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Russia's Accession to the WTO

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William H. Cooper
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

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Summary

In 1993, Russia formally applied for accession to the General Agreement on Tariffs and Trade (GATT). Its application was taken up by the World Trade Organization (WTO) in 1995, the successor organization of the GATT. Russia's application has entered into its most significant phase as Russia negotiates with WTO members on the conditions for accession.

Accession to the WTO is critical to Russia and its political leadership. President Vladimir Putin has made it a top priority. He views accession as an important step in integrating the Russian economy with the rest of the world and in fostering economic growth and development by attracting foreign investment and by lowering trade barriers. For the United States, the European Union (EU) and other trading partners, Russia's accession to the WTO could increase stability and predictability in Russia's foreign trade and investment regime.

The Russian accession process is moving forward, but differences over some critical issues remain, making the time for Russian accession to the WTO uncertain. The European Union and the United States have raised concerns about Russian energy pricing policies which allow natural gas, oil, and electricity to be sold domestically far below world prices providing, they argue, a subsidy to domestic producers of fertilizers, steel, and other energy-intensive goods. Russia counters that the subsidies are not illegal under the WTO. Concerns regarding Russian trade barriers in the services sector, high tariffs for civil aircraft and autos, and intellectual property rights have slowed down the process and made the original target of completion in 2003 unattainable.

Congressional interest in Russia's accession to the WTO is multifaceted. Members of Congress are concerned that Russia enters the WTO under terms and conditions in line with U.S. economic interests, especially gaining access to Russian markets as well as safeguards to protect U.S. import-sensitive industries. Some Members also assert that Congress should have a formal role in approving the conditions under which Russia accedes to the WTO, a role it does not have at this time. The Congress has a direct role in determining whether Russia receives permanent normal trade relations (NTR) status which has implications for Russia's membership in the WTO and U.S.-Russian trade relations. Without granting PNTR to Russia, the United States would not benefit from the concessions that Russia makes upon accession. This report will be updated as events warrant.

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Accession to the WTO is critical to Russia and its political leadership. President Vladimir Putin has made it a top priority. He views accession as an important step in integrating the Russian economy with the rest of the world and in fostering economic growth and development by attracting foreign investment and by lowering trade barriers. For the United States, the European Union (EU) and other trading partners, Russia's accession to the WTO could increase stability and predictability in Russia's foreign trade and investment regime.

Congressional interest in Russia's accession to the WTO is multifaceted. Members of Congress are concerned that Russia enters the WTO under terms and conditions in line with U.S. economic interests, especially gaining access to Russian markets as well as safeguards to protect U.S. import-sensitive industries. Some Members also assert that Congress should have a formal role in approving the conditions under which Russia accedes to the WTO, a role it does not have at this time. The Congress has a direct role in determining whether Russia receive permanent normal trade relations (NTR) status which has implications for Russia's membership in the WTO and U.S.-Russian trade relations. Without granting PNTR to Russia, the United States would not benefit from the concessions that Russia makes upon accession.

This report examines the issue of Russia's accession to the WTO, focusing on the implications for Russia, the United States, and the WTO. It begins with a short overview of the WTO accession process and reviews the history of the Soviet Union's relationship with the GATT/WTO. It provides a brief discussion of Russian economic conditions and the status of economic reforms as they are a major impetus for Russia's application to join the WTO. The focus of the report is the status of Russia's accession application and the outstanding issues. The report concludes with an analysis of the implications of Russia's accession to the WTO for Russia, the United States, the other WTO members and for the WTO itself and an analysis of the outlook for the Russia's application. This report will be updated as events warrant.

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[1] These agreements include the General Agreement on Trade in Services (GATS) and the agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), among others.

The WTO and the Accession Process

The WTO's membership of close to 150 countries and customs areas spans all levels of economic development, from the least developed to the most highly developed economies. The WTO came into existence in January 1995 as a part of the agreements reached by the signatories to the General Agreement on Tariffs and Trade (GATT) at the end of the Uruguay Round negotiations. The WTO's primary purpose is to administer the roughly 60 agreements and separate commitments made by its members as part of the GATT (for trade in goods), the General Agreement on Trade in Services (GATS — for trade in services), and the agreement on trade-related aspects of intellectual property rights (TRIPS).

The membership in the GATT/WTO has grown exponentially. The GATT was originally founded in 1947 by 23 countries, and the WTO now has 148 members. Among the most recent entrants are China and Taiwan, which joined on December 11, 2001, and January 1, 2002, respectively, Armenia which joined on February 5, 2003, and the Former Yugoslavian Republic of Macedonia, who joined on April 4, 2003. Membership in the WTO commits its members to fundamental principles in trade with other members, including:

- **Most-favored nation treatment (MFN)**: The imports of goods and services originating from one member country will be treated no less favorably than imports of goods and services from any other member country. MFN is to be unconditional. In practical terms, this means that in most cases a country cannot apply a higher import tariff to a good from one member country than it applies to like goods from any other member country.

- **National treatment**: Imports of goods and services are treated no less favorably than like goods and services produced domestically. In practical terms this means that governments cannot discriminate against imports in the application of laws and regulations, such as regulations to protect consumer safety or the environment.

- **Transparency:** Government laws and regulations that affect foreign trade and investment are to be published and available for anyone to see. Procedures to implement the laws and regulations are to be open.

- **Lowering Trade Barriers Through Negotiations:** Since the GATT's creation, its members have conducted eights rounds of negotiations to lower trade barriers. At first these negotiations focused on lowering tariffs. But over time, the rounds have broadened GATT/WTO coverage to include nontariff barriers, such as discriminatory government procurement practices, discriminatory standards, and trade-distorting government subsidies. The last completed round, the Uruguay Round (1986-94), resulted in the most ambitious expansion of rules to cover, for the first time, trade in agricultural products and services and government policies and practices pertaining to intellectual property rights protection and foreign investment regulations that affect trade.

- **Reliance on tariffs:** In order to promote predictability and openness in commerce, the WTO requires member countries to use tariffs and avoid using quotas or other nontariff measures when restricting imports for legitimate purposes, such as on injurious imports.

As part of its function to administer the rules established under the agreements, the WTO provides a mechanism for the settlement of disputes between members where the dispute involves alleged violations of WTO agreements. Moreover, each member's trade regime is reviewed by the WTO Secretariat from time-to-time to ensure that it conforms to WTO rules. Trade among WTO members accounts for about 90% of total world trade. [2]

The collapse of the Soviet Union and its East European Bloc and the movement of many developing countries toward liberal trade policies have spurred interest in joining the WTO. Article XII of the agreement that established the WTO sets out the requirements and procedures for countries to "accede." "Any state or customs territory having full autonomy in the conduct of its trade policies is eligible to accede to the WTO on terms agreed between it and WTO members."

The accession process begins with a letter from the applicant to the WTO requesting membership. The WTO General Council, the governing body of the WTO when the Ministerial Conference is not meeting, forms a Working Party (WP) to consider the application. Membership on the WP is open to any interested member-country. More than sixty member countries, including the United States, are part of the WP. The U.S. delegation is led by the Assistant U.S. Trade Representative for WTO and Multilateral Affairs and includes representatives from the U.S. Departments of Commerce and Agriculture.

The applicant submits a memorandum to the WP that describes in detail its current trade regime. The applicant and the WP then negotiate to determine what legislative and structural changes the applicant must make to meet WTO requirements and to establish the terms and conditions for entry of the applicant into the WTO. The WP's findings are then included in a "Report of the Working Party" and are the basis for drawing up the "Protocol of Accession."

While it negotiates with the WP, the applicant must also conduct bilateral negotiations with each interested WTO member. During these negotiations the WTO member indicates what concessions and commitments on trade in goods and services it *expects* the applicant to make in order to gain entry, and the applicant indicates what concessions and commitments it is *willing* to make until the two agree and set down the terms. The terms of the bilateral agreements are combined into one document which will apply on an MFN basis to all WTO members once the applicant has joined the WTO. The accession package is conveyed to the General Council or Ministerial Conference for approval.

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[2] Based on WTO background information located at [http://www.wto.org].

Article XII does not establish a deadline for the process. The length of the process depends on a number of factors: how many legislative and structural changes an applicant must make in its trade regime in order to meet the demands of the WP, how quickly its national and sub- national legislatures can make those changes, and the demands on the applicant made by members in bilateral negotiations and the willingness of the applicant to accept those demands. Because WTO accession is a political process as well as a legal process, its success depends on the political will of all sides — the WTO member countries and the applicant country. A formal vote is taken in the WTO that requires a 2/3 majority for accession, although in practice the WTO has sought to gain a consensus on each application. The process can take a long time: China's application took over 15 years.

The Soviet Union and the GATT/WTO

The Soviet Union was not invited to become a contracting-party of the GATT in 1947 after it declined to join the International Monetary Fund (IMF) and the World Bank — the other two multilateral organizations that resulted from the Bretton Woods conference immediately following the end of World War II. In fact, Soviet trade and economic policy conflicted with the principles of the GATT. The GATT was based on removing barriers to trade and on developing economic interdependence among countries. Soviet foreign economic policy was largely based on the concept of self-sufficiency — the domestic economy would produce as much as possible for itself and import only those products which it could not produce. Exports were used merely to buy necessary imports, not to build markets. These economic policies helped to bring about the collapse of the Soviet Union. The Soviet Union modified the concept of self-sufficiency to include members of the Soviet Bloc- the East European countries, some Asian communist countries and Cuba, confining most of its trade with these countries in a system of limited international division of labor. Only a small amount of trade was conducted outside the Bloc. The Soviet Union spearheaded the formation of the Council for Mutual Economic Assistance (CMEA), what could be loosely described as the Soviet Bloc's version of the GATT.

In August 1986, the Soviet Union applied to take part in the Uruguay Round negotiations of the GATT as an observer with the intention of becoming a full member. The United States and other Western industrialized countries opposed the request because of the Soviet Union's central planning economic system.[3] In 1990, however, the Soviet Union received observer status to the Uruguay Round negotiations after GATT signatories, including the United States, concluded that the Soviet Union was moving toward becoming an open economy under President Mikhail Gorbachev.

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[3] It should be noted that other nonmarket economies had acceded to the GATT, albeit under special conditions: Poland (1967); Hungary (1973); and Romania (1971). The United States was also concerned that the Soviet Union intended to use GATT membership for political purposes. The Soviet Union sought observer status once before in 1982. Kennedy, Kevin C. The Accession of the Soviet Union to the GATT. *Journal of World Trade Law*. April 1987. p. 23-39.

After the collapse of the Soviet Union in 1991, Russia retained the observer status held by the Soviet Union and, in June 1993, it formally applied to accede to the GATT. On June 16, 1993, the GATT established a working party on Russia's accession and, in January 1995, the application was converted to an application to become a member of the WTO.

Russian Economic Conditions and Reform: An Impetus for Joining the WTO

Russia's motivation for and progress toward accession to the WTO are directly related to efforts to dismantle the Soviet economic system of central planning and replace it with a more market-based economy. President Putin has made entry into the WTO a top priority, because he sees it as a mechanism for overcoming the political hurdles that have impeded economic restructuring. The possibility of accession to the WTO has been an opportunity for him to get some significant economic reform legislation through the Russian parliament. Many Russian and foreign experts have argued that these reforms and more are necessary if Russia is to achieve long-term economic growth and development. At the same time, a number of economic interest groups that favor the status-quo, such as agriculture, the auto industry, and raw material producers, have fought against economic reforms and oppose Russian accession to the WTO.

Domestic Economic Conditions

Russia has enjoyed economic growth (measured in annual changes in GDP) since 1999. Russian GDP increased 5.4%in 1999, 9.1% in 2000, and 5.0% in 2001, and 5.3% rate in 2002.[4] But the growth occurred after a long period of economic stagnation during the final years of the Soviet Union and a deep recession/depression during the 1990s. According to one estimate, the level of Russian GDP in 2000 was still 21% below its level of 1992.[5] Many specialists have attributed the economic growth to the depreciation of the ruble and to the rise in world energy prices at the end of the 1990s.

However, Russia has been plagued by economic problems including a high poverty rate and poor health conditions. In addition, economic growth has taken place unevenly throughout the country with the major cities of Moscow and St. Petersburg and regions well-endowed with marketable natural resources accounting for most of the economic growth, while less fortunate regions remained stagnant or have become poorer. Moreover, income distribution among the Russian population has become increasingly unequal as a small portion of the population acquires larger shares of wealth.

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4 *Russian Economic Trends.* October 14, 2002. p. 16 and Goskomstat. *Basic Economic and Social Indicators.* [http://www.gks.ru].

5 U.S. Congress. Joint Economic Committee. *Russia's Uncertain Economic Future.* William Cooper. *Russia's Economic Performance: Entering the 21st Century.* 107th Congress. 1st Session. S. Prt. 107-60. p. 6.

Russian Foreign Trade, Investment, and Debt

Since the collapse of the Soviet Union, the Russian economy has become more open to the rest of the world. The role of foreign trade in the Russian economy has grown. By 2002, Russian exports were equivalent to 30.6% GDP and imports were equivalent to 17.5% of GDP.[6] Russian foreign trade has become more geographically diverse. By 2002, most of Russian foreign trade took place outside the former Soviet Union — only 15% of Russian exports and 22% of Russian imports were with former Soviet states.[7]

However, the commodity composition of Russian export markets has become less diverse. Russia is increasingly dependent on exports of fuels and raw materials. In 2002, fuels, including crude oil and natural gas, made up 54.6% of Russian exports, an increase from 40% in 1993. In 2002, machinery and equipment made up only 9.5% of Russian exports, a decrease from 14% in 1993.[8] This trend indicates that Russia's manufacturing sector has not been able to achieve global competitiveness to date. Therefore, Russia has been reluctant to make commitments in the WTO accession negotiations that would further expose its manufacturing sector to global competition.

Russia has enjoyed sizeable foreign trade surpluses over the past few years largely because of the rise in the value of Russian fuel exports resulting from higher world fuel prices and because of the import-substitution driven by the ruble devaluation after 1998. Russia had a current account surplus of $35.0 billion in 2001 and a surplus of $32.8 billion in 2002.[9]

Russia's record on the capital account side of the balance of payments has not been as stellar. From 1991 through 2003, only about $26.1 billion in foreign direct investment *flowed into* Russia. At the same time, $2.8 billion in foreign direct investments *flowed out* of Russia to other countries.[10] In contrast, *in one year alone* (2001), $44.2 billion in foreign direct investment flowed into China.[11] Russia is substantially behind other former Communist states, such as Hungary, Poland, and the Czech Republic in terms of foreign direct investments on a per capita basis and is even behind such former and poor Soviet states as Armenia, Azerbaijan, and Kazakhstan.[12]

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[6] Calculations based on data found in Economist Intelligence Unit. *Country Report: Russia.* March 2003. p. 5.

[7] CRS calculations based on data in IMF. *Direction of Trade Statistics*. September 2002. p. 216.

[8] Slay, p. 34 and EIU. Country Profile. *Russia.* March 2003. p. 33.

[9] IMF. *International Financial Statistics.* May 2003. p. 922.

[10] OECD. *OECD Investment Policy Reviews: Russian Federation — Progress and Reform Challenges.* p. 24-25. Paris. 2004.

[11] IMF.

[12] Slay, p. 34.

Russia also has a huge volume of foreign debt. At the end of 2002, Russia's foreign debt totaled $153 billion, $62 billion of which was leftover from the Soviet Union. However, Russia's budget surpluses and strong foreign reserve position have allowed it to pay down the debt to $147 billion in 2002 from $175 billion in 1999.[13]

Russian Economic Policy and Restructuring

Russia's transition from central planning was bound to be more difficult and longer than that of the Central and East European states. The communist system was much more entrenched in the Soviet Union than it was in the rest of the Soviet Bloc. Furthermore, Russia does not have a legacy of a market economy to draw on as is the case with some of the Central and East European countries. Russia has had to deal with the legacy of a Soviet economy that was administered to meet the needs of the military while civilian production and investment were given low priority.

However, Russia's economic problems also were the result of policy failures during the transition. These failures included loose monetary and fiscal policies early in the transition period. They have also included structural problems such as poorly developed and executed privatization programs that have left many potentially productive assets in the control of enterprise mangers from the Soviet period or in the hands of a few politically-connected individuals ("oligarchs") who extracted the value from many of these assets rather than making them commercially viable for the long run. In addition, an inefficient banking system, the lack of private land ownership protection, the absence of adequate commercial laws, and an inefficient and corrupt government bureaucracy have inhibited economic growth and development.

Despite the setbacks, Russia has made some important strides:

- The government has eliminated price controls on most goods and services. This reform has been important because it allows the market forces of supply and demand to guide producers and consumers on purchasing, production and investment. Controls have remained on some important items, such as energy, housing, and transportation, but these, too, are to be removed eventually.

- The structure of Russian production more closely resembles that of an open economy than of a militarized economy. For example, the services sector, once a minor part of Soviet economy, has emerged in the post-Soviet Russian economy and now accounts for more than half of national output.

- The private sector has grown and accounts for roughly 3/4 of national output.

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[13] Economist Intelligence Unit. *Country Profile 2002 — Russia.* p. 50 and EIU on line at [http://countrydata.bvdep.com/cgi/template.dll?product=101&user=ipaddress]

Since taking the reins of power, President Putin has forced Russia into a new phase of economic reform. Putin has enjoyed a high degree of popularity among the Russian people that has translated into overwhelming political clout in the Russian parliament. In addition, the continuing period of economic growth has provided a window of opportunity for Putin and his government to tackle economic restructuring. He has been able to push important economic legislation through the Russian parliament: tax reform; land reform; reform of government bureaucracy to make it more responsive to the needs of the economy rather than an impediment to development and growth; judicial reform; and improvement in corporate governance, especially the protection of minority shareholders' rights.

Still, the fragile basis of Russia's economic growth strongly suggests that Russia has far to go in economic reform. Analysts point to Russia's weak and underdeveloped financial sector, poorly developed system of commercial laws, and confusion over federal vs. regional and local responsibilities in important economic policy areas. Furthermore, even though Russian laws have been passed to restructure the economy, the success of their implementation remains to be seen. With parliamentary elections coming in December 2003, and with President Putin up for re-election in 2004, many observers question whether the Kremlin will push politically difficult reforms whose immediate costs could be substantial and whose benefits might be realized only in the long-run.

Russia's Foreign Trade and Investment Regimes and Policies

In determining the terms and conditions for Russia's accession to the WTO, WP members scrutinize Russia's foreign trade and investment regimes and policies to ascertain to what degree they conform to WTO rules and where Russia needs to change. Russia has made significant strides in that regard. It eliminated two important pillars of Soviet central planning in November 1991, the state monopoly on foreign trade and the ban on foreign investment in the Russian economy.

In October 1992, another legacy of central planning was eliminated when the Russian ruble was made convertible into foreign currencies and multiple exchange rates were eliminated. A dual exchange rate was briefly introduced in January 1999 as a result of the August 1998 financial crisis but was eliminated in June 1999. In the early to mid-1990s, the Central Bank imposed fixed or pegged exchange rates in an attempt to control ruble depreciation. Since the August 1998 crisis, the ruble has been allowed to float but the Central Bank of Russia intervenes by buying or selling rubles. The ruble has remained relatively stable since 1999.

In 1992, the Russian government adopted the Harmonized Tariff System that is used by WTO members, and it maintains a system of two-column tariff rates — MFN and non-MFN tariff rates. Tariff rates on non-agricultural products range from 0 to 30%. Some countries receive tariff advantages under Russia's Generalized System of Preferences(GSP) program in the form of tariff rates that are 25% below the MFN rate. A tariff-rate quota is applied to imports of sugar from countries receiving Russian GSP treatment.[14] Of the more than 11,000 commodity categories in the Russian tariff tables, only fifty have tariff rates above 30%.

Over time, the Russian government has lowered tariff rates. In 1995, the trade-weighted average tariff rate was 16.0%; by 2001 it was 11.1%.[15] Most products can be traded without restrictions, but the government requires exports and imports of some products, for example, pharmaceuticals, alcoholic beverages, precious metals and stones, to be licensed.[16] Russia also applies export tariffs on oil to ensure that domestic oil supplies are adequate and to compensate for the large differential between domestic and export oil prices. In 1998, the Russian government passed laws to provide for antidumping, countervailing, and safeguards measures against imports. Legislation is pending in the Russian parliament to revise them.

The Status of the Accession Process and Outstanding Issues

In early 1995, Russia submitted to the working party(WP) the "Memorandum on the Foreign Trade Regime" which describes the structure of its foreign trade regime and also the structure, policies, and practices of its economy that would likely affect its conduct of trade.[17] Subsequently, the WP members submitted questions based on the memorandum, to which the Russian delegation replied. The process of submitting the original description of the trade regime, followed by a series of questions and replies established a benchmark on which the negotiations to determine the terms and conditions of Russia's accession would be based. The initial series of questions, replies and follow-up responses indicated strong concerns by the WP members in a broad range of areas including privatization, property rights, price controls, government financial support for business, and the structure and implementation of the tax regime.[18]

The Russian accession process is now at a critical stage. As with most negotiations, however, the last stages are the most difficult because negotiators now face the most contentious issues.[19] In November 2002, the WP released a draft report of the negotiations that indicates areas of agreement and bracketed text that indicates

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[14] GSP is a program under which a country gives preferential tariff treatment to imports from developing countries. Many industrialized countries have GSP programs to encourage economic growth and development in developing countries.

[15] WTO. Draft Report of the Working Party. WT/ACC/SPEC/RUS/25/Rev.1 p. 124

[16] Some working party members wanted to be assured that Russian traders were not favored over foreigner traders in license approval process. Ibid. p. 19-23.

[17] WTO L/7410

[18] World Trade Organization. *Accession of the Russian Federation: Questions and Replies to the Memorandum on the Foreign Trade Regime.* Geneva. June 2, 1995. WT/ACC/RUS/2

[19] World Trade Organization. *Draft Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization.* WT/ACC/SPEC/RUS/25/Rev.1

areas of continuing disagreement. According to the draft report and other reports of the negotiations, the United States, the European Union, and other participants have strong reservations about Russian policies and practices on intellectual property rights, energy pricing, agriculture, sanitary and phytosanitary regulations, trade in services, civil aircraft, and other issues. Russia's accession to the WTO will likely hinge on the resolution of these issues, which are examined below in more detail.

Energy Pricing

The energy sector dominates the Russian economy. Not only do oil, natural gas, and electricity drive industry and provide heat to residents, but energy is also the largest Russian export and hard currency earner. The current structure of Russia's energy sector is largely a legacy of the Soviet Union. The oil industry has been broken up into several privatized companies. Natural gas and electricity are largely monopolies run by Gazprom and United Energy Systems (UES), respectively, which are joint-stock companies with significant government ownership. The structures of these companies are now the subject of reform, but that process has proved politically controversial and therefore slow.

Domestic prices for Russian energy are regulated by the government while exports of energy products command world prices. Domestic prices are lower than world prices, in some cases significantly. The EU and the United States have pointed out that the gap between the world price for natural gas and the Russian domestic price has been as large as six to one, for electricity — five to one, and for oil — four to one.[20] The "dual pricing" is partially a result of a policy of providing affordable heating and electricity to residential customers regardless of ability to pay and providing favorable fuels rates to enterprises and to government agencies, such as the military.[21]

Some WP members, particularly the EU, and to a lesser extent the United States, have raised concern that dual energy pricing gives Russian manufacturers an unfair competitive advantage and would be illegal under the WTO subsidy agreement.[22]

WTO disciplines regarding subsidies are contained in the "Agreement on Subsidies and Countervailing Measures." Under the agreement, a subsidy is actionable only if it is a "specific subsidy," that is, it is a subsidy that is available only to an enterprise, an industry, a group of enterprises or industries in the country that gives the subsidy. The agreement defines three kinds of subsidies:

- Prohibited subsidies are ones that distort international trade, for example, subsidies that require recipients to meet exports targets or to use domestic products. These subsidies must be eliminated;

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[20] Ibid. p. 16.

[21] OECD. *OECD Economic Surveys 2001-2002: Russian Federation.* p. 125.

[22] Ibid. p. 17.

otherwise, the country that complains about them can take countermeasures.

- Actionable subsidies are not prohibited unless it is determined that the subsidy causes injury. If such a determination is made, then the complaining country can impose a countervailing duty.

- Non-actionable subsidies are non-specific, or are specific subsidies for industrial research or development activity, for assistance to disadvantaged regions, or for adapting existing facilities to new environmental laws or regulations. They cannot be challenged in the WTO.[23]

European and U.S. fertilizer producers have been strong opponents of Russia's energy pricing policies because natural gas is a significant input in fertilizer production, accounting for 3/4 of the final price, according to one estimate.[24] The Russian government and Russian delegates to the WTO negotiations have strongly argued that Russian energy prices are not an actionable subsidy under WTO rules because they are available to all industries. They assert furthermore, that Russia's domestic energy prices reflect its comparative advantage in energy production. To date the dual energy pricing issue is still a huge roadblock, especially for the EU, in Russia's accession to the WTO.

Intellectual Property Rights Protection

WTO members are calling on Russia to be in full compliance with the WTO agreement on trade-related aspects of intellectual property rights (TRIPS) at the time of its accession, in terms of laws in place and enforcement. All WTO members are bound by the provisions of the TRIPS agreement, which was designed and ratified to introduce predictability and order to IPR protection in all WTO members, because it has become an important factor in international trade. The TRIPS agreement requires WTO members to apply the fundamental principles of national treatment and most-favored-nation treatment in intellectual property rights protection. The agreement also requires WTO members to ensure protection of copyrights, trademarks, geographical indicators of products, and patents by imposing and enforcing appropriate laws.[25]

Russia has passed a number of laws on IPR protection and is a member of the major multilateral intellectual property rights conventions. Russia has committed to IPR protection in bilateral agreements with the United States and other trading partners. However, foreign investor and exporters have complained that the Russian government has not adequately enforced its laws allowing intellectual property piracy

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[23] The description of the agreement is taken from "What is the WTO?" located on the WTO website: [http://www.wto.org].

[24] *International Trade Reporter.* November 7, 2002. p. 1904.

[25] The description of the agreement is taken from "What is the WTO?" located on the WTO website: [http://www.wto.org].

to continue and grow with impunity — culprits are either not caught, or if caught they are not punished.[26]

U.S. producers of copyrighted material have cited unauthorized Russian reproduction of American-made films, videos, sound recordings, books, and computer software as a source of lost revenues. Recently, Russian production of pirated DVDs has increased and has been a special source of concern. Losses due to intellectual piracy of U.S. products in Russia in 2002 are estimated at $755.8 million dollars.[27] The production of counterfeit American products has become so large that they now make up the vast majority of Russian purchases of these products.[28] Russia has argued that its enforcement of intellectual property rights is improving, and that it should not be singled out since intellectual piracy continues to take place in WTO member countries.

Agriculture

Agriculture has been a sensitive part of the economy throughout Russian/Soviet history. Its political importance far outweighs its share of the Russian economy (7.2% of Russian GDP in 2001).[29] Agriculture has been severely affected by the transition to a market economy as much as, or more than, any other sector of the economy. According to one estimate, agricultural production declined around 40% in volume terms since 1991, much of the decline occurring in livestock production.[30]

Several factors have contributed to the downturn. One factor is Soviet agriculture policy. The Soviet government determined what and how much the economy should produce and directed resources accordingly. In the 1960s, the government decided that the Soviet people should eat more meat, and it subsidized animal feed production and imports of animal feed to fulfill this objective. The government set meat prices at a low level to make it affordable to consumers. However, after the collapse of the Soviet Union, market prices were instituted and state subsidies were dramatically cut, increasing the cost of meat production.[31] Furthermore, when the Russian government liberalized trade, Russian producers of poultry and other meats could not compete with foreign producers who could sell them more cheaply. While the Russian federal government has cut support, local and regional governments have continued to provide assistance in the form of equipment, favorable credits, and export subsidies. They are concerned about food security and unemployment and about maintaining the supply of housing, education, and other

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[26] Office of the U.S. Trade Representative. *National Trade Estimate Report on Foreign Trade Barriers.* April 2003. p. 335.

[27] The estimates are according to the International Intellectual Property Rights Alliance (IIPA), a non-profit group representing copyright-based industries. [http://www.iipa.com.]

[28] Office of the U.S. Trade Representative. p.335.

[29] Economist Intelligence Unit. *Country Profile 2002: Russia.* p. 58.

[30] Liefert, William. *Agricultural Reform: Major Commodity Restructuring but Little Institutional Change.* in Joint Economic Committee. p. 278.

[31] Ibid.

services that state farms provided to the rural communities during the Soviet period and continue to provide.

A second factor contributing to the decline in agricultural production has been the slow pace of restructuring of Russian farms. Despite the introduction of privatization, the vast majority of former state and collective farms remain intact as joint stock operations or cooperatives and operate in virtually the same inefficient manner as they did under the Soviet government.

The Russian federal government is under pressure from regional and local governments and from factions within the Russian parliament to protect agriculture from further erosion and to provide time and resources to permit it to become competitive. This pressure has translated into a difference in positions in the accession negotiations between Russia and agricultural exporting countries including the United States, Canada, and Australia over the level and longevity of government support to agriculture. The Russian government has argued for higher levels and longer phase-out periods for supports than its negotiating partners are willing to accept. Russian negotiators have also asserted that it should not be required to bind itself to dramatically lower support levels during the accession process while other WTO members are currently in the process of negotiating the agriculture subsidies in the current round of WTO negotiations, Doha Development Agenda (DDA). The WTO members have argued that the subsidies that Russia wants to maintain distort trade and are concerned that they give Russian agriculture producers an unfair advantage. The Russian side has argued that without government support, Russian agriculture could not compete with EU and U.S. agriculture, both of which receive sizeable government subsidies.[32]

Another controversy in agriculture has emerged over Russia's recent decision to restrict meat imports. On January 23, 2003, the Russian government announced it would impose a three-year quota on poultry imports effective May 1, 2003. At the same time the government announced tariff-rate quotas (TRQs) on imports of beef and pork effective April 1, 2003, and to remain in effect until 2010.[33] Meat exporting WTO member- countries, including the United States, Canada, Argentina, Australia, and New Zealand, have expressed stiff opposition, claiming that the restrictions may retard the process of Russia's accession to the WTO. They specifically argue that Russia has violated the "standstill" principle under which countries applying for WTO membership are to refrain from imposing new trade restrictions during the accession process. Russia counters that it is imposing the

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[32] Bush, Keith. *Russian Economic Survey.* April 2003. p. 25.

[33] USDA. Foreign Agricultural Service. Russian Federation Livestocks and Products. *Gain Report # RS3006.* . February 20, 2003. p. 7. USDA. Foreign Agricultural Service. Russian Federation Poultry and Products. *Gain Report.* #RS3001. February 10, 2003. p. 1. TRQs are restrictions in which a limited volume of a product can be imported at one tariff rate but imports above that limit can be imported only at another, usually much higher tariff rate.

restrictions to protect its domestic meat producers from import surges, a right that is enjoyed by WTO members.[34]

During the Uruguay Round, WTO members agreed to expand disciplines over trade in agricultural products, and agricultural trade is on the agenda of the current round, the DDA. Under the Agricultural Agreement all WTO members, except least developed countries, are committed to reduce tariffs and subsidies on the production and export of agricultural goods.[35]

Sanitary and Phytosanitary Regulations

Some WP members have raised concerns over Russia's sanitary and phytosanitary (SPS) standards, that is standards and certification procedures that determine the safety of meats and other animal products, plants, and plant products. They argue that these procedures are not scientifically based and discriminate against imports thus violating WTO rules. Under the Agreement on Sanitary and Phytosanitary Measures (SPM), WTO members are permitted to apply controls on products in order to protect public health and safety, but those controls must be scientifically based and must not discriminate against imports.[36] Russia has argued that its SPS controls meet the requirements of the SPM agreement.

The United States has expressed particular concern about this issue. In March 2002, the Russian government imposed a ban on imports of U.S. poultry because of the possible presence of avian influenza. Russia had become the largest market for U.S. exports of chicken. After months of negotiations, the United States and Russia agreed in August 2002 on a new veterinary certificate for U.S. poultry that would include inspections by Russian veterinarians of U.S. processing and storage facilities, but technical issues remained that prevented the process from being implemented. On April 3, 2003, the two sides announced the resolution of the problems, allowing the inspection of the facilities to go forward and U.S. poultry exports to resume.[37] Nevertheless, the United States is concerned that Russia would impose similar restrictions in the future and has pressed Russia to adhere to the WTO requirements as part of the conditions of its accession.

Services

Services, especially financial services (banking, insurance, and securities), are a relatively new phenomenon in the Russian economy. Under the Soviet Union, services were government-owned and operated and were confined to personal services (for example, lodging, hair salons, restaurants). They were not well developed because they were not a government priority. Financial services were virtually non-existent in the Soviet Union because their function as intermediaries between savers and borrowers of capital had no role in the Soviet planned economy.

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[34] *Inside U.S. Trade.* March 14, 2003.

[35] WTO. op. cit.

[36] Ibid.

[37] Ibid., p. 332. *Washington Trade Daily.* April 7, 2003. p. 1.

The services sector has grown rapidly during Russia's transition to a market economy but has not matured in most cases. The United States, the EU, and other advanced developed WTO members have argued that Russia needs an efficient financial services industry to promote economic growth and development and that opening the industry to foreign investment would introduce expertise and new capital.

Russian officials and business representatives claim that their service industries must have government protection as "infant industries," because they are too immature and would be wiped out if they had to face foreign competition too soon. An example is the fledgling Russian insurance industry. Private insurance companies have been developing since the government monopoly was removed after the collapse of the Soviet Union, but not sufficiently to meet demand. Foreign insurance companies that could help fill the gap and bring expertise and a wide range of products are restricted. For example, the government: limits total foreign capitalization to 15% of the domestic insurance industry; requires the general director and the chief accountant to be Russian citizens; restricts participation to foreign companies that have been in business no less than 15 years in their home country; and requires that foreign insurance companies operate as a minority shareholder in a Russian insurance company before they can be granted their own license. In addition, foreign providers are prohibited from underwriting and reinsuring mandatory insurance — auto and health insurance and insurance taken out by government entities — the fastest growing insurance market in Russia.[38] Russian negotiators assert that those restrictions should remain while U.S., EU, and other working party participants want them loosened or removed.

The Russian banking sector is similarly underdeveloped. About 30% of the volume of Russian banking activity is conducted by two banks — Sberbank and Vneshtorgbank, both of which are owned by the Central Bank of Russia. Sberbank holds roughly 70% of the Russian savings deposits. Foreign participation in the banking sector is restricted by government laws and regulations. Foreign banks may operate in Russia only as subsidiaries and not as branches of the parent bank. Foreign banks have cited the lack of an effective deposit insurance program as a disincentive for new, private banks to develop. The government in effect backs deposits of Sberbank 100%.[39] Russian negotiators claim that the government will establish a deposit insurance program for deposits in all banks but argues that the limit on foreign participation in Russian banking must be maintained to allow domestic banks to become competitive.[40] U.S. negotiators and negotiators from some of the other working party countries are requesting that Russia liberalize its banking

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[38] Vastine, Bob and Vladimir Gololobov. Moscow and the WTO: A Unique Chance to Modernize Russia. *European Affairs.* Winter 2003. The Russian Ministry of Finance has proposed that the ban on foreign company issuance of compulsory insurance be lifted. EIU. *Country Report: Russia.* March 2003. p. 28.

[39] Coalition of Service Industries. *CSI Background Paper on Russian Banking Services.* May 22, 2002.

[40] Legislation to establish deposit insurance for other Russian banks is pending in the lower house of the Russian parliament, the Duma, but has not received action. *Reuters.* June 3, 2003.

sector to increase foreign participation, arguing that the foreign influence would increase, not undermine, the competitiveness of Russian banks by promoting stability and popular confidence. Furthermore, a liberalized banking sector would likely boost other sectors of the economy.

In telecommunications, Russia permits 100% foreign ownership of telecommunication services providers, but it has requested to be bound by a commitment of only 49% foreign ownership. U.S. and EU negotiators oppose such a ceiling because they view the Russian telecommunications market as potentially lucrative for its firms. The Russian government has also indicated it wants long distance and international telephone communications to remain in the control of a monopoly, Rostelcom, until 2010.[41]

WTO rules on trade in services, including financial services, are contained in the General Agreement on Trade in Services (GATS) which was agreed to during the Uruguay Round. In general, the GATS is designed to apply internationally accepted rules, such as most-favored-nation treatment, to trade in services that are similar to those applied to trade in goods. In important respects, however, the GATS is less comprehensive than the GATT. For example, WTO rules on goods trade contained in the GATT apply to all goods, but many of the rules, contained in the GATS, including, “national treatment,” apply only to those services and the modes of delivery of those services on which that the member country has identified in its schedule of commitments.

Civil Aircraft

Russian aircraft manufacturers, as the case with the Russian defense-related industries in general, have seen demand for their production plummet after the government dramatically cut defense expenditures and after airlines from former Communist countries in Central and Eastern Europe and the former Soviet Union shifted to European and U.S. manufacturers for their aircraft. The Russian government wants to protect domestic aircraft manufacturers from further erosion of business. It imposes a 20% ad valorem tariff on imported aircraft. Russia argues that its aircraft industry is operating at only 0-15% of capacity and is in great need of modernization. For it to become competitive, it needs to be protected from foreign competition and therefore must apply high tariffs to imported aircraft. The United States and EU are pressing Russia to sign on to the plurilateral WTO Civil Aircraft Agreement (CAA) (only 26 members are currently signatories) which commits the signatories to eliminate tariffs on trade in civil aircraft and some related equipment. In an 1996 bilateral Memorandum of Understanding with the United States, Russia stated that it would sign the CAA but has backed off that commitment during the accession negotiations. Because its is a plurilateral agreement, a WTO member is not required to sign the CAA as part of its obligations.

Russia does grant some tariff waivers to allow domestic airlines to fulfill needs that cannot be accommodated by domestically manufactured aircraft. It has recently favored the European firm, Airbus Industries in granting those waivers. The United

[41] *Washington Trade Daily.* January 23, 2002.

States has demanded that the waivers should be granted without favoring any particular company.[42]

Other Issues

In addition to the above issues, the United States, the EU, and other working party members have raised other issues about Russia's trade and foreign investment regime and want Russia to make changes as part of the conditions for its accession to the WTO. They include:

- **Tariffs:** The Russian government has lowered tariffs on most categories of products in the tariff schedule. Nevertheless, it maintains high tariffs on some items to protect fledgling industries from foreign competition. High tariffs on autos, for example, have been a concern of U.S. manufacturers. Tariffs and excise taxes (that vary depending on the engine displacement) can add over 70% to the delivery cost of an imported new car. The Russian government also recently increased tariffs on used vehicles that are 3-7 years of age because they compete with Russian domestically produced new cars.[43] U.S., Japanese, and Korean delegations want Russia to lower tariffs on autos.[44] The Russian government asserts that the fledgling domestic auto industry requires some temporary protection from more developed foreign producers in order to become competitive.

- **Customs regulations:** Some WP members have argued that the implementation of federal customs regulations is inconsistent, leading to confusion and inhibiting trade. Some also raised problems with the policy of restricting trade of certain goods to specific ports, making it difficult for imported products to be delivered to customers. Legislation establishing a new customs code is pending in the parliament.

- **Import licensing:** The Russian government requires import licenses on certain products: pharmaceuticals, sugar (to implement a tariff-rate quota on sugar imported under Russia's Generalized System of Preferences program), precious metals and stones, and alcoholic beverages. Some WP members have expressed concern that Russia might impose additional licensing requirements that would further impede imports and are asking Russia to commit to removing import restrictions and not impose new ones that are not consistent with WTO requirements. Legislation to simplify the import licensing procedures is pending in the parliament.

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[42] USTR. p. 340.

[43] USTR. p. 333.

[44] *Moscow Times*. March 4, 2002. p. 12.

- **Government procurement:** WP members have requested that Russia join the plurilateral Government Procurement Agreement which commits signatories to open contracts for government purchases to bids from other signatory countries.

U.S.-Russian Economic Ties and WTO Accession

The United States has strongly supported Russia's accession to the WTO since Russia first applied to join the GATT in 1993. Most recently, President Bush reiterated U.S. support just prior to his June 1, 2003 summit meeting with Putin in St. Petersburg.[45] The U.S. government has provided advice to the Russian government on how to make its trade and investment regime WTO compatible and to educate Russian firms on the implications of WTO accession. Because the United States is the world's largest economy, its support is critical to the success of Russia's application. However, the United States has also insisted that Russia enter the WTO on "commercial terms," that is, on terms that do not distort trade, and that Russia immediately adhere to WTO agreements upon accession.

U.S. support for Russian accession is just one part of post-Cold War U.S. trade and economic policy that has encouraged Russian endeavors to establish a market economy. And the trade and economic policy is itself part of a larger U.S. foreign policy strategy to anchor Russia in the world community and to reshape the U.S.-Russian relationship into one of cooperation.

U.S. support to Russia in the trade and investment areas has come in the form of technical assistance, trade preferences (including tariff preferences under the U.S. GSP program), and financial assistance to U.S. exporters to and investors in Russia through the U.S. Export-Import Bank and the Overseas Private Investment Corporation (OPIC). Since 1992, the United States has granted Russia conditional normal trade relations (NTR), or most-favored-nation (MFN), status, which means that lower tariffs are applied to imports from Russia than was the case when Russia did not have NTR status.

U.S.-Russian trade and investment flows have increased in the post-Cold War reflecting the changed U.S.-Russian relationship, although they remain lower than what many observers consider their potential. U.S. imports from Russia have increased substantially since the end of the Cold War from $0.5 billion in 1992 peaking at $8.6 billion in 2003. U.S. exports have increased but not as significantly, from $2.1 billion in 1992 peaking at $3.6 billion in 1998 just before the financial crisis and declining to $2.4 billion in 2003. Since 1994, the United States has incurred small but growing trade deficits with Russia, peaking at $6.2 billion in 2003. The large increase in U.S. imports may reflect not so much an increase in the volume of trade but the rise in world prices of raw materials, particularly oil, that comprise the bulk of those imports.

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[45] Reuters. *Bush Says He Support Russian WTO Bid, Relations Good*. May 29, 2003.

Table 1. U.S. Merchandise Trade with Russia, 1992-2002
(Billions of Dollars)

Year	U.S. Exports	U.S. Imports	U.S. Trade Balances	Year	U.S. Exports	U.S. Imports	U.S. Trade Balances
1992	2.1	0.5	1.6	1998	3.6	5.7	-2.1
1993	3.0	1.7	1.3	1999	2.1	5.9	-3.8
1994	2.6	3.2	-0.6	2000	2.1	7.7	-5.6
1995	2.8	4.0	-1.2	2001	2.7	6.3	-3.5
1996	3.3	3.6	-0.3	2002	2.4	6.8	-4.4
1997	3.4	4.3	-0.9	2003	2.4	8.6	-6.2

Source: Compiled by CRS from U.S. Department of Commerce Data. Bureau of the Census. FT900.

Slow Russian economic growth and the rapid depreciation of the ruble after 1998 constrained demand for imports from the United States. Russia's limited export base has constrained U.S. demand for imports from Russia. In 2002 close to 70% of U.S. imports from Russia consisted of precious metals, inorganic chemicals, fuels, and aluminum.[46]

Although the United States is the largest source of foreign direct investment in Russia, the level of the investment is far below most expectations and limited in scope. U.S. investors accounted for $4.08 billion in foreign direct investment as of the end of 2001, largely in the transportation, fuel, communications, and engineering industries.[47]

U.S. exporters and investors claim that a number of factors make them cautious about entering the Russian market: the lack of adherence to international standards of accounting; weak enforcement of intellectual property rights; the lack of protection of share- holders rights; burdensome taxation; and poor legal protection of contract sanctity. These concerns are largely mirrored in the demands the United States has made on Russia during its negotiations in the WTO.

For their part, Russian policymakers have asserted that U.S. trade policy has also been slow to adjust to the post-Cold War era. For example, they point out that the United States only recently removed the "nonmarket economy status" that was

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[46] CRS calculations based on data from the Department of Commerce. Bureau of the Census.

[47] The island of Cyprus is the second largest source of foreign direct investments (considered largely the repatriation of offshore capital of Russian investors) with $3.72 billion and the Netherlands is the third largest source at $2.15 billion. U.S. Department of Commerce. International Trade Administration. *BISNIS Overview: U.S. Foreign Investment in Russia*.

applied in antidumping duty cases against Russian imports.[48] Under U.S. antidumping laws, "fair value" for imports from nonmarket economies is calculated differently than for imports from other economies. That methodology leads to higher dumping margins and antidumping duties and, therefore, placed imports from Russia at a competitive disadvantage vis-a-vis other imports or U.S. domestic production. In response to requests from Russian steel producers, the U.S. Department of Commerce examined the possibility of no longer treating Russia as a nonmarket economy and removed the designation on June 7, 2002.[49]

More critical for Russia has been the U.S. government's continued application of the Jackson-Vanik amendment to trade relations with Russia. Russia's current conditional NTR status from the United States is governed by Title IV of the Trade Act of 1974, as amended. Section 401 of Title IV requires the President to continue to deny NTR status to any country that was not receiving such treatment at the time of the law's enactment on January 3, 1975. In effect, this meant all communist countries, except Poland and Yugoslavia. Section 402 of Title IV, the Jackson-Vanik amendment, denies the countries eligibility for NTR status as well as access to U.S. government credit facilities, such as the Export-Import Bank, as long as the country denies its citizens the right of freedom-of-emigration. These restrictions can be removed if the President determines that the country is in full compliance with the freedom-of-emigration conditions set out under the Jackson-Vanik amendment. For a country to retain that status, the President must reconfirm his determination of full compliance in a semiannual report (by June 30 and December 31) to Congress. His determination can be overturned by Congress via the enactment of a joint resolution of disapproval at the time of the December 31 report.

The Jackson-Vanik amendment also permits the President to waive full compliance with the free emigration requirement, if he determines that such a waiver would promote the objectives of the amendment, that is, encourage freedom of emigration. This waiver authority is subject to an annual renewal by the President and to congressional disapproval via a joint resolution. Before a country can receive NTR treatment under either the presidential determination of full compliance or the presidential waiver, both the United States and the country in question must have concluded and enacted a bilateral agreement that provides for, among other things, reciprocal extension of NTR (or MFN) status. The agreement and a presidential proclamation extending NTR status cannot go into effect until a joint resolution approving the agreement is enacted. In 1990, the United States and the Soviet Union signed a bilateral trade agreement. The agreement was subsequently applied to each of the former Soviet states. The United States first granted NTR treatment to Russia under the presidential waiver authority beginning in June 1992 and, since September 1994, under the full compliance provision. Presidential extensions of NTR status to Russia have met with virtually no congressional opposition.

Russian political leaders have continually pressed the United States to "graduate" Russia from Jackson-Vanik coverage entirely. They see the amendment as a Cold War relic that does not reflect Russia's new stature as a fledgling

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[48] *Washington Trade Daily*. June 7, 2002.

[49] Ibid.

democracy and market economy. Moreover, Russian leaders argue that Russia has implemented freedom-of-emigration policies since the fall of the communist government, making the Jackson-Vanik conditions inappropriate and unnecessary.

While Russia remains subject to the Jackson-Vanik amendment, some of the other former Soviet republics have been granted permanent and unconditional NTR- Kyrgyzstan on June 29, 2000, and Georgia on December 29, 2000. Perhaps, what has particularly irked Russian leaders is that on January 1, 2002, the United States granted permanent and unconditional NTR status to China, which is ostensibly still a communist country.

Granting Russia permanent and unconditional NTR status will have little direct impact on U.S.-Russian trade, since Russian imports have entered the United States on a NTR basis since 1992. The initiative would be a political symbol of Russia's treatment as a "normal" country in U.S. trade, further distancing U.S.-Russian relations from the Cold War. For investors and other business people, permanent NTR (PNTR) may mean a more stable climate for doing business. But many observers have concluded that U.S.-Russian economic ties will grow only when Russia has undertaken sufficient economic reforms to improve the climate for trade and investment.

It has a direct bearing on the WTO accession issue since the WTO requires its members to extend mutual *unconditional* MFN status to one another's exports. If the United States does not extend permanent NTR to Russia, the United States would not benefit from the concessions, except tariff reductions, that Russia makes upon acceding to the WTO.

Implications of Russia's Accession to the WTO

Because the major trade powers — the United States, the EU, and Japan — strongly support Russia's entry into the WTO, the pending question is not whether Russia will accede but when. The answer to that question depends on when Russia and the more than sixty members of the working party can finish hammering out the conditions of accession. Negotiators have reportedly reached agreement on most issues, but disagreements on difficult issues of energy pricing, agriculture, services, civil aircraft, and intellectual property rights, have slowed down the process and have likely made the original goal of accession by the September 2003 WTO Ministerial Meeting in Cancun, Mexico unattainable. The next goal for Russia is to enter the WTO in time to have some influence in the Doha Development Agenda round of negotiations that is scheduled for completion in 2005.

Implications for Russia

The stakes for Russia in joining the WTO are high. Russia's political leadership, led by Putin, has made a commitment to join the WTO. In his April 18, 2002 address to the Federal Assembly, the bicameral Russian legislature, Putin underscored his administration's priority to get Russia into the WTO. In the speech, Putin emphasized the need for the Russian government to establish the conditions to improve the economic well-being of the Russian people and linked that effort with joining the WTO:

> Tight competition is a norm in the international community and in the modern world, competition for markets, investments, economic and political influence. Russia must be strong and competitive in this fight.
>
> The world market is already here and our market has become part of the system...
>
> The WTO is an instrument. He who knows how to use it grows stronger; he who prefers to sit behind a fence of protectionist quotas, and duties — he is doomed, absolutely doomed strategically.
>
> Our country is still excluded from the process of making world trade rules. We are already in the world trade but we have no say in shaping the rules of trade. This tends to stunt the Russian economy and make it less competitive.[50]

In acceding to the WTO, Russia is making a *legally binding* commitment to conform to WTO rules. In so doing, it agrees to make its foreign trade and investment regimes open to the scrutiny of the WTO and its members. At the same time, the WTO provides a multilateral forum for Russia to settle trade disputes with other WTO members. As a WTO member, Russia will have a voice in how those rules are made and implemented. It would be a major step in integrating Russia within the international trade system.

But before it can accede to the WTO, Russia must satisfy WTO members that it is ready to meet its obligations. The working party negotiations and the bilateral negotiations to date suggest that those countries are not satisfied and require that Russia make major adjustments in policies and regulations.

The adjustments include reviewing and possibly changing more than 100 Russian laws and reviewing more than 1,000 international agreements that Russia has with various countries.[51] However, the overall impact of WTO accession on Russia will depend on the terms and conditions of accession that Russian and its trading partners in the WTO finally agree on. In general, Russia will likely have to reduce tariffs and other protective measures for import-sensitive industries such as autos and aircraft and will have to open up key financial service industries — banking and insurance — to foreign competition. In the short run, such adjustments could lead to the loss of jobs in those areas and the need for the Russian government to provide unemployment insurance and other adjustment assistance.

However, globally competitive industries, such as the raw material producers, could see markets abroad opening up and an increase in foreign investment as

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[50] *Annual Address by President of the Russian Federation Vladimir Putin to the Federal Assembly of the Russian Federation Moscow, April 18, 2002.* [http://www.russiaeurope.mid.ru]

[51] Likhachev, Aleksei Evgenievich. (State Duma Committee on Economic Policy and Enterprise). Presentation at Adam Smith Institute International Congress on Russia's Accession to the WTO. October 16-17, 2002. Moscow.

accession forces Russia to restructure its economy. In the long run, mainstream economic theory and the record of economies that have gone through similar transitions suggest that trade liberalization will lead to a more efficient Russian economy and to raising the living standard of the average Russian citizen.[52] New industries will probably emerge over time helping to diversify the Russian economy.

The Russian business community is divided on the issue of accession. Some have expressed skepticism if not out right opposition to accession. Among this group is Oleg Deripaska, an influential and powerful aluminum and auto business magnate. He is concerned that WTO accession will force Russia to eliminate protection and that the domestic auto industry will face competition from U.S., European, and Japanese manufacturers. He is also concerned that Russia would have to charge higher prices for energy, a major input in aluminum production. Similarly, representatives of aviation, furniture, financial services, telecommunications, and agriculture have asserted that Russia stands to lose more than it will gain from accession because Russia has not matured sufficiently to meet the competition.[53]

On the other hand, the Russian "oligarchs" (business magnates) who control industries that can compete on world markets, support accession. Among them is Mikhail Khodorkovsky who controls the Yukos oil company. He claims that accession will open foreign markets and make Russia more attractive to foreign investment. In addition to Khodorkovsky, the Russian Union of Industrialists and Entrepreneurs, a group that includes many Russian business leaders, has supported accession.[54]

Views on accession cut across regions with support coming from regional political leaders in the major business centers of Moscow and St. Petersburg and in regions where raw material production is located. Political leaders in regions where fledgling import-sensitive manufacturers are located have been skeptical or opposed to accession. For most Russians, accession has not attracted much interest.[55]

Putin and the current Russian political leadership have made economic growth and development their highest priority and they view Russia's admission into the WTO as an essential part of the strategy to fulfill those goals. Putin appears to view the accession process as a way of forcing the government bureaucracy, the Duma, and Russian industry to confront the changes that are required if Russia is to attain long-term sustainable economic growth and development. While Putin's political future probably does not depend directly on whether Russia gets into the WTO, it will likely be evaluated on the basis to what degree economic life in Russia has improved.

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[52] For an examination of the possible economic impact of accession see, Stern, Robert M. *An Economic Perspective on Russia's Accession to the WTO.* William Davidson Working Paper Number 472. June 2002. The William Davidson Institute at the University of Michigan Business School.

[53] *Financial Times.* April 15, 2002.

[54] Ibid.

[55] EastWest Institute. *Regional Report.* vol 7, no. 22. July 10, 2002.

WTO accession would be a further sign of Russia's acceptance and participation in the major multilateral economic institutions: the World Bank, the International Monetary Fund; and the G-8. In so doing, Russia would distance itself further from its Soviet past.

Implications for the United States

For U.S. exporters and investors, Russia's accession to the WTO may improve the business climate in Russia which has been unpredictable. The U.S. business community often cites poor intellectual property rights protection, inconsistent and opaque customs regulations, inconsistent enforcement of the regulations, and irrational SPS and technical trade barriers as among the impediments to trade and investment. Accession could bring more stability and openness in the business climate since Russia would have to adhere to WTO rules that promote these conditions.

The volume of U.S. imports from Russia has been low primarily because Russia's limited export-base. Nevertheless, some U.S. import-sensitive industries, for example steel, may face increased competition from Russian producers. These industries may press U.S. negotiators to include as part of the terms and conditions for Russia's accession, a special safeguard provision, beyond that provided in the WTO agreements, that would cushion the potentially adverse impact of a large increase in Russian imports upon accession. Such a provision was included in the conditions for China's accession to the WTO and was codified in U.S. law as section 421 of the Trade Act of 1974.

Similar to section 201 (escape clause) provision of the Trade Act of 1974, section 421 allows the United States to temporarily restrict fairly traded imports that cause or threaten to cause injury to the domestic injury. Unlike section 201, however, section 421 permits the restrictions to be applied solely to imports of like products from China, rather than requiring them to be applied on an MFN basis on imports of like products from all countries. In addition, the required thresholds of cause and level of injury to the domestic industry for relief under section 421 is lower than under section 201. Section 201 requires that imports be a "substantial" cause of "serious injury," whereas section 421 requires only that the imports be a "significant cause" of "material injury." For many in the U.S. business and agricultural community, the issue is not whether Russia should be allowed to join the WTO but one of assurance that Russia will enter under conditions that are commercially sound and will have minimal negative impact on U.S. industries.

Implications for Other Countries and the WTO

Russia is the largest and most populous country that is not a member of the WTO. If Russia accedes, it would significantly expand the geographical coverage of WTO rules to all major economies leading to a larger degree of stability and transparency to the international trading system.

At the same time, Russia's entry into the WTO would continue a trend in which as the membership of the WTO becomes larger and more diverse, it becomes more difficult for that membership to reach a consensus on important issues. In addition, trade disputes between Russia and its trading partners will be brought to the WTO for resolution rather than addressed bilaterally, adding to the ever growing caseload of the WTO.

As an economy still in transition, Russia would bring its own perspective to WTO negotiations. For example, Russia could be expected to challenge the positions the United States and other countries have taken in the WTO on the role of subsidies in trade and the degree to which trade in services should be liberalized.