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Opening Russia?

Contemporary foreign trade

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Economic developments in Russia during the past two years have been fairly positive, compared to the earlier transition trajectory of the country. Belying most of the expectations, the mid-August crisis in 1998 has not resulted in a deepening of the output contraction. To the contrary, main macroeconomic performances of the Russian economy since 1999 have been impressive: economic growth has accelerated, reaching 7.7 per cent in 2000; after a peak linked to the monetary upheavals that had occurred immediately after the August crisis, inflation rate has progressively slowed down to about 20 per cent for the year 2000. Investment rate has also improved sharply, while industrial production accelerated its recovery.

The role of external factors in the Russian recovery is now widely recognised. This paper focuses on the design of commercial policy, in the broader context of external economic policy. Section I discusses whether the policy changes that have occurred in 1999 and 2000 can be seen as the progressive elaboration of a genuine economic strategy for the Russian external sector. Section II gives a preliminary assessment of the results registered so far in the external sector. Section III concludes briefly by recalling the main choices Russian government is going to face regarding commercial policy.

1. After the crisis: the progressive design of a strategy

Between 1998 and 2001, two major political shocks have changed the institutional environment of commercial policy. Firstly, the rouble devaluation and the partial default over the sovereign debt, in August and October 1998, have drastically altered the making of Russian economic policy. Secondly, the end of the so-called "Eltsine era", accompanied with new elections has made possible a partial reshuffling of the political heads of the State. This is not, by itself, a sufficient cause to a sudden move towards the design of a long-term economic strategy more favourable to Russia's economic and social interests, after six years of a missing strategy (Vercueil, 2001). But certain recent decisions of Russian authorities have shown a new tendency that is worth being explored.

Legislative (in December 1999) and Presidential (in March 2000) elections opened a new period of political stability that was more favourable to the progressive design of a genuine commercial policy. In the first "long term economic program" of the new Government, the target fixed to the mean import tariff was 15 to 16%, in line with the maximum levels usually accepted by IMF, World Bank and WTO. The tariff structure eventually adopted in the beginning of 2001 was based upon four main rates (5, 10, 15 and 20%), with higher rates for individual categories (cars, sugar, alcohol and tobacco). Nevertheless, a number of others restrictions are still being imposed on external trade and currency exchange: fuel exports are subject to a floating tax regime, depending on energy prices in world markets (Tchernavski, 2000), and exporting firms are required to sell 75% of...
their foreign currency earnings to the Russian market within 7 days after the sale. In the field of foreign investment, a clear breakthrough was obtained during 2000 by the progressive clarification of fiscal legislation, coming into force in January 2001. Several notorious disputes involving foreign investors were also settled during last year\(^1\), strengthening the general improvement of investment climate in Russia. As a result, international rating agencies have progressively raised their evaluation of the Russian economy, while German and Finnish public export insurance companies resumed guaranteeing national exports to Russia\(^2\). The last progress in this area was, in March 2001, the approval by the upper house of Parliament of an amendment to the Civil code allowing private property of non farm land\(^3\).

A topic of major interest in this context is the current process of WTO accession negotiations (Broadman, 1998). More than five years after the first official talks, it is now widely admitted that Russia has taken in 2000 decisive steps in the credibility of its accession process\(^4\). For Russia, economic incentives endeavour being better accepted by western commercial partners are clear: financial damages caused by various anti-dumping procedures and quotas imposed by European Union, on the basis of the classification of Russia as a non-market economy, are estimated at 2.5 bns $ a year. Canada, United States, South Korea and others countries are taking similar measures, that could be removed or, if not, discussed in a more comprehensive framework if Russian accession to WTO was completed. The latest Russian proposals were a little more liberal than previously announced in the long term economic program. They allow foreign investors to take bigger shares in service industries. Several structural laws are under preparation, aiming to bring Russian legislation closer to international rules in various areas (namely, intellectual property protection, State support for industries, customs regulations, commercial licensing, etc.). Nevertheless, recent statements from top level government officials tend to mean that Russia is willing to bargain strongly its accession. For instance, a five to seven years period of special status has already been asked for by Russian authorities, in order to enable domestic industries to face a more acute competition from outside. Among a wide range of topics, agricultural policy will be a subject of particular sensitiveness, given the political weight of the sector in Russia.

It is a bit early to assess the chances of Russia to become rapidly a full member of the WTO. But from an institutional point of view, the most important is to give confidence to economic agents, be they Russian or not, that the legal framework in which they conduct their activities can be stabilized et secured. Compared to the progress made in this area, it is of less importance to know whether Russian authorities have run as fast as possible in a so-called liberal direction.

2. Preliminary results: local strengths and global weakness of the Russian economy

Russian authorities may have been comforted in their strategy by some good news coming from the external sector: Russian trade balance posted a record surplus of 61 bns US $ in 2000, with an increase of the total value of export estimated at 39% over the year before,

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1 For example, BP Amoco versus Sidanko and the lawsuit regarding the Lomonossov factory.
3 It is interesting to note that, on the other hand, the possibility to own privately agricultural land has been postponed by the Sate Duma.
4 See the assessment of WTO Director General Mike Moore: « Russia, the International Economy and the World Trade Organization », Moscow, 30 March 2001.
thanks to the rapid rise in world fuel prices. The sharp devaluation of the rouble in fall 1998 provided an effective protection under which import-substitution became possible: in 1999, imports dropped by almost 30%, while industrial production increased by 8.1%; in 2000, the growth was even brisker (9%), with light industry showing the most spectacular recovery (+22%). For the whole year 2000, Russian enterprises declared 37-38 bns US $ of profit (most probably, a figure underestimated), of which more than 40% originated from the sole energy and metal sectors, two leading exporters in the Russian economy. Budget earnings also benefited from the windfall gains provided by the improved international position of Russia in 2000: the largest increase was recorded in customs revenues, which soared as a share of total revenues from over 14% in 1999 to over 20% in 2000. Therefore, customs duties contributed largely to the impressive budget surplus recorded in 2000, totalling some 2.5% of GDP. In addition, one of the major weaknesses of Russian economy, the lack of investment, began to alleviate, thanks partly to the external sector: fixed investment totalled 42 bns US $, a 17% increase over previous year. Crude oil industries doubled their investments to a fifth of the total amount. On the other hand, metallurgy continued to lag behind (5% of the total investment), stagnating at the 1999 level. FDI represented 5% of the total registered this year, amounting to 4.4bn US $ - a 4% increase over the previous year-. Clearly, the role of external sector in the recovery of Russian economy was determinant in 1999-2000.

However, this picture is a bit too rosy to be complete. Several drawbacks inherited from the first years of transition are still far from being overcome:

First, the role of the energy sector in the restructuring of the Russian economy remains to be clearly defined by the authorities. The real appreciation of the rouble since 1999, due for the most part to export earnings from the energy sector, is beginning to impair the gradual recovery of others industrial sector: during the last quarter of 2000, imports have risen at an accelerated pace (20%), while exports began to slow down, as did domestic industrial output (+2.5% on a year-to-year basis in December). If this tendency were confirmed in 2001, hopes for an industrial diversification of export, much needed by the Russian economy (Popov, 1998), could once again vanish.

Second, distorted incentives produced by the lack of a comprehensive policy cannot be abolished merely by the “dictatorship of the law”. A practical illustration of this idea is the continuation of capital evasion in spite of the measures mentioned above and a continuous commitment of the authorities to fight against it (Sicular, 1998, Westin, 2000). In 2000, capital flight rose again to an estimated amount of more than 20 bns US $, representing about ten percent of Russian GDP. At the same time, the value of foreign direct investment received by Russia was half the amount of Chile. This does not indicate that Russia is becoming an attractive country for genuine investors.

Third, while institutional weaknesses that used to affect the Russian economy may have been less acute since the new administration clearly demonstrated its will to strengthen law implementation, a number of institutional issues regarding the external sector remain far from being solved. According to parliamentary estimations, more than 40 percent of private and some 60 percent of state-owned firms are now controlled by organized crime, with the figure in the banking sector reaching 85 percent. Most often, corruption is closely linked with international operations, since those activities provide earnings in hard currencies. In January 2001, the G-7’ Financial Action Task Force (FATF) quoted Russia for the second time among the “non-cooperative jurisdictions” concerning legislative fight against money laundering. Economic negative consequences of corruption are not simply of an “efficiency” nature (even
if the estimated cost of corruption in Russia is 15 bns US $) : the principal threat is that they undermine the credibility of the major institutions of the country (the State, laws, conventions between economic agents, etc.). The collective character of an institution is not recognised anymore when it becomes obvious that its initial purpose has been diverted for the profit of a minority. Under such conditions, the informational and stabilising role of the institution is no longer fulfilled; it leaves economic agents coping with an uncertain environment by striving to secure short term outcomes from their decisions. This logic of emergency brings many damages to the whole society, which begins to dislocate in various groups closed one to another. It also impairs normal wealth creation and economic development, as most of the resources are not used to invest in productive capacities, or to restructure and modernise economic organisations, but are simply dilapidated.

We have to add to this picture two others difficulties that Russia is bound to face in the near future :

The first one is linked with the most likely end of the exceptional window of opportunity enjoyed by Russia since the rouble devaluation : on the external side, the progressive strengthening of real exchange rate is likely to pursue, and world prices for energy have already declined, showing no clear tendency to recover soon. Given the dependency of both current account balance and budget earnings on the exports of fuel, a sharp fall of energy prices could destabilise Russian international economic situation. On the internal side, there are many signs that the ‘honeymoon’ Russian government enjoyed with the State Duma has come to an end. Politically, it is likely to be more and more difficult to implement certain key reforms delayed until now, for instance in the banking sector.

The second one is the external debt burden, on which a partial default had been declared after the rouble devaluation. The domestic short term debt has been rapidly restructured in 1999, and an agreement has been reached over the longer term sovereign debt in 2000 with the London club, which represents foreign private creditors. However, this is not the case with the Paris club, which assembles public creditors to Russia. The beginning of year 2001 has shown the difficulties of the Government to cope with the problem, as well as the bargaining power of the Duma in such a strategic issue. Meanwhile, Russian budget is still lacking the necessary funding for the repayment of other parts of its debt this year. Furthermore, the debt burden which is currently costing about 25% of the federal budget, is going to reach a peak in 2003. Last but not least, any restructuring agreement with the Paris Club requires a preliminary approval of an economic program by the IMF. So far, despite long and repeated talks, Russian officials have neither obtained nor accepted such an approval.

3. Conclusion : taking advantage of a favourable context.

5 In this paper, we see institutions as collective devices designed to produce and interpret rules of behaviour.
6 However, the budget projections for 2001 were calculated on the basis of a rather cautiously estimated fuel price of 21 US $ per barrel.
7 After official declarations threatening that Russia would not be able to pay its duty for the first quarter of 2001, bitter reactions of the main creditors - Germany and Italy - led to a u-turn in official attitudes and the full payment of the sum, thanks to an in-extremis agreement obtained by the Prime Minister with the Upper House of Parliament.
As it has been shown, Russian commercial policy needs to be designed with due regard to the broader external economic policy. In order to achieve a consistent strategy, Russian authorities should bring together several types of policy:

1. An industrial policy, aiming at reducing scientific and technological backwardness in comparison with western countries, and at the same time encouraging spill-over from the energy and raw material sectors to others industries.

2. A capital account policy, managing in a comprehensive framework the various flows of capital - discouraging short term flows, and encouraging longer term ones - to dismantle the adverse selection effect currently affecting this sector.

3. A debt settlement strategy, aiming to encourage debt-for-equity swaps with western creditors in order to alleviate the external burden on the budget and the modernisation of various domestic industrial sectors. From the point of view of international creditors, it could be of great interest to bargain a substantial discount on their controversial credit against stakes in some potentially valuable Russian enterprises.

These strategies require well-functioning banks to be fully implemented. For the time being, most of the financial sector’s activity is concentrated in the management of public loans and the placement of major Russian enterprise earnings abroad. Banks accounted for only 2% of the financing of productive investment in 2000. Hence, one of current top priorities of the Government should be to implement the restructuring of Russian banks, enabling them to act as normal financial institutions.

At the same time, Russia will have to look carefully at its relationship with international organisations such as IMF, World Bank or WTO. Presently, Russia is in a position to choose whether to open or to close the door to international financing and complete access to world markets. But if its external situation were to deteriorate rapidly, it could force Russia to admit control conditions from abroad that are, for the moment, considered as politically unacceptable. That is why it is time for Russia to tackle actively the main problems discussed above, taking advantage from its current favourable situation to implement the necessary institutional and structural reforms, before the possible vanishing of the current window of opportunity.

References:


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8 Agreements have already been signed in March 2001, with German and Italian Counterpart, on an experimental scale.
