

# CHAPTER 4

## WTO Constraints and Opportunities

### Global Pressures on Russia's WTO Accession

For Wallander, Russia's strategy in foreign policy is "a matter of luck brought about by high energy prices, the United States' ongoing in Eurasia, and the autonomous forces behind forces behind the rise of the twenty-first century's likely global powers in Asia."<sup>97</sup> These global forces are being brought into high relief, as this research contends by the globalizing forces of the WTO accession, a process that fundamentally alters the economic governance capability of the Russian state. If Russia were outside the WTO framework, however, its situation will become complicated for Russian producers to find new markets, namely because, in the absence of WTO protection, producer would be susceptible to rigorous interpretations of anti-dumping rules. The author notes that according to the Russian Ministry of Trade some 120 anti-dumping actions are currently in place against Russian products, costing the country up to US\$4 billion a year.

The European Union and the United States have raised concerns about Russian energy prices pricing policies which allow natural gas, oil and electricity to be sold domestically far below world prices providing, they argue, a subsidy to domestic

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<sup>97</sup> Wallander, 108.

producers of fertilizers, steel, and other energy-intensive goods...gaining access to Russian markets as well as safeguards to protect U.S. import-sensitive industries.”<sup>98</sup> The following chart compares the average prices for natural gas for industrial customers, where Russian pay less than 1/5 as much of people from the US and less than half as much as those from the Ukraine.

Table: Average prices for natural gas for industrial customers

Russia	Ukraine	Poland	UK	France	EU	US
40	90	115	125	140	145	205

Source: World Bank, “Russian Economic Report”, No. 10, March 2005.

“Unlike the old WTO members China insists that the transitional period should be as short as possible. According to china, Russian import duties should be lowered by several factors in just two or three years. Russian negotiator advocate the transitional period of five o seven years.”<sup>99</sup> According to Chowhury,

“Russia views many of these to be WTO non-compatible. Recent decisions by the United States and the European Union to classify Russia as a market economy under antidumping and countervailing duty regimes may not fully alleviate this problem. As it would make Russian subsidies on such public services as gas and electricity more susceptible to anti-dumping and/or countervailing duty actions. Although WTO membership does not render a country immune to protective action against the producers, it does provide access to the WTO’s dispute settlement mechanism.

In a nutshell, for Russia, there are both constraints and opportunities that avail themselves through WTO membership.

## Russian Government Legitimacy under WTO

With the urgency of WTO membership the government’s legitimacy will be increasingly based on how society’s competing interests are resolved concomitantly with the balancing of WTO obligations, foreign pressures and the instituting of state power.

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<sup>98</sup> Cooper, 2-3.

<sup>99</sup> “China Proposes Non-Standard Conditions for Russia’s Entrance into WTO,” *The Russian Business Monitor*, May 14, 2002.

While the WTO accession process can be seen as the modern culmination of transition, in formal terms, the accession process began in 1993 when 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 of the GATT.”<sup>100</sup> According to the author,

“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.”<sup>101</sup>

The fact that WTO accession can act as a source of legitimation for the federal government economic governance, as an aspect of its the changing economic conditions; the importance of leadership and the rhythm of domestic politics; and the role of crises as catalyzing events for politicians to adopt certain reforms are central point that this research is trying to explore. Based on the demands that the WTO puts on society as well as the central government, Cooper points out that

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 interests groups that favor the status-quo, such as agriculture, the auto industry, and raw materials producers, have fought against economic reforms and oppose Russian accession to the WTO.”<sup>102</sup>

Moreover, explains that the factors constituting Russia’s primary objectives in a bid to join the WTO is to obtain new trade advantages; gain access to foreign markets and provision of non-discriminatory treatment for Russian exporters; access to the international dispute settlement mechanism, creation of a more favorable climate for foreign investments; creation of conditions for growth of domestic production’ quality and competitiveness as a result of increased flow of foreign goods, services and

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<sup>100</sup> Cooper.

<sup>101</sup> Ibid., 5.

<sup>102</sup> Ibid.

investment and ; expansion of opportunities for Russian investors in the WTO-member countries.

Thus, because the federal government is beholden to legitimation in the Post-WTO framework, the prospects and challenges that reveal themselves domestically through the new economic framework should be seen in light of the most significant issues structural trade issues that that surround the aftermath of Russia's transition. Firstly, rise in that foreign trade has become increasingly important for the Russian economy, with exports rising from less than 20 percent of GDP in early 1990s to around 40 percent in 2002.<sup>103</sup> No Russia's international competitiveness in terms of trade can help to make or break the domestic enterprises. Secondly, natural resources account for a significant percentage of exports: In the first quarter of 2003, crude oil, fuel, gas and metal made up more than 75 percent of total exports. Third, Russia 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.<sup>104</sup>

In fact, there are several positive aspects about Russia's economic performance since the reforms. Russia has enjoyed sizable foreign trade surpluses over the past few years largely because of the rise in the value of Russian fuel exports resulting from higher world prices and because of the import substitution driven by the ruble devaluation after 1989. Russia had a current account surplus of US\$35.0 billion 2—1 and a surplus of \$32.8 billion in 2002.<sup>105</sup> Yet Chowhury seems optimistic and the scholar uses statistics that point out to a Russia with a more robust economic picture. For instance, the scholar notes that Russia has ended up with a surplus in both current account and merchandise trade – the later culminating in a surplus of \$60 billion in 2000, \$48 billion in 2001, \$46 billion in 2002, and about \$15 billion in the first three months of 2003. In terms of Russia's main exports -- Crude oil, petroleum products, natural gas – the category accounts for about two-thirds of the export earnings 2002. Russia's current account has also shown record surplus – about 33 billion or 10.5 percent of GDP in 2002.<sup>106</sup>

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<sup>103</sup> Ibid.

<sup>104</sup> Ibid, 6.

<sup>105</sup> Ibid.

<sup>106</sup> Chowhury, 1.

Moreover, according to Stern, Russia's total merchandise exports in 2002, exclusive of barter and shuttle trade, was \$42 billion. Again, Europe was the major source of imports (49 percent) followed by the CIS countries (22 percent). Asia (including China and Japan) accounted for about 15 percent while the USA's share was slightly higher than 6 percent). In terms of commodity composition, machines (equipment and instrument and chemicals (including pharmaceuticals and rubber) account for a combined 53 percent of total imports while food and agricultural products account for 23 percent.<sup>107</sup>

However, Cooper is pessimistic about the changes and worries about the industrial concentration in natural resources, leaving the country overly dependent on under stable international commodities markets. For the author, In order for Russia to achieve sustainable economic growth and that the country will have to diversify its exports into higher value-added goods.<sup>108</sup> In this light, Russia has been reluctant to make commitments in the WTO accession negotiations that would further expose its manufacturing sector to global competition. Chowhury notes,

One needs to consider these risky conditions when considering many of the realities of economic governance that inhere in Russia. "Since in many cases formal rules are absent and the economy is governed by a set of informal rules, authorities at different levels enjoy substantial discretion. Consequently, a number of WTO members have doubts about Russia's ability to fulfill the obligations in the future."<sup>109</sup>

The author goes on to say that WTO membership would also mean a further liberalization of Russia's domestic market. This is attributable to the fact that its import penetration can be considered relatively high at 24%. Nevertheless, competition continues to be sub-optimal, hampered by quasi-monopolies formed on a sectoral regional basis. Concomitantly, the injection of international competition would make it unfeasible for inefficient producers, creating a level playing field for the more dynamic small and medium-sized industry – like in China with TVEs, proving it could be a significant aspect of its competition. The implementation of the WTO in Russia would not help to delineate investment regulations and intellectual property but also develop the service industry.

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<sup>107</sup> R. Stern, "An Economic Perspective on Russia's Accession to the WTO," *William Davidson Institute Working Paper 472* (2002).

<sup>108</sup> Cooper, 6.

<sup>109</sup> Chowhury, 1.

Transparency in the business environment would also aid in attracting foreign investment. “In short,” says Chowhury, the most tangible benefits of acceding to the WTO would be the improvement of the business environment.”<sup>110</sup>

Surely, successful implementation of the goals above, while promoting stability and economic growth will be cornerstones of the federal government’s legitimacy. The intent of joining the WTO and promoting competition and deepening Russia’s global economic role, while restructuring the industrial base, may be the key to pursue economic policies that defy comparative advantage. We argue that if Russia is able to achieve its goals in terms of the WTO, it will act as a major source of legitimation.

## **WTO Primary Purpose for Russia**

Specifically, 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 property rights. 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.”

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<sup>110</sup> Ibid., 3.

- Lowering Trade Barriers Through Negotiations: Since the GATT's creation, its members have conducted eight 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 non-tariff 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 right 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 non-tariff measure when restricting imports or legitimate purposes, such as on injurious imports.<sup>111</sup>

According to the IMF:

“It is ... essential to move as rapidly as possible to a transparent and decentralized trade and exchange rate system, in order to hasten the integration ... into the world economy ... The exchange rate [needs] to be moved to market levels. [Only] a few sectors [need to be shielded] for a short time for intense competition of in international markets.”<sup>112</sup>

## **Changing Economic Governance Institutions in Russia**

In many ways, Russia's experience transitioning toward the WTO – by that I mean, the measures undertaken to become a member – have changed the economic system and the means by which Russia can govern its economy. These actions fundamentally alter the state's relationship with the state, not by weakening it vis-à-vis an institutional liberalization of government control on enterprises but, first, by simplifying trade regulations. For instance, on January 2001, the number of customs duties was reduced from seven to four. Subsequently, the average tariff was reduced from 13 to less

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<sup>111</sup> Chowhury.

<sup>112</sup> IMF et al., 17.

than 10 percent. A Customs Code was announced on 1 January 2004; and with the assistance of the World Bank, the customs administration saw restructuring. The administration had 60,000 civil servants to more than 40% of the budget instead of only 10%. In addition, other regulatory measure for foreign trade were also simplified, including a single taxation system for exports of crude oil has been set up, and some taxes on exports of raw materials have been abolished. In 2006, the exchange control for revue from exports was abandoned completely.<sup>113</sup> Moreover, the government instituted a 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. Cooper points out that according to the system,

“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. Of the more than 11,000 commodity categories in the Russian tariff tables, only fifty have tariff rates above 30%.”<sup>114</sup>

While Russia has committed themselves to the modification of their existing bankruptcy laws, dating back to 1998, containing inconsistencies that greatly hampered court sentences, Vercuiel points out that in Russia “main issues still are to be resolved in the area concern the application of laws and the Russian judicial system’s capacity for action.”<sup>115</sup>

While Russia is a member of the main intellectual property rights conventions, it has also signed many bilateral agreements regarding the issue. According to Vercuiel, however,

The problem comes from the application of these agreements within Russia: losses from unauthorized production of American audiovisual goods are estimated to be more than 750 million US dollars. This means that over half of private individuals’ purchases of this type of product in Russia are forgeries of American goods. At the end of 2005, the US Congress suspended the most-favored nation clause for Russia in order to better combat the violation of American companies property rights. For its part, Russia highlighted the efforts it was making to reduce

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<sup>113</sup> Vercuiel, 12.

<sup>114</sup> Cooper, 9.

<sup>115</sup> Vercuiel, 12.



the scale of the problem, and noted that other member so the WTO (especially China) were facing the same difficulties.<sup>116</sup>

In 2000, Russia also drew up plans to reform the gas, electricity, and telecommunications sectors so they could become under state supervision. This plan was presented to working group of the WTO on the opening of the telecommunications companies' capital to foreign investors in February 2001. From 2001 to 2003, privatizations were carried out with more transparency than ever before. The restructuring programs of main national monopolies (such as RAO UES, an electricity producer progressed according to model recommended by international organizations.<sup>117</sup> This points to the fact that while, seemingly, the WTO seems to be giving up many concessions regarding the WTO, Russia is also concomitantly instituting state control, albeit through different means. In this case, the solidification of state control through legal and transparent means is one of the main strategies for Russia if it were to pursue a comparative advantage defying strategy. The pursuits of the government might also pit government efforts against its commitments to the WTO.

Putin has pushed through important legislation through the Russian Parliament, including land reform, tax reform, reform of government bureaucracy to make it more responsive to the needs of the economy rather than act as an impediment to development and growth; judicial reform; and improvement in corporate governance, especially the protection of minority shareholders' rights.<sup>118</sup> However, from 2004, the pace of reform slowed in regard to state-corporate relations, reflecting a change in the 'doctrine of power' on Putin's role. This was put into sharp relief when Putin re-nationalized Yukos, a move that significantly dampened Russia's investment climate. In 2004, the planned restructuring of RAO UES was ultimately abandoned, while only a partial privatization plan was drawn up. At a pace that was considered slow even by the government, privatization continued in 2005. In addition, in December 2005, an amendment voted by the Duma further opened the capital of Gazprom, the world's leading gas producer, to foreign investors. According to Vercuiel, by 2006, however, the government was officially granted the monopoly on gas exports by presidential decree, a move that clearly

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<sup>116</sup> Ibid., 16-7.

<sup>117</sup> Cooper, 8.

<sup>118</sup> Ibid, 8.

demonstrates the government's intent to solidify its sinews of political control. The same privilege was then granted to Rosoboron's exports regarding arms exports. After several hesitant years, the privatization of Svyazinvest, a predominant holding company for national fixed telephone networks, was finally postponed until after 2007.<sup>119</sup>

Vercuiel also highlights the legal system's transformation, which the government has sought as a vehicle to pursue WTO accession. The author points out that between 2003 and 2005, twelve legislative texts referring to the accession negotiations were promulgated. According to the author,

“Yet, as this the Russian case in question, a degree of uncertainty remains in regard to how effectively laws are applied. The measures taken by President Putin since he came to power have shown the new administration's willingness to re-establish the ‘vertical of power.’ In order to reduce any risks of corruption, the number of trade activities under license has been reduced from approximately 450 to 120; administrative registration procedures have been simplified; and companies now have more rights during inspections. In reality corruption has not ceased to spread, according to regular studies conducted in Russia by international organizations and non governmental organizations (like the World Bank, Transparency International). Moreover, the separation of powers and the independence of the judicial system vis-à-vis the government in particular are still regularly being reappraised in Russia, which makes combating corruption even more problematic.

The fiscal code and the financing of social security were reconsidered from the summer of 2000. Taxation on revenue was simplified by adopting a single rate of 13 percent; social security contributions were merged into one single contribution; value added tax rates were fixed at 10 to 20 percent; and the tax base for companies was reviewed to conform to Western practices. In July 2001, the TBC rate was reduced to 24 percent and a simpler fiscal regime was applied to small and medium-sized companies from 1 January 2003.

In terms of national recognition, the primary results from Russia's reform of its economic legislation were the granting of market economy status by the European Union and then by the US in the spring of 2002. Its full involvement in the G8 was made official at the start of the summer of 2002.<sup>120</sup>

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<sup>119</sup> Vercuiel, 14.

<sup>120</sup> Ibid., 14-5.

## WTO Primary Purpose for China

The “spirit” of the WTO, say Lin, Cai and Li, “is to lower tariff rates, to eliminate non-trade barriers, and to allow market entries so that production could be allocate [sic] globally according to the principle of comparative advantage.”<sup>121</sup> But the WTO’s implications are many; here’s a short assessment of its pros and cons. According to Lardy, China has committed to reduce its average statutory tariff on industrial products to 8.9 percent by 2005; for other Argentina, Brazil, India, and Indonesia, four other large countries, the comparable figures are 30.9, 27.0, 32.4, 36.9 percent, respectively. Moreover, says the author, China’s market access commitments on services, China has made commitments in all of the services covered by the WTO General Agreement on Trade in Services.<sup>122</sup>

Firstly, the implication is that WTO membership would help bring in foreign competition. This would create the impetus for firms to specialize in sectors that follow China’s comparative advantage, delegating autonomy to micro-management units so they would be consistent with the traditional macro-policy environment, thereby helping to promote investment and job opportunities to the hinterland, promoting balanced.

The foreign competition induced by the WTO, would promote more product variety and prices and better quality. It will also promote a more flexible prices system, which could better reflect supply and demand of factor endowments and commodities, promoting efficiency. Foreign capital and technology will be introduced. Most importantly it will change the economic structure, promoting efficiency and advancing China into an economic development stage that would see the importance of state-actors relative to non-state sectors decline, and experience a relative increase in the importance of manufacturing and financial services industry compared to the agricultural industry.<sup>123</sup> The WTO will also serve as an institutional blueprint for further reform, and a guideline to pursue stability and sustainability at an incremental pace.

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<sup>121</sup> Lin et al., 283.

<sup>122</sup> Lardy, 79.

<sup>123</sup> Gregory C. Chow, *China’s Economic Transformation* (Princeton, J.J.: Princeton University Press), 77.

The WTO's reforms will also help to deregulate the banking system, facilitating growth of small and medium-sized banks, thereby facilitating growth of small- medium-sized enterprises, seen as one of the "propellers" of reform.<sup>124</sup> The reforms would also help to "internationalize" the banking sector, thereby allowing for more issuance of loans by foreign banks to domestic firms, thus promoting domestic investment and growth; foreign expertise in asset management can also be borrowed. Moreover, competition in the sector might put pressure on the banks to do something about NPLs, make loans out to assessment on risk, and promote novel financial services.

Finally, the WTO makes China a player in a rule-based world economy. Foreign enterprises will have more confidence in making direct investments in China, attracting FDI. Internationally, it would act as mechanism to settle international trade disputes. TRIPS and TRIMS are examples of these institutions.

However, some worry about the fast pace of the reforms. Hasty reform might create rent-seeking opportunities and present great economic inefficiencies because the micro-units under incremental reform may not have enough time to synchronize with the macro-economy. Moreover, the reforms might be ill-suited for China because many of the WTO's assumptions are based on the Washington Consensus; other countries aren't quite as bureaucratized. The stability/speed debate might induce factionalism within the government, creating political instability, detrimental to economic growth. Foreign countries may also use special safeguards for 12 years after accession, limiting China's export opportunities.<sup>125</sup> Anti-dumping will also present a challenge for exports especially in industries like textiles, and other labor intensive goods. Foreign banks will receive national status, local banks will lose current protections; "foreign banks [will] have the ability to bring a large enough shock to end the monopolistic nature of China's banking industry."<sup>126</sup> This might exacerbate NPLs and present liquidity problems. Also, unless proper regulations are imposed on short-term foreign capital inflows into enterprises, including SOEs, in domestic real estate and security markets "[t]he adverse effects of WTO entry may be particularly adverse in the motor vehicle industry, agriculture, and financial services, especially banking. Namely, the author points out that employment in

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<sup>124</sup> Ibid., 293.

<sup>125</sup> Lardy, 105.

<sup>126</sup> Chow., 289.

the auto industry is expected to fall by 500,000 and in agriculture by 11 million. In banking the jobs of a substantial share of 1.7 million in workers in the four largest state-owned banks are thought to be at risk.<sup>127</sup> Already, according to statistics furnished from the Chinese government, total state sector employment as well as the number of SOEs have dropped substantially in the mid 1990s, with total state – sector employment falling to just below 80,000,000 in 2002 from a peak of over 100,000,000 in 1997. in 2001 from a 1996.

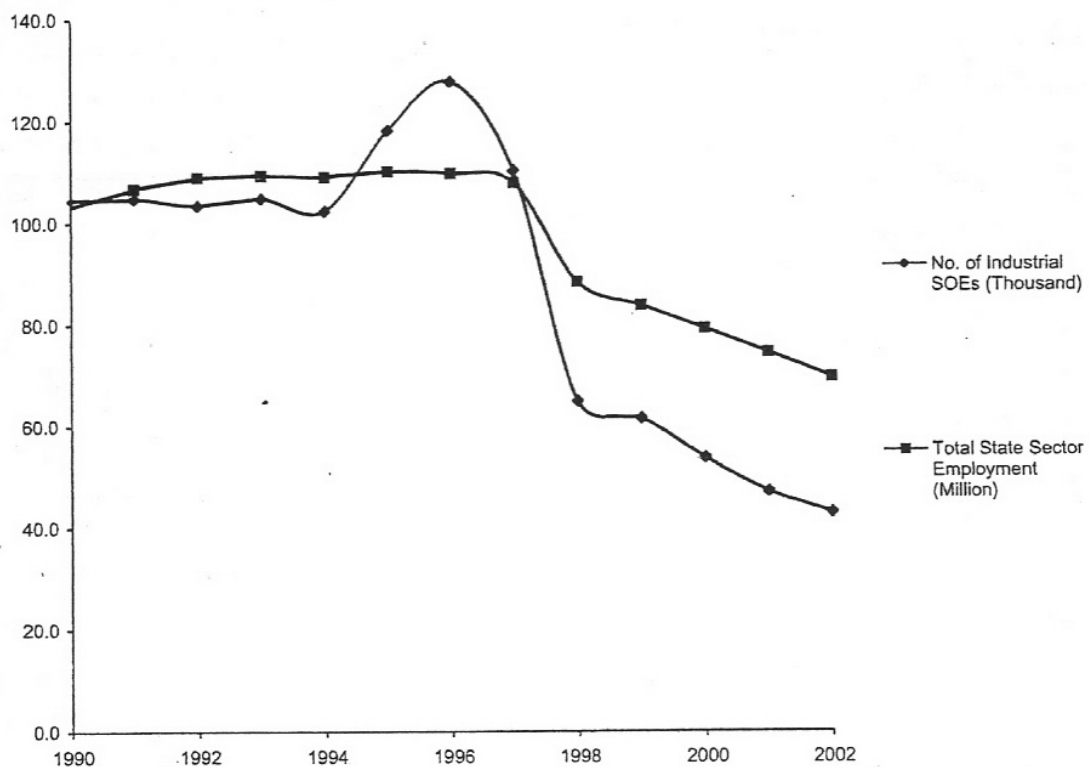


Figure: Number of Industrial SOEs and Total State-Sector Employment. Note: The number of industrial SOEs includes both state-owned and state-majority-controlled industrial enterprises. For 1990-1995, the figures are for state-owned enterprises only  
 Source: Yang, Dali L. 2004. *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China*. Palo Alto, CA: Stanford University Press.

Thus it is unsurprising when Moore and Yang note that, while China has joined WTO, there are ways the government sees the potential benefit of WTO is also slanted with skepticism:

<sup>127</sup> Lardy, 106.

Beijing must still be characterized as resisting, or at least trying to resist, the logic of economic interdependence wherever possible, even in light of its decision to accept the cost of WTO membership. Although all countries try to resist the constraints of economic interdependence, or at least try to minimize the costs of economic interdependence (while readily accepting the benefits), this observation still applies to China with more than usual force. From its mixed record of abiding by agreements on arms proliferation and intellectual property rights to its unwillingness to commit the South China Sea dispute to processes of international law, China continues to vigorously guard its economic autonomy and political sovereignty.<sup>128</sup>

Moreover, since the financial system in China is less developed and cannot effectively use monetary policy to reign in the economy like the US, says James Areddy, further impetus is put on China to use innovative techniques – ‘other levers’ – including currency exchange rate adjustment and even rhetoric.<sup>129</sup>

## Comparison of Contentious Issues in Russia and China

This section will explore the most contentious political and economic issues that underlie Russia and China’s WTO accession. By exploring how will assess how trade issues related to WTO membership would greatly affect industries variably. By highlighting the most salient problems that Russia is to face because of economic liberalization, it is hoped that the reader will become better acquainted in with Russia’s economy, so that later on in the research, we can begin to explore the new competing interests that arise resulting from Russia’s transition into the WTO.

### *Agriculture*

Russia’s subsidies on agriculture continue to be a major source of conflict for the members of the working party. Russia has already drawn up with the working party not only customs duties on imports of agricultural goods, but also for subsidies granted to the sector (for livestock farming, agricultural production, investment aid, government subsidized loans, agricultural aid, etc. According to Vercuiel, if Russia follows the WTO

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<sup>128</sup> Thomas G. Moore and Dixia Yang, “Empowered and Restrained: Chinese Foreign Policy in the Age of Economic Interdependence,” in *The Making of Chinese Foreign and Security Policy in the Era of Reform 1978-2000*, ed. David M. Lampton (Palo Alto: Stanford University Press, 2001), 228.

<sup>129</sup> James T. Areddy, “Beijing warns China lenders,” *The Wall Street Journal Asia*, June 15, 2006, 3.

agreements on agriculture, “Russia must fix a ceiling on its involvement, with reference to a three-year period prior to its accession, and commit to reducing aid by 20 percent for six years afterwards.”<sup>130</sup>

Initially, Russia drafted proposals that were based on figures from the period 1989-1992. According to Vercuiel, these proposals amounted to US\$84 billion in internal support and subsidies on exports to a tune of 1.6 billion US dollars. Since the working party members rejected these proposals several times. Most recently, according to the author, it proposed to reduce the maximum level of internal support to US\$9.5 billion US dollars, and for subsidies on exports to 0.7 billion US dollars. According to the author, the issue remains contentious, especially among countries that would be put at a disadvantage if Russia’s agricultural proposals went through. Trade issues, however, should also be seen as aspects of a country’s bargaining chips. According to the author,

“The strongest opposition to Russia’s proposals came from the countries in the Cairns group [Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Pakistan, Paraguay, Peru, Philippines, South Africa, Thailand, Uruguay], which wanted the reference period to be the years 1997 to 1999, when the budget crisis considerably reduced agricultural subsidies: at that time, support amounted to between 2 and 3 billion US dollars, i.e. less than the minimum level authorized by the agricultural agreements, and corresponding to 5 percent of the sector’s costs.”<sup>131</sup>

Lardy points out that for China, Market opening in agriculture under China’s WTO commitments, especially the tariff-rate quota system for grains and other major commodities such as cotton, would probably reinforce the trend of greater reliance on imports for land-intensive agricultural crop. “Overall China’s agricultural imports as a share of world total are forecast to more than double—from just over 5 percent in 1995 to more than 12 percent in 2010.” The author cites statistics from the Development Research Center, which estimates that employment in the production of rice, wheat, and cotton will decline by 2.46 million, 5.40 million, and 4.98 million, respectively as a result of China’s WTO commitments.”<sup>132</sup> Thus there is no question that the WTO accession will create tremendous reverberations due to the hastening of its economic development.

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<sup>130</sup> Vercuiel, 18.

<sup>131</sup> Ibid.

<sup>132</sup> Lardy, 109.

The reports also predict that cumulatively more than 11.3 million agricultural jobs will be lost as a result of accession.<sup>133</sup>

## *Tariffs*

Another contentious issue is that of accusations about Russia not respecting the WTO's regulations on tariff limits, by pleading unjustified health and sanitary and phytosanitary standards. According to Vercueil,

“[t]he interpretation of regulations thereof basically depends on the observer's perspective; hence, the US has expressed doubts over the consistency of Russia's measures against imports of American chicken suspected to have transformed bird flu. Negotiations between the two parties over veterinary inspection protocols ended only very recently, with the Americans doubting that such measures could be redeployed at a later stage.<sup>134</sup>

However, according to Cooper, through the negotiation process, the Russian government has already significantly lowered tariffs rates. The author points out that:

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%. 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. 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.<sup>135</sup>

In the era of globalization, more than ever, Russia will attempt to use all its leverages to promote its interests. Like on tariffs, Russia will make some concessions, but certainly not all of them. Becoming a member allows Russia to be protected in a framework of rules, and more importantly, allow it to seek out its interests within the WTO. Hence, transition into the WTO would entail a significant transition in the way the government can conduct its economic governance. Yet, Russia must also balance the

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<sup>133</sup> Development Research Center, State Council of the People's Republic of China, *The Global and Domestic Impact of China Joining the WTO*, 52.

<sup>134</sup> Vercueil, 19.

<sup>135</sup> Areddy, 9.



demands placed onto it by the WTO accession process – an issue that will be expanded on at length in the following later.

Moreover, as will be shown later, how the government conducts itself within the WTO will be intrinsically tied to its legitimacy because of the connections that its trade policy has reverberations to a reconfiguration of the country's vested interests. According to Lardy, In China, Since the government had imposed a 80% tariffs on autos with engines less than 300CC. and 100 percent for those with engines of three liters or more and introduced new or more restrictive quotas on imports of automobiles, other vehicles, and parts (to increase share of domestically produced vehicles to 90 percent of total consumption), its WTO membership, because it will reduce tariffs to 25 percent for all automobiles by mid-year 2006 and reduce tariffs on auto parts to only 20 percent. The author forecasts that the market-opening moves will place additional competitive pressure on the domestic vehicle industry, consolidating them into a handful of major auto enterprises while the local governments may continue to resist closure of their small, mostly inefficient plants. In 2000 there were still about 120 companies, while the 13 largest companies accounted for 92 percent of the 1.6 million vehicles of all time produced in 1998, implying average production of about 113,000. But the average production of the remaining companies was a mere 1,200.<sup>136</sup> According to the author, the potential impact of WTO accession on China's auto industry is huge:

“The effect of WTO entry on the inefficient, small-scale producers of cars, motorcycles, and other vehicles is almost certain to be adverse. If China had a fully functioning market economy, many if not most of these firms would have disappeared some time ago, through mergers or bankruptcies. As prices of cars and other vehicles fall following China's entry into the WTO, the financial losses of these firms certainly will rise. Given the pressure on state banks to operate on more commercial terms, the rising burden of subsidizing these small-scale producers may well be the final straw that leads Chinese banks to curtail the flow of new credit to these firms, thus ensuring their demise.

Thus, the preceding point made by the highlights how in China's case, too, it's vested interests related to the WTO entry would also be shaken up, causing the government to decide when to use their political and economic leverages in economic governance by either propping up the small auto makers, using levers such as the state apparatus'

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<sup>136</sup> Lardy, 108.

relationship with domestic car firms – large or small – as well as its relationships with the banks.

### *Automotive and Aeronautical Industries*

Russia's issues related to the automotive and aeronautic industries will also be contentious. For Verduciel, these two issues "have certain elements in common: a highly symbolic bearing owing to past prestige (they were the jewel of Soviet civil industry); a structural weakness related to the crisis of the 1990s; a propensity for lobbying (representatives of these industries learned how to make politicians listen to them); and concern for the future (competition from Western Asian industrialists threatens them directly on their domestic market). Because of these interests based on the vested interests in Russia, since 2000 the country's negotiators, led by M. Medvedkov, negotiator in chief, in liaison with G Gref, Minister of Economic Development and Trade hammered two main demands regarding the two sectors. Namely, "Russia's accession to the WTO cannot entail an immediate significant reduction in customs rights. Reductions are possible in the mid-term and only in certain, specifically identified sectors" and [n]o optional sectoral agreement will be accepted as a precondition for accession to the WTO.<sup>137</sup> The author point out that despite Russia having custom tariffs of 25% on imports, its main automobile manufactures' share of the domestic market has been declining for 15 year, and has recently fell below 50 percent. According to Verduciel, in the wake of higher tariffs on imported vehicles and components, Russia is proposing near-zero tariffs for components intended for assembly at private Russian sites, on the condition that these be progressively redirected to Russian suppliers."<sup>138</sup>

Similarly, in the aeronautics industry, tariffs imposed on imported aircraft at 20 percent. Because of its structural problems, Russia argues that its industry is only running at 1 to 15 percent capacity, resulting in the need for further investment in modernization, an endeavor that could only succeed by including it under the security of solid customs barriers. The European Union and the US are urging Russia to sign an optional multilateral agreement on civil aviation drawn by the WTO. Russia was prepared to sign

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<sup>137</sup> Verduciel, 19.

<sup>138</sup> Ibid.

this agreement at one time, but has since withdrawn its commitment, following new official objectives already mentioned. However the negotiators themselves appear uncertain about limiting the necessary concessions efficiently.<sup>139</sup>

## *Banking*

In terms of the banking sector, Sberbank still continues to retain 55 percent of private accounts in Russia. However, Russia has undertaken measures to restructure the [banking] sector, which affected primarily the reform of the state guarantee on accounts, the minimum level of capital required for commercial banks' approval with the CBR, and restrictions on foreign banks' access to the Russian market. In November 2002, the ceiling imposed on foreign states in Russian banks was abolished. Moreover, two laws suppressing money laundering were voted upon in July 2001 and September 2002, enabling the Russian authorities to show their willingness to conform to the standards of the Financial Action Task Force on Money Laundering (FATF) and Russia's banking sector's recently increased role in financing consumption and investments is indicative of the sector's progressive maturation; the sales of Impexbank (with assets of 1.8 billion US dollars) to a foreign establishment in February 2006 was a symbolic step. However, Gazprombank – still holds 36 percent of the sector's assets, 45 percent of private loans, and 33 percent of corporate loans; and foreign banks only control 10 percent of the banking assets, compared with 70 percent on average in Central European Countries.<sup>140</sup>

As for China, based on its commitments in terms of banking, a few near term impacts could be seen. The lifting of geographic restrictions would likely usher in more branches of foreign banks into more Chinese cities – not just in China's special economic zones along the coast but also in its interior regions. In addition, international banks could offer a wider range of services with their expertise, such as housing mortgages, consumer auto loans, debit-card and credit-card operations and Internet banking. In the context of these developments, "The fact that foreign banks, as newcomers on Chinese markets, intend to enter this sector may have reflected their perception that not only is this a niche with huge potential, but also where it can apply expertise obtained elsewhere." It is our

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<sup>139</sup> Ibid., 20.

<sup>140</sup> Ibid., 13.

view that the growing presence of foreign banks in China would put pressure additional local banks to offer similar services.

Most importantly though, with the WTO commitments of December 2006, China will have to start letting foreign banks take customer deposits of the Yuan. The Chinese government might be tempted to delay foreign entry and give its banks more time to prepare, but that would result in a further delay of the development of an efficient banking sector. That is, China's domestic banks are unlikely to have restructured well enough by then. Another factor that may help to counteract the expansion of foreign banks – and therefore influence -- after 2006 is the perceived lack of credit worthy domestic borrowers in China. Namely, Lardy has noted that

Since foreign banks, like their domestic counterparts, have to pay interest on deposits, they will only be willing to take domestic currency deposits to the extent they can be used to support interest-bearing loans. Thus if foreign banks are unable to identify a sufficient number of creditworthy borrowers, they are likely to limit the expansion of the deposit-taking business as well. The net result is that *commercial considerations* in the short run may be of greater constraint than regulations limiting the expansion of foreign banks.<sup>141</sup> (emphasis added)

However, many foreign investors have shown considerable interest in the four major SCBs, as well as many of China's smaller banks. For example, in June 2005, Banc of America (BOA) agreed to buy a 9% stake in China Construction Bank (CCB) for US\$2.5bn from Huijin (China SAFE Investments Limited (known previously as Central Huijin Investment Co, Ltd.), a company under the direction of the State Council) and subscribed for a further US\$500m of shares in the initial public offering of CCB. It has also been granted an option by Hujin to increase its holding to 19.9% over the next five years. Temasek bought a 5.1% stake for US\$1,466m, and subscribed for a further US\$ 1 billion worth of shares in the initial public offering of CCB. Because of Bank of America's investment, Mr. Gregory Crul, Global Corporate Planning and Strategies Executive with BOA had been appointed with the board CCB. As noticed by Daiwa's prospectus on CCB, CCB and BOA have entered into an exclusive agreement for the latter to provide CCB with strategic assistants in the following areas: risk management, corporate governance, credit cards, consumer banking, global treasury services and

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<sup>141</sup> Lardy, 117.

information technology. We believe that this CCB and BOA partnership is emblematic of banking reform strategy.<sup>142</sup>

Namely, SOEs, including state-controlled listed companies, have a significant influence on the whole economy. Because of the large population in the PRC, the country faces a great deal of pressure to ensure adequate employment. Therefore, the government has great difficulty in allowing companies that have performed poorly to be de-listed or go bankrupt. As there is no sound exit mechanism, a company that has performed poorly can rely on the value of its listing status “shell” to substantiate its share price because this is a rare resource in the market. Shareholders therefore have no awareness of any risk or crisis relating to their shares. They are not concerned about the quality of corporate governance and have no strong demand for high quality financial information.<sup>143</sup> Frank M. Tamagna, for instance, notes that “the rapid growth of Chinese modern banks was connected with government financing.”<sup>144</sup> In light of these peculiarities about China there is no wonder, then, why in 2002, that Credit Lyonnais Securities Asia – Emerging Markets, a prominent banking firm, ranked China 19<sup>th</sup> out of 25 emerging markets for a macroeconomic environment conducive to corporate governance (with factors such as transparency and legal norms). Namely, they note that, “Part of the reason is that China’s accounting standards are poor, stock price manipulation is widespread, and a predictable and unbiased legal system is still in its infancy.”<sup>145</sup>

Hence the banking system has been used to keep state enterprises afloat via the issuance of loans (many of which are now non-performing). Some scholars fear that without reform, China’s public debt stock would only grow further as corrective fiscal measures are neglected with the accumulation of NPLs and greater budgetary expenditure pressures. IMF scholars warn, “strong growth alone will not solve China’s public debt

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<sup>142</sup> Kenneth Lee and David Lum, “Asian Banking Insight”, Daiwa Institute of Research LTD., 2005.

<sup>143</sup> Wei Guo Zhang, “Shareholding Structures, Related Party Transactions and Corporate Governance in China,” in *The Governance of East Asian Corporation*, eds. Ferdinand A. Gul and Judy S.L. Tsui (New York: Palgrave/MacMillan, 2004), 41.

<sup>144</sup> Frank M. Tamagna and T.V. Soong. “Banking and Finance in China,” *Pacific Affairs* 16, no. 1 (March, 1945), 45.

<sup>145</sup> Richard Daniel Ewing, “Chinese Corporate Governance and Prospects for Reform”, *Journal of Contemporary China* 14, no 43 (2005), 325

problem. Even with average real annual growth of 7-8 percent of GDP.”<sup>146</sup> In fact, any reform to the banking system could also produce excessive layoffs and raise the cost of market transition to levels where social stability might be threatened.<sup>147</sup> This is made worse when China lacks an adequate pension system. With its estimated US\$476bil - US\$911billion in bad loans, there is no denying that banking reform is needed.<sup>148</sup> This is especially true when in China an adequate pension system that addresses these changes is lacking at best. Moreover, the dominance of state banks compared to private banks would continue to leave the private and commercial and industrial sector little access to credit.<sup>149</sup>

This is perhaps why Zhou Xiaochuan, governor of the People’s Bank of China, has once emphasized the importance of sequencing banking reform as the first of the financial sector reforms, so that the banking system could be put on a sound position by recapitalizing large SOEs and turning them into joint stock companies with the participation of foreign strategic investors.<sup>150</sup> He noted, in fact, that China “cannot wait to start reforming the exchange rate regime until all banking reform measures have been completed.”<sup>151</sup> The issue becomes especially pressing where poor corporate governance continues to wreak havoc on China. In a scathing account, one scholar affiliated with the Nixon Center noted:

“In short, not only do individual shareholders need to worry about traditional principal-agent concerns, but owners of Chinese firms also face the fact that chief executive officers (CEOs) may act in the political interest of the Communist Party...Support from local governments during tough economic periods makes credit allocations more a function of political connections than of market

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<sup>146</sup> James Daniel, Thomas Richardson, Raju Singh and George Tsibouris, in *China Competing in the Global Economy*, eds. Wanda Tseng and Markus Rodlauer (Washington: International Monetary Fund: Washington D.C., 2003), 118.

<sup>147</sup> Kenneth W. Dam, “China As a Test Case: Is the Rule of Law Essential for Economic Growth?” *John M. Olin Law & Economics Working Paper* (January 2006): 24.

<sup>148</sup> “China’s NPLs exceed foreign reserves,” *Wall Street Journal*, May 4, 2006. According to the newspaper’s May 31<sup>st</sup> 2006, Ernst & Young rescinded its figure, while Fitch Ratings put the figure closer to US\$476bil, which could make China’s financial system lose \$220 billion.

<sup>149</sup> Jianglian Wu, *Understanding and Interpreting Chinese Economic Reform* (New York: Texere, 2005), 232-234.

<sup>150</sup> James A. Dorn, “Ending Financial Repression in China,” *CATO Institute Economic Development Bulletin*, March 23, 2006, 2.

<sup>151</sup> Xiao-chuan Zhou, “Governor Zhou Xiaochuan speaks on Issues Related to the Reform of the Exchange Rate Regime,” *People’s Bank of China News*, September 10, 2005, 13, on the world wide web at [www.pbc.gov.cn/english/detail.asp?col=6400&id=572](http://www.pbc.gov.cn/english/detail.asp?col=6400&id=572)

considerations. Furthermore, local governments' interests may not coincide with a company's desire for national or international competitiveness. Specifically, political concerns over unemployment and social stability are slowing the pace of ownership reform, bankruptcies, and corporate restructuring."<sup>152</sup>

The State has absolute control of most listed companies in the PRC, and determines the appointment of senior management. This is usually selected from governmental officials or leaders of SOEs. In this situation, the market for the recruitment of senior executives does not function to monitor management. Additionally, the imperfection of the capital market further adversely affects the function and effectiveness of this monitoring mechanism because the company cannot use commensurate remuneration packages to attract or retain new talent. Without an effective senior executive recruitment mechanism, it is difficult to achieve the maximization of the interests of the country and its shareholders.<sup>153</sup> Moreover, due to high degree of ownership concentration, despite the reform efforts of the past 20 years, the macroeconomic regulatory system and micromanagement of the state is still poor. While the amount of material and financial resources and the scope of state management diminished, "a corresponding indirect system of regulation and management making use of various kinds of economic policy and regulatory measures has not been set up in its stead," says Gao Shangquan, a former member of the Economic Committee of the Chinese People's Political Consultative Conference, by noting that it results in an economic system where no institutional and organizational measures exist that would guarantee that the measures and objectives of the different departments of the state are united and compatible.<sup>154</sup>

In terms of sectors in Russia's financial system, similar arrangements were secured. Namely, under new agreements, foreign companies would be allowed to operate in local markets, but only as registered Russian companies – not as branches of foreign companies.<sup>155</sup> Moreover in the area of insurance, Russia has allowed foreign companies establish to establish branches provided after a 9 year transition period and provided that

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<sup>152</sup> Richard Daniel Ewing, "Chinese Corporate Governance and Prospects for Reform", *Journal of Contemporary China* 14, no. 43 (2005): 322.

<sup>153</sup> Moore et al., 41.

<sup>154</sup> Shangquan Gao, *China's Economic Reform*, (London: MacMillan Press Ltd., 1996), 119

<sup>155</sup> Vladimir Tikhomirov, "WTO – It's a De Facto Go: What Does It Mean for Russia?" *Russia Equity Financial Corporation*, 1.

they have met capitalization and other requirements – requirements that have not yet been established. Namely, the government has doubled the allowance of foreign participation from 25% to 50%, excluding foreign capital already present before the beginning of 2007 and foreign investment in state insurance companies that would undergo privatization in the future.

Yet despite the areas of progress, many other issues remain unresolved and contentious among the Russian government and the working party negotiators. Though Russia is working assiduously, and the urgency for Russia to join the WTO has created the impetus to create real progress, contentious issues are likely to come back again in the future as all parties privy to the trade negotiations try to maximize their interests. Because of these tendencies – that contentious issues takes a lot of time to resolve and may create significant displacement on Russia’s society -- it is likely that many of the contentious issues will be used by other states to create issue-linkages for the creation of issue ‘bargaining chips’ for the maximization of power vis-à-vis trade negotiations. .

While in November of 2002, the working party released a draft report of the negotiation that indicates areas of agreement, the document also highlights “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.”<sup>156</sup> Chowhury points out that EU demands that Russian domestic energy prices; access to Russian markets domestic energy prices be better aligned with world market prices; access to Russian markets for telecommunications, finance, and transportation services markets; and demand that Russia accede to a voluntary agreement government trade in civil aircraft.<sup>157</sup>

China is also interested in the impact of Russia’s economy, but unlike the EU and US, it is not a member of the working party. Yet China is also looking forward to the economic opportunities that avail themselves through Russia’s WTO accession. Optimistic about the process, Chinese Vice Minister of Commerce Guangzhou told

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<sup>156</sup> Cooper, 10.

<sup>157</sup> Chowhury, 3.



reporters on February 14, 2007 that “[t]he investment and trade environment in Russia will be further optimized after the country enters the WTO.”<sup>158</sup> In order to boost China’s automobile exports to the country, a part of made-China vehicles will be held in Russia in June 2007.

Sino-Russian trade volume grew 15 percent in 2006 over the previous year (2006-2007) to 33.4billion. China has become Russia’s fourth-largest trading partner, which Russia is China’s eighth biggest.”<sup>159</sup>

## Conclusion

The globalizing forces of the WTO accession are a process that fundamentally alters the economic governance capability of the Russian and Chinese state. If Russia were outside the WTO framework, its situation will become complicated for Russian producers to find new markets, namely because, in the absence of WTO protection, producer would be susceptible to rigorous interpretations of anti-dumping rules. The previous section has highlighted both advantages and disadvantages of the accession. As in China’s case, where it has only recently acceded to the organization in 2001 WTO membership has already helped to bring in foreign competition, creating further impetus for firms to specialize in sectors that follow China’s comparative advantage and delegating autonomy to micro-management units so they would be consistent with the traditional macro-policy environment, thereby helping to promote investment and job opportunities to the hinterland, promoting balanced growth. Moreover, foreign competition induced by the WTO, would promote more product variety and prices and better quality. It will also promote a more flexible prices system, better reflecting supply and demand of factor endowments and commodities, which would promote efficiency and move the economy closer to the production frontier. Foreign capital and technology has also been introduced.

While Chow has argued that the reforms in the economic structure in China after WTO membership would see the importance of state-actors relative to non-state actors, I argue that compared to Russia, the way in which China has already divested its state control on the non-state actors allows it to maintain significant capacity to pursue

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<sup>158</sup> “China-Russia links helped by WTO Bid,” *Russian Business Monitor*, February 15, 2007.

<sup>159</sup> *Ibid.*

economic governance that help the state to not only comply with WTO regulations (at times begrudgingly and not without intensive negotiations), while it pursues a comparative defying strategy, which takes into account the reality of globalizing forces. It is in this connection, that China was able to retain significant control, comply with requirements for WTO membership and promote economic growth and stability that we view China's strategy as helping to convey insights onto the promise for China as a successful economic model that Russian reformers should be mindful of when instituting its own policies own trade and other WTO related policies.

With the urgency of WTO membership the government's legitimacy will be increasingly based on how society's competing interests are resolved concomitantly with the balancing of WTO obligations, foreign pressures and the instituting of state power.

Moreover, explains that the factors constituting Russia's primary objectives in a bid to join the WTO is to obtain new trade advantages; gain access to foreign markets and provision of non-discriminatory treatment for Russian exporters; access to the international dispute settlement mechanism, creation of a more favorable climate for foreign investments; creation of conditions for growth of domestic production' quality and competitiveness as a result of increased flow of goods, services and investment and; expansion of opportunities for Russian investors in the WTO-member countries.

In addition, for Russia, compliance with the WTO while attaining economic growth and stability acts as a source of legitimation for the federal government in economic governance in the Post-WTO framework in two senses. Firstly, the prospects and challenges that reveal themselves domestically through the new economic framework should be seen in light of the most significant issues structural trade issues that that surround the aftermath of Russia's transition. How successfully the federal government deals with those issues as it transitions into the WTO and becomes a full fledged member will be key to legitimize the government's economic governance ability. Secondly, the WTO also acts to legitimize government action on enterprises by stipulating several compliance measures that Russia must follow. The central government can use the WTO as a legitimizing tool for reforms in industrial sectors that could be unpopular among the "losers" of the reform.

There will inevitably winners and losers in the process. The structural changes that are occurring because of Russia's transition to the WTO has the potential to affect major sectors like natural resources (accounting for 75% of Russia's total exports), protected sectors like that of autos and smaller sectors like that of goods and services. Moreover, its mosaic-like distribution of economic growth is additional concerns. Despite these challenges, as I have highlighted in this chapter, there are many opportunities as well.