

Russia and the World Trade Organization

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Since 1993 Russia has been negotiating to join the World Trade Organization (WTO), which with 144 members is one of the world's largest and fastest-growing clubs. With the successful conclusion of the GATT's Uruguay Round of trade negotiations, the cost of exclusion from the international trade regime rose, but so did the bar for countries seeking to join. The WTO now includes extensive rules on agriculture, public procurement, intellectual property rights (TRIPS), trade-related investment restrictions (TRIMS), and the service sector (GATS), which were areas traditionally ceded to domestic control. Poland, Hungary, Yugoslavia, and Romania joined the GATT, the predecessor to the WTO, during the Cold War under much more lenient conditions. Other countries have joined after meeting more arduous tests of market openness: Moldova and Lithuania joined last May, and China joined in November. Until September 11, every indication was that Russia would be held to this higher standard. However, in return for President Vladimir Putin's strong support for the U.S.-led intervention in Afghanistan, and as part of an informal package of emerging policy compromises, the Bush administration has signaled a commitment to try to accelerate Russia's entry into the WTO.

The Stakes for Russia in WTO Membership

Putin signaled the importance that he attached to membership in the WTO when he met with its director general in March 2001. He has made a priority of passing bundles of legislation aimed at reaching this goal. In the wake of the events of September 11, his administration began dropping hints that WTO membership might be the price for cooperating with the United States on Afghanistan. In his speech to the German Bundestag at the end of September, he emphasized—to substantial applause—“We are ready for close trade and economic cooperation. We are also planning to join the WTO in the immediate future. We expect international and European organizations to support our efforts.”

Membership in the WTO is important for three reasons: market access, dispute resolution, and writing the rules of the game. First, during the last decade, while subject to substantial trade discrimination from advanced industrial countries, Russia has labored to build a market economy. Some of this discrimination is a legacy of the Cold War and has gradually been dismantled, some of it applies generally to nonmembers of the WTO, and some of it was adopted

in response to pressure from domestic interest groups, such as steel producers in Europe who Russian competition threatened. While Western countries have been fairly liberal with foreign aid—particularly when it helped them to promote their own exports—they have been less willing to accord Russia equal trading privileges, because the interests of concentrated domestic groups are more directly engaged. This has complicated an already painful transition, in which Russian output declined by 40 percent in the first eight years of reform. With a small market, Russia does not have the leverage to negotiate deep cuts in foreign protection on a bilateral basis comparable to those provided automatically to all WTO members. Furthermore, as a WTO member Russia would automatically benefit from any additional concessions made in future trade rounds.

Second, even if Russia successfully negotiated expanded market access, without WTO membership it would not have access to the WTO Dispute Settlement Process, so it would have to continue to enforce its access with bilateral pressure. As a WTO member it can rely on the fact that the losers routinely implement dispute settlements that are resolved by the WTO, because losers are concerned about protecting their reputations in the organization and the long-term value of the dispute settlement process itself.

Third, Russia has an interest in participating in negotiations over the future rules of the international trade system, rather than being a passive bystander. This is particularly urgent after the WTO Ministerial Conference successfully launched a new round of trade talks at Doha in November. The next trade round will cover controversial issues of great interest to Russia, such as rules about foreign direct investment and agricultural subsidies. If Russia fails to become a member in time, it could find the bar for joining the WTO raised again, perhaps to a level that Russia is unwilling to meet.

Obstacles to Accession

Accession to the WTO is formally a unilateral process: the subjects for discussion are when the new member will formally be in compliance with the existing body of WTO rules, and what “membership fee” it will be required to pay in terms of increased access to its market by WTO members. WTO members do not offer the applicant additional concessions, and the current rules of the WTO are nonnegotiable, although waivers and extensions may be granted on particular points.

Russia announced its intention to join the WTO in June 1993. By March 1994 it had circulated the required Memorandum on Russian trade policy, a complex document that covers many aspects of legislation. Subsequently, for several years the members of the Working Party on Russian accession (which is open to all WTO members, and in which 50 members actively participate) submitted written questions—some 3,500 of them—to which Russia was obliged to submit written answers. Finally, by February 1998, Russia was ready to submit its initial offer on trade access in goods; it did not submit an initial offer in services until October 1999. By this time, the financial crisis of August 1998 and Russia’s policy response, which protected domestic banks at the expense of foreign creditors, had severely shaken international confidence in Russian economic reform. Consequently, international participants felt that it was necessary to reevaluate Russia’s trade regime. Since 1999, negotiations have been taking place simultaneously on two levels: bilaterally, between Russia and 30 members that have raised concerns regarding Russia’s market access offers, and multilaterally, concerning Russia’s satisfaction of WTO rules. Russia submitted a revised set of offers in goods and services early in

2001 that appeared to reenergize the process, but participants continued to speak privately about Russian accession in 2003 or 2004.

The Russian market continues to fall short of WTO requirements in four main areas: (1) informal subsidies, (2) banking sector reform, (3) protection for foreign investment, and (4) protection of intellectual property rights.

In terms of formal trade policy, Russia is one of the most open economies in the world. However, the weakness of the state and of corporate governance in Russia creates a plethora of informal, nontariff barriers to trade. First, the energy industry has been used to informally subsidize Russian industries through depressed prices, barter, and the extension of cheap and uncollectable credit. Second, the federal and regional governments subsidize industries by accepting tax payments in barter. Third, insolvent firms are not subjected to bankruptcy, so their creditors are compelled to subsidize them. All of this creates a very uneven playing field on the Russian market, and consequently raises concerns among Russia's trade partners. These practices are also an important factor impeding Russian economic development, and should be ended for that reason in any case. Indeed, Putin appears to recognize that solving these problems is essential to rebuilding the power of the Russian state, and every indication is that he is much more committed to solving them than his predecessor Boris Yeltsin ever was. Doing so, however, will not simply be a matter of passing appropriate legislation. This will be a bureaucratic struggle in detail, waged in every one of Russia's regions, and the outcome of the struggle will likely remain unclear for years to come. Although leading indicators such as the amount of payments arrears in industry and the share of taxes collected in barter have been down for the last three years, this appears to be primarily due to the weak ruble and the economic recovery in the energy sector that was driven by high world prices, rather than to a significant improvement in governance.

The Russian banking sector continues to be the weakest link in Russian economic reform, and this generates grave misgivings among WTO members, which have consistently raised the service sector as the area in need of most reform in order to bring Russia into compliance with WTO rules. Russia's policy toward its banking sector is extremely protectionist. The banking sector, for its part, fails to perform the functions of commercial banking: markets for consumer credit, for example, do not exist, and retained earnings rather than bank loans finance industrial investment. Over the years the banking sector's efforts have gone into speculation on the currency market and on the (now defunct) exchanges for futures, commodities and government bonds. Russian banks became major players in the equity market in 1996, and they participated infamously in corrupt auctions and loans-for-shares deals with the government. The central bank's management of the 1998 crisis led to the closing of many small banks, but insulated the banks from their foreign creditors and allowed many loss-making banks to hide their assets through a nontransparent bankruptcy procedure. Indeed, some closed their doors, shifted their assets to new financial structures, and reopened for business under new names. Fundamentally, Russian banks are powerful players in Russian politics with close ties both to top government officials and to organized crime, and they represent a significant obstacle to economic reform.

Protection for foreign investment in Russia has been a persistent problem. The equities market is well developed, with self-governing institutions that have been favorably compared to all but a few Central European markets, and it survived the 1998 crisis despite suffering a tremendous drop in value. However, behind these relatively well-developed institutions for

trading equities lies a very weak institutional framework for protecting investors' rights. In Russian law, the property right to an equity belongs to the name written in the official registry, not to the bearer of a stock certificate, and the registries have little protection. Names of small investors, or foreign investors who do not have local connections to protect their rights, may be deleted from the rolls. In addition, stockholders' meetings are often held suddenly, or under circumstances that are designed to prevent stockholders from attending, and managers generally control the proceedings. The extraordinarily low capitalization of the Russian stock market is in large measure due to the failure to enforce investor rights, which in turn is a major cause of the poor corporate governance of Russian industry.

Finally, Russia does not enforce intellectual property rights. Music CDs, DVDs, and expensive software packages can be purchased on Moscow streets for \$1. The United States has made the international enforcement of intellectual property rights a major priority in trade policy, arguing that property rights are a public good, and investment in these industries will be undermined if the rights to the products are not protected. Like other developing countries that do not produce much of the content of these products, however, Russia has little interest in protecting the property rights of foreigners. To the contrary, the ready availability of pirated software increases the productivity of the Russian economy. This concern was the most serious issue that the United States raised regarding the recent accession of China and Taiwan to the WTO, and it ranks as the most important U.S. objection to Russian membership.

The Pros and Cons of Accelerating the Process

In any bargaining process, pushing for rapid progress has distributional implications. Until September 11, Russia was pushing for rapid conclusion of the accession negotiations, and the Western countries could credibly claim to be indifferent (as they have never been able to do when the forum was the IMF). The national trade interests of the negotiating countries were directly involved, and they saw no overriding incentive to compromise. Dramatically accelerating the process means that Russia can afford to be less forthcoming, and that some opportunity will be lost to push for Russian reform. On the other hand, Russia's membership in the WTO will itself create incentives for reform. Access to foreign markets will help to support the competitive part of Russia's economy and create new opportunities for export-led development. At the same time, membership in the organization will open Russia to institutionalized efforts by its trading partners to expand their market access.

The process of China's accession to the WTO has been prominently featured in the news, and may have given U.S. citizens the incorrect impression that the United States wields overwhelming influence in the organization. The WTO accession process operates by consensus, and the United States was the country most resistant to China's accession, the United States exercised disproportionate influence and was able to garner significant concessions. On the other hand, U.S. trade interests in Russia are meager, so countries that have more at stake present the greatest obstacles to Russian accession. Consequently, the United States may not be able to assure a rapid review of the Russian case. By pushing for rapid closure of the process, the United States will reduce its influence over the final agreement, and will probably sacrifice progress on the intellectual property rights (TRIPS) front. However, integrating Russia into the world trading system and deferring the issue of intellectual property rights may better serve U.S. interests, broadly conceived, than holding Russia's accession hostage to this issue when Russia is not a

major part of the relevant consumer market. Progress on informal subsidies, banking reform, and investor protection are much more critical to Russia's long-term economic health and political stability.

Conclusions

On balance, the arguments for accelerating Russia's accession to the WTO are more compelling than the objections. Putin appears to be serious about implementing legislation to bring Russia more broadly in line with WTO standards, and lack of full access to international markets has seriously handicapped Russia's reform. Speeding the accession process along may weaken pressure for reform on some fronts, but it will also create greater incentives to implement the conditions that are agreed on. The U.S. policy does not guarantee a rapid conclusion of a very cumbersome process, but it dramatically improves the prospects for Russia's full membership in 2002. A U.S. policy aimed at accelerating the negotiations transfers U.S. bargaining leverage to other WTO members during the accession process; however, this may not be a bad outcome, because emphasizing intellectual property rights in Russia at this point in the transition is shortsighted.

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