ECONSTOR
Make Your Publications Visible.

A Service of
ZBW
Leibniz-Informationszentrum Wirtschaft
Leibniz Information Centre for Economics

Lücke, Matthias

Working Paper — Digitized Version

Accession of CIS countries to the World Trade Organisation

Kiel Working Paper, No. 796

Provided in Cooperation with:
Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

Suggested Citation: Lücke, Matthias (1997) : Accession of CIS countries to the World Trade Organisation, Kiel Working Paper, No. 796, Kiel Institute of World Economics (IfW), Kiel

This Version is available at:
https://hdl.handle.net/10419/941

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

WWW.ECONSTOR.EU

Mitglied der Leibniz-Gemeinschaft

Kieler Arbeitspapiere
Kiel Working Papers

Working Paper No. 796

Accession of CIS Countries to the World Trade Organisation

by

Matthias Lücke

Institut für Weltwirtschaft an der Universität Kiel
The Kiel Institute of World Economics

Kiel Institute of World Economics

Düsternbrooker Weg 120, D-24105 Kiel

Department IV

Working Paper No. 796

Accession of CIS Countries to the World Trade Organisation

by

Matthias Lücke

740063

The authors themselves, not the Kiel Institute of World Economics, are responsible for the contents and distribution of Kiel Working Papers.

Since the series involves manuscripts in a preliminary form, interested readers are requested to direct criticisms and suggestions directly to the authors and to clear any quotations with them.

Accession of CIS Countries to the World Trade Organisation

Abstract

This paper discusses the benefits as well as the adjustment problems resulting from the proposed accession of the member countries of the Commonwealth of Independent States (CIS) to the World Trade Organisation (WTO). In the area of trade-related policies, the CIS countries will have to make strategic decisions on policy objectives that have so far been avoided. Necessary adjustments to specific policy instruments will be limited and mostly technical in nature. Similarly, current plans for regional integration among CIS countries are fundamentally in compliance with WTO rules. However, negotiating strategies should be carefully coordinated among CIS countries that are in a *de facto*, though not necessarily a *de jure* customs union. Systemic transformation, especially the imposition and further strengthening of financial discipline on formerly socialist enterprises through privatization and elimination of subsidies, will need to be carried forward vigorously. Benefits of WTO accession include the consolidation of recent improvements in market access and, above all else, greater credibility for market-oriented reform policies through the international commitments to be entered into by CIS governments with respect to future trade-related policies.

JEL Classification: F02

Matthias Lücke
Kiel Institute of World Economics
D-24100 Kiel (Germany)
Phone: (0) 431 8814 212
Fax: (0) 431 85853 or 8814 500
E-mail: mluecke@ifw.uni-kiel.de

Accession of CIS Countries to the World Trade Organisation

1 Introduction

In 1992 and 1993, most member countries of the Commonwealth of Independent States (CIS) applied for membership in the General Agreement on Tariffs and Trade (GATT).[1] With the change from the 'old' GATT 1947 to the World Trade Organisation (WTO) in 1995, these applications are now considered to be for membership in the WTO. Thus the CIS countries find themselves among the last major trading countries to join the WTO, a group that also includes China, Taiwan, Saudi-Arabia, and Vietnam.

This paper analyses the benefits and the adjustment issues involved in the accession of the CIS countries to the WTO. The paper focuses on Russia, Ukraine, and Belarus which are the largest CIS economies and whose negotiations on accession (together with those of Armenia) are the most advanced. These three countries have submitted memoranda on their trade-related policies, and are now at different stages of answering successive rounds of questions from members of their Accession Working Parties and conducting

---

[1] By January 1997, only Azerbeidshan, Tadzhikistan and Turkmenistan had not applied for GATT/WTO membership (WTO internet page <http://www.wto.org/wto/memtab2_wpf.html.> as of 22 January 1997).

bilateral and multilateral talks on trade concessions. In spite of the narrow focus of this paper on only three out of twelve CIS countries, it is expected that both the benefits and the adjustment problems involved in acceding to the WTO are broadly similar for Moldova and for the more advanced Transcaucasian and Central Asian economies. Certain adjustment issues, such as in the area of subsidy reduction, may be less urgent for some of the less advanced CIS economies if these qualify to enter the WTO as developing countries.

From the point of view of the CIS countries, their accession to the WTO would represent an important step in their systemic transformation into market economies. By subjecting their trade-related policies to the scrutiny of their trading partners and by undertaking binding liberalisation commitments, the CIS countries would enhance the credibility of their market-oriented reforms. WTO membership would represent the institutional side of their integration into the international division of labour after several decades of self-imposed isolation. In addition, many improvements in market access in OECD countries would become permanent which, so far, have only been accorded to CIS countries on a provisional basis. Furthermore, from the point of view of the WTO, the accession of the CIS countries would strengthen the multilateral trading system against the background of moves towards regional economic integration in many parts of the world.

Along with the potential benefits, the accession of CIS countries to the WTO involves formidable adjustment problems that arise mainly from three sources. First, when the CIS countries were still member republics of the former Soviet Union, they had no foreign trade policies of their own. Because of their only recent independence, the institutional framework is still quite weak in many policy areas affected by WTO rules, including the trade regime, financial sector regulation, and monetary and exchange rate policies. Frequently, strategic policy objectives are not completely defined. Furthermore, the legal frameworks in CIS member countries are not fully developed in some areas that have been brought into the scope of the multilateral trading system through the WTO agreements, such as services and intellectual property rights.

Second, the disintegration of the former Soviet Union proceeded in an unplanned and, at times, haphazard fashion. Therefore, it took several years for new market-type institutions to be formed for the conduct of trade among the CIS countries, e.g. contractual relationships directly between enterprises, a functioning payments system, national currencies, currency exchanges. Against this background, moves towards regional integration among CIS countries, which were motivated by a variety of political and economic considerations and

took place at the bilateral, plurilateral, and multilateral levels, frequently lacked consistency and transparency.[2]

Third, WTO rules assume the existence of an economic system based largely on market transactions among economic agents. In a state-dominated economy, fulfilment of many membership obligations would be difficult, if not impossible, to implement and verify. However, market-oriented reforms in many CIS countries are far from complete. In practice, of course, present WTO members show widely varying degrees of state involvement in the economy, and the difference between a market economy and a centrally planned economy may ultimately be one of degree. Nevertheless, systemic transformation has progressed less far in most CIS states than in most transition economies that are now WTO members (with the possible exception of Mongolia and Bulgaria). Therefore, further progress in systemic transformation is bound to be an important topic in negotiations on accession.

While many of the adjustment problems stem from the common Soviet past, it is important to note that economic policies even the three selected CIS countries, and more so in the full group of twelve, are becoming increasingly

---

[2] The term plurilateral in this context refers to groups of more than two CIS countries cooperating through special agreements, rather than through the established CIS institutions. Cooperation at the latter level is called multilateral.

differentiated. This applies to policy areas as varied as subsidies, agricultural policies, and the role of state-trading enterprises. In treating the accession issues in the CIS countries as "broadly" similar, this paper takes a bird's eye view for the benefit of providing a concise overview. A closer look would reveal considerable divergence at levels of greater detail.

This paper starts with a brief survey of the evolution of the external trade of the CIS countries since 1992, including a discussion of those features of the central planning system that continue to affect progress in systemic transformation in general and the market-oriented restructuring of external trade in particular (Section 2). The subsequent sections analyse the institutional and policy changes to which CIS country governments would have to commit themselves in the course of accession to the WTO (Section 3: trade related policies; Section 4: regional integration; Section 5: systemic transformation). Section 6 discusses the benefits of WTO accession for the CIS countries in terms of more secure market access and the lock-in of market-oriented reforms. Section 7 concludes on the implications of the accession of CIS countries for the multilateral trading system.

2 External Trade of the CIS Countries Since 1992

The former Soviet Union could be characterised as a large, essentially closed economy. Its relatively small foreign trade was concentrated disproportionately

on the other centrally planned economies that were members of the Council for Mutual Economic Assistance (CMEA). The small size of trade with the OECD countries was not only due to a politically motivated preference for trade among socialist, rather than with capitalist countries. In addition, on the part of the OECD countries which would have been the most important trading partners under market conditions because of their large economic size, many imports from the centrally planned economies were subject to quantitative restrictions.[3] At the same time, OECD exports of many technologically advanced capital goods were subject to restrictions for strategic reasons (Cocom list).

Since 1991, the politically motivated barriers to East-West trade have been reduced considerably on both sides. As a result, trade has increased markedly between countries where barriers have been reduced. A variety of empirical studies have produced broadly similar estimates of how the regional composition of the foreign trade of the CIS countries would change once

---

[3] The former Soviet Union was not a member of GATT 1947. However, special rules allowing quantitative restrictions against exports of centrally planned economies existed even for those socialist countries like Poland and Hungary that were contracting parties to GATT 1947 (OECD, 1994; Schultz, 1996).

foreign trade is governed fully by market incentives.[4] Gros and Dautrebande (1992) apply several models to the trade patterns of the CIS countries and estimate the long-run share of intra-CIS trade in total trade at no more than 25 per cent, irrespective of the chosen model, for the European CIS states, with a much lower figure for Russia.[5] However, foreign trade statistics from Russia, Ukraine, and Belarus, even if they are not entirely reliable, show this share still at more than 50 per cent in Ukraine and more than 60 per cent in Belarus, with only little reduction over the last few years.

---

[4] Such studies are based on the observation that, among market economies, there is a stable relationship between the volume of (bilateral) trade between pairs of countries, on the one hand, and their gross domestic products and geographic and cultural distance, on the other (gravity model). This relationship can be used to estimate the regional pattern of trade for the CIS countries under (hypothetical) market economy conditions.

[5] There are some reasons to suspect that such estimates indicate a lower bound for the future importance of Belarusian trade with CIS countries, rather than a realistic point estimate. First, national income in the former centrally planned economies is notoriously difficult to estimate, and Gros and Dautrebande have used a conservative (i.e. low) figure. In the simulations, this procedure will lead to similarly low estimates for trade with the CIS countries. Second, the legacy of the Soviet system - isolation from Western markets, a common business culture, similar consumer preferences - may well, for an extended period, exert a stronger influence than factors such as a common language among market economies. Third, the development of the transport infrastructure may be path dependent without much effect on the economic appropriacy of the resulting trade; for example, natural gas will continue to be transported through existing pipelines.

The very slow pace of regional restructuring in CIS trade contrasts sharply with the experience of the more advanced Central and East European transition economies. In the six largest economies[6] combined, the share of East European countries in total exports fell from 51 per cent in 1989 to 15 per cent in 1994. During the same period, the combined share of the 15 EU countries, which are now the most important trading partners due to their geographic proximity, increased from 23 per cent to 64 per cent (Piazolo, 1996). With a similar picture for imports, it may be concluded that it was not external conditions that prevented a more rapid reorientation of the foreign trade of the CIS countries, but rather the comparatively slow pace of systemic transformation in the CIS compared to the Central and East European countries.[7]

While the regional composition of CIS trade has thus changed only slowly, its volume has decreased dramatically.[8] To a large extent, this is due to the collapse of exports of finished industrial goods. These had been directed mostly to other centrally planned economies and frequently did not conform to international standards in terms of quality and price. The decline in aggregate output and

---

[6] Poland, Czech Republic, Slovak Republic, Hungary, Romania, Bulgaria.

[7] A more detailed discussion of the determinants of trade reorientation may be found in Kaminski et al. (1996).

[8] The best available estimates by Michalopoulos and Tarr (1994) show 1993 trade volumes at roughly one third of their 1990 levels.

demand in all European transition economies, coupled with import liberalisation and increased competition from OECD country firms, reduced CIS manufactured exports to a fraction of their former volume. In a parallel development, Russia increased the prices for its energy exports significantly from their former, artificially low levels. As a consequence, net energy importers among the CIS countries reduced their import volumes sharply without, however, finding stable sources of financing the remaining current account deficits. Both Ukraine and Belarus repeatedly ran up payment arrears on Russian energy imports and were obliged to request debt rescheduling. Only to a limited extent were reduced intra-CIS exports of intermediate goods, like energy materials, steel, non-ferrous metals, basic chemicals, re-directed from CIS destinations to the world market.

Initially, the decline in trade among the CIS countries was also caused by the breakdown of the central planning institutions and the absence of market-type institutions that could have taken their place. Because of the absence of a functioning payments system in 1992 and 1993, many CIS countries and even regional administrative units imposed quantitative export barriers in order to maintain a sufficient supply of scarce goods in the local market or to ensure that internationally marketable goods were exported in exchange for convertible currency. However, the institutional framework for trade among the CIS countries has since improved markedly. By 1994, nearly all CIS states had

introduced national currencies, most of which were *de facto* convertible for current account transactions. A workable system of inter-state payments now exists through correspondent accounts maintained by commercial banks. It is therefore unlikely that the absence of trade-supporting institutions in this narrow sense is still the main cause of the low level of trade.[9]

In spite of progress in some areas of systemic transformation, major deficiencies persist with respect to all three key elements - macroeconomic stabilization, structural adjustment, and institutional change.[10] In the field of macroeconomic stabilization, Russia, Ukraine, and Belarus have all succeeded in reducing

---

[9] The evolution of the policy environment for CIS trade, and particularly the trade and payments system among the CIS countries since 1992 have been extensively described by Michalopoulos and Tarr (1994) and IMF (1994).

[10] A wide variety of sources provide detailed analyses of systemic transformation and economic developments in Russia, Ukraine, and Belarus. The following sources have been drawn upon heavily in the preparation of this paper, and readers are encouraged to consult these for more detailed information and documentation of developments. In English language, Russian Economic Trends, Ukrainian Economic Trends, and Belarus Economic Trends, all sponsored by the TACIS program of the European Union, provide detailed analyses on a quarterly basis with monthly statistical updates. In German language, the following publications regularly summarise developments in Russia, Belarus, and Ukraine, respectively: DIW/IfW/IWH, Die wirtschaftliche Lage Rußlands; Die wirtschaftliche Lage der Republik Belarus (both semi-annual); Clement, Hermann et al. (1994; 1995; 1996). Foreign trade policy in Russia is documented in greater detail in a recent addition to the literature: Russia: Foreign Economic Relations. Trends and Prospects. Quarterly Review (first issue in June 1996).

Bibliothek des Instituts
für Weltwirtschaft Kiel

inflation to moderate or even low levels. However, exchange rate policies have been erratic. Nominal exchange rates were fixed for extended periods while domestic inflation exceeded foreign inflation significantly. The resulting overvaluation of domestic currencies reduced the profitability of export sales compared with sales in the domestic market.[11] The profitability of exports, however, is critical for the successful reorientation of exports towards OECD markets. Firms only will incur high outlays for the setting-up of new marketing channels if the expected return is sufficiently high (though inevitably uncertain). Even when central bank interventions in the foreign exchange market ultimately had to be abandoned because foreign exchange reserves were depleted, exports were effectively discouraged because fluctuations in the real exchange rate and, hence, uncertainty about the profitability of exports became more pronounced.[12]

---

[11] Export revenues in domestic currency would change little because of the relatively fixed nominal exchange rate, while both domestic producer prices and production costs in domestic currency would increase along with domestic inflation.

[12] In Belarus, throughout the summer of 1996, *de facto* import restrictions were even imposed to defend overvalued exchange rates. The highly arbitrary administration of these quantitative restrictions would have made them inconsistent with the obligations of WTO membership.

In the field of structural adjustment, the size structure of enterprises is still heavily distorted by the legacy of the central planning system. Planners preferred large enterprises to small ones because the former were easier to set up and control than an equivalent number of smaller enterprises. Not only was output large by Western market economy standards, the degree of vertical integration (value added as a share of the value of output) was also very high (Lücke, 1994; Langhammer, Lücke, 1995). Enterprise restructuring therefore requires a decentralization of decision-making, reduced vertical integration, and ultimately the restructuring of large enterprises into smaller, more flexible units. Such flexibility and enhanced managerial competence are also crucial for enabling enterprises to enter new markets which, in turn, is a precondition for the reorientation of CIS foreign trade.[13]

Furthermore, the existence of many very large enterprises, each of which necessarily supplied a large proportion of Soviet demand for a particular good, led to a sophisticated division of labour among the economic regions of the former Soviet Union. When some of these regions became independent states in 1991, traditional links between enterprises were interrupted by the new borders.

---

[13] The related issues of the commercialisation (change of legal structure) and privatisation of enterprises (change of ownership and system of corporate governance) are discussed in greater detail in Section 5.

Quite generally, but *a fortiori* under such conditions, the market-oriented restructuring of enterprises requires a well-functioning legal system that allows firms to conclude enforceable, inter-firm contracts to replace the former intra-enterprise transactions. In this area, like in other fields of institution-building, the process of systemic transformation in the CIS countries is far from complete.

3 Implications of WTO Accession for the Trade Regimes of CIS Countries

The problems involved in bringing CIS country trade regimes into compliance with WTO rules can be related to the strategy for multilateral trade liberalisation developed by GATT 1947 and further elaborated by the WTO agreements. In general, WTO rules permit different levels of protection for particular industries or service sectors across member countries. However, each member is required to commit to a maximum level of protection for each activity, i.e. to "bind" import tariffs for goods or market access regulations in service sectors (Art. II of GATT 1994). Only in closely defined exceptional circumstances may actual levels of protection be increased above bound levels (for example, in the case of a sudden increase in imports of a particular good; Art. XIX of GATT 1994 and Agreement on Safeguards). Given the bound levels of protection, progressive trade liberalisation is achieved through multilateral negotiations that lead to

mutually agreed timetables for reductions of protection, for example by given percentages of bound tariff levels.

In order to verify effective compliance with liberalisation commitments, many WTO rules seek to ensure the transparency of the trade-related policies of WTO members. This is rendered difficult by the fact that a wide range of trade or domestic policy measures, such as export or import tariffs, quantitative restrictions, taxes on consumption or on production, can be used equivalently to obtain protection.[14] WTO rules therefore define a limited range of policy instruments (for example, export and import tariffs in the case of trade in goods), through which protection may be afforded.[15]

As the CIS countries accede to the WTO, they will have to bring their trade-related policies into compliance with WTO rules on the use of the various policy instruments. Furthermore, they will have to define the level and sectoral

---

[14] This is the essence of various equivalence theorems, the earliest of which is the Lerner equivalence of export and import taxes under certain, essentially plausible conditions (James Anderson, 1994).

[15] Such rules include a general ban on quantitative restrictions except under exceptional circumstances (Article XI of GATT 1994), strict definitions of the customs value on which tariffs are charged (Article VII and Agreement on the Implementation of Article VII of GATT 1994), upper limits on other charges such as customs user fees (Article VIII), currency convertibility for current transactions (Article XV), and the provision that domestic taxes must be neutral as to the origin of the goods taxed (Article III).

structure at which they wish to bind their tariffs, subsidies, and market access regulations. Based on their initial offer, they will negotiate with interested incumbent WTO members on a definite schedule which would become part of their protocols of accession to the WTO. The following subsections first discuss policy adjustment issues and the binding of protection in the case of trade in goods (3.1 and 3.2, respectively) and then turn to trade in services (3.3) and other WTO-related issues like intellectual property rights (3.4).

3.1 Necessary Adjustments to Policies Related to Trade in Goods

Trade policies in Russia, Ukraine, and Belarus have evolved rapidly since 1992. Government intervention in foreign trade, which was pervasive initially, particularly in trade among CIS countries, has been reduced significantly. Many newly developed policy instruments were designed from the beginning to comply with GATT/WTO standards. This section describes the status of the more important policy instruments in the second half of 1996 and discusses the extent of necessary adaptation to WTO rules, if any. Due to frequent policy changes, the emphasis will be less on institutional detail than on the broad issues. This task is facilitated by the fact that current trade-related policies in the three countries are still essentially similar. This is not unexpected in the case of Russia and Belarus because Belarus has explicitly pursued a policy of adapting its trade-related policies to those of Russia as part of a bilateral regional

integration scheme (see Section 4.2). However, even in Ukraine which has proceeded rather cautiously in the area of regional integration and policy harmonization with Russia, the issues raised by WTO accession are essentially the same.

Import tariffs that are substantially differentiated by product are probably the most important trade policy instrument in the three countries. Import-weighted average tariffs are in the order of 15 per cent.[16] Most tariffs are ad valorem rates in the range from 0 to 50 per cent for imports from countries with most-favoured-nation (MFN) status. Higher rates, sometimes in the order of several hundred per cent, are applied to a few luxury goods such as vodka. Russia and Belarus also use specific and combined tariffs, for example on used cars where customs value (on which an ad valorem tariff would be calculated) would be difficult to establish. Apart from the MFN import tariff rates, Russia and Belarus have preferential rates for developing countries at half the MFN level and zero tariffs for least developed countries.[17] Special tariffs at twice the MFN

---

[16] This figure is based on various unpublished documents. A more detailed analysis of the import tariff structure of Belarus (and, therefore, Russia; cf. Section 4.2) in mid-1994 is found in Lücke (1995). Where similar calculations are available for unweighted averages at tariff-line level, these do not diverge substantially from the import-weighted averages. This is because few tariffs are so high as to seriously reduce imports.

[17] Special and differential treatment for developing countries is covered by the enabling clause agreed in the Tokyo Round (Gatt, 1994, pp. 53ff.).

rates are applied to imports from a very few countries with which an MFN agreement does not exist, and to imports whose country of origin cannot be established.[18] Broadly similar rules are applied in Ukraine; however, the number of countries benefiting from MFN treatment is smaller, and tariff preferences for developing countries extend only to agricultural products (Clement et al., 1994, p. 40). In addition, free trade agreements that provide for tariff exemptions exist between most CIS states (see Section 4).

In the area of trade remedies, the laws on the customs tariff in all three countries provide in general terms for safeguard measures, antidumping and countervailing duties. However, no specific procedures for the imposition of such measures have been laid down, and no such measure has been applied so far. It can be expected that detailed regulations, if and when they are written, will be designed to comply with WTO rules (especially the Agreement on Implementation of Article VI of GATT 1994 (anti-dumping), the Agreement on Subsidies and Countervailing Measures, and the Agreement on Safeguards). In the area of non-tariff import barriers, practically all explicit quantitative restrictions have been abolished. Import license requirements exist mainly for a few, potentially hazardous chemical products, and import bans are in force for

---

[18] For some time, the Federal Republic of Yugoslavia (i.e. Serbia and Montenegro) and Estonia were the most important cases.

hazardous wastes that cannot be adequately processed. Some administrative charges like transit and customs user fees are presently calculated in a way (with a strong ad valorem element) that does not ensure correspondence between the services rendered by customs authorities and the amount of the fee. Further technical adjustments may be required to ensure compliance with the remaining Uruguay Round agreements on trade in goods, especially the Agreement on the Application of Sanitary and Phytosanitary Measures, the Agreement on Technical Barriers to Trade, and the Agreement on Implementation of Article VII of GATT 1994 (customs valuation). Here again, new legislation has typically been designed right from the start to comply with WTO rules, and any necessary adjustments should not constitute major stumbling blocks.

The application of indirect taxes to foreign trade differs between trade with CIS countries and trade with the rest of the world. The indirect taxes concerned are the value added tax (VAT) on most goods (roughly in the order of 25 per cent with reduced rates for some product groups) and additional excise taxes on a more limited number of products. As a general rule, the country-of-origin principle is applied in trade with CIS countries, i.e. exports to CIS countries are taxed at the domestic rate but imports from CIS countries are not.[19] The

---

[19] Ukraine appears to be an exception in that it applies the country of destination principle to indirect taxes on all trade.

country-of-destination principle is used in trade with the rest of the world, i.e. exports are exempt from taxes but imports are taxed at the domestic rate. At first sight, to maintain indirect taxes on imports only from some countries may appear to contravene the MFN principle (Article I of GATT 1994). However, current practice can probably be justified on the grounds that tax-exempt imports are already subject to indirect taxes when exported by the partner CIS country, and that the application of the country-of-origin principle to indirect taxation in intra-CIS trade is a consequence of regional integration in general, and of the abolition of border controls, as between Russia and Belarus, in particular.

In some cases it has proven difficult to understand on exactly what base VAT on imported products is calculated. However, such lack of transparency appears to be a largely technical issue as present procedures do not appear to violate the national treatment rule of Article III.2 of GATT 1994. This provision is usually interpreted in the sense that the tax burden must be same for domestic products on the one hand, and imported products after importation on the other hand. This is taken to imply that ad valorem taxes like VAT may be calculated on the customs value of imported products plus customs duty (as currently done in the CIS countries), although VAT is then paid on the amount of the import tariff and protection of the domestic product is higher than the nominal import tariff rate indicates (GATT, 1994, p. 140-141).

Export taxes exist mainly as specific duties on some raw materials and resource-intensive products. They are intended to ensure that there is a sufficient supply of goods to the domestic market when domestic prices are regulated and below the world market level. The size of export taxes depends on the resource rent that the state is attempting to capture. Some of the highest rates are for mineral oil products with ad valorem equivalents of more than 30 per cent. In economic terms, export taxes could be construed to constitute an implicit subsidy to domestic downstream industries whose input prices are reduced below the world market level. However, the definition of subsidies contained in Article 1 of the Agreement on Subsidies and Countervailing Measures (SCM) does not cover export taxes, and consequently they should not raise any problems in WTO accession.

Initially, many export taxes were supplemented by export quotas to ensure that domestic supply objectives were met. Over time, however, export quotas have largely been abolished. The remaining export license requirements are motivated by the protection of scarce natural resources like wild plants with medicinal uses. In addition to these controls, there are export quota regimes to ensure the fulfilment of obligations resulting from international agreements, especially bilateral agreements on textiles and clothing in the framework of the MFA.

Export subsidies exist at least in Belarus where the profit tax on profits from exports in convertible currency is halved and for extended periods VAT was cancelled on certain exports to Russia.[20] Such measures may be justified economically by the high cost incurred and social benefits created by enterprises entering non-traditional markets (see Section 2). However, under Article 29 of the Agreement on Subsidies and Countervailing Measures (SCM), export subsidies in transition economies are only allowed for a seven-year period after the SCM Agreement has entered into force; national schedules for phasing out the existing subsidy schemes will probably become part of the protocols of accession of CIS countries.[21]

After the abolition of most export quotas and the associated license requirements, Russia and Ukraine sought to maintain a limited measure of government control over raw material exports in order to prevent tax evasion

---

[20] As indirect taxation follows the country of origin principle in trade with CIS countries, exports from Belarus to Russia would normally be subject to VAT.

[21] The CIS countries will therefore find it difficult to employ export subsidies for industrial policy objectives although such a strategy was pursued (with ultimate success) by the newly industrialising countries in Asia in the 1960s and 1970s. Even productions subsidies could render CIS exports subject to countervailing duties unless subsidies were strictly focused on enterprise research and development, regional development, or else avoided any semblance of sectoral targeting (i.e. subsidies would have to be non-specific; see Article 8 of SCM Agreement).

and dumping. In Russia, certain commodities can only be exported by specially licensed enterprises that are subject to special surveillance to ensure payment of export taxes. Since several hundred enterprises of this kind exist, this rule should not represent a hurdle to exports. Ukraine, since abolishing most export quotas in 1995, has established a system of indicative prices that are effectively minimum prices to be observed by exporters.[22] Such measures reflect the fact that during a transition period not all domestic prices are permitted to adjust to world market levels and soft budget constraints persist in the form of access to underpriced raw materials. It is clear, however, that such measures would not be compatible with WTO rules if maintained on a permanent basis.

Turning now from the trade regime to the exchange rate regime, all three countries have generally moved towards the establishment of *de facto* current account convertibility since 1992. This is a crucial success because a multiple exchange rate regime, for example an official, overvalued rate along with a black market rate, creates disincentives for exporting and leads to administrative interference in imports when foreign exchange is allocated to importers at the official rate. One exception from this favourable trend is Belarus where an overvalued official exchange rate has been propped up (with varying intensity)

---

[22] It is unclear how exactly indicative prices are enforced (if at all).

by arbitrary administrative controls on imports since 1995. In the medium to long run, accession to the WTO will require the CIS countries to commit themselves to maintaining full current account convertibility as under Article VIII of the Statutes of the International Monetary Fund.

The binding and reduction of domestic agricultural subsidies in line with the Agreement on Agriculture will be difficult to implement. The base level from which subsidies are to be reduced relates to the years 1986 through 1988 (Annex 3 of Agreement on Agriculture). This is infeasible in the CIS countries because, in the former Soviet Union, agriculture was subsidized in ways that are not covered adequately by the Aggregate Measurement of Support as defined in the Agreement on Agriculture. On the other hand, the conceivable alternative of using the present subsidy level as a base does not appear feasible either. The value of subsidies such as directed credit is intrinsically difficult to calculate and probably fluctuated substantially over the last few years. Nevertheless, it was probably low compared with many OECD countries, and CIS countries could therefore legitimately expect to be permitted to increase their agricultural subsidies temporarily to a somewhat higher level, for example to ease the systemic transformation in agriculture. Recent demands by major incumbent WTO members that acceding countries bind very low levels of domestic support as well as zero export subsidies appear very stringent against the background of actual OECD country policies.

Overall, then, while many technical adjustments will be required, there are few areas where the trade regimes of the three selected CIS countries are substantially in conflict with WTO rules. Some flexibility will be required of incumbent WTO members in applying WTO rules whose exact phrasing is inappropriate for CIS countries.

3.2 Strategies for Binding Levels of Protection

While technical adjustments to the trade regime for goods are extensive but not especially far-reaching, the CIS countries face a more fundamental problem as they start negotiations on their tariff schedules and other concessions. Binding levels of protection for individual economic activities presupposes a strategic decision as to the underlying objectives of trade policy. Possible choices include the maximisation of fiscal revenue, which would call for a substantial, but not excessive average tariff level with limited sectoral or regional differentiation; an explicit industrial policy which would imply a strongly differentiated import tariff, but not necessarily a high average level; or regional integration, which would call for a substantial tariff on extra-regional trade while intra-regional trade should ideally be free from restrictions.[23] As these options are partly

---

[23] Langhammer (1994) discusses possible trade policy strategies for CIS countries in greater detail.

exclusive, a strategic decision must precede detailed negotiations on concessions with incumbent WTO members.

So far, none of the three selected CIS countries have taken an explicit or implicit decision in this respect. As described in Section 3.1, all three countries have high import tariffs on certain luxury consumption goods such as spirits, which suggests a fiscal motivation. Russia also has high import tariffs on passenger cars, while Belarus has failed to apply these fully in spite of the existing customs union. This suggests that the protectionist demands of individual interest groups are gaining in practical importance (the automobile industry is a major employer in Russia but does not exist in Belarus).[24] Partly this may be due to the fact that CIS country currencies have steadily appreciated in real terms over the last few years, and imports have therefore become more competitive compared with domestic goods. Similarly, export restrictions have been used to maintain energy prices below the world market price level which represents an important subsidy to domestic households and enterprises. However, an analysis of the full range of protective measures does not reveal an explicit industrial policy that discriminates clearly between branches of

---

[24] Langhammer (1995) suggests that, in general, large countries tend to be more inclined towards protectionism because the cost to consumers relative to the benefit to producers tends to be lower.

industry; much less are there time limits on the protection currently granted. If the Southeast Asian approach to industrial policy through trade protection were to be followed (this is sometimes proposed in the policy debates in the CIS countries), time limits on protection would be one of its constituent elements (Rodrik, 1995).

Given this uncertainty, the CIS countries may seek to follow the example of many developing countries as well as Slovenia in binding import tariffs at higher levels than are presently in force. This would leave room for increases in tariffs at a later stage if considered necessary as part of an industrial or fiscal policy still to be defined. At the same time, the CIS countries would not feel compelled to raise actual tariffs before entering the WTO in order to have more freedom later in choosing their sectoral structures of protection. In the present situation, the attraction of tariff protection over sector-specific subsidies is that it causes the cost of protection to be born by consumers, rather than by the government budget.[25] Given the serious budgetary situation in the CIS states, this traditional second-best argument for industrial policy through the trade

---

[25] The impact of protection on exporters may be alleviated through import duty drawback schemes such as are operational in some CIS countries (under such schemes, import duty is not charged on inputs into goods that are later exported). However, such schemes normally extend to import duties only on intermediate inputs and fail to cover investment goods.

regime may be too strong for the CIS countries to forego its use once and for all by binding protection at low levels.

The CIS countries would gain some flexibility with respect to the future conduct of their trade-related policies if they could enter the WTO as developing countries.[26] For example, under Article XVIII of GATT 1994, developing countries may withdraw previous concessions if there is no alternative way of implementing policies promoting economic development.[27] Transition periods for the implementation of the SCM Agreement are more generous for less advanced developing than even for transition economies. It might well be argued that living standards in the CIS countries are broadly similar to many less-advanced (low-income and lower-middle-income)

---

[26] A more exhaustive list of possible advantages of acceding to the WTO as a developing country is provided by Yang (1996) from the point of view of China, but these considerations apply equally to the CIS countries.

[27] Sections A through C of Article XVIII contain provisions for those developing countries whose economies "can only support low standards of living and (are) in the early stages of development" (para. 4(a)), while Section D makes less liberal provisions for the remaining developing countries.

developing countries;[28] that the industrial restructuring and financing of supporting policies required in the CIS countries present problems which are structurally similar to those faced by many developing countries in their industrialization process; and that the CIS countries already benefit from tariff reductions in most OECD countries under the General System of Preferences like developing countries. However, major incumbent WTO members have so far resisted even China acceding to the WTO as a developing country (Yang, 1996). As China's per capita GNP is still below that of Russia and Belarus and its industrialization has progressed rather less far, the more advanced CIS countries would probably face even stronger resistance if they aimed to accede to the WTO as developing countries. Therefore, if they are to remain capable of using tariffs as instruments of industrial policy, the CIS countries will have to bind tariffs at sufficiently high levels to have room for adjustments.

---

[28] Russia, Ukraine, and Belarus are all classified by the World Bank as lower-middle-income countries on the basis of their per capita nominal GNP. Compared to the US on a purchasing-power-parity basis (which is more relevant than nominal GNP for standard of living comparisons), their per capita GNPs stood at 18 per cent, 10 per cent, and 17 per cent of the US level in 1994. The corresponding values for other CIS lower-middle-income economies are 11 per cent for Kazakstan and 9 per cent for Uzbekistan. Low-income economies among the CIS countries include Armenia (8 per cent), Kyrgyz Republic (7 per cent), Azerbaijan (6 per cent), and Tajikistan (4 per cent; World Bank, World Development Report 1996, Table 1).

3.3 Trade in Services

The approach of the General Agreement on Trade in Services (GATS) to the liberalisation of trade in services differs somewhat from that of GATT 1994 in trade in goods. Market access, which is automatic in the case of trade in goods, is based on specific commitments of each WTO member country for each service sector. Beyond this, there are general rules on the conduct of national policies on services trade, for example the MFN principle, a ban on quantitative limits on the number of service providers, and transparency requirements. However, members may register far-reaching exceptions even to such fundamental principles as MFN treatment (Luyten, 1996).

Most problems facing CIS countries in conforming to the rules relate to the rather underdeveloped state of regulations in most service sectors. There are currently few explicit policies on privatisation and foreign participation in the main sectors of interests, i.e. telecommunications and financial services. Since GATS provisions are not very tight, it should not be difficult for the CIS countries to conform to these rules. However, clarifications will be required on many legal issues that for good reasons have so far not been at the centre of attention of CIS country legislatures. It remains to be seen how far incumbent WTO member will attempt to push acceding CIS countries to accept

liberalisation commitments in the more important service sectors, such as telecommunications, financial and professional services, and maritime transport. Exchange regulations should not pose major problems either. For foreigners to establish a commercial presence in the CIS countries, capital imports must be permitted. While there are some restrictions on capital exports, there are none on imports. Also, the importation of services through consumption abroad is hindered when there are limits on the amount of foreign currency that may be transferred abroad for certain purposes. Except in Belarus where the state of the foreign currency market was not very transparent throughout 1996 (see Section 3.1), there are now few currency restrictions that would impede imports of services through consumption abroad.

3.4 Other WTO Issues

The Agreement on Trade-Related Intellectual Property Rights (TRIPS) obliges members to protect the various intellectual property rights broadly as defined by the appropriate international conventions, adding provisions especially on enforcement. Most relevant legislation on intellectual property rights in the CIS countries has only been written since 1991 because intellectual property rights in the international sense of the word did not exist under Soviet law. Since all new laws have been drawn up in close co-operation with the Secretariats of the international conventions, there are few problems with the conformity of legal

texts to the TRIPS Agreement. Shortcomings exist, however, in the actual application and enforcement of these rules because the legal systems as a whole have not yet been fully transformed. Specifically, national legislation in the CIS country does not yet implement fully the border enforcement provisions of TRIPS Agreement (Articles 51ff.).

Some incumbent WTO members have expressed a strong interest in the CIS countries joining the (plurilateral) Agreement on Government Procurement. The CIS countries have generally taken the view that since they would not be obliged to join under present rules, this technically complex issue should not have a particularly high priority in the negotiations. It might be worthwhile to explore whether some fears on the part of incumbent WTO members regarding persistent state influence in the CIS economies (see Section 5) could be allayed if the economic behaviour of CIS governments themselves were subjected to the disciplines of the Agreement on Government Procurement.

At the WTO Ministerial Conference in Singapore in December 1996, discussions were initiated or continued on a variety of issues that some WTO members want to bring into the scope of the WTO. These include environmental and labour standards, rules for the treatment of foreign direct investment, and international competition policy. Potentially, some of these debates might affect the CIS countries considerably; for example, CIS exports of intermediate goods

with high pollution intensity (steel, non-ferrous metals) to OECD countries have increased in recent years, and might face new barriers if the use of trade policy instruments for environmental objectives were accepted. While CIS countries are therefore well-advised to participate actively in these debates as far as their observer status with the WTO allows, it is too early to predict the outcome of the discussions or the possible implications for CIS countries.

4 Implications of WTO Accession for Regional Integration Among CIS Countries

The foundation of the Commonwealth of Independent States (CIS) after the dissolution in 1991 of the former Soviet Union aimed at creating an institutional framework for economic relations among CIS countries that could replace the former central planning system. However, the diverging interests of net energy exporters and importers, the absence of a functioning monetary system, the changing role of the state in the CIS economies, and political concerns about possible dominance by Russia all prevented the emergence of functioning regional institutions and even of effective regional cooperation. As the CIS countries are now preparing to join the WTO, it is appropriate to ask what economic incentives remain for regional integration (Section 4.1), what institutional implications are involved (Section 4.2), and how the choices are affected by prospective WTO membership (Section 4.3).

4.1 Political Economy of Regional Integration Among CIS Countries

Several years into the systemic transformation in the CIS countries, intra-regional trade still accounts for a large proportion of total trade in nearly all CIS countries except Russia. This share will probably decline only in the medium to long run if further dismantling of barriers to East-West trade and continuing systemic transformation encourage trade especially with Western Europe (Section 2). Against this background, a regional integration scheme among the CIS countries offers benefits potentially in three areas. The first applies broadly to all CIS countries, while the others are more important for the smaller countries than for Russia.

First, all CIS countries are interested in preventing further disruption in their traditional trade relationships through new trade barriers. A regional free trade area or even closer integration in a customs union would provide some insurance against sudden changes in national trade policies that have frequently occurred during the last few years and that have caused significant adjustment costs to firms. In this sense, a regional integration scheme would promote the openness of national markets, help to maintain a competitive environment, and prevent the emergence of local monopolies (Hine, 1994). This would apply especially when not only trade in goods, but also trade in services and the capital and labour markets were integrated.

A second motivation for pursuing regional integration is particularly important from the point of view of net energy importers in the CIS. Russian export prices for energy materials, particularly natural gas, have increased much faster than Russian domestic prices. This has not only led to balance of payments problems for net importing countries, but has also distorted the markets for energy-intensive products by implicitly subsidizing Russian producers. The abolition of restrictions on intra-CIS trade, especially the elimination of Russian export taxes on energy materials, ought to equalize prices across the CIS countries. When there is price discrimination by the Russian distributor independent of any Russian export barriers, then regional integration, especially if it went as far as the economic union planned between Russia and Belarus, could be used to bring political pressure to bear on the Russian distributor for equal treatment with Russian consumers.

A third possible motivation for regional integration lies in the enlarged protected market that would be created for industries in the region. An industrial policy through trade protection would be infeasible for the smaller CIS countries because of the small size of their domestic markets; it might be feasible, however, at the regional level. This raises the question of whether regional integration should be pursued through a free trade area, where each member may freely determine its trade policy in relation to extra-regional trade, or through a customs union with a uniform external trade regime. In a free trade

area, the protection that an industry enjoys in a partner country against extra-regional imports is determined by the protection granted by that partner country. If substantial protection were to be given to specific industries throughout the region, a customs union with a common external trade policy would be required. At the same time, a customs union aiming at regional import substitution would oblige each member to impose higher output prices for protected products on its consumers even in those industries that do not exist domestically; this might be politically infeasible, for example, in a large country when the benefits accrue mainly to small partner countries.[29]

4.2 Existing Agreements

Out of a variety of motives including those discussed in the preceding section, several multilateral agreements on regional economic integration have been

---

[29] Furthermore, scepticism is warranted with respect to the use of trade protection for industrial policy in the CIS countries in general. First, it is not clear how sectors should be selected for support. Measuring the external effects produced by a sectors, and weighing them against the cost of protection is intrinsically difficult in stable economic conditions, and even more so in rapidly transforming economies. Second, by offering protection the government would become a target for the lobbying efforts of interest groups, and it is likely that political rather than economic criteria would ultimately dominate decision-making on industrial policy. The inability of many OECD countries to phase out protection for largely moribund sectors like coal, basic steel, traditional textiles, and many branches of agriculture provides a vivid illustration of the effects of lobbying by sectoral interests.

discussed and signed in the institutional framework of the CIS. The more important include the Economic Union Treaty of 24 September 1993 which envisions the creation of a common economic space with free movement of goods, services, capital, and labour through a staged process, starting with a multilateral free trade zone and culminating in a monetary union. A first step in this direction was undertaken by an agreement, signed on 15 April 1994, that establishes a timetable for the creation of a multilateral free trade area with a common list of goods exempted from preferential treatment during a transition period.

However, these as well as some similar agreements have not been implemented, mainly due to the diversity of interests among CIS member countries. Cooperation in the framework of the CIS affects not only economic, but also political and military relations. Smaller, independent-minded countries have tended to resist what was perceived as Russian attempts to use intra-CIS cooperation to bring them into a Russian sphere of influence. Such reservations were reinforced, for example, by Russian proposals for a joint military defence of the external borders of the CIS countries or for harmonized economic policies that would inevitably be dominated by Russian interests. On the other hand, it is difficult to see how Russian interests could not play a large role in any regional integration scheme among CIS countries because of Russia's sheer economic size.

Because of the absence of a functioning multilateral framework, economic relations among the CIS countries have in fact been regulated mostly by bilateral agreements. In particular, there is an extensive network of bilateral free trade agreements which typically provide for free trade between the two countries concerned and often include a list of products exempted from the free trade regime. Such exemptions normally relate to commodities that are subject to export taxes in order to ensure a sufficient supply in the domestic market in the presence of regulated (maximum) prices.

Until recently, the bilateral free trade agreements were complemented by intergovernmental agreements that established quotas on deliveries of certain strategic commodities that would be expected to be compatible with a bilateral balance of trade equilibrium. During the early years after the dissolution of the former Soviet Union, both quantities and prices were set at least for the core commodities and deliveries were guaranteed by governments, often through state orders to enterprises or else through procurement procedures. Deliveries of other commodities were subject to contracts between enterprises, but export licences would automatically be issued in fulfilment of the agreed quotas. Over time, the intergovernmental agreements became less binding; fulfilment ratios

were erratic and, on average, low.[30] Many CIS governments were either unable or unwilling to enforce state contracts or, as in the case of Russia, abolished the system of state orders as part of their systemic reform. It appears that for the 1995 and 1996 agreements concluded by Russia and Belarus with various CIS countries, prices were negotiated by the enterprises concerned, and enterprises were under no pressure to deliver goods in the framework of the agreements; nor did they receive special privileges in return for their participation. The main function of the remaining agreements seems to be to exempt a limited amount of the intra-CIS trade from export taxes and, where required, from import duties.

Beyond bilateral free trade agreements, some clusters of CIS states have sought to move towards "plurilateral" regional cooperation. These include the Central Asian countries and countries bordering on the Black Sea. Other CIS countries, especially Russia and Belarus, are in the process of developing more advanced frameworks for regional integration. The spring 1994 treaty on Economic and Monetary Union between Russia and Belarus provides for a staged approach to regional integration. The first step that more or less reflected the status quo consisted in a free trade area in which no taxes of any kind were levied on bilateral trade. The second step consisted in a *de facto* customs union which was

---

[30] Lücke (1995) surveys the agreements concluded by Belarus in 1994 and 1995 in some detail.

created by Belarus effectively copying all Russian foreign trade regulations. As a result, the customs border between the two countries was abolished in 1995, which has probably led to a significant reduction in trade costs. Since then, Kazakhstan and Kyrgyzstan have stated their intention to join the Russia-Belarus customs union.

However, the present arrangements between Russia and Belarus raise several questions as to their sustainability. First, there is no formal division of tariff revenues. In practice, when goods are brought into Belarus, customs declarations must indicate their final destination (Belarus or transit to Russia); tariff revenue is then allocated accordingly. This system is presently undermined by extensive tariff exemptions granted independently by both sides to supposedly charitable organizations that import large amounts of spirits, among other things, duty-free and resell them throughout Russia and Belarus. Second, there are no joint institutions but each country formally retains its sovereignty over the trade regime. This has been feasible so far because Russian import tariffs, which Belarus copied, tended to be low and conflicts of interest did not arise. In the medium term, however, industrial interests will probably gain greater influence over Russian trade policy. Since specialization patterns in Belarusian industry are highly selective, the industrial policy priorities of

Belarus will probably differ from those of Russia and will therefore be impossible to pursue through a common external trade policy.[31] Third, Belarus had hoped to have its import prices for energy reduced to the lower level in the Russian domestic market. It is difficult to understand why energy prices are still higher in Belarus than in Russia. While transport costs may play a limited role, a more likely explanation is monopolistic practices by Gazprom and other Russian state enterprises, or continuing price controls in Russia which are not applied to inter-state trade. It remains to be seen whether the Russian government is really willing to extend the benefit of heavily subsidized energy prices to Belarus, and whether it is in a position to put sufficient pressure on energy exporters if required.

4.3 WTO Implications

As regards the substantial provisions for regional integration schemes, Article XXIV of GATT 1994 states that, after a transition period, substantially all trade originating in the member countries must be free from tariffs and other trade barriers. Judging from current intentions as well as current practice, this condition could probably be fulfilled by the existing or planned bilateral or

---

[31] Belarus already applies lower tariffs on imported passenger cars than does Russia, on account of the fact that there is no car industry in Belarus while there is one in Russia.

multilateral integration schemes. The use of export taxes to protect domestic consumers of a limited number of commodities could probably be justified if there were a timetable for their gradual reduction and eventual abolition. CIS countries should therefore experience few substantial problems in adjusting existing or planned customs unions or free trade areas to WTO rules upon accession.

However, the present, less than transparent state of regional integration among CIS countries with a mixture of multilateral, plurilateral, and bilateral agreements raises two procedural issues. First, Article XXIV, para. 5 of GATT 1994 states that customs unions or free trade areas may be created that comprise the territories of WTO members. This provision could appear to raise a problem if not all CIS countries join the WTO at the same time, as seems likely, and there exist integration schemes involving simultaneously members and non-members. However, although the wording of Article XXIV, para. 5 is straightforward, it appears that regional integration schemes involving both GATT 1947 contracting parties and non-contracting parties have been approved under this provision, rather than under the more appropriate Article XXIV, para. 10 which would require approval by a two-thirds majority (of GATT 1947 contracting parties or WTO members; GATT, 1994, pp. 742f. and 770f.). As WTO accession requires approval of the terms of accession by a two-thirds majority of WTO members anyway (Article XII of WTO Agreement), the

difference between para. 5 and para. 10 of Article XXIV of GATT 1994 will be of little practical consequence for acceding CIS countries.

A second procedural issue is raised by the *de facto* customs union between Russia and Belarus which may be joined by Kazakhstan and Kyrgyzstan. Under the terms of Article XII of the WTO Agreement, countries can only accede to the WTO if they possess full autonomy in the conduct of their external commercial relations as well as other policies affected by the multilateral agreements. Formally, so far, Belarus copies the Russian trade regime without giving up its sovereignty over trade-related policies. Even if a similar arrangement were chosen by the new members of the customs union, close cooperation in accession negotiations on all matters covered by the *de facto* customs union would be desirable. For example, it would make little sense for the smaller countries to negotiate their import tariff schedules independently of Russia. If a full-fledged customs union with joint institutions is eventually implemented, these joint institutions should lead negotiations on those policy areas for which they are responsible, with national governments coming in for all areas not covered by the customs union agreement. In sum, the present strategy of each CIS country negotiating individually on WTO accession needs to be supplemented, at least, by close cooperation with respect to those policy areas that are covered by regional integration agreements.

Many bilateral and multilateral agreements among CIS countries go beyond trade in goods and provide for some regional integration in trade in services. This does not appear to raise substantial difficulties under WTO rules. Article V of the GATS aims at permitting regional integration agreements only with substantial sectoral coverage in terms of the numbers of sectors, volume of trade affected, and modes of supply (Footnote 1). However, these provisions appear rather weak and probably would be met in a reasonable fashion by existing or future agreements among CIS countries, judging from current intentions.

5 Implications of WTO Accession for the Role of the State in the Economy

The WTO agreements implicitly assume that contracting parties are market economies where state involvement is ideally limited to the production of public goods and corrective action for market failures. This assumption is clearly not satisfied in the CIS countries where systemic transformation is far from complete. On the other hand, systemic transformation, integration into the international division of labour, and integration into the multilateral trading system are closely intertwined. Therefore, it would be a major setback for the CIS countries if their accession to the WTO were to be postponed until systemic transformation is more or less complete. This section starts by surveying the possible concerns of trading partners, referring back to the position of centrally

planned economies under GATT 1947. Subsequently, progress in reducing the economic role of the state in the CIS countries is discussed and implications for WTO accession during the transition period are derived.

Direct state involvement in the production or distribution of tradeable goods, which exists widely even in established market economies, is dealt with in Article XVII of GATT 1994 which defines state trading enterprises by the existence of exclusive or special rights or privileges, rather than ownership. It also states that the activities of state trading enterprises may create obstacles to the expansion to trade, and that such obstacles should be removed through negotiations on the basis of reciprocity and in a mutually beneficial manner. Because of concerns about pervasive state trading, centrally planned economies acceding to GATT 1947 were required to accept special commitments on increasing their imports from GATT contracting parties (for example, Poland and Rumania in the 1960s and 1970s; Schultz, 1996). At the same time, the exports of GATT 1947 members with centrally planned economies were subject to the imposition of anti-dumping duties under less restrictive conditions than if they had originated in market economies.

A large economic role of the state may undermine the rights of trading partners in several ways, and verification of violations may be difficult. On the import side, state-dominated enterprises may discriminate among sources of supply on

other than commercial grounds and thereby undermine the most-favoured-nation principle (Article I of GATT 1994). Further, they may apply (prohibited) quantitative import restrictions (Article XI), or introduce markups that exceed the level at which the country in question has formally bound its import tariffs. On the export side, there is a suspicion that countries where the state plays a large role in the economy have a greater tendency than market economies to subsidize industries in non-transparent ways. Thus the focus is on the possible granting of prohibited or actionable subsidies in connection with state trading.[32]

As it is the stated intention of the transition countries, including the CIS states, to transform their economies into market systems, special rules like those for centrally planned economies are no longer appropriate to ensure implementation of trade concessions. Further progress in privatization and stricter enforcement of market principles in all transactions (culminating in the implementation of bankruptcy procedures for economically non-viable enterprises) should go a long way towards ensuring that CIS country enterprises choose among suppliers on none but commercial grounds. As regards CIS exports, the GATT 1947 rules on subsidies have been tightened considerably in the Agreement on Subsidies and Countervailing Measures, and have been made compulsory for all WTO

---

[32] See Low (1994) for a detailed discussion.

members. Acceptance of these rules by the transition economies should reduce distortionary intervention by the state and subsidization of production and exports along with the resulting incentives for dumping on the part of enterprises.

At present, however, state involvement in the CIS economies still extends to several areas where it cannot be justified fully as production of public goods or corrective action for market failure. While progress in reducing the economic role of the state has been achieved in some CIS countries and in certain policy areas, stagnation (or worse) is found elsewhere. Furthermore, the economic impact of government involvement is not fully accounted for by a list of institutional arrangements and direct or indirect subsidies that do not comply with market economy principles. Rather, many subsidies are granted in a way that results in the absence of financial discipline or "soft budget constraints" (Kornai) on the part of enterprises. Government interference and subsidies thus lead not only to a different incentive structure for production and consumption, but also to a mode of enterprise behaviour that is incompatible with market economy principles.

Soft budget constraints were a pervasive feature of the centrally planned economy. They arise when the costs incurred by an enterprise may exceed its revenue even in the medium to long run without the enterprise being forced to

improve its performance or go out of business. Managerial decisions in such enterprises are unlikely to be determined solely by market incentives, and WTO rules may not achieve their purposes in this context. Crucially, in the case of soft budget constraints, the amount of state support for a given enterprise is not fixed a priori or subject to pre-existing rules, but is fixed *ex post* depending on the loss that would otherwise be incurred by the enterprise. For example, arrears on tax liabilities to the state may be allowed to accumulate, directed credit may be provided by the central bank on an ad hoc basis as the financial position of enterprises in a particular sector deteriorates, or direct subsidies may be granted in highly discretionary ways to pay for past losses. The persistence of soft budget constraints in the CIS countries is epitomized by the fact that so far very few enterprises (if any) have been allowed to go bankrupt.[33]

The "hardening" of budget constraints will require continuing reforms in economic institutions as well as increasing transparency of and reductions in direct and indirect subsidies. Foremost in institutional reforms is privatization. Here, progress has varied widely across CIS countries and, within countries, across economic sectors. Retail trade enterprises and small and medium-sized enterprises were typically among the first to be privatized. In Russia,

---

[33] Strategies for economic transformation in the presence of soft budget constraints are discussed by Lücke (1993).

considerable progress has also been made with the conversion of large-scale enterprises into joint-stock companies and the transfer of shares to management, employees, and the general population through the voucher privatization scheme. By contrast, privatization in Belarus has hardly begun and is currently stuck as very few enterprises are offered for sale and private sector development is generally discouraged through intensified state controls on private enterprises. Although the WTO agreements do not prescribe any particular ownership pattern for enterprises, the incumbent WTO members can be expected to scrutinize progress in privatization as a primary indicator of progress in the transformation of economic institutions generally.

Apart from issues of ownership and corporate governance, state involvement in the CIS economies also takes the form of direct administrative measures. Initially, after the disintegration of the central planning system, a wide variety of administrative controls were introduced at the national, regional, and local levels in an attempt to ensure a sufficient supply of essential consumer goods and intermediate products, to hold down retail and wholesale prices, and to protect local producers. Minimum and maximum prices, upper limits on profit margins, regional export quotas, and buy-local requirements are illustrative examples. By the end of 1996, most administrative controls in Russia, at least, appear to have been formally abolished. Nevertheless, there remains a lack of

transparency as to the effective determinants of, for example, relative prices of imported vs. domestically produced goods at the retail level.

One area where considerable progress has been made in all CIS countries is the reduction of state orders to enterprises. CIS governments had used these to ensure a sufficient supply of goods to local distribution systems and to fulfil obligations incurred through bilateral trade agreements with other CIS countries.[34] In some countries, state trading enterprises still account for a significant share of certain raw material exports to non-CIS countries. These are frequently natural resources where supply is concentrated in a limited number of deposits and traditional marketing channels continue to function. A special licence is sometimes required for exporting particular commodities, for example for energy materials in Russia (cf. Section 3.1). It seems safe to state that such controls typically aim at alleviating principal-agent-type problems faced by the state as creditor of tax liabilities and owner of natural resource rents,[35] rather than at permitting governments to interfere in the operation of enterprises. Accession to the WTO will require the gradual abolition of administrative

---

[34] State orders are therefore distinguished from government procurement which relates only to goods destined for government consumption.

[35] Resource rents are defined as the scarcity value of natural resources, which is roughly the difference between world market price and extraction cost. Taxes on resource production or exports allow the state to capture some of the resource rent.

controls at the national, regional, and local levels as progress is made in hardening budget constraints, reforming the tax system, and replacing maximum prices for essential consumer goods with targeted transfers.

With respect to direct and indirect subsidies, the major problem at present appears to be the lack of transparency. Both direct budgetary payments and indirect subsidies, e.g. through directed credit from central banks at artificially low interest rates, are limited through agreements with the International Monetary Fund at least in Russia and Ukraine. Nevertheless, it is still difficult to gain an understanding of the underlying regulations, the amounts involved, or the recipients. Incumbent WTO members can be expected to require acceding CIS countries to increase the transparency of their subsidy systems so that compliance with the WTO Agreement on Subsidies and Countervailing Measures can be effectively verified. Beyond transparency, the phasing out of subsidies according to the timetables agreed with the IMF, which tend to be ambitious, should represent sufficient progress towards the hardening of budget constraints.

6 Benefits of WTO Accession for the CIS Countries

As the former Soviet Union was not a contracting party to GATT 1947, the trade policies of partner countries were not subject to GATT discipline. As a result, the former Soviet Union faced higher tariffs and more extensive non-

tariff barriers than other country groups for extended periods. This situation improved when most major OECD countries concluded MFN agreements with the Soviet Union since the 1970s. MFN status was transferred to the CIS countries in 1992 and 1993, and they were frequently included in OECD country General Systems of Preferences (GSP) that had previously benefited almost exclusively developing countries.[36] In order to maintain this position, the CIS countries will be expected to show further progress in systemic transformation, culminating in WTO membership. Only then will their trading partners be fully bound by mutual obligations to respect WTO rules, including those on anti-dumping and safeguards.[37]

In the case of the European Union, MFN treatment and participation in the GSP were first granted by the EU on a provisional basis. They will become permanent as the Partnership and Cooperation Agreements between the EU and

---

[36] A detailed description of the changes in OECD country trade policies towards the CIS countries is provided by Michalopoulos and Tarr (1994) and OECD (1994), pp. 61ff.

[37] Some residual elements of the trade regime formerly applied to imports from the Soviet Union persist: selective (bilateral) safeguard clauses seek to prevent injury to domestic producers by restricting imports only from certain transition economies (outside the WTO); anti-dumping measures may be based on prices in third countries with market economies or even on domestic prices in importing countries, rather than actual prices in the exporting transition economy.

the individual CIS countries are ratified.[38] Nevertheless, EU tariffs on imports from the CIS are still higher than for other important third countries with more generous preference schemes, for instance EFTA, Visegrad and Baltic countries (Europe Agreements). This may change if and when negotiations start in several years' time on free trade agreements between the EU and the individual CIS countries as foreseen by the Partnership and Cooperation Agreements. However, any move towards closer regional integration along these lines would be politically feasible only if the CIS countries accede to the WTO first. WTO membership would also be a precondition for regional integration with the East

---

[38] The texts of these agreements may be found in: Vorschlag für einen Beschluß des Rates und der Kommission über den Abschluß des Abkommens über Partnerschaft und Zusammenarbeit zwischen den Europäischen Gemeinschaften und ihren Mitgliedstaaten einerseits und der Russischen Föderation andererseits (von der Kommission vorgelegt). Luxemburg: Amt für Amtliche Veröff. der Europ. Gemeinschaften, 1994 (KOM; 94,257 endg.); Europäische Kommission: Vorschlag für einen Beschluß des Rates und der Kommission über den Abschluß des Abkommens über Partnerschaft und Zusammenarbeit zwischen den Europäischen Gemeinschaften und ihren Mitgliedstaaten einerseits und der Ukraine andererseits (von der Kommission vorgelegt). Luxemburg: Amt für Amtliche Veröff. der Europ. Gemeinschaften, 1994 (KOM; 94,226 endg.); Europäische Kommission. Vorschlag für einen Beschluß des Rates und der Kommission über den Abschluß des Abkommens über Partnerschaft und Zusammenarbeit zwischen den Europäischen Gemeinschaften und ihren Mitgliedstaaten einerseits und der Republik Weißrußland andererseits. - Luxemburg: Amt für Amtliche Veröff. der Europ. Gemeinschaften, 1995 (KOM; 95,44 endg.).

European countries, for example through membership in an extended Central European Free Trade Area (CEFTA).

In sum, accession to the WTO will not confer many short-term benefits to the CIS countries in terms of improved market access. It is a necessary condition, however, for consolidating the gains made in recent years on account of the stated commitment of the CIS countries to systemic transformation. Failure to accede to the WTO, possibly because of lack of progress on systemic transformation, would call recent improvements in market access into question.

Furthermore, the recent literature on the political economy of policy reforms emphasizes the importance of government credibility for the ultimate success of a reform programme. International commitments entered into by a government, such as those involved in accession to the WTO, may enhance credibility as they raise the cost to the government of deviating from its stated policy path (Rodrik, 1989). WTO accession will require the CIS countries to commit to further reform in several crucial fields:

First, a pervasive problem is the lack of transparency in many regulations which raises uncertainty about the payoff from economic decisions and may ultimately even undermine the rule of law. During accession negotiations, legal texts pertaining to a wide variety of policy areas will be scrutinized by incumbent WTO members. In many instances, for example in the area of intellectual

property rights, the emphasis will be less on the letter of law than on establishing judicial procedures for the actual enforcement of rules. This will require far-reaching reforms in the judicial system.

Second, systemic reform will be closely monitored by incumbent WTO members, and CIS countries may be asked to make specific commitments on progress in particular areas. In particular, de-statisation and privatisation of internal trade at the wholesale and retail levels, privatisation of small and medium-sized enterprises, and gradual privatisation of large enterprises are conceivable stepping stones. Financial discipline on the part of enterprises needs to be tightened through continuing institutional changes like implementation of bankruptcy procedures and through reductions in direct and indirect subsidies.

Third, accession to the WTO will require the CIS countries to take policy decisions that they have avoided so far, for example with respect to the strategic objectives of trade policy. The precise form of regional integration will be of particular importance as it will become apparent whether Russia can be moved to extend the benefit of low domestic energy prices to net energy importers among the CIS countries. Furthermore, the CIS governments will have their autonomy over some policy parameters reduced, for example when import and export tariffs are bound. Accession to the WTO can thus provide a focal point

for policy decisions that would have to be taken at any rate sooner or later, but have now to be dealt with simultaneously, under scrutiny from incumbent WTO members, and under an obligation to bind policy parameters with little chance of future changes. This is likely to enhance the consistency of the decisions taken. In the short to medium run, the impetus to further market-oriented systemic reform through enhanced credibility of governments may well be the most important benefit of WTO accession.

7 Implications of the Accession of CIS Countries for the Multilateral Trading System

With the transition from GATT 1947 to the WTO, the multilateral trading system has undergone far-reaching change. On the one hand, the interpretation of many provisions of GATT 1947 was clarified and tightened in the multilateral agreements on trade in goods and in the Understandings on various GATT articles that became part of GATT 1994 (Annex 1 to the WTO Agreement). On the other hand, a variety of new issues were brought into the scope of the WTO. The protection of trade-related intellectual property rights, both with respect to definition and enforcement, is covered quite exhaustively in the TRIPS Agreement. The General Agreement on Trade in Services (GATS) lays down general rules for the regulation of trade in services which are to be supplemented by more specific rules and liberalisation commitments in selected

service sectors. Negotiations have started on financial and professional services, maritime transport, basic telecommunications, as well as on the movement of natural persons as one important mode of supply in international trade in services. Furthermore, discussions are taking place on the possible role of the WTO with respect to the social and environmental implications of trade, investment policy, and competition policy.

At the same time that the scope of the WTO is being extended, the membership applications by the CIS countries, most importantly Russia, along with China, Taiwan, and several others, provide an opportunity for bringing all the world's major trading countries into the multilateral trading system. However, in the CIS countries, the legacy of the central planning system and the uncertainties afflicting the transformation of the economic, political and social systems raise serious problems in terms of the transparency of policies and time requirements for the necessary adjustments. While this is true for many traditional GATT concerns, it applies *a fortiori* to the new WTO areas, especially trade in services where policies in the accession countries (like in many other countries) are still ill-defined.

It has been argued in this article that the accession of the CIS countries to the WTO, beyond consolidating recent improvements in market access, will lend credibility to the process of systemic transformation itself and will thereby help

to stabilize it. Not only the CIS countries, but also incumbent WTO members have a high stake in the success of systemic transformation, both in economic and in political terms. Provided that the CIS countries make demonstrable progress in increasing the transparency of their trade-related policies and bringing them into compliance with WTO rules, incumbent WTO members should accord high priority to a speedy accession of the CIS countries to the WTO.[39] Accordingly, they should refrain from pushing acceding countries to commit themselves to more stringently liberal policies than incumbent WTO members themselves accepted as a result of the Uruguay Round agreements. In the interest of speedy accession, it would also be appropriate to extend the benefit of already established adjustment periods fully to new WTO members, such as for the phasing out of prohibited subsidies by transition economies (SCM Agreement). All this would strengthen the traditional function of the multilateral trading system as a set of basic rules for global free trade which can

---

[39] It is not especially encouraging that during the Singapore Ministerial Conference in December 1996, accession issues played only a minor role in spite of the deadlock in negotiations with China where the positions of incumbent WTO members differed significantly. Furthermore, the wording of the very brief Section 8 of the Ministerial Declaration places responsibility for progress with accession rather single-handedly on the applicants by calling on them to "accept... the WTO rules" and "offer... meaningful market access commitments".

be supplemented, but never replaced by other forms of bilateral or plurilateral cooperation or economic integration.

References

Anderson, James E., The Theory of Protection. Chapter 5 in: David Greenaway and L. Alan Winters (eds), Surveys in International Trade, Oxford UK and Cambridge US 1994, pp. 107-138.

Clement, Hermann, Michael Knogler, Alexei Sekarev, Die wirtschaftliche Lage der Ukraine. Working Papers, No. 174, Osteuropa-Institut, München 1994.

Clement, Hermann, Michael Knogler, Alexei Sekarev, Die wirtschaftspolitische Lage der Ukraine. Working Papers, No. 189, Osteuropa-Institut, München 1995.

Clement, Hermann, Michael Knogler, Alexei Sekarev, Strukturwandel und Probleme der realwirtschaftlichen Anpassung in der Ukraine. Working Papers, No. 196, Osteuropa-Institut, München 1996.

General Agreement on Tariffs and Trade (GATT), Analytical Index. Guide to GATT Law and Practice. Geneva 1994.

Gros, Daniel, Bérénice Dautrebande, International Trade of Former Republics in the Long Run. An Analysis Based on the 'Gravity' Approach. CEPS Working Document No. 71, Centre for European Policy Studies, Brussels 1992.

Hine, Robert C., International Economic Integration. Chapter 9 in: David Greenaway and L. Alan Winters (eds), Surveys in International Trade, Oxford UK and Cambridge US 1994, pp. 234-272.

International Monetary Fund (IMF), Trade Policy Reform in the Countries of the Former Soviet Union. Economic Reviews, No. 2, Washington D.C. 1994.

Kaminski, Bartlomiej, Zhen Kun Wang, L. Alan Winters, "Export Performance in Transition Economies". Economic Policy, No. 23, October 1996, pp. 421-442.

Langhammer, Rolf J., Designing New Trade Policies for the CIS States. Legacies, Barriers and Prerequisites. Kiel Working Papers, No. 625, Institut für Weltwirtschaft, Kiel 1994.

Langhammer, Rolf J., Endogenous Tariffs and Economic Transformation. Intereconomics, Vol. 30, No. 2, March/April 1995, pp. 77-86.

Langhammer, Rolf J., Matthias Lücke, Trade Among the Post-Soviet States: Evolution and Policy Issues. Kiel Working Papers, No. 708, Institut für Weltwirtschaft, Kiel 1995.

Low, Patrick, Issues Relating to State Trading. Geneva 1994 (mimeo).

Lücke, Matthias, "Policy Options for Economic Transformation in the Republic of Belarus". MOST, No. 3/1993 (November), pp. 53-71.

Lücke, Matthias, "Beschäftigungsstruktur und realwirtschaftliche Anpassung in der ehemaligen Sowjetunion". Die Weltwirtschaft, 1994, No. 3, pp. 349-362

Lücke, Matthias, "The Impact of Accession to GATT on the Trade-Related Policies of CIS Countries: The Case of Belarus". Journal of World Trade, Vol. 29, 1995, pp. 165-192.

Luyten, Paul, Introduction to the World Trade Organisation (WTO). Centre for European Policy Studies, Brussels 1996 (mimeo).

Michalopoulos, Constantine, David G. Tarr (eds), Trade in the New Independent States. Studies of economies in Transition, 13, Washington D.C. 1994.

Organisation for Economic Co-Operation and Development (OECD), Integrating Emerging Market Economies into the International Trading

System. Centre for Co-Operation with the Economies in Transition, OECD, Paris 1994.

Orlowski, Lucjan T., "Indirect Transfers in Trade Among Former Soviet Union Republics: Sources; Patterns and Policy Responses in the Post-Soviet Period. Europe-Asia Studies, Vol 45, 1993, pp. 1001-1024.

Orlowski, Lucjan T., "Direct Transfers Between the Former Soviet Union Central Budget and the Republics: Past Evidence and Current Implications". Economics of Planning, Vol. 28, 1995, pp. 59-73.

Piazolo, Daniel, Trade Integration Between Eastern and Western Europe: Politics Follows the Market. Kiel Working Papers, No. 745, Institut für Weltwirschaft, Kiel 1996.

Rodrik, Dani, "Credibility of Trade Reform - A Policy Maker's Guide". World Economy, Vol. 12, No. 1, 1989, pp. 1-16.

Rodrik, Dani, "Getting Interventions Right: How South Korea and Taiwan Grew Rich". Economic Policy, No. 20, April 1995, pp. 53-107.

Schultz, Siegfried, "Transformationsländer und multilaterales Handelssystem: Schnellere Einbindung erforderlich". DIW-Wochenbericht, 5/1996.

Yang, Yongzheng, "China's WTO Membership: What's at Stake?" World Economy, Vol. 19, No. 6, November 1996, pp. 661-682.