

**Effect of EU Expansion in 2004 and  
Russia's possible accession to WTO on  
Russian economy  
(Review based on surveys and current  
statistics)**

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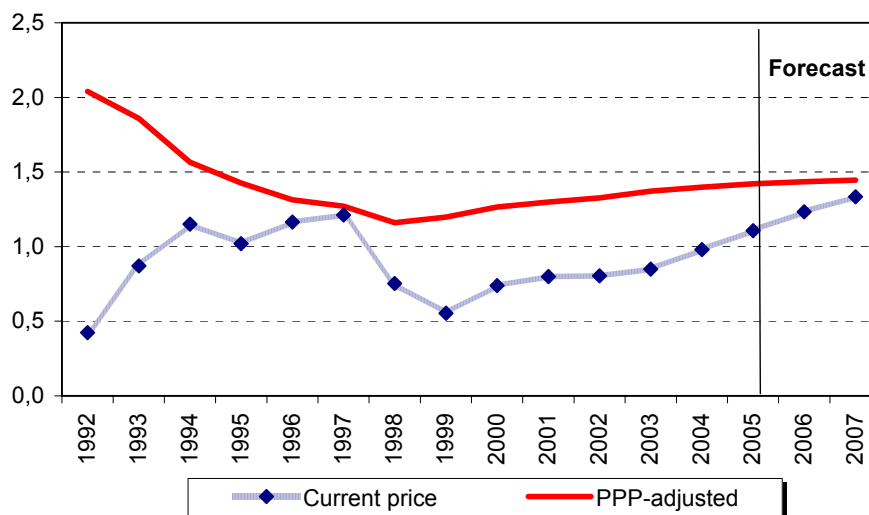
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## 1. EU expansion in 2004 and its consequences for Russian economy

At the Copenhagen summit in December 2002 the European Union (EU) officially decided on “Europe’s enlargement” admitting as its members 10 countries from Central and Eastern Europe (CEE countries). On 1 May 2004, Hungary, Cyprus, Latvia, Lithuania, Malta, Poland, Slovak Rep., Slovenia, Czech Republic and Estonia (or the EU-10 member states) also joined the EU ranks.

The countries that were acceded the EU membership in May 2004 are by many measures comparable to Russia even despite that for the last ten years the volume of PPP-adjusted GDP of the EU-10 member states made up around 1.8 percent (Figure 1) of the world GDP and Russia’s share in the world GDP varied considerably reflecting the course of the economic reform in the country. During the financial crisis of 1998 the share of Russia in the world economy declined to 2.2 percent, approaching the economies of the ten CEE nations. The subsequent economic upturn strengthened, to a certain extent, its position in the world economy up to 2.6 percent. In our estimate, however, it will take at least 10-15 years to restore the proportions of the early 1990s when Russia’s economy doubled EU-10 economy while the IMF forecasts a much longer period. IMF’s pessimism partially is attributed to the fact that now Russia and the EU-10 member states are reducing the gap between their PPP-adjusted GDPs and current price GDPs (Figure 1), which, according to the IMF forecast, will regain the 1997 level in several years. That is a sign that the advantages of the weak ruble shaped in foreign trade after the 1998 crisis will soon cease to be the backing of Russian producers, and will hamper the price competitiveness of Russian commodities on the international markets and domestically.

**Figure 1. Russian GDP to EU-10 GDP, ratio**

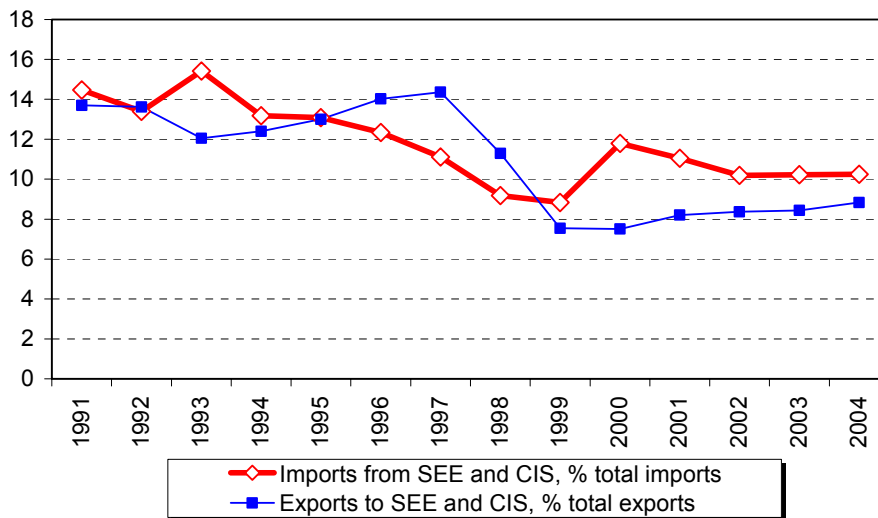


Source: IMF

This fact actualizes the importance of the analysis of the new factors of economic growth including factors related to the institutional dynamics of main neighboring Russia markets, in particular with the European market.

Building of “Enlarged Europe” impacts the interests of Central and Eastern Europe, South-East European (SEE) nations and the CIS countries, as the enlargement involves the states which were closely integrated with the former Soviet Union (FSU). In future, some CIS states may become the next candidates for admission to the EU. Although the collapse of the FSU dented foreign trade between these countries, the post-1999 period saw a weak and gradual recovery of the foreign trade volumes between the EU-10 member states and the countries of these two regions (SEE and CIS). In 2004, the SEE and CIS nations accounted for 9 percent of exports and 10 percent of imports of the EU-10 member states (Figure 2).

**Figure 2. Foreign Trade of EU-10 with SEE and CIS**

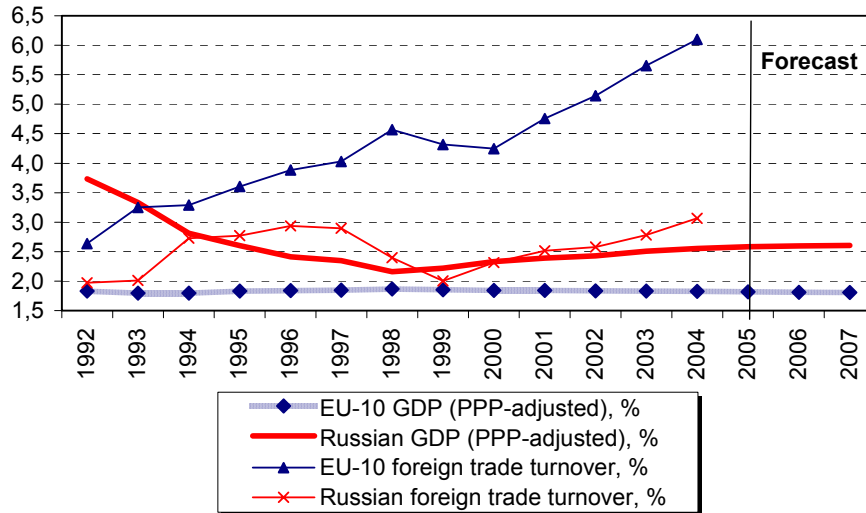


Source: UNCTAD

### **1.1. Scale and factors of economic growth in EU-10 and Russia**

Apart from differences in the scale of the economies, there are more principal distinctions between the Russian and EU-10 economies related mainly to national economic growth models.

First of all, Russia is a country, where the contribution of production to the domestic market is fairly high. At the same time, in some EU-10 member states (primarily in Hungary, Slovak and Czech Republics) production output directed to domestic market is shrinking drastically. Apparently, these countries chose to be export-driven economies and are successfully trying to integrate into international division of labor by penetrating new markets with competitive goods and concurrently ceding domestic markets to more competitive foreign products. Undoubtedly, they are more dependent on the world economy than Russia. For example, the share of foreign trade turnover of the EU-10 countries within the world economy is two times larger than Russia’s (Figure 3).

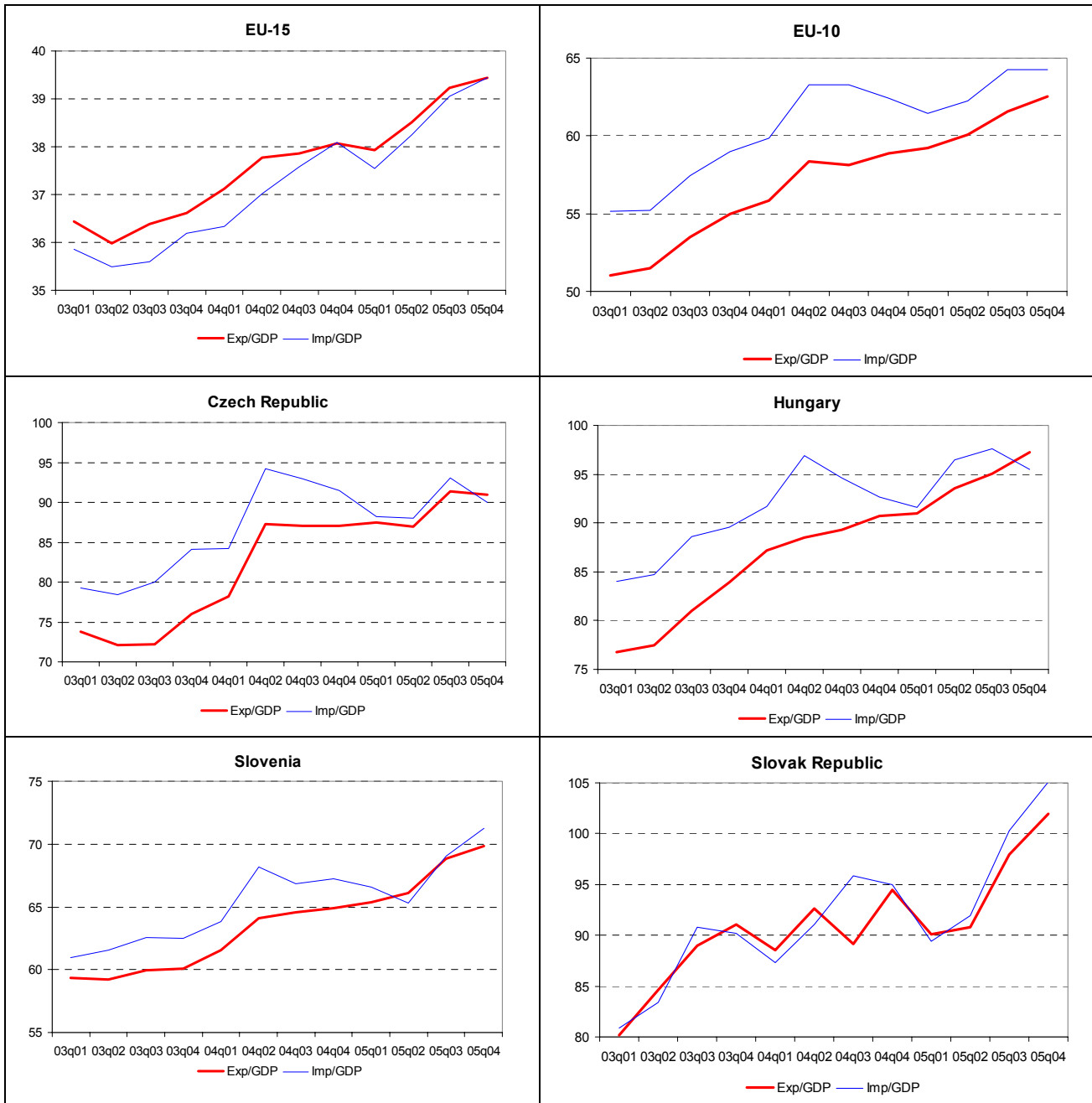
**Figure 3. Share of Russia and EU-10 in the World Economy**

Source: IMF

Comparing to Russia and to the more advanced and “older” EU-15 countries, the new EU-10 member states (as a group) firmly continue to post trade deficit in goods and services. However, the second quarter of 2004 (the time when these countries were admitted to the EU) was marked by deceleration in imports growth. In all evidence, the accession of these countries to the EU was followed by the restrictions already imposed by the EU on trade with their former trading partners. This reduction was not compensated by rising imports from the EU countries, evidently, because prices for higher quality goods from Western Europe stay at quite a different level than the prices for goods, for instance, from South East Asia.

The EU enlargement had no noticeable effect on exports of EU-10 countries so far (the exception is Czech Republic suffering over a year-long stagnation). Nonetheless, Czech Republic, Hungary and Slovenia managed to cut sizably their trade deficits after they joined the EU owing to the slowdown in imports growth (Slovak Rep. has never had a large trade deficit).

**Figure 4. Correlation of Export/Import of Goods and Services to GDP, %\***

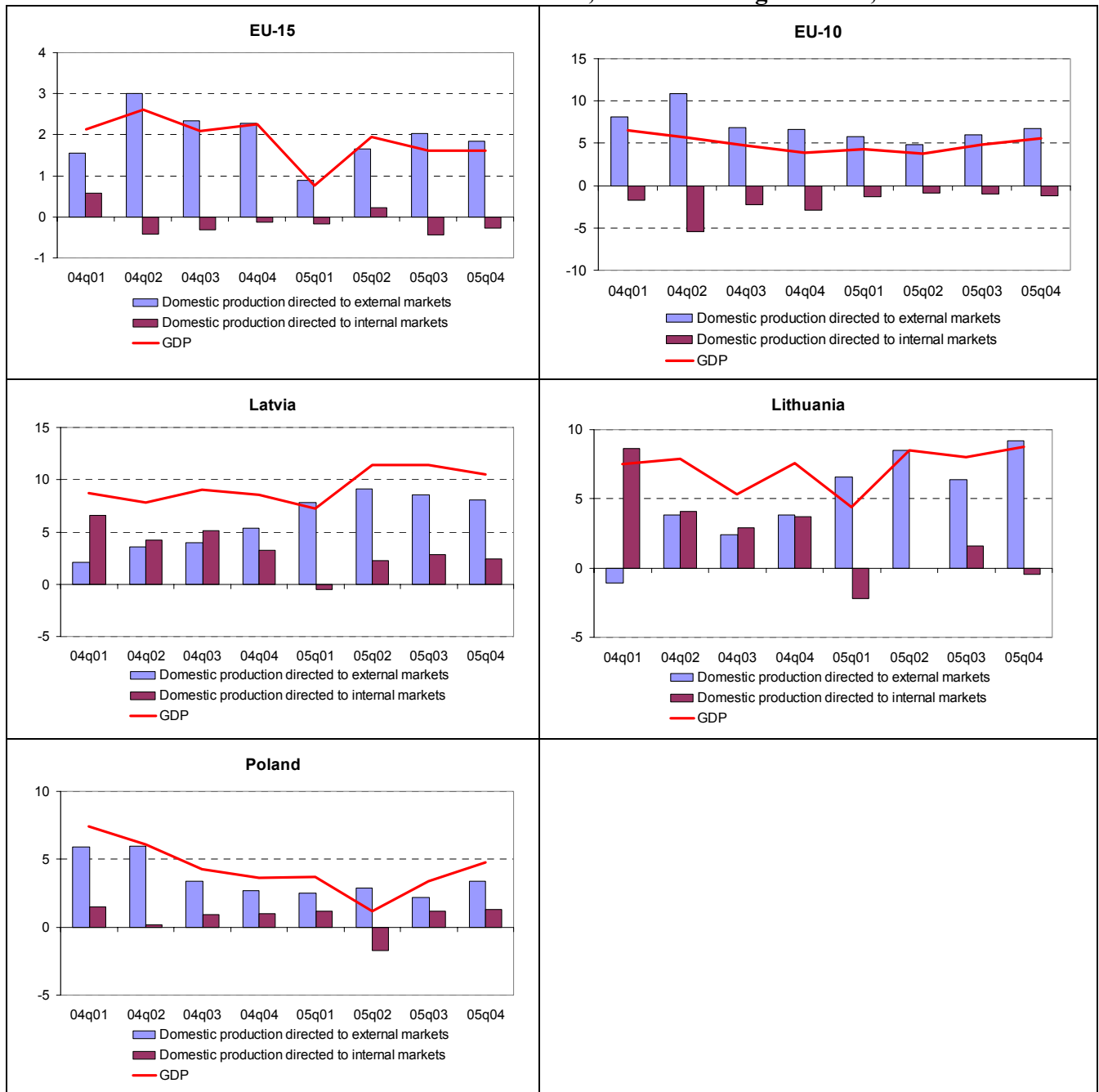


\* estimates are based on GDP, export and import volumes at constant 2000 prices.

Source: Eurostat

On the one hand, the new EU-10 countries and Russia differ from the old member states by much higher GDP growth rates. On the other hand, their common feature is that external demand is the driving force of their economic growth. Domestic demand, to a considerable degree, is met with imports, while supply of domestic output to the domestic market is slightly contracting (in the new EU-10 countries the downtrend is stronger than in the old EU -15).

**Figure 5. Growth in Real GDP and Share of Domestic Output in External and Domestic Markets in the EU and Baltic States, As a Percentage of GDP, YOY\***



\* domestic production directed to external markets (export of goods and services) and domestic production direct to internal market (calculated as a difference between domestic demand and import of goods and services) to total GDP, %

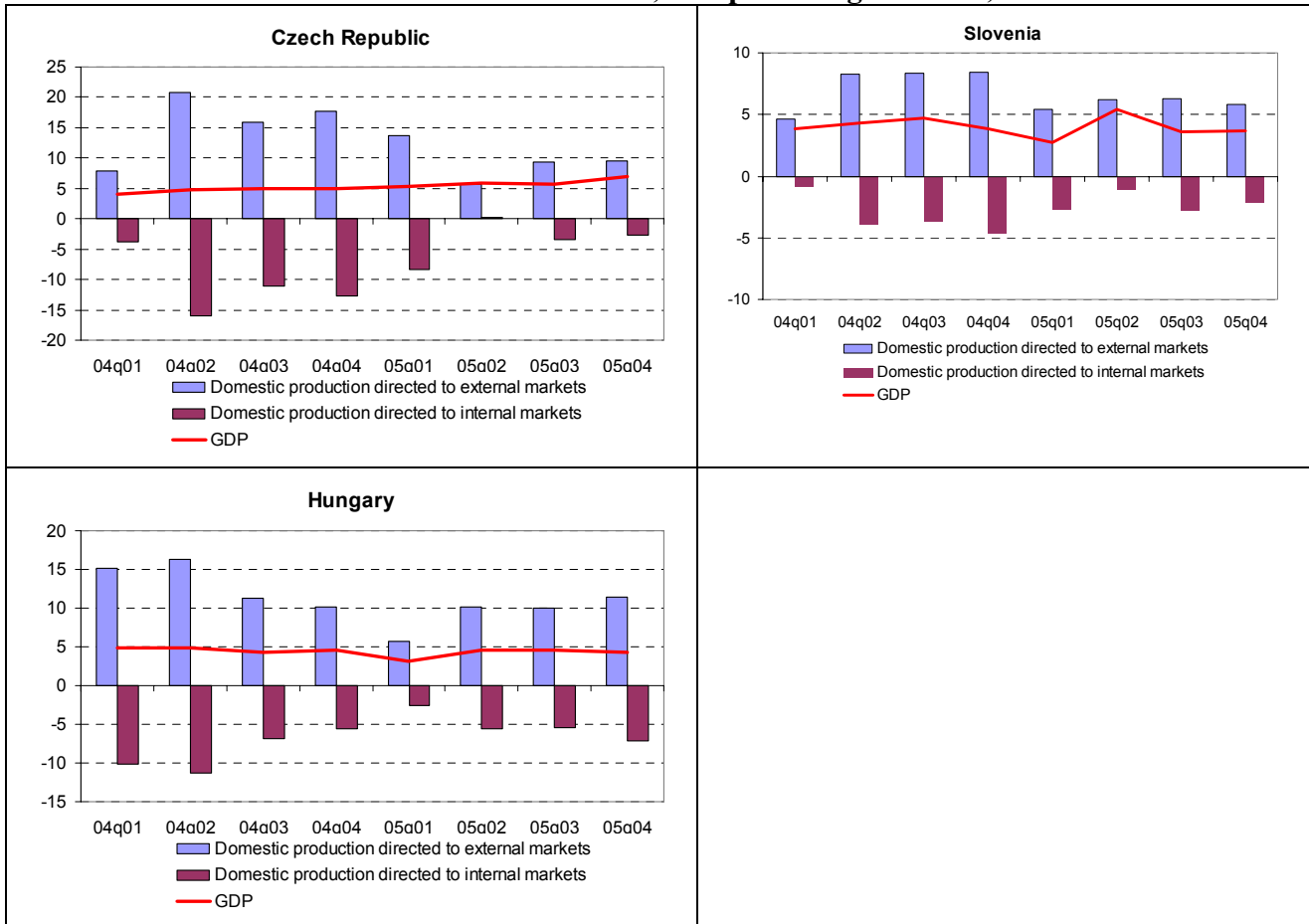
Source: Eurostat

In Latvia and Lithuania the share of exports in the domestic market picked up. The share of their domestic production dwindled, but still stays above zero, which makes Lithuania and Latvia different from the other EU-10 countries, except Poland, where domestic production for the local market is growing steadily.

After Poland's accession to the EU, however, the share of exports in the domestic market in this country went down. The contribution of exports has also weakened in Czech Republic, Slovenia and Hungary. Moreover, "deduction" from GDP arising on curtailment of domestic production directed to the local market has narrowed down (only in Hungary it began to grow again).



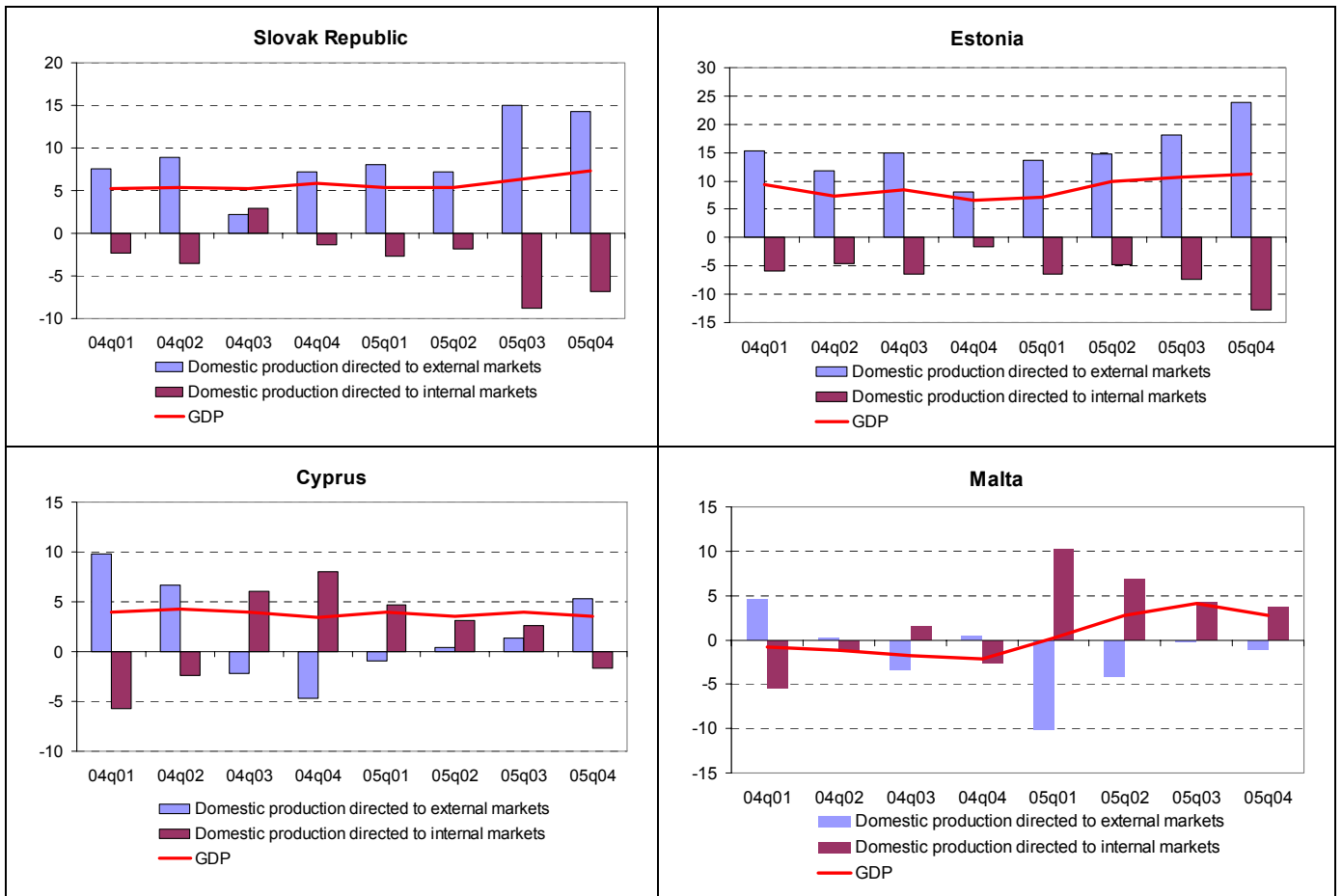
**Figure 6. Real GDP Growth and Share of Domestic Production in External and Domestic Markets in CEE countries, as a percentage of GDP, YOY\***



Source: Eurostat

In Slovak Rep. and Estonia the contribution of exports is expanding in step with falling domestic production for the local market. The same pattern is observed in Cyprus. Malta differs from the rest by exports staying in the negative territory, although this “deduction” is decreasing as well.

**Figure 7. Real GDP Growth and Share of Domestic Production in External and Domestic Markets in CEE countries, as a percentage of GDP, YOY\***



Source: Eurostat

The compiled a classification of the EU countries by changes in the structure of the GDP growth factors is presented below:

**Table 1. Changes in the structure of the GDP growth factors in the EU-10 member states**

	Share of domestic production directed to domestic market	
Share of domestic production directed to external market	Increased*	Decreased**
Increased*	-	<i>Latvia, Lithuania, Estonia, Slovak Rep., Cyprus, Malta</i>
Decreased**	<i>Poland, Czech Republic, Slovenia, Hungary</i>	-

\* Increase in positive share or reduction of negative share

\*\*Reduction in positive share or increase in negative share

Therefore, the countries may be roughly divided into two groups. The share of domestic production directed to the domestic market widened (or reduced its negative value) in Poland, Czech Republic, Slovenia and Hungary, but the expansion of these countries on international markets was less successful. Other countries (like Latvia, Lithuania, Estonia, Slovak Rep., Cyprus and Malta)

demonstrated the growth (or reduced negative value) in the share of domestic production directed to external markets.

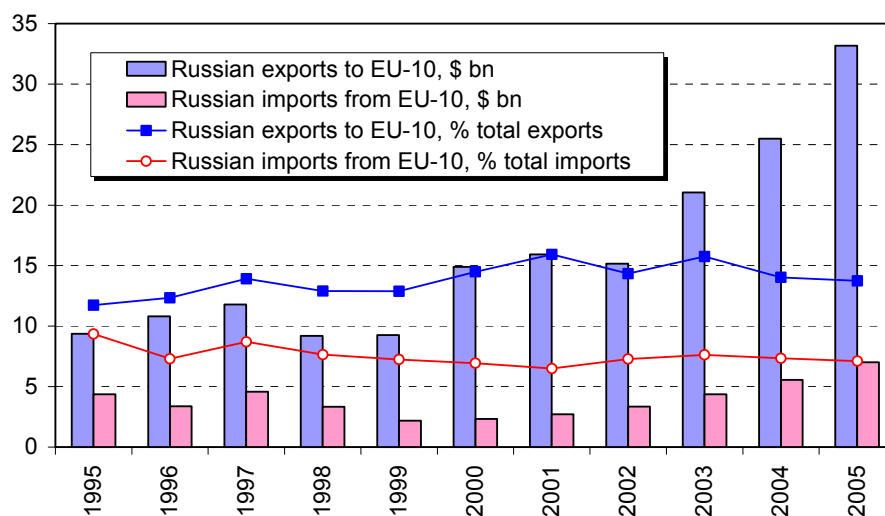
On the one hand, none of the EU-10 countries could build up its competitive strengths in the domestic and international markets during the period after EU enlargement. On the other hand, none of the countries in the post-accession period suffered from worsened competitive advantages on both markets concurrently.

## 1.2. Foreign Trade between Russia and EU-10. Key Risks and Benefits for Russia from EU enlargement

According to the statistics of Russia's Federal Customs Service (FCS), in 2003 the EU-10 countries accounted for over 13 percent of Russia's trading turnover. Even despite the elements of crisis in the economy and the braking growth in foreign trade after 1998, the volumes of trade with this region remained fairly stable.

In the post-crisis period (since 1998), the trading activity peaked in 2003, when the share of Russian exports to the EU-10 climbed to 15.7 percent of all organized exports of Russia, and the share of imports climbed to 7.6 percent (Figure 8). As a whole this stability led to that after the EU enlargement the EU share in Russia's foreign trade reached nearly 50 percent.

**Figure 8. Foreign Trade between Russia and the EU-10 countries**



Source: FCS of Russia, Federal Service of State Statistics

Expected growing trade volumes from EU enlargement led to the economic space unification, in particular, the common frontier between the EU and Russia extended to 2.2 thousand kilometers, and Kaliningrad is surrounded by the EU member states. In the early days of the EU, the only EU member state with which Russia bordered in the north-west was Finland. Close integration between Russia and the EU caused by the territorial proximity and strong economic ties gave rise to fears that the EU enlargement may have a negative effect on Russia's trade with its traditional "buffer" trading partners.

Basically, Russian experts focused on negative implications from customs tariff hikes for separate commodities and quantitative restrictions, problems associated with transit of goods through the new EU member states, dampened competitiveness of Russian agricultural goods resulting from export subsidies to the new EU members, etc.

On the contrary, most EU experts argued that Russia will only benefit from the EU expansion: tariffs will not rise, and, on the average, they will even go down, quantitative restrictions will disappear (in cases, when for some new EU member states such restrictions applied earlier), Russian business will gain foothold to the entire Eurozone market through long-established ties with the countries joining the EU. The optimistic assessment by the EU of prospective trade and economic cooperation with Russia is based on the assumption that expansion of the integration group should facilitate further growth in economic cooperation of the emerging markets with the entire block of the EU candidate countries and with “enlarged Europe”, as whole.

In other words, economic consequences of the EU enlargement for Russia were viewed from different perspectives in Russia and abroad. The controversy in opinions made the Russian Government start negotiations with the EU to sort out the most vexed issues. Among the results achieved we can mention:

- reduction in the average level of tariffs (from 9 percent to about 4 percent, on average) on goods of Russian origin imported to the new EU-10 countries (tariff reduction, for example, applies to Russian exports of unalloyed aluminum and aluminum products);
- broadened quota on some Russian export commodities (for example, steel products);
- limitation of EU anti-dumping measures with regard to Russian exports (potassium chloride, ammonium nitrate, electric steel, silicon carbide, aluminum foil and, possibly, with respect to steel wire and steel rope);
- contracts for delivery of nuclear materials, signed with the joining countries, persons and enterprises prior to joining the EU-15 member states, remain in effect;
- there are no any new constraints on imports of natural fuel and electric energy from Russia to the enlarged EU.

### ***1.3. Structure of Trade between the EU-10 and Russia. Foreign Trade Physical Volumes. Losses and Benefits.***

As a whole, after a two-year period, it is still early to assess the impact of the EU enlargement on trade between Russia and the CEE countries. The analysis of integration process effectiveness normally requires a five-year period within which all positive and negative aspects of the integration come up. Nevertheless, tentative conclusions may be drawn up now. For this purpose, we used a three-year period starting from 2002, when the effect of future integration was minimal, up to 2005. During this period the value of Russian commodities imported by the EU -10 countries soared by 60 percent, whereas imports

to the non-EU countries inched up by a mere 3 percent. The value of the EU-10 imports from the EU countries grew even less than from Russia (Table 2). The EU-10 exports to Russia accelerated also (the value of exports more than doubled) versus exports to other countries.

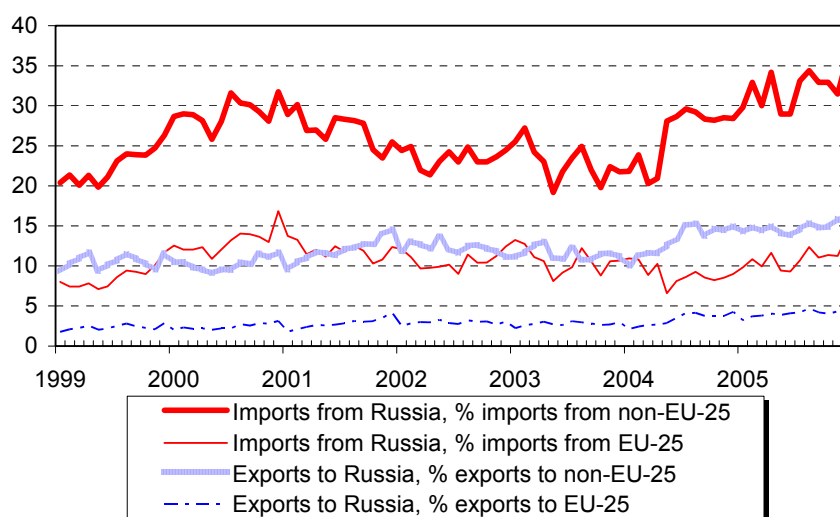
**Table 2. Monthly Average Trade Volumes of the EU- 10, EUR mln.**

	Imports			Exports		
	2002	2005	%	2002	2005	%
With the EU-25	11170	17158	54	10836	16253	50
With the non-EU-25 countries	5040	5845	16	2588	4499	74
With Russia	1182	1885	60	318	666	110
With other non-EU-25 countries	3858	3960	3	2271	3833	69

Source: EUROSTAT

As regards to the Russian side, the accession of the CEE countries to the EU did not brought about, in our opinion, the reduction of Russia's share in the CEE markets. If during 2001-2003, the share of Russian goods in the imports of the EU-10 countries from the non-EU countries dropped from over 30 percent to 20 percent, by the end of last year Russia's share rebounded to 35 percent (Figure 9). The uptrend of Russian imports is observed not only with respect to the non- EU-25 countries, but within this group as well. Logically, the share of Russian imports to the EU had broadened. However, as it is shown below, there was no substantial leap in physical volumes of price-adjusted imports from Russia. Evidently, after cardinal changes in the geographical structure of the CEE foreign trade in the 1990s, there remained few opportunities for fast re-tracking of commodity flows.

**Figure 9. Russia's Share in the Trade Volume of the EU-10**



Source: EUROSTAT

With the current structure of Russian exports, Russia's benefit from the reduction of the EU average customs protection level, in our opinion, was minimal. As regards each of the ten nations that joined the EU, the effect depended on the level of the earlier applied local customs duties and the structure of Russian exports to a particular country. For example, in 2001 the average tariff rate for industrial goods was 4.6 percent in Czech Republic, 7.1 percent in Hungary, 7.1 percent in Slovak Rep.,

8.1 percent in Slovenia, 9.9 percent in Poland, 10.1 percent in Bulgaria and 15.6 percent in Rumania. Hence, in trade with Poland, where the import duties on Russian goods were the highest, the effect from the EU enlargement may be beneficial for Russia. In trade with Czech Republic and, especially, with Hungary, Russia is likely to run up net losses. The EU expansion embraces many important and traditional Russian markets. Such proliferation requires a rigorous analysis of the implications for the Russian economy by separate commodity groups and analysis of not only monetary but physical trading volumes simultaneously.

Currently, the share of energy products supplied from Russia to the CEE countries averages 75 percent of all imports by these countries (Table 3). It is the lion's share of the fuel in the value of imports that laid the groundwork for growth in the value of all goods imported to the EU-10 for the last few years. That period coincided with the boom on all world markets for raw materials. We note, that over three years the value of deliveries of machinery and transport equipment from Russia to the EU-10 countries plunged (-11 percent).

In real terms, however, the effect from the EU enlargement looks less gloomy. At constant prices of 2002, the growth in fuel deliveries to the EU-10 countries was only 7 percent. Deliveries of Russian mechanical engineering goods fell by 3 percent. Overall, imports from EU-10 to Russia rose by 16 percent.

The value of exports from the EU-10 to Russia increased by all commodity groups, and primarily, by such groups as machinery and equipment, chemicals and industrial goods. To put it differently, the upshot of the EU expansion was the growth in raw materials deliveries from Russia to the EU-10 against the background of rising deliveries of finished goods from the EU-10 to Russia.

**Table 3. Monthly Average Volumes of Trade between the EU-10 and Russia, EUR mln.**

	Import from Russia						Export to Russia		
	at current prices			at 2000 prices			At current prices		
	2002	2005	%	2002	2005	%	2002	2005	%
Foodstuffs	8.7	9.0	4	7.8	7.8	0	51.3	79.8	55
Spirits and tobacco	1.5	1.6	7	1.5	1.7	16	2.6	8.9	249
Raw materials, except fuel	46.5	93.4	101	48.7	79.5	63	3.2	6.7	112
Fuel	897.1	1422	58	955.7	1020	7	3.6	6.8	88
Animal and vegetable oils, fats	0.1	0.3	400				1.2	1.3	7
Chemicals	38.2	57.8	51	37.8	47.2	25	56.0	129.5	131
Industrial goods	83.6	102.4	22	93.8	107.1	14	61.3	132.0	115
Machinery and transport	38.5	34.3	-11	40.8	39.7	-3	99.3	214.2	116
Other finished goods	5.8	6.8	17	5.8	6.4	11	38.8	84.1	117
Other goods	61.8	158.3	156	65.8	149.3	127	0.4	2.7	491
Total goods	1181.7	1885	60	1257.3	1456	16	317.7	666.0	110

Source: EUROSTAT

Overall, the short-term effect of EU expansion was an increase in real terms of raw deliveries from Russia to EU-10 on a background of even more substantial growth of deliveries of finished goods

from EU-10 to Russia. Speaking about future prospects of analyzed processes, it is necessary to mean the influence of the number of the institutional factors.

In view of Russia's resource-driven export to the CEE countries, prospects of compliance by the new members with the EU Energy Policy provisions are of particular importance to Russia. This policy, among other things, contains recommendations to limit, "for the purposes to ensure energy security", the imports of energy resources to the level of 25-30 percent of the consumption volume and diversify the sources of imported energy supply, restricting the share of separate countries to 30 percent.

Possibly, it has already influenced on exports from Russia of nuclear fuel and electric energy. Russian exports of nuclear fuel cycle goods (largely represented by fuel elements) to a number of the EU -10 member states make up about 90 percent of these countries' consumption. In May 2006, the Russian corporation TVEL (one of the leading nuclear fuel producers controlling 17 percent of the world market) won an international tender for the delivery of nuclear fuel to Temelin Nuclear Power Plant in Czech Republic. This victory is a step forward expanding Russia's presence in the European nuclear fuel market. Czech Republic is not the only country buying nuclear fuel from Russia. All Central and East European countries, the former CMEA states, are importing Russian fuel elements. Traditionally, Russia has been delivering fuel for nuclear power plants in Bulgaria, Hungary, Lithuania and Slovak Rep.. There are nearly twenty nuclear reactors operating in these countries which were built with the assistance of the FSU, and only one reactor in Slovenia is of American design. All "Soviet-make" reactors in the CEE countries are to be supplied with Russian fuel under the terms of long-term contracts which Russia managed to save notwithstanding the accession of these countries to the EU. The European Union, as we know, sets quotas on nuclear fuel exports from Russia. In 2004, after long negotiations, the EU was forced to widen Russia's quota to incorporate all fuel element deliveries for nuclear reactors located in the CEE countries. But all these deliveries are nothing but capitalizing on the past achievements. In this respect, Federal Agency for Nuclear Power (Rosatom) has long been trying to secure from the EU the expansion of the Russian quota for nuclear fuel exports.

Transition of the EU-10 countries to the EU technical standards (instead of partially preserved CMEA or GOST standards) and similar certification procedures may impede growth in exports from Russia of mechanical engineering products, industrial and finished goods. Agricultural products and foodstuffs also deserve a brief comment. Application to the CEE countries of the common EU agricultural policy substantially trims the niche of Russian agricultural exports and renders our products on the CEE markets uncompetitive. On the whole, the size of possible damage from the worsening conditions for Russian machine-building and agricultural exports will not be so noticeable, due to their moderate volumes, as it may be in other sectors, for example, in the energy industry. But in future in case of growing demand for ecologically-pure agricultural production from Russia the importance of these barriers for Russian producers may rise.

## **1.4. What are the results of the EU - enlargement in 2004 from the industrial enterprises head managers point of view**

Let's consider, on described above macroeconomic background, the Russian enterprises head managers opinions about influence of expansion of EU in 2004 on their economic activity.

### **1.4.1. The description and characteristics of the polling sample**

Below see the analysis of the results of the survey made in cooperation by DC and REB-monitoring. We have excluded from our sample the “monsters” and “rank-and-file” enterprises operating in the fuel and energy sector and extraction industries. Our special poll was conducted on the basis of the sample of industrial enterprises provided by the Russian Economic Barometer (REB). The structural indicators of this sample roughly correspond to the structural indicators of the population of Russian industrial enterprises operating in the manufacturing sector as regards their distribution by key industry, region, size and form of ownership. The main indicators of this sample and their comparison to the data on industrial production in general are presented in Table 4. The poll was conducted in the winter of 2005-2006 when 119 respondents were polled.

**Table 4. General Structural Indicators of the Sample (%).**

Industry	Share in output of manufacturing industries		Share in the number of employed in manufacturing industries	
	Rosstat	REB	Rosstat	REB
Ferrous and non-ferrous	0.28	0.34	0.11	0.15
Chemical and petrochemical	0.08	0.08	0.08	0.08
Machine-building and metal- working	0.28	0.28	0.31	0.33
Forestry, wood & paper	0.06	0.07	0.09	0.11
Building materials	0.05	0.08	0.06	0.11
Light	0.02	0.01	0.06	0.05
Food	0.19	0.10	0.14	0.07
Other	0.05	0.03	0.16	0.09

*Source: Federal Service of State Statistics), REB and Development Center estimates.*

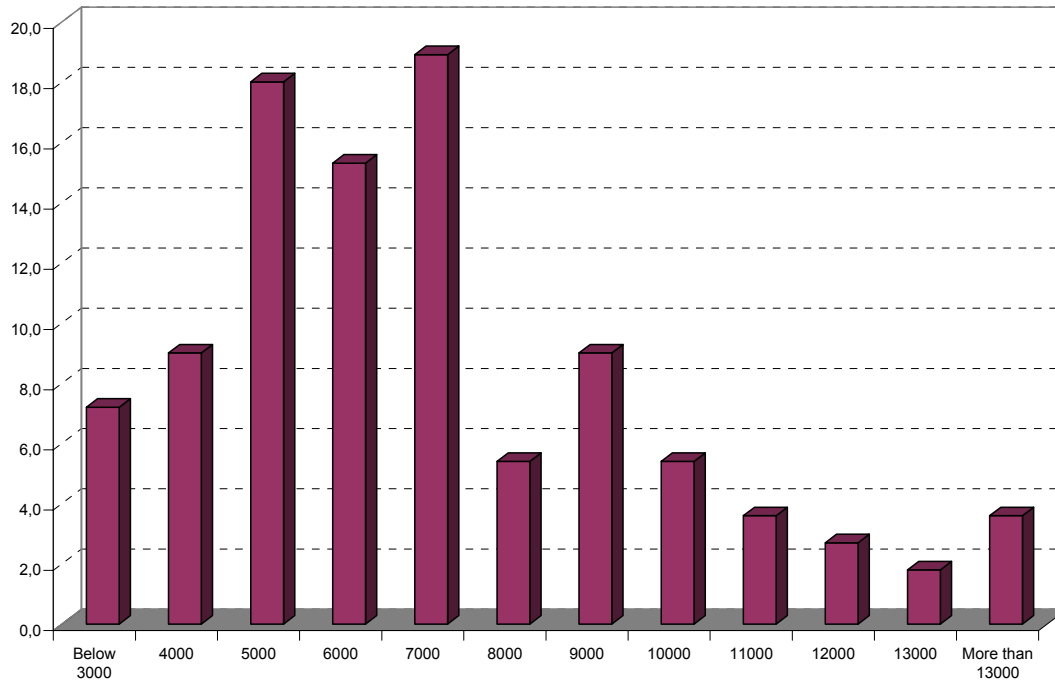
As follows from the table, the sample under review is largely in agreement with the general population of enterprises operating in the Russian manufacturing sector. There are some differences observed in respect of companies operating in the food industry. The number of employed and output of these enterprises in our sample is lower than in the total industry and in the building materials industry. These differences will be taken into account further in our research.

The monthly average wage in our sample appeared to be slightly below the average pay in the manufacturing sector (RUR 7 864 per month, according to the Federal Service of State Statistics



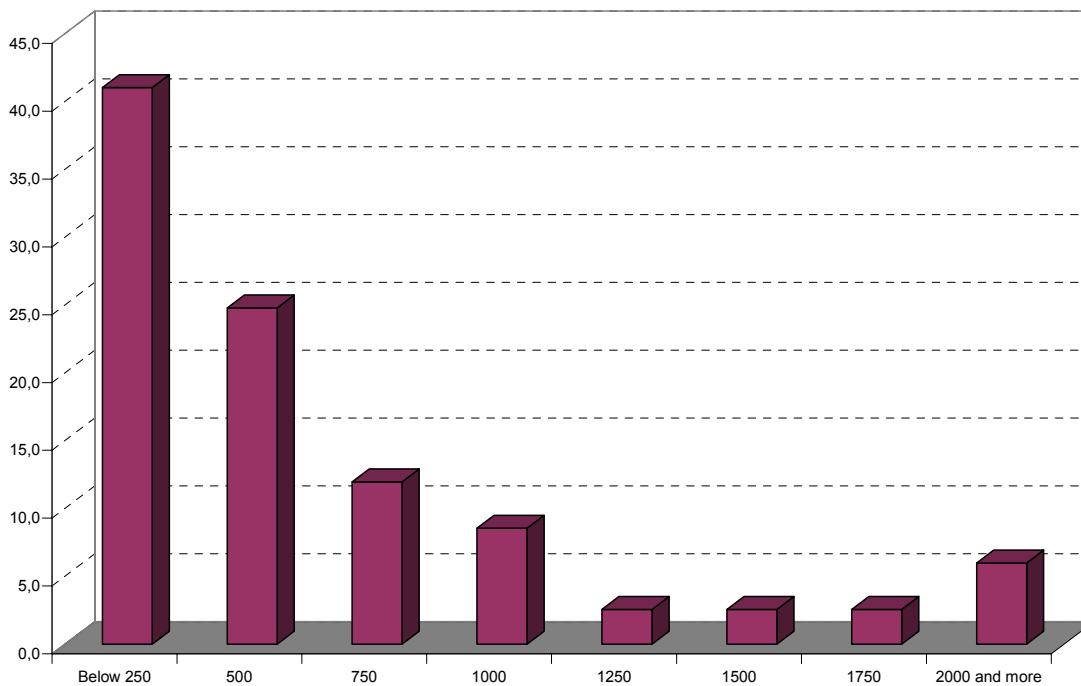
(Rosstat), and RUR 7 350, based our sample), and the average number of employed at one enterprise is 725. The bar charts below exhibit concentration of the polled enterprises by average monthly wage and the number of employed.

**Fig. 10 Russian Enterprises Grouped by Average Monthly Wage and Number of Employed**



Source: REB poll, Development Center estimates.

**Fig. 11. Russian Enterprises Grouped by Number of Employed.**



Source: REB survey, Development Center estimates.

In conclusion we note that aggregated indicators of the polled enterprises stand close to the indicators of the REB standard industrial sample.

Obviously, involvement in foreign trade is the main factor that differentiates firms by their view on Russia's accession to the WTO and EU expansion occurred in 2004. In this context, the most important feature of our sample is that a considerable number of Russian industrial enterprises included in it are exporters of their products and importers of component parts, materials, etc. To put it differently, in most cases the enterprises are integrated into the international division of labor both as exporters and importers. Among 49 exporting companies of our sample (41 percent), 40 enterprises (or 82 percent) also import equipment and components required for production purposes. The inverse dependence is less obvious, as these 40 enterprises combining export and import operations make up less than a half of all sampled companies (in our sample they are 86 or 72 percent of the total sample) that imported components and raw materials.

At the same time, there are enterprises operating solely on the domestic market. In our sample they represent 18 percent of all respondents. We believe that the attitude of the management of industrial enterprises operating in the manufacturing sector to Russia's accession to the WTO and EU expansion in 2004 depends, to a substantial degree, on the extent of their involvement in international trade. In this context, from this point onwards, along with the analysis of average assessments drawn from the entire sample, we will also compare the answers of these two groups of respondents to identify the most important differences in the attitude to these processes among the Russian industrial elite.

We can now pass on to the analysis of our sample findings. Our calculations showed that the share of exports of the exporting producers included into our sample made up approximately 12.5 percent of their output and, extrapolated to the entire sample, their share will be around 6.5 percent. This last figure is fairly close to statistics on the manufacturing sector in general (NB: our sample disregards the fuel and energy sector). As for imports of foreign produce, we estimate the share of imports in the cost of capital goods utilized at 20 percent for the enterprises which use import goods and at 12.4 percent if extrapolated to the entire sample. Generally speaking, these are meaningful figures, though, as we see it, not as convincing as to allow us to say that our industry is open to the foreign supplier.

Sometimes, selection by Russian enterprises of geographical areas for their foreign trade activities gives one a surprise. For instance, we did not expect that by their intensity, export flows are distributed rather evenly in different regions of the world. Thus, CIS exports account for 4.8 percent of total exports, EU exports make up 3.8 percent and "rest of world" countries represent 3.9 percent. At the same time, flows of imported goods differ by their intensity. CIS imports make up 6.6 percent, EU imports account for 10.7 percent and only 2.9 percent of imports come from the "rest of world" countries. Hence, while distribution of exports is more diversified, importers appear to be more selective.

In any case relative involvement of Russian producers in international trade is likely to gather momentum only gradually. This conclusion was prompted by the respondents' answers to the question on the enterprises' short-run plans regarding their entry to the world commodity markets. Thus, about 20

percent of the enterprises already engaged in export of their products are going to expand the number of countries importing their goods. About 30 percent of the respondents currently trading on the domestic market pointed out that they plan their entry to external markets in 2-3 years. The target area is the CIS, as nearly 20 percent of the respondents plan to penetrate this market. Only 7 percent of the respondents view EU countries as their prospective markets and a modest 4 percent intend to expand their sales to the “rest of world” countries.

#### **1.4.2. What was the impact of EU expansion in 2004 for Russian industrialists?**

In 2004 ten countries were admitted to the EU: Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovak Rep., Hungary, Slovenia, Cyprus and Malta. Three of these countries are ex-Soviet Republics and four of these states were members of the Council for Mutual Economic Assistance. Slovenia, as part of ex-Yugoslavia, was also within the sphere of Soviet influence.

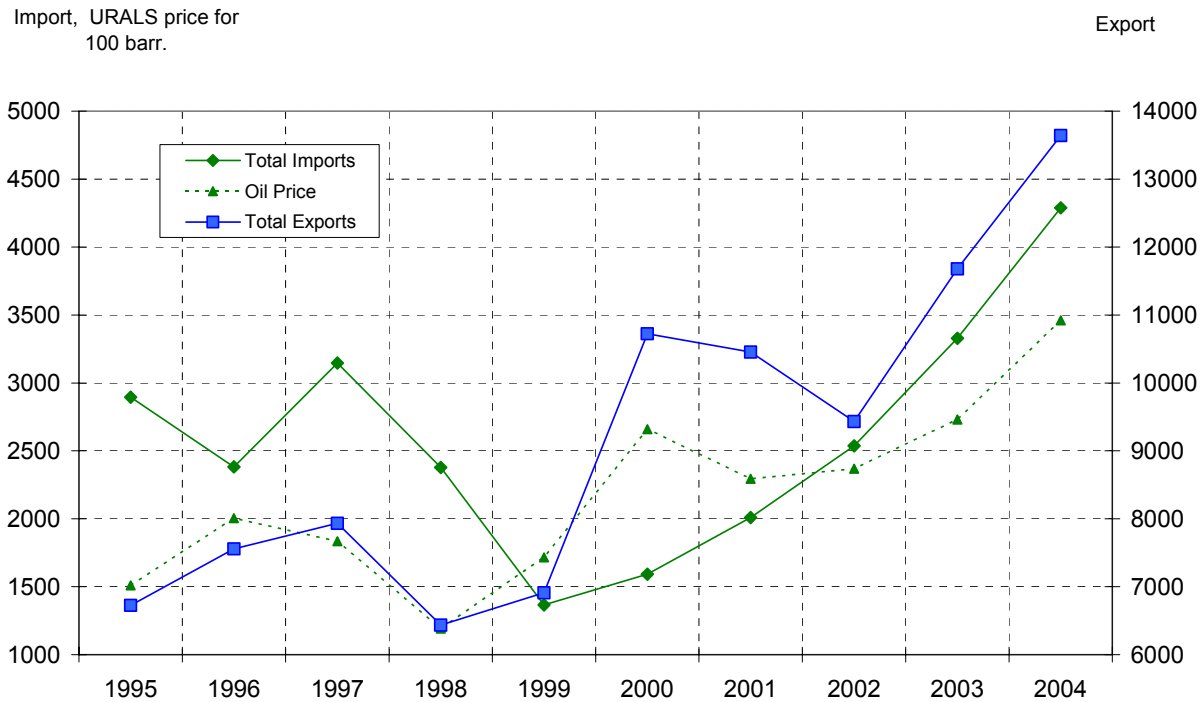
Admission of these countries to the EU as equal members of the Union was only a formal seal of the shift in their economic contacts, as even before EU accession these countries were set on reinforcing their westward orientation during almost 15 years from the time they became politically independent from the Soviets and then from Russia. At the same time, such a tough breakup of the well-established economic links with the Soviets which at first was more of political nature gave way to a more pragmatic approach to handling economic issues and by 2004 the contacts between Russia and these countries were increasingly governed by economic sense and not by political reasoning.

As an example proving the above viewpoint we can take the trends in export and import volumes between Russia and Hungary, Poland, Slovak Rep. and Czech Republic for the period from 1995 to 2004 shown in Figure 12. The share of imports from these countries was falling up to 1999 when the downtrend was reversed by the upward dynamics. The export trends are more complicated. However, exports stagnation observed before 1999 was reversed by an upturn and a real boom in 2000<sup>1</sup>.

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<sup>1</sup> The most brisk trade is with Poland. Almost doubled volume of exports to Poland brought about peak export volumes in 2000.

**Fig. 12. Trends in Imports and Exports between Russia and Hungary, Poland, Slovak Rep. and Czech Republic from 1995 to 2004 (Current Prices, in Millions of USD)**



*Source: Federal Service of State Statistics, Development Center estimates*

With this as a backdrop, let us look at the opinions of the polled enterprises regarding the EU enlargement impact on their business operations. We note that for the respondents who have not any economic relationships with foreign partners this issue is not important at all and their opinion will be treated as marginal since they are not exposed to any direct influence of the EU expansion. But while analyzing the opinion of Russian industrial elite, we will identify within the internationally operating enterprises a group that has economic links with the EU countries.

Such enterprises make up 44 percent of our sample and their opinion, undoubtedly, will carry much weight in the total population of the opinions. Besides, the export flows of these enterprises to the EU countries and imports from the EU are rather sizeable. As we mentioned earlier, within 20 percent of the components, building materials and capital goods imported by the sampled enterprises trading on the international marketplace, EU countries account for 11 percent and within 12.5 percent of products exported from these enterprises (as percentage of total output), EU countries make up 3.8 percent.

Let us first look at differing answers of these respondents to the question whether and how the attitude of the new members that joined the EU in 2004 changed in respect of Russian trading partners. According to Table 5, half of the respondents of the entire sample, as well as the group of the respondents that have up and running partner relationships with the EU member states, believe no changes have occurred at all. In both groups the share of the respondents thinking that the relationships

have improved is slightly higher than the share of the respondents saying that the relationships have deteriorated (27-30 percent and 23 percent, accordingly).

**Table 5. Change in Attitude of New Members Admitted into EU in 2004 to Russian Partners (%)**

	Strongly positive	Slightly positive	No change	Negative	Strongly negative
Total	4.0	25.7	47.5	16.8	5.9
Working with the EU	4.2	22.9	50.0	20.8	2.1
Non/imp.Non/exp.	0.0	53.8	38.5	7.7	0.0

*Source: REB survey, Development Center estimates*

Strong optimism of unclear origin is demonstrated by the respondents operating only on the domestic market. More than half of these enterprises (53.8 percent) believe that these relationships should improve and only less than 8 percent are of the opinion that they will slightly worsen. Naturally, this opinion cannot be taken seriously, although overall, assessment of the implications of the EU eastward expansion into these countries by the informed respondents of our sample is positive.

Such evaluation is in line with the opinion of our respondents on changes in trading turnover with the EU after 2004 (Table 6). Thus, 37.5 percent of the respondents trading with EU member states argue that, overall, the trading turnover with these countries after the EU enlargement by another 10 members has grown. This is an obvious fact, as all foreign trade that existed with these 10 countries before the accession became part of the trading turnover with the EU countries. Besides, as shown above, import and export volumes were rising in this direction prior to 2004, and would continue to rise in future, even if the accession had never taken place.

**Table 6. Has EU Expansion Impacted the Newly Admitted Members' Trading Turnover with Russia? (%)**

	Strongly increased	Slightly increased	No impact	Slightly decreased	Strongly decreased
Total	0.0	35.9	51.5	9.7	2.9
Working with the EU	0.0	37.5	52.1	8.3	2.1
Non/imp.Non/exp.	0.0	46.7	53.3	0.0	0.0

*Source: REB survey, Development Center estimates*

Nonetheless, if all countries that joined the EU in 2004 had stopped trading with Russia, or would have cardinally slashed the trading volumes, our respondents would have come out with different answers. However, more than 10 percent of the respondents of our reference group believe that the trading turnover with these countries has dropped. This is very close to the actual state of things, given the aspiration of the new EU members to reinforce economic links with the EU members.

We note that on this point, as well as on the previous one, the opinion of the third group turned out to be more optimistic than for the entire sample and the reference group, in particular. Neither of these respondents thinks that admission of the newcomers to the EU led to contraction in the trading

turnover with the EU member states, and almost half of them (by 10 percent more than in the other groups) believe that the trading turnover widened.

Finally, let us see what economic and political reasons rein in the expansion of trading turnover between our country and the EU member states (Table 7).

**Table 7. What Are the Constraints for Trade between Enterprise of Your Industry and EU? (%).**

	All enterprises	Trading partners of the EU	Domestic operators
Visa regime, etc.	4.8	6.9	2.9
Antidumping investigations in the EU	0.4	0.0	0.0
Government support of the competing firms in the EU	8.3	10.8	2.9
Language barrier	3.9	2.0	11.8
Insufficient information on the EU trade legislation	13.5	13.7	20.6
Protection of intellectual property	1.3	2.9	0.0
Taxation complications, etc.	22.2	20.6	23.5
Low quality of Russian products	17.8	13.7	20.6
Drawback of Russian economic policy	23.9	23.5	17.6
Other	3.9	5.9	0.0
Total	100	100	100

*Source: REB survey, Development Center estimates*

Among the main constraints, the respondents of the reference group named the drawbacks of the Russian economic policy and taxation complications were pointed to as the second main barrier, which are, to a certain extent, the implications of this policy. Next come two problems the solution of which, in our opinion, fully depends on these enterprises: low quality of goods produced by their enterprise<sup>2</sup> and insufficient information on the EU trade legislation. Both issues may be resolved by the enterprises themselves, whereas the first two snags should be addressed at the state level.

The unexpected result was a high percentage of the respondents of this group, who pointed out that one of the most significant problems for them are government support of the competing firms in the EU. Especially so, that none of them is afraid of antidumping investigations in respect of their enterprises and a very small share is concerned about protection of intellectual property.

The average percentages of answers given by the enterprises operating on the domestic market clearly reflect the problems faced by this group of the enterprises. Thus, rather high is the share of the respondents who defined language barrier as their problem (11.8 percent versus 2 percent in the reference group and 3.9 percent for the entire sample). There are by far more respondents in this group who

<sup>2</sup> Possibly, these respondents referred to the quality of Russian goods in general, but we don't think that it changes the substance of the problem.

answered that the deterrent of their trade with the EU countries is low quality of their products (20.6 percent against 13.7 percent in the reference group).

We also note a higher percentage than in the sample and the reference group of the respondents who have no or very vague idea of the EU trade legislation (20.6 against 13.7 percent), and a very low percentage, evidently due to the lack of the relevant practical experience, of the respondents who pointed to visa regimes and government support of the competing firms.

## 2. Russia's Accession to WTO: General Assessment

The answers of the respondents to the question "Does Russia really need membership in the WTO?" are divided as follows:

**Table 8. "Does Russia Really Need Membership in WTO?" Answers by Category (%).**

	All respondents		Actively involved in foreign trade		Involved only in domestic sales	
Yes, and as soon as possible	9.3	53.7	17.0	61.7	0.0	53.3
Yes, provided a reasonable transition period is granted	44.4		44.7		53.3	
The issue should be put off and revisited later	36.1	46.3	29.8	38.3	26.7	46.7
No, Russia should discard the idea of joining the WTO	10.2		8.5		20.0	

*Source: REB survey, Development Center estimates.*

These statistics may be interpreted differently depending on the viewpoint taken. As an optimistic option, we may group the first three answers and interpret the obtained information in such a way that the overwhelming majority of Russian industrial producers do not object to WTO accession and only 10 percent (4<sup>th</sup> answer) of all respondents reject the idea absolutely. It is notable, that among such respondents, the number of negatively minded enterprises limited to domestic sales exceeds twofold (20 percent) the sample total. It was an unexpected finding that 8.5 percent of the respondents involved in Ex-Im operations are also up in arms against Russia gaining membership in the WTO, regardless of the terms for such accession.

If we choose to look at things pessimistically, we should group the answers of the last three categories. Then, the conclusion will be almost the opposite: most respondents feel wary of Russia's accession to the WTO, advocating "no-haste, be patient" stance on this process. Almost 90 percent of all the respondents share this point of view and only slightly above 9 percent (1<sup>st</sup> answer) of the respondents argue that Russia should join the WTO immediately, just jump at the opportunity. Among the respondents involved in Ex-Im operations, 17 percent (twice as much as the total) look at the WTO accession as an immediate step, whilst all 100 percent of the respondents involved only in the domestic sales feel cautious about joining the WTO.

We suppose that the most reasonable division of all the respondents will be their division into two groups. The first group unites those respondents who, although with reservations, chose the “yes” answer (1<sup>st</sup> and 2<sup>nd</sup> categories). The second group includes the respondents gravitating to the “no” answer (3<sup>rd</sup> and 4<sup>th</sup> groups). The respondents so divided may be sensibly regarded as “advocates” and “opponents” of the WTO accession.

Table 2 shows that they are almost equal in number for the total population with some slant in favor of the WTO. Simple vote has shown that the positive attitude won, with “advocates” accounting for 54 percent and “opponents” for about 46 percent of the sample. Division of the respondents operating on the domestic market into the WTO “advocates” and “opponents” almost agrees with the division in the entire sample. We think that is the cohort of Russian industrialists that sows the seeds of negative attitude to the WTO accession among the public, or to be more exact, a shilly-shally approach to Russia’s prospective membership in the WTO.

Meanwhile, among the enterprises trading on the global markets, whose CEOs know from experience about the benefits and disadvantages of entering the world markets, over 60 percent of the respondents welcome the idea of Russia’s accession to the WTO (61.7 percent against 38.3 percent). Comparison of these two groups of enterprises will allow us to get a better understanding of the underlying reasons that drive a wedge between the Russian industrial producers on this point.

## **2.1. Genuine Reasons are Objective Business Indicators**

The analysis of the real operating conditions - the extent of production capacity utilization, profit margin, wage levels and the number of employed of the two groups under review - has revealed that the above indicators substantially differ by group (Table 9).

**Table 9. Average and Weighted Average Business Indicators of Entire Sample and Two Groups of Enterprises**

	All respondents	Actively involved in foreign trade	Involved only in domestic sales
Number of employed	725	1209	392
Wages	7350	7220	2790
Extent of production capacity utilization	65.1	68.7	63.2
Profit margin	7.2	10.8	2.5
State orders for products are received			
Regularly	6	12.2	0.0
Occasionally	22	20.4	19.0
Never	72	67.3	81.0

*Source: Federal Service of State Statistics, REB survey, Development Center estimates.*

These data explicitly demonstrate that the number of employed at the enterprises whose operations are confined to the domestic market is twice less than for the sample average and three times less than at enterprises participating in international trade. Despite the fact that the degree of their



production capacity underloading is quite comparable with the sample average (they lag by 2 percent only), such financial performance indicators as profit margin and average wages heavily undershoot the sample average, and even more heavily the enterprises that have built well-developed ties with foreign companies.

For instance, their profit margin is four times less than for the enterprises exporting their products abroad, and the wages are 2.5 times less. In other words, production processes at these enterprises are inefficient and their products, most likely, are not in high demand even on the domestic market. We note, that almost half of this group is represented by enterprises operating in the light and food industries.

That goes to say that managers of these enterprises do not have the production and technological base measuring up to international standards. That considered, their negative (or at best wary) attitude to Russia's accession to the WTO is quite understandable and even justifiable. By the way, even the state has no permanent contacts with these enterprises and only occasionally issues state orders to them. Meanwhile, almost one third of the enterprises placed in the first group receive state orders on a regular basis.

Let us compare the opinions of the respondents of these two groups regarding changes in the business operating environment after Russia gains membership in the WTO and the resulting cut in the import tariffs for the products consumed by them in production process (as we know, import tariffs are expected to be cut by 5 percent).

**Table 10. General Assessments and Assessments by Two Groups' Respondents of Changes in their Prices and Output Caused by Reduction in Import Tariffs for Products Consumed by Them after Russia's Accession to WTO (%).**

	The prices for your products will			
	Decrease	Not change	Increase	No idea
All respondents	4.0	65.7	6.1	24.2
Actively involved in foreign trade	4.7	65.1	4.7	25.5
Involved only in domestic sales	0.0	55.5	0.0	44.5
	The output of your enterprise will			
	Decrease	Not change	Increase	No idea
All respondents	7.1	65.7	10.1	17.1
Actively involved only in foreign trade	7.0	67.4	11.6	14.0
Involved in domestic sales	11.1	55.6	0.0	33.3

*Source: REB survey, Development Center estimates.*

Our survey shows that a sizeable share of the respondents does not know how these changes may impact their prices and output. As we anticipated, the majority of them are the enterprises operating on the domestic market only. Thus, 44.5 percent (Table 10) or almost half of their population has no idea how their prices may change. The remaining part believes that the prices won't change and there is simple logic in this, as the enterprises placed in this group do not use imported products in their technological processes. They feel even more pessimistic about changes in their output – 10 percent of

the respondents believing that nothing will change to the better are of the opinion that the output will drop.

We did not expect the answers of the respondents actively involved in world commerce to the first two questions to diverge like that: two thirds believe that the cut-down in tariffs for imported capital goods, building materials and components will not bring about any changes in the ex-works prices for their products and almost 5 predict price growth. Roughly the same percentage of the respondents thinks that the prices will go down.

There are, basically, two reasons for such pessimistic view on possible decline in product prices. First, reduction in tariffs for the imported produce is not really substantial. Second, the share of imports in total production costs of these enterprises is rather small and cannot significantly change the general pricing policy in respect of goods produced<sup>3</sup>.

As regards changes in output, two thirds of the respondents believe that nothing will change. However, 12 percent expect this change in tariffs to boost production. The “pessimists” block here is less by 5 percent. It is quite likely that the representatives of the last group consider that increased imports will squeeze out their traditional suppliers of components and materials from their historical niche, which, naturally, can complicate and cause deceleration of the respective production processes.

Proceeding from the above, we will now find out the attitude of all Russian enterprises and the attitude of the two reference groups of enterprises to possible strengthening of the foreign producers’ role in their “niches” on Russian commodity markets after Russia’s accession to the WTO.

## **2.2. Does fear of “foreign invasion” really exist?**

The common belief is that one of the major reasons for most enterprises’ cautious attitude to the WTO is their concern about the advent of foreign competitors on the domestic market. In broad terms, our poll statistics do not support this assumption. Indeed, by the beginning of 2006 the share of foreign suppliers on the domestic market, according to all respondents surveyed, made up around 20 percent. After joining the WTO, as our respondents forecast, their share will widen inconsiderably to 29 percent. And although, other things being equal, that is tantamount to a 9 percent contraction in Russian enterprises’ domestic sales, their share will still remain significant (about 70 percent against the pre-accession 80 percent).

This slight reduction will not trigger any grave negative implications for the Russian economy and makes some respondents believe that their products will be the ones that will manage to retain their positions on this market.

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<sup>3</sup> For example, the cut in VAT by 2 per cent in 2004 did not help pare off the prices in Russia, and, possibly, only put a slight brake on their growth.

The differences in the assessment of changes in the share of imports on the domestic market by the respondents actively operating on the world markets and domestically selling producers are quite telling. The first group believes that the share of the competing imports will pick up from 24.5 to 33.5 percent, i.e. will seize one third of the market. Nonetheless, despite the fact that their assessments are higher than the sample average, they are not scared by such prospects, because, as we see it from Table 2, it is the group of the respondents most loyal to Russia's accession to the WTO.

At the same time, respondents involved only in domestic sales who have, in general, a negative attitude to Russia's accession to the World Trade Organization give inadequate estimates of the volume of imports on the domestic market (13.9 percent) and its growth after accession (up to 19 percent of the market). So it is hard to believe that this group of respondents is wary of WTO accession for fear of competition from foreign suppliers and, as shown above, they are mostly concerned about the current business environment in which they have to operate now.

Now we will look at the stance taken by other reference groups of the respondents differing by the share of imports on their markets. Table 11 summarizes the answers of our respondents divided into three groups with the share of imports not more than 20 percent, 21 - 50 percent and more than 50 percent.

The results speak for themselves. In the group of the respondents with share of imports on their respective market segments not exceeding 20 percent, two thirds (67.3 percent) are the proponents of Russia's accession to the WTO. Nearly 14 percent think it should be a priority move, despite the fact that the share of imports, according to their estimates, will almost treble (from 6.8 to 18.5 percent). Obviously, from their point of view, that will not jeopardize their own interests.

**Table 11. Attitude to WTO Accession and Assessments of Change in Share of Imports, by Three Polled Groups (%).**

	Not more than 20	21 - 50	Over 50
Attitude to WTO accession			
Yes, and as soon as possible	13.5	3.7	4.0
Yes, provided a reasonable transition period is granted	53.8	48.1	28.0
The issue should be put off	23.1	44.4	52.0
No, Russia does not need it at all	9.6	3.7	16.0
Total answers	52	27	25
Estimated share of imports on the respective market			
Share of imports before WTO accession	6.8	34.0	58.7
Share of imports after WTO accession	18.5	44.1	69.8

*Source: Federal Service of State Statistics, REB survey, Development Center estimates.*

The group of respondents with the presence of imports on their markets rather sizeable but not exceeding 50 percent demonstrated almost even division into advocates (52 percent) and opponents (48 percent) of this step. In their opinion, the share of imports on their respective markets after WTO accession will swallow almost half of their trading niche, and it is quite possible that a substantial part of

those respondents who are against WTO accession or want to put it off indefinitely, is afraid that their products will not find their buyers at all.

Surprisingly, but even among the respondents with imports occupying over half of their market one third vote for the WTO accession, although more than two thirds of them are against this move. Sixteen percent are not sure whether Russia should bury the idea at all. The respondents of this group are even more scared that their products will be ousted from the market than the respondents of the previous group, as by their estimates their markets may be gobbled up by imports by 70 percent.

Hence, the answer to the question raised in the heading is rather no than yes. Indeed, the fear of foreign suppliers' penetration into the Russian markets would be justified, if that was the feeling of the enterprises whose markets have a tiny share of imports which is likely to increase through driving out their products from the market after Russia's accession to WTO would. But that's not the case. That very group welcomes Russia's accession to the WTO and does not think that world producers will be very dangerous competitors to them.

The concerns of the enterprises, whose markets are by half occupied by import suppliers (over 50 percent) and who expect imports to gain a lion's share in their markets, are quite understandable. But since these producers are almost pressed out of their markets, WTO accession will bring little change to them. Besides, optimistic and pessimistic positions are, actually, industry-specific. Optimists include a considerable portion of enterprises operating in the machine-building and metal-working industry and forest, wood & paper sector. Pessimists are by half represented by light industry. As this industry is currently in a plight, Russia's accession to WTO is unlikely to aggravate the situation there any further.

Now, let us see how these three groups assess the prospect of the 5 percent cut in import tariffs for import commodities competing with their goods (Table 12).

We note, that a substantial part of the respondents (from 20 to 30 percent) has no idea what will happen to the prices for their products and output volumes after the tariff is brought in. Overall, the response of respondents of the two groups with markets where the share of imports is above 20 percent is very pessimistic. One third of the respondents with the share of competing imports in their markets ranging from 21 to 50 percent ( 35 percent weighted average) think that prices for their products will be knocked down and half of them are confident that output volumes will slide down too.

**Table 12. Assessment of Change in Prices and Output Caused by Reduction in Import Tariffs for Competing Products, by Three Groups (%)**

	The prices for your products will			
	Decrease	Not change	Increase	No idea
Not more than 10 percent	10.2	53.1	10.2	26.5
11 – 50 percent	33.3	29.2	8.3	29.2
Over 50 percent	24.0	56.0	0.0	20.0
	The output of your products will			
	Decrease	Not change	Increase	No idea
Not more than 10 percent	14.3	55.1	6.1	24.5
11 - 50 percent	50.0	20.8	4.2	25.0
Over 50percent	48.0	36.0	0.0	16.0

*Source: REB survey, Development Center estimates.*

Almost the same forecasts are given by the respondents who share over 50 percent of their markets with foreign suppliers. Some slight difference between these two groups lies in the opinion of the aforementioned group in which none of the respondents believes that prices for the goods produced by their enterprises and their volumes will increase as a result of such change in the tariff.

In our opinion, only the predictions of the respondents with the presence of imports on their markets of not more than 20 percent make most sense. Over half of the respondents in this group argue that the prices will not change. The other half of the respondents is equally split into those who expect a price upswing and those who expect a price downswing. Decline in output is anticipated by the block of the respondents whose share is three times less than the share of the respondents of the above two groups (14.3 percent against 50 and 48 percent, accordingly).

Summarizing the assessments of our respondents, we may say that the fears of Russian industrial producers in connection with Russia's accession to the WTO and possible repercussions of this move largely stem from the current state of things at these enterprises and not from competition of the world economic community, although for some groups of enterprises (and even the entire industries) expansion of imports in their trading niches is a strong argument against Russia joining the WTO.

### **2.3. Exports and investments: benefits for Russian enterprises**

In the previous section we focused on the opinions of Russian enterprises on the conditions that are likely to take shape on the domestic market after Russia's accession to the WTO. Let us look at the assessments of these enterprises on possibilities of their goods' entry to the international markets after the accession.

As follows from Table 13, almost one fourth of the enterprises actively involved in international trade flows (vis-à-vis 15 percent of the whole sample) consider that Russia's accession to the WTO will simplify their operations on the international markets. We think it is a rather high percentage, which explains this group's overall positive attitude to accession of our country to the world trade system.

**Table 13. Answers to Question “Will WTO Accession Simplify or Complicate Enterprise Entry to World Markets?”, by Group (%)**

	Will simplify considerably	Will simplify slightly	Will not have any effect	Will complicate slightly	Will complicate strongly
All respondents	2.0	12.9	51.5	8.9	24.8
Actively involved in foreign trade	2.4	21.4	40.5	9.5	26.2
Involved only in domestic sales	0.0	0.0	64.7	0.0	35.3

*Source: REB survey, Development Center estimates*

None of the enterprises operating internally share their point of view. Two thirds of the respondents in this group (64.7 percent) believe that accession to the WTO will not facilitate the entry of their products to international markets and over one third (35.3 percent) are sure that this move will strongly complicate their penetration into the markets of other countries. We note that among the enterprises actively involved in foreign trade approximately the same part (35.7 percent) believes that they will face more difficulties after accession to the WTO.

Our poll statistics do not offer any sound argumentation of such a response, but we can assume that, to a certain degree, the reason for this answer is the Russian industrialists' fear of strengthened antidumping control over their goods, toughened control over observance of intellectual property rights and obtaining certificates for their commodities. After accession to the WTO, they will have to comply with the generally accepted rules of this Organization and will have to forget the laws and principles in effect in a country to which this or that group, or a specific enterprises, export their products.

Now, what is the response of the polled respondents to the questions relating to some financial aspects of Russia's accession to the WTO?

One of the challenges confronting Russian producers now is the question on the sufficiency of investment loans (by accepted definition, these are loans maturing in 3 years and later) and on the conditions of borrowing. Foreign loans are currently a significant component of such loans, as Russian banks in many cases are not yet ready to provide the required amount for the required term at a reasonable price.

So it was interesting for us to find out what our respondents think about the prospects of foreign investment in the Russian economy after its accession to the WTO. It turned out (Table 14, upper half), that around one fourth of the total number (24.1 percent) expect foreign investment to pick up. One third has no definite opinion on this score and almost none of them think that foreign investment will shrink. The largest share of the respondents (nearly 40 percent) is of the opinion that this event will change nothing.

The answers of the respondents actively involved in foreign trade (37.8 percent) followed the same pattern. Generally speaking, it is hard to imagine another response, as mere accession to the WTO will not set off an immediate upsurge in foreign investment and only in the not so near future the flow of

foreign investment will speed up. Nevertheless, almost 30 percent of internationally exposed respondents count on expansion of foreign borrowings after this event.

Among the enterprises trading locally we found few optimists on this issue. Half of them have no definite idea on this point. The largest of all the blocks within the group believes that foreign investment will even contract (6.3 percent) and only 12.5 percent believe that their enterprise may obtain an investment loan. Therefore, this aspect of the problem does not give enough reasons for them to consider Russia's accession to the WTO as a timely and beneficial step. It is one of the factors that determined the division of their answers whether it is advisable for Russian to join the WTO as shown in Table 14.

**Table 14. Assessment of Some Financial Aspects of Russia's Accession to WTO (%)**

How will Russia's accession to the WTO impact FDI?						
	Strong increase	Slight increase	No impact	Slight decrease	Strong decrease	Hard to say
All respondents	9.3	14.8	39.8	0.0	2.8	33.3
Actively involved in foreign trade	15.6	13.3	37.8	0.0	4.4	28.9
Involved only in domestic sales	6.2	6.2	31.3	0.0	6.3	50.0
How will increased presence of foreign banks and other financial institutions in Russia impact the operations of your enterprise?						
	Positive impact	No impact	Negative impact	Hard to say		
All respondents	24.1	25.9	10.7	39.3		
Actively involved in foreign trade	34.0	27.7	8.5	29.8		
Involved only in domestic sales	11.8	17.6	5.9	64.7		

*Source: REB survey, Development Center estimates*

There is much talk around issues associated with Russia's accession to the WTO and one of the most stumbling blocks in negotiations with many countries, including USA, is access of international banks to the Russian financial system. So, naturally we included this question into the poll of the sampled enterprises. The poll statistics are set out in Table 14 too.

Figures show that almost 40 percent of the respondents cannot say how the presence of international banks can influence their business. At the same time, 25 percent believe that this will help them financially and roughly the same percentage of the respondents believes that nothing will change for their enterprises. As only slightly above 10 percent of the respondents have a negative attitude to the strengthened presence of foreign banks in Russia, we can assume that this consequence of Russia's accession to the WTO is, in general, welcomed by Russian industrial elite.

A more positive effect from presence of international banks is even more expected in the group of the enterprises operating on international markets. Over one third of the respondents believe that expanding presence of foreign banks in Russia, whose assets leave far behind the assets of the Russian

banking system will make it much easier for them to raise the required loans at far lower interest rates than those offered by Russian banks.

Among the respondents operating within Russia, over 65 percent demonstrated that they feel uncertain on this issue and were hard put to give some definite answer to this question. Their optimism runs low, as only 12 percent expect to get some benefits from the enhancing role of international banks in Russia.

In the final remarks to this section, we would like to point out that Russian managers who will immediately and to the largest degree feel the impact of the WTO accession (they are the ones that operate on the world markets) are not afraid of growing imports. They are rather lukewarm about the idea that this move will help them step up export volumes and a possible increase in investment inflow is what attracts most. Entry of foreign banks to Russia is also welcomed, the move against which the Russian government wages the severest battle.



## **Conclusions**

Rapid erosion of price competitiveness of Russian goods both on foreign and domestic markets forced by the strengthening of the real effective exchange rate of the ruble, puts forward the task of finding new drivers of economic growth. In this respect institutional aspects of the major export markets are among the principal factors determining the future prospects for the Russian economy. That is why the experience of EU enlargement in May 2004 – accession of ten new countries that formerly were acting as a buffer-zone between EU and Russia – is highly valuable. This should be supplemented by extensive research of managers' opinion on the potential consequences of WTO accession.

EU-Russian trade in post crisis period peaked in 2003 when share of Russia's exports to EU-10 reached 16% of total organized export from Russia, and imports – almost 8%. As a result after May 2004 share of Russia's foreign trade with new (enlarged) economic block amounted almost 50% of foreign trade turnover.

Our research showed that neither Russia nor any other country from EU-10 improved its export or import competitiveness after EU enlargement. At the same time none of these countries experienced any significant deterioration in its competitive position.

The short run effect of EU enlargement was a slight real increase in shipment of energy products from Russia to EU-10 mirrored by even more significant rise of trade flow of finished goods from EU-10 to Russia.

The future of processes under consideration depends on several issues of institutional nature, namely on the new EU Energy Policy, and also on the adoption of European technical standards by new member-states that could hamper Russian export of manufactured goods and equipment. Overall, negative impact on Russian agricultural exports and exports of production of machine building wouldn't be very large compared for example with potential decline in exports of energy sector. Though these problems would certainly arise by the time when the Russian economy would move towards a more diversified structure and when demand for ecologically clean agricultural goods would rise on European market.

The poll of Russian managers that was carried out within the INDEUNIS framework on the sample of industrial enterprises, having the same structure as the general sample of Russian manufacturing enterprises, revealed certain organizational, economic and political factors that impede increase in EU-Russian trade.

Members of the base group – those that are already involved in foreign trade – on the first place put deficiencies in the Russian economic policy, and on the second place – complex taxation, more or less being the result of this very policy. Low quality of output and lack of information on commercial legislation in EU were put on the third and the fourth places. These two problems depend largely on the

efforts of managers themselves. A rather unusual finding is that a high percentage of managers from this group mentioned EU support of domestic producers as one of the important obstacles for trade.

Enterprises that operate only on domestic Russian market mention a different set of obstacles to their potential trade with EU. Among them 12% said that language barrier represents a primary factor (compared to only 2% in base group); 20% mentioned low quality of their products (around 14% in base group). We should note that a higher percentage of these managers don't have or have a poor knowledge of EU commercial legislation (20% against 14% in base group); they also mention problems with visa regime and government support of their EU competitors.

It is noteworthy that answer on the question "Whether Russia should enter WTO?" split managers into two almost equal subgroups. But that's based on those answers that include strong and weak forms of responses (i.e. "Yes" and "Yes, but later"). With simple voting the number of supporters turns out to be slightly higher – 54% against 46% of those who are against WTO accession.

The structure of responses on the question "whether Russia should enter WTO?" among managers of enterprises operating only on domestic markets is almost the same as in the whole sample. In our view this very layer of managers stands beyond the generally negative (or semi-negative) view of Russian society on WTO membership. At the same time approximately 60% of those enterprises which are involved in foreign trade – those who have a real life experience on foreign markets – approve this step. Comparison of these two groups unveils basic motives that divide Russian managers in their perception of WTO membership. One of the main factors that shape the negative (or suspicious) attitude of enterprises that sell their products only on Russian markets is obsolete production base that fails to keep up with international standards. No doubt they try to protect themselves from foreign competitors with help of political gears if economic ones are almost nonexistent.

We also studied the attitude of these two groups of managers on future consequences of WTO accession and potential cut in import tariffs on intermediate products.

In general they expect that after WTO accession the share of foreign suppliers of intermediate goods will rise, but this increase won't be of any substantial influence. The estimated share of foreign suppliers would rise from 20% by the start of 2006 to slightly below 30% after all the necessary changes in legislation are made. That means only a 9% drop in share of local producers, so overall they will maintain their dominant position – 70% after WTO against 80% before.

Thus, the quite negative attitude of managers is based on the situation on their enterprises than with potential increase of competitive pressure from international enterprises. Nevertheless import growth is still one of the main reasons for them to struggle against WTO membership.

In this respect it is important to note the difference in responses between those managers who are involved in foreign trade and those who operate on domestic markets and also between those who have different share of imported goods in their market segments.

The first think that the share of competing import will rise from 25% to more than 30% of domestic market. Though these estimates are higher than sample averages these managers are not afraid of such perspective – they are among those who approve accession.

In the second group – where share of import is under 20% of domestic sales – two thirds support accession. While in the third group – where share of import is higher but not larger than 50% - there is a fifty-fifty division of answers. But in the last group where foreign goods occupy more than 50% of domestic market, two thirds are strongly against this step.

We have also received responses on the attitude of Russian managers towards some financial aspects of WTO accession.

In particular about 40% of managers have no clear understanding of the possible impact of foreign banks arrival on their operations. At the same time 25% among them hope that this would help to improve their financial position. Although approximately the same share thinks there will be no any significant change in environment for their companies. As far as only 10% are strongly against foreign banks the overall picture is quite positive – Russian industrial elite

This positive effect is even more pronounced among those firms that are actively involved into foreign trade. More than thirty percent of managers have a positive view on the expansion of foreign banks operations on the Russian market. With assets several times larger than those of Russian banks, foreigners have much more capacity to provide cheap loans that are so needed by Russian industry.

Finally, one should take into account that those companies that are already exposed to foreign markets are not afraid of WTO accession and possible increase in imports and are rather restrained in what concerns the opening possibility to expand exports. The most important result for them will be an increase in foreign investment inflow. In the same vein they approve the arrival of foreign banks and other financial institutions. The opposite side is occupied by firms operating exclusively on domestic markets. Their position is rather uncertain and highly skeptical.