billed to Russian industrial companies and world prices.

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<sup>30</sup> Retained at 50.01 percent by the state, which appoints six of the eleven members of the Administration Council, *Gazprom* has an estimated market capitalization of over 250 billion US dollars as at the start of 2007. This means that it ranks among the top four companies worldwide.

**Table 1. Average prices for natural gas for industrial customers  
(US dollar per m3)**

Russia	Ukraine	Poland	UK	France	EU	US
40	90	115	125	140	145	205

Source: World Bank, "Russian Economic Report", No. 10, March 2005.

Russia's partners regard its domestic market prices as concealed subsidies to Russian industrial companies. The OECD has estimated that the subsidies amount to 5 percent of GDP.<sup>31</sup> The consequences of low gas prices are, in fact, felt across many sectors, such as chemical fertilizer production, where 75 percent of the expense is to cover the price of gas.<sup>32</sup> This is why several members of the working group believe that domestic energy prices (and gas prices in particular) should be brought appreciably more in line with international prices. Russia's response is that domestic prices reflect Russia's comparative advantages; they are applied to all the different national industries and therefore, according to the Russian negotiators, should be considered as "non-actionable" subsidies in accordance with WTO's regulations in the "Agreement on Subsidies and Countervailing Measures".<sup>33</sup> This means that they should not come under the list of prohibited subsidies or be subject to countervailing measures by the plaintiffs.<sup>34</sup> At the same time, the government revealed a project to deregulate national gas consumption prices, and those of companies in particular, by 25 percent from 2007. Supply price liberalization for private individuals is to be spread out over several years.<sup>35</sup>

## ***Intellectual property rights***

Russia set up a legislative arsenal to regulate the protection of intellectual property rights. The country is a member of the main conventions regulating the protection of intellectual property rights and has also signed a number of bilateral agreements on this matter. The problem comes from the application of these agreements within Russia: losses from unauthorized reproduction of American audiovisual goods are estimated to be more than 750 million US dollars. This means that over half of private individuals' purchases of this type of product in Russia are forgeries of American goods. At the end of 2005, the US Congress suspended the most-favored nation clause for

<sup>31</sup> OECD, *Economic Surveys 2001-2002: Russian Federation*, Paris, OECD, 2002.

<sup>32</sup> W. Cooper, "Russia's Accession to the WTO", *CRS Report for Congress*, No. RL31979, April 2006.

<sup>33</sup> "Actionable subsidies" are subsidies attributed to a company, a group of companies or a country's industry granted subsidy. They are prohibited by WTO regulations.

<sup>34</sup> W. Cooper, 2006, *op.cit.*

<sup>35</sup> *Bofit Russia Review*, No. 10, 2006.

Russia in order to better combat the violation of American companies' intellectual property rights. For its part, Russia highlighted the efforts it was making to reduce the scale of the problem, and noted that other members of the WTO (especially China) were facing the same difficulties.

## **Agriculture**

The issue of agricultural subsidies is still a cause for contention between the parties. All accession candidates must draw up proposals for customs duties on imports of agricultural goods, but also for subsidies granted to the sector (for livestock farming, agricultural production, investment aid, government-subsidized loans, agricultural goods transportation aid, etc.). In accordance with the WTO's agreement on agriculture, Russia must fix a ceiling on its involvement, with reference to a three-year period prior to its accession, and commit to reducing aid by 20 percent for six years afterwards.

Russia's initial proposals were based on figures from the period 1989-1992, giving rise to proposals for internal support for the sector to the tune of 84 billion US dollars, and subsidies on exports of 1.6 billion US dollars. As the members of the working group rejected these proposals, Russia has had to reconsider its position several times. Its recent proposals reduced the maximum level of internal support to 9.5 billion US dollars, and that for subsidies on exports to 0.7 billion US dollars. The strongest opposition to Russia's proposals came from the countries in the Cairns Group,<sup>36</sup> which wanted the reference period to be the years 1997 to 1999, when the budget crisis considerably reduced agricultural subsidies: at that time, support amounted to between 2 and 3 billion US dollars, i.e. less than the minimum level authorized by the agricultural agreements, and corresponding to 5 percent of the sector's costs.

The agricultural case indicates the unbalanced nature of the accession negotiations:<sup>37</sup> Russia is not in a position to dictate its conditions to the members of the working group. The negotiating scales are tipped in favor of the latter on a number of points, meaning that they can substantially influence the conditions under which Russia will finally accede to the organization.

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<sup>36</sup> The Cairns Group at the heart of the WTO consists of 18 members (Argentina, Australia, Bolivia, Brazil, Canada, Chile, Columbia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Peru, the Philippines, South Africa, Thailand, and Uruguay) opposed to the use of agricultural subsidies.

<sup>37</sup> J. Vercueil, "Vstuplenie Rossii v VTO: Vybor Strategii" [Russia's accession to the WTO: the choice of strategy], *Problemy Prognozirovaniâ*, No. 5, 2002, p. 75-93.

## ***Sanitary and phytosanitary regulations***

Russia has been accused of not respecting the WTO's regulations on non-tariff limits, by decreeing unjustified health and sanitary and phytosanitary standards. The interpretation of regulations thereof basically depends on the observer's perspective; hence, the US has expressed doubts over the consistency of Russia's measures against imports of American chicken suspected to have transported bird flu. Negotiations between the two parties over veterinary inspection protocols ended only very recently, with the Americans doubting that such measures could be redeployed at a later stage.

## ***The automotive and aeronautic industries***

These two sectors have certain elements in common: a highly symbolic bearing owing to past prestige (they were the jewel of Soviet civil industry); a structural weakness related to the crisis of the 1990s; a propensity for lobbying (representatives of these industries learned how to make politicians listen to them<sup>38</sup>); and concern for the future (competition from Western and Asian industrialists threatens them directly on their domestic market).

Since 2000, Russian negotiators have focused on the following principles<sup>39</sup> during the negotiations on opening the capital market:

- Russia's accession to the WTO cannot entail an immediate and significant reduction in customs rights. Reductions are possible in the mid-term and only in certain, specifically identified sectors;<sup>40</sup>

- No optional sectoral agreement will be accepted as a precondition for accession to the WTO.

Despite a customs tariff of 25 percent on imports, the main national car manufacturers' share of the market, which has been in decline for 15 years, has now fallen below 50 percent. In compensation for a higher tariff on imported vehicles and components, Russia is proposing near-zero tariffs for components intended for assembly at private Russian sites, on the condition that these be progressively redirected to Russian suppliers.<sup>41</sup>

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<sup>38</sup> Such as the *BazEI* group, headed by Oleg Deripaska, which concerns industrialists in the automotive sector.

<sup>39</sup> Led by M. Medvedkov, negotiator in chief, in liaison with G. Gref, Minister of Economic Development and Trade.

<sup>40</sup> Agricultural goods, raw materials, semi-finished goods or high-tech industrial equipment not produced in Russia.

<sup>41</sup> *Bofit Russia Review*, No. 11, 2006.

The situation is very similar for the civil aeronautic industry. Tariffs imposed on imported aircraft are fixed at 20 percent. Russia argues that its industry is only running at 0 to 15 percent of its capacity, and that it requires investment for modernization which can only be granted under the security of solid customs barriers. The European Union and the US are urging Russia to sign an optional multilateral agreement on civil aviation drawn up by the WTO. Russia was prepared to sign this agreement at one time, but has since withdrawn its commitment,<sup>42</sup> following new official objectives already mentioned. However, the negotiators themselves appear uncertain about limiting the necessary concessions efficiently:

"Bilateral negotiations will no doubt bring Russia far more into line with the terms of certain optional agreements. But this should not be interpreted as a sign of Russia's willingness to sign such agreements."<sup>43</sup>

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<sup>42</sup> W. Cooper, *op.cit.*

<sup>43</sup> "Strategy of Shaping up Tariff Proposals on Market Access for Goods Within the Framework of Russia's Accession to WTO," December 2005, <[www.wto.ru](http://www.wto.ru)>.

# The Conditions for a Final Agreement

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In order for a general agreement to be reached on accession, several weeks, or indeed months, of multilateral negotiations still appear to be necessary. The political will manifest at Russia's highest levels is one of the factors that will help to accelerate the negotiations, as indicated by President Putin during his first mandate:

"Our country is still excluded from the process of formulating the rules of world trade. We already take part in world trade, but are kept out of making the rules. This cuts off the Russian economy from world development and makes us less competitive."<sup>44</sup>

It remains to be seen whether the Russian authorities are prepared to tackle the consequences of such a diagnosis. The most important is to effectively implement the necessary means for the agreements announced during the negotiation period.

Time has been against Russia since negotiations began.<sup>45</sup> The process is unbalanced by its very nature, as Russia must concede more than its partners. Moreover, these partners have little to gain from allowing Russia to accede to the WTO under its conditions: their own lobbies<sup>46</sup> have long been fighting to impose the most liberal conditions possible on global trade, and the political concessions a single state may negotiate in exchange for its support would remain essentially uncertain in the mid-term. At the same time, the integration of new members to the WTO automatically leads to an expansion of the working group, which could only complicate the task in hand for the Russian negotiators: some of them are former satellite states of the Soviet regime, whose relations with Russia are not the warmest (Georgia being the prime example<sup>47</sup>).

Over the past five years, political analyses and declarations have constantly oscillated between equally excessive optimism and pessimism. In the summer of 2006, the initial aim of accession happening between 2006 and 2007 seemed to have been completely forgotten. Since then, the recent

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<sup>44</sup> The President of the Russian Federation's address to the State Duma, 18 April 2002.

<sup>45</sup> J. Vercueil, 2002, *op.cit.*

<sup>46</sup> Such as the Union of Industrial and Employers' Confederations of Europe (UNICE), which has attempted to influence the conditions of the bilateral Russia-EU agreement.

<sup>47</sup> Negotiations between Georgia, a member of the WTO, and Russia have unearthed political disagreements particularly affecting the status of Abkhazia and South Ossetia, separatist regions of Georgia. Following a breakdown in the last quarter of 2006, bilateral negotiations re-started in January 2007, paving the way for a possible definitive multilateral agreement in July.

bilateral agreement (regarding the US), which was critical for the process, was made only a few weeks behind schedule, giving the green light for final multilateral negotiations to take place.

In order to maintain his objectives (obtaining Russia's accession before the end of his mandate), President Putin's "window of opportunity" is in early summer 2007. It is likely that additional concessions will be required in order to get there.