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Diplomová práce

Russian Accession to the World Trade Organization.

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Prohlášení

Prohlašují, že jsem diplomovou práci vypracovala samostatně a použila pouze uvedené prameny a literaturu.

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Abstract

Russia applied to join the WTO in 1993 and its accession is now making rapid progress. This work discusses the economic and political factors associated with the Russian entry to WTO, focusing on tariffs, difficult sectors, services, IPRs and the environment for FDI. The impacts of WTO accession on Russia's domestic restructuring as well as on Russia's relations with the EU are also analysed.

While recognising the delicate political and economic conditions, I conclude that Russian premature accession to WTO could cause some difficulties on many yet undeveloped Russian markets. Although earlier or later its enter is necessery, and Russia - subject to some transitional adjustment periods - should allow access to the Russian market for western services sector companies. WTO accession was seen as helpful to Russia in the sense of locking in reforms, and promoting further market-oriented reforms.

Abstrakt

Poprvé Rusko požádalo o vstup do WTO v roce 1993 a v současné době se proces připojení zrychluje. Tato diplomová práce zkoumá ekonomické a politické faktory vstupu, zaměřuje se na cla, citlivé položky zahraničního obchodu, sektor služeb a ochranu vlastnických práv. Analyzuje dopad vstupu na jednotlivé složky ruské vnitřní hospodářské politiky a restrukturalizaci, vliv na vztah Ruské federace a EU.

Vzhledem k choulostivým ekonomickým a politickým podmínkám by předčasný vstup Ruské federace do WTO mohl způsobit určité potíže v určitých segmentech dosud rozvíjejících se trhů. Dříve či později je však vstup Ruska do WTO je nezbytný. Diplomová práce vyúsťuje v ekonomicky zdůvodněné přesvědčení, že Rusko by mělo umožnit přístup západních společnosti na domácí trh služeb, což by mohlo přispět k urychlení tržně zaměřených reforem a následně i k urychlení ekonomického růstu. Členství Ruska ve WTO je přitom v zájmu i globálního rozvoje světové ekonomiky.

TEZE DIPLOMOVÉ PRÁCE

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Název: **Russian Accession to the WTO**

Cíl :

The Russian Federation first applied to join the WTO in June 1993 and its accession is now making progress, with possible entry in 2004. The aim of this work is to acquaint readers with the current economic and political factors associated with the Russian entry to WTO, focusing on tariffs, difficult sectors, services, IPRs and the evironment for FDI. The impacts of WTO accession on Russia's domestic restructuring as well as on Russia's relations with the EU are also analised.

In this work, which is based on reserches of Russian and western European experts, I am trying to express my own point of view on Russian accession to WTO and to show some current and future difficulties associated with this process.

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3. Why should Russia join the WTO? The Political Economy of Accession.
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Podpis vedoucího diplomové práce: Podpis autora:

I. Introduction

The World Trade Organization (WTO) came into being in 1995. It is the successor to the General Agreement on Tariffs and Trade (GATT) concluded shortly after the Second World War. In 1998 GATT celebrated its golden jubilee in Geneva. The system, which is aimed at regulating the world trade through the mechanism of restraining unilateral actions, has existed for almost 50 years now and has proved its efficiency as a legal base for the multilateral trade. Years after the Second World War have seen an exceptional growth in world trade. Merchandise exports grew on average by 6% annually. Total trade in 1997 was 14-times the level of 1950.

The system was developed through a series of trade negotiations (rounds), held under GATT. The first rounds dealt mainly with tariff reductions, but later negotiations included other areas such as anti-dumping and non-tariff measures. The latest round, so-called Uruguay Round held in 1986-1994, led to the WTO creation, which considerably extended GATT's areas by covering trade in services and trade related intellectual property rights. So, GATT mechanism was improved and adjusted to the current stage of trade development. Also, GATT, being actually an international organization, officially was not considered to be such; the WTO did get the official status of a specialized UN agency institution and a legal personality.

WTO is both an organization and at the same time a complex of legal documents, a multilateral trade agreement, in a way, providing for governments' rights and commitments in the area of international trade in goods and services.

Overriding objectives of the WTO are liberalization of the international trade, providing for the trade to flow fairly and predictably, contributing to economic growth and raising people's economic welfare. **Countries WTO members,** which are **more than 140** today, solve these problems through the control over implementation of multilateral agreements, conducting trade negotiations, trade disputes settlement in compliance with the WTO procedure, and also through rendering assistance to developing countries and running review of the countries' national economic policies.[1]

The Russian Federation first applied to join the WTO in June 1993. In line with the WTO's standard procedures, a Working Party was established to consider the application and oversee the process. By early 2002, the Working Party had met over 10 times to consider an initial memorandum on its trade policy regime submitted by the Russian government, to consider and discuss questions from Working Party members and responses by the Russian side, and to start the process of negotiating specific agreements concerning trade in goods, trade in services, agriculture, and other matters of concern to WTO members. Despite this activity, interest from the Russian side was at best erratic, periods of enthusiasm for the WTO alternating with periods of apparent indifference. Likewise, it cannot be said that there was huge enthusiasm from existing WTO members, especially the major states and trading regions such as the USA and the European Union, to accelerate the Russian application.

This sluggish approach to the WTO has now been superseded by events, both within Russia and in the wider international context. As regards the former, soon after Yeltsin was replaced by President Putin, Russia's interest in the WTO revived, aided by the support of his leading economics minister, German Gref. Membership of the WTO now forms a key plank in Gref's economic programme for the Russian Federation, as a result of which there have been several high-level meetings in Geneva concerning the Russian application. In May 2001 the Russian Federation submitted an updated statement on its trade policy regime[2], and the current position, noting the huge volume of legislative amendment that WTO accession would entail for Russia. Many of the practical issues associated with a Russian accession were also discussed in the joint Russian-Canadian study, vanDuzer *et al.* (2000). Topics covered by such events in the year 2000/2001 have included: agriculture and WTO agreements; trade policy and poverty reduction; and the future of the international trade order in light of the current dispute settlement climate.

In the wider context, the dramatic and shocking events of September 11 th 2001, and its aftermath, the war against the Taliban and Al-Qaeda forces in Afghanistan, have

[1] For more detailed information about WTO structure see appendix 1.

drawn Russia back into a closer relationship with the Western Powers. Russia joined the USA-led alliance formed to defeat the Taliban and provided helpful logistical support to facilitate movements of US military equipment, troops, and aid supplies to some of the countries bordering Afghanistan. As a result, the present Russian leadership is very much in favour with the US Administration and the EU, and one benefit of this is that there is now a far more positive attitude towards an early Russian accession to the WTO. Indeed, a speech by Mike Moore, Director General of the WTO, suggested that negotiations regarding the Russian accession could be completed this year, with entry as early as next year, assuming that the necessary ratification procedures could be completed within such a short time[3] (though more recent speeches have cast some doubt on this optimistic schedule).

Given this apparent acceleration of the schedule for the Russian accession, it is timely to consider some of the key economic and political issues associated with WTO membership for Russia. After outlining briefly what WTO membership entails, I would like to examine some of these issues under the following headings:

- Why should Russia join the WTO? The political economy of accession
- Outstanding Issues
- Tariff structure
- Difficult sectors
- Services trade
- Intellectual property rights
- Investment and capital flows
- Trade preferences within the CIS
- Impact on Russian domestic policies
- Impact on EU-Russian relations

The work concludes by discussion under three main headings: what shoul Russia be offering in its WTO negotiations?; how will WTO accession affect Russia?; and how

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[2] WTO, 2001
[3]speech referred to in *Russia Journa*l, 2002a

will accession impact on EU-Russia relations? In these sections I conclude what have been said about it and try to express my own point of view.

II. The WTO and the Accession Process

2.1. The Process

The Russian Federation is one of around 30 countries which are currently seeking accession to the WTO. Being one of the largest economies among the applicant countries, its accession has great potential to increase trade that would benefit current WTO members as well as Russia itself. On the other hand, its relative size and importance within the CIS, many of whose members are also in the WTO accession process, also mean that Russia's entry terms would have important implications for other countries, and should therefore be considered very carefully.

The fact that, like many of the other applicants, Russia is in the midst of a process of economic reform and transition towards a market economy also makes the accession process more complicated than it would be for an already well established market economy.

As we have already said the WTO was established on 1 January 1995 by building on its predecessor, GATT, and incorporating the Uruguay Round (UR) agreements which introduced new disciplines in areas such as trade in services, trade related aspects of intellectual property rights (TRIPs), and trade related aspects of investment measures (TRIMs). All the UR agreements plus the new strengthened rules of the GATT (known as GATT 1994) form the basis for accession negotiations. Accession to the WTO therefore becomes a more complex and demanding process than the former process of joining the GATT.

The guidelines for the accession process are set out in Article XII of the WTO of the Marrakesh agreement. Any state or customs territory having full autonomy in the conduct of its commercial relations may accede to the WTO on terms agreed with WTO members. The accession process begins as soon as the applicant government submits a request for accession. The General Council thereafter establishes a Working Party with standard terms of reference. The Working Party is open to all WTO members. The applicant country is then requested to submit a detailed memorandum on its foreign trade regime to be reviewed by the Working Party. Then follows a clarification process between the Working Party and the applicant through questions and replies, both oral and written. This process helps the member states better understand the applicant's trade policy regime and enables them to assess its ability to meet the obligations of a WTO member. It also serves as a forum for WTO member countries to identify the policies of the applicant country which are not consistent with WTO rules. As the process evolves, the accession negotiations will increasingly focus on the terms and conditions of entry and the commitments to be undertaken by the acceding state.

In parallel with the above process, the applicant and interested individual WTO members hold bilateral negotiations regarding market access in goods and services. Once bilateral negotiations have finished and the Working Party has concluded its review, a mandate is prepared comprising the Working Party's report and the Protocol of Accession, the latter containing the precise terms and conditions of accession. The applicant country is normally then invited to accede to the WTO upon agreeing to the terms of this mandate. (For more detailed information about Accession proccess see Box 2.1.)

As the accession process involves negotiations between the applicant country and various WTO member countries on specific trade related matters, as well as with the WTO itself, each accession is unique. The WTO does not set any timetables or deadlines. The speed of accession to a great extent depends on the acceding country's ability to clarify its trade policies and make them consistent with WTO requirements. However, it is not unusual for the process to take some years. One of the great difficulties experienced by an applicant country during the accession process is to provide a detailed report on its trade regime in a clear and consistent manner. This is partly due to lack of understanding of certain technical terms such as ‘state trading’ and the fact of their complex trade policies[4].

[4] Milthorp, 1996

Box 2.1: The accession process

The accession process is resumed through four independent parallel tracks:

- Track 1: Multilateral negotiations/Working Party
- Track 2: Bilateral negotiations on goods
- Track 3: Bilateral negotiations on services
- Track 4: Plurilateral negotiations on agriculture subsidies

Track 1: Multilateral Negotiations/Working Party

Track 1 negotiations take place at the WTO Secretariat in Geneva, Switzerland in the form of working party meetings open to all WTO Members and observers. Multilateral negotiations are conducted as follows:

Six-eight weeks after submission of the Memorandum and its annexes, members of the working party submit questions to the acceding country regarding the Memorandum

Six-weeks after submission of replies by acceding country, the working party convenes

Discussions during the working party meeting mainly revolve around state of the acceding country's foreign trade regime, required reform (policy, legal, regulatory, and institutional) for conformity with the WTO, status of reform, and commitments with regard to policies and rules.

Additional questions are usually submitted within a month after the working party meeting; the acceding country must reply within 6-8 weeks; the next working party meeting takes place 6-8 weeks after submission of replies to questions only if the acceding country can demonstrate that significant progress toward reform for conformity with the WTO agreements has been achieved since the last working party meeting

The process of working party meetings and questions/replies continues until WTO members are satisfied that the acceding country had taken all necessary legal measures to bring its policy, legal, regulatory, and institutional base into full conformity with the WTO

Track 1 ends by drafting the Report of Working Party which reflects the Memorandum, the questions/replies, rules commitments, and discussions of the working party.

Around six working party meetings are needed in order for a country to conclude multilateral negotiations.

Track 2: Bilateral negotiations on goods

Bilateral negotiations on goods may take place in Geneva Switzerland or at any other location agreed upon between the acceding country and a specific WTO Member. Bilateral negotiations are conducted bilaterally and confidentially between each of the Member countries interested in trading with the acceding country.

Each WTO member country interested in bilateral negotiations evaluate the acceding country's initial offer on goods and usually request that the acceding country make additional concessions and commitments to the initial offer. The process of meetings and revisions of the initial offer is repeated until the WTO member is satisfied that the acceding country had made sufficient concessions and commitments for those goods of interest to the WTO Member. The process with each country concludes by signing a bilateral protocol.

The overall process of bilateral negotiations on goods concludes by merging all commitments and concessions in the area of goods and preparing the Schedule of Concessions and Commitments on Goods. Concessions and commitments provided to a specific country during bilateral negotiations extend to all WTO members on an MFN basis.

Usually around 15 countries are interested in bilateral negotiations on goods including always Australia, Canada, EU, Japan, Switzerland, and the US. Around five rounds of bilateral negotiations on goods are required with each country.

Track 3: Bilateral negotiations on services

Bilateral negotiations on services may take place in Geneva Switzerland or at any other location agreed upon between the acceding country and a specific WTO Member. However, most WTO members prefer that such negotiations take place around the dates of the working party meeting in Geneva. Bilateral negotiations are conducted bilaterally and confidentially between each of the Member countries interested in the acceding country's service sector.

Each WTO member country interested in bilateral negotiations evaluate the acceding country's initial offer on services and usually request that the acceding country make additional commitments to the initial offer. The process of meetings and revisions of the initial offer is repeated until the WTO member is satisfied that the acceding country had made sufficient commitments to open its service sectors in those sectors of interest to the WTO Member. The process with each country concludes by signing a bilateral protocol.

The overall process of bilateral negotiations on services concludes by merging all commitments in the area of services and preparing the Schedule of Specific Commitments on Services. Commitments made to a specific country during bilateral negotiations extend to all WTO members on an MFN basis. However, limited exemptions from MFN in the area of services may apply.

Usually around 8 countries are interested in bilateral negotiations on services including always EU, Switzerland, and the US. Around five rounds of bilateral negotiations on services are required with each country.

Track 4: Plurilateral negotiations on agriculture subsidies

After submission of ACC/4, countries (usually Australia, Canada, EU, and US) request additional clarifications on domestic and export subsidies in the areas of agriculture. The acceding country revises and updates its ACC/4 to the satisfaction of those interested members. Once ACC/4 is finalized, plurilateral negotiations take place. The main objectives of such negotiations will be to agree on a binding level of domestic and export subsidies of the acceding country. In certain cases, reductions may be requested. The Group of CAIRNS countries, US, and EU usually participate in these negotiations. The final commitments are linked to the Schedule of Concessions and Commitments on Goods.The Accession Package is prepared by the WTO Secretariat and consists of the following items: the Working Party Report and the Protocol of Accession including the Decision on Accession, the Schedule of Concessions and Commitments on Goods, and the Schedule of Specific Commitments on Services.

All tracks are eventually concluded through one final working party meeting that adopts ad referendum the Accession Package and recommends accession of the applicant country to the WTO General Council (or Ministerial Conference). The WTO General Council (or Ministerial Conference) meets and adopts the Accession Package and approves the Decision by a two-thirds positive majority vote of the WTO Members, in case of objection of at least one country. Otherwise adoption and approval are achieved through consensus. Practically, decisions are all taken by consensus.

The Protocol of Accession enters into force on the 30th day after acceptance by the Applicant country. That could be done through either signature or, in case of parliament approval, a deposit of instrument of ratification (e.g. law).

The overall process of accession may take 2-3 years from the date of submission of the Memorandum if the acceding country (i) conducts its bilateral negotiations actively and required reform; promptly and (ii) is forthcoming and responsive to Working Party requests.

As an observer or as Member, a country must pay an annual fee depending on the size of its economy and the value of its international trade. In the case of Lebanon, the annual fee for observer status is half of the minimum contribution (around SFr 20,000) and the annual fee for membership is SFr 219,000 . Upon accession, a one time contribution of SFr 39,000 toward capital fund must be paid.

http://www.economy.gov.lb/MOETEN/Texts/Summary%20of%20WTO%20Accession.htm)

2.2. What WTO Membership Entails

WTO membership involves both rights and obligations. The most important of these rights and obligations of WTO membership are probably best illustrated by its three main principles: non-discrimination, reciprocity, and transparency.

Non-discrimination is the most important principle of the WTO. This is represented by the well-known most favoured nation clause (MFN). The MFN ensures that any trade concessions offered to one country are extended to all WTO member states automatically in a non-discriminatory fashion. There are exemptions to the MFN principle in the case of a free trade agreement (FTA) or a customs union.

Reciprocity is introduced in order to avoid the free-rider problem under the MFN. It requires that any country receiving trade concessions from another country should offer something comparable in return. This requirement is not normally imposed in the case of developing countries.

Transparency refers to the use of different barriers to international trade. The WTO regards tariffs as more transparent devices than non-tariff barriers (NTBs) such as quotas and voluntary export restraints (VERs). Therefore the most acceptable method of protection under the WTO is tariffs. The use of NTBs should be prohibited wherever possible.

The WTO also introduced the ***Dispute Settlement Mechanism*** whereby a member country can establish whether another member has been unfair in its trading practices in ways that harm thatmember.

The benefits of WTO membership are therefore potentially very substantial even if attention is confined to the basic principle of MFN treatment. In the case of the developing countries, they commonly enjoy these preferences without having to offer the same degree of concessions to other countries. This is also true for the Uruguay Round agreements covering agriculture and services, as developing countries have much longer transition periods than the developed countries. For countries in transition, accession to the WTO also means that they would be able to enjoy important benefits which were not previously available to them. For example, the various restrictive practices still operated by developed countries against state-trading economies like Cuba and North Korea would most likely have to be terminated if these countries became WTO members. But the WTO emphasises that WTO membership is not only about rights but also about obligations. Unless the acceding country is judged to be ready and capable of taking on the challenges and obligations of membership (possibly after an initial transition period), then it is unlikely to gain entry to the 'club'.

It is generally accepted by the world community that accession of countries in transition to the WTO is highly desirable, moving them from a past characterised by isolationism or bilateral approaches to trade policy towards fuller integration into the world economic system[5]. However, as Drabek (1996) emphasises, there are some serious difficulties to be faced. These include major shortcomings in terms of economic structure and the institutional framework, a frequently far from completed macroeconomic stabilisation, as well as quite fundamental uncertainties regarding the proper sequencing and speed of trade policy reforms. There is also a significant question over the stability, and even the credibility, both of policies covering foreign trade and investments, and in regard to any commitments that might be entered into in these areas in the course of WTO accession. Faced with these difficulties, it might be possible to offer countries in transition some form of special status or preferences. But Drabek (1996) argues against that approach on the grounds that it tends to "lock in" whatever special conditions might be agreed. His preferred alternative is a defined transition period, by the end of which any given transition economy would have in place the full set of commitments and policies required for WTO membership. The length of the period might need to be based on judgements about the pace of institutional and macroeconomic change, the strengthening of administrative and political structures, and the improving sustainability of economic policies.

[5] see Michalopoulos, 1998

III. Incentives to Join the WTO

Russia principally exports fuel products (notably oil and gas) and raw materials (diamonds, metals, timber and the like) in exchange for manufactured goods such as transport equipment and processed agricultural produce. In recent years, according to *State Committee of the Russian Federation on Statistics*, Russia has enjoyed huge trade surpluses, of the order of USD 20-60 billions per year. Table A (in appendix) shows exports and imports by principal trading partner, hence illustrating the regional structure of Russian merchandise trade, with non CIS and the CIS appearing as principal trade partners. [See also tables below]

Table 3.1.:EXTERNAL TRADE TURNOVER OF RUSSIA[1)]

(bln. US dollars)

	2000	**2001**
Total	150.4	156.4
exports	105.5	103.0
imports	44.9	53.4
including:		
with out of CIS countries	122.8	128.0
exports	91.3	87.7
imports	31.5	40.3
with CIS countries	27.6	28.4
exports	14.2	15.3
imports	13.4	13.1

Source: Goscomstat

[1)] Data calculated according to the methodology of Balance of Payments.

Table 3.2.: EXPORTS AND IMPORTS OF RUSSIA[1)]
(bln. US dollars)

	Export		Import	
	2000	2001	2000	2001
Total	103.1	100.7	33.8	41.2
including:				
out of CIS countries	89.3	86.2	22.3	30.1
CIS countries	13.8	14.5	11.5	11.1
of which countries EuroAsEC[2)]	8.0	8.1	6.2	6.1

Source: Goscomstat

1)Data include external trade with Belarus.

[2)] Euro-Asian Economic Communities.

Such large merchandise trade surpluses do not suggest a nation in great need of whatever support and benefits would ensue from WTO membership. So why is Russia interested to join, why is the world community now so ready to collaborate in the accession process? It is not possible to answer these questions without referring to a rather complex mix of economic and political considerations.

3.1. International community

Though Russia's economic weight in the world economy is small, she is a major player politically, not least because the country remains a substantial nuclear power, and as the leading successor state of the former Soviet Union. Russia attends many meetings of the G7 powers (the United States, Canada, the UK, France, Germany, Italy, Japan), this group enlarged to include Russia often being referred to now as the G8, and has belonged to international organisations such as the IMF and World Bank for some years. Russia also belongs to most of the more specialist international organisations such as the ILO (International Labour Organization), the WHO (World Health Organization), and the like. It is therefore somewhat anomalous for such a key country not to belong to the WTO.

On the other hand, the Russian government itself has often been ambivalent about membership, and important members of WTO[6] have put up barriers in the way of Russian accession. Russia has desired the benefits of membership while being reluctant

[6] see appendix 2

to contemplate the possible costs in terms of necessary changes to domestic policies (sometimes perceived as unwanted external interference in Russian concerns), costly industrial restructuring, and a possible flood of foreign goods and services entering the Russian market. These fears are not groundless, but with careful preparation their impact can be limited or spread over a longer period. At the same time, those states that saw Russian accession as “problematic” because of expected difficulties in sectors like steel, agriculture, financial services, and others (see below), increasingly consider that the international community can function better with Russia inside the WTO rather than outside. As explained below, this is not to say that the problems have disappeared, merely that with a more positive approach on all sides, it is expected that they can be resolved.

Since world trading rules are evolving over time, Russia might also prefer to be on the inside, with a significant “voice”, than to remain on the outside, able to do no more than respond to changes in the rules agreed by everyone else. This was, after all, part of the argument used in China concerning WTO accession for that country[7].

3.2. Comparison with the accession of China

Remaining with China, it is worth pausing to sketch the issues that arose in the Chinese WTO accession, and to compare them with the corresponding Russian situation. China signed its WTO Accession Protocol in late 2001 and entered the WTO in December. Like Russia, China has enjoyed substantial trading surpluses in recent years, though in China’s case these have resulted from the successful expansion of manufacturing exports - largely from Special Economic Zones and the burgeoning Township and Village Enterprise (TVE) sector. A key reason for joining was to secure more reliable access to the vital US market - before accession, the US renewed China’s MFN status annually, and the country had been subject to increasing numbers of anti-dumping allegations originating in the US.

A second factor favouring WTO membership was the prevalence of loss-making state-owned enterprises (SOEs) in China. Many need to be restructured and, if necessary, closed down, but the political and social costs of this are expected to be huge. WTO

[7] See Martin and Ianchovichina, 2001

membership was perceived as an external factor that could assist China's leadership to bring about this type of domestic change, though it is acknowledged that the process will be slow.

Walmsley *et al.* (2002) also show, by means of a multi-sectoral, multi-regional and multi-period model, that WTO accession for China will result in large increases in FDI and, over a 10-20 year period, very substantial gains in investment, GDP and general living standards as compared to scenarios in which China remained outside the WTO. GDP, for instance, was expected to be almost 30% higher by 2020 with China inside the WTO. Such large gains come through four principal channels:

(a) reduction in the perceived riskiness of investment in China, which implies a rise in the perceived returns;

(b) efficiency gains due to the removal or considerable reduction of tariffs and quotas across most sectors;

(c) improved productivity in certain key sectors, notably automobiles (due to the high initial protection, including inter-provincial barriers to trade within China, and initial output levels only a fraction of the minimum efficient scale in many plants); and

(d) liberalisation of services trade and improved conditions for foreign investment in services.

The key economic factors, therefore, have been market access, locking in reforms through provision of an external anchor (in China's case, to support long-delayed SOE reforms), and improving conditions for FDI. All of these apply with great force to the Russian case. However, we should also highlight some significant political and economic differences between Russia and China in terms of their starting points and recent reform experience. In some respects, as we shall see below, these factors make Russian entry to WTO a bit more problematic than that of China.

Table 3.3. Differences between Russia and China

Factor	Russia	China
Politics	Democratic,following collapse of communist systém in 1991.	Communist party in power. No significant political reforms.
Economy (general)	Severe decline in GDP and output in most sectors untillate 1990s, modest recovery since then.	Rapid economic growth since late 1970s. General living standards rising quickly.
Economic structure	Industrial economy with most sectors in need of restructuring and modernisation. Lack of dynamism.	Huge shifts out of agriculture into the very dynamic TVE sector. TVE output and exports now exceed that from SOEs.
Trade	Exports dominated by primary produce, notably oil and gas.	Exports dominated by manufacturing.
FDI	Not very attractive conditions, little FDI thus far.	Substantial FDI to mid-1990s, then a slowdown, recovery since 2000.

As we have already mention as China so Russia have a significant foreign trade surpluses due to different countries, international financial groups and world trade organizations. But the main difference is that Russian foreign trade surpluses are caused by the selling the oil, gas and other row materials, which the world need, and it is the reason why it doesn't make any worries in the world community. Vice versa China's consumer goods flood are dengerous for countries of WTO and the rest of the world. For example USA is compleatly full of China's goods, imprort from China to Czech Republic is 11 times more than its export. So Russian foreign trade surpluses don't hinder to the world trade markets vice versa it is required to associate it with possibility of Russian Federation to pay old-soviet and new (from the begining of 90's years) foreign debts, what is obviously in the interests of the world's financial groups and western governments.

3.3. Market access

Russia perceives itself, sometimes not incorrectly, as a country whose export products are denied access to many potentially important markets. (See the table below).

Table 3.4.:BASIC EXPORTS FROM THE RUSSIAN FEDERATION[1)]

	2000	*2001*	*2001 percentage of 2000*
Fresh and frozen fish, thou. tons	916	864	94.3
Iron ore, mln. tons	19.2	23.6	122.9
Coal, mln. tons	44.2	47.6	107.6
Crude oil, mln. tons	145	160	110.5
Oil products, mln. tons	62.7	70.8	112.9
Natural gas, bln.cu.m	194	181	93.3
Electric power, bln. kW.h	15.1	19.6	129.3
Ammonia, thou. tons	2943	2813	95.6
Round wood, mln. cu.m	30.8	37.5	121.8
Sawn wood, thou. tons	4535	4593	101.3
Pulp, thou. tons	1677	1778	106.0
Ferrous metals, mln. US dollars	6733	6093	90.5
Copper, thou. tons	646	597	92.5
Nickel, thou. tons	197	189	95.7
Aluminium, thou. tons	3203	3082	96.2
Machinery and equipment, mln. US dollars	9071	10354	114.1

Sourse: Goscomstat

[1)] Data of the State Custom Committee of the Russian Fedration, including exports to Belarus.
[2)] Including fish and sea products fished in neutral waters.

While many developed countries already accord Russia MFN treatment or better, there are numerous exceptions or special cases where particular sectors are treated differently. Some of these are the standard **"difficult" sectors** like steel, textiles, agricultural and food products where many developed countries regularly maintain restrictive policies. Some countries, such as the United States, have tended to link the granting of MFN status to unwelcome and, indeed, largely outmoded political conditions (freedom of emigration for Russian Jews). As part of its WTO negotiations, it is to be expected that many such conditions would be dropped, or at least that Russian exporters would find themselves competing on equal terms with exporters from other countries.

It is needless to mention that now Russia-s **automobile industry** may not cope with foreign competition if Russia becomes a WTO member. Moscow is first and foremost interested in the protection of such important branches of industry as automobile and **aircraft production**. AvtoVAZ can not compete with Ford. The same situation is expected with Russian aircraft. After Russia's perspectives to join the WTO became favorable, there was a question raised at the European Union pertaining to Russian airliners and western standards.

Moreover, leakage of sensitive **nuclear or nuclear-related equipment**, materials, or **missile technology** from Russia remains a troubling concern. Russia has made great progress in improving its system of laws and regulations to license and control its sensitive exports. But it faces major problems in implementing its system of controls. Lack of resources, inadequate company internal compliance systems aimed at stopping illicit exports, a poor export control culture, and a desperate emphasis on commerce slow progress on the creation of an effective export control system.

On the other hand, there is a clear downside to all of this, one that is much less well understood in Russia[8]. This is the reciprocity aspect of WTO membership. In this instance, what this means is that in exchange for access to the general privileges of WTO membership, Russia will need to open up many of its domestic markets to foreign competition, both in manufacturing and services sectors of the economy. What this might mean in practice, we consider further below.

3.4. Protection against unfair treatment

Not only does Russia encounter restrictions in its access to certain markets, but even when it does enjoy access it is vulnerable to charges of anti-dumping[9] and other forms of unfair trade practice. Many such charges are brought against Russia by the United States, by the EU, and by other countries. (See the Table B below and Box 3.1.) Since countervailing duties or other trade restrictions are often put in place while an investigation is being pursued, the charges can disrupt trade even if they are not subsequently found to be justified. Moreover, Russia remains especially open to such charges due to its continuing designation by many important trading partners as a state-trading economy. For instance, Russian metal producers claim that at least 24 countries have introduced protectionist measures against Russian metal exports, with voluntary export restraints (VERs) being agreed in some cases following anti-dumping

[8] Though some concerns are expressed in *Russia Journa*l, 2002b

[9] Dumping is an informal name for the practice of selling a product in a foreign country for less than either (a) the price in the domestic country, or (b) the cost of making the product. It is illegal in some countries to dump certain products into them, because they want to protect their own industries from such competition.

allegations[10]. Naturally, Russia would prefer to operate in a trading environment in which it was far less vulnerable, and WTO membership is likely to help.

However, the key to better treatment in international trade is being accepted as a normal, market economy country by getting rid of the state-trading designation, and by operating with domestic economic arrangements that do not include numerous hidden subsidies, and the like. Clearly, Russia expects to gain full recognition as a market economy country in the course of its WTO negotiations, but achieving this has not proved a straightforward matter. While the UK and a few others of Russia's trade partners have been comfortable with the idea of according a market economy status for Russia, both the US and the EU have appeared more hesitant. One of the possible ways forward was for market economy status to be considered sector-by-sector rather than across the board, placing the onus upon Russia in each case to justify any improved status. This approach was not welcomed in Russia, not least because it would have represented scarcely any improvement on the current position. In the event, both the US and EU have recently declared that they are prepared to accord full market economy status to Russia[11].

Nevertheless, the difficulties over this issue reflect the view by major trade partners of Russia that, despite the country's enormous moves towards a market economy, accompanied by complex institutional and policy reforms in many fields, very large domestic economic distortions still remain in place, distortions, moreover, that are likely to have a substantial - unfair - impact on the competitiveness of Russian products in the world market.

Probably the most critical of such domestic distortions concerns the pricing of energy - gas, oil, electricity - to Russian producers (and, indeed, to households, though that is of less concern from the international trading standpoint). After rising somewhat through the mid-1990s, Russian domestic energy prices (measured in dollar terms) fell sharply in the wake of the 1998 financial crisis and devaluation[12]. They currently stand at a small fraction of the prevailing world market prices for the major types of energy. The result is that there are **two kinds of distortion in the pricing of Russian energy**: (a)

[10] *Russia Journal*, 2000
[11] Hare, 2002c

average domestic prices are far too low and are mostly well below any reasonable measure of production costs; (b) the relative price ratio between the consumer price of energy (paid by households) and the producer price (paid by firms) is exactly wrong, with consumers enjoying much lower prices than the already unreasonably low prices paid by firms. Quite aside from the directly damaging effects of such prices in terms of encouraging the profligate use of energy and distorting vital investment decisions, the low prices paid by Russian firms for their energy can readily be used as an argument of unfair subsidies. Exactly this line of argument then justifies Russian trade partners in advancing anti-dumping claims and the like. For instance, French aluminium producers, which themselves benefit from cheap hydro-electric power, are opposed to their Russian competitors receiving cheap energy unless this is truly justified by the production costs involved; and most likely it would not be.

Energy pricing is thus an area where Russia is likely to have to offer quite significant steps towards more rational domestic pricing if the country is to achieve the international status it desires as a result of its WTO accession. I think this is one of ways in which participation in the international trading community has implications for domestic policies.

As Minister of the Trade and Economic Development, Mr. German Gref has said: „The negotiations of Russian accession to the WTO became stump".[13] Energy pricing is not the only question of the conflict between Russia and the Europe, there are some more quesions due to which it is difficult to find a compromise, like: balancing of domestic and world energy prices, elimination of the export tax[14], to enable the freely transit through the russian pipelines, to get possibility to build private pipelines, to abolish the monopoly of „Gasprom" for the gas export. For Russia these requests seems to be very strickt. „Gasprom" wants to secure own status quo. Government and russian bussinesses rich the concensus in negotiations of Russian accession to WTO – nobody in Russia wants to harry up with accession.

Also **politically**, this could be quite a difficult issue for Russia, with some resenting what will be perceived as undue external pressure on Russia's domestic

[12] OECD, 2002b
[13] RosBussiness Consulting, 2003 (http://www.rbc.ru)

policies, others using external requirements as helpful levers to push through long overdue domestic reforms.

Box 3.1.: On WTO Anti-Dumping Agreement

On WTO Anti-Dumping Agreement

The WTO Anti-Dumping Agreement allows governments to act against dumped imports where there is material injury to the competing domestic industry. In order to do that the importing government has to determine, after investigating, that dumping is taking place, calculate the extent of dumping (how much lower the export price is compared to the exporter's home market price or "normal value"), and determine that the dumping is causing injury. (See the table B)

The WTO Secretariat reported that in the period 1 July — 31 December 2001, 19 Members initiated 186 anti-dumping investigations against exports from a total of 55 different countries or customs territories. During the corresponding period of 2000, 18 WTO Members had initiated 187 anti-dumping investigations.

India initiated 51 investigations during the second semester of 2001, as compared with 21 investigations initiated during the second semester of 2000. The **United States** had the second highest number of initiations (35) during the second semester of 2001, compared with 38 during the corresponding period in 2000. **Argentina** had the third highest number of initiations, 16, a decrease from 34 initiations in the comparable period during 2000.

China, with 25 investigations on its exports, is at the top of the list of countries subject to anti-dumping investigations, although this number is a decrease from the 32 investigations initiated on Chinese exports during the second semester of 2000. **Brazil, Chinese Taipei, Thailand** and the **United States** were next, each with 9 investigations initiated on their exports in the second semester of 2001. **Indonesia, Korea** and **Japan** each had 8 investigations initiated on their exports in the second semester of 2001.

The largest group (60) of investigations initiated during the second semester of 2001 involved products classified in the base metals sector of the Harmonized System of Tariff Classification, which includes **iron, steel** and **aluminium products**. The other two sectors most affected were **chemicals** and **plastics**, with, respectively, 41 and 34 investigations initiated. The United States initiated 33 out of its 35 investigations on base metals products, while India initiated the majority (28) of its investigations on chemical products. Turkey initiated 12 out of its 13 investigations on products in the plastics sector.

Eight WTO Members imposed a total of 79 final anti-dumping measures against exports from 33 countries or customs territories during the second semester of 2001. This total represents a sharp decline from the 107 measures imposed during the corresponding period of 2000. Notable also is the decline in the number of countries imposing measures, from 16 countries during the second semester of 2000. The United States imposed the most final measures (21) during the second semester of 2001, a significant increase from the 8 final measures imposed by the United States during the corresponding period of 2000. India was a close second to the United States in the number of final measures imposed during the period, with 20 measures. The European Communities and Argentina each adopted 11 measures during the period, which for the Communities was significant decrease from the 32 measures imposed in the second half of 2000. Argentina had imposed 10 measures during the second half of 2000.

Exports from China were the subject of the largest number, 21, of final measures imposed during the second semester of 2001. Chinese Taipei was a distant second, with 6 measures. For China,

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[14] About export tax see Appendix 3.

this represents a slight increase from the 17 measures imposed against its exports during the second semester of 2000.
As was the case for initiations, the sector most affected by final measures was **base metals**, with 34 final measures imposed on products in that sector. This was followed by the **chemicals sector**, with 13 measures imposed, and the **machinery** and **electronics sector** with 8 measures.

The anti-dumping semi-annual reports by Members for the period 1 July — 31 December 2001 can be found under document series G/ADP/N/85.
22 April 2002 - http://www.wto.ru/ru/content/documents/docs/ADJulDec01.doc

3.5. Attraction of foreign direct investment

During the 1990s, the Russian Federation attracted remarkably little Foreign Direct Investment (FDI)[15], as compared to the more successful transition economies such as Hungary, Poland and the Czech Republic, and most of what there has been concentrated in a few natural resource-based sectors (and the associated machinery and equipment), with a little going into hotels and catering establishments mostly in Moscow and St Petersburg, and modest amounts into food processing and a few other sectors (see Table 3.5.).

[15] Direct investment is a category of international investment that reflects the objective of a resident entity in one country obtaining a lasting interest in an enterprise located in another country. A lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise. A direct investment relationship is created when a foreign investor owns 10 per cent or more of the ordinary shares or voting power in the direct investment enterprise.

Table 3.5: Sectoral breakdown of FDI in Russia in 2000

Sector	FDI (million dollars)	%
Industry	1844	41,6
Incl. Energy sector	*442*	*10,0*
Machine building	*228*	*5,1*
Food	*821*	*18,5*
Transportation	948	21,4
Communication	378	8,5
Trade and catering	835	18,9
Others	424	9,6
Total	4429	100,0

(source: Goskomstat)

About 40 % of foreign direct investments were directed to the industrial sector of the economy in 2000. Among the industries the food industry attracted most FDI, 800 million dollars, while the oil extracting industries received 450 million dollars of FDI. In addition to industrial investments the transportation, communication, trade and catering were also among the sectors, which received significant FDI in 2000[16].

Table 3.6.: COUNTRIES WITH THE MOST PROMINENT INVESTMENTS IN THE ECONOMY OF RUSSIA in 2001

(mln. US dollars)

	Investments		including		
	total	percentage of the total	direct	portfolio	other
Total investments	14258	100	3980	451	9827
Cyprus	2331	16.3	512	153	1666
USA	1604	11.3	1084	4	516
United Kingdom	1553	10.9	273	92	1188
Switzerland	1341	9.4	51	1	1289
Netherlands	1249	8.8	575	4	670
Germany	1237	8.7	495	0.2	742
France	1201	8.4	50	0.0	1151
Virginians (UK)	604	4.2	63	71	470
Austria	423	3.0	36	0.3	387
Japan	408	2.9	184	0.0	224

Source: Goscomstat

The **regional breakdown of FDI in Russia** is very uneven. Moscow as the major economic and administrative center of the country has attracted 40 % of FDI in Russia during the years of 1996-2000. During the same period the city of St. Petersburg has attracted close to 5 % of FDI. The border regions of Murmansk Karelia and Leningrad Oblast have been much less favoured as FDI targets. The new North-West Federal District attracted about 10 % of all FDI in 2000[17]. (See table 3.7.)

Table 3.7. Foreign Direct Investment in Russia and the north-west regions during 1996-2000 (thousand dollars)

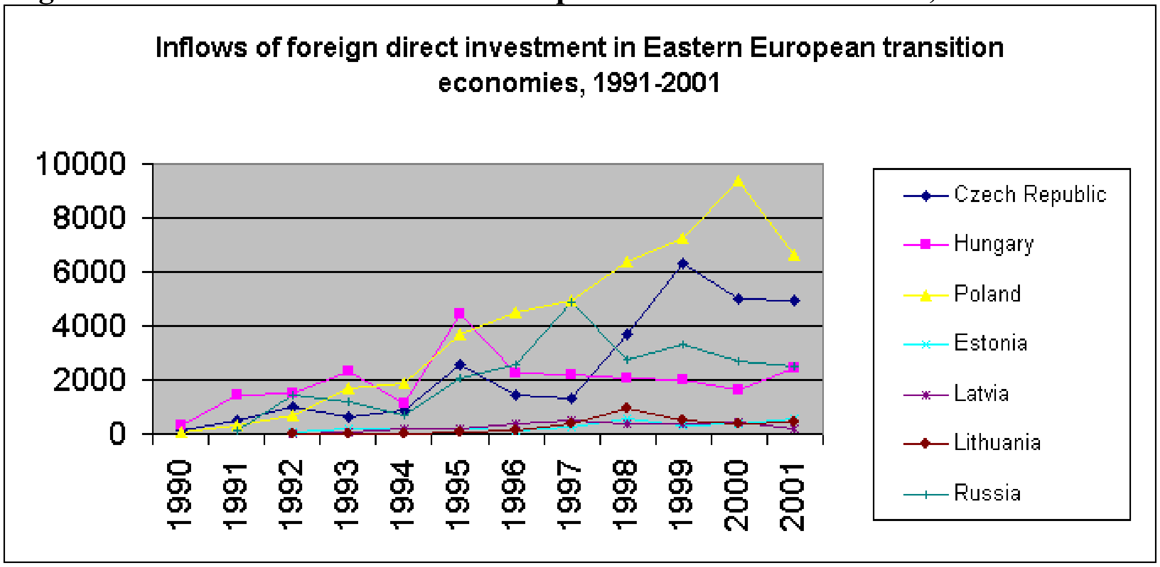
Region	**Foreign Direct Investments (USD 1 000)**					
	1996	***1997***	***1998***	***1999***	***2000***	***1996-2000***
Russia total	2 439 759	5 333 403	3 360 768	4 260 000	4 429 000	19 822 930
Moscow	1 031 888	4 117 916	803 255	787 590	1 472 807	8 213 456
St. Petersburg	113 026	149 370	259 866	272 014	146 681	940 957
Leningrad Oblast	43 692	75 599	90 568	236 169	205 462	651 490
Murmansk Oblast	2550	2 331	2 188	8 153	29 250	44 472
Republic of Karelia	2301	3659	5 137	4 532	6 765	22 394
North-west district					448 762	

(source: Goskomstat)

By the end of 1999, accumulated FDI inflows into Russia amounted to USD 19.9 billions (USD 135 per capita), as compared to inflows into Hungary of USD 19.8 billions (USD 1,967 per capita), Poland of USD 20.4 billions (USD 527 per capita) and the Czech Republic of USD 16.5billions (USD 1,612 per capita)[18] (See Figure 3.1.).

[16] Expert, 2000
[17] Expert, 2000
[18] See UNECE, 2000

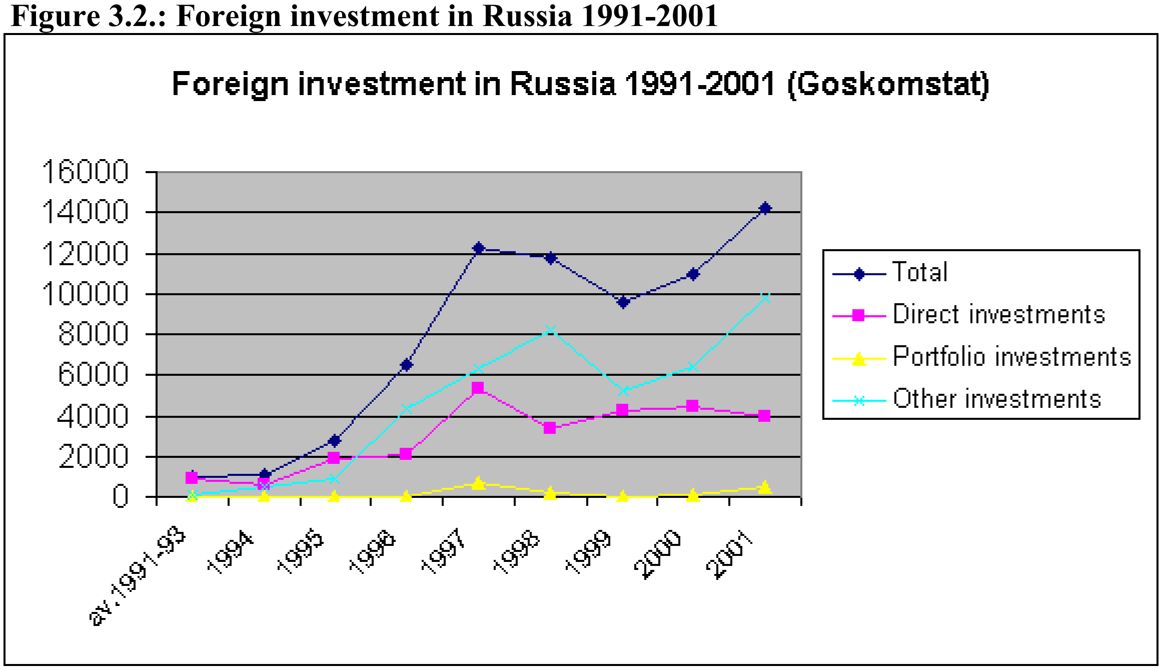
Figure 3.1.: Inflows of FDI in East European Transition Economies, 1991-2001



Source of the data: ECE Economic Survey of Europe 2001 No.1, United Nations

According to BOFIT (2002a), FDI inflows to Russia in 2001 amounted to USD 4 billion (1.3% of GDP), down from USD 4.4 billion in 2000, though Central Bank of Russia balance of payments data report lower totals, somewhat under USD 3 billion in each of the last two years. Whatever figures one accepts, these are extremely small numbers. (See Figure 3.2.)

Figure 3.2.: Foreign investment in Russia 1991-2001



Source: Goskomstat (State Statistical Office of the Russian Federation)

The main reasons for such a dismal performance have to do with Russia's **domestic policies** – in particular the delayed and erratic macroeconomic stabilization, a privatization programme that strongly favoured insiders (workers and managers) as the new owners, and a poor institutional framework to support banking, financial institutions in general, and investor protection[19] - and a variety of **political and social problems** - notably the prevalence of economic crime and corruption, the influence of interest groups and lobbies, confusion over the respective jurisdictions of Federal and regional authorities, and the prevalence of barter and other forms of non-monetary transaction. While nominally, Russia has had in place suitable legislation to promote FDI for some years, few investors have therefore felt sufficiently secure in the Russian environment to invest large sums for long periods. Moreover, the serious lack of investor confidence is also apparent amongst Russians themselves.

Table 3.10.: VOLUME OF FOREIGN INVESTMENTS BY TYPES[20]

(mln. US dollars)

	2000	2001
Total investments	10958	14258
including:		
direct investments	4429	3980
of which:		
contributions into starting capital	1060	1271
credits extended by foreign co-owners of enterprises	2738	2117
other	631	592
portfolio investments	145	451
of which:		
shares	72	329
securites	72	105
other investments	6384	9827
of which:		
trade credits	1544	1835
other credits	4735	7904
foreign governments' credits guaranteed by the Government of the Russian Federation	23	36
other	82	52

Source: Goskomstat (State Statistical Office of the Russian Federation)

Clearly, acceding to the WTO would not, in itself, do away with these serious impediments to investment flows. However, by continuing its reform process, and by

[19] See Hare, 2001a

locking in new institutions and practices through the commitments it will have to make to join the WTO, as western experts suppose that the climate for FDI in Russia could improve markedly in the coming years. The enormous potential benefits in this area are highlighted by comparison with the likely impact of the Chinese WTO accession, analysed briefly above.

3.6. The domestic political debate on WTO accession

The politics of WTO accession are quite complex, since most of the economic aspects of the process are linked to interest groups that might support or oppose different proposals. Hence even if an economist might argue that WTO accession should be supported on the grounds that aggregate net benefits for Russia will come out positive - what always matters **for the politics is the distribution of gains and losses**[21]. Politics is virtually always about distributive issues, and Russia is no exception. In relation to trade policy matters, such distributional issues are often contentious, and the associated political pressures tend to be weighted in favour of potential losers from reforms – for in practice one is often having to compare smallish gains for the great mass of consumers with possibly substantial losses for relatively few, large, vocal producers.

While President Putin and his economic ministers are pushing for early WTO entry, opinion around the country is extremely divided[22]. Thus a recent survey of companies in the Moscow region carried out for the Union of Goods Producers found that two-thirds regard 2007 or later as an acceptable time frame for WTO entry - most consider themselves unprepared for earlier entry.

Many firms in the **energy sector** and **primary produce sectors**, already successful exporters, support WTO entry not so much because it will have much impact on their trade, but because they see it as encouraging foreign investment - including in their sectors.

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[20] *Hereafter the data are given excluding bodies of monetary regulation, commercial and savings banks; including receipts in roubles converted in US dollars.*
[21] Hare, 2002c
[22] See *Russia Journa*l, 2001

Other firms, especially those in declining **heavy industry** or in remote regions where economic conditions are poor, simply feel threatened. They do not see WTO membership as offering any sort of positive opportunity.

As for the **Russian population**, there is widespread lack of understanding of what WTO accession might mean, accompanied by suspicions of unwelcome foreign interference in Russian economic policies.

In the **financial sector**, the banks clearly feel unready to meet foreign competition, and the President of Sberbank has argued for restrictions on the activities of foreign banks in Russia for at least ten years after accession. Other bankers have supported this view. Some senior Duma representatives have urged Russia to accept substantial liberalization in the fledgling insurance market, while the companies themselves feel unready and WTO negotiators representing the EU in particular press for greater openness.

In **agriculture**, the Federation Council argued in June for the creation of a common market for agricultural produce across the CIS, as a precondition for Russian integration in the world economic system. It was also asserted that Russian agri-business is ready for WTO entry, though presumably this would be on the basis of the high levels of tariff protection currently sought by the Russian negotiating team. A senior official in the Volga region, in a discussion of food security, acknowledged the need to balance consumer interests with helping Russian producers to compete in the market.

As it seems to me, the **political environment** for WTO accession is something of a minefield, through which the government will need to steer a very careful course - to secure accession without being seen to give too much away, and hence avoid alienating important interest groups.

IV. Outstanding Issues

For the Russian Federation, WTO accession will result in important changes in the foreign trading regime, involving substantial changes in tariff rates and structures for many imported products, changes in taxes and other levies associated with exports, some further liberalisation in regard to trade in services, and associated measures of domestic economic policy. The latter will include reforms to enhance the competitive character of domestic markets, rationalisation of parts of the domestic tax system, and measures to allow foreign companies access to the Russian market - as far as possible on the same terms as domestic firms - with rights to trade and invest freely, subject only to the general provisions of the prevailing economic regulatory framework.

According to the very thorough World Bank study edited by Broadman[23], there are four basic issues that Russia will need to manage with care in connection with its WTO application. These are:

(a) the dispersion of the tariff structure;
(b) questions of trade and investment in services sectors;
(c) the WTO treatment of state-trading entities; and
(d) reform of the policy regime relating to FDI.

The first two of these are certainly important, and are discussed further below. But item (c) really has to do with the extent to which Russia will be treated as a market economy country, and this was already referred to briefly above. However, there are some other issues that were barely touched on in Broadman (1999), and bringing these into the analysis gives us the following list of topics to cover in this section: tariffs; difficult sectors (incl. agriculture); services trade; intellectual property rights (IPRs); investment and capital flows; and trade preferences within the CIS.

Energy sector is playing a paramount role in the structure of the Russian economy amounting to 40% of all Russian exports and exerting a significant impact on political agenda of the Russian Government is a boost for an earlier accession of the country into the WTO, so I decided to include as well this extremly important sector into further analysis.

4.1. The Tariff Structure

The Russian foreign trade regime has generally included not only a very complex import tariff structure, with thousands of distinct tariff lines (including both *ad valorem* tariffs and specific tariffs), but also a variety of licensing requirements and other quantitative restrictions (incl. problems of certification and technical standards), as well as export duties payable on exports of gas and oil[24]. In countries with weak governments or governments experiencing problems with the public finances - such as Russia during the very unstable decade of the 1990s when policies in all areas were undergoing rapid change - tariff revenues can provide an important contribution to public sector financing. However, to the extent that this is a valid argument, it is an argument for fairly uniform tariffs that are consistently collected, rather than the rag-bag of diverse rates, with numerous exceptions and exemptions, that characterised Russia until very recently. Tarr (1999) reviews the standard arguments for tariffs and argues for a uniform tariff for Russia on efficiency grounds. Uniform tariffs are less distorting, do not generate excessive rates of effective protection as goods pass through different stages of processing, and are far less susceptible to the corruption that is often associated with highly variable tariffs.[25]

In the late 1990s, the weighted average import tariff in Russia was about 13.9%, not terribly high by international standards though well above the average external tariff of the EU. (See Table C below in annex) Given the exemptions and non-collection, the effective rate averaged nearer 10%. At the three-digit product level, the standard deviation of the tariff was about 7%, implying that about two-thirds of Russian tariffs at that level of aggregation were in the range 7% - 20%[26]. Gradually, Russia has been simplifying its tariff structure by reducing the number of rates in use and lowering the average rate. Thus at the start of 2001, over 30 per cent of products were classified into

[23] see Broadman, 1999
[24] See appendix 3
[25]Corruption opportunities arise when customs officials are offered bribes in order to classify a product into a product group where it would attract a lower tariff than it ought to have. See Hare (2001b).

[26] WTO, 1990-2003

just four categories with tariff rates of 5%, 10%, 15% and 20%. Although a few products, including cars, sugar, alcohol and tobacco will be taxed at rates well above 20%, these changes brought the average rate down to 11-12%[27].

In its WTO negotiations, Russia is seeking initial tariff bindings at levels well above current effective rates, presumably in order to give itself some room for manoeuvre in the future. Final bound rates - after an expected post-entry transition period of 6-8 years - are being proposed at rates close to current effective tariff levels.(See Table D in annex). The notable exceptions are the sectors of agricultural produce and food products, where the proposed final bound rates remain well above current tariff rates (about 25% as compared to a current tariff of about 15%). However, many WTO members will be seeking to persuade Russia to commit to lower tariffs, by accepting lower bindings right from the start. There is some risk that by demanding excessively high initial bindings, Russia will leave itself open to continuing pressure from domestic industry lobbies seeking protection –hence this approach to the WTO could merely provide a means to delay restructuring even more, which is not to be welcomed.

Ksenia Yudaeva, a leading expert on Russian trade policy and a new Scholar-in-Residence at the Carnegie Moscow Center presented her analysis of Russian WTO negotiations in which she assessed the potential effects of the tariff changes in the short run on output and employment, and effects of accession on firm productivity, consumers and foreign direct investment (FDI). Many people believe WTO accession and trade liberalization will increase unemployment. Using data collected from Russian firms between 1996 and 2000, the study found that the most active lobbying industries-including the machine building industry-are also the most sensitive to tariff changes. With a uniform tariff reduction of one percent, a decline in industrial employment of one percent or more would occur in four of Russia's eighty-nine regions, while a decline of between 0.5 percent and one percent would occur in seven regions. The remaining regions would suffer a decline of less than 0.5 percent. This data suggests that substantial rises in unemployment are not likely to result from WTO accession. Russia's average tariff, which is now between 12 and 14 percent, would be decreased by 2 percent in case of accession. Studies conducted by the Higher School of Economics and the National

[27] See Hare 2002c

Investment Council similarly concluded that WTO accession would not significantly affect unemployment rates. In the long run, the effects of accession on employment seem positive but small. Yudaeva explained that these results should not come as a surprise: exchange rates have a larger effect on the economy than tariff rates due to the importance of oil prices, and tariff rates have fluctuated several times in recent years with little effect on output or unemployment.

[More about Russia's approach in tariffs in Appendix 3]

4.2. Difficult Sectors

Sectors can be classified as "difficult" for a number of reasons. They could be sectors requiring major restructuring, for instance, and Russia has many of these inherited from the period of central planning. Also, they could be sectors that many other countries tend to subsidise and protect in various ways, such as agriculture, textiles, aerospace, and so on, where impediments to trade are widespread. In this sub-section I make no attempt at completeness, merely providing brief information and suggestions about a few key sectors. One of which is energy sector.

4.2.1. Oil and Gas Export

Energy sector playing a paramount role in the structure of the Russian economy amounting to 40% of all Russian exports[28] and exerting a significant impact on political agenda of the Russian Government is a boost for an earlier accession of the country into the WTO. The Russian energy sector is an export-oriented industry trying to export every barrel of oil and every cubic meter of natural gas, which remain after the local demand is met (a legally binding requirement imposed on these industries).

Naturally, the reason for this is a price gap between the domestic and export prices for hydrocarbons, most notably for oil and natural gas. The energy prices for domestic consumers may be 3 to 6 times less than the export prices. This gap makes WTO member-states unhappy since the price difference renders their products uncompetitive at the Russian market even if the trade tariffs are favorable.

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[28] Energy Information Administration, www.eia.doe.gov

The WTO member-countries concern here is the competitiveness of their products at the Russian market. They view the low energy prices as a form of governmental subsidies for the domestic producers, which is clearly a protectionism measure. On its part, the Russian Government insists that the WTO requirement to unify energy prices for domestic and foreign consumers exceeds the regular WTO requirements and falls into the so-called "gray zone" or WTO+ requirements.

Oil exports

Prior to 1991, the Soviet Union was the world's largest oil exporter, with net exports in excess of 3.5 million bbl/d at its peak. Russia, the largest republic in the U.S.S.R., accounted for nearly 90% of overall Soviet oil exports. Soviet oil production and exports declined throughout the 1980's, and in the aftermath of the breakup of the Soviet Union in 1991, Russia's net oil exports plummeted from around 5 million barrels per day (bbl/d) in 1988 to just 3.1 million bbl/d in 1994[29].

After Russia restructured its oil industry into a number of vertically-integrated, private oil companies, the country's oil production and exports began to increase again. In 2001, Russia's net oil exports rose for the seventh consecutive year, reaching 4.91 million bbl/d in net crude oil and oil product exports. Russia is now the world's second largest oil exporter, behind only Saudi Arabia. Russia's net oil exports are projected to increase again in 2002, to 5.17 million bbl/d, and then to 5.4 million bbl/d in 2003. (See the diagram below).

[29] Energy Information Administration, www.eia.doe.gov

Figure 4.1.: Russian Net Oil Exports, 1992-2003

Source: Energy Information Administration, EIA, www.eia.doe.gov

The majority of Russian oil is exported via terminals in the Baltic Sea (several ports) and Black Sea (mainly Novorossiisk, but also Tuapse and Odessa). Russian crude oil also is exported to Europe via the 1.2-million bbl/d capacity Druzhba pipeline[30]. However, as Russian oil producers continue to increase production, these export routes have been running at or near capacity. In addition, Black Sea exports must pass through the increasingly crowded Bosporus Straits, raising environmental concerns about an oil spill in the Straits. As a result, Russian oil exporters are looking for alternative export routes.

The Baltic Pipeline System, which began operations in December 2001, allows Russia to export oil directly from its Baltic Sea port of Primorsk rather than shipping it through Estonia, Latvia, or Lithuania. In addition, the integration of the Druzhba and Adria pipelines in Croatia gives Russian oil exporters direct access to the Adriatic Sea, where tankers can be loaded at the deep water port of Omisalj.

[30] Energy Information Administration, www.eia.doe.gov

Despite being restricted to exporting 30% of their production by a long-standing quota arrangement[31], Russia's oil producers have been seeking to maximize their exports by whatever means possible, constraints on export capacity notwithstanding. The discrepancy between export and domestic prices (Russian prices are typically just over half of the world market price), plus the guarantee of hard currency payment for oil exports, combine to make a compelling argument for increased sales abroad.

Thus, Russian oil companies are attempting to challenge Transneft's monopoly position on export pipelines by developing pipeline projects of their own. Yukos, one of the country's largest oil companies, is negotiating with the Chinese government to build an oil pipeline to China, and the international consortiums that are developing oil projects Sakhalin Island are considering building pipelines to China and Japan to supply oil to customers there. A deepwater oil terminal at Murmansk that would enable Russian oil exporters to ship their oil to the United States also has been proposed. Huge investments in infrastructure will be needed to bring these pipelines and terminals online.

Relations with OPEC

Crude oil exports are a key source of income for Russia, as revenues from exports provide approximately 25% of the Russian government's income[32]. It is estimated that every $1-per-barrel price increase in the price of Russia's Urals Blend benchmark brings in almost $1 billion in extra earnings. On the other hand, a decrease in oil prices adversely impact Russia's budget. While Russia experienced a windfall in extra oil revenues in 1999 and 2000 when world oil prices were relatively high, the drop in world oil prices in late 2001 cut into Russia's revenue intake.

Although Russia is not a member of the Organization of Petroleum Exporting Countries (OPEC), the Russian government agreed to a 150,000 bbl/d oil export cut in the first quarter of 2002[33], following suit with other non-OPEC members such as Mexico, Oman, Norway, and Angola.

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[31] Energy Information Administration, www.eia.doe.gov
[32] Energy Information Administration, www.eia.doe.gov
[33] OPEC, www.opec.com

Despite the Russian government's pledged oil output cut, Russian oil exports actually increased in the first quarter of 2002. Government-imposed export tariffs caused a glut of crude on the Russian market, causing a price collapse and leading to calls from Russian oil companies to lift the export ceiling. Russian oil companies then sent their crude to Russian refineries, which led to an increase in oil product exports and a surplus of refined products on the market. In order to reduce the amount of crude on the market, some Russian officials called for the creation of a strategic Russian oil reserve.

In March 2002, over the opposition of domestic oil companies, the Russian government announced that the country would continue to reduce its oil exports by 150,000 bbl/d. Regardless, Russian oil companies increased their crude oil exports as world oil prices climbed, and Russia formally abandoned its stated export cuts. As idustry experts say, the scene is set for a cold war between Russia and Organization of Petroleum Exporting Countries (OPEC).

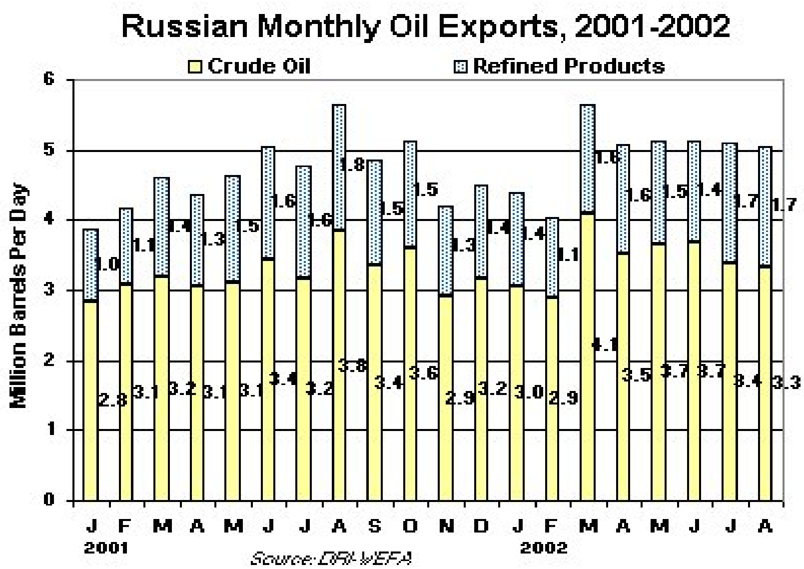
Export Destinations

Since 1991, Russian oil exporters increasingly have shifted their focus from the countries of the Commonwealth of Independent States (CIS) and central Europe to Western Europe. As countries in the former Soviet Union have racked up oil debts, Russian oil exporters have targeted customers in Western Europe, where demand is strong, supply is limited, and payment is in cash.

The majority of Russian oil exports are sent to countries in **Western Europe**, such as the United Kingdom, France, Italy, Germany, and Spain. The share of net exports to countries outside the former Soviet Union rose from 53% in 1992 to 86% in 2001 as the share of net exports to former Eastern Bloc and Soviet Union countries decreased[34]. Russia's net exports outside the CIS totaled approximately 4.23 million bbl/d in 2001, while only about 680,000 bbl/d was exported to CIS countries.

[34] Energy Information Administration, www.eia.doe.gov

Figure 4.2.: Russian Monthly Oil Exports, 2001-2002



Source: Energy Information Administration, EIA

An October 2000 energy summit between the **European Union (EU)** and Russia, whereby the EU agreed to help Russia develop its oil and natural gas reserves in return for a long-term energy supply commitment, promises to boost Russia's oil exports. With pipeline projects such as the Baltic Pipeline System, Russia hopes to increase oil exports to Europe to over 5 million bbl/d in the future[35].

Russian oil exports to **Asia** are set to increase in the next decade with the development of oilfields in East Siberia and on Sakhalin Island, as well as the integration of the Druzhba and Adria pipelines. In addition, the proposed Murmansk oil terminal and connecting trunk pipeline to West Siberia may give Russia the ability to export significant quantities of oil to the United States. However, the transportation and production costs of delivering Russian oil to the U.S. are higher than those of Middle East producers, making it unlikely that Russian oil will replace Middle East oil on the U.S. market.

[35] Energy Information Administration, www.eia.doe.gov

Natural gas exports

Russia is the world's largest natural gas exporter, with 6.7 trillion cubic feet (Tcf) in net natural gas exports in 2001[36]. Gazprom, Russia's state-run gas monopoly and the country's largest natural gas exporter, has forecast that Russia's natural gas exports will climb to 7.1 Tcf by 2002 and to 7.5 Tcf in 2005.

Many Russian oil companies sit on huge natural gas reserves, which they have not developed commercially because they do not have access to lucrative export markets. Gazprom keeps firm control of Russia's pipeline network, but with restructuring in the country's natural gas sector in the works, all natural gas producers finally may receive equal pipeline access. When third-party access to Russia's natural gas transportation infrastructure becomes a reality, Russia's natural gas exports could increase dramatically: Russian oil companies currently produce approximately 2.2 Tcf of associated natural gas that could be treated and exported rather than flared off.

Already, Russian independent Arktikgaz has been given access to Gazprom's pipeline network to supply 4.2 billion cubic feet (Bcf) of natural gas to northern Ukraine from October 2001 until 2010[37]. Arktikgaz also has signed contracts to supply 5.3 Bcf to Belarus and 2.1 Bcf to Georgia over the next 10 years and hopes to become the first Russian independent producer to export natural gas outside the former Soviet Union.

While these figures are minuscule compared to the amount of natural gas that Gazprom exports, it represents the first challenge to Gazprom's monopoly position on Russian natural gas exports. In March 2002, Yukos, Russia's second-largest oil company, acquired a controlling stake in Arktikgaz and announced its plans to become a major player in Russia's natural gas industry. Further restructuring of the natural gas sector and the potential break-up of Gazprom could open the export market to additional producers.

Export Markets

Historically, the majority of Russia's natural gas exports were sent to customers in Eastern Europe, but since the collapse of the Soviet Union, Russia increasingly is looking

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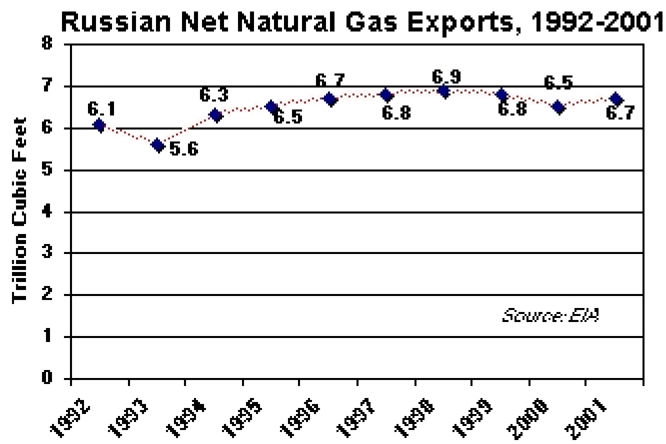
[36] Energy Information Administration, www.eia.doe.gov
[37] Energy Information Administration, www.eia.doe.gov

to diversify its export options. Russia continues to export significant amounts of natural gas to customers in the Commonwealth of Independent States (CIS) because of the existing natural gas distribution network linking the former Soviet republics, but Gazprom is shifting its export strategy to send more natural gas to the EU and Turkey. In addition, Russia is looking at markets in China, Japan, and possibly South Korea for its natural gas.

Figure 4.3.: Russian Net Natural Gas Exports, 1992-2001



Source: Energy Information Administration, EIA

To the Commonwealth of Independent States

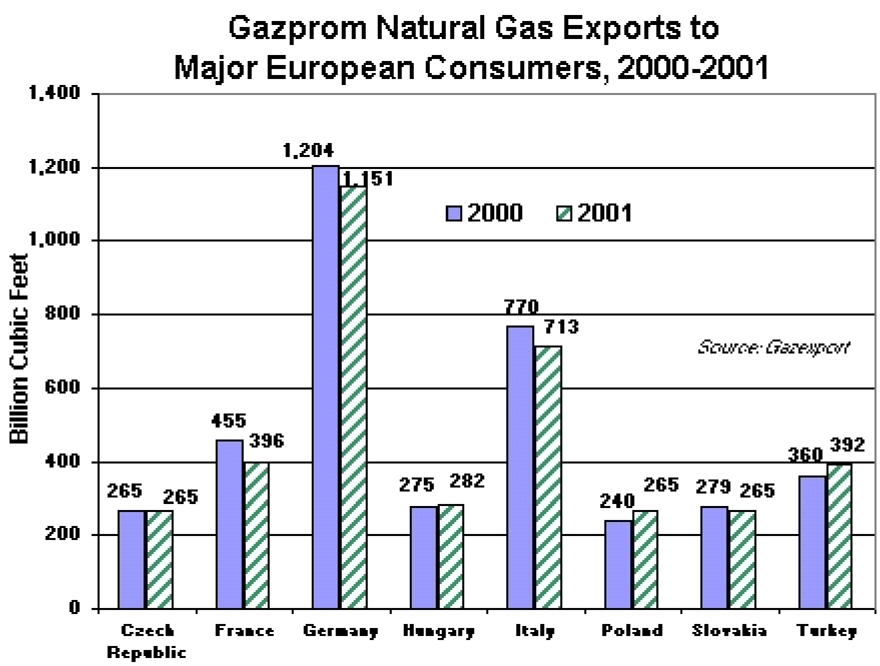
Since the breakup of the Soviet Union, Russian natural gas exports to the former Soviet republics have decreased dramatically. Russia has reduced its natural gas supplies to CIS customers by over 1 Tcf per year. Gazprom has complained that it does not receive a reasonable price for natural gas sales to CIS countries, it often receives payment at least partly in-kind, and that many CIS countries owe substantial payment arrears to the company for supplies already received. In particular, Ukraine, through which Russia sends over 90% of its natural gas exports to Europe, owes Gazprom approximately $1.4 billion for natural gas supplies[38].

Russia has been relatively effective in reducing non-payments from the CIS by threatening to cut off natural gas supplies to debtors. After Itera, the Gazprom-linked gas

[38] Energy Information Administration, www.eia.doe.gov

trader that supplies Russian and Turkmen gas to Ukraine, threatened to cut off gas supplies to Ukrainian power generators unless Ukraine's debts were paid, Russia and Ukraine reached an agreement on Ukraine's natural gas debts in August 2001. In December 2001, the two sides ended the dispute with a 12-year deal restructuring Ukraine's natural gas debts. Similarly, Russia periodically has cut off natural gas supplies to Georgia and Armenia over their debts for natural gas supplies.

Figure 4.4.: Gazprom Natural Gas Exports to Major European Consumers



Source: Energy Information Administration, EIA, www.eia.doe.gov

To Europe

Between 1992 and 1999, Russian natural gas exports to non-CIS countries rose by 1.24 Tcf, from 3.14 Tcf in 1992 to 4.48 Tcf in 1999. Russian natural gas exports to Germany, Italy, and France all rose in 2000, when Russia exported 4.6 Tcf of natural gas to European consumers. Although that figure slipped to 4.48 Tcf in 2001, Russian natural gas exports to Europe now account for approximately 65% of Russia's total natural gas exports[39].

In September 2002, Gazexport, Gazprom's export arm, announced that natural gas shipments to Europe reached 85.1 billion cubic meters (Bcm) (3 Tcf) in the first eight months of 2002, up 3.7 Bcm (130.6 Bcf) over the same time period in 2001. Of this total, natural gas exports to Western Europe were 4.1% higher year-on-year, while deliveries to Eastern European customers had increased 5.4% over the same period last year. Overall, Russian natural gas exports to Western Europe from January 2002 to August 2002 totaled 57.8 billion cubic meters (Bcm) (2.04 Tcf), while natural gas exports to Eastern Europe stood at 27.3 Bcm (963.7 Bcf)[40].

Russia supplies Europe with over 25% of its natural gas imports, and with the energy accord signed by the EU and Russia in October 2000, Russia is seeking to increase this percentage. Gazprom, Russia's sole natural gas exporter to Europe, already has contracts to deliver 6.2 Tcf to 7.2 Tcf per year to Europe beyond 2007. However, if Gazprom is to fulfill this long-term aim of increasing its European sales, it will have to boost its production, as well as secure more reliable export routes to the region. Several proposed new export pipelines would serve European markets if constructed.

Energy producers are pushing for Russia's WTO accession not just for the sake of leveling the difference in the domestic and export prices thus deriving greater revenues from domestic consumers. The WTO membership will also facilitate exports trough an increased foreign investment into the energy-producing infrastructure, urgently needed to increase energy production and transportation capacity. Foreign participation and greater domestic market transparency will also provide impetus for the development of a more robust refined energy product market in Russia.

The Russian energy exports, specifically crude oil and natural gas, have been booming for the 3 consecutive years even without the WTO membership. Fossil fuel prices are global and are not impacted by being a party to the WTO. So the Russian energy producers feel relatively secure regardless of the accession process results but accession to this institution will help the Russian and foreign energy producers attain a

[39] Energy Information Administration, www.eia.doe.gov
[40] Energy Information Administration, www.eia.doe.gov

wealth of opportunities both at the international and domestic market and they are not going to miss that.

4.2.2. Steel

The steel sector ia an example of a sector that many countries find difficult (and also needing considerable internal restructuring and modernization). March 2002 when the United States - responding to lobbying from its own producers, especially the high-cost, heavily unionised ones - unilaterally imposed tariffs of up to 30% on the major categories of steel and steel products. The EU immediately protested against this US decision and declared it to be in violation of WTO trading rules. As result, the EU has both lodged a formal complaint at the WTO, and in the meantime acted to protect its domestic market for steel by imposing tariffs of its own. Already suffering severe over-capacity at the level of the world steel market[41], these developments in the steel sector cannot but damage the prospects for Russian exports. At present, implementation of these restrictive measures is temporarily deferred.

Russia's steel exports already faced quotas in the EU market (recently cut in response to Russia's insistence on maintaining export duties on scrap iron) and VERs in the US market (the latter in response to allegations of dumping), so the new tariffs make an already uncomfortable situation somewhat worse. Russia is one of the world's leading exporters of steel items, though in value terms they lie behind Japan, and in 2000 Russian exports accounted for under 5% of the world market. Russian producers clearly regard their position in the EU and US markets as unsatisfactory. Interestingly, however, they also acknowledge the dependence of their relatively favourable costs on the current low prices for energy (referred to above), without appearing to appreciate that this is precisely what can be used to justify anti-dumping actions. Like steel producers elsewhere, the Russian companies need to be faced with realistic prices for their inputs, and then to

[41] OECD, 2002

restructure to eliminate loss-making capacity and modernize what remains. It is not enough merely to cite the absence of direct state subsidies[42].

Steel is one of several sectors whose trade has not been well managed by the WTO, due to protectionist pressures in many countries and the perception of the sector as strategically vital. Given this, it would be surprising if the present crisis in the world steel market were resolved through WTO procedures. It is somewhat more likely that the Steel Committee of the OECD might provide a suitable forum for further negotiations. In any event, this will not be an easy market for Russia, regardless of WTO accession.

4.2.3. Vehicles, esp. Automobiles

As we have already mentioned now Russia-s automobile industry may not cope with foreign competition if Russia becomes a WTO member. Some western car producers do have plants in Russia but they face many practical barriers to expansion and development. Importers face even more barriers, with high import tariffs (25%) plus excise duties depending on engine size (especially hard on imports of large cars from the US), plus the usual VAT applied to most imports (with a few exemptions for children's good and a few other items). In effect, Russia domestic producers of cars enjoy rather high rates of protection, despite which they perform poorly and restructure slowly, if at all. This raises a serious question about the appropriate strategy for the industry.

The official Russian view appears to be that the domestic industry should be protected by import barriers, and given time to restructure and modernise. There are even suggestions that a great deal of public money should be directed towards the industry to assist this process. And in its WTO negotiations, Russia has sought high import tariffs on automobiles, a request that has proved acceptable to major trading partners. What is important, though, is not so much the levels of tariff applicable to the sector, but creating an encouraging environment for foreign investment[43].

4.2.4. Agriculture

Negotiations on agricultural issues are an important part of the negotiations on the goods market access. Alongside the tariff aspect, they include a review of the Russian

[42] Shevelev, 2002

policy towards government support of the agricultural sector and export subsidies of food products.

Russian agriculture did not perform well after the Soviet Union was dissolved in 1991. Agricultural reform has moved very slowly, causing output to decline steadily through the mid-1990s. In December 1990, the Congress of People's Deputies of the Russian Republic enacted a number of laws that were designed to restructure the agricultural sector and make it more commercially viable. The Law on Peasant Farms legalized private farms and allowed them to operate alongside state and collective farms, to hire labor, and to sell produce without state supervision. The same session of the congress passed the Law on Land Reform, which permitted land to be bequeat hed as an inheritance from one generation to the next, but not to be bought or sold. This restructuring program has progressed slowly. Although 95 percent of the state and collective farms underwent some form of reorganization, about one-third of them retained essentially their earlier structure. Most of the others, fearing the unstab le conditions of market supply and demand that faced individual entrepreneurs, chose a form of collective ownership, either as joint-stock companies or as cooperatives. The conservatism of Russia's farmers prompted them to preserve as much as possible of the inefficient but secure Soviet-era controlled relationships of supply and output.

As of 1996, individual private farming had not assumed the significance in Russian agriculture that reformers and Western supporters had envisioned. Although the number of private farms increased considerably following the reforms of 1990, by the early 1990s the growth of farms had stalled, and by the mid-1990s the number of private farms actually may have dropped as some individuals opted to return to a form of cooperative enterprise or left farming entirely. By the end of 1995, Russia's 280,000 private farms accounted for only 5 percent of the arable land in Russia[44].

A number of factors have contributed to the slow progress of agricultural reform. Until the mid-1990s, the state government continued to act as the chief marketing agent for the food sector by establishing fixed orders for goods, thus guaranteeing far mers a

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[43] Hare, 2001a
[44] Country Study & Guide
http://reference.allrefer.com/country-guide-study/russia/russia123.html

market. The government also subsidized farms through guaranteed prices, which reduced the incentive of farmers to become efficient producers.

Agriculture is a sector subsidised a good deal in most countries, especially the more developed ones, the EU's CAP being only one of the more extreme instances of this practice. Yet at present, levels of subsidy to the sector in Russia are relatively low, and have been for some years, at least in part due to the inability of the government to make any more money available from its limited budget. This fact is creating difficulties for the Russian position on agriculture at the WTO negotiations. For in determining the acceptable subsidy levels in Russia, other WTO members such as those belonging to the Cairns Group[45] expect the late 1990s to be used as a reference period. Since Russian agricultural subsidies were low then, this would determine a low upper limit to the subsidy levels that Russia should commit to in the course of WTO accession. Conversely, since Russia is perfectly well aware that current subsidies are low, the country is seeking to use the late 1980s as a reference period, this being a period when applied subsidies were far higher than at present.

It should be noted that the aggregated support measure (ASM) only includes subsidies making the most distorting effect on trade and manufacture (subsidies for animal husbandry and crop production, reimbursement of some costs of materials and equipment, loans on soft terms, price support of domestic agricultural producers, discounted rates of agricultural product transportation, and others). In compliance with the WTO Agreement on Agriculture, Russia is undertaking to bind or maintain the current support level and later reduce it in stages by 20% within 6 years after accession. These are measures of the so-called "yellow, or amber, basket"[46].

However, subsidising agriculture is not the way to improve its efficiency. Far more important is to carry through the long delayed reforms in other areas, to do with property rights, improving training and technical standards, establishing an agricultural land market, improving credit conditions, improving infrastructure, developing more effective marketing links for agricultural produce, and creating more effective input markets. While some progress has been made in all these areas, there is still much to be

[45] 18 leading exporters of agricultural products
[46] Commission 2002a

done. Subsidies, on the other hand, would merely delay restructuring and put off developments in these vital areas. Thus on agriculture, it is not easy to support the Russian position on subsidies. On the other hand, their position on tariffs, seeking relatively high tariffs in order to offset the dumping of subsidised agricultural produce by the EU and the USA in the Russian market is far more understandable.

The Duma has recently passed measures to legalise the land market, though placing significant restrictions on ownership by foreigners and foreign-owned companies. Even before this step, however, much agricultural land was being concentrated into large farms run by large Russian companies - these farms often owned or leased by the Russian *nouveaux riches* - and this was enabling agricultural performance to improve. Significant investment was starting to flow into the sector by the late 1990s.

Since January 2003, Russia introduced some tariff quotas on the imports of beef, pork and poultry. The key disputable issue was whether Russia had a legitimate right to impose the quotas in the context of the WTO rules. In April 2003 the Russian side informed the Working Party about the tariff distribution system based on the principle of “historical importers”.

My own opinoin concerning this issue, as well as the most widerspread opinion on the Russian side, is that Russia is ready to compromise, though not at the expense of unilateral concessions in reducing the level of protection for the Russian agri-industrial complex.

4.2.5. Technical Standards

These constitute a significant barrier to trade in many sectors, affecting both imports into Russia, as well as exports. The problem is that certification procedures are slow, non-transparent and expensive, and result in approvals that are often only valid for three years rather than for the life of a given product. Recent years have seen some improvement, with about a third of Russia’s 22,000 or so technical standards conforming to international standards. However, implementation is not consistent across Russian regions, and a huge amount of work remains to be done in this field. The Russian government improved legislation to the Duma on this topic[47], but even so, it is hard to see how full conformity to international norms and standards can be achieved quickly. Thus as part of its WTO Protocol, Russia should be offering full conformity, but everyone needs to accept that implementation might take up to a decade.

4.2.6. Nuclear Export Controls

Russia has made great progress in creating nuclear and nuclear-related export control laws and regulations following the demise of the Soviet Union. The legal structure has been developed with extensive assistance from the U.S. government and the non-governmental community. The highest levels of the Russian government are committed to the creation of an effective export control system aimed at stopping enterprises and individuals from conducting illegal or otherwise damaging exports. Many positive steps have been taken toward full implementation of this system[48].

However, creating an adequate Russian export control system remains complicated and urgent. Albright (2002) stressed significant problems that must be overcome if Russia is to implement an effective system. Problems that ISIS staff has encountered include:

- An overemphasis on obtaining sales and exports without adequately weighing the security problems that could be caused by a sensitive export. Too many Russians view sales as essential to the survival of enterprises and export controls as hindering those sales. One official put the situation starkly for smaller companies- the choice for the company is either "money or life;"

- An environment or culture at enterprises that does not adequately emphasize the harm of illicit exports;

- A shortage of effective internal compliance systems at Russian enterprises. Larger enterprises, particularly those with nuclear experts, are creating internal compliance systems, but they remain in need of assistance to make them effective. Many smaller enterprises, particularly those outside Moscow, often lack

[47] The law “On Technical Regulation“ came into force on 1 June 2003. The concept of GOSTs have become obsolete. From now on, the government only guarantees the product safety and the business is to improve its quality. *Finansovie Izvestia*, May 28, 2003.

rudimentary knowledge of the laws and regulations and cannot afford to create an internal compliance system;

- Inadequate education and training opportunities for employees at enterprises who must ensure that exports are legal and for students who will become the next generation of export control officials;
- A dearth of information at Russian enterprises that would enable sellers to check on end users in foreign countries. One Russian export control official said that more than 90 percent of all Russian enterprises do not have books or other resources to research the companies buying their items. Thus, a seller has a difficult time checking whether the information provided by the customer is true or reliable. Another senior Russian official stated that this problem is already hard to deal with in the United States and Europe, and it is much harder to cope with in Russia.
- The need for improved controls over the sale of Minatom nuclear assets. This problem can be traced to the general problem in Russia of tracking and controlling the resale of items to buyers within Russia that may subsequently export them; and
- Inadequate enforcement of violators of export control laws. For example, many potential violators work at enterprises owned by the Russian government. As a result, Russia may not prosecute them adequately to discourage similar behavior by others. A "slap on the hand" may be the only outcome, particularly if the case is limited to an administrative inquiry at the government-owned enterprise.

My personal observation is that many officials in Russia are overly confident that Russia will not export illicit nuclear items, although many of them recognize the above problems. If they concede that such exports could happen, some of these officials add that the proliferant states receiving the item could not build nuclear weapons regardless. This failure to recognize the possibility or consequences of illicit sales is too common. Because all countries seeking nuclear weapons in the last thirty years have depended

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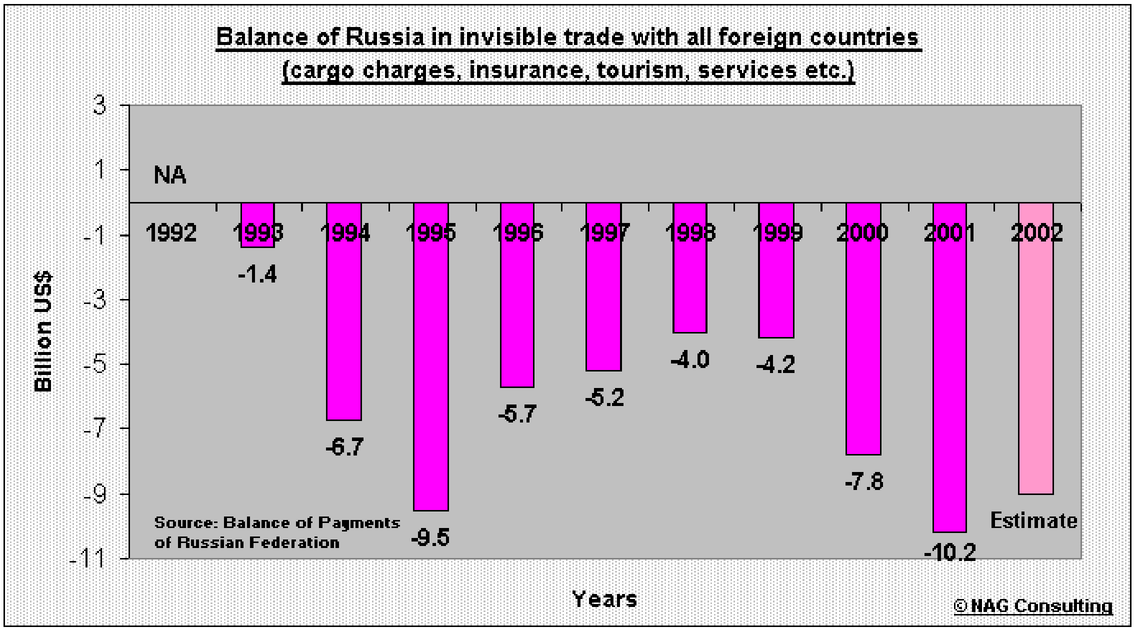
[48] Albright D., 2002

extensively on foreign assistance, these statements border on the irresponsible and illustrate the lack of a culture supporting export controls in Russia.

4.3. Services Trade

Services trade represents a small fraction of Russia's total international trade, and is a component in which Russia is consistently in deficit.(See Figure 4.5.)

Figure 4.5.: Balance of Russian Service trade



Sourse: NAG Consulting, www.russiaexport.net

It is proving a difficult area for Russia as many WTO members wish to see considerable opening of the Russian market - both for trade and for the location of foreign-owned businesses - notably in banking and insurance where existing Russian provision is mostly of extremely poor quality.

The modern banking sector in Russia is only 10 years old, and in spite of making a significant progress over the last decade it continues to suffer from inefficiency and low capitalization. Also, these sectors are not yet well regulated in Russia. Foreign banks are more competitive than domestic financial institutions as they have much more experience and command larger resources. For instance, the combined assets of all credit institutions operating in Russia as of January 2001 total about $100 billion, while Citigroup's assets alone exceed $900 billion. Although likely to meet with some resistance from Russian negotiators at the WTO, since the country wants to give its domestic financial sectors time to improve and become more competitive, in my opinion is that undertaking further reforms to meet WTO access conditions in the services sectors is exactly what Russia needs. Most probably Russian banking and insurance industries will simply use protection to delay long overdue change and to continue producing bad services for the Russian population and the Russian business community.

Another area of the service sector is telecommunications, considered critical for the development of Internet-based businesses. New technologies that appeared in the last 10 to 15 years, such as mobile phones, broke the former position of this sector as a natural monopoly; however, the Russian offer is still based on a natural monopoly view of the sector. Rostelecom, the incumbent Russian telecommunications firm, is supposed to keep its monopoly on long distance and international telephone services until 2010.

Even more importantly, if Russia wishes to attract serious amounts of FDI and other capital inflows, then it needs to have in place a reasonably decent financial sector able to offer incoming businesses the types and quality of service they expect elsewhere in the world. Hence providing a better environment for foreign financial and business services companies to locate themselves and operate in Russia, while it is not a sufficient condition for boosting FDI, is certainly one of the necessary conditions.

Foreign access to the Russian services market is among the four main areas of talks on Russian accession to the WTO. The talks are aimed at finding mutually acceptable terms and conditions of foreign services and service providers' access to the Russian market and exemptions from the most-favored nation treatment (MFN). As it joins the WTO, Russia must adhere to the General Agreement on Trade in Services (GATS) and make commitments following the List of Specific Commitments in Services, which assure a certain level of market access for all WTO members under the most-favored nation treatment principle (with the exception of items which the member country manages to include in the MFN Exemptions List in order to keep preferential and privileged relations in the services trade area with another country or group of countries). The talks are based on the commitments enumerated in the above-mentioned Schedule of Commitments and List of Exemptions. The Schedule of Commitments is subdivided into horizontal and sectoral. Horizontal commitments include regulations of all service sectors where Russia makes commitments. All service sectors (over 150 in all) are grouped into 12 sections in accordance with the GATS Services Classifier. Four main methods of service provision (transborder delivery, consumption abroad, commercial presence, individuals' migration) are determined for each sector included in the List.

Existing WTO members will expect national treatment for their investors in Russian services sectors, and considerable relaxation of the restrictions - currently in place, or proposed in the course of the WTO negotiations - that would limit the share of foreign ownership in many activities.

4.4. Intellectual Property Rights

If IPRs are not protected from unauthorized use, then trade in goods and services suffers as a result. For this reason, the Agreement on Trade-Related Aspects of Intellectual Property Rights, or TRIPS, has been adopted by the WTO. TRIPS sets new, comprehensive standards for the protection of IPRs in all member countries of the WTO. TRIPS requires every WTO country to abide by the most important international intellectual property conventions and then calls to countries to grant even greater protection to inventors, authors and trademark owners.[49]

This issue is probably rather less critical for Russia than it was in relation to China's WTO accession, since Russia is apparently far less involved in the production of pirated CDs and videos, the use of unlicensed software, and so on. Nevertheless, it has been estimated that the US alone lost over USD 1 billion in 2000 due to video piracy in Russia[50], so the matter is not entirely trivial. Moreover, US companies have experienced difficulties over registering even quite well known trade marks in Russia. Although Russia formally adheres to the relevant international conventions regarding copyright, patents, trade marks and the like, its implementation of the rules remains quite uneven.

In order to reduce IPR violations in Russia, the country needs strong civil, and more importantly, criminal penalties. The Russian government is in the process of learning that protection of intellectual property is vital for economic growth of Russia. The fact that intellectual property can be profitable for the Russian government is a new

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[49] www.wto.org
[50] Hare,2002c

concept for the authorities. A fundamental problem of enforcement is that Russian courts have neither extensive experience, nor sufficient number of judges familiar with IPR cases. Foreign companies are aware of this problem. Sometimes they use political mechanisms to solve the issue instead of a lawsuit. This creates a vicious circle; without a growing judicial practice, IPR issues will never be resolved. Another enforcement problem lies in lack of respect in the society for the legal system. If there is a conflict between two Russian entities, they will most likely use mechanisms that do not include court[51].

Hence in the accession negotiations, WTO members will be seeking much improved implementation of existing policies. In order to join the WTO, Russia has to harmonize its IPR laws with TRIPS.

4.5. Investment and Capital Flows

It was already noted above that Russia has attracted very low levels of FDI, while also experiencing serious capital flight. (See Table E below in annex).

In 1994 Russia appeared as net external investor. The overall volume of capital outflow from Russia totalled bn. \$17.0 while capital inflow was estimated at bn. \$10.4 leaving negative bn. \$6.6 on the balance.[52] The outflow of capital in 1994 predominatingly took place in the form of loans (bn. \$5.9 mostly state-backed including bn. \$2.8 increase of Near Abroad countries' indebtedness for energy supplies), direct and portfolio investments (bn. \$2.2), hard currency cash accumulation by residents (bn. \$6.2). Foreign loans traditionally serve as principal means of capital inflow into the country. Their total volume in 1995 equalled bn. \$15.1 (bn. \$6.4 in 1994) of which bn. \$8.3 were state-destined (bn. \$4.2 in 1994), covering about 17% of Federal budget receipts. Out of the mentioned bn. \$8.3 of state-destined loans bn. \$1.7 were attracted by means of bilateral credit agreements against state guarantees while bn. \$6.4 came from international financial institutions and organizations, inclusive of bn. \$5.5 received from the IMF. In 1994 major creditors were Germany (bn. \$1.6) and the IMF (bn. \$1.5). Inflow of FDI through 1995 doubled the volume reached in 1994. In 1995 Russia

[51] Business Information Service for the Newly Independent States (BISNIS)

invested $ 216 million abroad of which only 5 % fell into FDI category and the rest encompassed trade credits, bank deposits, etc. Thus portfolio investments were not effected. On the contrary, rouble investments abroad of 43.5 bn. ($ 9.4 million at end-year exchange rate) contained over 40 bn. of FDI or 92% of the total volume. The bulk of Russia's dollar investments abroad has gone to Germany (77%). The nearest following Italy and Switzerland managed to attract only 4% and 3% respectively. As to the industry breakdown of Russia's foreign investments fuel industry accumulated 72% of the total, trade and catering - 10% and construction - 5%. (For more actual data see Table F below in the annex).

The latter might conceivably be addressed by reimposing tough capital controls, and by requiring export revenues to be deposited in the Russian banking system, but such controls are hard to enforce, relatively easy to evade. In any case, they fail to address the key problem of the Russian transition, namely the very poor investment climate in the country. In a sense this has little or nothing to do with the WTO question, since investment basically depends upon the quality of macroeconomic management in a country, as well as on numerous details of the institutional environment to do with protecting property rights and business contracts, protecting shareholders (esp. minority shareholders), ensuring consistency between Federal and regional levels of government, etc. In all these areas, the Russian record for much of the 1990s was quite abysmal, and has only started to pick up in the last few years, especially since the 1998 crisis and the renewed pro-reform direction taken by the Putin government[53].

As regards WTO accession, therefore, improving the conditions for foreign direct investment and capital flows is mostly about improving the domestic environment for investment. The main dilemmas for the Russian financial sector have to do with improvement of the investment climate and protection of creditors' rights, not with WTO membership. Similarly, liberalization of control of capital flight, which is widely discussed in Russia nowadays, will not be enough to improve Russia's investment position if reforms and improvements in legal areas, accounting procedures, corporate governance and financial regulation are not realized.

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[52] VNIKI, 1995
[53] See Hare, 2002

In other words, if Russia maintains its current, quite well balanced, macroeconomic posture while continuing the microeconomic policy and institutional reforms already referred to, then it should be well on the way to meeting any likely conditions requested by WTO members to do with capital and investment flows.

4.6. Trade Preferences within the CIS

Since the disintegration of the Soviet Union in late 1991, the 15 successor states form two distinct groups. First, there are the three Baltic States - Estonia, Latvia and Lithuania – which were quick to turn towards the West, undertake market-oriented reforms, and join the negotiations for EU membership at the end of the 1990s. Given their EU-orientation, these countries are therefore only discussed in Section 6, where we discuss several aspects of EU-Russia economic relations in the context of WTO accession.

Second, we have the Commonwealth of Independent States (CIS), comprising Russia itself and 11 other states: the European group - Belarus, Ukraine, Moldova; the Caucasus - Armenia, Azerbaijan, Georgia; and Central Asia - Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. Of these states, just three are already WTO members, namely Moldova, Georgia and Kyrgyzstan, most of the others being applicants. Several attempts have been made to develop various forms of economic integration across the CIS or in sub-regions within it, despite which the actual volumes of intra-CIS trade undertaken fell sharply in the early 1990s and have only grown a little since the mid-1990s: from USD 53.74 billion in 1994 to USD 60.98 billion in 2000. As early as 1994, the 12 CIS member states agreed to establish a Free Trade Area (FTA), and only a little later, several states - Russia, Belarus, Kazakhstan, Kyrgyzstan and later, Tajikistan - agreed to form a Customs Union (CU)[54].

Russia and Belarus have also announced their intention to move towards a complete economic union. Russia is the largest partner for Belarus in the economic and political fields. In terms of trade, two-thirds of Belarusian exports go to Russia. Due to the structure of Belarusian industry, Belarus relies heavily on other CIS countries and

[54] see Hare, 2001b

Russia in particular both for export markets and for the supply of raw materials and components. The introduction of free trade between Russia and Belarus in mid-1995 led to a spectacular growth in bilateral trade, which was only temporarily reversed in the wake of the financial crisis of 1998. Lukashenko seeks to develop a closer relationship with Russia. The framework for the Russia-Belarusian Union was set out in the Treaty On the Formation of a Community of Russia and Belarus (1996), the Treaty on Russia-Belarus Union, the Union Charter (1997), and the Treaty of the Formation of a Union State (1999). The integration treaties contain commitments to monetary union, equal rights, single citizenship, and a common foreign and defense policy. They also have established a range of institutions modeled after the EU. After protracted disputes and setbacks, the two countries' customs duties were unified as of March 2001. Belarus has made progress in monetary stabilization in the context of ongoing negotiation with the Russian Central Bank on monetary union. In early 2003, a bilateral working group was developing a draft Union constitution to be ratified by a referendum held in both countries. Belarus and Russia had also reaffirmed their intention achieve currency unification by 2005. A single currency unit will ensure a new quality of financial flows. Belarus has unique geographical position which makes it "a centre of Europe" and to the annual trade traffic amounting to 250 million tonnes, what is a a big advantage for Russia.

Several other groupings of CIS states have been announced. None of these groupings can thus far be claimed to have had much real economic effect, nor would it necessarily be particularly desirable for them to become more effective.

Concerning the *effectiveness* of these groupings of states, the main problem has been the failure to ratify or implement agreements, the continued use of tariffs and a range of quantitative restrictions limiting trade within the supposed FTA, the failure to agree on and implement a common external tariff in the CU, and numerous bureaucratic, technical and institutional obstacles resulting in very high transactions costs in intra-regional trade. To cite just one example, it is apparently far cheaper to import Australian wine into Moscow than wine from Moldova[55]. In any case, the useful analysis of Michalopoulos and Tarr (1997) argues that success in achieving closer integration across

[55] cited in Dyker, 2002a

the CIS would probably not be *desirabl*e. This is because the countries might then tend to be locked into the use of out-dated, Soviet-era technology. Proposals for the CU's external tariff are also not very attractive for those CIS members that have already liberalised trade based on low and fairly uniform tariffs.

Regardless of these considerations, intra-CIS trade will be affected by a Russian accession to the WTO, unless the CIS Free Trade Area is able to secure a derogation from WTO rules during the negotiations. For without such a derogation, Russia would quickly be expected to revert to its normal MFN tariffs in its intra-CIS trade and would no longer be able to subsidise its energy trade within the region. In addition, the current practice of tolerating barter deals and counter-trade in order to enable trade to take place with partner countries lacking credit-worthiness might also be scaled down[56]. One would expect Russia increasingly to demand normal monetary transactions and payment in convertible currencies as it develops its own institutions to support such practices.

Existing myth about relation of Russia and CIS countries, that regional free trade agreements are becoming more important than the WTO. Membership in the WTO will not offer Russia any special advantages, and may even weaken its position if the Customs Union with the CIS members is abandoned**.** It is true that regional free trade agreements have become very popular recently, but if Russia joins the WTO, it will gain at least one "instrument" for breaking the regional boundaries. As for the Customs Union, all of its functions may be preserved through bilateral agreements or formation of a regional free trade association.

[56] Marin and Schnitzer, 2002

V. Impact of WTO Membership on Russian Domestic Policies and Domestic Restructuring

Integrating the Russian economy with the rest of the world through commerce and expanded foreign investment has been a high priority of Russian economic reform.

5.1. Russian foreign trade restructures

By the end of 1993, the Russian government had liberalized much of its import regime. It eliminated nontariff customs barriers on most imports, although it still requires some licenses for health and safety reasons. In mid-1992 the government took control of imports of some critical goods, including industrial equipment and food items, which it sold to end users at subsidized prices. In the early 1990s, government-controlled imports constituted about 40 percent of total Russian imports, but by 1996 most such controls had been phased out.

Although Russia has eliminated many nontariff import barriers, it still maintains high tariffs and other duties on imports of goods to raise revenue and protect domestic producers. All imports are subject to a 3 percent special tax in addition to import tariffs that vary with the category of goods. Some of the high tariffs include those of 40 to 50 percent on automobiles and aircraft and 100 percent on alcoholic beverages. Excise taxes ranging between 35 and 250 percent are applied to certain luxury goods that include automobiles, jewelry, alcohol, and cigarettes. Russia's average tariff, which is now between 12 and 14 percent, would be decreased by 2 percent in case of accession. A decrease in tariffs would also benefit consumers. If tariffs were to drop to 5 percent, the average Russian family would see a 5 percent decrease in annual spending, equal to roughly $20 a year[57].

The Government has used licensing and quotas to restrict the export of certain key commodities, such as oil and oil products, to ease the effect of price differentials between controlled domestic prices and world market prices. Without such restrictions, Russian policy makers have argued, the domestic market would experience shortages of critical materials. The government eliminated quotas on oil exports in 1995 and export taxes on oil in 1996. In addition to customs restrictions, the government imposes other costs on exporters. It charges a 20 percent VAT on most cash-transaction exports and a 30 percent VAT on barter transactions. It applies additional tariffs on the exports of industrial raw materials. By the mid-1990s, much of Russia's foreign trade, even that with the former communist countries of Central Europe, was conducted on the basis of market-determined prices. Immediately after the dissolution of the Soviet-dominated Comecon in 1991, the Soviet Union sought to maintain commercial relations in Central Europe through bilateral agreements. But as market economies developed in those countries, their governments lost control over trade flows. Since 1993 Russian trade with former Comecon member countries has been at world prices and in hard currencies.

Foreign investment is the other major element of Russia's reform strategy to strengthen international economic links. The Foreign Investment Law of 1991 provides the statutory foundation for the treatment of foreign investment. The law provides for "national treatment" of foreign investments; that is, foreign investors and investments are to be treated no less favorably than domestically based investments. The law also permits foreign investment in most sectors of the Russian economy and in all the forms available in the Russian economy: portfolios of government securities, stocks, and bonds, and direct investment in new businesses, in the acquisition of existing Russian-owned enterprises, in joint ventures, in property acquisition, and in leasing the rights to natural resources. Foreign investors are protected against nationalization or expropriation unless the government declares that such a procedure is necessary in the public interest. In such cases, foreign investors are to receive just compensation.

In response to demands by foreign oil investors for stronger legal guarantees before making large capital commitments, in July 1995 the State Duma passed the Law on Oil and Gas. It provides a basic framework for other laws and regulations pertaining to exploration, production, transportation, and security of oil and gas. In late 1995, the Duma passed the Production-Sharing Agreement bill, which provides for foreign investors to share output with domestic partners. Among other things, the bill lifts many of the financial impediments by removing excise and customs duties on the exportation

[57] Yudaeva, 2003

of oil by joint ventures, and it requires contract sanctity for the life of the project. But in a clause that drew criticism from the United States business community , the bill requires State Duma approval of new joint-venture agreements on a case-by-case basis. As of mid-1996, the United States Department of Commerce considered the Duma's veto power over such agreements a key obstacle to expanded United States investment in Russia. Futher energy reform is the only real obstacle to accession from the economic perspective, but the issue also reveals a divide between the prime minister and his ministries. The delay in accession is largely due to the absence of a reformer who views WTO accession as major goal.

By the end of 1995, foreign investment in Russia since 1991 had totaled an estimated US$6 billion, a small amount considering the size of the Russian economy. Of that amount, US$3.2 billion had been invested between 1991 and 1993 and US$1 billion in 1994. Of the approximately US$2 billion invested in 1995, about 28 percent came from the United States, 13 percent from Germany, 9 percent from Switzerland, and 6 percent from Belgium. By sector, 15 percent of 1995 investments went to trade and catering; 13 percent to finance, insurance, and pensions; 10 percent to the fuel industries; and 8 percent to chemical industries. Telecommunications, food processing and agriculture, pharmaceuticals and medical equipment, and housing are in particular need of additional foreign investment[58].

Table 5.1: Foreign Investment (total in $ million)

1994	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**1st half 2002**
1.05	2.80	6.51	12.30	11.77	9.5	11.96	14.12	8.29

Source : The Russian State Statistics Committee

Many in Russia believe that WTO accession will scare off foreign investors, thinking that tariffs must be raised to increase FDI. A close examination of FDI inflows from OECD countries to developing countries, however, reveals that WTO accession will result in an average $4 billion increase in FDI from developed to developing countries,

[58] The Foreign Broadcast Information Service's *Daily Report: Central Eurasia* includes periodic economic reviews devoted to statistical and textual analysis of economic trends in Russia and elsewhere in the CIS.

roughly equal to Russia's overall inflow in 2001. Russia could thus increase its FDI-to-GDP ratio considerably by joining the WTO[59].

Russia inherited a large **foreign debt** burden from the Soviet Union that clouds its economic situation. At the end of 1991, the debt was estimated at US$65 billion, in January 1996, Russia's total foreign debt was US$120.4 billion, including US$103 billion of the Soviet Union's debt that Russia assumed. Russia has been hard pressed to service that amount. In March 1996, the IMF approved a three-year loan of US$10.1 billion to Russia, the first loan payment of US$340 million was paid almost immediately, and it helped Russia to overcome a large budget deficit that it had been trying to cover by issuing securities. The new schedule gave Russia a six-year grace period for repayment on the principal it owes[60].

Whatever the detailed policy changes might be, it is clear that post-accession, Russia's structure of domestic relative prices - affecting both firms and the household sector - will differ markedly from that which prevails now. Many quantitative restrictions impeding trade will also have been lifted, as will various licensing and market access constraints. Domestic subsidies and other, more indirect supports to various industries (such as through directed credits, delayed tax payments, and the like) will have been greatly diminished. The equilibrium exchange rate might well change, too[61].

5.2. Restructures in the production activity

From the standpoint of structural change, the principal implication of the reforms that will have taken place in the Russian Federation in the course of WTO accession will be to increase the profitability of some production activities, and reduce that of others. In response, especially as Russian firms and industries come to be governed more and more by profit considerations, one would expect to see structural change on an enormous scale. Earlier research suggested that a substantial fraction - indeed over 50 per cent - of the industry in the former USSR was highly uncompetitive, on the basis of profitability

[59] Yudaeva, 2003
[60] Economic review of Russia, http://reference.allrefer.com/country-guide-study/russia/russia143.html

[61] Hare, 2002

assessments using world market prices and detailed input-output data for the late 1980s[62]. In other words, this was the situation as it appeared pre-transition, prior to the major liberalisations and other reforms that were undertaken in Russia from 1992 onwards.

On the other hand, a good deal of the then Soviet and now Russian industry appeared to be quite competitive; in particular, branches such as ferrous metallurgy, non-ferrous metallurgy and engineering came out relatively well. Across the whole region of the economies in transition, as one would expect, energy intensive sectors of the economy appeared highly uncompetitive when evaluated properly in terms of world market prices. This is merely an expected consequence of the policy, maintained since the mid-1970s, of holding domestic energy prices, both for consumers and firms, a long way below the prevailing world market prices. That policy evidently induced a great deal of inefficient investment, and resulted in considerable wastage of energy.

How would one expect an economy to react, when faced with sectors characterised by very different profitability ratios? Even under the most favourable circumstances this is not a particularly easy question, and the relevant economic theory provides at best some rather ambiguous pointers towards the possible outcomes. Moreover, it is evident that Russian conditions are far from favourable in that any structural change that might be envisaged is superimposed upon a very drastic overall decline of output across all sectors - only since 1998 has aggregate output in Russia started to recover significantly from its post-communist collapse. Hence it is important to ensure that the analysis of structural change is carefully distinguished from that of aggregate output decline, since both the causal factors and the associated policy implications in each case are likely to be very different[63].

Focusing on the economic forces stimulating structural changes, profitability differences typically give rise to two sorts of effect, namely a short- to medium-term effect on market shares, and a longer term impact upon investment. For instance, in the absence of trade restrictions and other barriers, a branch that is loss making or generating

[62] Note that value of this sector output in world prices is less than the value of the produced inputs used to generate the output. If such a sector were shut down, GDP measured in world market prices would increase. For the USSR/Russia, over 20% of industry was in sectors with negative DRC at the start of transition. See Senik-Leygonie and Hughes (1992), Hughes and Hare (1992). For the technical details of the methodology, based on the calculation of domestic resource costs (DRCs) for each sector, see Hughes and Hare (1991).

relatively low profits can be expected to be losing market share in its home market to import competition, and the share of its production that is exported will also be in decline (if the product was already active in export markets). On the other hand, if domestic entrepreneurs or foreign investors judge that the branch is one with long term promise, for instance because the demand for its output is less affected by the general downturn in the economy than many other branches, or because the income elasticity of demand is high (so demand will recover rapidly with an economic revival), then investment will start to take place in order to modernise the branch and make it competitive. Obviously, if there is no particular reason for taking such a favourable view of the long term position, then investment will not take place and the branch concerned will go into rapid decline as firms go out of business and fully depreciated capital is not replaced[64].

Arguments along these lines suggest that it might be useful, at least as a starting point for more detailed analysis, to categorise branches of the economy according to the following simple table.

Table 5.2. Structural Change in the Short-run and Long-run

	Long-ran Prospects		
Short-run Profitability	***Good***	***Medium***	***Poor***
Good	**MS**-rise; **Inv**.-rise	**MS-**rise**; Inv.-?**	**MS-**rise**; Inv.-**fall
Medium	**MS- ?** ; **Inv**.-rise	**MS- ? ; Inv.-?**	**MS-? ; Inv.-**fall
Poor	**MS**–fall; **Inv**.-rise	**MS-**fall; **Inv.-?**	**MS-**fall **; Inv.-**fall

*Note***:** **MS**-market share, **Inv**.- investment.
*Source***:** Hare, 2002

While Table 5.2. would enable Russian industries to be classified into nine categories, depending on profitability and prospects, it is important to bear in mind a number of additional points before doing so:

- **Geographically**, Russia is a huge country, so the assessment of a given branch or sector might not be uniform across the country. Some branches could be highly profitable and/or enjoy good growth prospects in the Russian Far East while being uneconomic in European Russia, and conversely.

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[63] Hare, 2002
[64] Hare, 2002

- **Social and/or political factors** - rightly or wrongly - might delay the adjustment of certain branches to market conditions. For instance, mining in much of Russia's Far North is no longer economic and should gradually close, but the resulting devastation of the communities affected cannot yet be politically tolerated. Either alternative economic activities and jobs must be provided or virtually whole communities must be re-located. Either option is difficult and costly.

- **Domestic price adjustments** during the 1990s have already changed drastically the relative costs and profitabilities of many economic activities in Russia. The government is well aware that many enterprises are in uneconomic locations or are using out-dated technology that cannot be competitive any longer (if it ever was). As with the previous point, adjustment is costly and painful, therefore slow.

- As discussed above, some important domestic price adjustments are still to occur, notably in the **energy sector**. These will further promote a drastic round of enterprise and industrial restructuring across the country[65].

- Regardless of the **prices nominally** in place, it is clearly vital that these prices actually apply to all transactions. Thus the Russian practice of tolerating barter and other non-monetary forms of completing transactions distorts the market and is extremely damaging. Such practices keep alive many firms that should have gone out of business long ago, and discourage entry by new firms since established firms trade through existing networks and alliances, closing the market to newcomers. Likewise, the practice of tolerating non-payment for energy supplies (i.e. not even the payment of existing very low prices) conveys the wholly wrong signal that energy is free. This, too, is very damaging. Fortunately,

[65] see Hare, 2002a and 2002b

since 1998 the prevalence of such practices has slowly declined, and Putin's government appears to be determined to continue this trend[66].

- Against this background, the additional changes in **relative prices and costs** brought about by WTO accession, in particular by the tariff changes and domestic policy reforms likely to be agreed as part of the Accession Protocol, will be quite minor. Russia already has a massive restructuring task to face, and the relevant relative prices will not be much affected by WTO accession. However, what ought to change is various features of the economic environment in Russia that currently impede restructuring as a result of special interest lobbying, weak implementation of economic laws and regulations (especially, but not only, at the sub-Federal level), and the continued influence of ideas that have more to do with old-style central planning than with the management of a modern and dynamic market-type economy.

5.3. Government program of social and economic development of RF in 2002-2004.

As we have said, Russia's economic reform achievements (mostly concentrated in the early 1990s and the last couple of years) have been modest so far. But it is important that the strategy for further reform is based on recognition of this fact. The Government's new, radical and detailed economic programme, the 'Medium-Term Programme for Social and Economic Development of the Russian Federation (2002-2004)', states that: 'The progress, which has been made in various sectors, can now be viewed only as a prerequisite for further changes'. This also means that the three-year programme is related to and built upon the results of the previous two-year reform programme (2000-2001).

The new Programme rightly puts the main emphasis on social development and social policy and avoids unfounded promises. The objective is only to 'close the gap in living standards between Russia and developed economies' based on GDP growth of four

[66] see Ledeneva, 1998;.Seabright, 2000

percent per year, i.e., on a significantly slower growth dynamic than that experienced since mid-1999, under conditions of high oil and other commodity prices[67]. Among the main priorities are improvement of the demographic situation – 'reduction of the mortality level and creating preconditions for stabilising the birth rate', reduction of poverty, and significant development of education (human capital). The document calls for increased share of labour income in GDP, introduction of means-tested instruments into social policy, reform of the pension system (including partial shift to a funded regime), as well as 'transition to a system of mandatory medical and social insurance'.

Implementation of the Programme aims to achieve three main goals:

⇨ To provide social support to those who really need it.

⇨ To relieve enterprises and business as a whole from an excessive share of 'socialist' organisational and financial costs related to social support.

⇨ To secure macroeconomic stability of the Russian economy based on balancing of Government revenue and expenditure.

The distinguishing feature of the changes required by the Programme is that they are comprehensive and incorporated to overall economic policy as parts of an integral course of action to provide fundamental conditions for economic growth. Unwavering pursuit of this integral course in the entire system of Government social spending is an extremely important task.

Box 5.1.: Measures that will be implemented in the power industry until 2004

In the medium term, until 2004, the following measures will be implemented in the power industry:

1. Restructuring of UES and "energos" (regional power utilities) to enhance their transparency and secure non-discriminatory access to power transmission infrastructure.
2. Establishment of power generating companies and the beginning of demonopolisation of the power generating sector.
3. Establishment of a tariff setting mechanism in regional markets dependent of wholesale prices for power.

[67] Brunant, Soos, 2002

4. Establishment of a centralised system of Government regulation of electricity prices, preparation for liberalisation of prices for power generation and sales.
5. Significant expansion of the number of operators on the competitive wholesale power market.
6. Scaling down of cross-subsidisation in all forms.
7. Creation of conditions for attracting large-scale investment in the power industry. The following priority measures are planned in the power sector during 2002:
8. Development of a programme for step-by-step elimination of cross-subsidisation.
9. Development of a programme to establish agencies in charge of Government tariff regulation on the regional level.
10. Development and approval of rules for equal access of power users and producers to the services of natural monopolies in the sector.
11. Establishment of an operator of the market, to be a 100% UES subsidiary.
12. Establishment of regional transmission companies.
13. Development and approval of rules for the operation of a competitive energy market

One of the main goal entitled '**Russia's integration** into the system of the world economic relations' as the main priority of the Government's Medium-term Programme. Russia's accession to the WTO is part of this integration. Another component of this process is participation in regional trade agreements. The Medium-term Programme stresses the need to develop regional trade relations within the CIS and the Eurasian Economic Community, and to intensify cooperation with the EU. These two goals cannot be considered separately. On the one hand, WTO accession requires preferential trade agreements to comply with the Free Trade Area definition in the WTO Charter, and with WTO rules. On the other hand, one of the key conditions for establishment of the EU-RF Free Trade Area is accession to the WTO. The sub-chapter on foreign economic policy states that 'It is in Russia's interests to complete the accession procedure in time to participate, as a full member, in the next WTO round of talks according to some estimates'. The sub-chapter also states: 'Benefits enjoyed by Russia as a result of joining the WTO will increase along with growth of the share of goods and services with high value added in its exports. That is why, in the short run, issues related to implementing an effective state policy for export promotion, aimed at ensuring growth, diversification and improved structure of exports, will acquire a special importance.'

Top priority among groups of partner countries is given to the CIS, with which economic integration initiatives and establishment of free trade agreements must be continued. Cooperation with the EU – Russia's main trade partner, accounting for about 35% of Russia's foreign trade turnover and 25% of its foreign investment – will also be given priority[68]. The document states that importance of the EU for Russia will increase when CEE countries join the organisation. On this basis, possible establishment of a free trade zone with the EU should be considered.

[68] more about in chapter 6

VI. Impact of WTO Membership on EU-Russian Economic Relations

The relationships between Russia and the EU, albeit largely structured through the framework of the Partnership and Cooperation Agreement (PCA)[69] that came into force in late-1997, are complex and multi-dimensional. Russian accession to the WTO will introduce an additional dimension and some significant changes to the established relationship. To explain the full complexity of Russian-EU relations, we proceed as follows. First, the main elements of the existing PCA and its likely evolution are outlined. Next we draw attention to some crucial issues for Russia, notably the likely impact of EU enlargement, the situation of the Baltic States, and the special position of Kaliningrad. Against the background of these issues, we are then able to draw some conclusions about the likely impact of WTO accession on this nexus of relationships.

6.1. The PCA and its Evolution

The European Union and the Russian Federation have an important trade relationship. This will be even more so following EU enlargement, when they will become direct neighbours. Hence the interest of both parties in maintaining and strengthening solid, predictable, transparent and open trade relations.

The PCA establishes the framework for Russia-EU relations for an initial period of 10 years. A Partnership is hereby established between the Community and its Member States, of the one part, and Russia, of the other part.

The objectives of this Partnership are:

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[69] The formalisation of bilateral relations between the EU and individual partner countries has been achieved through the negotiation of **Partnership and Co-operation Agreements (PCAs),** now in force with ten of the Eastern European and Central Asian countries. PCAs are legal frameworks, based on the respect of democratic principles and human rights, setting out the political, economic and trade relationship between the EU and its partner countries. Each PCA is a ten-year bilateral treaty signed and ratified by the EU and the individual state.

- to provide an appropriate framework for the political dialogue between the Parties allowing the development of close relations between them in this field;

- to promote trade and investment and harmonious economic relations between the Parties based on the principles of market economy and so to foster sustainable development in the Parties;

- to strengthen political and economic freedoms;

- to support Russian efforts to consolidate its democracy and to develop its economy and to complete the transition into a market economy;

- to provide a basis for economic, social, financial and cultural cooperation founded on the principles of mutual advantage, mutual responsibility and mutual support;

- to promote activities of joint interest;
- to provide an appropriate framework for the gradual integration between Russia and a wider area of cooperation in Europe;

- to create the necessary conditions for the future establishment of a free trade area between the Community and Russia covering substantially all trade in goods between them, as well as conditions for bringing about freedom of establishment of companies, of cross-border trade in services and of capital movements[70].

Technical assistance under the TACIS programme has been allocated to Russia since 1991, totalling around € 2.6 billion up until 2003. In addition, Russia benefits under Tacis regional programs in the fields of justice and home affairs, the environment and nuclear safety. The EU is the largest provider of economic and technical assistance to Russia.

TACIS currently focuses on institutional, legal and administrative reform, including support for judicial reform and the development of civil society; fiscal and banking sector reform; deregulation; corporate governance and social reform. This includes addressing the social consequences of transition, as well as support to the agenda developed in the PCA institutions and Russia's accession to the WTO.

Other sources of assistance are the European Initiative for Democracy and Human Rights, and the European Commission Humanitarian Office, which is active in the North Caucasus[71].

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[70] EU, 2002
[71] European Commission, 2003

Sectoral Agreements: Steel and textiles are the main industry sectors covered by bilateral trade agreements. The ***Steel Agreement***[72] entered into force in July 2002. A ***Textiles Agreement*** was concluded in 1998. The Commission has proposed negotiating directives to the Council for an agreement on trade in nuclear materials.

Cooperation agreements have been concluded on **Science and Technology**, **Nuclear Safety and Nuclear Fusion**. In addition, negotiations for a Fisheries Cooperation Agreement and on a Readmission Agreement are currently being held. Other international agreements such as the Aarhus Convention and the International Humane Trapping Standards Agreement have been signed by both the EU and Russia, and are awaiting ratification by Russia.

In parallel with the EU instruments, the **Energy Charter Treaty** and its **Transit Protocol**, which also await ratification by the Duma, provide a legal basis for enhanced trade, investment and transit provisions regarding energy products.

This structure of agreements about trade is clearly of enormous importance since, as noted above, the EU is Russia's largest trade partner, accounting for about 25% of Russian imports, 35% of her exports. Conversely, Russia is the EU's sixth largest trade partner, accounting for 4.4% of imports into the EU in 2000, and 2.1% of the EU's exports[73]. See tables below.

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[72] **9 June 2002 , was signed a new EU-Russia agreement designed to increase imports of certain Russian steel products into the EU.** The Agreement gives the Russian producers larger export opportunities compared with the former agreement in so far as the quantitative contingents have been increased by more than 40% for 2002 (1,214 Million tons) and by another 2,5% for 2003 and 2004 to a level of 1,266 Million tons in 2004.
http://europa.eu.int/comm/trade/goods/steel/pr_100702.htm

[73] Hare, 2002

Table 6.1: EU trade in goods with Russia (€ Million)

	1995	2000	2001		1995	2000	2001
Imports	22,112	44,979	47,204	**Exports**	16,081	19,749	27,713
Trade balance	-6,031	-25,230	-19,491				

Source : European Commission

Bilateral trade in services is significant (over EUR 6 billion in 1999) and rather balanced.

Table 6.2: EU trade in services with Russia (million ECU/EUR)

	1997	1999	2000		1997	1999	2000
Imports	3,681	3,430	4,172	**Exports**	4,216	3,123	3,637

Source : European Commission

Some Russian exports to the EU already benefit from GSP (General System of Preferences) treatment, and Russia has requested that the scope of such treatment be extended. In any case, much of Russia's export trade with the EU already benefits from the liberalization that has already occurred. Remaining restrictions in steel and textiles are likely to be removed gradually. Moreover, 1998 saw a modification to the EU's anti-dumping rules that enabled Russian firms to be regarded as operating under market economy conditions; however, this judgement was to be made on a case-by-case basis, not across-the-board (see Section 3, above, for the current position). Although EU-Russian trade bounced back from a sharp fall around the time of the financial crisis of 1998, EU exports have not returned to their pre-crisis levels. There is some concern in the EU over Russia's maintenance of protectionist policies in sectors such as alcoholic drinks and vehicles (especially automobiles), but such protection is likely to remain in place.

As regards **Foreign Direct Investment** (FDI), European FDI in Russia is still low (€1.5 billion in 2000) and far below its potential. Moreover, capital flight is very important (around $15 to 20 Billion in 2000). See the table below. An improvement of the investment climate, notably through a more effective protection of property rights, is essential for Russia to attract more investment and know-how from abroad and to reverse the capital flight trends Completion of the reform process would also open the door to much needed foreign investment and know how, still deterred mostly by corruption and inefficient bureaucracy.

Table 6.3: EU Foreign Direct Investment in Russia (million ECU/EUR)

	1997	1998	1999		1997	1998	1999
Inflows	293	-6	883	**Outflows**	1,723	1,086	1,500
Inward Stocks	2,456	1,730	2,613	**Outward Stocks**	2,419	3,976	5,476

Source : European Commission

Since 1999, an ***EU Common Strategy on Russia***[74], valid for four years, has been in effect. Like the PCA, this identifies several policy priorities, the one relevant here involves the "Integration of Russia into a common European economic and social space".

The main goal of the EU Common Strategy on Russia is to further strengthen the strategic partnership between the European Union and Russia at the dawn of the new century. The Common Strategy is intended to improve the diverse forms of cooperation between Russia and the EU by coordinating the policies of the individual member states and the European Commission and so through complementarity producing synergies.

Box 6.1.: The EU Common Strategy on Russia

The Common Strategy concentrates on four areas. The EU wants to:

(a) help consolidate democracy, the rule of law and public institutions in Russia to form the basis for a prospering market economy;

(b) further integrate Russia into a common European economic and social area;

(c) increase cooperation with Russia to improve stability and security in Europe and beyond;

(d) meet jointly with Russia the challenges we face on the European continent, e.g. as regards energy policy and the common fight against organized crime.

To implement the EU Common Strategy on Russia each EU Presidency will describe in their work schedule the particular fields and initiatives which the EU will concentrate on during their Presidency.

The EU and Russia have entered a new phase in their relations. An important initiative was launched at the EU-Russia Summit of May 2001: to establish a High Level Group to elaborate the concept of a Common European economic space. The harmonisation of certain parts of Russia's economic legislation with that of the EU is part of the final objectives. In parallel, analytical studies are underway both in Russia and in the EU to assess the effects of the CEES on Russia and the EU. This initiative should contribute to integrate Russia in an enlarged Europe. Indeed, by aligning with EU legislation, Russia will be able to attract foreign and domestic investment and to reverse capital flight trends and thus to gradually reduce the economic and regulatory gap with Central and Eastern European countries.

[74] European Commission, 2003

Source: European Commission, http://europa.eu.int

6.2. The Impact of EU Enlargement

Ever since the start of transition in 1989/90, many **Central and Eastern European Countries (CEEC)** have sought full membership in the European Union. The enlargement process has turned out to be far more prolonged and complex than many of the CEEC applicants envisaged. The current position, however, is essentially as follows[75]. Leaving aside Malta and Cyprus, 10 countries from Central and Eastern Europe are currently progressing through the detailed negotiations concerning the various chapters of the ***acquis communautaire***. These countries are (moving, roughly, from north to south): Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary, Slovenia, Romania and Bulgaria.

6.2.1. EU enlargement

As of end-2001, most of these countries had closed at least half of the chapters (meaning that agreements had been reached), while the more advanced countries only had a handful of chapters awaiting agreement. Perhaps not surprisingly, chapters that are only being opened last year include those on agriculture, transport, and structural funds. These chapters are particularly difficult not only for the applicant states, but also for the EU itself. Some of the proposals from the EU side will not prove popular, for instance proposals on agriculture will not be well received in Poland since they delay full participation in the Common Agricultural Policy until 2013[76]. By early 2002, the European Commission had set out its negotiating position on the financial framework for accession, focusing on the years 2004-2006, as a basis for the final stages of negotiation during 2002 and 2003[77].

In order to help the countries that have applied to become members of the European Union to carry out the reforms required, the Union is providing financial

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[75] In addition, much documentation, including assessments of the individual applicants and their progress with the negotiations can be found on the website of DG Enlargement. The web address is: www.europa.eu.int/comm/dgs/enlargement/index_en.htm

[76] Commission, 2002a

assistance in different areas. As far as the candidates from central and eastern Europe are concerned, these include institutional building measures through the 'Phare' programme; environment and transport investment support under the ISPA programme; and agricultural and rural development support by means of the SAPARD' programme. The applicants from the Mediterranean region, i.e. Malta, Cyprus and Turkey receive support via different budgets, which you can learn about on the European Commission web site (http://europa.eu.int/comm/enlargement/financial_assistance.htm).

Nevertheless, negotiations was substantially complete by end-2002, enabling existing EU member states and the applicant states to ratify a Treaty of Accession during 2003, with new members formally joining the EU in 2004.

13 countries have applied to become new members: 10 of these countries - Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, and Slovenia are set to join on 1st May 2004. They are currently known by the term "acceding countries". Bulgaria and Romania hope to do so by 2007, while Turkey is not currently negotiating its membership[78]. In order to join the Union, they need to fulfil the economic and political conditions known as the **'Copenhagen criteria'**, according to which a prospective member must:

- ⇨ be a stable democracy,
- ⇨ respecting human rights,
- ⇨ the rule of law, and
- ⇨ the protection of minorities;
- ⇨ have a functioning market economy;
- ⇨ adopt the common rules, standards and policies that make up the body of EU law.

As a Commission economist dealing with enlargement issues, some economists realise the enormity of EU Enlargement issues[79]. Most obviously, enlargement represents a multi-dimensional economic, political and social transformation for the Candidate Countries themselves. At the same time, it affects existing EU Members and third countries.

The 1 st century Roman historian Tacitus stated that 'All great things are full of ambiguity'. EU enlargement is certainly a great thing! An unprecedented number of

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[77] Commission, 2002b
[78] European Commission, 2003
[79] Willem Noë, 2002

countries have applied to enter the Union, which will challenge both these nations and the existing structure of the Union itself. Accession therefore brings concurrent pressures for economic and political reform for both existing and new MS. Inevitably, this will have repercussions for the Union's external relations.

The dichotomy between 'external and internal' is of little analytical use in our increasingly globalised and interdependent world. A large part of the EU economy is effectively outside of the EU, and vice-versa. It is clear that instability around the EU and from further afield can and will directly affect the EU Member States. The interdependence of the global economy is unprecedented in terms of its overall depth and complexity. Accordingly, an understanding of the effects of EU Enlargement on external relations requires first an understanding of the effects of enlargement on the EU and its new future Members.

Through its effects on the Union, enlargement inevitably changes relations with third parties. The economics and politics of enlargement are complex, with the shifting perceptions of 'ins' and 'outs' constantly changing priorities and relations with third parties. The economist's concept of a general equilibrium, or continuous dis-equilibrium, is perhaps a useful notion here.

These third parties also influence the European Union. The idea of the completion of the Internal Market, proposed in 1986 as the 'Single Market' or '1992' project, was mostly a product of the perception that Europe was falling behind the US and Japan in economic terms.

It is also clear that enlargement will not affect economic and political relationships to the same degree, nor necessarily in the same direction. This is very much where the importance of empirical work comes in, and I freely admit that this I have not done.

What is the incentive for a European country want to join the EU in the first place? One can, I think, group these under three headings: *historical, economic, and politica*l: Very briefly:

Historical **–** There are the old ideas of Christian and Roman Empire myths of unity; there are commonalities in geography, culture and language; there is the experience of 20 th century wars; the need to defend against domination by Germany, the

US and the USSR; and after its constant feuding, there is a belief that the credibility of the nation state itself can only be reinstated through surrendering some sovereignty.

Economic – Most obviously, there is the lure of access to one of the largest and most sophisticated markets; the stimulation of competition; the creation of economies of scope and scale; the redistribution of financial resources; the economic interdependence that creates economic incentives to co-operate; and the fact that in a globalised economy, capital tends to undermine *de facto* national sovereignty toward larger groups of countries.

Political – The ‘elephant’ argument - the Union already affects the margin to manoeuvre, so why not join and be included in its benefits; the Union is a way of ‘locking in’ other nations into binding commitments (and your own future governments); it offers power for a nation’s elites and a stronger voice both in Europe and vis-à-vis third countries; it offers security, both from each other and from Russia; and there is the symbolism of belonging to Europe.

In short, EU membership is a huge confidence-building measure. It confers *credibility* on the Member country through the acceptance of clear and enforceable mutual restraint. It is therefore a public good for economic actors and investors.

Membership decreases uncertainty in wide areas of public life since Membership rules - the *acquis communautaire* or body of EU law - are clear, well established, have legitimacy, and are institutionally enforced.

The international affirmation of the EU project has also been expressed in tangible commercial terms. For instance, the announcement of the 1992 project with the introduction of the SEA in 1986 produced a surge in foreign and domestic investment in the EU. Similarly, there has been a wave of mergers and acquisitions in the EU in the lead-up to the introduction of the Euro, and a surge in foreign direct investment toward the confirmed candidate countries.

6.2.2. Impact on Russia

Of course, Russia has a big presence in Europe, both historically and politically. Its attitude directly affects the whole European and Central Asian regions, not so much in economic but political and security domains. It is not hard, therefore, to predict that EU enlargement will lead to deeper and more complex economic and political relations with Russia.[80]

Economically, Russia has a GDP less than that of Spain. Trade flows between the EU and Russia are relatively small at about 4% of extra-EU trade (the EU takes 40% of Russia's trade).[81] This low overall percentage perhaps does mask the importance of certain sectors, notably energy. The 1998 economic crisis in Russia hit the EU mainly through confidence effects rather than any direct trade, investment or financial channels. Russia needs EU capital and trade to help its process of economic reform. Its welcoming the upcoming enlargement reflects a belief that an enlarged zone of prosperity and stability in Central Europe and enlargement– induced growth in the EU is strongly in its interests.

With enlargement, direct trade links between CEECs and Russia will be internalised. Although Russia is not the major trade partner of the Candidate Countries (as in the Comecon days) both sides have the experience and interest in opening their trade links. Moreover, the Candidate Countries have a high level of energy dependence on Russia. An enlarged EU will be more dependent on imported Russian energy supplies. Oil and gas currently already account for over half of Russia's exports to the current EU. The EU's increasing energy dependency on the one hand, and Russia's crumbling energy infrastructure on the other, indicates a future of strong mutual interdependency.

That said, there will be a few sectors that could be hard hit by enlargement. For instance, Russia's sales of nuclear fuels to some of the accession states might disappear completely, since the Russian fuel and the associated transport arrangements for it do not comply with EU regulations[82].

The enlarged Community will, however, offer Russia a somewhat simpler and more liberal trading environment, since the new entrants to the EU will apply the EU's Common External Tariff to the bulk of Russia's exports. Hence Russia will face a unified

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[80] The EU has created various economic and political co-operation agreements with Russia, such as the1997 Partnership and Co-operation Agreement (see above), 1999 Common Strategy Paper.
[81] Willem Noë, 2002
[82] see Dyker, 2002b

set of trading conditions, rather than the EU as it is now plus the 10 applicants each applying different tariffs to Russia.

Since for industrial sectors, most EU tariffs are rather low, Russia will tend to benefit overall from these changes. On the other hand, bilateral trade agreements that Russia has with some of the applicant states will most likely fall by the wayside in the course of the enlargement process, and in a few instances this might marginally disadvantage Russian interests.

Russia already neighbours the EU through Finland, and after enlargement the EU border will extend to the Baltics and Poland by proxy of Byelorussia. However, the direct threats or problems posed by Russia to European security are no longer of a military nature. More urgent is the progressive breakdown of civil society, declining life expectancy, the health crisis, large scale environmental pollution and widespread crime and corruption. Enlargement brings the EU closer to this, literally.

The EU has an obvious long-term interest in a stable & prosperous Russia. The attitude of EU politicians toward Russia will be crucial here. To what extent will Russia be given a voice as a partner of the EU with legitimate concerns on how enlargement impacts on the Union? To what extent will Russia be allowed to interfere in internal EU policy and enlargement?

New MS will have significant influence on EU relations with Russia. All applicant countries attach major importance to relations with Russia and the Ukraine. Upon entry, the new MS take with them intimate knowledge and various close historic and economic relationships with Russia. No doubt there is a certain fear of or weariness toward Russia. But one of the benefits of EU membership is that new States can deal with Russia with the imprimatur of the EU.

However, until they are actually members, there are also worries that Russia might try to influence membership proceedings which may lead to more delays. As indicated earlier, new MS might push for membership of neighbouring countries. It is not clear if the Ukraine, Belarus, Moldova and other NIS will apply for Membership. Nor is it clear what Russia's react would be, or if indeed it would itself apply for Membership. For the moment, though, these are not pressing issues.

One potentially major problem in EU-Russia relations is the geographic situation. After enlargement, part of Russia will be encircled by the EU with the Russian *oblast* of *Kaliningrad* (or formerly Koenigsberg in Prussia). This region, wedged on the Baltic coast between Poland and Lithuania, has a population of 1 million and supports a naval base. Is it a Trojan horse with smuggling, high crime and disease levels and environmental disasters (and reports of nuclear weapons stationed there), or a bridge for closer economic relations?

But also in Estonia and Latvia (but not Lithuania, as that country will border Belarus), will be a relatively “hard” frontier, with rather tighter border controls (incl. a new visa regime) than have normally been in place between, say, Latvia and Russia hitherto. Such controls might impede normal cross-border flows of workers in each direction, and might also increase the transactions costs associated with trade[83]. However, one should probably not make too much of this point as the Finland-Russia border has been the EU frontier since the last EU enlargement in 1995, and Russia has not been especially vocal in complaining about the border controls there. Hence it appears that workable solutions can be found, and the Finnish model - based on a visa regime but with very quick processing and a flexible approach to local cross-border traffic - could usefully be extended.More about in the next sections.

6.2.3. The Baltic States

The three Baltic States were first to declare their independence from the Soviet Union in 1990 and 1991, they immediately declined to have anything to do with the CIS, and announced their intention to adopt a strong western orientation, including the intention to seek both NATO membership and EU membership. Estonia was first to adopt radical market reforms, Latvia and Lithuania both being somewhat more cautious.

In the **economic sphere**, the introduction of new standards and regulations as well as EU trade preferences to developing countries will strongly impede Russian exports to applicant and new member states. These impediments are unlikely to be offset by increased demand for Russian goods by growing new member economies; by potential

[83] see Batt, 2001

benefits from single EU tariffs for individual industries; or by prospects for transborder cooperation along the longer EU-Russian border.

All three countries have large Russian minorities and have also served as transit routes for Russian exports, important due to the lack of ice-free ports in Russia itself (but Russia is now building new port facilities near St Petersburg). After Austria, Finland, and Sweden joined the EU, for example, Russian **economic losses** were estimated at 100 million dollars annually. Similar effects should be expected in this case; moreover, they will become apparent well before the current applicants become full members. Further reorientation of their trade away from Russia in favor of intra-Union operations simply cannot be accompanied by finding new markets for many Russian goods, particularly those produced in neighboring regions. The already visible geoeconomic divide will deepen. The largest living standards gap in Europe--that which exists along the Russian-Finnish border--will be extended southward of the Finnish Gulf.

The **freedom of movement of people** will be seriously limited. The intensity of people-to-people and business-to-business exchange cannot be maintained at the current level after the Schengen regime (which creates free movement of people within EU borders) is introduced, followed by Russian reciprocal measures. In 1998 Lithuania received the most Russian travel abroad, with over 1.1 million entries, nearly 900,000 of which were for private and tourist purposes. Poland ranked fifth with 546,000 Russian entries (372,000 for private and tourist). In turn, citizens of Poland were the second most frequent visitors to Russia with 806,000 entries, 600,000 of which were private and tourist. Lithuania ranked third, with 798,000 and 645,000; Estonia ranked sixth, with 274,000 and 196,000; and Latvia ranked eighth, with 213,000 and 97,000. Although the effect will be two-sided, it is clear that citizens of EU applicant countries will have greater opportunities to reorient their travel, particularly business travel, than will Russians[84]. For the year 2001 see the table below.

Table 6.4: Estimated border crossings by Russian citizens in 2001

Source	**Russia**	**Lithuania**	**Poland**
Towards Lithuania	2.2 million	500-600,000 (transit estimates)	950,000 (total crossings)
Towards Poland	2 million		

source: Kaliningrad regional administration

[84] A. Moshes, 2000

The most **negative outcome of the restrictive visa regime** will be impediments to ongoing networking and, less directly, to creating a "security community" that would include people on both sides of the prospective Russia-EU border. The experience of Finland—which after its entry to the EU succeeded in issuing millions of visas for Russians every year and thus neutralized this risk--cannot be treated as a precedent. Finland, unlike the present applicants, had a non-Schengen option, and therefore could establish procedural rules of its own. Further, its political will to maintain the frequency of contacts with Russia was not doubted, which is far from the case regarding the political leadership of Poland and the Baltic states.

EU enlargement may unfortunately add to Russia's relative **political isolation**. It may affect region-building in the Baltic Sea area by drawing the resources and attention of national governments away from this process in favor of fulfilling the task of enlargement. Thus far, regional initiatives such as the Council of the Baltic Sea States and especially the Northern Dimension (an originally Finnish proposal of far-reaching transborder cooperation in the region) have been perhaps the most effective and efficient means of both engaging Russia and building a new type of relations in northeastern Europe. Whether this momentum will be upheld amidst enlargement remains uncertain.

Also of concern is the potential negative influence of countries that now have **problematic bilateral relations** with Russia on EU common foreign and security policy, especially when these states hold the presidency. The perceptions of Russia shared by large parts of the Polish political elite and the Baltic states are one-sided and prejudiced. There are, therefore, concerns that their representatives will not be interested in building a genuine Russia-EU partnership, and instead will do their best to minimize interaction.

Instead of rendering a stabilizing effect, EU enlargement may **destabilize Russia-EU relations**. This will result from the need to deal with the problem of Russian-speaking non-citizens of Latvia and Estonia in a Moscow-Brussels debate, which has thus far been avoided. Currently Moscow aims at holding consultations with the EU in order to guarantee the rights of Russian speakers before the enlargement occurs. If this fails, Russia might refuse to extend the Partnership and Cooperation Agreement of 1994 to candidate countries where these rights are not guaranteed. This will most likely become a near-intractable problem between Russia and the EU. Furthermore, Russia will not drop its claims to protect its compatriots without citizenship after they become "EU alien residents." The Union will lose a lot of maneuvering space when, having accepted Latvia and Estonia with their legislation, it ceases to be a mediator and becomes a side in the conflict. The collision, totally unnecessary in a trilateral format, will therefore become inevitable, perhaps putting the whole Russia-EU relationship at risk[85].

Hence the shift of the Baltic States into the EU's orbit has been viewed as **problematic for some years**, though the EU has been at pains to stress that normal trade and personal links with Russia should not be damaged thereby. In fact, as part of the enlargement discussions, the EU has pressed the Baltic States not to adopt policies that discriminate against their Russian minorities – language and citizenship laws in particular have been highly controversial in this regard[86]. I would suggest that the EU's approach in the Baltics seem predominantly negative.

6.2.4. The Special Position of Kaliningrad

Kaliningrad (formerly Königsberg) became part of the Soviet Union as a result of the Potsdam Agreements that determined the political configuration of Europe after the Second World War.

Following the dissolution of the Soviet Union in 1991, this *oblast*', isolated from the rest of Russia, was nevertheless retained as part of the Russian Federation. The Kaliningrad *oblast'* is bounded by Lithuania to the north and east, Poland to the south, so that following EU enlargement it will be entirely surrounded by EU member states (plus the Baltic Sea, of course).

Cooperation on Kaliningrad forms part of the broader EU-Russia partnership which has developed over the past years and which will become even more important for both the EU and Russia after EU enlargement. The EU wants to work with Russia to maximise the benefits of EU enlargement for Russia and Kaliningrad. The issue of transit is important and the EU is ready to assist Russia in issuing valid documentation and to contribute to improving infrastructure at the borders so that people can cross as speedily and easily as possible. The EU is also cooperating on other important issues which concern this part of Russia and the wider Baltic region, including economic development,

[85] A. Moshes, 2000

energy, environmental and health issues. All citizens of Russia, including those in Kaliningrad, and the EU stand to benefit from close co-operation between the EU and Russia on Kaliningrad, the impact of EU enlargement, and the development of the wider region.

Within Russia, Kaliningrad was declared a Free Economic Zone in the mid-1990s, with the intention of attracting foreign investment and promoting the region's development. Such efforts have proved unsuccessful, largely due to the generally poor investment climate in Russia alluded to earlier, though a handful of significant projects has done well. Kaliningrad itself suffers from high levels of crime, shocking pollution, and a local administration that is considered to be inefficient and ineffective even by Russian standards.

As elsewhere in Russia, unemployment and poverty in Kaliningrad have increased dramatically since 1990, but the standard of living is lower than the Russian average: GDP is 35% lower than the Russian average and 30% of the population is estimated to live below subsistence level. There is a growing, evident, wealth gap between the region and Poland and Lithuania. Industrial production dropped by 60% since 1990, with drastic changes in the regional economy. Kaliningrad has a significant formal external trade deficit (with the EU, the deficit in 2001 was $313 million). However, much activity is now informal, with the black economy accounting for more than 60% of GDP and over 90% of mined amber is smuggled out of the region.[87]

Kaliningrad will benefit economically from enlargement. But at the same time it will face changes affecting the movement of people and goods as well as its energy supplies with the rest of Russia and with its neighbours. A series of suggestions for how to cope with these changes are made, to be discussed with Russia, Poland and Lithuania. These include :

- carrying out, in the first half of 2001, an assessment of the **trade** impact of enlargement on Kaliningrad;
- launching discussions between the EU, Russia, Lithuania and Poland to improve **border management** and speed up border-crossing procedures;

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[86] Hare, 2002
[87] European Comission, 2003

- designing a multi-modal **transport** strategy with a view to securing funding for priority transport projects;
- identifying key **investment** requirements to modernise the regional transport infrastructures;
- assessing the possibility of using Community rules on **small border traffic** and transit;
- facilitating **visa issuance** and managing **migration** flows efficiently (reducing cost of passports and of visas) and considering opening Member States' consulates;
- concluding quickly a **readmission agreement** with Russia;
- assessing possible scenarios for Kaliningrad's future **energy supply;**
- reviewing consequences of enlargement on **fishing** access and on the future fisheries agreement between the EU and Russia;
- discussing key issues of **environmental concern** in Kaliningrad.

The European Union has provided **significant support** to Kaliningrad. It has financed a variety of projects, mostly through Tacis, including large projects in the sectors of institution building, energy, transport, enterprise restructuring, management training and the environment. Kaliningrad has received EUR 15 million of Tacis assistance with another EUR 15m in the pipeline. Tacis activities were begun in Kaliningrad in 1991 and were increased in 1994, when Kaliningrad was selected as a priority region. In 1999 and 2000 new projects to be implemented in 2001 were identified. These include border crossing, waste management and health projects, the development of Kaliningrad's port, support to innovative SMEs and the promotion of trade and investment in Kaliningrad. EU current and future Member States are also active in the region, mainly in administrative reform, health and the environment.[88]

Russia central authorities have estimated that, in 2001, the total number of crossings between Kaliningrad and the rest of Russia were 960,000 by train and 620,000 by car. These **transit figures** have to be compared with a populatioon of Kaliningrad which is estimated at around 947,000 residents.

[88] European Commission- External Relations, 2003

Passports

Russia has indicated that 250,000 Kaliningrad residents already possess a passport valid for international travel. Russia reports that they are issuing 50,000 international passports to Russian citizens per year. After 2003, the Polish and Lithuanian authorities have estimated that their Consulates in Kaliningrad should be ready to issue respectively 50,000 and 150,000 visas per year.

Visa fees

However, at present Russia charges much higher prices for visas issued to Poles and Lithuanians and both countries are expected to address the issue on the basis of reciprocity.

Box 6.2. Visa fees

Lithuania currently charges \$15 for a regular visa, \$8 for a transit visa, \$25 for a multiple entry visa and \$18 for a multiple entry transit visa.
Poland charges \$5 for single entry and \$14 for multiple entry visas. Fees for future transit visas have not been set yet.
Russia is reported to charge \$15 for a regular visa for Lithuanian citizens and \$35 for Polish citizens. The figures for multiple entry visas are \$25 and \$120 respectively.

Multiple entry/exit visas can be issued to those who need them, for example for professional reasons (bus and lorry drivers etc). The Commission has urged Russia to begin compiling lists of such people now so that they could apply for Lithuanian and Polish visas before 1 July 2003. The ***new visas will be machine readable*** which should speed up checks on the border itself and reduce the current long checking times.

The impact of the visa requirement can be further reduced if all Russian citizens resident in Kaliningrad are fully informed, ahead of 1 July 2003, of what the new rules will be and how they can comply with them. The EU is willing to fund and run an information campaign, if Russia would find this helpful.

Even if Russia as a whole does not form part of a wider free trade area with the EU, it would make good economic sense for the Kaliningrad *oblast'* to do so, subject to suitable safeguards to prevent Russia from taking unfair advantage of such an agreement. It must be debatable, however, whether such a special status for Kaliningrad would be acceptable to the EU given the military importance of Kaliningrad as the Headquarters of the Russian Baltic Fleet. Nor would it be politically acceptable to Russia, since it might be seen as the start of a process of gradual disengagement of the region from the rest of the country. Although in the context of Russia's wider negotiations for WTO accession, the Kaliningrad question ought to be regarded as relatively minor, it has actually become a highly emotive issue for Russia. Russia seeks visa-free transit between Kaliningrad and the rest of Russia, which is proving difficult for the EU or the Baltic States to accept. But if Kaliningrad becomes the touchstone for EU-Russia relations, failure to resolve this matter satisfactorily could impact on other important aspects of their relations, including trade[89].

6.2.5. Summary

The EU is Russia´s largest trade partner. Already, 35% of Russia´s current exports go to the EU; this will increase to over 50% after EU enlargement. EU enlargement will bring significant benefits to Russia, providing an integrated market of 500 million consumers neighbouring Russia[90].

The EU and Russia also co-operate on the concept of a **Common European Economic Space**, which should in time contribute to greater legislative approximation and regulatory convergence, thereby making it easier to do business together.

Russia´s decision to engage in a wide-ranging reform process is fully supported by the EU and co-operation is well-developed. The **EU has since 1991 through its technical assistance programme TACIS provided € 2.4 bn to support Russia´s transition** and is ready to continue this support to all key areas of Russia´s reform process. See tables below.

Table 6. 5: TACIS funds allocations to Russia in million €

Russian Federation Action Programmes

	1997	1998	1999	2000
Institutional, legal and administrative reform	16	30	15	28
Private sector support and econ. dev.	29	32	18	14
Alleviation of social consequences of transition	11	3	5	6
Development of infrastructure networks	24	20	11	0
Environm. Protection, nat.resources manag.	5	10	8	4
Rural economic development	13	9	5	0
Policy advice; small project programmes	31	28	23	39

89 more about on European Comission web site: http://europa.eu.int/comm/external_relations/north_dim/news/ip_01_66.htm

90 European Commission, 2003

Others	4	10	8	7
Total	133	140	92	98

Source: European Commission

Table 6. 6: Estimated Allocations to Russia through other Programmes (Tacis funds) in million €

	1997	1998	1999	2000
Regional programmes	21	22	16	15
Nuclear safety	34	17	12	33
Donor co-ordination	27	29	29	32
Programme Impl. support	17	16	19	18
Others	6	5	5	2
Total	105	88	80	100

Source: European Commission

As the EU-Russia relationship develops new areas of co-operation emerge and the **fight against terrorism**, organised crime and trafficking in human beings are issues of common concern on which the EU and Russia have begun a promising dialogue.

Co-operation is thus intensifying in all areas, which is natural given the close proximity of the EU and Russia. As the EU enlarges, the EU and Russia become even closer neighbours and our relationship will become even more important.

The EU´s announcement at the 29 May Summit to recognise Russia as a market economy will help strengthen trade relations further as well as contributing to Russia´s WTO accession, which the EU strongly supports. Indeed the EU has been at the forefront of those countries with whom Russia is negotiating its terms of accession.

Through the PCA, the European Union is already pressing Russia to adopt and implement much of the domestic economic legislation that will be needed as part of any plausible WTO agreement. In this sense, WTO accession and Russia's political and economic links with the EU are, to a very large extent, mutually reinforcing. Further, as we have just seen, EU enlargement is likely to simplify and improve the environment for foreign trade along Russia's western border, though Baltics and Kaliningrad remains a thorn in the side, as just noted.

As I think WTO accession itself is not likely to impose conditions on Russia that would be contrary to EU interests, not least because those sectors where the EU has special interests - such as agriculture, iron and steel, and a few others –are not particularly effectively regulated at WTO level. Hence overall, Russian membership of the WTO is more likely to improve than to damage Russian-EU economic relations by providing a more rules-based framework within which to manage the relationship and any disputes that might arise therein.

VII. Conclusions

In this concluding section of the paper, I shall organise the discussion under three headings:

7.1. What Should Russia be Offering in its WTO Negotiations?

Russia submitted its first market access offer in February 1998, and in spring 2002 the working party completed its report. This means that Russia is entering the final phase of the accession process, in which it will negotiate the conditions of entry and implement the required legislative reforms. However, because of the many disagreements between Russia and other countries, this final stage could take some time to complete.

As an organization whose aim is to liberalize trade, the WTO's aim during accession negotiations is to decrease trade barriers. The Russian case is unusual, because when Russia applied to the WTO, its economy had a different structure from traditional nonplanned economies. A number of sectors such as services did not exist, and many important regulations had not been formally legislated.

Even now, after 10 years of transition, Russia still lacks legislation in a number of areas. This situation had a direct consequence for the accession process, because for several years Russia was unable to provide the required information about regulations. Given the absence of formal rules and the set of informal rules that governed the economy, authorities at different levels enjoyed significant discretion. Thus when formal rules were introduced, the authorities failed to enforce many of them. Because of this a number of member countries have doubts about Russia's ability to fulfill its obligations in the future, making the negotiation process more problematic for Russia than the average would-be member.

In its negotiations, the Russian government has to balance two partly opposing considerations:

(a) what offers does it judge will be acceptable to existing WTO members? and

(b) what does it think it can sell to the Russian business community, the Russian Duma?

The latter is especially delicate as much of the economic thinking in Russia still derives from the mind set of central planning, emphasising protection, state controls, limitations on competition, and so on. Understanding of what a market economy really entails for the Russian domestic economy is developing, but is still far from universal. This is partly why attempts to influence Russian domestic policies via the WTO process are often perceived as "interference", regardless of the objective merits of the policies being proposed. However, much of the domestic reform that would be entailed by adherence to WTO principles is what Russia should be doing anyway. So if issues are presented in the right way, the WTO process could be seen as supporting an on going reform process, rather than interfering.

Assuming that such a positive approach can be sold, the Russian offer to WTO should be along the following lines:

Goods. Russia's WTO accession does not coincide with any major trade liberalization. Russia liberalized its international trade in the early- to mid-1990s as part of the IMF stabilization program. It has already eliminated almost all quotas and most tariffs are set below 20 percent. Trade liberalization in Russia coincided with a deep economic decline, and most Russians believe that trade liberalization was one of the major causes of the decline. Thus a number of strong lobbying groups insist on an increase in tariffs during WTO accession.

Many western experts reccomend Russia to go for a uniform tariff schedule or a schedule with only a few basic rates and very few additional excise charges, with the average MFN tariff rates no higher than at present. Accept tariff bindings at or only slightly above the tariff rates currently in force. Abandon most non-tariff barriers to trade, including a major simplification of licensing and certification rules and procedures; this should also include much tougher control over the trade restrictions imposed by sub-Federal levels of government. Limited and/or temporary special treatment for difficult sectors such as steel, automobiles, commercial aircraft, etc. Agree to reform public utility and other sectors where domestic prices currently distort industrial competitiveness. Continue the process of conforming to international technical standards and strengthen implementation.

Services. The most difficult negotiations concern the service sector, most of which is new to Russia, for example, no proper financial sector existed under the planned economy.

Western experts insist on freedom of establishment and national treatment for foreign firms in sectors such as business services, insurance, banking and like, while improving domestic regulation. Introduction of such measures could be phased in gradually, over agreed transition periods, especially as regards foreign ownership of key service sector businesses.

The current position is largely affected by lobbying groups from this new sector, which use the infant industry argument in their defense. On the other hand Russia insists on limiting the foreign presence in a number of service sectors to allow the domestic sectors to develop, and also insists on retaining a state monopoly in some areas. Newly independent regulation agencies, which do not want to be subjected to international accountability, play an important role in this process. The current Russian accession offer is extremely restrictive. In the banking sector, for instance, the Russian offer not only set limits on the combined foreign equity share and restricts the mode of operation of foreign banks on Russian territory (branches are prohibited), but it also restricts the types of operations foreign banks can engage in (lending is restricted). The situation is even worse in the insurance sector. Foreign firms are prohibited from participating in the country's compulsory insurance schemes, which are vital for foreign insurance companies' presence in Russia.

Another area of the service sector is telecommunications, considered critical for the development of Internet-based businesses. Foreign operators can only provide services at the local level and are not allowed to have more than a 25 percent equity share when providing resale-based services and 49 percent when offering facility-based services. This offer appears to be completely unacceptable for the WTO, which requires a shortening of the period before foreign competition is allowed and an increase in the limits on foreign equity shares. Moreover, the foreign presence in some sectors is higher than the proportion proposed in the offer, for example, in mobile telecommunications, and foreign counterparts require a drop of all foreign equity limits in sectors where foreign providers are already allowed.

Price Control Price control is another important impediment to Russia's accession negotiations. Other countries, mainly the United States and EU countries, insist on equalizing prices, which would apply to Russian natural gas sold both internally and externally.

This request confronts strong opposition in Russia, because implementation of this measure would significantly increase the domestic price of energy and could once again render Russian manufacturing uncompetitive.

Agriculture. Russian agriculture is largely still state owned, thus translating Russian agricultural support measures into traditional WTO classifications of green, red, and yellow light subsidies is difficult.[91] Accept the late 1990s as the reference period for determining permitted subsidy levels, since Russia cannot afford to pay the higher subsidies it claims to want, and agriculture will not become more efficient under a subsidy regime. Perhaps introduction of other domestic reforms needed to support improvements in agricultural efficiency, including the development of an agricultural land market. Legal steps to protect the property rights position of those large farms already operating as successful commercial entities.

Investment and Capital Flows. Both sides supposethe agree to national treatment for firms wishing to locate and invest in Russia, with far fewer restrictions on sector of operation, ownership shares, location, and the like, than exist at present. Otherwise, Russia should merely continue the existing programme of reforms intended, among other things, to improve the general investment climate in the country.

Regional Alliances. If Russia and the CIS partners wish the CIS Customs Union to be recognised by the WTO, this should be asked for in the negotiations. But as noted above, the Union is ineffective and not particularly beneficial to its members. Hence western experts do not recommend this approach.

For Russia its relations with CIS partners is historical and mostly political question. As result Russia could not abondon this relations even if its not so efficient.

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[91] Note: Red light subsidies, which are contingent upon export performance or on local content, are prohibited because they distort marketing decisions, that is, international trade competition. Yellow light subsidies, the category into which most subsidies belong, are not prohibited, but if they adversely affect the trade interests of other WTO members, they can be subjected to countervailing duty procedures or WTO dispute settlement. Green light subsidies are permitted if used for research and development, regional development, and environmental compliance assistance programs.

In return for the above, WTO members should offer Russia unambiguous and across-the-board market economy status (as the US and the EU have already announced their intention to do), and should remove many of the QRs still in place to limit their imports from Russia.

Official announcements had indicated that basic agreement on the main issues needed to enable Russia to accede to the WTO could be completed in 2002 year, with entry possible in 2003. But my own view is that many of the outstanding issues are still too complex and controversial, there are still a lot of difficulties with undeveloped or developing sectors and that such rapid progress is therefore unlikely.

I think for Russia it is not reasonable to hurry up with enter the WTO it is much more important now to stabilize and to strengthen domastic economy and political environment.

Meanwhile in the press we could see the year 2007 as a year of finishing of the final stage of accession negotiations and finally beginnig of a practical steps into the WTO. Some publications declared that the earliest possible date for adhesion will be October or November 2004. It is difficult to predict the concreate date of accession.

7.2. How Will WTO Accession Affect Russia?

The short answer to this, especially in the short-run, is “not very much”. The trade regime, in so far as it concerns the level and structure of tariffs is unlikely to change drastically upon WTO accession. Given the pressures for wide-scale restructuring across the Russian economy, resulting from the reforms already undertaken during the 1990s, it is really hard to see that WTO accession could exert more than a small additional pressure for change.

However, in the longer term there could be substantial, and mostly highly beneficial and desirable effects. **First** the commitments associated with WTO accession will serve to lock in and reinforce Russia’s market-oriented reforms. Among other things, this fact alone will be good for investor confidence.

Second, as insist most of the western experts, loosening up key services sectors by permitting foreign firms to operate in Russia with full national treatment will do more to improve these sectors than the slow and erratic reforms seen in recent years. Russian firms will come under huge competitive pressure and many will fail - as they should! But some will prove able to adapt and compete, and they will become some of the Russian success stories of the next decade or two. The point is that we don't know which of the existing firms will prove to be the winners - so there is no way that any form of government intervention or selective support would pick out the right companies, except by pure chance. Hence the importance of trusting to the market mechanism.

Third, in industrial sectors such as car production, aerospace, pharmaceuticals, food processing and many others, there are again some Russian firms capable of competing internationally, especially if they receive injections of the right kind of modernising technology, management expertise, marketing skills, and so on. But again, we have no way of knowing in advance which firms will succeed, and Russian government support programmes, if pursued, are likely to waste a great deal of money. Here also we meet compleatly opposit opinions. Some experts insist that it is far better for Russia to join WTO, improve the general investment climate in the country, and welcome foreign investors to assist in the restructuring of major industries. Others suppose that it could hamper or even destroy domestic industrial development.

Fourth, it is worth noting a general observation based on a study of many countries around the world, namely that resource-rich countries tend to exhibit poorer economic performance, slower growth than resource-poor countries. Hence from the point of view of its long-term growth and development, Russia is almost certainly disadvantaged by its rich natural resources - it becomes an economy of rents rather than an economy of innovation and productive investment. To change this, it is therefore even more important than already suggested to change the investment climate and create conditions for enormous amounts of new firm formation (Russia has about a fifth the number of firms that it should have!), including firms with foreign partners, foreign investment. The conditions associated with WTO accession can only be helpful here.

There is, however, a **negative side**. Business will face a hard time because the country will open up to cheaper quality imports. About 80% of goods are produced at factories which can not compete with major world facilities, and Russian goods can not enter open competition with foreign goods.

There are a lot of personnel problems that Russia should solve. For example, about 5-8% of highly skilled workers have remained in the Russian industry, while this figure for Germany is 56%.

Further, lower import tariffs may also result in a significant fall in budgetary revenue and the losses will apparently have to be made up with higher levies, a higher value-added tax and other domestic taxes.

WTO membership will limit the state's room for maneuver in applying effective measures regulating foreign-economic activity, especially those restricting import.

Entry may destroy the financial and banking sphere by the stronger foreign banks - that is the most crucial issue or question of survival.

WTO membership may hamper Russia's integration with CIS countries, especially within the framework of the Customs Union.

What Russia will gain or lose might largely depend on the terms that might be agreed on in the course of ongoing negotiations. But, in general, Russia is unprepared yet to entry into WTO space, and it might lose more than gain. But the political and economic scenes have changed in Russia considerably. Russia in 2003 is not the same as Russia in 1992. There are serious and positive shifts in the economy now, greater predictability in the activities of different political structures and an elite consensus on market and democracy. It is already clear that Russia is righting itself, albeit more hesitantly than we would wish. The economy is in better shape than it was at the end of the 90s.

There is less chaos, a bit less corruption in politics and a liberal bias in government. Most Russians now believe that the country must develop a market economy and adhere to the principals of electoral democracy, although many are dissatisfied with the performance of democracy and the so-called "Russian market" economy. People have begun to play by the rules and are coming to believe that their country will move forward.

There is a new sense of optimism among management. They have begun to believe that the only way for their business to grow is hard work and investments, not through political connections and government subsidies. Many of the new generation want to build something new, not just to get rich.

Ten years into the game, a new generation of bright young people that have worked only in modern Russia are attaining top executive jobs. Many either have experience in working for international companies or are returning from MBA or PhD studies abroad. These people are increasingly acting as a force for change.

Russia is gaining a new identity in the external arena as well. Most Russians, although disappointed with Western policies toward Russia, believe that integration with the West is in Russia's national interest.

Things, in general, are changing. There is a chance that Russia will consolidate a market economy and a democratic society and join the community of market democratic states.

7.3. How Will WTO Accession for Russia Impact on EU-Russia Relations?

Since WTO accession will, to a large extent, merely require Russia to introduce further reforms along the lines already envisaged in the existing PCA, accession is likely to provide a good working framework for further improvements in EU-Russia relations. The key message I think on this is that both sides have a common interest to fully respect the obligations they have accepted in the PCA, and to strengthen it where possible, for example through the adoption of objective and transparent rules of procedure for settling disputes. This will upgrade this agreement to mutual benefit.

Moreover, EU enlargement, as we suggested above, ought to be a helpful factor, too, since the trade regime that Russia faces in Europe will be simplified, will generally involve **lower tariffs** than at present, and will cover over half of Russian foreign trade. **The Common Economic Space**, brings us back in the first instance to EU enlargement. When this has happened, many of Russia’s neighbours will share the same rules and standards as those currently applied in the European Union. The question for Russia is whether it would not benefit from voluntary adoption of rules which are compatible with or, fully consistent with the EU's "acquis communautaire", in those areas where it is in Russia’s interest to do so? A few examples can illustrate why this is potentially so important. If Russian producers wished to sell micro-wave ovens in Poland or Portugal, that will obviously be greatly facilitated if Russia were to apply the same technical and product safety standards, as well as conformity assessment procedures.

Equally, if EU apply the same prudential and other standards in the **services sector**, this will greatly encourage cross border trade and mutual investment. It is not need to explain that services is the sector where a transfer of management know-how, technology and employment is central to its being traded internationally. Services companies, whether they are banks, accountants or travel agencies, all tend to offer their products through local outlets. This is the key difference with trade in goods, because in the services sector Russia "go local", and create employment locally.

The **energy sector** is also one that will remain at the centre of bilateral relationship in the years and probably even decades ahead. It is one of mutual dependency and opportunity: the EU has some of the world's most competitive energy companies and they are looking to come and invest in Russia. Russia's enormous reserves of gas (about 30% of the world's total) are encouraging the EU to seek to consolidate a long-term security of supply through close links with Russia national industries and between EU respective governments.

Some difficult areas still unresolved concern the status of Kaliningrad, issues of the possibly "hard" EU border following enlargement, and policies regarding sensitive sectors that currently receive special treatment within the EU - such as agriculture and steel - and will continue to do so. These difficulties will not go away, nor will they be "solved" by WTO accession. But in my view the combination of WTO accession, EU enlargement, and further developments in the framework of the existing PCA between the EU and Russia should enable all these matters to be managed reasonably well.

As Romano Prodi, the President of the European Commission, have said on the threshold of summit Russia-EU in St.Petersburg: "Russia's membership should mark a major step in consolidating the process of reforms in Russia and should help Russia to integrate deeper with the world economy. It will also pave the way for deepening the economic ties with the EU and will facilitate the creation of the Common European economic space".[92]

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[92] European Commission, *May 26, 2003*

Appendix :

Appendix 1: The World Trade Organization (WTO) Structure Information

The World Trade Organization – Structure Information

Location: Geneva, Switzerland

Established: January 1, 1995

Created by: Uruguay Round negotiations (1986-94)

Membership: 146 countries (as of April 2003)

Budget: 134 million Swiss francs (approximately 90 million US Dollars)

Secretariat staff: 500 members

Head: director-general

Objectives and principles. The World Trade Organization (WTO), the successor to the General Agreement on Tariffs and Trade (GATT) which existed since 1947, began to operate on January 1, 1995. The WTO is designed to regulate the trade-political relations of the members on the basis of agreements of the Uruguay round of multilateral trade talks (1986-1994), the legal foundation of modern international trade.

Decisions are made by the entire membership, typically by **consensus**, which is an additional stimulus for stronger consent within the WTO. A majority vote is also possible, but it has never been used in the WTO, and was extremely rare under the WTO's predecessor, GATT.

The WTO's top level decision-making body is the **Ministerial Conference** that meets at least once every two years. The first conference in Singapore in December 1996 supported the course taken by the member countries towards trade liberalization and added three new working groups to the existing WTO structure. They deal with the relationship between trade and investment, the interaction between trade and competition policy and transparency in government procurement. The second Ministerial Conference held in Geneva in 1998 was devoted to the 50-th anniversary of GATT/WTO; besides, the ministers decided there that the WTO regulations would also cover the area of electronic commerce. The third conference in Seattle (USA) in December 1999 where the decision on the new round of trade negotiations was to be taken, was actually unsuccessful. The next Ministerial Conference is due to be held in November 2001 in Doha (Qatar).

Under the Ministerial Conference is the **General Council,** which is responsible for carrying out current tasks; it meets several times a year in the Geneva headquarters. It is represented by WTO member countries, normally ambassadors and heads of delegation in Geneva. The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body. Also, the following committees work under the General Council: committees on trade and development, on restrictions related to trade balance, on budget, finance and administrative issues.

At the next level, the **Council for Trade in Goods, Council for Trade in Services** and the **Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS)** report to the General Council.

Council for Trade in Goods, in its turn, supervises activity of specialized committees, exercising control over fulfillment of WTO principles and implementation of 1994 GATT agreements related to trade in goods.

Council for Trade in Services exercises control over implementation of the GATS agreement. Within this Council there is a Committee on trade in financial services and Working group on professional services.

Council for Trade-Related Aspects of Intellectual Property Rights, apart from exercising control over implementation of the relevant agreement (TRIPS), deals also with preventing of conflicts related to international trade in counterfeit goods.

Numerous specialized committees, working groups and working parties deal with the WTO individual agreements and other areas such as the environment, development, membership applications and regional trade agreements.

WTO Secretariat, based in Geneva, has around 500 staff and is headed by a Director-General. Since decisions are taken by the members themselves, the Secretariat does not have the decision-making role that other international bureaucracies are given. The Secretariat's main duties are to supply technical support for the various councils and committees and the Ministerial conferences, to provide technical assistance for developing countries, to analyze trends in the world trade, and to publicize the WTO activities. The Secretariat also provides for some forms of legal assistance in the dispute settlement process and advises governments aspiring to accede to the WTO, which are more than twenty today.

Appendix 2: The WTO Working Party Members

1	**Argentina**	**35**	**Latvia**
2	**Australia**	**36**	**Lithuania**
3	Albania	**37**	Mauritius
4	**Bulgaria**	**38**	**Malaysia**
5	Bolivia	**39**	Morocco
6	**Brazil**	**40**	**Mexico**
7	Brunei Darussalam	**41**	Moldova
8	**Canada**	**42**	**Mongolia**
9	**Chile**	**43**	**New Zealand**
10	**China**	**44**	**Nicaragua**
11	Columbia	**45**	**Norway**
12	**Costa Rica**	**46**	**Oman**
13	Croatia	**47**	**Pakistan**
14	**Cuba**	**48**	**Panama**
15	Cyprus	**49**	**Paraguay**
16	**Czech Republic**	**50**	**Peru**
17	Dominican Republic	**51**	**Philippines**
18	**Ecuador**	**52**	**Poland**
19	Egypt	**53**	**Romania**
20	Estonia	**54**	Salvador
21	**European Union**	**55**	**Singapore**
22	**Georgia**	**56**	**Slovak Republic**
23	**Guatemala**	**57**	**Slovenia**
24	Honduras	**58**	South Africa
25	Hong Kong	**59**	**Sri Lanka**
26	**Hungary**	**60**	**Switzerland, Liechtenstein**
27	**Iceland**	**61**	**Taipei**
28	**India**	**62**	**Thailand**
29	**Indonesia**	**63**	Tunis
30	**Israel**	**64**	**Turkey**
31	**Japan**	**65**	**United States of America**
32	**Korea**	**66**	**Uruguay**
33	Kuwait	**67**	**Venezuela**
34	The Kyrgyz Republic		

in colour are WTO members conducting with Russia negotiations on tariff

Appendix 3: Export Tax

Export tax

An export tax is a tax collected on exported goods. As with tariffs, export taxes can be set on a specific or an ad valorem basis. Not in every country national budget include an export tax. In the US, export taxes are unconstitutional since the US constitution contains a clause prohibiting their use. This was imposed due to the concerns of Southern cotton producers who exported much of their product to England and France.

However, some other countries employ export taxes. For example, Indonesia applies taxes on palm oil exports; Madagascar applies them on vanilla, coffee, pepper and cloves; Brazil imposed a 40% export tax on sugar in 1996. In December 1995 the EU imposed a $32 per ton export tax on wheat. Russia uses export taxes on petroleum.

The taxation of oil and gas production and consumption has become an important fiscal issue in most countries of the former Soviet Union (FSU). The countries of the FSU are typically large consumers of energy, and four of them—Azerbaijan, Kazakhstan, Russia, and Turkmenistan—are large producers of oil and gas. Revenues from the petroleum sector averaged about 4.5 percent of GDP in Russia, Azerbaijan, Kazakhstan, and Turkmenistan during 1993–96, compared with between 10 and 30 percent of GDP in oil producers elsewhere.

The existing petroleum reserve base in former Soviet Union countries is very large and could support significantly higher production and exports. Russia has one-fourth of the world's proven gas reserves and is the world's largest producer of natural gas. Turkmenistan has the sixth-largest gas reserves in the world. Russia has an estimated one-seventh (6.7 billion tons) of the world's proven oil reserves outside the Middle East, which is comparable to the oil reserves of Mexico. It is the world's third-largest oil producer, with an output of 300 million tons in 1996. Production has fallen 45 percent, however, since the peak year of 1988. Azerbaijan and Kazakhstan each has oil reserves about one-sixth those of Russia. Oil production in these two countries could double or triple once oil export pipelines are built from the Caspian Sea fields.

The rationale for the taxation of energy supply (production and delivery) in market economies is twofold. First, the government as sovereign tax authority should collect as much of the "economic rent" as possible through taxes that are as neutral as possible. These rents are surplus revenues that remain after allowing for all costs and a minimum return to the owner or investor. The more revenue that can be raised through the taxation of these rents, the less revenue the government will need to raise by using distortive taxes on goods, factors of production, or asset transactions. Second, government owns the resource and needs to receive an appropriate royalty or fee for its use. The approach used in market economies is to tax petroleum production using multiple fiscal instruments to balance risk and return between government and investors, and to introduce flexibility as energy prices vary. These include value-added taxes (VATs), profits taxes, fees, and additional profits taxes. Taxes are collected primarily at the point of production, and fees for the transportation of energy are regulated to prevent monopoly pricing. Countries also tax consumption of petroleum products, such as gasoline and diesel fuel, to raise revenue, improve income distribution, cover road user fees, and protect the environment.

Toward the end of last year Russian government finally agreed to its first ever deal with OPEC, the cartel of oil-producing countries. Russia agreed to cut its oil exports by 150,000 barrels per day as of January 2002 in an effort to help the cartel give a boost to slumping world oil prices.

Appendix 4: Russia's Approach to Tariffs in 2002

Russia's Approach to Tariffs in 2002			
Section	***Improvements Implemented Since Last IAP***	***Current Tariff Arrangements***	***Further Improvements Planned***
Bound Tariffs	More precise definition of initial version of tariff proposals made by the Russian Federation in relation to the access of goods to the market as a result of negotiations carried out with member-countries of the Working group on joining WTO by Russia as well as a result of consultations carried out with representatives of Russian business circles.	Participation of Russia in negotiations on joining WTO on the basis of guidelines and tariff proposals on access of goods to the market approved by the Government. Participation of representatives of Russian business circles in forming Russian positions at negotiations on establishing tie-up levels of tariff proposal.	Russia undertakes to bindimport tariff rates in accordance with its tariff proposal starting from 1st January of the year following the year of joining WTO by Russia.
Applied Tariffs	Over a year, starting from January 2001, 30% of rates of unified Customs tariff have been changed, 90% out of them – reduced. Duty rates for state-of-the-art processing equipment under 400 commodity items were reduced. Specific and advalorem components of combined rates of import duties were brought in line.	Permanent improvement of import tariff of the Russian Federation in accordance with its application as a regulator for saturation of domestic market with goods required for consumers as well as protective measures against excessive importation of import products threatening national commodity producers. The use of import tariff as a source for replenishment of federal budget.	Gradual decrease of fiscal load on import tariff, transfer of main emphasis to its role as a defender of national commodity producer and consumer. Consecutive reduction of import-weighted average tariff rate with selective protection of separate sectors of Russian economy.
Tariff Quotas		Staring from 1st January 2002, tariff preference in the form of tariff quota for importation of raw sugar to the territory of the Russian Federation was granted in relation to raw sugar originating from developing countries enjoying national preferences system of the Russian Federation.	Improvement of mechanism for distribution of tariff quota.
Tariff Preferences		Duty rates are differentiated depending on the country and	Further improvement of Russia's national preferences system and co-

Russia's Approach to Tariffs in 2002			
Section	***Improvements Implemented Since Last IAP***	***Current Tariff Arrangements***	***Further Improvements Planned***
		origin of goods. Basic rates are applied in relation to countries and unions of countries enjoining the most favoured nation treatment in trade with Russia, otherwise these rates are doubled, except developing and least developed countries. As regards goods from developing countries, import tariff rate of 75% of its base value is applied, from least developed countries – importation of goods subject to the validity of the system is duty free.	ordination of main directions of customs-tariff policy within the framework of Eurasian Economic Union.
Transparency of Tariff Regime	In 2002 alone the Ministry of Economic Development and Trade of the Russian Federation, jointly with the Russian foundation of legal reforms, carried out 24 round-table discussions on the issue of socioeconomic consequences for Russia in joining WTO in regional aspect with a view to informing business and public circles on negotiation about joining WTO by Russia.	All changes in rates of effective tariff are made by the Government on the basis of recommendations of the Commission on protective measures and customs-tariff policy. Representatives of Russian exporters, importers and commodity producers are permanently invited to attend the meetings of the Commission. Decisions of the Commission of the Government of the Russian Federation on protective measures and customs-tariff policy are regularly covered by mass media.	Further support to openness in putting government tariff policy into effect.

Source: http://www.apec-iap.org/document/RUS_2002_IAP.htm

Tables:

Table A: Merchandise Trade of the Russian Federation

Table B-1): AD Initiations: reporting party vs affected country

AD Initiations: reporting party vs affected country from: 01/07/01 to: 31/12/01

Affected Country	Argentina	Australia	Brazil	Canada	Chinese Taipei	Colombia	Egypt	European Community	India	Indonesia	Israel	Jamaica	Korea, Rep. of	Malaysia	Mexico	South Africa	Turkey	United States	Uruguay	Totals:
Belgium	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1	0	**2**
Brazil	4	0	0	0	0	0	0	0	2	0	0	0	0	0	1	0	0	2	0	**9**
Bulgaria	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	**1**
Canada	0	0	1	0	0	0	0	0	2	0	0	0	0	0	0	0	0	1	0	**4**
China, P.R.	4	3	2	1	0	0	0	1	9	0	0	0	0	0	1	0	1	3	0	**25**
Estonia	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	**1**
European Community	0	0	0	0	0	0	0	0	6	0	0	0	0	0	0	0	0	0	0	**6**
Finland	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	**1**
France	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	**1**
Germany	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	1	2	0	**4**
Greece	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	**1**
Hungary	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0	0	1	0	0	**3**
India	0	0	0	0	0	0	0	3	0	0	0	0	0	0	0	0	0	1	0	**4**
Indonesia	1	1	0	0	1	2	1	0	0	0	0	0	0	1	0	0	0	1	0	**8**
Israel	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	2	0	0	**3**
Japan	0	0	1	0	0	0	0	0	4	1	0	0	0	0	0	0	0	2	0	**8**
Korea, Rep. of	1	1	1	0	1	1	0	0	2	0	0	0	0	0	0	0	0	1	0	**8**

Lithuania	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	**1**
Moldova	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	**1**
Romania	0	0	0	0	0	0	1	0	0	0	1	0	0	0	0	0	1	0	0	**3**
Russia	0	0	1	0	0	0	0	1	0	0	0	0	0	0	0	0	1	1	0	**4**
Singapore	0	0	0	0	0	0	0	0	7	0	0	0	0	0	0	0	0	0	0	**7**
Slovak Republic	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	**1**
South Africa	1	1	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	3	0	**6**
Spain	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	1	0	**2**
Sweden	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	**2**
Chinese Taipei	1	1	0	0	0	1	1	0	3	0	0	0	1	0	0	0	0	1	0	**9**
Thailand	1	2	1	0	0	1	0	0	3	0	0	0	0	0	0	0	0	1	0	**9**
Turkey	0	0	0	0	0	0	0	1	1	0	1	0	0	0	0	0	0	1	0	**4**
Ukraine	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	**3**
United Kingdom	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	1	0	0	0	**2**
United States	0	1	1	1	0	0	0	1	3	0	0	0	0	0	1	0	1	0	0	**9**
Totals for 01/07/01 - 31/12/01	**16**	**13**	**13**	**2**	**3**	**6**	**6**	**15**	**51**	**1**	**3**	**1**	**1**							

Source: http://www.wto.ru/ru/content/documents/docs/ADJulDec01.doc

Table C: Average Tariff Rates

Trends on Average Tariff Rates for Several Developing and Industrial Countries, 1980-2001 (Unweighted in %)

Code	Country/Group	1980	1985	1990	1995	1996	1997	1998	1999	2000	2001
1	**Ukraine**				9.1		10.4	10.0			
2	**Belarus**					12.3	12.6	13.0			
2	**Bulgaria**						16.6	17.6	14.8	13.5	13.8
2	**Czech Rep.**			5.3	5.0	7.7	7.3	6.9	6.8	6.5	
2	**Estonia**				0.1	0.1	0.0	0.0	0.0	3.1	0
2	**Hungary**		24.0			15.2	14.3	13.3	12.4	11.9	8.2
2	**Latvia**					4.3	5.6	5.8	5.2		4.0
2	**Lithuania**				3.9	4.5	4.6	3.9	3.8		3.4
2	**Poland**				11.6	18.7	13.1		15.9	14.5	10.0
2	**Romania**				6.0			19.8	15.2	13.1	18.1
2	**Russian Fed.**					10.9	12.6	13.9			11.1
2	**Slovak Rep.**				8.0		8.1	6.9	6.4	6.1	6.1
2	**Turkey**		24.7			13.2	13.4	12.3	13.7	8.4	8.1
2	**Yugoslavia, FR**	12.0	11.8								
3	**Slovenia**					10.6			10.6	11.8	11.4
4	**European Union**			8.7	6.8	6.7	6.2	6.0	5.6	4.8	3.9
	Memo: average										
1 to 2	**Developing Co (116)**	12.0	20.2	5.3	6.2	9.7	9.9	10.3	9.4	9.6	8.3
2	**Middle Income (71)**	12.0	20.2	5.3	5.8	9.7	9.8	10.3	9.4	9.6	8.3
3	**High Inc. Non-oecd (13)**					10.6			10.6	11.8	11.4
4	**High Income OECDs (9)**			8.7	6.8	3.4	3.1	3.0	2.8	2.4	2.0

Note: All tariff rates are based on unweighted averages for all goods in ad valorem rates, or applied rates, or MFN rates whichever data are available in a longer period.

Country codes are based on the classification by income in GEP 2002, where 1 = low income, 2 = middle income, 3 = high incone non-OECDs, and 4 = high income OECD countries.

Sources: WTO, IDB CD ROM database and Trade Policy Review -- Country Report, Various issues, 1990-2003; UNCTAD, Handbook of Trade Control Measures of Developing Countries -- Supplement, 1987 and Directory of Import Regimes, 1994; World Bank, Trade Policy Reform in Developing Countries since 1985, WB Discussion Paper #267, 1994, The Uruguay Round: Statistics on Tariffs Concessions Given and Received, 1996; and World Development Indicators, 1998-2003; OECD, Indicators of Tariff and Non-Tariff Trade Barriers, 1996 and 2000.

Table D: Weighted averages of the effective, initial and final bound rates of import tariffs

(according to the statistics on the imports of the year 2000)

Weighted averages	Effective tariff rate (January 2001, %)	Initial bound rate of the import tariff , %	Final bound rate of the import tariff, %
Agricultural goods	14,70	34,71	25,11
Industrial goods	9,73	14,32	9,84
All the trade nomenclature engaged in the foreign economic activity	10,92	19,18	12,82
Alimentary goods and agricultural raw materials (with exception of textiles)	14,77	34,86	25,16
Mineral production, including fuels and energy sources	5,43	11,06	5,43
Chemical industry production, caoutchouc	8,48	10,22	6,09
Wood and cellulose and paper goods	8,73	14,62	7,85
Textiles, apparel and shoes	11,69	18,31	12,37
Precious stones, precious metals and goods made out of them	20,00	25,00	20,00
Metals and metal goods	11,35	19,29	11,70
Machinery, equipment and means of transportation	9,48	14,83	8,75
Gypsum, glass and ceramics	15,51	20,18	14,39
Raw materials for the tanning industry, furs and goods made out of them	14,94	21,13	13,25
Other (clocks, musical instruments, other items)	18,04	20,20	16,43

Clarifications:

Initial bound rate of the import tariff: the rate on the moment of accession of the country to the WTO Final bound rate of the import tariff: the rate the country commits to decrease its initial bound rate to within the implementation period (6 –8 years) and which the country will operate with in the WTO framework.

Table E: Net Outflow of Private Sector Capital

Net Outflow of Private Sector Capital
(based on the balance of payments, flows data)
($ bln.)

Net outflow of private sector capital, total
(2+5)
Net capital outflow by banking sector
(3+4)
of which:
Net capital outflow by non-financial enterprises and households
(6+7+8)
of which:

Foreign assets
Foreign liabilities

Foreign assets
Foreign liabilities
"Net errors and omissions" of balance of payments**

1
2
3
4
5
6
7
8

2002
-8.2
2.8
-0.5
3.3
-11.0
-18.8
13.9
-6.1

Q1, 2002
-2.8
-0.6
-0.6
0.0
-2.2
-3.4

2.2
-1.0

Q2, 2002
1.2
1.7
0.1
1.6
-0.5
-3.5
3.9
-0.9

Q3, 2002
-2.2
0.2
0.7
-0.5
-2.5
-3.0
2.5
-2.0

Q4, 2002
-4.3
1.5
-0.7
2.2
-5.8
-9.0
5.3
-2.2

2003

Q1, 2003
-0.1
1.3
-0.1
1.3
-1.4
-3.5
4.0
-1.9

Q2, 2003
3.7
3.4

0.5
2.8
0.4
-2.3
4.2
-1.6

Q3, 2003*
-7.7
-3.9
-2.7
-1.3
-3.8
-5.2
4.2
-2.8

Notes:
1. Sign "-" denotes an outflow of capital, sign "+" implies an inflow.
2. Assets of non-financial enterprises don't cover the indebtedness on supplies of goods according to intergovernmental agreements; excluded from banking sector's transactions is short-term obligations of the Bank of Russia.
** Preliminary data.*
*** The item "Net errors and omissions" entirely relates to the sectors of non-financial enterprises and households. It could be explained by the fact that most noticeble difficulties come to light upon the recording in the balance of payments of capital transactions undertaken by these sectors.*

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Table F: International Investment Position of Banking Sector of Russia

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