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## Russia, WTO and Customs Reform: an Uphill Struggle

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Cover story

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Much has been written over the past seven years about Russia's pending application to the World Trade Organization. Every few months it seems that we see a flurry of announcements and legislative initiatives intended to meet WTO requirements. In June President Clinton again offered his support to Russia's admission to the WTO. Recently, AmCham hosted several Russian officials who discussed how the proposed Customs Code and the new customs tariff schedule were designed to accelerate Russia's acceptance to the WTO. What is The World Trade Organization? Why does Russia want to join? What kind of reforms will Russia have to implement in order to be accepted to the WTO? These are the issues I wish to discuss in this article.

Every nation establishes its own trade policies and has its own best national interests at heart when dealing with other nations. As a result every country, to some degree, has trade barriers. In addition, there are many reasons that nations want to regulate imports. Collection of revenue is a principle reason for establishing tariff rates. Regulation of import competition and retaliation against foreign government trade barriers are also significant factors. Other reasons are protection of national defense and the protection of local cultural, religious, or ethnic values. While we see direct trade barriers implemented by national tariff policies, indirect trade barriers such as restrictive currency exchange policies and overly complex licensing requirements for imported goods can also serve the purpose of restriction of imports. In many countries government policies lack transparency. For example when a nation's import regulations or procedures are not readily available to foreign firms, these firms cannot easily gain entrance to its markets.

The World Trade Organization and its predecessor GATT (General Agreement on Tariffs and Trade) were established to deal with the complex issues of trade barriers, building on the belief that the mutual interests of nations can best be served if they could find a way to encourage free trade in goods, unfettered by high tariffs and other barriers, by enacting "liberalized" trade rules. In 1995, the WTO replaced the provisional status of the GATT with a permanent internationally recognized body that would negotiate trade agreements and settle disputes. The concept of consensus with regard to dispute resolution was transferred to an official dispute settlement system and the WTO also carried over the GATT concept of most favored nation treatment (that a tariff rate granted to one member would be extended to all).

The WTO implements its principles through a series of agreements which cover goods, services and intellectual property, spelling out principles of liberalization, and permitted exceptions. They include individual countries'

commitments to lower customs tariffs and other trade barriers; they set procedures for settling disputes; prescribe special treatment for developing countries and they require governments to make their trade policies transparent.

Among the most interesting agreements is that on tariffs. This agreement contains 22,500 pages of individual countries' commitments on specific categories of goods and services. These include commitments to cut and "bind" their customs duty rates on imports of goods. When a commitment is "bound" it means that they can only be modified or withdrawn after negotiations with affected countries, this means that these commitments are virtually guaranteed.



"In joining the WTO, Russia should receive the same treatment as its partners in the E.U and central Europe. With regard to WTO negotiations, Russia seeks comparable tariff quotas. If other countries use tariff quotas, Russia should have the right to as well," said Deputy Minister of Agriculture Sergey Kiselev (left), speaking to Jeff Singer, Country Representative of ACDI/VOCA (right).

It is generally believed that the free trade encouraged by the WTO has a positive economic impact not only on the 137 member countries but also on many multinational companies. OECD projections indicate that the increase in China's GDP, due to its WTO accession, will be 1.8 to 2.5 %. The European Union is projected to show an increase of 1.3 to 1.4 % in GDP due to WTO reforms. Multinational companies like IBM anticipate saving \$110 million annually as a result of reduced tariffs in addition to untold millions as the result of increased enforcement of IPR. The recent support given by multinationals to China's accession to the WTO is driven by the prospect of increased markets in China resulting from reduced trade barriers required by the WTO.

After the fall of the Soviet Union, Russia seemed eager to join major Western institutions, such as the International Monetary Fund, the World Bank, the G-7 Group, and the WTO. Russia submitted its application to the GATT in June 1993. In 1995, Russia transferred that application to the newly formed WTO. A country's accession process begins with a letter to the WTO director general, stating its intention to join. The WTO General Council considers the request, and it then sets up a Working Party (WP) that takes charge of the clarification of the acceding country's current trade regime and the negotiations with the country on the terms of admission. All WTO member countries may join the WP, and in the case of a large nation as Russia, a large number of countries have participated.

Next, the acceding country must submit its Memorandum, detailing the status of its trade regime. The Memorandum covers much more than simply the nation's tariff schedule on goods; rather it should detail all aspects of its trade and economic policies and aspects of macro-economic policy, such as the protection of intellectual property rights and investment and competition policy. Collecting and collating the multitude of legislation and administrative policies in these areas consumed a great deal of time for Russian officials. The process then moves on to the first question and answer period, which Russia completed in 1995. Russia also was involved in additional query rounds between 1995 and 1998. Multilateral and bilateral negotiations have been going on since 1995 and are currently taking place. The final steps that need to be taken include a Draft Working Party Report and its adoption by the General Council of the WTO.

For the past five years the level of activity taken by Russia to comply with WTO requirements has been influenced by the political situation. In 1997, predictions of WTO accession by 1998 were made, only to be dashed by the economic crisis of August 1998. In 1999, hopes of progress were high until the NATO bombing of Serbia began. Currently, the

political and economic mood is good; Putin is strongly in charge of Russia and has exercised his power by enacting significant tax reform. The accession of China (probably in 2001) and Kyrgyzstan along with applications for WTO membership by other CIS countries certainly applies some pressure on Russia to complete the accession process.

### **WTO SPOKESMAN**

"This is an organization about rules, which are established by a process involving member governments. Until Russia joins the WTO, it does not have any say in how these rules are developed and so Russia's interests are not being put forward. The WTO would benefit from Russia's membership because until big players in the global scene like Saudi Arabia, Taiwan, China and Russia join, the WTO is not the World Trade Organization. WTO rules bring greater stability and certainty to the trading system so having them extended as widely as possible benefits everyone," said WTO Spokesman Keith Rockwell, speaking from the WTO headquarters in Geneva.

Benefits derived from accession to the WTO include not only increased trade but also the benefits that will be achieved by domestic companies as a result of WTO induced reforms. In addition to the general degree of openness that such WTO-inspired reforms would induce, efforts to join the WTO would almost certainly increase the levels of transparency and predictability not just for other countries but also for Russian businesses themselves. Accession to the WTO will bring enhanced access to export markets. Currently the United States and the European Union still treat Russia as a non-market economy for purposes of anti-dumping regulations. This designation increases the ease with which the EU and U.S. can apply trade restrictions. Russia's accession to the WTO would greatly limit these types of arbitrary trade policies. Beyond these issues, Russia's accession would allow it to utilize the WTO dispute resolution system to resolve disagreements. Foreign investment into Russia would greatly increase as a result of Russia's accession to the WTO. As we saw from

the situation with China's accession, the removal of various trade barriers resulted in billions of dollars of foreign investment. The reforms suggested by the WTO are completely consistent with those supported by international firms for the past few years. Removal of various trade barriers and the increase of transparency of trade related legislation would create confidence in the Russian economy and a great increase of foreign investment would result.

Many obstacles to Russia's WTO accession currently exist. Almost every report on this topic includes similar trade barriers that Russia must correct before it is allowed to enter the WTO. One of the major shortcomings of Russia's accession to WTO is its compliance with TRIPS (Trade in Intellectual Property Rights Agreement of WTO). The WTO is strongly convinced that Russia must improve its IPR situation before accession is allowed. More work needs to be done with regard to the protection of trademarks, high-tech goods, and enforcement of penalties for copyright infringement. With 90% of software sold in Russia reported to be pirated the cost to multinational companies runs to billions of dollars in lost revenue and tarnished reputation.

Another area that WTO has problems with is services. Russia seems especially sensitive and reluctant on the question of the liberalization of services. For example, Russia has restricted the total share of foreign capital in the banking sector to 12% and the ceiling on foreign capital in insurance has actually moved from 49% a few years ago to 15% currently. Standards, testing and certification have become a significant obstacle to market access. Exporters in various sectors have encountered problems. This is due to the lack of transparency of the Russian standardization system and to the conformity of assessment procedures in force.

By all accounts the most significant feature of Russia's accession to the WTO is in the area

of customs duty and tariff reform. Because almost every aspect of Russian customs (laws, rates, enforcement, corruption etc.) is considered to be a barrier to trade, this topic warrants close examination in terms of its history, development of customs procedures and the efforts that have been made to meet WTO requirements.

The current Russian word for customs *tamozhnya*, originated in the times of the Mongol-Tartar yoke. The word *tamga*, in Tatar, meant a customs tax, the official who collected it, and the stamped seal or statement verifying that it had been paid. Each market had its *tamozhnya*, and the right to collect duties could be purchased from the State. Powerful merchants often acquired this right. Thus, the history of customs in Russia extends for almost 800 years and its operations have been reflective of economic policies at the time. During the Soviet period, customs officers had the role of political police and vice squad, preserving the high moral profile of the Soviet. They worked closely with the KGB, whose duty it was to oversee troops guarding the Soviet borders, protecting its people from forbidden literature like *Playboy*, or even the Bible. The current State Customs Committee of the Russian Federation (SCC) has existed since President Yeltsin issued a decree providing for its establishment in 1991. Since then the SCC has mirrored Russia's transition to a free market economy. In its early years it concerned itself largely with shuttle traders smuggling goods in their luggage. Today, it must adapt itself and its 58,000 employees to deal effectively with the official figure of \$52 billion worth of goods that are imported into Russia on a yearly basis. Revenue generated by the State Customs Committee makes up about 40% of the total revenues collected by the Russian government.

During its nine year existence, the SCC has made a strong effort to ensure that its major customs legislation resembled international standards. In 1993, the Customs Code was enacted that established 15 customs regimes such as free circulation, temporary import, and duty free, all of which are similar to customs regimes found in the U.S. and Europe. The Customs Tariff Law was also enacted in 1993, establishing rules for the valuation of goods imported into Russia. These rules closely resemble standards set by the WTO and the law itself states that the purpose of the SCC is to assist in the integration of Russia into the world economy.

While the customs legislation may resemble legislation of the U.S. and the EU, a wide gap exists between the legislation and how it is implemented. The cash-strapped Russian government frequently implements laws that are intended to maximize short-term revenue without regard for their long-term impact on business or long-term revenue. By virtue of article 217 of the Customs Code, customs officers are afforded complete decision making authority over the classification of goods. New and contradictory laws give SCC authorities, whose discretion is broad to begin with, endless opportunities to make arbitrary use of that discretion, often concerning transactions they do not fully understand. It is this individual "policy making" which forms the labyrinth. The implementation of customs regulations is shaped not by logical goals, but by individual prejudices. It is nearly impossible to operate in the spirit of the law, as the "spirit" varies with each inspector. Examples of this attitude abound and are freely discussed in the press and in meetings with customs officials. While various ministries within the government have made numerous attempts to correct the situation i.e. restructuring of customs houses, introduction of computerized systems, it is still an uphill struggle. This is largely because



Anatoly Krouglov, President of the National Association of Customs Brokers, calls for more delegation from the State Customs Committee and for investment in new electronic customs clearing equipment, offices and training. "The time is right for us to assist each other to find solutions to issues," he said to AmCham members as he described plans to convene a nonprofit customs club to bring together customs officials and business people, openly appealing to AmCham members for direct input



the attitudes I have described are deeply entrenched in most of the customs officers. These officials earn about \$20 per month and must use their positions simply to survive.

### **Automating Customs Procedures**

Elena Aroustamova, Clear-PAC program director and President Carol Vipperman, Foundation for Russian-American Economic Cooperation recently visited the AmCham offices to discuss Clear-PACCs program of automated customs clearance which will begin in April 2000. A Vladivostok-based programmer is creating a three-interface system that links freight forwarders, customs brokers, and agents. Once the software has been fully developed and tested, Clear-PAC hopes to use it on a national level - where they have support from regional customs officials. They also intend to work with regional administrations to address issues as they occur with the Russian government.

Over the past few years, the Russian Government, as a result of its efforts to join the WTO, has issued various decrees and introduced a new Customs Code and tariff rate schedule. In 1997, decree #1347 was issued that requires changes in customs rates to be published and allows them to be changed only once in six months. A new Customs Code was introduced in 1999 that was intended to meet some of the requirements of the WTO. It passed the first reading in the Duma in November of 1999. Since that time there have been about 70 pages of amendments that have been proposed by the Ministry of Trade and Economic Development. The ministry feels that this draft of the Customs Code contains too many clauses allowing wide discretion to customs officers. The Ministry of Trade and Economic Development has proposed amendments that would clearly define the classification of goods and the calculation of customs value. Completing the new Customs Code and achieving passage in the Duma will be a long process and customs officials think that a new Customs Code may not be operative until 2002.

On November 27, 2000 decree 886 was enacted. This decree replaces the customs tariff rates from 1995 and lowers the number of rate levels from seven (0, 5%, 10%, 15%, 20%, 25% and 30%) to four levels (5%, 10%, 15% and 20%). The punitive rates of 25% and 30% will be abolished as of January 1, 2001. The SCC wisely believes that by lowering the rates it will collect more revenue because there will be less incentive for importers to cheat. This decree also lowers the weighted average tariff rate of Russia to 10.7 % and this reduction puts Russia much closer to WTO requirements in this regard.

Russia's journey to join the ranks of the World Trade Organization has been long and arduous, and the road ahead promises many more bumps and missteps. As we can see by the recent changes in tariff rates and by efforts to produce a new Customs Code, Russia is moving in the right direction. The current political climate favors the reforms necessary for WTO accession and the world political environment seems ready to take Russia in. So with a little luck and a lot of political will, we may see Russia as a member of the WTO in the near future.

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