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One Year after Russia's WTO Accession: Time for Reform

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Russia entered the World Trade Organisation (WTO) about a year ago. In September this year Russia also joined the WTO Information Technology Agreement (ITA). Both moves have been necessary for Russia to provide transparency in its trade policy and, above all, improve market access for foreign providers. However, while it is evident that the real benefits of Russia's WTO accession will emerge in the long run, improving the business environment by joining the multilateral trading system will not be a panacea. Russia will have to do much more to improve its business opportunities, especially if it wants to exploit its claimed comparative advantage in technological-intensive products.

On August 22 last year Russia became a member of the WTO after a lengthy negotiation process. With its accession Russia has agreed to a legally binding average tariff ceiling of around 8 percent, which includes agricultural tariffs of around 11 percent (average tariffs on industrial goods are around 7 percent). Russia has also made a cluster of commitments in services, most importantly in telecommunications, transportation and distribution. Furthermore, Russia accepted that export duties would be fixed for more than 700 tariff lines. And it agreed to several other commitments such as eliminating quantity restrictions and subsidies; joining the ITA and the Government Procurement Agreement (GPA); plus applying all its so-called SPS measures in accordance with the WTO agreement (SPS stands for sanitary and phytosanitary regulations). All this should happen in a relatively short transition period.

Russia's list of commitments to access the multilateral trading system seems impressive. It would certainly increase transparency and create a more predictable environment for firms when they enter Russia's domestic market. Before the accession Russia had developed a so-called outsider-status within the trading scene which meant that all trading partners who had become member of the WTO were trading significantly less with Russia. In other words, it looked as if Russia was rather trading with other non-WTO partners, mainly a number of Former Soviet Union economies. However, now that it has finally entered the WTO its trade patterns will likely align with the rest of the world. But this process of readjustment will not be quick. Although studies suggest that Russia's export could expand by 50 percent following WTO accession, along with export expansion comes export reorientation which will hit some Russian businesses. And this will take time.

That said, being a WTO member can make Russia much more competitive and productive. Russia will not only benefit from more exports. After implementation of its WTO obligations, Russia will also see increased imports and foreign investors who will be more inclined to bring in capital. In fact, several studies suggest this to be the main channel of benefits from WTO accession. The new inflows create additional productivity gains through spill-over effects that benefit domestic manufacturers, including Russian downstream producers. Ultimately they create higher welfare gains to Russia's millions of consumers given that relative prices will go down thanks to increased external competition, more innovation and expanded employment. According to analysts Russia is potentially "one of the most dynamic economies anywhere in the world" and has an "untapped demand" when it comes to the domestic consumer goods sector. In addition, it is argued that more opportunities can be seized by looking East. Russia is fairly close to other emerging Asian countries. China, a WTO member since 2001, is already Russia's largest trading partner.

Yet, joining the multilateral trading system does not in itself provide Russia with the magic stick. For instance, Russia claims to have comparative advantage in technological-intensive goods such as chemicals, nanotechnology, aerospace, electronics and software. This means that the relative costs for Russia to specialize further in these fields are low; therefore, capitalizing on these sectors will be rather lucrative. The underlying reason for this potential benefit is that

Russia has a long history in technology which means that it is to a certain extent well-endowed with technical skills. Hence domestic and foreign manufacturers of technological goods will find it easier to take advantage of Russia's technological base. But even though entering the WTO undoubtedly provided Russia with an improved business climate in which these technical sectors can flourish, it will have to undertake much more in an attempt to exploit its comparative advantage in these areas.

For one, Russia should lower its trade barriers across the whole range of technological industries. This would not only be beneficial for Russia's exports when it obtains lower tariffs for these goods in return, but would also help expand these technological industries by allowing for more imports. Many technology industries are dependent on each other through a whole variety of different inputs. Importing these inputs from abroad against lower prices will make it much more efficient for these sectors to develop. Russia has partly done so by joining the ITA this year. The average (unweighted) applied tariffs for all ITA-covered goods had been 3.44 percent and they will now go down to zero. This reduction seems trivial, but one should bear in mind that margins on technical products covered under the ITA are low. And Russia's post-accession programme should not stop at tariffs. Even more important, it should reform the panoply of administrative red-tape barriers for technology firms. For instance, it could abolish licensing requirements and various other regulatory procedures such as expert evaluations and approvals on technological goods. These regulatory barriers are much more burdensome than low tariffs.

Undeniably, some of the ITA products categories overlap with Russia's comparative advantage sectors. When excluding these categories, one obtains a "net" tariff of 6.97 percent (unweighted) on all other technology goods industries. These are sectors that Russia can exploit much more. Some of the tariffs in these sectors are still high, such as a tariff peaks of 20 percent in the aerospace industry, for helicopters and smaller aeroplanes as well as for spacecrafts. Reducing tariffs and regulatory restrictions on such goods will signal to the rest of the world that Russia's comparative advantage sectors are strong and competitive enough to attract further investment.

Second, Russia should reduce its applied barriers in services. In the WTO agreement on services, only so-called bound commitments in services are negotiated and they can differ much from the applied services trade regime. A comprehensive liberalisation of services barriers would enhance productivity for domestic firms and therefore contribute to economic growth in the long run. Studies indeed suggest that such gains are especially palpable for Russia as it could attract additional investment in technology sectors. And it is correct: foreign services inputs – particularly business services, finance and insurance – are real contributors to trade expansion in technology-intensive industries such as chemicals, machinery and electrical equipment. Applied barriers in these services sectors are nonetheless still high. On a scale from 0-100 Russia's restrictions for insurance services still stand at around 80 for Mode 1 (cross-border trade) and 50 for Mode 3 (commercial presence) while its barriers in finance hovers around 30 (Mode 1) to 50 (Mode 3). Barriers in professional services are relatively low for Mode 1 and 3, but around 70 in Mode 4 (presence of natural persons).

Last, domestic institutions for governance are important for developing comparative advantage. In particular, a country's dedication to the rule of law is a key enabler to expand trade in those industries where contracts play an important role. The reason is that all product specificities cannot be as easily defined in a contract in all sectors. These sectors are so-called "differentiated industries" and need a strong domestic institutional system that controls the legal enforcements of these contracts. It is fundamental condition in order for such "sophisticated" sectors to take part in economic transactions. Typically, technological intensive sectors are highly differentiated and hence require a strong rule of law system in order to expand. Russia's rule of law has an abysmal score. It has not increased much since 1996, when it was ranked similar to Venezuela. Today it shares its ranking with Laos.

Acceding to the WTO is important but not sufficient for Russia to exploit its comparative advantages. Domestic economic reform in the areas of tariffs, regulation and institutions are needed to make Russia's domestic industries more competitive, especially regarding its technical sectors. These reforms are in the hands of Russia itself, they will not come as a consequence of WTO accession. But they will define the scope of Russia's economic growth in the future – and if the Kremlin is really dedicated to diversifying its economy.