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The United States Should Establish Permanent Normal Trade Relations with Russia

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After 18 years, Russia is finally on the verge of acceding to the World Trade Organization (WTO). No country has struggled for so long to become a member of this important organization. The last impediment was removed on November 9, when Russia and Georgia concluded an agreement on monitoring trade flows across their disputed border. The WTO Working Party, which oversaw the negotiations, then approved Russian accession on November 10, clearing the way for formal membership to be adopted at the WTO ministerial conference to be held December 15–17, 2011 (WTO 2011).

Russia is the last of the Group of Twenty (G-20) countries to join the WTO. Its entry will strengthen the global trading system and yield potentially large benefits to the United States. A major question remains for Washington, however. Will the United States act to take full advantage—or will it allow other countries to seize opportunities that slip from American hands?

Russia's joining the WTO does not require any US legislative action. All conditions for Russia's accession have been settled. The Russian State Duma has until June 15, 2012 to ratify its accession. Thirty days after Russia's notification to the WTO of its ratification, Russia will become the 154th member of the WTO.

However, US benefits of Russia's accession to the WTO are not automatic. They will materialize only if the United States Congress grants permanent normal trade relations (PNTR) status to Russia—by repealing application to Russia of the 37-year-old Jackson-Vanik Amendment, which bars favorable trade relations with countries that restrict emigration. President Barack Obama, in a statement issued November 10 after the Working Party's preliminary approval of Russian accession, said he looked forward to working with Congress "to end the application of the Jackson-Vanik Amendment to Russia in order to ensure that American firms and American exporters will enjoy the same benefits of Russian WTO membership as their international competitors."

It is imperative that Congress respond constructively in the same spirit of bipartisanship that led to the successful approval earlier this year of the Colombia, Korea, and Panama trade accords. Political wrangling, misjudgment, and miscalculations must not be allowed to cost the United States a significant new source of economic growth and cooperation in the future.

WHAT THE UNITED STATES WILL GAIN FROM GRANTING RUSSIA PNTR

The potential benefits to the US economy from Russia's WTO accession are substantial but the United States can enjoy them only if it grants Russia PNTR. US exports to Russia could double over the next five years—from $9 billion in 2010 to $19 billion—adding jobs in the services, agriculture, manufacturing, and high-tech sectors. More generally, with Russia's accession to the WTO and the United States granting PNTR to Russia, US-Russia commercial relations will be set on a sounder and friendlier footing, facilitating cooperation on national security and political issues. By strengthening the rules-based global trading system, WTO accession and PNTR will discourage Russia from undertaking protectionist measures.

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The US gains arise from solid growth in the Russian economy. From 1999 until 2008, Russia's gross domestic product grew by an average of 7 percent a year, establishing Russia as one of the world's top ten economies. After contraction during the financial crisis in 2009, Russia's growth rate seems to have stabilized at a still respectable 3 to 4 percent a year. This growth is creating substantial opportunities for foreign producers, both in trade and investment, and global firms are responding accordingly. Russian imports, exports, and inward foreign investment all quadrupled between 2002 and 2008. Still, Russia ranks only 37th among US export markets, suggesting great potential for improvement.

At present, the governing agreement for trade between the United States and Russia is the Bilateral Trade Relations Agreement reached in 1991 between the United States and what was then the Soviet Union. That agreement provides for mutual extension of most favored nation benefits. It was adjusted to apply to Russia in 1992 after the Russian Federation was established. The bilateral agreement was authorized by Section 405 of Title IV of the Trade Act of 1974. However, this old bilateral agreement covers only part of the trade and none of the investment.

On November 19, 2006, Russia reached a much more extensive bilateral agreement with the United States on market access conditions for its accession to the WTO. This accord of 800 pages and various follow-up agreements were a prelude to Russia's accession to the WTO. They contain significant concessions of great value to the United States in intellectual property and market access conditions for several important products: meats, agriculture, biotechnology, harvesters, leased aircraft, and goods with encryption technology. Once Russia accedes to the WTO, these agreed advantages for US firms and farmers will depend on a US congressional vote in favor of PNTR.

From the US point of view, granting Russia PNTR is a winning option for both sides. A vote for PNTR will offer to Russia, on a permanent and unconditional basis, the same trade conditions that the United States grants to other signatories of the WTO. Extending PNTR to Russia entails no special favors or privileges; rather PNTR will accord to Russia the basic treatment enjoyed by nearly all other US trading partners on a permanent and unconditional basis. In turn, the United States will gain three major economic advantages:

- First, PNTR will ensure that the best available trade and investment conditions of access to the Russian market offered to foreign firms are also offered to US firms.
- Second, estimates in our related forthcoming Policy Analysis (Åslund and Hufbauer forthcoming) show that US exports to Russia could double from $9 billion (in 2010) to $19 billion. These gains will be realized as the obligations of the agreement are phased in; the gains will be distributed across the board, from agriculture to manufactures to services. In addition, econometric models indicate that new US export opportunities will also flow from an expansion of US foreign direct investment in the Russian economy, highlighting the importance of the PNTR vote.
- Third, WTO accession will require Russia to enact new rules on issues ranging from services regulations to inward foreign investment to agricultural standards to intellectual property. These rules will bring greater certainty for US firms doing business in Russia. Moreover, membership in the WTO requires a country to observe a vast fabric of commercial law.

But what will happen to US imports from Russia? Commodities account for 90 percent of Russia's overall exports and this share is even greater in its exports to the United States, with refined petroleum products comprising 65 percent and various metals most of the rest. These imports into the United States are subject to zero or minimal tariffs, and no further reduction is foreseen through Russia's entry into the WTO. Therefore, no large rise in US imports from Russia is to be expected. Since US imports of oil and petroleum products have fallen in recent years because of sharply rising domestic production and flat consumption, Russia's exports of petroleum products to the United States may actually decline over the next few years.

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Finally, with PNTR, the United States can invoke the WTO dispute settlement provisions in the event Russia fails to observe these obligations in its dealings with US firms. China is often accused of failing to comply fully with WTO norms, but the WTO has a solid record of winning compliance with its standards from many countries, ranging from the European Union, Canada, Japan, Brazil, Indonesia, and of course the United States itself. In fact, when it loses in the WTO, China like other countries typically changes its laws and procedures to conform to the WTO ruling (Hufbauer and Woollacott 2010).

Russia's WTO accession contains many valuable Russian commitments. In comparison with other emerging-market economies, Russia's import tariffs were not very high to begin with, but they are declining significantly. On average, the final legally binding tariff ceiling for the Russian Federation will be 7.8 percent compared with a 2011 average of 10 percent for all products. The average tariff ceiling for agricultural products will be 10.8 percent, lower than the current average of 13.2 percent. The ceiling average for manufactured goods will be 7.3 percent versus the 9.5 percent average today on manufactured imports. Some commitments are immediate but others are phased in. The longest implementation period is eight years for poultry followed by seven years for motor cars, helicopters, and civilian aircraft (WTO 2011).

Possible US gains from Russia's WTO accession and PNTR on a sector-by-sector and state-by-state basis are summarized below. More detail is provided in box 1.

Agriculture

Russia is one of the world's top meat importers and has historically been the largest importer of US poultry. Russia offers a meaningful market for states with a strong agricultural base, such as Arkansas (poultry), Iowa (beef and pork), and California (wine, fruits, and nuts). Russia's accession to the WTO will help ensure that Russia's markets remain open and will curtail the hassles that US firms confront when they ship beef, pork, or poultry to Russia, particularly with regard to sanitary and phytosanitary (SPS) measures. Accession will also constrain the room for maneuver by the Russian Ministry of Agriculture to invoke trade restrictions based on SPS considerations that are not anchored on science-based criteria. The limit on Russia's total trade-distorting agricultural support will be capped at $9 billion in 2012 and then gradually reduced to $4.4 billion by 2018. Meanwhile no agricultural export subsidies will be permitted.

Manufacturing

Russia's WTO accession and PNTR will open doors for US manufacturing firms, particularly in high-technology products such as pharmaceuticals and aircraft. Russia relies on foreign manufactures for the majority of its domestic supply of drugs (77 percent) and medical devices (60 percent) (Coalition for US-Russia Trade 2011). US manufacturers already have a strong position in the Russian market (supplying 25 percent of Russian medical devices and 5 percent of pharmaceuticals), with Pfizer alone exporting $164 million worth in 2008. Immediately following WTO accession, Russian tariffs on imported pharmaceuticals will fall from 15 percent to around 6 percent, creating much greater market access for US firms. Robust growth in the Russian economy will benefit US exports of industrial machinery equipment such as tractors, oil and gas field equipment, hydraulic hand tools, and transportation vehicles. Texas, Iowa, and Illinois have already realized gains in exports of specialized machinery to Russia. Russia's development of its natural resources (forestry, agriculture, mining, and energy) will provide additional opportunities for US producers of capital goods.

Since 2001, new export opportunities in "transportation equipment"—a category that includes automobiles, trucks, and spacecraft—have boosted exports not only for such obvious industrial states as Michigan, Ohio, and Wisconsin but also for Washington, Arizona, and Tennessee. Russia's WTO accession and PNTR will improve conditions for direct investment by US auto firms in Russia. This will enable US firms to export a wide range of parts and components and to earn investment income on operations in Russia.

Box 1 Impact on the US economy

- Qualitative gains
  - Accession will prevent Russia from arbitrarily raising tariffs and invoking nontariff barrier (NTB) protectionist measures in the future. During the Great Recession of 2008–09, Russia hiked tariffs on numerous manufactured imports (Hufbauer, Kirkegaard, and Wong 2010). Once Russia's tariff schedule is "bound" in the WTO, this sort of arbitrary action will no longer be possible.
  - In future trade remedy cases, Russia will have to follow WTO safeguard, countervailing duty, and anti-dumping duty procedures, observing established procedures with open hearings.
- Quantitative gains
  - In 2010, the United States was the destination of only 3 percent of Russian exports and the source of just 4 percent of Russian imports.
  - Between 2005 and 2010 total bilateral trade between the United States and Russia doubled.[1] The next five years should see a similar increase; our estimates indicate a doubling or more of Russia's external trade following WTO accession, assuming strong Russian economic performance.
  - The associated increase in Russia's inward foreign direct investment (FDI) stock (estimated to be 50 percent) would trigger a further increase in total Russian two-way trade in manufactures. Good Russian economic performance will further enlarge two-way commerce.
- Russia has committed to binding its applied tariffs on detailed tariff lines. The average weighted applied tariffs will thereby be cut (phased in over three to six years) to the following levels (WTO 2011):

Sector	**Current average weighted applied tariffs** (percent)	**Post-WTO accession rates** (percent)
Dairy products	19.8	14.9
Cereals	15.1	10.0
Oilseeds and oils	9.0	7.1
Automobiles	15.5	12.0
Electrical machinery	8.4	6.2
Wood and paper	13.4	8.0
Chemicals	6.5	5.2

- Increased market access for US agricultural exports
  - Russia is the world's second largest import market for beef and pork and has historically been the largest importer of US poultry. Consumer spending on food grew by 70 percent between 2002 and 2008 and is predicted to keep growing rapidly.
  - WTO accession will ensure that the United States enjoys the same access to Russian agricultural markets as its leading competitors such as Brazil and the European Union. In the absence of WTO accession, Russia will be free to discriminate against US exports.

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1. Even when oil is excluded from trade, total bilateral trade between the United States and Russia still doubled.

Box 1 Impact on the US economy *(continued)*

- Revised Russian sanitary and phytosanitary (SPS) regulations will help ensure that any trade restrictions are based on scientific criteria.
- Under these liberalized conditions, US agricultural exports to Russia are expected to double or triple within a few years of WTO accession.

- Increased opportunities for US industrial exports
  - Industrial goods already account for 86 percent of US merchandise exports to Russia; however, the US export structure has become more diversified in recent years, with significant increases in exports of aircraft, motor vehicles, and sundry equipment.
  - Tariffs on the sale of civil aircraft will be reduced from 20 percent to single digits; tariffs on civil aircraft parts will drop to an average of 5 percent.
  - Russia is the largest importer of pharmaceuticals among the BRICs (Brazil, Russia, India, and China). Currently, US exports to Russia are only $70 million, a fraction of its pharmaceutical exports to the other BRICs.
  - Russia has agreed to reduce its export duties on steel scrap (an important input for US steel mills) to one-third of their current levels.
- Significant liberalization of banking, finance, and other services
  - Under WTO accession, Russia will allow 100 percent foreign ownership of banks, securities firms, and nonlife insurance firms.
  - Russia agreed to open its telecommunication services market to all foreign suppliers and allow companies to operate as 100 percent foreign-owned enterprises.
  - These commitments on liberalization will become effective immediately upon accession.

High Technology

Russia has committed itself to joining the Information Technology Agreement (ITA) upon accession to the WTO, and it will allow information technology (IT) imports to enter Russia duty free. No licenses will be required for imports of more than a dozen encryption technology products. California and Massachusetts have tapped Russian markets in software, computers, and electronic equipment, while Washington state and others have taken advantage of better access for aircraft exports and Microsoft products. Some of the concessions the United States has secured from Russia in its 2006 Bilateral Market Access Agreement with respect to such matters as aircraft tariffs will be enjoyed by US firms only if Congress passes PNTR. However, membership in the WTO on equal terms with Russia will enhance the position of US high-tech exporters and improve conditions for additional investment in Russia.

Services

The United States is very competitive in a wide range of services industries, from finance to education to retailing, as noted by J. Bradford Jensen (2011) in his recent book. Russia's WTO accession will enable qualified firms to establish a commercial presence through their investment stakes. A large number of specific commitments have been made in this sector.

For telecommunications the foreign equity limitation of 49 percent will be eliminated four years after accession. Foreign insurance companies will be allowed to establish branches nine years after Russia accedes. Foreign banks will be allowed to establish subsidiaries, and there will be no cap on foreign equity in individual banking institutions, though the overall foreign capital participation in the Russian banking system will be limited to 50 percent. Russia will allow 100 percent foreign-owned companies to engage in wholesale, retail, and franchise sectors upon accession to the WTO.

But PNTR holds the key to enabling US firms to enjoy Russia's market-opening commitments and greater regulatory transparency in these sectors. Services exports are likely to increase at least as fast as merchandise trade, and with time, Russia's accession will likely present new opportunities in other services sectors, such as energy and professional services.

WHY A US CONGRESSIONAL VOTE IS CRITICAL FOR THE UNITED STATES TO REAP THESE BENEFITS

Russia is not only the largest economy outside the WTO but also the only one with which the United States does not have PNTR (often called "most favored nation") status. While congressional approval is not necessary for completion of Russian accession to the WTO, Congress needs to grant Russia PNTR by repealing the Jackson-Vanik Amendment so that US companies can take full advantage of the best available conditions of access to the Russian market for both trade and investment.

The Jackson-Vanik Amendment to the US Trade Act of 1974 was approved at the height of the Cold War, when Russia generated outrage by barring Jews from emigrating. It was sponsored by Senator Henry M. ("Scoop") Jackson of Washington and Representative Charles Vanik of Ohio. Free emigration for Russian Jews, however, has not been in question since Russia became independent in 1991. The amendment is an outdated remnant of the politics of a distant era, though it remains a major irritant in relations between Washington and Moscow and a political issue in Congress. Many lawmakers, citing a range of disagreements with Russia over human and legal rights in Russia and various foreign policy issues, say that refusal to lift Jackson-Vanik would send a signal of displeasure over these matters. But other tools exist for exerting pressure on Russia that would be more effective and far less destructive to US economic interests. The US government has alternative bilateral and multilateral mechanisms that can be used to engage Russia on human rights questions and political and religious freedoms, such as the US-Russia Bilateral Presidential Commission and the Organization for Security and Cooperation in Europe. If necessary, economic sanctions and tailored penalties, including draconian measures, are readily available under other US statutes, such as the International Emergency Economic Powers Act (IEEPA).

Originally, Jackson-Vanik applied to almost all communist countries. Over time, nearly all of them were "graduated" when they joined the WTO. Most entered the WTO without having previously secured PNTR from the United States. Only Ukraine, which became a WTO member in 2008, was graduated by Congress in March 2006 in advance of its WTO accession. All but Moldova have eventually been granted PNTR (Pregelj 2005).

The irony is that annual waivers of Russia and others from the trade penalties imposed by the Jackson-Vanik Amendment have been a fact of life for more than 20 years. Russia was originally granted most favored nation status in 1992 under the US-Soviet Bilateral Trade Relations Agreement of 1991. Even so, for Russian exports to continue entering the US market at normal tariff rates, the US president must either grant an annual waiver or issue a semiannual report certifying that Russia is in compliance with the freedom of emigration provisions in Section 402 of Title IV of the Trade Act of 1974 (the formal name of Jackson-Vanik). The US president or the Secretary of State has issued such a waiver or report finding Russia to be in compliance with the freedom of emigration requirements every year since 1994. There has been no recorded vote in Congress challenging these decisions (US-Russia Business Council and AmCham Russia 2005).

Some Americans object to granting PNTR to Russia, citing foreign policy grounds. They may disapprove of Prime Minister Vladimir Putin, who has signaled his intention to return to the presidency next year. But trade penalties in the Jackson-Vanik Amendment are too blunt an instrument for normal diplomatic use. If they were to be used, the United States might impose Depression-era Smoot-Hawley import tariffs of up to 50 percent on Russian goods, which would stop all such imports.

Can the United States simply continue to operate under the biannual waiver and report process? It cannot. Under WTO rules, that is not allowed. Congress must establish "permanent" normal trade relations, not just normal trade relations to be renewed regularly. Moreover, for Russia, this is an issue of principle: whether to live under the burden of continuous review by Congress or to be taken out of the shadow of an obsolete stigma. Regardless of whether the issue is one of principle or international trade rules, the bottom line is that rejection of PNTR would backfire and US trade with Russia would immediately become potentially worse than the status quo. Russia, for example, would be likely to retaliate by adopting very narrow and stringent interpretations of its obligations under the two existing bilateral agreements on trade with the United States—the US-Russia Bilateral Trade Relations Agreement and the 2006 Bilateral Market Access Agreement.

A vote against PNTR would require the United States to invoke the "nonapplication" provision of the Marrakesh Agreement, which created the WTO. "Nonapplication" means that the WTO rulebook does not apply to trade between the

United States and Russia. In response, Russia might withhold most favored nation treatment for US exports of goods and services not covered by the bilateral agreements. Russia would thereby deny US firms the full benefits negotiated by the United States and other governments in the WTO accession process over the past 18 years. US firms and workers would be placed at a disadvantage, possibly for years to come.

In addition, by voting "no" on PNTR, the US Congress would be missing an opportunity to support liberal voices within the Russian government who advocate political and economic engagement with the West. Over the last three years, the US "reset" policy toward Russia has revived US-Russia relations and has already resulted in the ratification of a new bilateral Strategic Arms Reduction Treaty and the Civilian Nuclear Agreement, both in December 2010. Russia has opened the Northern Delivery Network to Afghanistan and joined in supporting some UN Security Council Resolutions that put economic pressure on Iran to desist from its effort to acquire nuclear weapons.

It is time to move beyond the discord of the past and into a new regime that would function not only on trust but on economic interdependence and benefits as well.

Another danger is that a "no" vote on PNTR would provide fresh arguments to a large group of Russians who believe that the West (and the United States in particular) disdains a "relationship of equals" with Russia and simply cannot be trusted. As President Obama said, "Russia's WTO accession would be yet another important step forward in our reset of relations with Russia, which has been based upon the belief that the United States and Russia share many common interests, even as we disagree on some issues." It is time to move beyond the discord of the past and into a new regime that would function not only on trust but on economic interdependence and benefits as well.

HOW RUSSIA DIFFERS FROM CHINA

One objection to PNTR for Russia is the parallel that some draw with PNTR for China. President Bill Clinton signed the law granting PNTR to China in 2000 after debate over China's human rights and economic practices. But whatever the arguments about China, before or after PNTR, few apply to Russia. Economically, the two countries are vastly different, and US and Russian interests in the WTO are surprisingly complementary, sharply contrasting with current US concerns about China.

Among the big emerging markets—Brazil, Russia, India, China, and Mexico—Russia has the highest GDP per capita both in dollar and purchasing power parity terms. Its GDP per capita in current US dollars in 2010 was more than three times higher than China's (see table 1). Goldman Sachs forecasts that Russia will be the only one of the big emerging markets to approach the per capita income levels of developed European countries by 2050. This status has many important consequences for trade with the United States.

Far from fearing foreign goods, Russia looks on WTO accession as a way to expose its industries to more import competition, which Russian economists hope will enhance efficiency and mitigate inflation, currently at 6 percent. Given that Russia has a larger current account surplus than it desires, the government is interested in raising imports.

World Bank economists Thomas Rutherford and David Tarr (2010) have estimated that the Russian economy would gain 3.7 percent of GDP from WTO accession in the medium term (five years) and 11 percent of GDP in the long term. These gains are likely to derive predominantly from liberalization, resulting in increased competition in business services and foreign direct investment.

Moreover, since 90 percent of Russia's exports consist of commodities, mainly oil and natural gas, which encounter no trade barriers, Russia has few problems with market access. Russian exports are thus not expected to increase much with WTO entry.

In addition, Russia also hopes to attract more foreign direct investment. For many US companies active in Russia, notably in the automotive industry, food industry, and forestry, large-scale exports from the United States to Russia are not a realistic option because of expensive land transportation. Therefore, they can operate only through direct investments in Russia, and they need deliveries of components and critical machinery from the United States.

Another contrast to China is that Russia is not likely to become a significant exporter of manufactures for the foreseeable future, because the country has an exceptionally strong comparative advantage in exporting commodities and because of high costs Russia's exports of manufactured goods are not competitive in world markets.

On the other side of the trade balance sheet, the sophistication, income levels, and tastes of Russian consumers make the country attractive to US exporters of merchandise and services. Russia's middle class accounts for 30 percent of the population, and foreign brands are their top choices. In terms of social indicators like health and education, Russia is slightly ahead of Brazil

Table 1 Russia compared with other emerging-market countries, selected indicators, 2010

Indicator	Russia	Brazil	China	India	Mexico
GDP (market exchange rate, billions of dollars)	1,667	1,636	4,520	1,261	1,090
GDP per capita (market exchange rate, dollars)	11,739	8,626	3,404	1,066	10,216
GDP per capita (purchasing power parity, current international dollars)	16,034	10,526	6,189	2,868	14,546
Population (millions)	142	190	1,328	1,182	107
Two-way trade with the United States (billions of dollars)	28	54	335	45	386
FDI stock per capita (dollars)	1,512	1,499	288	104	2,736
Secondary education (percent)[a]	85	101	76	55[b]	90
Tertiary education (percent)[a]	77	34	23	14	27
Mobile phone subscription (per 1,000 people)[b]	1,322	785	478	304	708

FDI = foreign direct investment

a. 2008 data. This figure represents gross enrollment: a ratio of total enrollment, regardless of age, to the population of the age group that officially corresponds to the level of education shown. A gross enrollment ratio of 100 percent indicates that a country is, in principle, able to accommodate all of its school-age population, but it does not indicate the proportion already enrolled in the age group.
b. 2007 data.

Sources: IMF, *World Economic Outlook*, 2011; UNComtrade Database; UNCTAD Foreign Direct Investment Database; World Bank, *World Development Indicators*.

and Mexico in most—but head and shoulders above China and India. Most impressively, in 2008, no fewer than 77 percent of college-age Russians received some college education, compared with 23 percent of Chinese (according to the World Bank). Moreover, 51 percent of young Russians actually completed a first college degree, compared with only 11 percent of Chinese.

Another difference between China and Russia is their attitude to the protection of intellectual property rights. Unlike China, Russia is a significant high-end producer of software with a strong interest and track record in protecting software patents and copyrights. According to Keith Crane and Artur Usanov (2010), "intellectual property rights are not a major impediment […] countries have been able to prevent product theft successfully." Russia has several outstanding internet companies, and 40 percent of the population has access to the internet.

Finally, currency issues are not likely to cause the problems that plague US relations with China, which intervenes in currency markets to keep the yuan undervalued, making its exports artificially cheap and imports expensive. In the past Russia has pegged its exchange rate, but since 2009 the Russian ruble has floated relatively freely against other currencies. Today Russia has larger international reserves than it desires because of the unexpectedly elevated oil price and intends to let its current account surplus shrink toward balance, boosting its import demand.

The United States has so far not taken advantage of its opportunities to develop the US-Russian bilateral trade relationship, particularly with regard to US exports. US two-way trade with China in 2010 was almost 12 times larger than with Russia and the comparative ratio reaches 22 times when energy trade is excluded. While US imports from Russia are rapidly catching up with US imports from India and Brazil, US exports to Russia (in 2008) were still only one-half of US exports to India and less than one-third of US exports to Brazil.

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