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# Russia's accession to the WTO:

possible impact on competitiveness of domestic companies

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***On the 10th of November, 2011 the Working party on the Russia's the WTO accession has unanimously approved a set of documents defining commitments by the country within the World Trade Organization. One month later on the 16th of December the 8th Ministerial conference of the WTO (which is the highest decision-making body) once again unanimously made a decision to accept Russia as a member of the organization. It was an end of the long accession process, which at certain stages seemed to be almost hopeless, and rather infinite. In July, 2012 the Federal Assembly of Russian Federation ratified the set of agreements and President of the country signed the law "On ratification of the Protocol of accession of Russian Federation to the Marrakesh agreement Establishing the World Trade Organization". After these important steps were made and notified to the WTO, in August, 22nd, 2012 Russia became the 156th member of this international economic organization.***

***Analysis of the impact of the WTO accession on the competitiveness of Russian business entities could be divided into two stages – (1) the negotiations phase and (2) the period that has began after the actual accession to the organization.***

## **Negotiation phase**

At the moment, none of the other existing WTO members had spent so much time to join it (18 years). Though, Russia will almost certainly fail to retain the "record" (the obvious contenders are Belarus and Algeria that continue their negotiations). One might argue that such a long stay in the status of a candidate influenced a variety of the country's economic development aspects. The same is true with respect to domestic business competitiveness.

Indeed, at least from the beginning of the first decade of new century, when Russia's economy had started to recover from the shocks of the 1990s, the question of accession to the WTO was the subject of lively debate within the society. The points of view on the membership differed fundamentally. One of the key arguments of accession critics was the following one. The bulk of the Russian companies due to their relative lack of competitiveness cannot contend with foreign manufacturers, and this would ensure dramatic (if not tragic) consequences for the entire country. Therefore, the proper trade policy strategy should be not to hurry up with the accession process. The government has to secure

sufficient time-frame for domestic companies to prepare, to get ready, to examine the rules and regulations of modern international trading system, and to increase their competitiveness. Only after that the country might join the WTO.

The political decision to obtain the membership in the World Trade Organization was made regardless the above mentioned discussions. One might expect that under the circumstances, Russian business entities (or at least a certain part of them) should be interested in getting comprehensive information on the obligations imposed by the WTO on its members, and after proper analysis of new threats and opportunities, in improvement their business practices. An additional incentive in this respect could be the information that was spread out in media that Russian negotiators would like to finalize the terms of accession before the end of the Doha Round, in order to avoid the hazards coming from additional requirements.

Nevertheless, real life had its own scenario. Despite the fact that the supply of information resources on WTO issues was generally quite sufficient (many books and articles were published, numerous conferences and seminars

were held all around the country), the level of knowledge regarding the rules and procedures existing within the framework of modern international trade system among Russian business community remained extremely low. The bulk of the entrepreneurs did not perceive the accession process as something directly connected to their daily business operations. The fact that some publications were financed from abroad proved that, according to domestic publishers, such literature was not in mass demand. To sum up, the society was not ready to receive and adopt new information, saying nothing about providing proper response to it.

Why the potential demand did not turn into the real one? It was the result of a low level of personal sensitivity of Russian society to the issues associated with international trading system developments. This was curiously combined with the recent privatization of public life. Employees of the World Economy Department (St. Petersburg State University) held a series of mini-interviews with representatives of different society sectors in St. Petersburg. Their results were alike to the similar surveys in other regions of the country. Many respondents, even considering the process of Russia's accession to the WTO as very important in general, did not see its direct consequences for themselves. It is also important to keep in mind that due to the internal logic of the accession negotiations the degree of uncertainty with respect to the final conditions of the membership in the organization up to the last moment, remained very high.

The negotiations themselves also had an interesting effect on the phenomenon under review. They apparently used to be delayed. The situation to the certain extend was exacerbated by the recurrent statements made by the representatives of Russian authorities that negotiations will be completed by the end of 2004, 2005, etc. Later on, it was perceived by many Russians as almost mandatory, but a meaningless ritual. What could be the meaning of such statements? On one hand, their aim was "to keep in shape" various Russian agencies involved in the negotiation process (without

certain time constrains the negotiations might last in a low-intensity mode almost forever). On the other hand, it was important to demonstrate the seriousness of Russian intentions to the rest of the globe. Foreign partners taking into consideration similar invocations about the prospects of the Doha Round were inclined to perceive these signals in a more positive way.

How critical was it with regard to the willingness of Russian economic agents to adjust their performance (enhancing competitiveness) towards membership in the WTO? Trying to answer the question from the standpoint of an abstract model of ideally functioning market economy, one might argue that the consequences of abovementioned imprudence should be dramatic enough. But in real life we probably could assess the situation somewhat differently. As we know, people do not always behave rationally. This idea used to find many evidences in relation to Russia as well. The famous saying "they won't lock the barn door till after the horse is stolen" in general quite adequately reflects modus vivendi of the most human beings. For many Russians it is particularly true. In a somewhat different context, it can be argued that low level of personal sensitivity of Russian citizens with regard to accession to the WTO is not the only (and probably not the most dangerous) manifestation of civil society immaturity in the country.

However, if on the level of individual companies one could not observe any significant efforts to adjust business practices to the upcoming membership in the World Trade Organization, the state, as the subject of trade policy development, made a number of important steps. Under the direct influence of the ongoing negotiations transformation of Russian business environment was gradually conducted.

In particular, on the 8th of December, 2003 the Federal Law № 165-FZ "On special safeguard, antidumping and countervailing measures with regard to the imports of goods" was passed. It provided definitions of subsidy and injury, stipulated rules of investigations and administration of trade remedies. In general, this law

was consistent with three WTO Agreements: on Antidumping, Safeguards, and Subsidies and Countervailing Measures. Three years later, on the 30th of December of 2006, another law № 280-FZ “On Amendments to the Federal Law “On special safeguard , antidumping and countervailing measures with regard to the imports of goods” was introduced. The changes took into account comments expressed during the negotiations by the experts from the members of the Working Party on Russian Federation accession to the WTO. In addition, the law also contained some clarifications for procedures based on the existing practice in the Russian Federation with regard to investigation and application of trade remedies.

### Russia as fully-fledged WTO member

It is hardly possible to give a definite answer to the question of how the accession to the World Trade Organization would affect the competitiveness of Russian business entities. Firstly, this comes from the fact that any forecast describes possible routes of development with some degree of probability. Second, the WTO membership can have both negative

and positive impact on the level of competitive power. Which of the two trends prevails – will be clear only after certain period of time. Before analyzing each of these trends in details it should be noted that during the last year prior the accession one could observe a huge interest to the WTO issues within business community. Russian companies were hastily trying to adjust themselves to the new conditions. “A blot on the landscape” for them has been the complexity of regulations and procedures. Coming to understanding even the basics requires serious efforts and considerable time. The latter, as we know, is indeed the scarcest resource. Therefore, the entire premises for the implementation of the optimistic scenario are not very favorable. The main threats that could lead to the reduction of domestic business entities competitive abilities is related to the fact that as a result of trade liberalization some imported goods and services could become cheaper. Foreign producers should be able to attract more Russian consumers than before. Summarized information on the extent of import duties reduction after the accession to the WTO is presented in Table 1.

Table 1  
Obligations of Russia to liberalize import duties

	Common external tariff: average weighted	WTO: average weighted	
		Initial bound rate	Final bound rate
All goods	10,293	11,850	7,147
Agricultural goods	15,634	15,178	11,275
Industrial products	9,387	11,256	6,410

Price reduction on imported goods and services can occur not only through the decline of duties as such, but also because of the other components of liberalization. Thus, the maximum amount of customs fees was reduced by 3.3 times (from the 100 000 to 30 000 rubles.) At the same time their structure was not changed, since Russian negotiators managed to prove that the amount of fees is based on the real cost of the customs clearance procedures. It should be noted that in 2011 the Federal Customs Service received 31.4 billion rubles of charges coming from customs clearance, support, and storage.

The experience of Ukraine that joined the WTO on May 16th, 2008 shows that growth in competitiveness of foreign companies as well as imported goods and services is quite possible. Thus, according to the business community of the country, liberalization of sugar market resulted in substantial losses for national suppliers (11% of the domestic market). The reduction of import duties on passenger motor vehicles from 25 to 10 per cent led to the six fold decline of domestic car production in 2010 in comparison with 2008 . According to the Finnish experts' estimations, the annual benefits for the pulp and paper industry in Finland coming from the new rules governing exports from Russia might reach 20 million euro. In turn, the reduction of import duties on paper, cardboard and products made of them (total Finnish exports to Russia of these items is about 450 million euro per year) is able to reduce the annual costs for Finnish companies by about 10 million euro. Respectively, this should increase the attractiveness of their products.

Assessing the risks of competitiveness reduction of concrete Russian companies as a result of trade liberalization, one has to consider a number of additional circumstances.

First of all, Russian negotiators managed to agree upon various tracings of liberalization in trade in goods (pace, size and type of duties). The length of the transition period for different products varies. The final bound rates were imposed to approximately one third of the tariff

lines on the day of the accession. For a number of products (around 5600 tariff lines) a import duties will be reduced in several steps: initial and final bound rates were set up, as well as duration of transition periods. For a number of products at the end of transition period duties will be nullified. For other goods, they will only decline to the agreed level. Market access for some products will be liberalized by gradual moves in several years. In general, the longest transition periods for tariff reductions in non-agricultural products were established on the most sensitive goods: cars, helicopters and civil aircraft—seven years. It is assumed that domestic companies will properly use additional time by focusing on the modernization of production, and improvement of product quality.

Second, even a rather significant reduction of import duties does not guarantee the price lowering, or such reduction may not be very significant. Thus, import duties on wine in four years will be reduced from 20 to 12.5 per cent. It seems to be quite considerably. However, the share of import duty in the retail price of imported wines (depending on the price range) is just 4-5 per cent. Retail chains gain 7 per cent, wholesalers profit is about 15-17 per cent, and the retail margin is 44-51 per cent. In other words, the reduction of duties might be used by participants of supply chain to increase their profits.

Finally, talking about a possible competitiveness decline of Russian business entities it is important to pay attention to the fact that under the new conditions the rules of subsidizing will be tougher. This is true with regard to the grants provided both by the federal and regional authorities. The WTO Agreement on Subsidies and Countervailing Measures provides guidelines on the use of subsidies and regulates the actions that member states might undertake in order to withstand negative effects of subsidies. Determination of subsidies, which can be found in the agreement, is rather broad. It includes the following elements: 1) financial contribution (grants, loans, loan guarantees, financial incentives, etc.), 2) by the government or any public body (national

or sub-national level), and 3) which confers a benefit. In order to consider the measure as a subsidy, it must contain all three elements.

Let us now look at those elements of the WTO legal system, which can contribute to the competitiveness of Russian producers. First of all, such consequences might appear from already analyzed liberalization of tariff and non-tariff measures, but in the opposite context. Indeed, not only households consume imported products. Russian companies (including industrial ones) depend on imported components and equipment. It is worth mentioning that about half of the commercial import to Russian Federation comes from machinery, equipment and vehicles. In addition, one should take into account that the dominant trend in contemporary international business is the creation of supply chains and intra-firm trade.

Second, one can expect some positive changes in the priorities of national economic entities, which evaluate various options to improve their competitiveness. With a reasonable share of simplification it is possible to take them down to two alternatives. In the first case it is in fact an artificial strengthening of the competitive position of domestic producers over foreign companies, being achieved through various measures of state support (import duties, subsidies, technical barriers, licensing, etc.). In this case, the company does not undertake any serious improvements in production process (modernization, investments, innovations, etc.). However, one of the conditions in getting required support is lobbying. The company has to convince a certain state institution in the wisdom of such measures. In the second case, a business entity does not rely on the external assistance, but undertakes various steps (introduction of new technological solutions, staff skills improvement, organizational development, etc.), the implementation of which is able to improve its market positions.

The alternative nature of these strategies hardly needs any serious justification. The numero-

us examples provided by both domestic and foreign practices clearly indicate that while companies enjoy the comfort of the protectionist umbrella shade, they generally do not have enough desire to expose themselves under the scorching rays of international competition.

To analyze such situation one might consider a theoretical approach proposed by Gary Becker. As known, for the assessment the comparative profitability of economic crime, on the one hand, and following the requirements of the law on the other hand, he introduced the inequality:

Gary Becker model

$$(1 - p)b > pfu \tag{1}$$

where p – probability of the law exposure in fringement

u – utility of legal activities

b – utility of illegal operations

fu – the share of the legal utility that is lost as a result of arrest and prosecution

If the right part of the inequality exceeds a left one (as it is presented in formula 1), then the rational choice of the economic agent under consideration will be in favor of breaking the law.

By introducing into original model new designation in accordance with the proposed alternatives we might get the following modifications:

Gary Becker model (modification 1)

$$(1 - p)b >?< pfu \tag{2}$$

where p – probability of lobbying to fail

u – utility of “internal” steps aiming to promote competitiveness

b – utility of protectionist measures

fu – share of “internal” steps utility lost as a result of protectionists measures

In terms of quantitative indicators extra com-



petitiveness can be assessed by additional market share, passing under the control of the domestic manufacturer. Russia's WTO accession affects at least two parameters in formula (2). The probability of lobbying to fail (p) due to additional commitments made by Russia as a member of the organization should increase. Utility of protectionist measures (b) in connection with the liberalization of trade policies (tariff binding, etc.) should be reduced. As a result, the relative utility of "internal" steps aiming to promote competitiveness increases, and for the rationally operating economic entity the latter strategy would be preferable.

Similar conclusions might be made after analyzing abovementioned alternative from the point of view of costs required for the implementation of each of the two strategies. In order to prove this let us slightly modify the original model in the following way.

Gary Becker model (modification 2)

$$(C(\text{lob}))/P > C(\text{int}) \quad (3)$$

where P – probability of lobbying to succeed  
C(lob) – costs of lobbying  
C(int) – costs of "internal" steps aiming to promote competitiveness

Russia's accession to the WTO may have an impact on all three parameters in the formula (3). Indeed, due to the additional commitments made by Russia as a member of the organization, the cost of lobbying C(lob) should increase. For the same reason, the probability of lobbying to succeed (P) is likely to decrease. In turn, the cost of the appropriate measures to enhance the competitiveness C(int) may be reduced (by cheaper imported components and equipment) as a result of import duties cuttings. Thus, even though prior the accession of the Russian Federation to the World Trade Organization domestic enterprises could prefer an option of the lobbying, under the new conditions a choice in favor of internal measures to increase competitiveness may be more economically viable.

Third, becoming a member of the WTO, Russia

must not only adhere itself to rather strict set of international rules. Russian companies, on their side, have the right to the demand from foreign partners comparable discipline with regard to their products. Mr. Maxim Medvedkov, the chief negotiator of Russian accession to the WTO and Trade drew attention to this issue in one of his interviews. Already after the first round of talks in Geneva after Russia had reached the status of a fully-fledged member of the WTO, he said: "We have enough issues to discuss with many of our partners. About 25 WTO members, in our view, apply the controversial measures in terms of WTO rules ... there are signs of inconsistency of the measures used in respect of Russian goods and services suppliers to the EU's commitment in the WTO ... European Union in anti-dumping investigations towards some Russian goods arbitrarily applies the rules of the WTO, which leads to a strong overestimated anti-dumping duties ... We, similarly to other WTO members, would like to use our rights in the Organization in order to ensure the legal protection of the interests of our companies operating in the market of the other members".

To resolve this task, Russia may demand the review of trade policy instruments applied towards national producers. If necessary, the country might use the existing dispute settlement mechanism. Meanwhile, with regard to products coming to Russian Federation and other members of the RBK Customs Union (Russia, Belarus and Kazakhstan) the following actions might be used: measures against dumped imports, causing a material injury to certain domestic industries of the CU (anti-dumping), measures to counteract the effects of a subsidy, provided by a foreign country, causing an injury to the industry of the CU (countervailing measures) and a mechanism to limit the increased volumes of imported products, causing serious injury to the domestic industry of the CU (special safeguards). Starting from the middle 2012 appropriate investigations are opened and conducted by the Trade Remedies Department of the Eurasian Economic Commission (EEC). The decision on the application of above mentioned measures should be

adopted by the Board of ECE.

An application that initiates an investigation should be submitted by the manufacturers and/or association of domestic producers. It has to be supported by enterprises representing at least 25% of the total volume of produced goods and like products under consideration. Depending on the action requested the application must contain:

- in the case of anti-dumping measures: information about the presence of dumped imports, material injury and a causal link between dumping and injury;
- in the case of countervailing measures: information on specific subsidies, injury and a causal link between the two phenomena;
- in the case of special safeguards: evidence of increased imports, serious injury and a causal link between two of them.

As of February 2013, the following actions were imposed with regard to foreign goods imported to the territory of the RBK customs union: 5 special safeguards and 9 anti-dumping measures. Simultaneously conducted four antidumping and four special safeguard investigations, particularly in respect of manufacturers from China, India, Germany, Italy, Poland and Turkey.

Fourth, in the medium term, some positive outcomes might appear from the fact that, as a result of accession negotiations, Russia reserved the right not to participate in the Agreement on Government Procurement. Only four years after the official date of its accession, the country agreed to start negotiations on possible joining the agreement. Under the circumstances, Russian authorities have the right to apply discriminatory measures towards foreign suppliers of goods and services while making state purchases. For example, one can refer to Putin's proposal to require all civil servants to use only domestically produced automobiles for all kind of official purposes.

Fifth, according to the majority of experts, one

of the positive results of the Russian Federation to the WTO accession could be an increase in foreign direct investment (FDI). This might happen due to the general improvement of business and institutional environment in Russia in general, and of investment climate in particular. It might result from the boost in the degree of transparency and predictability, as well as from the country's obligations regarding the liberalization of trade in services.

Finally, it is necessary to take into consideration additional commitments taken by Russian Federation in the field of intellectual property rights (IPRs) protection. Concerns about vulnerability of the IPRs in Russia were mentioned in numerous surveys of foreign investors, as one of the major constraint for investment flows into Russia. It is known that the foreign investment inflows have the potential to generate a wide range of both direct and indirect positive effects. In particular, they might lead to competitiveness growth not only for individual companies directly involved in the investment process, but also for entire industries, and even for clusters of national economy.

In order to sum up, it should be once again noted that the high degree of uncertainty about the possible impact of Russia's accession to the WTO on the competitiveness level of Russian businesses is still remaining. This uncertainty is related, on the one hand, to the fact that it is extremely difficult (if possible) to separate clearly the effects of accession itself from the entire package of other factors that affect the capacity to compete. The final result will, for example, reflect fluctuations in the exchange rate, which can both dampen and strengthen the impact of trade policy liberalization. For instance, during the period of 2009 – 2012 fluctuations between Russian ruble and Euro were about 6 per cent. One cannot expect any radical changes in such volatility in the foreseeable future.

On the other hand, even if we assume the possibility of an isolated study of the accession effect, it would be still very difficult to predict exactly how domestic producers

would operate under new economic condition. Meanwhile, many things depend precisely upon that. With respect to this it is appropriate to recall the famous saying: we are the architects of our own fortune. In this sense, the accession to the World Trade Organization can be compared to the purchasing of expensive equipment (which was bought by the most of the other market players). If you know to use it, it would increase the competitiveness of your products. If you do not know how to operate the equipment properly, you will not be able cover the costs and avoid losses.

## Notes

1. It should be noted that initially it was planned to complete the Doha Round already by the beginning of 2005.

2. The concept of public life privatization in Russia was introduced by sociology professor V.Schläpentoich (Vladimir Schläpentoich Russia: Privatization and Illegalization of Social and Political Life. Michigan State Univ. CND((95)459).

3. The Law, as well as current legislation of the RBK Customs union, uses the term “special safeguard” in the same way as in the WTO the term “safeguard” is applied. Special safeguards (being authorized for some – but not all – WTO members) have slightly different nature and mechanism. At the same time, Russian Federation is not allowed to apply special safeguards in accordance with the terminology of the WTO: temporary increase in import duty to deal with import surges or price falls, under provisions that are special to the Agriculture Agreement.

4. Being a member of the Customs Union (together with Belarus and Kazakhstan), Russian Federation applies together with its partners a common customs tariff (ETT).

5. In this case, it is necessary to recall the famous maxim: “Post hoc non est propter hoc” Indeed, during the global financial crisis, which affected very noticeable Ukrainian economy, automotive industry all around the world was among the branches experiencing the most visible shocks.

6. Working Party on the Accession of the Russian Federation to the World Trade Organization. Commitments on Goods. Schedule CLXV -THE RUSSIAN FEDERATION. PART I-MOST-FAVOURED-NATION TARIFF. SECTION II - Other Products [http://docsonline.wto.org/imrd/gen\\_searchResult.asp?RN=0&searchtype=browse&q1=%28+%40meta%5FSymbol+WT%FCACC%FCRUS%FC%2A%29+&language=1](http://docsonline.wto.org/imrd/gen_searchResult.asp?RN=0&searchtype=browse&q1=%28+%40meta%5FSymbol+WT%FCACC%FCRUS%FC%2A%29+&language=1)

7. Although in this case the price cuts, reducing ceteris paribus labour costs may indirectly have a positive impact on the competitiveness of Russian enterprises.

8. The fact that in this group about a quarter accounts for imported automobiles somewhat reduces the weight of the argument, but in no way removes it completely.

9. <http://www.itar-tass.com/c1/537662.html>

10. [http://tsouz.ru/db/spec\\_measures/Pages](http://tsouz.ru/db/spec_measures/Pages)

11. This is so called plurilateral agreement – among less than all the WTO members. It is not a part of a single undertaking package that has to be accepted by

all WTO members.

12. The main mode of trade in services is so-called commercial presence. It involves creation a subdivision by a service provider in the host country (the country of the consumer), that is, in fact, the direct investment.



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