



Backgrounders

Executive Summary

No. 1551

May 22, 2002

WHY RUSSIA'S ACCESSION TO THE WTO IS IN AMERICA'S ECONOMIC AND STRATEGIC INTERESTS

ARIEL COHEN, PH.D.

Among the important topics of discussion for President George W. Bush and Russian President Vladimir Putin at their May 23–25 summits in Moscow and St. Petersburg will likely be Russia's accession to the World Trade Organization (WTO). The issue richly deserves their attention. Since China's accession to the WTO in November 2001, Russia is the largest economy that is not a part of this global trade forum. Given Russia's growing importance as a strategic partner of the United States in the war on terrorism and the growth in its economy over the past three years, Russia's accession to the WTO is clearly in America's interests.

The objectives of U.S. trade policy include achieving more equitable and reciprocal market access for U.S. goods, services, and investment, and reducing and eliminating barriers to trade and other market-distorting policies and practices. Consumers in America will benefit from reducing trade barriers to Russian goods, such as steel, fuel for nuclear reactors, and certain types of aircraft. Negotiations over Russia's accession to the WTO should clearly focus on such mutual benefits.

Complying with WTO Requirements. To join the organization, however, Russia must first implement important economic adjustments that would enable it to comply with WTO requirements. These include eliminating tariffs on certain goods; creat-

ing a non-discriminatory, transparent environment for foreign goods and services; reforming the financial and banking sectors; and introducing decisive measures to protect foreign investors and intellectual property rights. These requirements are part of the universal accession policy for all WTO candidate countries, and Russia should not be subject to any special considerations or compromises. The United States should be clear and unwavering on this point: Russia must fully implement all of the WTO accession requirements.

Promoting Russia's Accession. In discussions and negotiations with Russia as well as in the WTO Quad Group with representatives of the European Union (EU), Canada, and Japan, which is taking the lead in the Russian accession talks, the United States should:

Produced by the
Kathryn and Shelby Cullom Davis
Institute for International Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, D.C.
20002-4999
(202) 546-4400
<http://www.heritage.org>



This paper, in its entirety, can be found at: www.heritage.org/library/backgrounder/bg1551es.html

- **Support Russia's efforts to open its economy to trade and investment**, which will facilitate its integration into the community of democratic market-oriented states and boost its role as an anti-terrorism partner of the United States. In Moscow, President Bush should encourage Putin, the Russian government, and Russia's business community to improve the overall performance of the Russian economy by opening markets to trade and investment.
 - **Endorse Russia's "graduation" from Jackson–Vanik restrictions** that prevent it from enjoying permanent normal trade relations (PNTR) with the United States. The Jackson–Vanik Amendment prevents Russia's equal treatment as a trade partner, which is required by WTO rules. The United States, and Congress in particular, should take the first step to pave the way for Russia's accession to the WTO by permanently lifting these Jackson–Vanik restrictions.
 - **Focus discussions on the tariffs that Russia must eliminate or reduce**, as required by WTO accession rules. These should include sectors and products that Russia has tried to protect, such as pharmaceuticals; medical, construction, and agricultural equipment; aerospace; autos; and steel. These tariffs should also be discussed at the WTO Quad Group meetings.
 - **Support Russia's membership in the WTO Agreement on Government Procurement.** The WTO Quad Group also should include a requirement for accession that Russia sign this agreement, which stipulates that members provide transparency and non-discrimination in government procurement.
 - **Advise the Russian government and Central Bank on ways to reform and open the banking, financial, and insurance services sectors.** The U.S. Trade Representative should recommend that the WTO Quad Group make financial-sector reform before WTO accession a priority.
 - **Request that the Russian Ministry of Trade and Economic Development implement the WTO's intellectual property rights requirements** (known as TRIPS) prior to WTO accession.
- Conclusion.** President Putin understands that only the West has the capacity to become Russia's principal source of investment capital and a substantial market for Russia's energy resources. Putin and Prime Minister Mikhail Kasyanov have stated that Russia is eager to join the WTO and that it will become a reliable trade partner and energy supplier for the West, regardless of what may happen to the flow of oil from the Middle East. The lack of WTO membership slows both trade and investment activity in Russia.
- The United States should support Russia's efforts to join the WTO but also make clear that the Russian government must follow the WTO's universal requirements for membership, including taking decisive measures to protect intellectual property rights, eliminate and reduce tariffs, create a non-discriminatory and transparent environment for foreign goods and services, and reform the banking sector. At the May summit meetings, President Bush should publicly support Russia's accession to the WTO, provided its negotiations with the WTO are completed successfully.

—Ariel Cohen, Ph.D., is Research Fellow in Russian and Eurasian Studies in the Kathryn and Shelby Cullom Davis Institute for International Studies at The Heritage Foundation.

WHY RUSSIA'S ACCESSION TO THE WTO IS IN AMERICA'S ECONOMIC AND STRATEGIC INTERESTS

ARIEL COHEN, PH.D.¹

Among the important topics of discussion for President George W. Bush and Russian President Vladimir Putin at their May 23–25 summit meetings in Moscow and St. Petersburg will likely be Russia's accession to the World Trade Organization (WTO). The issue richly deserves their attention. Since China's accession to the WTO in November 2001, Russia is the largest economy that is not yet a part of this global trade forum. Given Russia's growing importance as a strategic partner of the United States in the war on terrorism and the growth in its economy over the past three years, Russia's accession to the WTO is clearly in America's interest.

The objectives of U.S. trade policy include achieving more equitable and reciprocal market access for U.S. goods, services, and investment, and reducing and eliminating barriers to trade and other market-distorting policies and practices. American consumers and Russian businesses will benefit from lower trade barriers to Russian goods, such as steel, fuel for nuclear reactors, and certain types of aircraft. The negotiations over Russia's membership in the WTO should clearly focus on such mutual interests.

To join the organization, however, Russia must implement several important economic adjustments in order to comply with WTO requirements.

These include eliminating tariffs on certain goods; creating a non-discriminatory, transparent environment for foreign goods and services; reforming the financial and banking sectors; and introducing decisive measures to protect foreign investors and intellectual property rights. These requirements are part of the universal accession policy for all candidate countries, and Russia should not be subject to any special considerations or compromises. The United States should be clear and unwavering on this point: Russia must fully implement all of the WTO accession requirements.

Produced by the
Kathryn and Shelby Cullom Davis
Institute for International Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, D.C.
20002-4999
(202) 546-4400
<http://www.heritage.org>



This paper, in its entirety, can be found at: www.heritage.org/library/backgrounder/bg1551.html

1. The author thanks Gerald P. O'Driscoll and Aaron Schavey of the Center for International Trade and Economics (CITE) at The Heritage Foundation, as well as former interns Piotr Kaznacheev, Ph.D. candidate, Moscow State University, and Elena Simonova, a former Russian Economic Ministry official, for their contributions to this study.

In discussions and negotiations with Russia as well as in meetings of the WTO Quad Group—an advisory group that is taking a lead in the Russian accession talks and that includes the United States, the European Union (EU), Canada, and Japan—the United States should support Russia’s efforts to join the WTO and open its market further to trade and foreign investment. That is the best course, both to facilitate Russia’s integration into the community of democratic market-oriented states and to boost its role as an anti-terrorism partner of the United States.

While in Moscow, President Bush should publicly endorse Russia’s “graduation” from Jackson–Vanik Amendment restrictions that prevent it from enjoying permanent normal trade relations with the United States and prevent equal treatment of Russia as a trade partner, which the WTO rules require. Among the issues to discuss, the President should focus on tariffs that Russia may seek to maintain, such as those on pharmaceuticals, the aerospace sector, and steel, and ways for Russia to reform and open its banking, financial, and insurance services sectors.²

AMERICA’S STAKE IN RUSSIA’S ACCESSION TO THE WTO

Economists and political thinkers have long recognized that free trade and the spirit of commerce promote international understanding and reduce hostility and mistrust among nations. The reality of the global economy today reinforces that principle.³ Free trade is a U.S. foreign policy priority: an effective way to promote and protect America’s economic interests. Given Russia’s new role as a strate-

gic partner in the U.S.-led campaign to end terrorism, expanding trade with Russia and helping it to become a full member of the community of developed democratic states is in America’s best interests.⁴

Joining the World Trade Organization would help fulfill these objectives and enhance Russia’s latest rapprochement with America and its allies. It would create more favorable conditions for U.S. exporters and investors in Russia, and give U.S. consumers greater access to cheaper Russian goods.

- Russia has been the largest market for U.S. poultry (until the recent but temporary ban) and a major market for U.S. beef and pork. Moreover, U.S. consumers buy 2 million gallons of vodka, over 3.6 million Arctic King crabs, and precious metals such as palladium from Russia.⁵
- According to the U.S. Department of Commerce, Russia has a massive potential for trade and investment and represents a ready market for a wide range of technologically sophisticated American products.⁶
- The 2002 *World Economic Forecast* of the International Monetary Fund (IMF) predicts that the global economic slowdown will be relatively less severe in Russia and Eastern Europe, which will continue to maintain viable markets for capital and consumer goods.⁷
- The Russian Federation is already the world’s second-largest oil-producing country.
- Russia is quickly becoming an important “swing” oil producer for the global energy markets. The instability in the Middle East raises

-
2. “WTO Reviews Draft Accession Texts for Russia; Negotiator Details Contention,” *BNA Regulation, Law and Economics* No. 81, April 26, 2002, p. A24.
 3. See, for example, Immanuel Kant, “Perpetual Peace: A Philosophical Sketch,” at <http://www.mtholyoke.edu/acad/intrel/kant/kant1.htm>; Richard Cobden, “Free Trade with All Nations,” at <http://www.geocities.com/Athens/Acropolis/5148/cobdenonfree-trade.html>; “Richard Cobden,” at <http://www.spartacus.schoolnet.co.uk/PRcobden.htm>; and Thomas J. DiLorenzo, “Frederic Bastiat (1801–1850): Between the French and Marginalist Revolutions,” at <http://www.mises.org/fredericbastiat.asp>.
 4. Ariel Cohen, “Russia and Eurasia,” in Stuart M. Butler and Kim R. Holmes, eds., *Issues 2002: The Candidate’s Briefing Book* (Washington, D.C.: The Heritage Foundation, 2002), at http://www.heritage.org/issues/russiaandeurasia/russia_background.html.
 5. Edward Gresser, “A View from Outside: Russia and the Case for the WTO,” *Progressive Policy Institute Policy Report*, April 2002, pp. 3–4.
 6. U.S. Commercial Services, “Country Commercial Guides for Russia,” at <http://www.usatrade.gov/website/ccg.nsf>.
 7. International Monetary Fund, “World Economic and Financial Surveys: World Economic Outlook: The Information Technology Revolution,” October 2001.

Russia's importance as a reserve oil supplier for Europe and Japan, helping to keep oil prices down. President Putin, his cabinet, and the major Russian oil companies have demonstrated a readiness not to march in lockstep with the OPEC oil cartel, keeping Russian oil prices within the \$21 to \$25 per barrel price range rather than raise them with OPEC.⁸

Accession to the WTO will help make Russia's economy more transparent and predictable, increase the protection of minority shareholder rights, and strengthen the enforcement of contracts. Such reforms, for example, will create a strong incentive for foreign corporations to boost their investment dollars in the Russian oil and gas industry, which in turn would allow Russia to increase energy exports at moderate prices. As energy exports expand, Russia's domestic output—or gross domestic product (GDP)—would grow, and demand for American goods and services would increase.

WHAT WTO MEMBERSHIP WOULD MEAN FOR RUSSIA

The WTO is one of the largest and fastest-growing international organizations, with 144 member states and regions representing all the major world economies.⁹ It has already admitted some former Soviet states, such as the three Baltic states of Estonia, Latvia, and Lithuania, as well as Georgia, Kyrgyzstan, and Moldova.

Joining the WTO would foster economic reform, which is important to Russia and to the global economy. President Putin's recent State of the Federation speech demonstrated his commitment to implementing free-market policies aimed at achiev-

ing stable economic growth and a modernized economic system.¹⁰ In his words,

[T]oday countries compete along all the parameters of economics and politics: the size of the tax burden, level of security of the country and its citizens, guarantees of protection of property rights. They compete as far as attractiveness of the business climate, development of economic freedoms, and quality of state institutions and effectiveness of the court and legal system.¹¹

Market Reforms Are Underway. In the past three years alone, Russia has begun to implement a coherent policy of economic reform, which includes lowering personal income taxes to 13 percent (a flat tax), the corporate tax rate to 24 percent, and small-business income taxes to 20 percent. Russia also is taking steps to privatize land, achieve a federal budget surplus, and introduce greater transparency in corporate governance.

Although Russia's economy is far from being prosperous, its economic performance during that same period fosters moderately optimistic forecasts. The Russian economy grew 5.3 percent in 1999, 8.3 percent in 2000, and 5 percent in 2001.¹² The Ministry of Trade and Economic Development estimates that the GDP growth rate will continue to rise at about 3 percent to 5 percent each year from 2002 through 2004.¹³ Industrial output is expected to have similar increases, and real disposable household income is expected to rise at a stable level of 4 percent to 5 percent.

In the long run, opening Russia's economy to free trade through WTO accession would increase for-

8. "Oil Price Deal Sought with Russia," at <http://www.cnn.com/2002/WORLD/europe/03/04/russia.opec/index.html>.

9. For background information on the WTO, see Brett D. Schaefer, "The Bretton Woods Institutions: History and Reform Proposals," Heritage Foundation *Economic Freedom Project* Report No. EFP 00-01, April 2000, at <http://www.heritage.org/library/efp/efp00-01.html>.

10. "Poslaniye Prezidenta Rossiyskoi Federatsii V. V. Putina Federal'nomu Sobraniyu Rosskiiskoi Federatsii (Message of the President Vladimir Putin to the Federal Assembly of the Russian Federation)," April 18, 2002, at <http://president.kremlin.ru/events/510.html>.

11. *Ibid.*

12. Evgeny Gavrilin, "Economic Growth and Crises: Evidence from Russia and Other Controversial Economies," Center for Strategic and International Studies, Washington, D.C., December 7, 2001, at <http://www.csis.org/ruseura/pl011207.htm>.

13. Ministry of Trade and Economic Development of Russia, "Main Economic and Social Indicators of Russia Federation Until 2004," at <http://www.economy.gov.ru>.

eign competition and investment and allow Russia to reduce its indebtedness (currently about \$137 billion). Russia would progress from one of the world's largest debtors to an important economic partner of the United States and other Western economies.¹⁴

Despite such benefits of joining the WTO, the issue is under debate in Russia. Proponents of quick accession view membership as a strong incentive for economic reform; opponents believe that the process is a way to pressure the government to make further economic reform. The financial industry in particular has been resisting accession, claiming that WTO membership would wipe out Russia's banking sector.

Such arguments, however, are protectionism at its worst. Lack of competition in the financial sector imposes a heavy burden on the economy. There is no reason to expect that this sector, which has enjoyed protection for 10 years and which was an active enabler and participant in Russia's 1998 financial crisis, will become more efficient in the foreseeable future without exposure to foreign competition and expertise.

In fact, the majority of Russian businessmen support Russia's accession to the WTO as a way to open markets overseas to their products and increase their ability to defend Russian business interests abroad. According to Igor Yurgens, Vice President of the Russian Union of Industrialists and Entrepreneurs (the leading Russian business coalition), 70 percent of its members support WTO accession.¹⁵ Besides giving Russia a unique chance to attract foreign capital, accession likely would improve the overall business and investment climate by introducing international product standards and making Russian goods more competitive globally.

WTO membership would protect the rights of both domestic and foreign investors. Russian economists predict that the overall decline in productivity following introduction of the WTO standards

would be minimal—perhaps no longer than a year, and primarily in food production and the transportation industry. But the increased competition and the availability of high-quality inputs for domestic industries would stimulate growth, and growth in productivity would likely begin in the second year after accession.¹⁶ If Russia does not join the WTO, however, it will find it harder to solve its serious economic problems and risk its best chance to integrate fully into world trade and investment flows.

Russia's Efforts to Join the WTO. The history of Russia's candidacy for membership began in 1990, when the USSR was granted observer status at the meetings of members of the General Agreement on Tariffs and Trade (GATT)—the precursor to the WTO. In 1992, Russia submitted a formal request to become a member of the GATT. A Working Party established by the General Council for conducting negotiations on Russia's accession was created in 1993 and became a WTO body after implementation of the WTO Agreement on January 1, 1995.

Currently, 50 member states actively participate in the Working Party on Russian accession, which is open to all WTO members that wish to participate in the negotiation process. Since 1998, Russia has opened bilateral negotiations on tariffs and specific market access with 30 countries and has pursued negotiations on trade in goods and services with 10 countries. Since 1999, Russia has conducted negotiations on two tracks: bilateral negotiations with countries concerned about market access and policies in goods and services, and multilateral negotiations with the WTO regarding changes in Russia's laws toward accession requirements.

Nevertheless, many Russian officials fail to understand that the rules of accession to the WTO are not subject to negotiation. These core requirements are standard for all countries seeking membership. What can be negotiated are the schedule of accession and the criteria and methodology of

14. "Finance Ministry Sanguine About Foreign Debt," Yahoo International Finance Center, at <http://biz.yahoo.com/ifc/ru/news/22602-4.html>.

15. "70% of Russian Businessmen for Russia's Early Accession to WTO," *Pravda.ru*, October 23, 2001, at <http://english.pravda.ru/world/2001/10/23/18898.html>.

16. "Russia in WTO: Myths and Reality (*Rossiia v WTO: Mify i Realnost*)", A Report by the Center of Financial and Economic Research supported by Club 2015, 2001, at <http://www.cefir.ru>.

adjusting policies to certain universal requirements. Extensions, not exceptions, are subject to consideration. The timetables for tariff reductions in third countries, which affect Russia, are not even under Russia's control. Not being a WTO member, and being outside the world trade negotiations, means that Russia cannot participate in such negotiations.

This lack of influence is a strong incentive for Russia to join the global trade organization. Minister of Economy and Trade German Gref said during testimony before the Russian Parliament that the country's inability to join the WTO costs the economy \$4 billion every year. He added that, in 2002, the government is planning to undertake a special program to prepare for membership.¹⁷

An additional incentive for membership is supplied by the more than 120 various sanctions and trade restrictions currently applied to Russia by world markets. Some of these sanctions are the legacy of the Cold War, and some apply generally to all non-WTO countries. For the most part, Russia's accession to the WTO would relieve this burden on its economy. A special committee on WTO accession was established within the Russian government in 2002 to coordinate the process.

Another difficulty is that accession is a consensus decision of all WTO members. It is difficult for a large economy like Russia's not to affect other countries' economic interests. It will be challenging for Russia and the other countries whose interests are at stake to compromise regarding trade rules.

A quick completion date for Russia's accession to the WTO is difficult to envision. During the last World Economic Forum meeting in New York in January 2002, WTO President Michael Moore said that he expects Russia to join the organization in two years.¹⁸ Gref has said that membership in WTO is not expected for at least the next 18 months. After the latest round of negotiations with the Working Party, which was viewed as relatively

unsuccessful, Maxim Medvedkov, the head of the Russian delegation and Deputy Minister of Economic Development, made a more pessimistic forecast of three to four years. Although Russia's leadership has demonstrated a strong commitment to accelerating the process, it now appears that 2003 or 2004 is more realistic for full accession.¹⁹

While it would be beneficial for Russia to have access to the WTO's dispute settlement process to protect its trade interests and provide foreign investors with a streamlined dispute resolution system, many obstacles remain to be overcome.

OBSTACLES TO ACCESSION

Like many other countries that aspire to WTO membership, Russia must overcome legislative hurdles. The Russian government has approved a list of legislative acts that are to be submitted to the Parliament in order to bring Russian laws in compliance with WTO rules. The list includes laws that regulate protective antidumping and compensatory measures for imports; licensing of exports and imports; government subsidies; customs tariffs and duties; standardization and certification of finished goods; foreign currency controls; and production of spirits and alcohol drinks. A new edition of Russia's Customs Code must be enacted as well.²⁰

Moreover, there are several areas in which the Russian government disagrees with the WTO on economic policies. The main areas of dispute involve tariffs, protection of intellectual property rights, non-tariff barriers to trade like subsidies and red tape, and reform of the banking sector.

Tariffs. Russia currently has one of the lowest levels of trade barriers in the world. The nominal tariff rates vary between 7 percent and 15 percent, which is low by WTO standards. The effective (real) rate is estimated at only 5 percent, since 50 percent of overall imports are subject to various waivers and exceptions.

17. "Russia in WTO—Pluses and Minuses," *Pravda.ru*, February 13, 2002, at <http://english.pravda.ru/economics/2002/02/13/26383.html>.

18. "Russia to Become Full-fledged WTO Member by Mid-2003," at <http://english.pravda.ru/world/2002/01/10/25186.html> (May 2002).

19. "Focus: Russia's WTO Accession Pace May Be Slowing," at <http://www.prime-tass.com/news/66/opened/20020402/210262.asp> (May 2002).

20. "On Approval of Plan of Action for Adduction of Russian Legislation in Conformity with the Norms and Rules of the World Trade Organization," Direction of the Government of the Russian Federation, No. 1054-p, August 8, 2001.

The adoption of WTO standards—despite fears among some Russian politicians and businessmen—would not decrease the overall level of protection for domestic businesses. To the contrary, it would allow the government to correct trade policy by shifting from ineffective, complex, and often contradictory and corrupt practices to more transparent ones. Under the influence of the WTO, Russia already has made a significant change to create more favorable conditions for external trade; it has consolidated tariffs into four major product groups (raw materials, semi-finished goods, foodstuffs, and finished products).

The Russian government disagrees with the WTO, however, on the length of the transition period for introducing new tariffs. Currently, all WTO candidates face a three-year period for introducing tariffs. Russian negotiators want an exception; they seek a seven-year extension to introduce tariffs in order to complete modernization of sectors that are most vulnerable to foreign competition. Resistance comes primarily from sectors that would be hurt by so-called sectoral initiatives, which assume zero tariffs for 10 groups of goods: pharmaceuticals, furniture, medical, construction and agricultural equipment, paper articles, steel, toys, beer, and strong beverages.

Other “sectoral initiative” requirements include harmonizing tariffs for chemical goods at the level of 5.5 percent to 6.5 percent; joining the Agreement on Trade in Civil Aircraft, which demands zero tariffs on a wide range of aircraft and related products; and signing the Agreement on Information Technology, which requires a gradual reduction of tariffs on 400 items, including computers and software.

Import tariffs also under negotiation between Russia and the WTO Working Party include those imposed on automobiles, non-ferrous metals, and furniture. In agriculture, four groups of products are under pressure for tariff reduction from other WTO members: meat, grain, fish, and butter. In addition, Russian tariffs for U.S. wood product

exports are at the level of 20 percent, compared with the preferential rate of 5 percent for tropical hardwood logs, lumber, and veneer.²¹ Russia should be looking to countries such as Chile to assuage its fears of how a decrease in tariff protection would affect such sectors.²²

Protection of Intellectual Property Rights (IPR). IPR is a major U.S. concern, especially regarding its software and entertainment industries. According to a 1991 U.S.–Russian bilateral trade agreement, Russia is required to provide adequate protection for intellectual property, and the Russian government took steps to create a legal framework that will approach international standards on intellectual property protection. After July 1998 amendments to Russia’s law “On Certification of Products and Services,” approximately 30 percent of 22,000 Russian legal norms became compatible with international standards, making the system more transparent and less time-consuming.²³

Nevertheless, in 2001, Russia was mentioned in the U.S. Special 301 Priority Watch List along with 16 other countries that lack legislation to control pirate optical media (CD) production and exports of CDs and CD-ROMs. The adoption of a new regulation in May 2000 was another important step to protect property rights. However, the situation has not improved significantly. Millions of pirated music and software CDs and DVDs are being sold for \$2 to \$3 across the country. The inability of Russia to cope with the requirements of the bilateral agreement shows that it is still unprepared to meet more complicated obligations under the WTO Agreement on Trade Related Aspects of Intellectual Property Rights.

Another related concern is Russia’s court system, which is considered to be inadequately prepared to handle sophisticated patent and trademark disputes.

Subsidies and Red Tape. Special WTO regulations allow countries to employ some non-tariff measures, such as import quotas and subsidies in

21. Office of the United States Trade Representative (USTR), “Foreign Trade Barriers: Russia’s Trade Summary,” 2001, at http://www.ustr.gov/html/2001_russia.pdf.

22. Glenn W. Harrison, Thomas F. Rutherford, and David G. Tarr, “Trade Policy Options for Chile: A Quantitative Evaluation,” World Bank Group Policy Research Working Paper No. 1783, June 1997, at <http://wbln0018.worldbank.org/research%5Cworkpapers.nsf/View+to+Link+WebPages/5C3A69A7767E040B852567E000541C6C?OpenDocument>.

23. USTR, “Foreign Trade Barriers: Russia’s Trade Summary.”

agriculture. The level and regulation of subsidies in Russia's agricultural sector remains one of the main points of disagreement with the Working Party on Russian accession. There are two principal concerns: the level of subsidies and the inability to change this level after an agreement with the WTO. WTO regulations do not allow members to extend protectionist policies or change the overall amount of subsidies or tariffs once their level has been set and approved by the organization.

The currently negotiated threshold for overall Russian subsidies is \$16 billion, which experts consider to be sufficient for effective protection. This level of subsidy constitutes a significant share of the current budget, and reaching it is unlikely to be feasible in the foreseeable future. Nevertheless, the Russian government insists on having decision-making power on the amount of agricultural subsidies in contradiction of the WTO standards. In addition, Russia has a wide variety of informal subsidies, primarily on the supply of cheap energy to producers as well as a system of barter trade.

The U.S. representatives in the Working Party have demanded that Russia join the WTO Agreement on Government Procurement, which stipulates a necessity for members to provide transparency and non-discrimination in bidding on government contracts. This would require the elimination of prohibitions against the purchase of foreign goods and services from foreign suppliers, as well as termination of set-asides and offsets for domestic producers or widely used red tape practices that prevent foreign products, services, and suppliers from entering the Russian market. Today, the government is engaged in vague tendering procedures, which allows use of single-source contracts and keeps vital technical specifications classified.

Reform of the Banking Sector. WTO membership will require Russia to have a more open and competitive financial sector. A few Russian banks that have a significant political influence on the government are among the major groups resisting WTO accession.

After the financial crisis of 1998, the Russian banking system collapsed. Today, the retail banking sector is dominated by a government monopoly, *Sberbank* (Savings Bank), which accounts for 73 percent of deposits and 20,000 branches.²⁴ *Sberbank* is a gargantuan and opaque institution. Similar to Russia's tariff policy, it is not the formal protection in the sector but the overall negative environment for investment that prevents foreign banks from entering the Russian market. The government has already waived a legislative limitation of 12 percent ownership for foreign banks, since it has never been reached.

After the 1998 financial crisis, many smaller banks were closed by the Central Bank, and a more restrictive system of licensing was introduced. According to some analysts, this created a non-transparent environment that stifles competition and prevents the sector from developing. Without a significant foreign presence, Russia's financial sector lacks the proper incentives to improve operations. Only sectors that are subject to strong foreign competition, such as investment, have seen competitive domestic financial firms emerge. Foreign financial institutions bring with them "best practices." At the same time, Russian institutions that are protected from foreign competition, such as the retail and commercial banks, insurance companies, and private pension funds, remain highly inefficient.

IMPLICATIONS FOR U.S.–RUSSIA POLICY

As Undersecretary of the Treasury John Taylor stated during a press conference in Moscow in October 2001, Russia's accession to the WTO remains a priority for the United States.²⁵ Indeed, the United States will play an important role in Russia's accession to the WTO as leader of the WTO Quad Group, which eventually will direct Russia's accession process. The U.S. objectives in helping Russia become a WTO member include achieving more equitable and reciprocal access for U.S. goods, services, and investment in the Russian market, and reducing and eliminating barriers to trade and other trade-distorting policies and practices.

24. Peter Aven, presentation at the U.S.–Russian Business Council 2002 Forecast Conference, Washington, D.C., April 17, 2002. Aven is president of Alfa-bank, the largest private bank in Russia.

25. Russian News Agency, *Interfax*, October 29, 2001.

One of the remaining obstacles to Russia's membership in the WTO is the lack of permanent normal trade relations (PNTR), which has been blocked by the restrictions in the Jackson–Vanik Amendment. This relic of the Cold War was passed in 1974 when the Soviet Union had severely limited emigration. Congress suspended application of the amendment after the Soviet Union collapsed, but it remains on the books, preventing Russia's equal treatment as required by WTO rules.

Members of Congress, in stalling on efforts to grant Russia PNTR, raise issues that go beyond free emigration and human rights. For example, some have conditioned removing the strictures of Jackson–Vanik on resolving disputes with Russia over U.S. chicken imports and compliance with U.S. demands on WTO accession.²⁶

At the upcoming summit in Moscow, President Bush can make clear America's support for Russia's accession to the WTO by emphasizing several key priorities. Specifically, the United States should:

- **Support Russia's efforts to open its economy to trade and investment.** Joining the WTO will cause Russia to open its market further to foreign goods, services, and investment; reduce barriers to trade and other trade-distorting practices; and support transparency, accountability, and the rule of law. Open trade will facilitate Russia's integration into the community of democratic states and boost its role as a strategic anti-terrorism partner of the United States. President Bush should publicly endorse Russia's accession to the WTO to open its market, especially its oil and gas industry, to American investors. Russia's growing economy, and especially the energy sector, represents a ready market for a wide range of technologically sophisticated American products. The United States should recommend that Russia create a non-discriminative and transparent environment to increase incentives for American entrepreneurs to develop its oil and gas sector. This would strengthen Russia's position as an important energy supplier in the global market and

improve the overall competitiveness and performance of the Russian economy.

- **Endorse Russia's "graduation" from Jackson–Vanik restrictions that prevent it from enjoying permanent normal trade relations with the United States.** Congress should assist Russia's effort to become a member of the WTO by permanently lifting the Jackson–Vanik restrictions, which it could accomplish by attaching an amendment to trade legislation.
- **Focus discussions on the tariffs that Russia must eliminate or reduce, as required by WTO accession rules.** The United States also should recommend to the WTO Quad Group that the Russian government eliminate or cut its tariffs, as required by the WTO accession rules, primarily on such products as pharmaceuticals; medical, construction, and agricultural equipment; aerospace; autos; and steel. The U.S. Trade Representative should insist on Russia's full implementation of the WTO accession requirements within the universal time frame and without maintaining any protectionist policies.
- **Support Russia's membership in the WTO Agreement on Government Procurement.** The WTO Quad Group should include a requirement for accession that Russia sign this agreement, which stipulates that members provide transparency and non-discrimination in government procurement. This would mean both eliminating constraints on the purchase of foreign goods and services by the Russian government and clamping down on Russia's well-known use of red tape.
- **Advise the Russian government and Central Bank on ways to reform and open the banking, financial, and insurance services sectors.** Russia's Ministry of Trade and Economic Development, Central Bank, and Ministry of Finance are in charge of the WTO negotiations and financial sector reforms. They should be encouraged to move forward with reforms of the banking and financial services sectors.

26. Opening Statement of the Hon. Sander M. Levin, a Representative from the State of Michigan, in *Hearing to Explore Permanent Normal Trade Relations for Russia*, Committee on Ways and Means, U.S. House of Representatives, April 11, 2002, at <http://waysandmeans.house.gov/trade/107cong/4-11-02/4-11levi.htm>.

Without significant foreign competition, Russian banks lack incentive to improve operations and achieve a transparent financial system based on international standards. Restructuring and modernizing the financial services sector also would create more support for WTO accession in the Russian business community.

- **Request that Russia's Ministry of Trade and Economic Development implement the WTO's intellectual property rights requirements.** Intellectual property rights requirements (known as TRIPS) should be implemented prior to WTO accession. The failure to introduce policies that protect intellectual property rights will result in a reduction of investment in vital high-tech sectors. Russia's inability to cope with the requirements of the 1991 bilateral U.S.–Russia agreement on protecting intellectual property rights in optical media shows that it is unprepared to meet the WTO standards on IPR.²⁷

CONCLUSION

Russian President Vladimir Putin understands that only the West has the capacity to become the principal source of investment capital for Russia and a substantial market for its energy resources. Putin and Prime Minister Mikhail Kasyanov have stated that Russia is eager to join the WTO and will become a reliable trade partner and energy supplier

for the West, regardless of what may happen to the flow of oil from the Middle East. The lack of WTO membership slows both trade and investment activity in Russia.

At the May summit meetings with Putin, President Bush should publicly support Russia's accession to the WTO by 2003 or 2004, provided its negotiations with the WTO in all sectors have been completed successfully. Russia's accession will facilitate political and economic reforms and promote cooperation with the United States and its allies in the war against terrorism.

Given Russia's increasing importance as a strategic partner of the United States in the war on terrorism and the growth in its economy over the past three years, Russia's accession is clearly in America's interests. The United States, however, should insist that Russia follow the universal requirements for WTO membership that all candidate countries must satisfy, including decisive measures to protect intellectual property rights, eliminate and reduce tariffs, create a non-discriminatory and transparent environment for foreign goods and services, and reform the banking sector.

—Ariel Cohen, Ph.D. is Research Fellow in Russian and Eurasian Studies in the Kathryn and Shelby Cullom Davis Institute for International Studies at The Heritage Foundation.

27. U.S. Department of Commerce, "NIS: Intellectual Property Rights—301 Watch List," at <http://www.bisnis.doc.gov/bisnis/country/000731BNAIPR301.htm>.