

Russia and the WTO

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Eighteen years after the start of the accession process, Russia is closer than ever to joining the World Trade Organization (WTO). The negotiations have been long and hard as Russia had to agree the accession terms with 57 out of the 153 WTO member countries which formed the working group. Moreover, the number of goods for which the extent and timeframe of the change of Russian tariffs were agreed exceeded 10,000. The negotiation team led by Maxim Medvedkov has done an immense amount of work and found compromises on sensitive issues such as pay for the flights of foreign planes over Siberia, compensating European producers for the discriminatory law on industrial assembly, the amount of support for the agricultural sector, access to the market of banking services, etc. Now, all these differences have been ironed out and the WTO has agreed with all the participants, and put on the table the final terms of Russia's accession.

It has to be noted that the change of tariffs after Russia's accession to the WTO will be insignificant. Average tariffs on goods after all the agreements have come into force will decrease to 7.8% from 10% in 2011.

The tariffs on agricultural goods will drop to 10.8% compared with the current level of 13.2%, and for manufactured goods from 9.5% to 7.3%. The duties on some goods will, however, drop significantly. For example, the tariff on new cars will be cut by half from 30% today to 15%. On the other hand, one has to bear in mind that the agreed decrease of all tariffs will not happen overnight after the Russian accession. It will rather take place gradually at a rate which has also been agreed on with the WTO members. The tariff for new cars will drop to 25% immediately after accession and will remain at that level for the next three years before the cuts resume at an

annual rate of 2.5% over the following four years to reach the targeted level of 15%. Russia has no commitments to reduce tariffs any further. The tariffs on used cars up to 7 years old will be fixed at 25% at accession and will not change over the next five years before being cut to 20% over the following two years. Duties on cars older than 7 years will not change at all. On the whole, tariffs will be changed completely immediately upon accession only on one-third of the goods. For many goods the process will extend over three years, and for some over 8 years after accession.

Not only trade in goods, but also service and foreign direct investment spheres will be liberalized. One of the most difficult negotiation items was the banking sector, where some WTO member countries (notably the USA) demanded a total opening up of the Russian market of banking services to foreign

financial and lending institutions. Moscow, for its part, insisted on preserving the current situation where only the subsidiaries and not branches of foreign banks operate in the Russian market. The difference between the former and the latter is that the activities of subsidiaries on Russian territory are regulated by the Russian Central Bank, while branches are regulated by the laws of the country of origin. The Russian position prevailed, which means that the situation for foreign banks will not change and the cost of entering the Russian market will remain at the current level. Accordingly, the cost of banking services for Russian clients will not change. This is not good news for Russian small and medium-sized enterprises which had hoped that a massive entry of foreign banks could help bring down the interest rates on loans.

Major changes may take place in the insurance market when Russia allows branches of foreign insurance companies. However, a nine-year transitional period appears to be enough for all the stakeholders to prepare themselves.

Assessment of the Consequences of Russia's Accession to the WTO for the Economy

The question that is uppermost in the minds of all Russians is whether the economy stands to gain or lose as a result of WTO accession. On

the one hand, opponents of accession point to the not very successful experience of accession to the WTO of some former Soviet republics. These opponents paint lurid pictures of the social consequences of the closure of a large number of Russian enterprises. By contrast, the advocates of accession cite the success of China whose export-led growth accelerated significantly after the country joined the WTO. Time will tell what the results of a WTO accession will be for Russia. The result will in many ways depend on well-thought-out and coordinated actions of the Russian federal and regional authorities. In the meantime, we can only talk about what we expect from accession and what its potential consequences may be. The Russian government and the World Bank have conducted several major studies, seeking to determine the economic consequences of a WTO accession. While there are some discrepancies in evaluating the quantitative changes in specific sectors and at the economy-wide level, researchers more or less agree in qualitative terms. The general consensus is that the changes in outputs, consumption, prices and welfare due to the new tariff agreements are likely to be fairly small. Because the overall reduction of import tariffs in Russia will be insignificant, one may expect that changes in specific sectors, too, will not be dramatic (within plus-minus 1-3% of the base level).

CEFIR jointly with the Belgian TML Centre and the German ZEW with the support of the European Union Seventh Framework Programme, recently build a general

equilibrium model of the Russian economy SUST-RUS (CEFIR 2011) which makes it possible to assess the effect of a Russian WTO accession on specific sectors. Several scenario calculations have been made to model the short term (one or two years after the reduction of all the tariffs) and long-term (five or six years after the reduction of all the tariffs) effects of a Russian WTO accession. The results of the scenario modeling should be seen as an indication of the direction of market processes caused solely by a WTO accession without taking into account any other possible changes in the economic environment (for example, a change of energy prices, the strengthening or weakening of the ruble against the leading world currencies, changes in the domestic market, etc.).

The short-term scenario assumes only a change of the tariff timetable. The long-term scenario has a further assumption concerning the return on foreign direct investments for the business service sector. Business services include banking insurance, financial services, transport services, wholesale trade, etc. Some terms of Russia's WTO accession pertain to the business service sphere and envisage considerable liberalization of foreign companies' access to these sectors. One can expect that lower barriers to entry would push down prices in these sectors and make them more accessible for Russian enterprises, which in turn would reduce their costs, boost production and create more jobs. The general equilibrium modeling of this mechanism assumes a conservative reduction of barriers

for foreign investments of about 10% of the current level.

According to CEFIR's results, the potential growth of welfare in the economy caused by a WTO accession in the short term will be 0.4% per year, and in the long term 1% per year. Budget revenues will fall due to diminished tariffs, and there may be a dip in the rate of GDP growth in the short term. Model calculations show a significant change of the trade balance, possibly a reduction of the trade surplus to 10%. At the sectorial level, a WTO accession will reduce domestic prices of timber and articles made from wood, foodstuffs, transport means, as well as equipment, clothes, chemicals and petrochemical products by 1.5-2.5% in the short term and by up to 3% in the long term. This will increase consumption by between 0.2% and 0.4% in the short term and up to 1.5% in the long term. It has to be noted that the liberalization of the service sphere is a very important assumption of these calculations as it accounts for half of the long-term gains for consumers.

The World Bank has also carried out a study of the consequences of a Russian accession to the WTO in 2004 (Jensen et al, 2004). That study put the net positive gain from liberalization of tariffs at 3.4% of the GDP. That analysis was based above all on the economic effect from a change in import tariffs. Trade liberalization is historically associated with lower tariffs. Most sectors stand to gain from accession. Because the

authors identify two main causes of the gains from liberalization – easier access to foreign markets and cheapening of the ruble in proportion to the change of tariffs – the sectors that will benefit are those which has a high share of exports, and which have not been heavily protected by tariffs to begin with.

The biggest beneficiary will be metallurgy, with a 25% increase in output and employment in ferrous metallurgy and 15% in non-ferrous metallurgy. The growth in the chemical and petrochemical industries can be up to 10% and in coal mining up to 6%. The significant gains predicted by the World Bank study owe something to the optimistic view of the possible terms of Russia's accession to the WTO. For example, it assumed that all the import tariffs would be cut by 50% and all (100%) of the administrative barriers to investment in business services would be removed. More modest assessments of the potential gains for Russia in other studies reflect the smaller Russian commitments to liberalization of import tariffs and the services sphere. For example, CEFIR's results show that steel-making enterprises will not experience difficulties after a WTO accession and may grow by about 2% in the long term.

Along with the cut of import duties, Russian producers will face tougher competition on the part of foreign goods for which prices will be cut. Accordingly, Russian producers will also have to cut their prices to be competitive. This is good news for consumers. Not all domestic producers will be able to cut their prices. The

enterprises whose production costs turn out to be higher than the new prices, and which fail to cut their costs, will be pushed out of the market. The sectors where one can expect a drop in production are above all those which have long been protected against international competition by high import duties. CEFIR's study has shown that in the short term, negative consequences may ensue for the food industry, pharmaceutical companies and textile enterprises which may see their output drop by between 0.5% and 2%.

According to the World Bank study, the biggest decline in output and employment may occur in the machine-building sector (12%) and in the food and light industries as well as in the construction-material industry (up to 7%). The above figures of decrease or increase refer to the summary effect from liberalization accumulated over a period of 7-10 years after a Russian accession to the WTO. Several studies have been devoted to the consequences of a WTO accession for regional economies. For example, World Bank experts (Rutherford and Tarr, 2006) point to positive, but uneven consequences of a WTO accession for Russian regions. The biggest beneficiaries from lower tariffs are likely to be the Tyumen region, the North Western District as a whole, and in particular, St. Petersburg, where welfare may increase by 1%. Low growth or no growth may be expected in the Central District and in the Urals. These results tally with the assessments of the consequences of WTO accession for the Russian regions made by the Independent Social Policy Institute (ISPI

2004) which also included some regions of the Volga Federal District among the high-risk regions.

Results of studies of changes in the labor market in the wake of WTO accession, generally accord with the other findings. The International Labor Organization (ILO 2003) predicts an average loss of 6000 jobs in industry in the year following accession and up to 1000 jobs in seven or eight years' time. The biggest number of jobs will be lost in the light-industry sector (up to 15,000 during the transitional period). Such a drop in employment will hardly make any difference to the unemployment situation in the country as whole, but may differ from one region to another.

Most studies agree that Russia may gain from easier access for Russian enterprises to foreign markets after a WTO accession, but that the gain will not be great compared to the potential gain from the liberalization of the service sphere. There are not many export-oriented enterprises in the country, but they exist. There are about 6,000 export-oriented enterprises in the processing industry. These enterprises include chemical, metallurgical and high-tech enterprises, and are the most efficient and competitive producers in the country. These enterprises may be expected to pick up the slack in the labor market due to redundancies in sectors that will be affected by a WTO accession. The coordinating role of the state is very important in creating conditions for movement of labor. The gradual reduction

of tariffs may dampen the social consequences of Russia's WTO accession. In the regions where some production facilities are "doomed", programs for retraining of labor must be launched without delay, especially in information technologies, and the services and skills required for starting a new business. The aim of such retraining should be to enable those who lose their jobs to be employed in other spheres of the economy. It is equally important to develop new forms of financing migration of the population within the country. The solution of this task may become one more – and very important – result of the WTO accession for Russia.

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