Foreign trade policy in Russia

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INTRODUCTION

Opening statement by Mr. Erik Berglof ¹

Good morning, ladies and gentlemen. I am very happy to welcome you to this interesting and important conference on behalf of the organisers – the EBRD, the World Bank, the Russian Ministry of Economic Development and Trade and the Centre for Strategic Reform in Moscow.

It is a particular pleasure for me to contribute to this conference. It was foreign trade policy that in a more serious way brought me back to Russia after transition started. In the mid-1990s Damien Neven and I did some work for the Russian government, for the Ministry of External Economic Relations as it was then called, working with the First Deputy Trade Minister, Gyorgy Gabunia. Many of you may have worked for him and will certainly have heard of him. He was an extremely sophisticated policy maker, very familiar with the institutions and issues of international trade policy. Unfortunately, he was also a chain smoker and left us several years ago.

At the time, we brought standard evidence based tools to the analysis of Russian foreign trade and produced a document summarising the strategic issues facing policy makers. Looking back at that time, it is striking how much remains the same. The fundamental challenges are the same: diversifying the economy, increasing competitiveness and addressing institutional weaknesses. Around 85 per cent of Russia’s exports still come from fuels and metals. Competitiveness remains a challenge for large parts of Russian industry, particularly when the prices of energy are increasing. Foreign direct investment is still modest, but inflows in recent years are encouraging. And Russia needs massive inflows of technology know-how more than ever.

However, many things are also very different. Trade has become much more sophisticated. When we were working in the Ministry there were about 10 million Russians who, directly or indirectly, lived off shuttle trade, travelling large distances to purchase individual pieces of electronic equipment and the like. And with more sophisticated trade the quality of institutions has also improved. Take, for example, customs collections. At the time we calculated that 50 per cent of income from customs duties disappeared between when imports were registered at the border and when duties were collected at the point of destination. The fiscal loss represented several per cent of GDP.

Much more importantly, Russian industry has changed. Russia today has many more sophisticated firms. Modern trade economics looks at firms as being much more heterogeneous, particularly acknowledging large variations in the level of productivity within an industry. We have seen clear improvements in productivity and there are now firms exporting and even investing competitively abroad. The many initial public offerings (IPOs), not the least here in London, also show that many Russian companies are attractive to foreign and domestic investors alike. All these developments are exciting. We also see the final steps towards full convertibility of the rouble being taken.

With the many changes that have taken place, the demands on trade policy have also become more difficult to meet. I understand that this is very much what we are here to discuss today. Looking back at how things were in the mid-1990s, I remember, for example, trying to obtain some electronic data. Electronic data were hardly used inside the Ministry. When we tried to obtain the electronic data of the State Customs Committee, they obstructed. In the end, we needed a Cabinet decision and the trade minister at the time, Mikhail Fradkov, signed an order forcing the State Customs Committee to give us the data so that we could carry out some elementary analysis of trade. Things have changed. I often have the pleasure of discussing with members of the Ministry of Economic Development and Trade and with think tanks and other institutions in Moscow. Today there is a very sophisticated debate on trade policy and I very much look forward to hearing more about it over the next few days.

¹ Chief Economist, European Bank for Reconstruction and Development.
Russia faces important trade-offs in building a system to support a modern trade policy within an ever more complex structure of trade and investment. You have to decide how much to do within the ministry, how much to do outside and how much to involve the outside world in a review of the policies that you are trying to support and develop. Those are the issues that we shall try to address today.

With these words, I very much welcome you here.

Opening statement by Mr. David Tarr

I should like to welcome you all here on behalf of both the Russia Country Team of the World Bank and the World Bank Institute; both of these departments within the World Bank are co-sponsoring this event. This is for us is another in a long line of cooperations in which we have been delighted to participate with the Russian government in support of their trade policy formulation.

The World Bank and the World Bank Institute have been active in Russia for a long time. We believe that this seminar is especially interesting in so far as we are working to develop institutions for trade. We often talk about trade and the importance of institutions, but how does a country develop trade institutions for effective trade policy? That is an important and interesting aspect of this seminar. The group which we have assembled to discuss this, both from the Russian side on trade strategy and international experts are, I think, uniquely qualified and extremely talented and I am very happy that we have brought together such an interesting and talented group.

I should like to mention some of the highlights and the more important contributions or collaborations between the World Bank, the World Bank Institute and the government of Russia since our involvement began in about 1992. We have developed a bilingual website for most of this work, though not all of it. I think probably many of you know about this website but, in case some of you do not, it is bilingual and contains an enormous amount of work that we have accumulated over the years on trade policy for Russia.

Let me give you a few examples. I shall not go through all of our contributions but shall mention some of the more important ones. Many of you may know about the paper that I co-authored with Peter Thompson on gas pricing in Russia called The Merits of Dual Pricing of Russian Natural Gas. As you know, there was a hugely controversial dispute on gas pricing as part of accession to the WTO, which was ultimately resolved. Many people have credited this paper with being very influential in resolving that dispute. That paper, both in Russian and in English, is part of your folder. Another paper in your folder is on tariff uniformity, a paper which I wrote in response to a request from Mr Gabunia. There are also several papers on the website, though not in your folder, on accession to the WTO and the impact on Russian industries, the impact on poverty and income distribution and recently on the different regions of Russia.

The Ministry of Economic Development and Trade requested the World Bank to train people in the regions of Russia on the impact of WTO accession. In response to that request, the World Bank Institute developed a two week course, in which several people here have participated as teachers, namely Sergey Afonstev, Ksenia Yudaeva and Natalya Volchkova. We delivered it twice to university teachers throughout the regions of Russia. We have a 43-chapter volume in Russian. There are also several papers on the website, though not in your folder, on accession to the WTO and the impact on Russian industries, the impact on poverty and income distribution and recently on the different regions of Russia.

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2 Consultant and Former Lead Economist, World Bank.
Let me finish here by saying that I am delighted to be here and I look forward to an interesting two days.

Statement by Mr. Sergey V. Chernyschev

On behalf of the Ministry of Economic Development and Trade, I should like to welcome all participants to this meeting and to thank the Center for Strategic Research, the EBRD and the World Bank for holding this seminar.

The seminar is very topical. Russia became an open economy 16 years ago and I have to point out that it was a kind of anti-crisis measure, a reaction to many empirical factors within the country and all kinds of economic factors, which we all recall very well. We are now among the most open economies in the world. I cannot give an exact figure but something like 40 per cent of our GDP is now export-oriented. This shows that we are among the most integrated economies in the world. This openness formed by external efforts was not the only factor. We also had, in a very short period of time, to set up once again a whole complex set of instruments in our trade policy to regulate our economic activities. It was mentioned here that colleagues, some of whom are sadly no longer with us, tried to formulate within a very short space of time in the 1990s what Russia’s position would have to be in the world and how we should set up relationships with both neighbouring countries and more remote countries, to decide what we were going to trade in, how liberal we would be and what kind of protection to set up. This openness of the economy, which began in the chaotic 1990s, continues now.

When one looks at the real trade barriers that Russia has, compared to the customs duties, one can see that we are among the most developed countries. In fact, our economy is now much more open than it was when we were negotiating for entry to the WTO. We have set up some very competitive branches of industry. Once again – and I am not saying anything new here – our situation is not improving. We shall look at that situation over these two days. Our competitiveness is not improving; as a whole, it is deteriorating. Our exports are more and more oriented to a group of products. We have really become exporters of oil, gas and coal, in fact energy sectors. Whether this is good or not so good, I think the answer is unambiguous. If we consider that it is not in fact good to be in that position, then we need to understand what sort of production we have to support or, if not support, at least what we should do in terms of our economic areas so as to make these products more competitive – to use all these various terms, “labour intensive”, and so on – what we should do in order to change the situation; or perhaps we do not have to position ourselves as an exporting country. As we see the expansion of our domestic market, then perhaps we should concentrate on the supply of products and services in the domestic market and therefore in fact decrease our dependence on exports. That is one side of the problem.

There is another side of the problem, and this is a fairly truistic topic. Many people talk about the need to improve the investment climate in Russia. It is obvious that the key factor in forming such a positive investment image for Russia must be stability and predictability with regard to the economic activities of the country, both domestically and also in external areas. What sort of spontaneous measures or unexpected decisions might be involved which could in fact damage the image of the country as a good place for investment? This is a much more serious aspect than the economic policies that have been carried on for a long time in forming this image. I think one has to understand, both ourselves and others too, what we should do about this trade policy. It is important not only for Russia but for everyone. How can we increase understanding in the world of the stability, where we would have predictable conditions as to how the economy is running? My colleagues from the Ministry and I have been asked to prepare a document in a fairly short period of time which, if approved by the government, could be the basis for foreign trade policy. I shall report on this document and urge that it be made public so that, before it is finally adopted,
it could well be the subject of public discussion. There is no point in a strategy if it is only something run up by bureaucrats and directed to satisfying their own purposes. It is only worth having if it is understood and discussed and takes account of the balance of interests and the positions of the interested parties, business and other organisations.

I just wanted to mention those points. I hope we shall all have a very fruitful discussion here. We are very grateful, in advance, for the opportunity to have this discussion here and we shall certainly take advantage of any results.

Opening statement by Mikhail Dmitriev

First of all, on behalf of the Center for Strategic Research, I should like to thank the experts who have worked on and planned this seminar. I should also like to express thanks to our partners in the European Bank for Reconstruction and Development and the World Bank. Without the contributions that these organisations have made to the work of international experts and setting up the proper conditions for this seminar to take place, we would not ourselves have been able to plan ahead for it. We are very happy to see the business-like way our partners have worked and responded to our initiative. The fact that we have been able to set up this seminar in a very short space of time shows what a good opportunity it will be.

I hope all participants will be able to appreciate the very high level of the reports. This is a chance for the Russian participants to hear directly what is happening in the world in respect of the planning and development of trade policies and at the very front line of this sort of activity. We could hardly obtain this sort of information in any other way. So much is written on these topics and specialists do not often have the chance to go to Moscow. The fact that we are able to meet in London and to talk directly with various people and to discover what is being done on the front line of work here in international trade policy is a unique opportunity for us.

It is happening at precisely the time when, in the next few weeks, we shall see the first draft of Russia’s approaches to trade strategy. This draft will be discussed by all the ministries and authorities. Many representatives of the ministries are taking part in this seminar, so the opportunity here is really unique, given the rapporteurs we see here and also given that it is a very timely event, knowing that international experience can have a considerable influence on what Russian experts and representatives will be doing in respect of this strategy that they are developing. Thank you very much. I hope that our work here over the next few days will be fruitful.

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4 Director, Center for Strategic Studies, Russia.
Part I: International Experience on Developing the Institutional Capacity for Evidence-based Trade Policy Decision-making
Evidence based trade policy decision making in Australia

Peter Dixon

I am very pleased to have been invited to make this presentation.

Part 1: Direct and indirect effects of trade policies and the need for an economy-wide framework

The first point I want to make is that evidence based trade policy decision making requires an economy-wide model. That is because when we change trade policies there are both direct and indirect effects. The direct effects are obvious. If we cut tariffs on textiles, clothing and footwear, then we can observe a reduction in employment and output in those sectors. The direct effects are obvious and rather negative, but we should not stop the analysis with the direct effects. We must also understand the indirect effects.

The indirect effects are diffuse and not easily observable. The indirect effects are that, when we cut tariffs – when we move to freer trade: we have improvements in productivity; and we have improvements in our international competitiveness, perhaps brought about by reductions in the rate of inflation or perhaps brought about by a reduction in the exchange rate. One way or another, the indirect effects will favour export-oriented activities.

How are we going to quantify the winners from reduced tariffs? To do that, we need an economic model, an economy-wide model. Over the last 30 years or so the dominant economy-wide framework for analysing trade policies has become the computable general equilibrium (CGE) model.

What is a CGE model? Let us look at these initials. We start with the "G": that means “general”. CGE models explicitly specify the behaviour of many agents. They explicitly specify the behaviour of households, what households optimise and how they will react to changes in prices and incomes. In CGE models all agents are given explicit optimising behaviour. Other agents include industries, exporters, importers, governments, distributors of goods, i.e. transport, wholesale and retail trade and so on. So the "G" aspect of a CGE model is that it looks at explicit behaviour of many agents.

In CGE, “E” stands for “equilibrium”. CGE models bring together the behaviour of many agents in demand and supply specifications, and those demand and supply equations are used to predict movements in prices.

As to "C", the final aspect of CGE modelling is that it is “computable”. It is all to do with numbers. It is not just algebraic quantities; we have real numbers and data here.

Part 2: A brief history of CGE modelling

For the second part of my talk, I present a brief history of CGE modelling.

On my definition, CGE modelling starts with the work of Johansen in Norway in 1960. He had a model with an optimising household and 20 industries. What about the earlier work of the great Russian economist, Wassily Leontief? Leontief did two wonderful things: he made the first input-output tables, which are the empirical basis of CGE models, and he made the first model that used the input-output data, namely the input-output model. But I do not think the input-output model qualifies as a CGE model. It does not have price-sensitive specifications of behaviour of many agents.

After Johansen’s contribution there was a pause in the development of CGE modelling. The 1960s and early 1970s were dominated by the large-scale econometric models. There were the

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5 Sir John Monash Distinguished Professor and former Director, Centre of Policy Studies, Monash University. The full paper on which this presentation is based is available from the author.
contributions to CGE modelling of the Americans, Scarf and his students Shoven and Whalley, but these contributions were from a much more theoretical stream of the literature, descending from Arrow and Debreu and, while important, did not prove to have practical applications.

So what happened? The large-scale econometric models were rather disappointing in policy work. When something important happened, like the oil shocks of the 1970s, the large-scale econometric models, in which the emphasis was on fitting the data, had little to say. The emphasis in the large-scale econometric models on fitting the data meant that the models, when faced with something that was not in the data, something that had not happened before, were all at sea. In fact, the prediction from those large-scale econometric models of the effects of the increases in oil prices was that there was nothing to worry about; but that was mainly a reflection of the idea that, in the past, the price of oil had not changed, which meant that the coefficients in the equations on the price of oil tended to be either zero or insignificant. The failure of the large-scale econometric models in the 1960s and 1970s to give policy insight encouraged the developed from the mid-1970s of practical large-scale CGE models, in which price-sensitive behaviour was fully recognised, dominated.

In recent years, the most important development in CGE modelling has been the Global Trade Analysis Project (GTAP), run by Tom Hertel at Purdue University. GTAP has produced a model which covers 50 countries and 60 commodities and includes a network of 2,000 researchers. It is used extensively in free trade negotiations. I am very proud to say that there is a close connection between GTAP and Australia. Tom Hertel spent a year or so in Australia in the late 1980s learning about Australian CGE modelling, and the GTAP network includes many Australian economists. GTAP has become the main analytical technique for the consideration of free trade agreements.

CGE models are now used in an enormous variety of applications well beyond trade. They show the effects on macro, industry, regional, labour-market, distributional and environmental variables of changes in fiscal policies, trade policies, environmental policies, international commodity prices, the availability of mineral reserves and so on. In recent years, CGE modelling has gone into forecasting, which means that, rather than asking how different the economy will be if there is a change in a policy, we are asking "What is the best estimate of where the economy is actually going over the next 10 years?"

Part 3: The Australian experience with CGE modelling

That brings me to the third part of my presentation, which is to do with the Australian experience. CGE modelling has been amazingly prominent in Australian economic debates since the late 1970s. I am sometimes asked why that is the case. I think there are three reasons. First, we had the right issue; second, we had the right institutions; and, third, we had the right model.

The issue was protection. This had been an important issue in the Australian economic debate since federation. I do not expect you to know Australian history. In the nineteenth century, Australia consisted of six British colonies, quite separate, with their own trade policies. There was not even free trade within the Australian continent. Victoria was a high-protection colony. New South Wales was a low-protection colony. A major stumbling block in bringing these colonies together to form the independent nation of Australia was to decide a national trade policy. In the event, the Victorians won and Australia adopted a high-tariff policy. Tariffs gradually increased until by the 1960s most manufactured commodities were protected by tariffs of more than 50 per cent and some by tariffs of more than 100 per cent. Protection was important. It attracted the interest of Australia’s best economists, for example Max Corden. It was a worthwhile issue to study. It also happens to be an absolutely ideal issue for CGE modelling. This is because protection is about price signals, which is a strength of CGE modelling, and it is about the reallocation of resources between industries, which is another strength of CGE modelling. So Australia had the right issue.
It also happened to have the right institutions. Australia had a Tariff Board, a government institution but with some independence from the government. This board advised the government on tariff policy and trade policy more generally. The Tariff Board had been set up in 1921 and, for most of its history, had been a fairly protectionist organisation. Its main role was to advise the government on how high tariffs had to be to ensure the future of a particular manufacturing industry. The question was: how much protection do we need to give these people in order to maintain the current level of employment in the industry against a particular shock?

In the 1960s, Alf Rattigan became the Chairman of the Tariff Board. He seemed a fairly safe choice. Alf Rattigan had a history of being a customs collector. He had no particular qualifications in economics and it was expected that he would continue the protectionist line of the Tariff Board. Alf thought about the issue for a couple of years and decided that he wanted some way of quantifying the effects of high tariffs on potentially losing industries. He wanted to quantify the effects of high tariffs on export-oriented regions of Australia. He thought that if there were some numbers attached to the theoretical arguments of the economists, then these arguments would carry more weight with the public and with politicians and there would be some hope of breaking the political consensus in favour of high protection.

In 1969 Alf persuaded the government to start a research project devoted to economic modelling in an Australian university. After about four years work in the university, nothing of practical use had been produced. I think this is where Rattigan showed real courage, and perhaps genius. He did not give up: he changed the institution. He said: "All right, this has not worked in a university environment" – I shall return to that theme in a moment – "we'll take the academics into the bureaucracy".

In 1975 he managed to start the IMPACT project, which was given the same assignment, namely to quantify the effects of high protection in Australia, particularly showing the winners and the losers. The project was part of the government bureaucracy and this gave it the discipline and policy focus that was required to get the job done. However, the main researchers were university people. They were bright young academics, so they had to have freedom to publish. The original director of IMPACT was Alan Powell, who was Australia's leading econometrician at that time. Guided by Powell, the IMPACT project emphasised openness. Even quite sensitive results were published early on. The researchers were encouraged to provide training courses and to let the rest of the policy-making community know what they were doing. They were encouraged to explain their results in a very clear way so that the results would be of immediate appeal and interest to policy makers. So, though the project was run in the government bureaucracy, it was run in a very open way.

What about the model? The model was ORANI and it was highly detailed, much more detailed than the models being produced in the rest of the world at the time. The detail is very important for policy makers. Policy makers want to see the effects of the policy on the motor-vehicle parts industry. They are not interested in manufacturing. They want to see the effects of the policy on the northern suburbs of Adelaide; they are not interested in just the national results. Right from the start the ORANI model had 113 industries, which was the full extent of the available input-output tables; it had 56 regions; and it emphasised details such as margins. Margins (transport costs, retail, wholesale etc.) cause a gap between purchasers' prices and producers' prices. This detail is important in trade policy. If we cut a tariff, this may reduce the landed duty-paid price of an import by 25 per cent; but what does that mean about the price to consumers? If the landed duty-paid price is only half the price to consumers, then we might expect the price to consumers to be reduced by only 12.5 per cent. Failure to understand details such as the role of margins leads to results that are easily discredited in the policy debate.

There were also various innovations in the ORANI model. Those of you who know about CGE models know the importance of the Armington assumption. This assumption allows us to model the behaviour of trade flows quite realistically. The ORANI model was the first of the detailed CGE
models to adopt the Armington assumption. Another innovation of ORANI was an emphasis on technological change. The computational approach was also innovative: it was both straightforward and easily adapted to general purpose computer programmes. A final innovation that I will mention was the use of flexible closures – that is, the idea that what variables are to be exogenous and what variables are to be endogenous is a choice that should vary with applications and should be left to the user of the model.

**Part 4: An example of CGE trade analysis**

In the next part of this presentation I want to look at what sort of evidence a CGE model brings to the policy discussion. Here are some results generated a couple of years ago for the U.S. International Trade Commission using the 500-sector USAGE model. In Slide 1, you can see tariff rate equivalents. For sugar, the tariff rate equivalent – that is, the tariff and the effects of the quota – is 119 per cent. That means that the landed-duty-paid price is 2.19 whereas with free trade it would be 1. For butter, the landed-duty-paid price is 1.6 whereas with free trade it would be 1.

What happens when we get rid of the tariffs and quotas? Slide 1 shows lots of bad news. Imports of sugar increase by 167 per cent, imports of butter increase by 162 per cent and outputs in these commodities fall by 20 or 30 per cent. That is the bad news.

Here is the good news. As shown in Slide 2, export-oriented industries, such as vegetable mills, export education (the industry that produces education for foreign students) and export tourism, are stimulated by the reduction in tariffs and the corresponding reductions in costs. These are the indirect effects. We see that chocolate does well. That is not so much because it has a high export share but because one of its principal inputs is sugar and the price of sugar is reduced sharply. There are some curious indirect effects, as with retail trade, which of course has no exports, but does well because US consumption of clothing increases. Clothing is imported and with cuts in tariffs it becomes cheaper. US imports of clothing and consumption of clothing go up. Clothing happens to carry very high retail margins.

**Slide 1: Illustrative application: cuts in US protection, some losing industries**

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<th>Tariff rate equivalents output</th>
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## Slide 2: Illustrative application: cuts in US protection, some winning industries

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<th>USACE-ITC Commodity</th>
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<td>79 Chocolate</td>
<td>19</td>
<td>3.41</td>
</tr>
<tr>
<td>99 Cigars</td>
<td>7</td>
<td>1.04</td>
</tr>
<tr>
<td>500 Export education</td>
<td>100</td>
<td>0.99</td>
</tr>
<tr>
<td>502 Water transport, international</td>
<td>0</td>
<td>0.87</td>
</tr>
<tr>
<td>344 Electron tubes</td>
<td>36</td>
<td>0.77</td>
</tr>
<tr>
<td>286 Oil &amp; gas field machinery</td>
<td>82</td>
<td>0.66</td>
</tr>
<tr>
<td>499 Export tourism</td>
<td>100</td>
<td>0.66</td>
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<tr>
<td>81 Candy</td>
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<tr>
<td>416 Retail trade</td>
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<td>0.58</td>
</tr>
<tr>
<td>358 Aircraft equipment</td>
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<tr>
<td>356 Aircraft</td>
<td>50</td>
<td>0.33</td>
</tr>
</tbody>
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**Usage-ITC results**

**Percentage changes**

Slide 3 is a map of the United States showing the regional effects. The nice warm colours (dark) are the regions of the United States that win from reductions in tariffs and the cold blue colours (light) are the regions that lose from reductions in tariffs. While it is a pretty diagram, the most important message from Slide 3 is how small the effects are. Even the import-competing regions lose rather little. That is because the highly protected industries now occupy rather small percentages of the economies of the regions of the United States. Even in regions such as North Carolina and South Carolina, that specialise in apparel and other textile products, these products account for rather small percentages of total employment.

Slides 1 to 3 are the sort of evidence that economic modelling brings to evidence-based trade policy decision making.

**Slide 3: Cuts in U.S. protection: state employment effects**
That brings me to my concluding remarks. How do we get started with CGE modelling?

CGE modelling is broadly applicable, but I recommend starting narrowly. Set the economists a policy problem to start with. Do not set them a problem of building a general-purpose model. Focus their minds on a particular policy problem. For example, set them the problem of finding out the effect on the Russian economy of exploitation of mineral resources and hope that they will produce a beautiful general equilibrium model for you.

Should the researchers be university people? Yes, they must be university people. It is only university people who have the skills to do this job. But do not leave them in their university; bring them into the government bureaucracy; get them focused on the practical problems that you want to be solved.

It is sad, but I think true, that there are now quite serious tensions between academic work and practical policy work. Success in academia depends on theoretical novelty within fashionable paradigms; it depends on succinctness, being able to write short papers; it depends on being erudite – that is, scholarly, referencing the literature, producing scholarly presentations, both verbally and in writing.

Those are worthwhile characteristics but they are not particularly relevant to the creation of policy-relevant models. For policy models we want relevant theory. It does not need to be fashionable, it does not need to be the latest, but it needs to be descriptive of the situation. We do not need succinctness; we need detailed documentation so that the models can live. We need hundreds of pages of careful descriptions of data sources, of what manipulations were made and so on. We do not need to be erudite. It is lovely to be erudite, but it is not an essential. What we need to be is simple, straightforward and direct.

There is, thus, tension between doing practical policy work and academic success. To do the practical policy work we need to get the people who can do it, and I think they are the academics. We need to get them into the bureaucracy, at least for a while, to get their minds focused on practical problems. Once that has been achieved, CGE work will then develop quite naturally outside the bureaucracy. In Australia, once the government began demanding CGE analyses of all sorts of issues, within a very short time consulting firms added CGE to their repertoires. Now there is excellent CGE work done in the government and in the private sector by consultants and, of course, by university people in the more commercially oriented parts of universities.

Summary of the discussion

**Question:** Could you tell us how this modelling is now built into political processes in Australia? For example, Australia is now participating in WTO negotiations. When you make your proposals for the WTO, at what stage do you go to CGE modelling to evaluate potential effects for the Australian economy? How is the process organised?

**Speaker:** The question is, how is the modelling built into the bureaucratic process? The government has its own modelling capabilities. It often refers an issue to the Productivity Commission, which is the successor to the Tariff Board, and asks for a report on the effects of whatever is being proposed. Government departments regularly undertake modelling or commission modelling studies. There is also a large amount of modelling work done in the private sector. People who feel that they might be damaged by whatever is being proposed will commission modelling. We therefore have competitive results from models. That can be bad in the sense that lazy commentators can say, “All right, you can get any results you like from a model; this model said this and that model said that”, and that is the reaction sometimes. On the other hand, the debate is quite often improved by the existence of competitive results because
people actually try to sort out why the models give different results. In the paper I have written for this seminar, I have mentioned a couple of instances of when the economic debate – that is, the debate in the parliament and in the media – has been improved by the fact that the government has commissioned research, the private sector has commissioned research and the results have been debated. Even quite technical matters are debated. For example, the size of Armington elasticities has been debated in the Australian parliament.

**Question:** In your opinion, were the results more reliable when quantitative evaluations of such models were rarely used in political discussions and there was only one model, or are they more reliable now when, as is the situation in Australia, competing interests use their own models? Which is better, one model without competitors or several competing results of different models for the same issue? Which is the preferable situation, in your opinion?

**Speaker:** For me personally, the one model was the preferable situation, because it happened to be my model. Clearly, from the point of view of the public debate, the multi-model situation is where we should aim to be. We need a situation in which people can use the models to inform the argument. For instance, when Australia introduced a goods and services tax, I was on the team against the introduction of that tax. My model showed that the introduction of a goods and services tax would be quite bad for the Australian tourism industry and would, in fact, have negative effects on the economy as a whole. My opponents, while agreeing that it would be bad for the Australian tourism industry, thought that the effects would be very minor.

How was this issue resolved? In the heated debate on this point, the issue was resolved in the following way. My opponents were using a static model built around data for 1993. This was in the year 2000 and the latest input-output table was for 1993. I was using a model that embedded a forecast and took the economy out to the year 2010. It is reasonable to suppose that by the year 2010 tourism will be more than twice as important as a share of Australia’s GDP than it was in 1993. The reason that my model showed much more damage to the economy than my opponents’ model is traceable to the assumption that tourism will continue to grow at a fast rate and that the share of tourism in GDP will be much larger in 2010, which is the relevant year, than it was in 1993, which is an irrelevant year. We were able to put this point to our policy makers, who – as I have told the story – naturally went with my side of the argument rather than the other side. It was the acrimonious debate that brought out this rather simple point, and that has happened quite often.

Certainly you have to start with one model but in a competitive industry like economic consulting, and with openness on the part of the government in making the model available, providing training courses and so on, it is not many years before you have a competitive situation in which there are many models. The models should be used not so much because of the exact figures in the models but because the models are used to draw out the economic implications of various policy proposals, refine the arguments and discipline the debate.

**Question:** Could I ask you to elaborate on some of the political-economic issues related to the use of these models in decision making? As mentioned, the results for this model became sufficiently well known and the business press would pick up on the results and it would inform policy makers and sometimes constrain policy makers and this resulted in political pressures in both directions. Could you elaborate on some of those issues?

**Speaker:** I think the big break-through for us in getting tariffs reduced was getting the state governments interested, so the regional results were very important. Western Australia is a state with large mineral resources and great export potential; so is Queensland. On the other hand, Victoria is the home of Australia’s import-competing industry. It was very important in the political debate to make the Western Australians and Queenslanders understand that the arguments about free trade were not just a question of academics being erudite, but that they were actually costing
them money. The Western Australian people were actually poorer than they would be with free trade. Once they understood that it was costing them money, the politics changed.

That has happened over and over again. Take the motor vehicle industry. The motor vehicle industry managed to convince the Australian public that it was absolutely essential for jobs to have very high protection and to produce cars at about twice the world price. Once it became well understood that the only part of Australia that really benefited from the Australian motor vehicle industry was South Australia and all the rest of us were paying for it, I think that really helped. Putting numbers on the losers has been critically important, I think, in giving governments the political will to change policies.

**Question:** Was there any reaction by the protectionists to kill the modelling?

**Speaker:** Yes. In fact, the sort of modelling that I do is not particularly popular with the Australian government at the moment. We have moved very much into labour-market issues. The trade issue has been won. We still have some tariffs, but they are no longer very important. We are basically a free trade country. We are now into all sorts of other issues, especially labour-market reforms. The effects of freeing up hiring-and-firing policies are important. We have had a history of unfair-dismissal laws. Once you are hired, it is very hard to fire you under any circumstances. You really have to do something very bad to be fired. CGE modelling is now throwing light on these labour market issues and I have become unpopular with both right and left on this subject. There are, therefore, always moves to close modelling down, but the point is that it is too late. The genie is out of the bottle. It is open; too many people know how to do it to get rid of modelling at this stage.

**Comment and question by Mr. Frontini:** Thank you for the very informative and succinct history of CGE modelling, which I found very interesting. In the Commission we use CGE modelling extensively. We think it is a good tool. We recently became members of the GTAP Board because we think we have to invest in that. However, one of the many problems we have in using CGE modelling is that, while these models are good for assessing the impact of a reduction in tariffs, they are less good for assessing the impact of other kinds of obstacles to trade. There are other issues which are increasingly important, such as behind-the-border obstacles, services, foreign direct investments (FDIs) and trade facilitation. For all those issues CGE modelling is less good. How confident are you that in the not too distant future CGE modelling would be able to tackle some of these issues?

**Speaker:** I think this is not so much a problem with CGE modelling as a problem of getting the shocks right. For instance, the figure of 119 for sugar includes the tariff, which is actually very low and is only a minor part of the story, but it includes an estimate by the United States International Trade Commission (USITC) of the effects of quota restrictions. The way it works, as I understand it, is that the United States issues quotas, or the right to export to the United States, to various sugar-producing countries and, surprisingly, even encourages them to charge what the market will bear. If I am going to export to you a particular amount and that is it, that is all I can export to you, and the amounts of exports from all the other countries are also restricted, then I charge way over the world price. CGE modelling is still the right tool for simulating the effects of getting rid of those restrictions. However, estimating what the restrictions really are then becomes a major task. It is not really the CGE model that is the problem, the problem is getting the shocks right and, of course, that is just a matter of very hard work. In the US sugar case, it is not too bad. You can look at what the world price of sugar is, you can look at what other countries are paying for sugar and then look at what the US is paying for sugar and make the obvious comparison, and then you have got the shock right. The CGE model is fine for the purpose.

**Question:** Thank you for your reply to the question asked by my colleague from the Commission. I should like some clarification. Did Australia try to estimate the effects of trade policy and
legislation in such areas as technical regulations? Secondly, export tariffs are topical for Russia. It would be good to know whether you see any opportunity to calculate the effects of export tariffs with the help of, for instance, the CGE model.

**Speaker:** There is no real problem about estimating the effects of export taxes in a CGE model. If you want to impose export taxes, theoretically there is no difficulty. The real issue is what the foreigners’ export demand elasticities are. For instance, if you believe that the export demand elasticities that you are facing are low – that is, you can raise your price without losing very much of your market – then the CGE model will show that there are benefits from imposing an export tax. Again, it is the empirical point as to exactly what you think your export demand elasticities look like.

On the issue of technical regulations on, say, capital inflow, that is again an area in which CGE modelling has been used quite successfully. There we have to ask ourselves what the effect is on the required rates of return on capital if we regulate capital inflow. Does it raise the required rates of return on capital in our country? If so, we can simulate the effect of an increase in required rates of return. If, because of regulations, investors require 20 per cent rather than 15 per cent, then we can simulate the effects of capital having to earn 20 per cent rather than 15 per cent. We get a very interesting result, which is that the people who pay for increases in required rates of return are the workers. Increasing required rates of return on capital has a profound effect on wage rates. Capitalists need more because they need to deal with regulations. If required rates of return on capital are high because of the uncertainties produced by regulation, then the returns to labour must be lower. A CGE model can bring out quite nicely the idea that it is labour that pays for regulations on capital inflow.

**Question:** As far as I understand it, Australia uses models to change its tariff policy and from higher tariffs you go to lower tariffs. What was the long-term effect of that reduction on the Australian structure for its economy? Did you receive significant competitive advantage? Did you receive new industries, or not?

**Speaker:** The question is: what actually happened? Very interesting things happened which are not exactly consistent with the CGE model. The CGE model said that we would have a smaller manufacturing sector, a larger agricultural sector, a larger mineral sector, and that the whole nation would be better off. I think that bit was right and that high protection was not necessary for the maintenance of high employment, which I think was also right. What has actually happened is that we have had tremendous growth in manufacturing exports, which was not predicted by the CGE model. In fact, even manufacturing, which was thought to be benefiting from high protection, has done better with low protection – not textiles, clothing and footwear, which have more or less disappeared, and not motor vehicles, but all sorts of high-tech manufacturing, all sorts of things that use the skills that a highly educated economy has. The CGE model did not really get it right. It pointed in the right direction and the right policy was supported by the CGE model, but I do not think you can say that the CGE model got the details of what happened right.

**Question:** What was it about the CGE model that did not allow it to capture these other effects?

**Speaker:** It did not have the idea that Australian manufacturing was not really competitive in the sense that there was not a competitive market structure. I think what happened was that, as we reduced tariffs, there was plenty of room in Australian manufacturing for improvements in efficiency so that they could meet the competition of the imports with improved technology or reductions in inputs per unit of output. That is hard to anticipate in that it seems illogical. If you could produce things with less input per unit of output, why do you need to be stimulated to do so by a reduction in protection? In fact, it does appear as though sharp reductions in protection stimulate a movement towards more profit-maximising behaviour.
Tariffs made it possible for Australian manufacturing to be fairly soft. We do not really understand why tariffs should do that. There are various firms. Why didn't some firms in Australia decide to undercut their rivals? Why do you need a cut in tariffs to bring on this behaviour? Anyway, that is what seems to have happened and now, if you want to simulate the effects of movements to free trade, you can make up scenarios which involve the cuts in tariffs, leading to more competitive behaviour by the domestic industries, but exactly how you do it is fairly speculative.

**Question:** Did you experience changes in your export structure, or not?

**Speaker:** Yes, we did. Australian exports of manufacturing products increased quite sharply. There has also been an enormous increase in service exports from Australia in tourism and education especially and, in fact, the importance of agriculture and mining has contracted.

**Question:** There has been a big increase in non-traditional exports?

**Speaker:** Yes.

### Evidence based trade policy decision making in the United States

*Robert Rogowsky*

I have to admit that it is a little intimidating to follow Peter Dixon, but it is nice because, if there are questions about the modelling at the United States International Trade Commission (USITC) I can always defer them to Peter. Indeed, he is almost an employee of the USITC, since we use him so much.

I shall talk more broadly about how the International Trade Commission works in the international policy mechanism in Washington D.C. I will go more lightly over some of the detail about the analysis, because much of that has been covered.

Trade policy in the United States is given by the Constitution to Congress and Congress ran the policy for many, many years – indeed, until 1934, when Congress first delegated authority to the President to conduct trade negotiations in terms largely of tariff reductions. It has been in the administration, the executive branch, since then – not full authority, but granted authority delegated to the President, who has, in turn, delegated this primarily to the United States Trade Representative (USTR).

The International Trade Commission was formed in 1917 to help Congress assess the effects of tariff reductions. When I say “effects”, that typically means how it affects specific industries. It has been conducting those analyses since that time. The name was changed to “International Trade Commission” in 1974 from “Tariff Commission” because by 1974 tariffs were becoming less important and other things in trade were becoming more important. We are an agency of Congress. We were created by Congress and we are funded by Congress. We do not belong to the executive and we do not participate in policy decisions or directly in negotiations with the executive branch because we are maintained as an independent analytical agency.

The ITC has a connection, of course, to the Senate Finance Committee and the House Ways and Means Committee, because those are the committees that are given trade-policy authority in the United States by the Constitution. They are the committees that are our clients and for whom we do work. We have a connection to the USTR’s office because we are charged by Congress to do work for the Trade Representative in any way we can.

Those are our three primary clients and in many ways we function as a consulting firm for them. That is, we do any analysis that they want us to do. It has a broad range and I shall talk more about that later. Other components of both the administration and Congress beyond specific trade responsibilities are involved because trade is now not just about tariffs. At least in the policies

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7 Director of Operations, United States International Trade Commission.
structure in Washington, when trade involves financial, agricultural, environmental or labour issues, which it does repeatedly, those parts of the administration and those parts of Congress become very active in the policy decisions and the trade negotiations that are taking place.

The dynamic of the discussion becomes much more complicated when you have many different agencies in the government and many different committees and sections of Congress involved in the negotiation. All of these, as you can probably imagine, have their own agendas and their own incentive structures, and so each one approaches every negotiation and every initiative from their own particular perspective. In this way, it becomes much more important to have quantifiable evidence-based trade policy to help with the discussions, because there are many, many individual views, there are many opinions and, even more important in trade policy, there are many special interests that weigh heavily in these negotiations. They weigh in with elected representatives and government bureaucracies who are closely aligned with those particular business interests and those sectors. Putting numbers on the effects of these gives a common avenue for discussion that allows a richer and much more transparent discussion to take place. Often these numbers are in contrast to those generated by special interests. The ITC role is seen by everyone as one that can offer objective, disinterested and, hopefully, highly competent analysis that can balance the special, sectoral or parochial interests that arise in trade negotiations.

When I say “trade negotiations”, I am referring first and foremost to the negotiating that takes place inside Washington. A negotiator at the USTR’s office once told me that he spent 90 per cent of his time negotiating a position within Washington and 10 per cent of his time negotiating with the rest of the world. We, the ITC, try to make that negotiation taking place inside Washington a little bit easier by putting more accurate numbers and more rigorous analysis into the negotiating process.

The ITC is small; fewer than 400 people. Even so, we do many things. We are mainly known for our anti-dumping activity. We also keep the harmonised tariff system for the United States. We have a group of lawyers who help protect US firms from patent infringement by foreign firms. About two-thirds of our resources go into economic research for Congress and the President, which I have just described, and into helping with trade negotiations.

I shall focus on the analysis part. To do that, we have about 150 people dedicated strictly to what I shall call economic research. It is not purely economic research as most academic economists would define it. We have two dozen PhD-level economists. We also have regional specialists who specialise in south-eastern Asia, south Asia, Japan or the Middle East or Europe. We have to have people who know very well the institutions and the dynamics in those regions as well as the politics in order for us to do competent, full analysis. We have over a hundred industry specialists, people who spend their day studying industries, digging into the market forces and the structures that drive these particular industries, such as pharmaceuticals, agriculture, telecom services and financial services. We have a number of issue specialists. This is newer for us. We need people who can understand intellectual property rights, labour issues, foreign direct investment and technical standards. We are developing expertise in trade facilitation, because that is very important for American industry. The questions that we are asked to analyse are those that are of interest to the Trade Representative and to the Congressional members. They, in turn, are interested in the problems confronting American business. We therefore have to be able to analyse both carefully and broadly issues that affect American industry.

When people, or businesses, are affected by trade, they go to Congress for relief. Congress has turned over the negotiations to the President but keeps pressure on the President to make sure that Congress is fully aware of the effects of these negotiations. This is where the analytical part comes in. Congress requires by law that any time the President formally starts a negotiation, the USTR must ask the International Trade Commission to analyse in detail the effects of the successful outcome of the negotiation.
The ITC relies on industry experts to look across the broad spectrum of industry to examine what the effects will be. The requirement is that ITC provide a probable economic effect analysis across all sectors of American industry. We have increasingly used economic modelling to do this and for this purpose we use partial equilibrium analysis in which we can look at particular sectors. We do not look at all sectors; we identify what sectors are likely to be affected by this negotiation. We do that by looking at imports and exports. We also ask industry what sectors they think will be affected.

We ask the USTR who is complaining about these negotiations and who is worried about them, and we analyse those sectors using partial equilibrium analysis to determine what the effect will be in that industry. We have economists looking at this, working hand-in-hand with industry analysts to make sure that we are getting our elasticities accurate, that we accurately measure trade and production and that we correctly estimate substitutability between foreign goods and domestic goods. These data are put into an analytical structure and each sector is individually analysed to produce a broad report called a “probable economic effect report”. This is a confidential report given only to the Trade Representative and to the negotiators as information available to them when they negotiate.

Sometimes this information is useful to develop the negotiating strategy; it is often useful to counter the arguments from special interests seeking for certain outcomes from the negotiation. It is crucial to have the most accurate figures possible on which the negotiators can rely for the negotiations within Washington and with trading partners. This includes all multilateral negotiations and all free trade agreement negotiations or preferential trade agreements, of which we now have many, because that is the United States’ preferred way of going. These are all prepared as confidential documents for the negotiators.

Because Congress has to approve a final trade agreement at the end of a negotiation, it desires an analysis by an independent party so that it has something to weigh against the favourable view given to it by the administration and the self-interested views of special interests. Congress turns to the International Trade Commission for an objective, disinterested and rigorous assessment.

Once a formal agreement has been proposed to Congress, the International Trade Commission is called to provide an economy-wide effect as well as an analysis of each provision of the agreement. For that we employ general equilibrium analysis. These analyses are public documents, which can be downloaded from our website.

Permit me to mention briefly some of the other significant studies that we do. Every two years we analyse the effect of all the trade restrictions we impose on ourselves. It is a measure of the welfare effect. With the help of the Australians we have been able to expand this and look at the effects of this state by state. We are now looking to expand this into labour markets and break down the effects on different kinds of households. We have been able to expand this quite extensively, again with the help of the Australians. We have looked at special safeguards for steel, China’s accession to the WTO and the effect of logistic services on American industry.

At the moment we are working on a study on US competition in medical services: who will compete with us and what barriers affect growth. We have started a number of studies of Chinese industry, to see, for instance, why Chinese industry is growing so rapidly and into what markets the United States can sell most effectively and which ones we are not. We are trying to find out how the Europeans can beat us in certain markets. We are starting to study trade facilitation constraints and the effects of security changes around the world and how they affect the trade facilitation problems of getting into different markets. There are many other examples.

Let me finish with a couple of notes that follow on from what Peter has said. One of the things we have been working on is non-tariff measures. This is very important for Congress. Measuring the gains and losses from trade is not so much about tariffs; it is often about non-tariff measures. So we are working with a broad coalition of scholars around the world on non-tariff measures, even our own. Sugar was mentioned. These are rather hard to measure. Ashley Winston from Australia,
who is helping us, has been spending a great deal of time calculating how we would take a tariff-rate quota or a quota which we have in sugar and put it into the modelling system so that we can measure how this affects us.

Let me say one or two things about that. Not only does our analysis have to be objective, but it has to be perceived by everyone — by Congress and the USTR — that it is objective. Not everyone likes our answers. We have given answers that the policy makers did not want to hear. We have paid a price for it. More than once people have tried to cut our budget or even eliminate the agency. And yet, everyone understands that the ITC will give them an objective answer. And everyone, in principle, understands how important this is.

In terms of the analysis that we do, we are increasingly working with the Australians and the GTAP coalition to develop modelling that can analyse these questions. The CGE economy-wide modelling becomes increasingly important. However, I want to offer some caveats. Bringing hard numbers to decision-makers enriches debate and balances what otherwise could be confusing special-interest arguments. However, people are likely to focus too much on very specific numbers when the complete analysis and the complex effects are so much richer. We have had this problem many times. Everyone seems to focus on one number: what is the effect on the economy? Economic effects are more complicated than that.

Our experts work diligently to identify more richly the effects across industries and why those effects are taking place. Sometimes the modelling does not comport with the reality that industry experts know. The discussion then becomes how to make the model fit reality. Often in these instances, telecommunication lines between the United States and Australia get full usage. These problems are really great opportunities. Solving them has enriched the debate. It is important to develop modelling skills along with industry expertise.

In the end, we use questionnaires, we use surveys, we bring in experts, we listen to testimony from industry, we use economic modelling and we use partial equilibrium models. We balance these with econometrics and CGE modelling. All of it gets mixed together in an analytical form that we hope is very rich and balanced for US policy makers.

Summary of the discussion:

**Question:** You said that one of the functions of the ITC was professional analysis of the various sectors of the economy in the United States to determine the effect of policy measures on people in the American economy. Do you also analyse, perhaps in more general ways, the situation in partner countries, the situation of investors and exporters? Does analysing the effect on partner countries come into your function?

**Speaker:** We certainly can and do analyse that. Let me take an example. With the free trade agreements we will actually try to measure to some extent what happens in other countries, as well, because that affects us. For example, with the US-Peru free trade agreement, it is important to understand what is going on inside Peru as well, because part of the measure is what happens to our exporters, where can we can export these goods, how much more might we export into Peru and what particular markets might be growing. Sometimes the modelling can help with this but often it is a question of having our regional experts understand that tourism might in fact grow in Peru or that it will make these changes in its foreign direct investment protection and, as a result, these kinds of industries are likely to grow. When we do an analysis we will ask industry to meet with us and give us their sense of what will happen in those other markets. We do not measure the labour effect in the market, but we will try to understand how the U.S. will gain by having a free trade agreement with Peru, for example. Often Congress will ask us specifically about other countries. They will ask us what happens in the United States if there is an agreement and what happens in the other countries. If they ask us specifically, then of course we do it.
Question: You are doing this work for Congress and the government. Can you also do such work directly for business, at the request, say, of a particular branch of business? Can you do that or do your terms of office prevent you from doing such direct business?

Speaker: The direct answer is no. However, as a practical matter, if a business wants a study done, they go to their Congressman, who can then ask us to do that study. In fact, we are doing the study on trade facilitation that I mentioned because American industry is very interested in understanding changes that are taking place in markets that they are going into in terms of security issues, particularly changes the United States is imposing on other countries in terms of new requirements in their ports for security reasons and health reasons. They want to know what the effect of those will be. They have asked, in this case, the United States Trade Representative to ask us to do this study.

Question: Following on from the previous question, what about benchmarking studies into the competitiveness of industries on the world market? Is there some structure in the United States which deals with that aspect? How is that organised?

Speaker: If you mean do we have a structure that benchmarks the competitiveness of industries, we do it on an industry-specific basis if Congress has asked us. For example, if they asked us about our competitiveness in certain components of civil aircraft, we would take a look at how the American civil aircraft industry is competing now. Who is growing in those markets? Where are the demand markets rising? What do we need to be able to compete effectively or maintain our position? We do not do any broad benchmarking for industry in general.

Question: I have a question on institutional stability. When discussing problems of institutional reforms in Russia we usually face a question of whether all these reforms will be stable and whether, after the next presidential election, the rules of the game will be changed and the legal status of the Commission or any institution will also be changed. How is the legal independence of the Commission granted? What is the status of legislative acts which form the basis of the activities of the Commission granted against all these politically related changes?

Speaker: It is a wonderful question. The agency has been in place since 1917 and yet, as I mentioned before, there was an attempt to eliminate us because certain interests did not like the analysis that we did, they did not like the answers that we gave on certain studies. It is possible that it could happen. On the other hand, I mentioned some of the other things that we do, like anti-dumping enforcement and the protection of patents and we maintain the tariff system, so all of these things would be very hard for Congress to remove. As a result, Congress sustains our research activity, as well.

On the other hand, whenever someone in our system does not like what we have done, when they do not like the answer, someone else really likes the answer, so there are always countervailing forces, which has been fortunate for us. What is surprising is that, even when one side or the other does not like our answer, there is an understanding that it is very important to have rigorous, competent analytical work that can be relied on to be as close as possible to the truth. Everyone understands that and accepts it.

It is interesting that there are times when people do not want to ask us to analyse something because they know that they are not going to like the answer. However, with much of our required work, Congress has required USTR to ask us for this information. That is an important part of our system which I am not sure translates into other systems. It is valuable because, quite honestly, trade negotiators usually do not want more information because it gets in their way. Congress wants them and itself to have the information because they have to make a decision that will affect them politically. One of the values of this in the great work that Peter Dixon and the Australians have been doing and which we have been working with, is that it identifies the winners and the losers much more effectively because in our system the losers always know who they are and they are always active in the political process. The winners are much less likely to be in the political process because the winners are in the future, the winnings are sometimes smaller.
and sometimes the winners do not even know that they are winners, but the analysis identifies that for them; at least it identifies for Congress that there are winners and, if you can do it state by state, then there are political people, Congress people, who did not know their constituents were winners but who now know.

**Question:** Are you able to tell us of one of those instances where they tried to get rid of you?

**Speaker:** Sure. By the way, I should point out that these comments are my own and do not necessarily represent the views of the Commission or any individual Commissioner. We had two very good instances that I can share. One was in about 1990 when the U.S. was worried about the Japanese and other importers. We were asked by the Congress to measure the effect of a bill in Congress that would require all goods coming in on ships that were not built in the United States to pay a special tax. We warned them about what the effect would be but they asked us to do it anyway. In the meantime, while we were doing the analysis, they introduced just such a bill, which was passed in the House of Representatives. Subsequently, we indicated through our CGE modelling at the time that this would have a significant costly impact on the American economy and almost every commodity that could possibly be imported. Having passed the bill, some were highly upset with the answer we provided.

Another instance is when we angered the United States Trade Representative. We did an analysis of anti-dumping cases, which was an analysis of our own use of our anti-dumping enforcement statutes and the effect in certain industries and the overall effect on the economy. Because we found that the ultimate economy-wide effect was negative, the United States Trade Representative would not help us with our budget and argued that maybe our budget should be reduced.

At the same time, a number of textile manufacturing representatives were also looking at the analysis we did on the import restraints study I mentioned earlier. As you can guess, we found that the tariff barriers and quotas that we impose on textiles were the most significant cost to the United States in terms of international trade. So they too did not want us to do this any more and were interested in cutting our budget. When both of these forces came together, there was a significant possibility of our budget being eliminated. Ironically, what saved us were not the people who were interested in anti-dumping but the members of the legal bar who were interested in patent protection. The part of us that was protecting United States patent holders counterbalanced the group in Congress that was trying to get rid of us for measuring the effect of our own tariff barriers on our economy. It is kind of a long, complicated story, but it is a nice metaphor for how Washington works and, hopefully, how important the evidence is in terms of the analytical process because, if you have solid numbers and solid quantitative evidence, it becomes very enriching to the debate.

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**Evidence based trade policy decision making in the European Union — Views from inside and outside of the European Commission**

**Gaspar Frontini**

I do not want to come back to the characteristics of different models which we have seen this morning but will, rather, try to concentrate on my experience and give a view of how trade analysis can be done in a useful way for policy makers.

To start my presentation, I would like first to give you a brief description of the institutional set-up so that you understand the context in which we are working. As you all know, there are 25 member states in the European Union and one of the characteristics of the Union is that there is only one trade policy for the 25 member states because there is only one external tariff. The managing of this trade policy is within the exclusive competence of the European Commission. It

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8 Head of Trade Analysis Unit, Directorate General for Trade, European Commission.
is the Commission, in particular Peter Mandelson, our Commissioner – or minister, if you like – who is the trade negotiator on behalf of the 25 member states. Within the Commission one administrative entity, namely the Directorate General for Trade, gives support to the design of trade policy and implements it. Within this Directorate, which consists broadly speaking of 450 people, one unit deals with trade analysis. This is the unit I head, and I would like to share with you my experience in that unit.

We are not the only unit which does analysis. All the other people in the DG – who are mainly negotiators – when dealing with their operational issues, also perform analysis for their particular purposes. However we are the unit in charge of more strategic or in-depth analysis, for the other units as well.

The Trade Analysis Unit has three main missions. The first is to give high quality economic analysis to our Commissioner and our Director General, to refine and review our policy priorities and also to assess the impact of these policies in order to provide feedback for new policy decisions. This is the main aspect on which I shall concentrate in my presentation; but first I think it is important to mention the unit’s two other missions.

One is the role of coordination. We coordinate not the analysis but the policy within the Directorate General for Trade (DG Trade) for a number of issues – for instance, issues relating to globalisation, competitiveness and some issues linked to trade and development. There is always a tension between the role of analysis and the role of policy coordination, and there are some risks, because policy coordination is very time consuming and it tends to take a lot of resources away from analysis. Since coordination work is frequently subject to time pressure and tight deadlines, there is a risk in concentrating on coordination to the detriment of the more analytical work. Resisting this tendency is not always easy. On the other hand, having some coordinating tasks is very useful because it gives a direct link with the day-to-day business of the negotiations and the activities of the DG. It keeps you linked to the reality, which is something very necessary when you are doing analysis.

The other function of the unit is to provide statistics. We provide statistics that we actually take mostly from Eurostat, but put into a user-friendly format. We make available these statistics on the internal web and, partially, also on the Internet. They are very widely used by all DG trade services and by EC delegations in more than 120 countries. Our statisticians also perform more specific tasks linked to the analytical work of the unit.

Those are the three main missions of my unit, but, as I said, I shall now concentrate on the first one, which is the topic of today’s discussions.

When speaking about analysis, I think there are four key issues which are relevant and must be tackled. The first is the definition of priorities, which is probably the single most important factor. You can analyse every single issue, you can write a lot of papers that are not used, but the point is to pick up those issues that are really relevant for policy makers and for policy decisions. That is not easy, but I would say that having this right may represent half of the value added of anybody doing analysis.

After that, you have to ensure that the analysis is of good quality, because your power and your capacity to influence depend on the quality of your work and your reputation. One piece of bad analysis alone can have a very negative impact on the trust policy makers have in your work and advice. So you have to ensure that anything that comes out of the unit is of really good quality. Quality control is, therefore, very important.

The third key issue is the way you communicate the results. The language of the academic community and the language of the policy makers are two completely different things. You have to find a way to translate the results into very direct language. You have to take into account the political realities so that the analysis can be understood and used by policy makers. You should be concise. Anything we write for our Commissioner, for instance, should be short (two or three
Finally, **timing** is very important. Advice should be relevant, of good quality, with a clear message, but it also has to be on time. If advice comes after the relevant policy decision has been taken, it is useless. That is not so easy. Usually, when you receive a request for analysis, it is too late to start working from scratch. You need to anticipate the topics on which you will have to work.

To complicate all this, human resources are always limited. In our case, the unit is small. There are six economists, two statisticians and two assistants. It is true that in this particular kind of work, quality comes before quantity and it is better to have six excellent economists than 15 good economists. However, even if they are very good, they cannot do everything, so there is a clear need to fix priorities and then, in our case, to do some work in-house and some work outside. We sub-contract part of the work. I shall explain these two issues.

The first issue is the need to fix priorities. This is, in fact, fixing the work programme for the unit. In this process, the first step is to consult all operational services. You have to take account of their needs. They know the details of the negotiations; they know the likely calendar of the negotiations; and they know the points on which they may have difficulties. But that is not enough. You also have to have some feedback for the highest level where the policy decisions are made. On the basis of that, you have to make your own judgment on what the key issues will be and then leave room for urgent priorities because any planning you do will be imperfect and you will need to work on things that you have not foreseen.

One of the main topics for us in 2006 was related to the analysis of the external aspects of EU competitiveness. This was an in-depth reflection that led to a European Commission Communication setting trade policy priorities for the EU in the years to come, which was approved a few weeks ago.

The economic analysis of the Doha Development Agenda (DDA) was another very important subject of analysis with very clear policy implications. Understanding where the gains of the DDA come from is full of policy implications. If you think that all the gains come from agriculture, that of course gives a clear message to the negotiators to focus their discussions on agriculture. If you think, as we do, that agriculture is important but industrial goods are also important, trade in services is also important and trade facilitation is also important, then the message you give to the negotiators will be completely different. There was a very interesting discussion on that.

Once the priorities are fixed there is still a decision to be made as to how best to organise the work to tackle these priorities. In our case we do part of the analysis in-house and part of the analysis outside. We tend to concentrate the in-house work on short papers directly linked to policy advice to be read by policy makers and which are normally based on more in-depth work which we outsource.

There are pros and cons with regard to internal and external analysis. Internal studies have the advantage that you have full control on technical details and timing. People working internally have a full understanding of the constraints of trade policy and the needs of policy makers, so they will consider all the realistic options. In addition, there is no problem of confidentiality. The main problem is, of course, that you have limited capacity and expertise available in-house and you cannot do everything.

We therefore have to do a lot of things outside. In order to do that efficiently, we have two framework contracts. In fact, it is legally one framework contract with two consortia of European and non-European research institutions. The first is led by the Centre d’études prospectives et d’informations internationales (CEPII) in Paris, but includes also the International Food Policy Research Institute (IFPRI) in Washington, the Kiel Institute in Germany, the Institut National de la Recherche Agronomique (INRA) in Paris, the International Trade Centre (ITC) in Geneva and the
University of Nottingham. The second one is led by Copenhagen Economics but also has participation from the Centre for Economic Policy Research, la Faculté des Hautes Études Commerciales de l’Université de Lausanne (CEPR, HEC) in Lausanne, the University of Neuchatel and the Vienna Institute for Economic Studies. This is therefore a very large net of academics and I think we have, through these two framework contracts, access to a very large number of specialists who cover most trade related topics.

Within the framework contracts we can ask these institutions to carry out studies for us, short studies and long studies, between two months and four months, which is the longest timing we consider. In addition to studies the framework contract foresees other possibilities. In particular, we have what we call workshops. We can ask these institutions to organise meetings in Brussels with a number of specialists on a specific topic. This is a good way to have, in a short space of time, a broad and in-depth discussion and allow us to form rapidly a clear view on a particular issue. This is something we usually do before launching a study, for instance, or to clarify our ideas on a particular topic before going into in-depth analysis.

Another product of in the framework contract is what we call flash reports. These are short notes, of four or five pages, to be done very quickly if we have a particular question on which we need a clear and rapid response.

This way of outsourcing work has advantages and also some disadvantages. As for the advantages, we have access to a wide range of expertise through a single framework. It is also relatively rapid. Compared to launching individual studies, this is much quicker. You can have results in, for example, a week, a month, two months or four months at the most. You have stable partners; you know what they are capable of doing. They know the quality and the format you expect. There is a stable relationship, a process of learning by doing, in which expectations from both sides are progressively known. This is linked to another important point, which is trust. You get to know the researchers doing the studies; you know what they are capable of doing and also their limits; and you have trust in the results. You do not have to check every single detail to make sure that all the studies are of good quality.

However, there are also some problems. You have less control on the detailed technical choices. It is also quite labour-intensive to follow it up well. If you want good results, you have to follow up very closely the work of outside researchers, in particular because they have less knowledge of the complexity of trade policy making and very close interactions are needed if the result you get is to be useful in operational terms. The work done outside implies a lot of work inside to monitor it. There may be problems of confidentiality if the work is closely linked to negotiating positions. Finally, respecting the timetable is sometimes difficult. The time-scales of policy makers and of the researchers are not always the same. Also, of course, researchers in the consortia are not working only for us, they have their own research programmes that they are sometimes very busy on, so sometimes putting the two calendars together is a bit difficult.

Overall, however, I think it is a very useful tool. In particular, we do not do any modelling internally. I think that was a wise decision because we have access to very high quality modelling which we could never have in-house with the number of staff that we can reasonably hope to have.

Let me say a word on the importance of networking. You cannot do everything; you have to see what other people are doing and use the analysis of others. Going to conferences and meeting other people also helps us to correct factual misunderstandings of EU trade policy and gives us some influence on the debate. I think it also feeds the research community with ideas for research, subjects that could be interesting for us but maybe also for others.

That is what I wanted to say. You can obtain more information from our website.

**Question:** How do you deal with confidentiality? Do you define confidentiality when you outsource? Do you not provide information? How do you deal with these kinds of issues?
Speaker: There are different levels of confidentiality, depending on the subject. It is always a difficult issue to deal with. Some of the studies we do are quite general, on topics that do not have a direct impact on negotiations. For those, we are very open. Very frequently we put them on our website. If you go to our website, you can see many of these studies. They are not uninteresting; on the contrary, they are very interesting and give useful information on a wide range of issues. But they are the kind of overall studies that are not linked to the conduct of particular negotiations.

There is another type of analytical work, more linked to providing insights or advice in the context of negotiations or relative to policy decisions to be taken. That is, of course, not the kind of information you can share with everyone, so you need some kind of confidentiality treatment for it. Therefore, depending on the sensitivity of the issue, we make it available to a more or less restricted group of people. Sometimes there are divergent views on how open you can be with a particular set of information, not everyone is of the same opinion. Negotiators tend to think that everything is very confidential. We, in the Analysis Unit sometimes are a bit more open. At the end a decision is reached taking into account all different views.

Question: I have a question about the framework agreements. As I understand it, you have two framework agreements for outside experts and both of these agreements are with a consortium of many institutions. How did you set up these agreements and can you tell us something about them? In particular, I assume that there had to be a tender. I assume that your department could not just write a contract for this consortium without an open competition under EU laws for allocating resources. What is the nature of this agreement? Do you have an upper limit on the resources? There are presumably sub-contracts. Do they have to be renegotiated in terms of reference? Can you explain that process?

Speaker: We are getting into operational details here. For any study you want to undertake, under European rules you have to go for a tender to allow for competition. This is a problem in terms of timing for doing specific studies. If you want to launch a study, you have to undertake a tender, which involves several different steps and it takes a minimum of six months plus the time for actually doing the study. If you want to go for outside expertise on a case-by-case basis, you need one year from the time you launch the study to when you receive the results. Most of the time these kinds of delays would be too long. We therefore decided to go for a tender, but not for a particular study. We launched a tender for what we call a framework contract. In this tender we specify our needs, what products we would like to have from the tendered. In our case the products are those I have mentioned: long studies, short studies, workshops and flash notes. There is a maximum amount of resources fixed for the framework contract and there is a time period during which you can spend this money (in our case three years). There is an open competition for awarding the framework contract, which takes closer to a year, more than what would be needed for a normal study. But, once the framework contract is signed, within this contract you have a simplified procedure under which you directly negotiate sub-contracts for particular studies with the consultant or consortium selected through the tender. This very much shortens the delays.

In our case the terms of the framework contract allow us to select two consortia. Under the terms of the contract, when we want to contract a specific study, we are obliged to contact first the consortium which came first in the open tendering. If that consortium is not able to deliver the study we ask for, or if it is not able to deliver the study in the time we want it delivered, then we can contact the second consortium. As I explained, the two consortia were selected through an open tender, among many other candidates.

Question: You described the main advantages and drawbacks of this framework networking. The United States experience is quite different. This is a large commission and most of the research is done in-house. What determines the way the country or the set of countries chooses to do this
kind of research? Is it just historical or do modern times require a new kind of framework of networking?

**Speaker:** I can give only a partial answer from my point of view. I think that with these kinds of things, as with many other things, there is not one solution that fits everyone. You are always working in a particular context with a particular history. In our case, we do not have in our constitution or treaty anything like the International Trade Commission in the United States, so this was not an option. In our context, I think the option we took of having a limited number of resources in-house and making a wide appeal to outsourced resources was a very good one. This may be specific to our set-up; I am not saying that it is the best option for everyone.

Evidence based trade policy: decision making in the European Union – views from inside and outside of the European Commission

*Lucio-Mauro Vinhas de Souza* ⁹

To give you some background understanding of the role and function of the Directorate General of the European Commission for Economic and Financial Affairs (DG-ECFIN), it can be seen as the core of the economic analytic organisations within the European Commission. We have roughly 400 economists who spend their working day doing economic analysis on a series of questions. The same applies, for instance, to the Russia Desk. I usually affectionately call Russia 80 per cent of my working day.

By definition, evidence based policy, which we can define as analysis to support both policy formulation and policy decision, should be a cornerstone of all policy areas within the European Union, not only on trade. Following up on the presentation given by my colleague, in ECFIN the main areas of competence are macroeconomic and fiscal coordination, but also areas like trade and energy when those have macroeconomic implications. ECFIN systematically produces internal studies and commissions external ones to support its policy formulation process. Like our colleagues in DG-Trade, we too use in-house and outsourced studies because of personnel and know-how constraints. To give you an idea of the envelope of human resources that we have, in our Directorate for International Economic Affairs, or Directorate D, we have 75 of the roughly 400 economists of DG-ECFIN. Of those 75, roughly 12 are in my unit, which deals with the states of the former Soviet Union, except for the Baltic states and including Russia, of course.

The use of evidence-based policies is also a standard procedure on joint intra-Commission activities. A very practical example which is relevant for the subject of the discussion here today and tomorrow is a study on which we are collaborating with our colleagues in DG-Trade. DG-Trade is currently in the process of commissioning a new study to assess the effects of a deep free trade area between the European Union and Russia, as foreseen in the EU-Russia 1997 Partnership and Cooperation Agreement (PCA). The PCA is the overall framework of relations that we have between the European Union and Russia, together with the road maps. ECFIN was actually represented in the selection committee of this study and we shall also be represented on the steering committee of the study itself. Evidence-based policy is something that we use overall in terms of the policy formulation procedure; it is not something that is specific to the area of economic policy of a specific DG. We do not necessarily have boxes in which the different DGs do not interact on the policy formulation process.

Once completed, this study will provide inputs for the policy formulation and the policy decision process of the EU and could also eventually be used in the same role by other interested parties in the process. To give you an idea of the consistency of the behaviour of the Commission in terms of basing its decision and its policy formulation processes on the existence of evidence, the study

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that we shall be undertaking soon is actually a follow up to an earlier study that we did concerning Russia and trade liberalisation.

Of course, the constitution of the eventual Free Trade Agreement (FTA) between the European Union and Russia – and I do not think I need to point out to all of you here that the EU is Russia’s most important trade partner and that Russia is at the same time a strategically fundamental partner for the European Union – will necessarily follow the entry of Russia into the World Trade Organization. Obviously, Russia’s entry into the WTO and all the related liberalisation and opening-up processes which are implied by it are supposed to have very powerful potential benefit effects for Russia. This is especially true in certain specific sectors, such as services, which I am sure David Tarr will mention at some point.

A more reliable and robust framework for private investment, both domestic and FDI, will also have potentially very significant effects for Russia’s growth, as shown by many studies, and this is a key question both in terms of the WTO and in terms of an eventual FTA that we may start negotiating with Russia at some time after accession to the WTO. The same and perhaps even more, given the importance of the EU as a trade marker and investor for Russia, holds true for an eventual Russia-EU FTA. The potential gains that Russia would have from such an FTA are even greater than WTO accession. This has been indicated by several studies, some of them produced by David and some produced by me.

As further evidence of the usage of this evidence-based policy framework, the same sort of set-up is behind a new framework for policy discussion which we at ECFIN are organising with counterparts in the Russian government. This is the so-called first meeting of the EU-Russia macroeconomic dialogue, which will take place in Moscow in late November this year. It will involve from outside ECFIN, contributions from our counterparts in DG-Trade, DG-Energy and Transport and the European Central Bank and our counterparts from the Russian government, who will be the Minister of Finance, the Minister of Economic Development and Trade, the Central Bank of Russia and the Federal Supervisory Authority for Financial Markets in Russia.

This framework for discussions of macroeconomic questions between the European Commission and the Russian government will involve several sessions which will cover different aspects of economic policy, from both fiscal and monetary to structural ones, including energy this year and, maybe at some point, trade.

The relevance for the subject of this meeting is that this sort of framework is also based on the previous production of quantitative studies, those produced internally for the Commission or those produced externally. All the sessions of the framework for macroeconomic discussion will be based on the studies produced for it, which will obviously support and guide the policy discussions. This is a recurring framework for policy discussions between the European Commission and the Russian government which will be managed from 2007 onwards within the structure of the Commission by DG-ECFIN and our colleagues in DG-Market.

In terms of all those questions which we consider essential to be discussed, a fundamental question from our point of view for Russia is what are the necessary macro and structural reforms that will ensure that growth is sustainable in the long run for Russia. For this to be possible, there needs to be reform – in other words, policy decisions – both in terms of the macroeconomic framework in Russia and in terms of specific structural liberalisation reforms. The systematic use of evidence based policy with those quantitative and qualitative studies and analysis enables the better formulation of such reform policies and, ultimately, Russia will engage in more liberalisation and structural reforms because this is something that is beneficial for Russia.

From our point of view, that is the key message that we would like to convey here. The usage of evidence-based policy is not restricted to any specific area of economic policy; it is a general framework for analysis which, at the end of the day, organisations and nations use because it enables them to construct and eventually follow policies which are better and more robust. Russia
obviously has an interest in following this sort of set-up because at the end of the day this is good for you.

I hope that my brief presentation has been useful and I look forward to hearing any comments you might have.

Comment by Mr Tarr:10 I should like to comment on this particular point. We have seen in Australia, the United States and the European Union three very different models. I think the EU model and the US model are opposites and the Australian model is somewhere in between, although more outside than inside, I would say. I think I agree with Mr. Frontini that you have to look at your own conditions and what is appropriate. One comment I would make is that, if we are thinking of developing institutions for evidence-based decision making in Russia, we have to think about the salaries of the Russian government and whether one can keep and attract in-house capability to do this kind of work. We know that it is very difficult to keep talented people who can do this type of work in the government for a significant period of time.

I shall make the following comment and I should like to hear some response from our Russian partners in this discussion. I would say that the European model is certainly a lot more relevant to Russia than the US model. The US model is viable but you need to have the salaries to ensure that you can retain very competent people in the government for a significant period of time. That is my view in terms of the process. That is why it was important for Mr Frontini to explain the tendering process, because the Russian government has similar constraints on awarding contracts.

Comment by Mr Chernyschev:11 Let me make a brief comment as well. Our system in Russia is in place and we outsource these types of studies, using money allocated by the federal budget to the relevant ministries and bodies, who commission independent organisations to conduct the studies for them. I think what we do is more similar to the European model. Unfortunately, we still have problems with financially rewarding the federal officials for the work they do, and that is one of the issues we are concerned about.

Comment by Mr Frontini:12 One of the useful features of this kind of framework contract is that it allows for a stable relationship with some key research institutions. There is a process of knowing the capabilities and the needs of both parties, which is extremely valuable. In a way it brings the academics into the government. Though they remain outside, they understand better what we need and what our constraints are and how we can use or not use what they produce. It is a way of having external expertise but enabling those experts to have a better understanding of the inside issues of trade policy.

Comment by Mr Rogowsky:13 For the record, I think the US has the perfect policy in place, of course! However, I can understand the constraints. Thinking about this, yes, it is important to have connections with outside people for doing policy-based analysis but, in a practical sense, we find that negotiators and people in Congress often need very good information very quickly, and for any organisation like that contracting out is too slow in many cases. For many of these people, having something in four months is just not relevant and having it in four days is often not relevant; they need it immediately. Yes, for the kinds of work required for good, solid evidence-based analysis you have to have a network and a community. The global network of people who are working on trade policy analysis and, increasingly, other kinds of economic analysis is really quite striking. We spend as much time with Peter Dixon, probably even more, as we do with many organisations in Washington. However, there are many instances in trade policy analysis where that kind of evidence needs to be brought to bear in a matter of hours or days, and having the kind of staff in-house that can respond to that is something that has been very valuable for the

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13 Director of Operations, United States International Trade Commission.
process in the United States. I understand the difficulty with regard to salaries and so on, but having an institution in-house and readily available for the people who are either negotiating or making the policy decisions can be very valuable.

Comment by Mr Dimitriev: 14 I should like to comment on what Mr Rogowsky has said. At one stage I worked as a deputy minister in the government, dealing with complex problems which were not concerned with foreign trade but which required many legal and other complex technical studies, and we had to make important decisions in a very short time-frame. For instance, I participated in the pension reform which was under development for two years in Russia. The majority of the studies for that reform were prepared for Russian policy makers by foreign experts. In fact, they developed an actuarial model which would allow evaluation of the consequences of introducing this model or that model. The departments that I led had 120 people working on this. The outside experts we used, who represented either themselves personally or their organisations, numbered 200. Despite the complex structure of the relationship between state government bodies and outside experts, we did not have many problems with over-running our time-frame. We were on schedule. The freelance expert market is highly developed and experts are used to working as consultants on the basis of individual contracts with the government and are capable of reacting very quickly with their expert replies to the questions and issues that are posed to them by the government and other bodies.

Comment by Mr. Jara: 15 I would like to briefly highlight something that DG-Trade has done over the years, which I have found very interesting. Once they have a set of issues, they will engage in brain storming inviting people from diverse backgrounds and countries to go to Brussels, interact and draw conclusions. This is a very effective and inexpensive way to test ideas in the market and consequently improve your positions.

The role of trade policy in Chile’s development

Alejandro Jara

Thank you for the invitation to make some remarks about Chile’s trade policy. I shall start with the usual disclaimer: nothing that I say reflects the views of the organisation I work for now (the World Trade Organization); nor those of the Chilean government.

I shall address three issues. The first is Chile’s uniform tariff policy. Second, why did Chile choose to liberalise trade through bilateral free trade agreements and not through customs unions? The third issue concerns institutional administrative questions about trade policy management, the mission to the WTO in Geneva and the requirements of resources and coordination.

First, a very broad picture of what Chile was like at the time that Allende was overthrown (1973). The tariff was on average 105 per cent. There were many prohibitions, including licences, quotas and exchange rate controls. Inflation was around 1,000 per cent a year. Production was completely disrupted. There were many price controls. Several factories and farms were intervened. The black market was rampant and there was nothing on the shelves of stores, etc.

The military coup did away with all the opposition, including Congress. The first thing was to stabilise the economy, particularly the currency and restore production. Thus, several policies to check inflation and bring it down were applied. Interventions and price controls were lifted. Trade liberalisation became a centrepiece of this endeavour and soon proved to be a growth engine and a development tool.

What happened to tariffs and other non-tariff measures? First, an institutional explanation: as in many countries, taxes and tariffs are set up and approved by Congress; but in Chile, for many years Congress had delegated to the executive an unlimited authority to fix tariffs. Pressure from

14 Director, Center for Strategic Studies, Russia.
15 Alejandro Jara, Deputy Director General of the World Trade Organization, former Chilean Ambassador to the WTO.
producers to bring down the tariff on an imported input or to raise the tariff on a finished product were directed at the executive. Congress did not intervene nor arbitrate; they were only too happy not to take responsibility. As a consequence, tariffs were fixed not on the basis of economic policy (for example, how best to allocate resources) but rather on the power of lobbies. In addition to that, Chile had signed a few trade agreements with some Latin American countries with limited coverage (mainly existing trade flows) and which were unstable because of periodic renegotiations. Chile had very few bindings under the General Agreement on Tariffs and Trade (GATT) and these were generally at very high levels.

Under the dictatorship, politics was suppressed, industry was grateful to get its plants back, as were the farmers to get their land. Although they had been traditionally protected, they could and would not resist too forcefully open markets with increased competition. The economists in charge of policy decided that tariffs should not be used to allocate resources in the economy; and that tariffs would not be part of an industrial policy, at least one determined by the levels of border protections. From 1974, tariffs were gradually reduced. By 1979 all tariffs were at 10 per cent. This had a notorious effect on the exchange rate. Under the import substitution approach, the exchange rate was traditionally depressed. Once freed-up, the exchange rate became an incentive to exporters and Chilean products, other than copper, began to show up in the world markets.

However, to further curb inflation, the government had decided to fix the exchange rate, which worsened the impact of the Latin American financial crisis of the early 1980s. This became unsustainable and a massive devaluation took place. Also, in 1984 all tariffs were raised to 35 per cent but not beyond because, in the meantime, Chile had bound at that level all products, in the Tokyo Round of the GATT (1973-1979), with no exclusions, even though the applied tariff was 10 per cent. It was the first time a country in the GATT bound all products.

In 1985 tariffs were reduced first to 30 per cent and then to 20 per cent; but there was always a flat tariff. In 1988 the United States, for political reasons, excluded Chile from the Generalised System of Preferences. The policy response of the government was to reduce tariffs from 20 to 15 per cent.

In 1991, once democracy had been recovered and Chile was being run by a centre-left coalition, the government considered that the tariff was too high at 15 per cent because it needed more room to manoeuvre in order to manage the exchange rate. The government proposed to reduce the rate to 11 per cent on all products. This was approved expeditiously by unanimity in both houses of Congress; still there was always a flat rate. Subsequently, in 1998, all tariffs were again reduced, gradually from 11 to 6 per cent, which is their present level. This account shows that the flat tariff has been tested politically and enjoys a widespread consensus that it is the best tariff policy.

What have been the effects? As in all processes of adjustment, there are winners and losers. From 1948 to 1973 Chile’s exports were about US$ 1 billion a year. In 1973 copper represented 80 per cent of total exports. This year (2006) Chile, a country of 16 million people, will export US$ 58 billion, about half of which is copper. As Chile opened the economy many products became exportable such as fresh fruits and vegetables, wine, salmon (Chile is now the world’s number two producer of salmon), forestry products and fisheries products. In other words, there has been a huge diversification and expansion of products and markets.

Among the losers are the textiles and clothing sectors because of several small factories that are family-owned and run, with low levels of technology. A few survived, modernised and became capable of exporting. The same thing happened with footwear. Another loser was the automobile sector, which in reality was not more than many assembly plants, with little local content added. The poor gained because of lower prices and better quality.

Why did Chile not choose a customs union but free trade agreements? As you will know, in a customs union there is, by definition, a common external tariff. This also requires that there be a common trade policy or strategy, at the very least to negotiate your common external tariff with
other countries, but it has to be common, which implies having partners with whom you have a
certain degree of commonality. If you have a flat tariff it is not easy to find such a partner.
Historically Chile has had two possibilities of joining a customs union. The first was the Andean
Pact which Chile left in 1976 and then, later on, in the 1990s, the Mercosur Pact (Brazil,
Argentina, Uruguay and Paraguay), but the minimum commonality was simply not there. For
example, the differentiated tariff structure designed to protect certain industries clashed with
Chile’s neutrality.

Instead, Chile negotiated free trade agreements with all countries in South America and other
regions. Bilateral free trade agreements are certainly not the first best and probably not the
second best but the third best policy. They present many problems and distortions. However,
FTAs: (i) are faster to conclude; (ii) are deeper than multilateral exercises; (iii) lock in multilateral
liberalisation; (iv) force the administration to be more transparent and accountable because of
increased monitoring thus improving governance; and (v) avoid the conditionality of preferential
schemes, such as the Generalised System of Preferences (GSP).

When a developing country concludes a free trade agreement with a highly industrialised country
or group of countries, it will provide that economy with a seal of good quality.

Free trade agreements certainly divert trade, but then the more agreements are made the lesser
the diversion effect. FTAs also prevent discrimination in markets that have engaged in FTA or
customs unions. For example, when Mercosur was established in the early 1990s and most tariffs
between Argentina, Brazil, Uruguay and Paraguay went down to zero, the Chilean exporters
pushed the government to negotiate a free trade agreement with Mercosur, otherwise they could
not compete since the common external tariff of that grouping was relatively high.

Free trade agreements can be negotiated in a shorter time than multilateral arrangements, mainly
because: (i) the number of sensitivities is much less; and (ii) there is a multilateral legal
framework of rules that governments can refer to or use in the bilateral deal.

To sum up, the lack of commonality in fundamental policies and Chile’s desire to open up its
economy faster and deeper explain why it chose to negotiate bilateral FTAs and not join a
customs union, while recognising that multilateral liberalisation is the first and best choice.

So far Chile has entered into FTAs with most Latin American countries, the United States, Canada,
Central America, the European Union, the European Free Trade Association (EFTA), Korea, China,
New Zealand and Brunei. Japan should be added to the list shortly. This means that close to 95
per cent of imports to Chile are or will be duty free very shortly. About 85 to 90 per cent of
Chilean exports access these markets with no duties.

The third point I have been asked to address is how to deal with WTO and trade policy in the
capital, in the Geneva Mission and the coordination mechanism. To begin with it is necessary to
define who makes trade policy. This may sound trivial, but it is not always obvious. In some
places the responsibility is shared by government agencies and parliament. In Chile it is simpler:
the Minister of Finance makes trade policy.

A different question is who negotiates trade agreements. In some cases this is the responsibility
of the ministry of trade; in other cases, as in Brazil or Chile, for example, it is the Ministry of
Foreign Affairs who houses a specialised team of trade negotiators. This team will also
administrate the trade agreements. They will also be responsible for coordinating all relevant
agencies, such as agriculture, banking regulators, insurance regulators, telecoms, maritime,
transportation, intellectual property, health, etc. This ensures that there is a position of
government shared by all. Sometimes consensus cannot be reached at the level of officials and
disagreements are kicked upstairs for ministers to settle matters. In all this, regular consultations
with business, unions and NGOs are necessary if not mandatory.
The capital also has to define who is a senior official. Often in the WTO or other forums, meetings are held at the level of senior official – in other words, officials who have a command of technicalities but, at the same time, enjoy a political responsibility.

In Geneva several countries, such as Chile, have chosen to have a mission to the WTO separate from the UN mission, which deals with United Nations matters, human rights, meteorological organisation, health, refugees, the International Labour Organization and many others. Brazil or Argentina, for example, only have one mission but their ambassadors spend most of their time on WTO affairs.

In Geneva, the Chilean WTO mission has a team of six experienced trade negotiators. Besides WTO this mission is also responsible for the United Nations Conference on Trade and Development (UNCTAD) and the World Intellectual Property Organization (WIPO). They interact with the capital on a daily basis through the telephone or e-mail and define the support they need, including whether officials from the capital should come to Geneva for meetings. All Geneva-based officials speak and write English well.

Summary of the discussion:

Question: Thank you very much for that interesting presentation. I have three questions.

First, Chile is a small country. We are discussing here countries which have adopted a flat tariff. Australia is probably not that small but many other countries are really small. Do you think that a large country can do this or should a large country explore the possibilities of an optimal tariff policy?

Secondly, I know that Chile has had a flat tariff for a number of years, but I remember that when I was in the US back in 1998 some of my Chilean class mates were buying cars in the US and those who worked for the Central Bank of Chile told me that they would be able to take those cars into Chile very cheaply. I do not remember all the details, but the discussion was to the effect that car prices in Chile were very high and it was much better for them to bring cars in from the US, which it was possible for them to do if they worked for a Chilean institution. I should like you to clarify what that is all about. It does not seem to me to go together at all with a flat tariff.

Thirdly, you mentioned consultations with the private sector. Could you elaborate on that? How do you do it? How is it organised? Do you have consultations with one organisation of entrepreneurs? Do you have consultations with several industrial associations? How is the process organised?

Speaker: First of all, I do not know whether a large country could or should have a flat tariff. Why not? Nowadays, almost all countries are liberalising their trade, unilaterally or by means of free trade agreements, which means that tariffs are being flattened to zero. The question seems to be not one of economics but rather political: how the level of the tariff will be determined and who will determine it. The political economy may be such that it is difficult to have a flat tariff; but the flattening trend is here.

Secondly, importation of cars into Chile is open and the normal tariff (6 per cent) is levied. However, the import of used cars is forbidden. If you have a fantastic two-year-old Rolls-Royce, you cannot import it into Chile! There is another tax, which is being eliminated, on the size of the engine. Whether the car was assembled in Chile or imported it did not matter (there are no longer assembly plants in Chile); the larger the engine, the higher the tax. Chilean diplomats and other people who were working abroad for the government or Chileans who had gone abroad to work could bring their cars, whether used or new, into Chile without paying this engine tax. The only requirement was that they could not sell their car within the first three years. This was done to facilitate people returning to Chile. This is a distortion, but a small one, because it did not involve many people.
Thirdly, as to consultations with the private sector, as time has gone by these have become more structured and institutionalised, to the point where there are formal committees set up. Regular reporting is done to business by the government to inform them of what is going on and seek their views on most aspects of trade negotiations.

**Question:** A flat tariff means that for some goods the tariffs are flatter but for some goods, such as cars, the tariffs are prohibitive. Are there other goods that have prohibitive tariffs? Secondly, as far as free trade agreements are concerned, are there institutions or commissions that do quantitative research on the consequences of free trade agreements for the Chilean economy?

**Speaker:** A flat tariff means that all products that enter into Chile pay one rate of tariff, which at the moment is 6 per cent. No tariff is higher than that, no tariff is lower than that. However, if there is a free trade agreement with another country and a product originates in that country, then that product will pay less than 6 per cent, probably zero, unless the tariff is in the process of being phased out. It means that no tariffs are prohibitive. There is just one single rate for all products.

**Question:** Used cars are not allowed. It means that the tariff is prohibitive.

**Speaker:** It is not a tariff; it is an outright prohibition that was a compromise with assembly plants, while opening up importations of automobiles. It was later justified as a means to prevent Chile becoming a junk yard for used cars, which can also be taken care of with good technical standards.

Secondly, is any quantitative research done? Before a decision is made to do a trade agreement, whether WTO or bilateral, a study is usually done on its possible impact. The results of the study are usually made public. Sometimes these studies are done in-house by resident economists and sometimes, depending on the workload, the studies are done by consultants. On the other hand, some research is done, usually by universities or research institutes, on the impact of existing trade agreements, whether on the economy as a whole or with regards to particular sectors.

**Comment and question by Mr Rogowsky:** You have made me think of two points. First, in terms of the involvement of the private sector in the decision making process, at least in the United States, as I tell my students, trade policy is all about politics because it is always about who is going to be pressing to get their case made in the policy process. In the United States we have set up a system that channels private interests into an organisational structure. These are formally established industrial trade advisory committees, or ITACs. Each sector has its own ITAC, its own committee that meets regularly with the trade negotiators. There is one for services, there is one for steel, and there are different ones for agriculture. This is valuable for two reasons. The influence from the private sector will be there anyway but this process organises it so that it is coordinated and, if there are disagreements within the trade sector or the industrial sector, those are channelled and organised in a way that negotiators can use. Sometimes there is a countervailing force because special interests will always find an avenue, but this process allows it to become coordinated in an effective way.

Secondly, in the United States – and I suspect this is true in Chile – there is an amazing amount of evidence being provided to policy makers. You cannot stop it; it is huge. The question is whether it is any good. The value of having organisations such as the ITC and at the European Commission and in Australia which provide disinterested evidence is that it countervails against that great flood of evidence that comes in which has a special interest attached to it. The problem for policy makers, not just in trade but in any policy, is how to organise the evidence and balance it against other evidence so that you know what is the truest of evidence and the closest to reality. That is the hard part.

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16 Director of Operations, United States International Trade Commission.
I have a question. I am very impressed with Chile’s decision that lower tariffs were better and that a flat tariff was a good way to go. Even when you raised it, you would always lower it. Clearly, economics is playing a part. What kept you from lowering it to zero per cent?

**Speaker:** That is a good question. The last time tariffs were dropped was in 1998. They went down by one percentage point a year, so it was not until the year 2003 that the level reached 6 per cent. I think you have to let the economy breathe a little bit. I would not be surprised if in the next five or six years someone asks the question, “if Chile is virtually a duty-free country, why bother to collect duties? There is a cost of collecting duties, so why do we not go down to zero?” I think Chile is getting quite close to moving in that direction.

I want to say something about the evidence. I think you are right that you get a lot of evidence. One case in particular has been very delicate and that is the question of applying trade remedies: safeguards, anti-dumping, countervailing duties. Chile is not like the United States or other places; there is an almost artisanal way of doing things, but I think the results are there. Very few measures are actually applied. When evidence is provided by the private sector seeking more protection, the information and evidence must be appraised. Chile has been careful enough to have an autonomous entity to go through the evidence and do the checking. That entity is the Central Bank, which in Chile is completely autonomous. At the time I was involved, we knew that if we gave the job to some governmental agency it would be subject to pressures that could distort the picture, so we said, “Independent Central Bank, you will take care of this; you will give the report on the basis of which the policy makers will take the decision”.

**Comment by Mr Tarr:** Chile’s experience in 1998 is really valuable. It lowered the tariff from 11 per cent to 6 per cent. As Mr Jara mentioned, there was earlier general political validation of the uniform tariff. In 1991 the lowering of the tariff was passed unanimously in the parliament. In 1998 testimony was taken before the Chilean parliament on the decision to lower the tariff from 11 per cent to 6 per cent. The organisation representing the Association of Manufacturers testified before the Chilean parliament and recommended lowering the tariff from 11 per cent to 6 per cent, so there was consensus on the commercial side, as well, to lower the tariff.

In most countries private interests often lobby for tariffs to be raised. Why did the commercial interests in Chile decide that the tariff should be lowered? My explanation is that when manufacturers know that it is not a question of “my tariff versus your tariff” but that everyone’s tariff will be affected, then the political economy for lobbying is changed dramatically. They recognised what was in the interests of the country as a whole and of industry as a whole and they lobbied for the tariff to be lowered. In my view, that is the overwhelming argument in favour of uniform or flat tariffs. This argument is set out in a paper of mine, which I originally did at the request of Mr Gabunia, in which we look at all the arguments for non-uniform tariffs. There are many theoretical arguments. In most cases they do not carry much weight, though there are some exceptions. The overwhelming argument for a uniform tariff is the political economy argument, in my view.

Mr Rogowsky asked “Why not go to a zero tariff?” There is the point about what you provide to your partner if you engage in a free trade agreement. If you have a 6 per cent tariff you are at least providing some preferred access. In practice, you are not really providing as much preferred access because almost everyone enters duty-free in Chile, but, if you are negotiating with Chile, you compete on the same basis as all those other countries. You essentially have free trade in this process. As Mr Jara mentioned, there is virtually no trade diversion in the Chilean strategy because they now have free trade agreements with virtually everyone.

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17 Consultant and Former Lead Economist, World Bank.
Part II. Institutions in Support of Government Trade Policy Decision-making
International experience with trade policy for specific industries and regional arrangements

David Tarr

I would like to pose the question of what a good model would be for Russia to follow in terms of its trade policies. If you look out there at the world and seek different patterns of development, and various countries have chosen different trade policies, which of these would be an appropriate model, if any, for Russia?

I would like to suggest that it would be best to look at the “development miracle” countries; that is, the countries that have had a rate of growth over a sustained period of time that I do not believe has ever been witnessed previously. The United States in the nineteenth century grew at a very low rate compared to these development miracle countries.

I would list these six or seven countries in three different categories. In the first category I would place Hong Kong, Singapore and Chile; in the second Mauritius and maybe China; in the third, South Korea, Taiwan and China. Possibly China could be put in this third category or with Mauritius.

I will mention the differences in the strategies. Different strategies are employed by these different groups of countries. All of them are development miracle countries but they have employed very different trade policy strategies. What is common to them all? The common feature is that they have all substantially increased their exports. It does appear that substantial export growth is a necessary condition for the very rapid rates of economic development that we have seen. Certainly all of these countries had very substantial export growth during their development miracle period.

Hong Kong and Singapore used virtually free trade; Chile, as we have heard, has used low uniform tariffs. These models are the classic, open economy policies typically recommended by the World Bank. Mauritius and China used export processing zones. I will talk a little bit about that. South Korea, Taiwan and to some extent China as well, initially had high tariffs that declined over time, but they used a complex system of incentives for exporters. There were very different models, all of which were very successful.

It is important, I think, to recognise some principles. High and diverse tariffs raise domestic prices relative to export prices and thereby provide incentives for businessmen or entrepreneurs to produce for the home market and to ignore exports. We have this principle in international economics which says essentially that tariffs are a bias against exports and that they are essentially equivalent to export taxes. The question is: how did some of these countries, despite their protection which discourages exports, nonetheless manage to have high export growth? How did they do it? Crucially, all these countries engaged in policies which gave their exporters equivalent incentives to those that produced for the home market.

Let me take Mauritius and, as I say, to some extent China, first. They used export processing zones as a key mechanism, or Mauritius did certainly; it exclusively relied on export processing zones. If you locate in an export processing zone, you can buy your intermediate imports tariff-free. That certainly worked for Mauritius. We may talk more about this later.

I simply want to say that they have failed in many places, like Brazil, Senegal and Iran. That does not do anything for exports in those countries and government, say, in Brazil is very much opposed to further export processing zones because of the failure of the ones that they have. So it is no panacea. I am happy to talk more, if we have time in the question and answer session, about export processing zones. They are not a panacea for export growth.

The more serious example I wanted to mention is South Korea and Taiwan. Many people point to South Korea and Taiwan as models of countries which used high and diverse tariffs but...
nonetheless had great export growth. Their tariffs declined over time but they did manage to provide incentives to exporters by managing a highly complicated regulatory regime that offset the anti-export bias of the tariffs. Taking South Korea in particular, they used duty drawback, indirect duty drawback and temporary admission. I do not have time to explain what indirect duty drawback is, but it is a very complicated mechanism to allow companies which are not even exporting to get tariff-free access to intermediate imports. They used capital allocation preferences to exporters.

Many countries in the world that tried duty drawback could not make it work. Exporters complain that that they do not receive the tariff rebates from the government. Under duty drawback, you pay the duty and then if you export, you are supposed to get a rebate for the tariffs that are embodied in the exports. Many countries cannot make duty drawback work; the exporters do not get the money back, or they get it too late. South Korea not only made duty drawback work but they made indirect duty drawback work.

The key to the South Korean system working is that they had a highly efficient and non-corrupt bureaucracy. I want to emphasise that. South Korea had a highly efficient, non-corrupt bureaucracy, which allowed them to implement a complicated regulatory regime that provided incentives to exporters that were equivalent to those producing for the home market.

Our experience in the World Bank is that most countries lack the kind of deep, efficient, non-corrupt bureaucracies that allow them to manage this kind of complicated regulatory regime. It is just not realistic for many countries to say “we are going to adopt the South Korean model”. Many countries think about the South Korean model as having high tariffs initially, which will be lowered over time. What is crucial for them is to provide incentives to their exporters through a complicated regulatory regime. That is a crucial component of the South Korean model and you have to be able to manage this complicated regime with an efficient, non-corrupt bureaucracy if you are really going to adopt the South Korean model. Again, we are sceptical that most developing countries have that type of bureaucracy.

Hong Kong, Singapore and Chile used free trade or low uniform tariffs. If you have free trade, the exporters already have equivalent incentives to those who produce for the home market. There is no anti-export bias; there is no need to manage a complicated regulatory regime. This is why the World Bank typically recommends the model of Chile or a low uniform tariff, as it were, because it is dramatically easier to manage in a world with inefficient bureaucracies.

For Russia, natural gas is an exception to what I am saying in terms of free trade. My paper has elaborated on that issue. I was going to talk about free trade agreements, but I do not think I have time because I want to elaborate a little more on what type of policies we would recommend.

I have said very briefly that the best model is low uniform tariffs, but that does not mean that you should not adopt these other mechanisms, such as were adopted in South Korea. It is not clear which, if any, of those will work but we certainly object. On the contrary, the World Bank Trade Study for Russia in 1993 has a chapter on these mechanisms for Russia and recommended a wide range of these mechanisms for Russia. It was written by a World Bank economist from South Korea, who recommended basically throughout his career in the World Bank that everybody all over the world should adopt these mechanisms. That is in the World Bank Trade Study of 1993. We certainly do not oppose that. I think it is worth investigating how many of these instruments could be useful in the Russian context.

Competitive exchange rates are certainly a critical mechanism, but I think the Russian government also has this objective of not allowing its exchange rate to appreciate too strongly. There is an issue about which mechanisms are worth further study to have a competitive exchange rate.

In the World Bank these days we are emphasising that, in effect, the trade policy must go beyond border measures; what we call behind the border measures. This includes many elements. It
includes encouraging foreign direct investment. As was stated earlier, Russia’s foreign direct investment share as a percentage of GDP is rather low. Why would you want to encourage foreign direct investment? If you want to encourage exports, we think it is important these days to be involved in international production sharing networks, such as who makes components for cars that are assembled maybe in Japan or in the United States but the components are produced all over. The International Trade Commission, who will be here later, is focusing a good deal on this issue. I leave it to Mr Sok to elaborate. I think it is important to be involved in production sharing networks.

We also believe that efficient business services are crucial to manufacturing productivity, good telecommunications, banking, insurance and transportation services. These services lower the cost of doing business. If you have good services, that lowers the cost of manufacturing production and allows you to export more effectively. Often the way to get good competition and good services is to lower your barriers against foreign direct investment in business services. So business services and foreign direct investment is a crucial area where foreign direct investment can help manufacturing exports.

Trade facilitation is another area where we believe it is important to do work to promote exports. This includes improving transportation facilities and improving customs procedures. These are not policy things that you can right at the stroke of a pen; they typically involve projects. There is presently a World Bank/Russia project on customs modernisation. It is important to have good trade facilitation if you are going to be involved in production sharing agreements.

I have been talking only about trade policy. Sometimes we refer to trade policy as necessary but not sufficient for economic development. There are important complementary policies that a country needs to develop to have a successful export development and development generally. Of course, macro stability is key. We also emphasise a neutral, transparent regulatory and tax regime that is neither pervasive nor costly. If your businessmen are worried that different agents, either official government agents or unofficial agents, are going to come to them and extract payments, that raises the cost of doing business considerably; it makes things very uncertain and it will reduce the level of productivity, production and growth.

I could go on a good bit with other policies, but I think I have run out of time, I will reserve any further comments to the question and answer period.

Summary of the discussion:

**Question:** I have two questions related to particular instruments to be used in trade policy. The first is to do with the experience of South Korea. You mentioned that this country has implemented system of indirect duty drawbacks. You can probably provide some details of this system to show the particular instruments used and why this experience is not repeatable in any other country that does not have this efficient bureaucratic system.

The second question has to do with the problem of export promotion and/or the problem of providing equal conditions for export and import competing industries. The basic idea of extra promotion recipes is, in fact, about how to create a positive environment and to develop and use comparative advantages to the country over the years. In Russia, it seems to me that the question is much more complicated. We do know our natural comparative advantages and they pose some serious problems for Russian exports because of this over dependence on oil and energy exports. The problem is how to shift from exporting one specific sort of commodity to finding alterative niches which are also based on natural comparative advantages but provide some diversification of exports. What instruments can be used to shift these?

**Speaker:** I will take the first question first, which is actually related to your second question. I am sure that some people are not familiar with what duty drawback means. Let us say your country is exporting automobiles or you are a producer of automobiles and you want to export
them. You import some steel and pay a tariff on that steel of, let us say, 10 per cent on the production of the automobile. With duty drawback you can go to the ministry of finance typically, or some ministry, and if there is one ton of steel in your automobile, let us say, then you get a rebate for the tariff that you paid when you can document that you exported the automobile. That is duty drawback.

In many developing countries what happens is that the exporter goes to the ministry, presents the documentation but does not get the money, or gets the money much later, or with some negotiations which potentially involve bribes. At any rate, in practice, the system does not work in many countries. Exporters then do not find it in their interests to use the system. That is duty drawback.

Indirect duty drawback is even more complicated. Let us say you are a steel producer in this country; you sell your steel to an automobile producer. The automobile producer exports automobiles. You as a steel producer do not export anything; you only sell to the automobile producer, but you import coal and you pay a tariff on coal. The question is: how much coal is involved in the export of the automobile? That is indirect drawback. With indirect duty drawback, you as the steel producer can go to the ministry and say, “a certain number of automobiles were produced with my steel and I paid this amount of tariff on the coal embodied in the automobile export”. It is a very complicated system with complicated coefficients and so forth. South Korea made indirect duty drawback work when most developing countries could not make regular duty drawback work. It is quite impressive that they could do that.

As I said, I think it is worth examining whether such instruments as duty drawback, temporary admission and export processing zones are worth implementing in Russia. To my knowledge, and somebody here can correct me, such instruments are not in place, or at least not being used. It could be that they are in place and exporters do not find it in their interests to use them because of the problems I have addressed. To my knowledge, they are not actually in place. It might be worth considering whether these should be implemented. We certainly have no objection in principle; on the contrary, the World Bank has loans in different parts of the world to put these in place.

Going on to your next question, and there is the issue of non-traditional exports, everybody is concerned about how you expand non-traditional exports in Russia. Some of the instruments that we have just mentioned may help to the extent that exporters have to pay for tariffs on intermediate imports. We know, going back to the World Bank volume in 1991, that we have no examples of export miracles where exporters had to pay tariffs on intermediate inputs. There is an issue either because it is free trade or you have duty drawback working,

Then there is the question of production sharing arrangements and how easy it is to have foreign direct investment coming in; how easy is it to get the goods in and out of the country. The trade facilitation questions are important for Russia.

I do not think there is a magic bullet that is going to expand on traditional exports in Russia. I think there is a complicated series of mechanisms that one needs to work on with this problem. I do think we could do a lot more to expand traditional exports in Russia.

**Question:** From your initial discussion of the great miracle countries, I was wondering whether you think that trade policies are actually all that important in explaining the great miracle. You went through all these countries with the different policies and they all do well. Are there other factors? You emphasised non-corrupt bureaucracies. If you have a non-corrupt bureaucracy, does it really matter what sort of trade policy you find?

**Speaker:** They all had very rapid growth of exports. You take somebody, for example Danny Roderick, who is very critical of typical conventional type trade analysis but he emphasises the importance of rapid export growth. We know, from both experience and from theory, that if you set up a regime where the incentives are to produce for the domestic market and not for exports,
then you will not export. These countries all managed to set up incentives so that the incentives were there for exporting.

I think I agree with you to the extent that there are other policies which are very important that are outside of the trade area. There are a lot of ways to mess up the development of a country. We emphasise that trade policies are necessary but not sufficient.

**Question:** This is a question about the message that it seems to be said that import tariffs are the equivalent to export tax and they provide a lead to this anti-export bias. We can put it the other way round: export tax also works as an import tariff. So, even if Russia has free trade agreements with every country, the existence of an export tariff on the major part of Russian exports will still act like an import tariff because of the relative price changes. What is your opinion on whether Russia should think about changing the tax burden on industry from trade instruments to domestic instruments, to domestic tax, production tax and so on?

**Speaker:** In general, yes. With respect to natural gas, as I mentioned earlier, I think that is an exception because Russia has very substantial market power in natural gas and I do not believe it is in Russia’s interest to have free trade in natural gas. As a tax instrument, I agree that in general on items where there is not substantial market power – and I think that is almost everything else – you could have a neutral tax so that it applies to exports but also domestic sales. That would be a more efficient tax simply from a fiscal perspective; that is, the marginal excess burden of the tax would be smaller.

**Comment by Mr Jara:** I just briefly want to confirm one thing about duty drawbacks, at least in the experience of Chile. First of all, they are an administrative nightmare. You need so many people and so much information and databases, etc. When you take into account the cost of that administration and the benefits, you start to wonder whether it is all worthwhile as opposed to having a low tax or no tax.

Secondly, even with a highly efficient administration, small and medium enterprises, as a rule, would not be in a position to take advantage of the system because it requires a lot of paperwork and a lot of people and they simply will say “I will forego this benefit because this is much too costly to me”. If I am not mistaken, Korea was able to set up this sophisticated system because for each product they made a calculation that normally so much of it was imported and, therefore, they broke down each component as to how much tariff was imposed. For each product they had this coefficient. That immediately disappears once, for example, Korea signs a free trade agreement because then they do not know whether the imported component comes from a country with which it has a free trade agreement that has paid no duty. If you are returning an import duty which has not been paid, that immediately becomes an export subsidy. I do not know if Korea maintains the system today but in Korea the system is doomed.

**Comment by Ms Balandina:** I would like to clarify how similar mechanisms work in Russia and what we plan to do in this area in the near future. It is true that in Russia we do not have a regime similar to the drawback regime. This was a conscious decision made at a certain time because we knew that a corrupt bureaucracy would not be able to administer this properly. However, there are other regimes and one of them is a processing regime; in other words, processing within a territory, a certain customs regime, which means that you can import certain commodities without paying duty if these commodities are used to manufacture something which is then exported.

However, I have to tell you that this regime in Russia, although it has been in existence for over 13 years, is not widely used. Why is that? Two-thirds of all the cases when processing customs regime is used are in the production of aluminum. In other words, aluminum constitutes two-

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19 Deputy Director General of the World Trade Organization, former Chilean Ambassador to the WTO.
20 Director of the Department of Regulation of International Economic Relationships, Ministry of Economy of Russia.
thirds of the volume of exported goods which were produced under the processing customs regime, i.e. from raw materials imported free of import customs duty.

The processing customs regime is also used in light industry, textiles and so on. This regime is used to effect repairs of items such as aircraft, ships, railway carriages and railway stock in cases where Russian or Soviet goods or parts were exported and then brought back to be repaired in Russian manufacturing facilities. Aircraft and shipbuilding industries do not use this regime widely.

Why is the processing regime still rarely used? There are several reasons. The key reason is that Russia, appears to not need additional raw materials, which is not true at all.

Russia also inherited from the Soviet Union certain systems and economic contacts and links with its former republics. When we produce something in cooperation with companies in Ukraine, Belarus, Kazakhstan and so on, we have free trade zones with these countries and commodities that are brought in from these countries can be imported without paying duty or at zero duty. The regime you described as working in South Korea works in a way in Russia, which means it is not duty drawback but rather a duty holiday or abolition or non-payment of duty. Officially, the duty is cancelled for a certain list of commodities in industries where they are widely used.

Secondly, for this regime to be useful, we apply this regime for newly created free trade economic zones or special economic zones. Everything that is imported to be used in these zones will be imported duty free. The products manufactured in these zones can be exported and manufacturers will not have to pay import duties on the commodities and goods they import. I cannot report on the effectiveness of this mechanism or this instrument of special economic zones, because they are not working yet. Not one of them is fully functioning now.

Speaker: I appreciate that clarification. I would just comment that it may be worth investigating further, to the extent that you were saying that such mechanisms exist but may not be used, why they are not being used and if they can be made more effective. Thank you for the clarification about the special economic zones.

Question: David, you have monitored in a professional capacity the development of the Russian trade policy for quite a while. I would like to ask you what is perhaps quite a sensitive, but not a simple, question. I ask you as a professional in this area.

We talk a lot about horizontal instruments of trade policy which could be used in the development of trade policy, Russian trade policy for instance. However, at the same time we have not spoken a lot about the geographical aspects of Russian trade policy. In your presentation you briefly touched on the differential agreements and said that they could be useful and significant instruments or tools to raise national competitiveness, especially with highly developed countries. However, it would be useful to hear your views in more detail.

The problem is that every country, as the international experience suggests, decides on certain key partners. It defines certain key partners for itself. It is not possible to have highly developed and deeply developed relationships with every country in the world. That is just not possible. A country has to set certain priorities, a list of priorities. It would be logical to suggest that the first priority for a country might be the differential agreement with trade partners.

In this case, Russia could look at the possibility of concluding free trade agreements and customs alliance agreements. A customs alliance agreement is quite a clear instrument and politically it is now clear that there will be a sort of free trade zone in the former USSR territories from a bit of inertia by two, three or however many partners. That is on the customs alliance agreements. We do not have such clarity for free trade agreements, but we need to develop this policy in relation to free trade agreements because the time has come to do something about that. Of course, we know that some counties that joined the World Trade Organization have intensified their activities in the area of free trade agreements. For instance, the United States, Canada and the European Union have tens of FTAs with various regions of the world.
What, in your opinion, should Russia’s approach be to this very sensitive issue? Are there widely used and accepted criteria which you see or which we should, from the geographical point of view, be taking into account when talking about free trade economic zones? Who, in your opinion, should be our priority key partners and how many such partners could a country have?

**Speaker:** This is obviously a crucial question. However, it is not one that can be answered briefly and in the time we have for this session. I would be more than pleased to talk with you about this further. I do have a paper regarding free trade agreements versus customs unions within the Commonwealth of Independent States (CIS). The bottom line conclusion on that is that I do not believe customs unions are a good idea for Russia or for countries in the CIS, but free trade agreements are acceptable. I do think it is important to think about the technology involved in your partner countries. This tends to suggest that agreements with the European Union or the United States might have more to offer, at least from that aspect. This is a complicated question and requires much further analysis.

**Strategies for export promotion and diversification**

*Sok Siphana* 21

First, may I say that, like Alejandro Jara, I am not an economist; I am a lawyer like him, so do not ask me a lot of economic questions. There are many economists in this room.

My presentation will probably be quite different from most of the others here. You are the economists, the architects. You will see this presentation more from the perspective of a plumber, electrician or bricklayer. That is how we perceive our case anyway. You will find out later. I want to throw out a few ideas.

You can see that 71 per cent of your exports are in energy products for non-CIS countries and nearly 50 per cent for CIS countries. The powerful role of Moscow covers about 25 per cent of Russian exports.

I am throwing out a few statistics to set the stage. Russia has a high dependence on export commodities. I do not have to go through the economic explanation for that. We see that because of that there is a tremendous need for Russia to look at trade diversification, particularly for small and medium size enterprises (SMEs). That is what I am mainly going to cover.

You know that you are about to join the WTO. I myself was involved in my small country, Cambodia, in the accession. We managed to get in. It is not easy and it is painful, but it is worth the effort. The challenge for Russia is probably the same: it will be painful but it will be worth it.

Why do I say it is painful? The challenge for Russia is that once you enter, you are going to have to show your people later on, two, three or four years later, whether or not your accession to WTO has brought benefits to your economy and the small people. That is probably the biggest challenge. That is where there is a need to diversify. Diversify means that you have to think not just of multinationals. The multinationals do not need us here. They are too powerful and they have everything that they can handle in their own areas. The problem is that the people who need all the policy makers in this room most are probably the SMEs. To give you an idea, there is lot of red tape that those poor SMEs have to go through if they really want to export. When I say SME, I am not talking about mom and pop, but a decent size, say a 300-employee company.

I am trying to minimise the details here as much as possible because there is so much work that needs to be done. You have to understand what is happening in the world market to develop your own export strategy and gear up for exports. Then you have to think about marketing. Ultimately, you have to get your product to the market. So, you see, it is not the country that is competing; it is the company that is competing.

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21 Director, Division of Technical Cooperation, International Trade Center, Geneva.
It comes down to diversification. Which way are you going to go? There are a few ways to diversify. You can have vertical integration where you expand production and services up and down the current value chain. Later on I will mention more about the value chain. You can go horizontally into one or more industries, or you can have geographical diversification and move into new territory. Diversification policies have had mixed results. There are some good results and there are also some negative results.

How can ITC improve the results of export growth and diversification if we work with Russia? We can work with Russia to help identify what the realistic market opportunities are for diversification and investment and to have greater value added. We can work with your stakeholder to design a development strategy working with the policy makers as well. We can support the policy makers by providing a lot of data and statistical analyses.

It is important that you know who we are. I thought I was the only person from ITC here but this morning I heard that there are representatives from ITC Washington. Everybody knows the WTO. People know about UNCTAD but not many people know about ITC. I do not know who is the father and who is the mother but we are the son of the WTO and UNCTAD. We are their joint technical cooperation agency for business aspects of trade development.

This is interesting because we are half UN and half WTO. We have a very specialised mandate on technical assistance. In fact, our clients are mostly from the private sector. This is an interesting mandate. At the 6th WTO Ministerial Conference in Hong Kong, trade ministers managed to introduce one paragraph in our favour. I like it and it is not all the time you get a paragraph in a ministerial declaration about your agency. This shows the role that we can play on the practical side of the trade dimension and trade development. We all hear about trade policy — and that is great — but ultimately trade policy alone without the products for export will get you nowhere.

We are working with the country at three different levels: at the macro level we support policy makers in integrating the business sector into the global economy; at the mezzo level we work with your federations of industry, trade support networks and promotion agencies to develop the trade sector; and at the micro level we work with the real enterprises to help them strengthen their competitiveness.

We have some tools and products which I want to highlight here which you will find of great relevance. The most interesting thing is probably our database – what we call the market access map. The WTO Director General, Pascal Lamy, considers that the ITC's database is probably the most user-friendly and, in Geneva, WTO and UNCTAD have used our trade database as the basis for their official trade database. The challenge is to work with the International Monetary Fund (IMF) and the World Bank to consolidate and have only one trade database.

Why do we have this trade database on market access? It is about transparency. I can show you a country agreement here to give you an idea that different arrangements call for different rates, different tariffs and different structures. It is not that bad. Do not worry about it. What I like most is probably the European preferential agreement. This is for all the countries in the world. Find Russia in that.

For those who are members of the WTO and have a most favoured nation (MFN), here you are. If you happen to be a member of the WTO and benefit from the Generalized System of Preferences (GSP), that is another arrangement. There are only two so far. But if you happen also to be a less developed country (LDC), that is another tariff line. If you are also a member of the Africa, Caribbean and Pacific states (ACP), that is another tariff line. Imagine four forms so far. Imagine this poor SME trying to figure out what form to use when he goes to a trade conference to meet with the customer. Then they have the European Collaboration in Measurement Standards (EUROMET), another arrangement, and then the Central American Common Market (CACM). For those countries fighting drugs, there is another preference. Then you have the rich countries that have another preference. There is a very rich country, Switzerland. That is where I work. Then of course you have those that do not have anything.
Just imagine if your company with a good product tries to navigate all this. If you have an order on the internet from a country placing an order for 15 containers of your product, there are at least 15 forms to fill in. Good luck.

This tool became very friendly. We have managed to get the United States Agency for International Development (USAID) to pay for all the LDCs to have access to this database for free. For a rich country like Russia, you have to pay something – not a lot, but something. It will not make you broke. Just to give you an idea, you can actually select an exporting country and a product and then you can run a tariff and you will find out what the tariffs are all about. In fact, the World Economic Forum has used our database as the basis for their global competitiveness report.

We also help at the macro level, the so-called public/private sector dialogue. This is interesting because since Cancún we have been able to bring about dialogue. The WTO has been very much involved lately in bringing together the various chairman of the different negotiations (agriculture and Non-agricultural Market Access negotiations (NAMA)). We bring in the private sector and academia and then we have a dialogue, and that helps to shape a lot of these negotiating positions. Since Cancún and Hong Kong, we have been shaping the private sector/government dialogue.

As for the development of an export strategy, somehow I think that my session would be more relevant tomorrow because there will be a lot of discussion tomorrow relating to what I am covering now. The ITC would claim that we have the competitive edge in the area of helping a country develop a national export strategy. Last year, we finished with Romania. The government of Romania have adopted the national export strategy and are implementing it.

The trade map is another database which over 50 countries have used. This gives you an idea. Unfortunately, we only use three languages because translation is so expensive. I do not know when this will be done in Russian. So far, you have to use English, French or Spanish. Here again you can go and look at the country and the region and you can even go to the six digit level for various products: country, value, quantity, global market share, growth rate, tariff and non-tariff. It is all there. What you need is to get somebody who loves numbers and let him sit down and do all the research for you. Lawyers are very bad at numbers. They do not like numbers. The only time they love numbers is when they come to the billing! I do not like numbers but I have to deal with them.

In Pakistan, they have to find out what is their tariff and non-tariff barrier. When you come to the export business, you find that sometimes the tariff is the easy part to find out; it is the non-tariff barrier that is so difficult to find out. We have that information in our database.

We are now working with UNCTAD to develop the investment map or something similar so that you can identify and target your industry for investment. For inward foreign direct investment, you can also look at the share of the world market, the imports. In other words, it is quite complex but very easy to use.

We have quite a good magazine written in plain English, Spanish and French explaining how trade works. We have about 100,000 to 200,000 hits per month. I suggest that when you have a chance, check our website and become inspired.

Another thing that we work on quite a bit is helping countries particularly with company enterprises and understanding standards and quality management. It boils down to this: you could have a nice European wine at lunch. You think it is easy but try to export another product to a European Community and see if you can meet the Sanitary and Phytosanitary Measures and Technical Barriers to Trade (SPS and TBT) requirements.

Look at what is happening in the Philippine fishing industry. In fact, 18 months ago we were asked to help them. The Philippine fishing industry employs about 1.5 million people. Because of changes in the EU SPS regulations, they were not able to meet them. That meant they were
almost disqualified from exporting their fisheries products to the EU. We were asked to help. It is all right now, but imagine a whole industry of 1.5 million people going out of business just because of SPS and TBT. It is as simple as that. One three page regulation written by some good trade lawyer could put 1.5 million people into hunger and poverty.

We have another interesting programme on export-led poverty reduction. You might say that we are talking about Russia here, not to an LDC. It is interesting how the two most successful cases that we have had are in India where we help the farming community to produce spices. Getting the poor into trade is not easy but here we have been able to find a methodology to harness the potentials of the poor and build a critical mass and export.

In Brazil, we are working on what is called community based tourism, getting the community to feed into the resort. Last month, we signed a memorandum of understanding (MOU) with the Association of Tourism in Brazil to cover 200 kilometres of coastline for the next 10 years using the community based tourism approach. Accord Hotels have engaged us to write a manual so that all their hotel managers worldwide use this approach. That is how they can justify their corporate social responsibility. That is interesting.

It is interesting but the difficulty lies in getting a product to the market and going through all that stuff. If one link in the chain is broken, forget it; your product will never make it to the market. Here again, we have good supply chain management. We go to difficult countries and get the universities and the national institutes to train people on an official course and we certify them so that companies can hire people who have graduated in supply chain management. I think ITC has enough tools and service and programmes to cover every sector in the economy.

Our involvement with Russia has gone on for quite a while but it is not extensive. We are currently working with the Moscow base export and investment promotion agency (MEXI). We help the agency in developing their blueprint.

We are also involved in the region of Kazakhstan on development projects and trade strategies and in Romania in organic agriculture. We help Ukraine with IT in the pharmaceutical industry.

How do we look at helping strategy, design and implementation? What you see is a whole international value chain. At different stages there is a different dimension of competitiveness. At the enterprise level, it is within their control but when you get out of that control, it becomes your control. That is, how do you get a sector that is environmentally conducive? We have two other tools we find are good: benchmarking and trade competitiveness assessment. We benchmark your country versus another country along various production factors. Then we look at the export potential assessment. You have a lot of products but which ones have export potential? Is it diamonds, gold or whatever? Here again, we look at where the promising industries are based in the various indices.

For example, in China there is the cut flower industry. We went through the methodology and found that there is a tremendous opportunity in cut flowers for export to the European market and that is what we did. There is now a multi-million dollar industry in cut flowers. We also look at the shape of global trade. In hi-tech industry, we find that Russia’s aim is, in ten years, to increase their market share from what it is now, at less than 1 per cent, to 8 or 12 per cent. Moscow is leading the country on that.

Look at the information and communication technology (ICT) industry and at how much potential there is from raw materials all the way to ICT equipment. You are talking of an increase of US$ 5 billion in value to more than US$ 100 billion. You have to compete. India is not soft; they are quite strong. Assume that later on we have a chance to work together. This is what we did in Mongolia. Look at your export value and your market share. We also look at industry for Mongolia. We have various indices and then we look the performance of industry, at whether it is a champion or under-performing. We give you, the policy maker, a very good picture of where you should be heading.
We also have the local domestic supply conditions. The world market is great but if your supply conditions are not there, then you will not be competitive. The same thing applies with Vietnam. We are trying to help them to see which industries have a low potential, a medium potential and a high potential. Vietnam is quite strong in that.

Returning to Russia and the issue of crude oil, before coming here, we ran a quick assessment of which Russian products have the highest export performance index. We also looked at the products with the highest world market index and then the products with the highest export potential index. You can see clearly from the list what your chances are. We also have products with tariff disadvantage as compared to products with tariff advantage. We calculate which ones have potential.

We have a methodology on sector strategy that can help you, in particular working with your producer associations and manufacturing chambers, to develop the sector; in other words, from raw to finished products, such as leather to shoes. The lesson learnt is that you need to bring the private sector with you from the very beginning. They are the ones that will be doing the exporting and they will know more about the industry and be able to tell you what they need and what issues affect them.

Lastly, you need to do nation branding: the nation as a brand and then the nation has a brand. There are many new countries that have come in during the last ten years, 19 new countries. I challenge you whether you know any of their flags. Imagine a product is coming into some of these countries; how are these poor countries positioned? I do not know where you come from. That product may be made under that flag. This is what the Swiss did. They had the nation branding of Mountain. Italy and Brazil have branding. For the United States, we talk about Lady Liberty. When people think of the United States, they think about this. They think McDonalds. It is about branding. I am in London and so I have to say something about British branding. This is what British branding does. In other words, once you develop a product in a sector, you have the nation brand. People think you only have oil and gas to export.

**Summary of the discussion:**

**Comment by Mr Frontini:** I think it is even more complicated than you have presented it and could be slightly misleading. It could give the impression that since preferences regimes are so complicated, they are not used. We have done some research on that. The results of the research are pretty straightforward. Preferences are used and the utilisation rate is very high. It is close to 90 per cent of eligible trade, which means that enterprises in countries that are allowed to export to the EU under a preference system, do export in that way.

In fact, it is not so complicated to understand. There are many different regimes, but for one particular country there is one regime which is better than the others. It is easy for the exporters to know which regime is relevant to them. Of course the situation is not perfect. In some cases there are problems frequently linked to the rules of origin, which explains the 10 per cent of trade potentially eligible for preferences which is not entering the EU under preferential access.

**Comment and question from Mr Raiser:** The last part of your presentation, the half an hour that was condensed into three minutes, which I thought was the most interesting part, suggests that you can actually pick winners. I would be interested, in the context of having quite a fair number of World Bankers in the room, to solicit some response from the World Bankers. I could try to respond myself but I would be more interested to see what David Tarr has to say on how that chimes with empirical evidence on whether this kind of thing has worked. I would be interested to hear from you whether, in ITC's experience, you could name some success cases where, as a result of having analysed your competitive potential in the way that you presented it

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22 Head of Trade Analysis Unit, Directorate General for Trade, European Commission.
23 Lead Economist for Ukraine and former Country Manager for Uzbekistan, World Bank.
for Russia in the tables, you were then able to say “pick product X with a value of 4.5 and then establish a trade strategy that allows you to double exports in product X with an index to 4.5” so that your prediction was in fact the correct one. Maybe you want to start with that part of the evidence, but I would also be interested in the general reaction. It does tend to conflict with a lot of the things that we say.

Personally, to be honest, I do not have a position on this. I feel attracted to this because I am often asked the question and I do not have an answer.

Like anything, ultimately the number is the number. It gives you the occasion to have the potential. So many things depend on the country’s ability to organise the sector so that it can ultimately produce something to export competitively. In other words, when you see the number, it only gives you a head start. If you compare the global market, the share, with your domestic situation and use that to work on this particular sector in the right environment to export, if you actually do it, you can make it, but so many other variables kick in. You may have a good product but if the design is not there, how can you compete with the Italians, for example?

It is not an absolute that once your index is 4.8 that sector is going to make it. It depends on other factors. The biggest factor is probably how the government can make the environment for that particular sector conducive. The supply side, you see, is only one small part of the larger picture. If your trade facilitation is not handled properly, you may have the best product but if that product is stuck in a container for two weeks, although the price may be competitive, the poor company will end up receiving the bill for two weeks’ storage at the port; that may kill half of the profit. This is an indication that you are on the right track but it depends on many other things.

Comment and question from Mr Tarr:24 The devil is in the detail. We say it is not a good idea to pick winners. By the way, even a well known critic of the World Bank’s conventional policies such as Danny Rodrik in his paper on stylised facts says that you cannot pick winners. I think there is a consensus on this. The question is: what policies are you talking about? When we say you cannot pick winners, we mean you do not want to put big subsidies into any sector; you do not want the government to decide that this industry is good for the future and has potential, so we will put lots of subsidies into that or we will give it high protection. That is one type of policy which we generally think is a bad idea. On the other hand, these types of programmes that I take it Mr Sok is talking about are more issues of technical assistance essentially to some industries and encouraging general trade facilitation which is neutral across industries.

As you mention, if you cannot get your goods in and out, then that is going to hurt the particular industries to which you might be providing technical assistance. If you help trade facilitation measures for that industry, that will help other industries and their exports as well.

I would bring the question back to you: could you provide us some kinds of specifics on just what was done in some of these success stories?

Speaker: Offhand, I cannot do that. I can send you this because we work with many countries. I can ask my country manager to give you a list and you can go from there. Offhand, I do not have that information.

Question: You mentioned a number of databases which you collect. Are those free of charge? How can we access them?

Speaker: As we speak, we are currently negotiating with the World Bank so that they help us pay the cost and it becomes a public good. As we speak now, we have a licensing fee for the rich countries. I think Russia is rich with the price of oil. For example, for a country that is not rich we have some arrangement with USAID whereby they would pay the licensing fee. It is not

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24 Consultant and Former Lead Economist, World Bank.
outrageous at something like US$ 30,000 a year for the set up and US$ 5,000 every year to keep it going.

**Question:** This is another technical question. Do you have experience of working not with countries but, for example, with companies, industrial associations and private business? Can they address this so that you can prepare some advice for them or some competitiveness maps to serve as a source of competence for private business from developing countries, transition countries and so on?

**Speaker:** For the developing and least developed countries, we provide technical assistance. Our main clients are very much at the mezzo level of trade support institutions and trade promotion agencies. In that case, you can write a request; we will prepare a proposal and more than likely we will have a trust fund that will cover the cost. If it is a big programme, then we will find a donor because we are an implementing agency and we do not have money of our own. We have a trust fund whereby donors put in money and we can use that to provide technical assistance to developing countries.

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**The role and development of centres of trade policy and law and similar institutions in transition countries**

*Martina Philipson* 25

Good afternoon, ladies and gentlemen. I am very happy to be here on behalf of the Centre for Trade Policy and Law in Ottawa, Canada (CTPL Ottawa).

I will briefly go over the outline of my presentation and then I will go into more detail. First, I would like to explain what CTPL Ottawa’s mandate is and our role in Canadian trade policy making and then share our experience in the CIS of exporting the CTPL model to the CIS, some similarities and differences among the various centres which we have established, the role of these centres in domestic trade policy making and, in conclusion, I will explain why we think that this worked.

What is the Centre for Trade Policy and Law? It is essentially a non-governmental, non-profit think tank specialising in trade capacity building and institutional support services for public or private sector clients and international organisations. CTPL is the only institution in Canada that devotes itself entirely to the programmes of WTO, international trade and trade policy matters. We cover all the aspects of international trade. We can offer a unique blend of the academic, governmental and private sector experience. Why is that? We are physically based at Carleton University in Ottawa and we are officially affiliated to the Norman Paterson School of International Affairs at Carleton and the Faculty of Law at the University of Ottawa.

Our core expertise includes about ten full-time staff members and then we have about 30 associates available. This pool of expertise draws from not only academics but also from the senior negotiators of the various officials affiliated not only to the Departments of Foreign Affairs and International Trade but also the Department of Finance, Industry Canada, Agriculture and Agri-Food Canada, the Canada Customs and Revenue Agency and the Canadian International Trade Tribunal. Most of our associates and experts have published widely on the WTO and trade policy matters.

The mandate of CTPL Ottawa: CTPL was established by the Department of Foreign Affairs and International Trade (DFAIT) after the completion of the Free Trade Agreement (FTA) negotiations between the US and Canada in 1989. DFAIT clearly saw a need for more trained professionals in various aspects of international trade who would be able to handle the implementation of the provisions just negotiated during the FTA. CTPL’s mandate in 1989 was threefold: to promote greater public understanding of trade and investment policy issues; to foster independent analysis

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25 Program Director, CIS and Eastern Europe, Centre for Trade Policy and Law, Ottawa, Canada.
and research on trade policy and legal issues; and to encourage the development of trade policy professionals and practitioners around the globe.

However, after the completion of the Uruguay Round which promised technical assistance to the developing countries and transition economies in terms of implementation of the various WTO agreements, CTPL found itself refocusing its agenda. From a focus on domestic trade policies issues, we started to branch out into international trade. In the last ten years, CTPL has established a strong reputation, both domestically and internationally, as a professional development institute, research centre and training institute on various trade policy and trade law issues. We have implemented many trade-related technical assistance programmes all over the world. We have worked in south-eastern Asia, the Caribbean, Central and Latin America and Eastern Europe. We work with various donors, with CIDA (the Canadian International Development Agency) obviously being our biggest client. We work with the World Bank, the Department for International Development (DFID), the Organization of American States, the United Nations Development Programme (UNDP), the Intra-American Development Bank, Canadian federal governmental departments, business associations and private groups overseas as well.

In Canada, there are many players in trade policy making, trade negotiations and trade agreement implementation besides the government and the private sector. The Canadian academic community has been quite active in trade policy dialogue since the beginning of the GATT and WTO. There are many universities and research centres which participate in the development of trade policy and various negotiations.

As I have mentioned before, CTPL was established by the Canadian government initially as a sort of formal mechanism for consultations with business and the media on the impact of the FTA between the United States and Canada and later North American Free Trade Agreement (NAFTA). Although our mandate and activities have changed a bit over the course of time, we still continue to hold an important position in trade policy making as an advisory body to all levels of the Canadian government. We advise government on the legal and administrative implications of international trade rules, such as the current Doha Round negotiations. We provide analyses of various trade policy issues; we train public officials and business executives on trade issues, negotiation strategies and techniques. As I have mentioned, we act as a strategic advisor to the Canadian government at the domestic level.

In the last decade, we have refocused our agenda on international work. This was at a time when many countries in the CIS and Eastern Europe have embraced economic reforms, but they have been struggling with their implementation. Often, this has been due not to a lack of political will but because, as relative newcomers to the international trading system, these countries lacked the necessary practical experience and theoretical knowledge to make the most of opportunities afforded by the system. Countries like Canada, on the other hand, have vast and longstanding experience of the international trading system. One of our government’s policies is to see the CIS countries succeed in making a transition to the market economy.

CTPL has begun to work with the various donor agencies. We became an executive agency for a number of projects aimed at increasing participation of the CIS countries in the international trading system. We began projects in Russia, Georgia, Armenia, Azerbaijan and Ukraine, the first project being with Russia from 1996.

After working for a couple of years in the CIS countries, CTPL has realised that there were not too many sustainable results from the traditional methods, such as one week training for hundreds of local officials when two international experts flew in and flew out. They delivered an excellent workshop but then, when you asked these officials two months later what they had learnt, they barely remembered that there was a workshop. CTPL began to look for a new approach.

As a reflection of our discussion here earlier, I would like to mention that when we started, it was important to build some sort of a home institution that would be able to assess and analyse
policies domestically. Each country has its own experience and we, as Canadians, did not know for
instance, the Russian regulations and the Russian system as intimately as the Russians. Another
issue was the question of technical assistance. It is nice that the World Bank, CIDA and DFID are
spending so much money providing technical assistance to these countries but, in the end, when
the money runs out, what will be left there?

These were questions we were asking ourselves in trying to figure out how we could help in a
practical way the Russian, Ukrainian and Georgian governments. As part of various trade capacity
building projects in Eastern Europe and the CIS, one of the goals was the establishment of a local
indigenous CTPL that would serve initially as a focal point for technical expertise and capacity
building initiatives in international trade issues, and which would gradually become self-sustaining,
expert institutions left there, no matter what.

If the Canadian government’s policy was to change and there was no more technical assistance
provided to Russia, this institution would have experts able to take over from the Canadian
experts. We established three centres: the Centre for Trade Policy and Law Moscow in Russia, the
International CTPL in Georgia and the Centre for International Trade Development in Kiev.

Although we did help to establish these three institutions and we did provide funding at the
beginning, it was left to the local partners how they wanted to proceed. Such autonomy was
reflected in the official status and structure of each of these centres. Each institution has a
different legal standing, structure, physical location and role in domestic trade policy making. I will
quickly cover all three of them and then we will focus more on the Russian centre.

CTPL Georgia was initially launched as the initiative of the project I have mentioned between the
former Ministry of Trade and Foreign Economic Relations (MTFER) of Georgia and CTPL Ottawa.
In February 2002, this project was transferred into an independent, non-governmental
organisation and ICTPL Georgia was established and registered under Georgian legislation. It was
initially housed within the Ministry of Foreign Affairs (which took over the responsibilities of the
then dissolved MTFER) and supported fully by CIDA but, after registration and the new status,
ICTPL was moved to an independent location; it diversified its clientele and gradually began to
support itself.

ICTPL Georgia has a board of directors as a governing body. There is only one person on the
permanent staff and then five associates or experts working with ICTPL on an as-needed basis.
ICTPL has been advising the Georgian government during the Doha Round negotiations. For
instance, last year they prepared the strategy for the Georgian government for the Hong Kong
Ministerial which, unfortunately, was not used for various, mostly political reasons and Georgia
moved towards a completely different strategy.

ICTPL Georgia has been working with the various Georgian ministries and governmental agencies
on different issues, such as harmonisation of domestic legislation with WTO, existing export
possibilities, economic development in Georgia and so on.

ICTD (Centre for International Trade Development) in Kiev is a fairly new centre established only
15 months ago in September 2005. Basically, it is a think tank attached to the Department of
International Economics and Management at the Kiev National Economics University (KNEU). This
centre has been fully supported by KNEU and CTPL Ottawa.

So far, due to the short time of its existence, they have not really played any significant role in
domestic trade policy making yet, but we did a couple of activities with them, round tables and
they are now working with the Ukrainian State Department of Intellectual Property, the Ministry of
Finance, National Bank of Ukraine and the State Commission of Ukraine on Securities and Stock
Market. They deliver various training activities jointly with these governmental bodies. They also
work with a couple of private sector associations, such as the League of Insurance Companies and
Union of Entrepreneurs and Industrialists in Ukraine.
CTPL Moscow is an independent commercial organisation incorporated under Russian legislation by a group of Russian experts with vast experience of international trade since 1996. CTPL Moscow currently has about six people on the permanent staff and approximately four associates. The associates tend to change because again they are being used on an as-needed basis. CTPL Moscow is very much involved in domestic trade policy making. As some of you know, they participate very actively in Russia’s WTO accession. They drafted legislation related to Russia’s foreign trade and have also been advising the Russian government on various WTO accession and other international trade matters. CTPL Moscow is also heavily involved in providing consultations to private sector clients. They consult on various issues such as market access, safeguards and anti-dumping investigations. They are also involved in a public awareness campaign. For instance, they do regional seminars on the WTO and trade remedies for the private sector.

We do think that this approach has worked because the local autonomous centres have been established. They serve as a local point for expertise in international trade and they work, in case of Russia and Georgia, with domestic governments to provide advice on international trade issues. We think that there are a few factors that have contributed to the success. The first was finding the right partners and building personal relationships. At the beginning, we tried to engage people who were plugged into the government decision making process and who intimately knew the structure and how things worked domestically. They all had experience in both trade negotiations and trade policy formulations. They also agreed with our approach – they thought that the CTPL model was viable and were interested in that.

Secondly, there was the relevance to the trade policy agenda of the country’s government. There was definitely a link between the leadership strategy of the domestic government in trade policy and the successful establishment of the local CTPL.

We tried to establish a CTPL Ukraine in 2001. It did not work out because at that time the Ukraine government was not really prepared or interested seriously in negotiating its accession, although there was lots of rhetoric about the WTO accession being a priority. We revisited the issue once the time seemed to be more suitable in 2005.

Third, there was a focus on supporting a small group of local experts. As I mentioned previously, we were looking for a more non-traditional approach to trade capacity building. We have learnt that some of the usual approaches did not work that well. We were looking for a practical policy that was relevant and a politically sensitive approach to establish an institution that could be involved in Russian or other CIS countries’ trade policy making.

Then there was the relevance of the expertise transferred, the unique Canadian perspective and the mutually beneficial partnership. What is meant by the unique Canadian perspective is self-explanatory — Canada is a small, open and well developed economy with an international perspective. We do not have so-called baggage and very limited geo-political interest in this region. That is why we are trying to provide advice that is as independent as possible.

In conclusion, I hope I have demonstrated that these centres can play an important role in domestic trade policy making in Russia and the CIS. We believe that this model is applicable and extendable to the other regions as well. Currently, we are thinking about establishing CTPL Central America. We also helped establish a similar institution in Bangladesh.

Thank you for your attention. I will be happy to answer any questions if you have any later.

Summary of the discussion:

Question: I have some questions regarding the sustainability of the institutions that you have been working with. Are CTPL candidates still putting money into these institutions? Secondly, are you choosing marketability activities for the work and your collaboration such that once you stop putting money in, the work would be marketable independently? How do you prevent people from
going off and taking alternative jobs? Has that been a problem — jobs which might be more
lucrative?

**Speaker:** Thank you. To answer your first question about whether CTPL is still putting money
into these institutions, each of these centres is at a different stage now. For instance, we do not
put any money into ICTPL Georgia at all. We are funding CITD Kiev jointly with the Kiev National
Economics University because, as I mentioned before, they have only been in existence for 15
months and so they obviously need the support. With CTPL Moscow, we are not putting in any
money. They are completely responsible for their own overheads and expenses. Basically, we still
have phase three of a CIDA project in Russia and there are activities under this project where we
need Russian experts and so we have contracts with a few individuals. They work for us. We have
foreign consultants and Russians working up to eight days a month and we reimburse them but,
other than that, they are basically working on a self-financing basis.

To answer your second question, yes, we did try to provide marketable products and services
during our previous projects. For instance, ICTPL Georgia was developing products like databases
or business guides for the private sector and obviously we were trying to gear them towards the
private sector more than the government because the governments in these countries will not pay
for these services. They do not have the money and it is not customary to pay for the information.
That is what we are trying to do. May I add one thing? We have also tried to market these centres
as potential partners for other international donor projects. Obviously, that is a source of funding.
In the case of ICTPL Georgia, I think they are now working with USAID.

**Question:** What about the stability of employees? You train somebody during the time when you
are putting in money and then they might go to work somewhere else. Has that been a problem?

**Speaker:** It has not really been a problem because, as I said before, we have focused on very
small groups of people. I am talking about four or five individuals. We have made sure that it is
something in which they have an interest. Basically, it was a question of ownership; they felt they
owned the centre. We helped them to establish the centre but they registered it and incorporated
it and under the legislation they have taken care of everything. It is their business basically and
so, no, it has not brought problems so far.

There was some migration between the government and the centres because, as I mentioned in
my presentation, we picked those people on purpose from government; they knew the system.
Then they came to work for the centre. It has happened on a few occasions that they were asked
by the ministries to return and continue work because meanwhile they had become experts and
they were asked to work on trade policy.

**Comment by Mr. Chernyschev:** I have a short comment. In Russia, many of our trading
partners have been providing us with their technical assistance on the issues that we have been
discussing at today’s seminar. Experience tells us that not everything was ideal from the point of
view of that technical assistance. Those who were monitoring the situation closely will know what
I am talking about. At the same time, experience was being gained and we now have enough
experience to know what is the best practice and the best experience. In particular, I must
emphasise that CTPL Ottawa is one of the organisations that provided us with great assistance
and helped us to create a debate and introduce this instrument into Russian trade policy and
trade activities. It is accepted by Russian legislators and the business community. This instrument
will be used in the process of preparing Russia’s accession to the WTO and with other trade
decisions.

I think many will agree with me that we cannot afford to lose this resource. At the same time, we
need to amend it to introduce changes into it to reflect the changes that have happened in Russia
itself. We need to transform it from an instrument of technical assistance into one of dialogue in
the trade policy area where both sides would share the material consequences of such a dialogue.

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26 Director of External Economic Relations Department, Ministry of Economic Development and Trade, Russia.
In other words, the costs and the experts on both sides should be selected in an open and competitive fashion. The experts would participate in preparing the proposals for such a dialogue and those who form the trade policy of the country, including for foreign trade.

If we use such an approach, this resource will continue to be very useful and assist in establishing an even better understanding between Russia and our key partners. This would also help to forestall potential trade conflicts or other negative situations that might arise within our trading relationships with other countries.

**Question:** I have a question about settings for the transfer of knowledge, which is important to support this activity.

**Speaker:** As part of our projects in all the CIS countries, or at least in Ukraine and Russia, as I remember from the top of my head, it was about cooperation with the local universities where we have established courses in trade policy and commercial diplomacy. In Russia, we had two partner universities: the first was the State University of Management in Moscow where, if I am not mistaken, the course in trade policy and commercial diplomacy is still being taught as part of the regular MA programme. The second one is the Higher School of Economy or more precisely the Institute for Trade Policy. That course is also being taught at the Higher School of Economy. We have trained a number of people in Ottawa, Canada, who worked with us on the delivery and modification of this course for Russian students. Another university is the St. Petersburg State University where we have developed a Masters’ Programme in International Trade. Some of the students who have graduated from these courses are currently being employed in the Russian public administration.

**Capacity building and technical assistance for trade related institutions**

*Gianni Zanini*  

Good afternoon. I have a presentation that will briefly touch upon four separate topics. I want to present to you the findings of a survey done very recently by colleagues at the World Bank on the effectiveness and relevance of technical assistance offered to accession countries. Then I will talk briefly about a WTO study on effective participation in the global trading system (a volume including 45 case studies). The third section will be on aid for trade, which I thought might be relevant to Russia, not so much as a recipient but perhaps as a future contributor or donor to other countries. Finally, I will make some points drawn from an overview paper on improving the effectiveness of participation in trade negotiations.

The study covering accession needs is still a work in progress. It tries to assess if the technical assistance provided to countries in the accession process and those that have already acceded has met their needs. These were categorised as: domestic preparation, negotiating market access and the implementation of commitments. Most relevant to Russia at this stage is the last part on implementation. Three parts of legislative and institutional reform need to take place: compliance with WTO rules, specifically on tax treatment; trading rights, pricing policies and state trading enterprises where WTO members want to ensure that the national treatment provision is in fact respected; and finally obligations under current agreements, such as customs valuation, SPS, TBT and Trade-Related Investment Measures (TRIM).

The main finding from the survey and interviews with a number of officials from acceding countries is that consensus-building and awareness-raising have been over-emphasised. Moreover, appropriate technical assistance, timing and targeting are very important and, in some cases, that has not happened at the right time or even with the right targets. Multiple agencies offering technical assistance with poor coordination often create duplication and a burden on the recipient governments. The effectiveness of the assistance provided should also be monitored and

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27 Lead Economist, World Bank Institute.
evaluated better than it is at the moment. The survey found that it was relatively difficult to find good evaluations of these efforts.

Technical assistance beyond training is needed for compliance, especially in the areas of tax treatment, pricing policy and trading rights, which seem to have been under supplied with technical assistance. Building local researchers’ capacity to advise their governments in a sustainable way may have been under emphasised and should be promoted from the beginning. Another type of activity that was found to be very useful was the sharing of accession experiences among various countries. Finally, long-term institution building should be integrated into the technical assistance offered for accession and more technical assistance should focus on the implementation of obligations both during and after the accession process. It often happens that after accession technical assistance falls away.

Moving on to the study of country participation in the WTO and in general in the global trading system, a point highlighted in this collection of 45 case studies is that business and civil society are often sceptical about the benefits of accession and concerned about sovereignty. The implication, at odds with the previously mentioned study by the World Bank, is there is a major need for consensus building in accession countries.

Beyond accession, many of the case studies show that developing countries have often succeeded in protecting their interests through the dispute settlement mechanism: for instance, Costa Rica and Pakistan against the United States on textiles. Thailand brought a case on tuna that was resolved through the mediation of the Director General of the WTO, which also shows how the mediation process can actually help avoid a costly process of formal dispute litigation. South Korea also brought a successful case against the U.S. on its application of anti-dumping of television sets. Here too, however, there is a major need for capacity because the use of the dispute settlement poses a heavy burden for legal expertise on the country initiating the case. Also, there has to be capacity for the governments to work together with their industry associations to make or defend their cases.

Among the many trade barriers faced by developing countries, those related to food, health and safety standards are the most challenging. Here too the case studies of Indonesia and Malaysia point to large capacity needs for compliance certification, information and transparency. There are similarly large capacity needs in the area of intellectual property rights (IPRs), and especially when trying to maintain geographical indications or trade marks, as highlighted in the cases of Darjeeling tea for India and basmati rice for Pakistan.

Regarding services, the level of commitment by established developing country members of WTO is very low and thus the WTO study did not find a major capacity deficit (for instance, in the case of Barbados). That is not, however, the case for all countries and especially the acceding countries, for which there are major capacity needs for objective evaluation of impacts of reforms demanded by members and for effective regulatory institutions in telecom, banking, etc. Where such capacity was not available or was weak, as in Sri Lanka, the result was telecom cartels.

The key to successful management of participation in the WTO, according to this study, is for governments to inform and consult the private sector stakeholders which are vocal about their interests about WTO decisions or negotiations. Governments should be responsive to the demands of stakeholders for consideration of their interests. They should also solicit information from them about domestic and global markets. Beyond their interaction with lobbies, several governments are also proactive in informing and consulting with the broader private sector and civil society.

It must also be stressed that the capacity to obtain persistent, coordinated, effective inputs to policy makers and negotiators must be balanced by the capacity to evaluate and pursue national development priorities. The WTO study highlights the case of Nigeria, where blind responsiveness to domestic lobbies led to the continuation of import prohibitions that have not succeeded in supporting domestic production and clearly failed in their development objectives. It also
highlights how South Africa structured its anti-dumping regime to limit its capture by domestic producers, by balancing national development priorities against the interests of special groups.

The third area I wanted to highlight is related to aid for trade. There has been a major effort in the last year or so among multilateral development and trade institutions and some key donor countries to create an agreed framework to increase aid for trade. The main rationale is to counter under investment in trade reform, which is a public global good. In some cases, governments may not fully see the benefits of making certain reforms and aid for trade can help provide an additional incentive. Linking aid to trade reforms can also help counteract the negative macroeconomic impact of scaled-up aid or a surge in capital inflows.

A WTO task force worked in early 2006 to come up with such a framework. The main principles proposed by the task force are country ownership and selectivity in country management and coordination. Also, a focus on regional issues to strengthen the diagnosis of needs and a costing of regional projects was recommended. For the moment, the task force proposal covers LDCs and a few other IDA-only countries. It is unclear whether that will extend to middle income countries. However, even if it will, Russian participation in this scheme is likely to be more on the donor rather than the recipient side.

To touch briefly on what the IMF and World Bank are doing on trade, there has been scaled-up support to trade in country and regional growth agendas by the two institutions. The IMF has expanded its work in this area, with its trade integration mechanism, various diagnostic studies and policy dialogue. Its focus has been especially on the customs and the tax reform dimension of trade policy. The Bank has also expanded its research and advocacy work on the Doha development agenda. It has conducted diagnostic work in many countries, with more than thirty LDCs and many other non-LDC countries having benefited from a full diagnostic trade integration study. Lending for trade has increased dramatically to about US$ 1.6 billion in fiscal year 2006 (ending in June 2006) and more than 50 outstanding loans (or IDA credits). The bulk of the money is for trade related infrastructure, but some operations also support customs modernisation and compliance with international standards. Only a limited amount of lending is for trade policy reform.

In conclusion, I would like to mention the main steps for effective policy making and negotiations. The critical two are: analysis of the issues and consultations with stakeholders to frame the issues and build public support at home. We have heard about how best to analyse the issues already today and so these remarks will not dwell on this aspect. Consulting the stakeholders should include not just central government ministries but also sub-central authorities, affected enterprises, labour unions, NGOs with a policy stake, academics with an interest and academic experts.

The benefits of domestic consultation are that they can yield critical information on commercial policy and legal issues at home and abroad and they serve to identify the interests of the stakeholders and to manage better their involvement in the domestic political process. They also offer insights into the interests and views of their counterparts abroad, both for unilateral reform as well for negotiations. Similarly, it is useful to consult with some of the foreign counterparts and foreign associations and so on, both in the policymaking process as well as in preparation for negotiations. Such direct consultations provide valuable insights into foreign decision making processes. They may even provide insight into possible win-win solutions in the negotiations.

In policy reform as well as in negotiations, it is clearly very important to frame the issue at stake and to communicate it clearly. The country’s policy or negotiation objective should be set out in a statement approved by the political leadership, to facilitate the selling of proposed policy reforms or negotiating positions to the stakeholders. These objectives should be communicated clearly and often at meetings with stakeholders and at conferences, in documents, press releases and perhaps on the WTO side. An example of such consensus building activities is the training for
provincial academics and officials that the World Bank Institute has provided in the last two years in Russia, Central Asia and Vietnam.

Summary of the discussion:

**Question:** How important is it for small and medium businesses to be represented and for their voice to be heard in policy decision making? Is it enough for large enterprises to be represented? It is very difficult to find a way, especially in Russia, to channel the interests of small and medium businesses in the regions to the high authorities. How is such representation done in America, Europe and other countries?

**Speaker:** The way that small and medium enterprises are affected by domestic trade policy reforms or by negotiated trade agreements, both on the goods side and in service reform, is very different from the way major companies are affected, as the latter are much more familiar with the global marketplace. That is why hearing the voice of small and medium enterprises is important. In terms of how they organise and present their views, clearly it has to be done through a trade association. It cannot be done individually. Our speakers from the U.S., EU and Australia may be able to provide more information on this aspect.

**Comment by Mr. Rogowsky:** In the United States we would say it is a motherhood and apple pie issue. It is clear that yes, of course they have to be represented in the system. One interesting example is that when you look at the free trade agreements we negotiate, you can find concerns among small businesses that they are not being represented as well, or that there are certain openings for large service providers that are not also made for services dominated by small businesses. For example, construction is opened up but architectural services are not. Because trade policy is politics, they have to be in the system or else they will not get the same kind of attention and representation; that is just a simple fact of life. The question is how you do it.

I mention the ITACs earlier and these are industrial trade advisory committees. The question is whether the smaller businesses can get themselves represented effectively in the services committee, steel committee or agricultural committee and then be heard and heard by the negotiators.

The question is a complicated one of how you get your voice heard in a complicated, democratic process. Typically, that is done by effective trade associations in Washington. The National Association of Manufacturers is very effective but it is dominated by large businesses. The US Chamber of Commerce is a very effective stakeholder in trade policy that is more representative of small businesses. Then there is the American Independent Small Businesses Association, which is all small businesses, and it is very actively represented. You have to have organised, efficient, professional representation that takes your interests into the important decision making meetings. It is just a matter of getting yourself organised.

**Question:** We were mainly talking about trade research and policy advice, but there is an issue that presents a much broader challenge, as we have discovered in Russia. The education system in Russia is an important constraint on the policy process. At the moment, there are no trade and investment policy education programmes for students at Russian universities. There are some universities that train in that domain but the training programmes are outdated, in particular with regard to modern technical analysis of trade policies, where we lack sufficient teaching resources and well trained teachers to develop such training courses. From the perspective of the World Bank Institute, what types of international experience would improve training capacity at the university level and could that be applied in Russia to address this educational challenge?

**Speaker:** I should probably get back to you following this meeting with some information because our team in trade has not been very active in preparing or informing a full curriculum for

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28 Director of Operations, United States International Trade Commission.
universities. We have done it in China. That was an excellent experience. We have now virtually transferred, after seven years, most of the in-country training events that we are still sponsoring to local trainers who have gone through our events previously. We have worked with two or three universities. This has been a combined effort with joint work on the research side as well as work on the teaching side. My colleagues in other units in the World Bank Institute, such as in the governance unit, in public sector management and other areas, have had a deeper experience of working with one or two universities in a country to develop fully blown training programmes and curricula in their topics. Those experiences would probably be valuable and we shall share them with you after I return to my office.

I want to mention a constraint, however, in how helpful we can be in meeting this challenge. When we have tried to offer training of trainers trade courses in Russia, it has been difficult to find the funds to mount those fairly demanding courses. Nonetheless, we succeeded in delivering such courses during the last two years. We are, however, at the point where we cannot find the funds from the World Bank or from other donors to support further this programme, although I would agree with you on the importance of such efforts. This lack of funding probably reflects the fact that Russia is no longer considered by the international community a developing country in need of grant aid. WBI would wish to continue its involvement, but we probably would not be able to find the funds to support trade related capacity building programmes. Even the Bank’s country assistance is being phased out or is changing tack, being increasingly offered on a paid per service basis. This latter approach could be discussed further if there is any interest on the Russian government side.

Summary of international experiences and the relevance to Russia and the CIS

Erik Berglof

I will make a few remarks to summarise the discussion of the international experience and its relevance to Russia and the CIS. A large number of models and approaches to policy formulation have been presented during the conference. That has been useful. The discussion has, I believe unavoidably, oscillated between, on one hand, actual policies and, on the other, policy formulation. My remarks will focus on policy formulation.

My starting point is that the process of policy formulation is as important as the policy itself, and the way you formulate policy also affects how well you can implement the policy. If you have the right process, you are more likely to end up with a sensible policy and a policy that is actually implemented. This may seem obvious, but in practice process is often compromised.

What are the key attributes of a good policy formulation process? Looking at the different experiences you have described, inclusiveness often comes up. Trade policy covers a very broad set of instruments, affecting many different ministries; there is a need to have coherence across ministries. Involving relevant decision-makers early on is critical.

But inclusiveness extends beyond coordination between ministries and government agencies. Several people have emphasised the importance of ownership of the process and the final policy. The composition of the Russian delegation to this conference is interesting in this regard. The delegation includes not only officials from different ministries (both the finance ministry and several line ministry), but also representatives of a labour union, an industry organisation, academic institutes, NGOs and SMEs.

The composition of the delegation may not be typical of Russia, but whatever you say about policy formulation, there is no doubt that in some areas a shift has occurred. Compare, for example, the drafting of the Gref Reform Program in 2000, the program that came to shape policies of the first Putin Presidency, to what I had seen of policy formulation in the mid-1990s. In

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29 Chief Economist, European Bank for Reconstruction and Development.
the early years of Russia’s transition there was little structure and no serious attempt to establish local ownership. Foreign involvement was frequent and special interest often interfered.

The Gref Program, on the other hand, strove to be inclusive. I cannot count the number of people who, at the time, claimed to have been instrumental in drafting the program. It was important in itself that so many people felt they had contributed even though, in the end, only a handful had any noticeable impact on the text. This sense of inclusiveness was one of the achievements of the Gref Program. Unfortunately, this approach to policy making has not been generally adopted by the Russian government.

Many remarks also emphasised openness and transparency as important attributes of a successful process of trade formulation and implementation. Less explicit, but nevertheless evident from the examples, is the need to structure the process well and stick to that structure. Trade policy formulation is too often hijacked by special interests with an agenda to derail the discussion by focussing on issues that are not core to the process. Again, I see promise in the fact that this conference is being organised as part of a longer-term exercise to forge a sustainable trade policy.

A common feature of the more encouraging examples of policy formulation has been the use of evidence-based methodologies. Solid evidence is more likely to yield better policy, but also helps prevent capture. The observation from the US is that as much as 90 per cent of trade negotiations are within the administration. That might be true for policy formulation in general but it is particularly true for trade policy. Evidence is important not only in the formulation, but also in the implementation, of policy.

What came out particularly from the most developed and elaborate models presented at the conference were the resources needed to support a strong process of policy formulation. Take again the US model, namely the International Trade Committee, where some 150 people, including around 20 economists with PhDs from the best universities in the country, are involved. It is not hard to understand that some developing countries feel under resourced when they enter into trade negotiations with the United States.

This goes to something that Mikhail Dmitriev raised at the end: we take a lot of institutions for granted when we try to transfer these models. Consider again the Washington model with its very successful elite universities supplying people to academia but also supplying ministries and government agencies, in between you have many institutions that perhaps do not exist in the same way in other countries – the whole think tank community. There are many hundreds of think tanks in Washington. They, in turn, rely on these good universities and the turnover of government officials in administrations. It is not only about producing data but also about formulating questions, absorbing data, undertaking or understanding analysis based on these data and reacting to the evidence. All this requires sophisticated institutions and wealth of experience.

Then of course there is the point about how you get strength and sustainability of institutions. Not even an institution like the USITC is completely secure. Having worked with much weaker institutions in more contentious environments, I know that sustainability is not only about financial resources but about human capital. Again, we come back to the education system and how to build human capital over time. It is not just about having people in place when you need them, but also about creating structures that help them continue in their development. It is about independence – independence from special interests and political pressures – and how you can build true independence into the “constitutions” of these institutions.

I thought some of the first papers this morning that tried to take up very specific techniques, like the GCE technique that is commonly used, showed the strength of the techniques. But they also illustrated the limitations. When you try to use these techniques, you need to understand what you are doing. It is not only about trying to generate specific models but also about interpreting the results and knowing and understanding the weaknesses of these models as well as their
strengths. You gave examples yourself of things that were not captured in the model and it is not always easy to understand the implications of these omissions for the results and for policy.

You often need to rely on environments outside ministries. You can do this kind of modelling inside but it might be better to do it outside. In any case, you need to have skills inside to pose the interesting questions and you need to know the question you want answered. That should come from the policy process. In order to know what questions you can ask on these kinds of models, you need to understand them.

What does all this mean for Russia and the CIS? Can we transplant the models when you do not have all the institutions in place? I am sure the Russian delegation has drawn its own conclusions, but let me end by re-emphasising one point: We need to think in very broad terms when developing a trade policy framework. Thought needs to be given not only to the policy itself and the process of policy formulation, but also to the environment in which the policy is formulated and implemented. We need to consider how to develop universities, how to nurture think tanks, how to build structures inside ministries and how to educate the public. It is a daunting, but worthwhile, task.
Part III. Russian Institutional Capacity for Evidence-based Decision-making and a Strategy to Respond
The business case for a trade strategy for Russia

Daniel Bolschun

Good morning, ladies and gentlemen. I am with the EBRD, Trade Facilitation Programme. We are involved in day-to-day business with Russian banks and also with other banks of the countries of operations of the EBRD. Our main goal is easy to explain: we are covering the risks of those institutions in the countries of operations of the EBRD towards western European, the United States, Latin American and all other trade partners dealing with the countries of operations of the EBRD.

I will be talking about Russian banks and Russian traders from the point of view of day-to-day trade finance. Obviously the Russian foreign trade strategy will be immensely important for what will happen with the way the trade partners are cooperating with each other.

Like most of the bankers, I also have a wish list and I write down almost daily the kinds of intellectual challenges I want to avoid in the future – why it is important, for example, to have specific legislation in place in this country or another in order to be able to finance trade in goods more easily than is the case now.

There are currently 24 banks in our programme in Russia. These banks are financing local importers and local exporters. We see a lot of import of machinery and equipment. It was mentioned yesterday that the investment climate in Russia can be optimised. From the point of view of the import of equipment, if this climate is optimised and if it becomes more interesting or easier or faster or cheaper for the foreign exporters of machinery to develop this machinery in Russia, this will mean the transfer of know-how and a gradual increase of living standards, because the production currently coming from abroad will be produced locally. It means the creation of employment. If the trade strategy that is being discussed positively influences this part of trade, we will see a huge increase in imports.

It is standard practice for banks to try to structure transactions. If somebody is importing equipment, then the usual structure would mean that the goods produced are then sold and the income generated is used to pay for machinery and equipment.

The other side is when the local producer sells goods abroad. Until recently there was a complex matter with the repatriation and obligatory conversion of foreign currency denominated sales proceeds in Russia. The degree of the conversion of foreign-currency-denominated sales proceeds was decreasing slowly, from 100 per cent to 75 per cent to 50 per cent to 25 per cent, and now it is no more. Currently everybody involved in day-to-day trading and writing the agreements between exporters and importers are very happy because now they can omit some 15 pages from their loan agreements where it describes how this procedure is supposed to work with the local bank – when the sales proceeds are supposed to come to four different accounts, converted, reconverted and booked into the current account of the exporter, converted again to foreign currency and given back to the bank that is financing the exports activities of its client. This is something that everybody is very happy about. The cash flow is now moving five days faster than before. The banks are a little upset because they are losing out on commissions on the conversion and booking back and forth from one account to the other, but at the same time they are happy because their customers are happy. It is now easier and more conspicuous and more transparent for everybody.

Obviously, once the Russian rouble becomes a freely convertible currency that will be another immense step into a better future because that would mean that all of the accounting procedures in connection with having receivables denominated in foreign currency and adjusted on a daily basis for the exchange rate differences will go away.

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As a banker, I would obviously have on my wish list in one of the top positions this convertible rouble. At the moment we are contemplating legal documentation, and I am happy to say that, after almost five months, we are very close to finally reaching an agreement. We hope to start operations in Russian roubles, whereby we would be issuing guarantees for Russian banks in Russian roubles. We hope to offer the Russian banks financing in Russian roubles for pre-export and local distribution.

The future trade strategy for Russia is hoped to be defined in such a way that our operations are even further facilitated. Obviously, all the parties involved in our programme will be very much obliged.

At the same time, a few issues should be mentioned regarding the legislation in Russia. There are still a few trade finance products that we cannot apply, simply because they are not described to such an extent that it would make it possible for banks and traders to avoid writing all of the conditions which are not mentioned in the law into the agreements. Take, for example, a trade finance product such as factoring; it is currently mentioned in Russia under chapter 43 of the Civil Code as financing against the assignment of payment claims, whereby a claim in this context is hard to understand as an account receivable.

A number of issues that are clearly defined in German or Austrian legislation, for example, are not defined to the same extent in Russian legislation. For example, in relation to factoring, in order to avoid in court any disputes of interpretation of this or that particular piece of an agreement, they write down everything that might be unclear. Obviously, it is a huge intellectual challenge to foresee what can go wrong, aside from such obvious things as bankruptcy, fraudulent documents and loss of goods. Those are bankers and lawyers. They are very well qualified and they are doing really well because the agreements at the moment are up to 75 or 100 pages, which, in my humble opinion, is outrageous. Reading 100 pages in two different legal departments in two different countries and usually in two different languages, can result in the loss of transaction altogether.

At the same time, this is one of the aspects that is usually described as non-transparent. Some colleagues here in London do not finance Russian trade; they say it is not transparent. In fact it is not that it is not transparent; it is unclear in terms of context, where to look up certain things. The sources of information are either in Russian, which creates a difficulty; or, if they are in English they are not always comparable in terms of the contents to Western equivalents. For example, there is no Dun & Bradstreet in Russia. There is no agency that could be helping Western investors with information on whom they are trading with and whether or not the particular entity or person is creditworthy, as is done by Dun & Bradstreet, admittedly at a relatively high price. This is still something that many people use in the UK. Before you start trading with somebody, you look up his reputation and if he seems to be fine he can be considered.

I would very much hope that in Russia local legislation will be optimised, maybe jointly with the EBRD and the World Bank and maybe with some technical cooperation. EBRD lawyers have already had projects where they were advising local authorities in the countries of operations of the EBRD on issues in connection with legislation, and it might be useful here as well.

Coming back to the wish list: bonded warehouses are institutions where one can store goods and the goods can be sold while still in the warehouse, so it is not necessary to deliver something to the final recipient of the goods. At the moment there is just one bonded warehouse in the whole territory of the former Soviet Union, in Riga, which has software that registers the inflow and outflow of goods and creates specific conditions for trade in certain goods, for example cotton and other soft commodities. It allows a potential buyer, instead of going to Tajikistan or somewhere else, to go to Riga, which is much closer, get a sample of goods, consider whether or not to buy, and buy by means of paying to the warehouse and obtaining a special warehouse receipt.

It is a very well known instrument for facilitation of trade. It helps overcome distance. It saves time on transportation of complete consignments. One can send part of the consignment, but
does not need to send everything. If such an instrument were possible in Russia, it would help overcome the problem of the vast territories. It would probably help the regional traders gain access to the suppliers and buyers from countries in Western Europe. If there were a comparable bonded warehouse in Moscow, you would not need to go to Vladivostok to check the production.

In general, we have noticed that there is currently an oversupply situation in Moscow and St Petersburg, which is also reflected in the pricing of the banks, which is much lower than in the regional areas of Russia. Because of the tasks which we have in TFP but also for obvious reasons, if there is a saturated economy in one place, obviously to achieve a better profit, as a commercially orientated person, I would be going to the place where there are still high margins. It might be very useful to consider the regional component in defining the trade strategy for the Russia. For example, if Moscow is saturated by foreign direct investments, maybe it should be the Urals region that should be made more attractive for foreign investors.

One very important aspect of our programme is inter-regional trade, trade between the countries of operations of the EBRD, for example Russia/Kazakhstan. It is worth mentioning trade between Russia, Kazakhstan and Ukraine, in terms of volumes under our programme. It is growing constantly. We are witnessing growth in terms of volume and number of transactions and in terms of groups of goods. It started with grain and went on to machinery. One interesting development was that John Deere, an American producer of agricultural machinery, built a manufacturing facility in Orenburg. They are now selling these agricultural machines locally. It was a huge investment by John Deere and was probably rather risky, but it shows that it has been worthwhile. This is something that is also on my wish list. I would very much like to see such trade going on, because it is more economically viable than bringing goods from the United States to local offtakers in Kazakhstan or other neighbouring countries via Russia.

If these ideas, from the practical point of view, could be considered while defining future global strategy for trade between Russia and the rest of the world trade community, we would be most obliged. Thank you very much for your attention.

Summary of the discussion:

**Question**: Do we understand that the EBRD can finance Russian exports? Is this something you are doing or are you allowed to do it according to your mandate?

**Speaker**: Yes. We are currently financing exports from Russia, for example, to Ukraine. If a Ukrainian importer wishes to buy something from a Russian exporter and the Ukrainian bank is opening a letter of credit, and these risks are unacceptable to the Russian bank, the EBRD issues a guarantee so as to cover the risks of the Ukrainian bank towards the Russian bank. So, for the Russian bank it is a AAA risk, instead of the risk of the Ukrainian bank; and it is the other way round if the Russian exporter needs to pay export finance in terms of cash. If he contacts his bank and his bank is on our programme, we will be financing this export via the bank itself, whereby our risk will be with the bank that will be taking out the loan; and in the drawdown request the Bank will mention what sort of operations are being financed by this money, who the final borrower is, what the goods are and a few other details so that we can make sure it is acceptable to TFP’s conditions.

**Question**: You mentioned that companies, like here in the United Kingdom, are confronted by a lack of confirmed information about their business partners in Russia. Do you have a similar problem with banks here – for example, you have this partnership with Russian banks – have you in the past been dealing with this issue? If so, what kind of advice can you give to people, based on your own experience?

**Speaker**: We regularly check the transactions. I will be mentioning one side of this – imports to Russia. We have in place in the EBRD environmental requirements so we need to make certain that the recipient of goods, for example machinery which will be installed later on, perhaps
somewhere in the Urals, is actually installed in an enterprise that is not polluting the environment. If we look up the letter of credit and see that the recipient of goods is not familiar to us because it is a small or medium sized enterprise far away from Moscow, we call up the local bank and ask them about the enterprise. That results in us constantly communicating with Russian banks. If we still have doubts, or if the enterprise is telling us they do not have the most recent updated environmental report on that manufacturer, we would ask them to provide us with a copy of the certificate, scanned in and sent by e-mail, or faxed over, as operationally as fast as possible. To be on the safe side, the Bank will know the counterparty and know that the counterparty is compliant with local requirements. This is one of the issues.

If we see that the Russian corporate counterparty, not the bank, seems to be a trader or some other intermediary, we usually ask who it is. What we do not do is provide information of this kind to any potential interested parties from outside, because this is strictly confidential banking information.

We have been asked if there is a global register of Russian enterprises and if there is any source where Western sellers can check the creditworthiness of Russian enterprises. The answer to this from our side is no because we do not have any access to an information source where we could say that based on information provided from this source this enterprise is creditworthy. There is a registry where main Russian players are listed, but they are already listed on the New York Stock Exchange, so the information is readily available. It is the small and medium size enterprise sector that suffers from this most. If a factory has a turnover of US$ 5 million per year and they want to buy a piece of equipment, they have a hard time because they have to go in person abroad and present themselves in relation to all possible affairs, just to make certain that people trust the enterprise exists. I hope I have answered your question.

**Question:** Can you say a little more about the John Deere investment? I am intrigued as to why they did it; what support they had and what help they had from US or Russian institutions? What lessons might there be from the John Deere case that would help others interested in investing in Russia? That also made me curious about where the Russians are in relation to agreeing to government procurement requirements that might allow foreign companies to come in and compete in construction activity in Russia as well.

**Speaker:** John Deere is a fascinating project. John Deere used to direct operations in Europe from, among other places, Switzerland and were concluding agreements and then delivering goods from the United States or wherever they had their sites, but they were not in the former Soviet Union. Then they erected this manufacturing site in Russia. I am not very familiar with the details of this project because in our programme we do not facilitate investments, but we facilitate trade that is relatively short term. This was a greenfield operation, so they invested their know-how locally. It was a foreign direct investment in the best sense of the word. I can imagine that it was probably financed or supported somehow by the Export-Import Bank of the United States (US ExIm) because this project would definitely qualify for such financing. I am not very certain how it was done. I would do it via an export credit agency myself, but that is my opinion.

Currently they are doing well. They are selling their machinery in Russia. They chose their site very wisely, because southern regions of Russia are well known as agricultural areas; they grow wheat and the conditions there are good. John Deere went to the off-taker and built the facility right there.

If you travel to Russia you have access via the Caucasus to the southern countries of Georgia, Azerbaijan and Armenia. The other huge offtaker is more to the south west which is Ukraine and to the south east, Kazakhstan. This project is probably an example of how to do foreign direct investment.

In terms of foreign direct investment in Russia, unfortunately I have never been confronted with these sorts of investments. Before coming to the EBRD I worked for a few commercial banks that were involved in financing of the former Soviet Union on the corporate finance side and the
financial institutions area; but investments back then were a little bit complicated because usually
the banks were trying to shove off all the risks on to the supplier of the equipment. They tried to
make certain that the supply was being financed by his house bank, so he produces this
equipment, sells it to the Russian off-taker, makes certain that his know-how is transferred in
such a way that this machinery can be installed and tested and start producing and, from there
on, everybody hopes the production will be sold and the foreign-denominated sales proceeds will
be used to repay the supplier.

Back then, I was not involved in any financing running for longer than three years. We currently
have under TFP transactions for five years, but those are guarantees. This is not really cash
finance. Unfortunately, I cannot answer the second part of your question.

**Question:** I have a question in regard to trade facilitation issues. You have mentioned interesting
cases for setting up warehouses with samples of goods all across the former Soviet Union and it is
one of the ways to bring down trading costs. The issue was access to information on reliability of
investors’ counterparts. There must be a very long list of such trade facilitation techniques which,
as far as I understand it, are not very well known in Russia. Many of the current problems, I
suspect, are related to the indirect barriers created by a lack of understanding of which particular
business problems and costs may become the focus of targeted policy measures. If the policy
measures are reasonably well applied, the costs can go down dramatically.

Can we think of drawing up a list of such trade facilitation methods, which would be particularly
relevant to the Russian case, where the trade barriers are huge in all areas?

**Speaker:** I mentioned a wish list. I know it is not Christmas! The list is extensive. I mentioned
information deficits because, obviously, this is something we are confronted with on a daily basis
in our business. On our side we tried to provide training to local banks within the framework of
technical cooperation. We started with simple things like explaining how letters of credit work. We
asked for sponsors to provide donor funds. We procured consultants in accordance with the
procurement rules of the EBRD. Those consultants, because it turned out to be a number of
projects in various countries, were then sent to Russian banks and they each spent five days on
five visits during a period of one year, making certain that the local understanding of how trade
finance instruments work, being guarantees, standby letters of credit, letters of credit, bills of
exchange, bilateral financing and bank-to-bank, is transferred in terms of know-how to the
personnel of those banks where those consultants were.

Those missions were then complemented by seminars. Last year there were two seminars on
structured trade finance, which the consultants attended in Moscow – this time not individually to
touched banks. A seminar was organised at the premises of the World Bank in Moscow, in the
same building where the EBRD is also residing. Banks were invited to participate in a two day
seminar and further trade finance techniques, and instruments and structures were explained
again, including: structured trade finance with amortising structure of repayment of an amount
which was being received for purchasing a piece of equipment; export credit agency involvement,
for example US ExIm; operations with warehouse receipts, whereby the consultant was trying to
explain to the banks how they could structure those transactions while using this one bonded
warehouse in Riga, because there is none in Russia at the moment; and a few other matters.
Currently we are planning to organise factoring training and a seminar in factoring.

We started negotiations with the consultant, who is supposed to go to Russia and deliver training
on factoring to banks chosen from those participating in our programme, because those banks
qualify best for technical cooperation (TC). It is an internal requirement to report to the donors on
how the funds were appropriated. The best way to report to the donor is to say “this bank is our
counterparty on a daily basis; we decided to improve the operations; we are financing them; we
explained to them how the new product works; they started using this new product and made
such-and-such a transaction and the turnover was such-and-such”. There is a quantifiable result
of the appropriation of those TC funds.
I know that the International Finance Corporation (IFC) is currently also organising seminars of this nature. The tendency currently is to go to the regions and help regional banks to obtain such training from consultants, be it seminars or individual training of the banks, whereas the consultant is travelling back and forth through the country.

It takes time. It is not something that is, in my understanding, currently presented in the Russian financial academy and the Russian university, simply because there needs to be a continuous execution of such transactions by a number of players in order to create a practice, a commercial tradition. There were no commercial banks during the time of the Soviet Union. There was a two-tier bank system and those banks were not involved in this rather complex way of financing trade, but nowadays it is becoming more and more topical.

The best performing Russian banks are very familiar with how those trade structures can be operated and sold to their clients, and there is not much need there at the moment. Those banks also came to the limits, once they realised that whatever innovation they want to do, it is not defined by the local legislation. This is the natural limit for those banks to use new products, be it factoring for warehouse receipts, finance or other issues.

In terms of information, some banks have participated in twinning programmes, for example ING. Other banks are asking financial institutions, their partners in the West, to allow them to send a colleague from the trade finance department to Frankfurt or London and to stay there for five or seven days in order to learn how it is done. We tried to send as many consultants as possible to all the banks that are our partners. I would very much hope that maybe some day those instruments would be taught locally, maybe through the Russian banking association. We also plan to organise a conference.

Measures are therefore being taken to mitigate this lack of information. Unfortunately it takes time in terms of organisation, finding the funds and getting somebody there to deliver these learning events, be they a seminar or consultancy.

The need for a trade strategy for Russia

Mikhail Dmitriev 31

Dear colleagues, the purpose of my brief presentation is to talk to you about circumstances in which we find ourselves when we start working on our trade strategy. The work has been ongoing for quite a while. However, we have not been able to produce significant results. This is not accidental. The problem is that, in the process of this work, the authorities and other bodies found themselves faced with very considerable problems, which could not be solved in one big swoop. These problems require great efforts to sort them out in a reasonable period of time.

Before I define the key problems and challenges we have come across, some of which it would be very useful to discuss here during the rest of the time we have for our meetings, I would like to make a few comments on the background of this issue. Many of the problems we encounter today that occurred during the process of our strategic planning, have roots in the history of Russia and its foreign economic policy.

If we look at how the foreign economic policy was defined and implemented in the Soviet Union, we can see that it was outside the Council for Mutual Economic Assistance (ComEcon). The Soviet Union was not well integrated in the world economy at that time. The volume of trade was very limited.

At the same time, the Soviet Union was a global superpower and attempted to maintain its economic presence all over the world, which is not what we can say about Russia today. The Soviet Union was the leading country of the second largest economic bloc in the world and it was

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one of the largest creditors and borrowers in the world. The former USSR also had a very logical, effective, well designed and well constructed foreign economic strategy and relations. This policy was well supported by very powerful economic analyses and studies because all the foreign economic activities plans were based on the input-output models of Gosplan, the committee for economic planning in the former Soviet Union, and they took into account all the demands, the resources, the supplies and the whole sphere of foreign economic activity, which was subject to a very thorough annual analysis. It may have been a distorted policy, but it was relevant to the economic system that existed in the country at that time.

The authorities were also able to instruct any manufacturing facility or any enterprise in the country through the trade and economic institutions to produce what they wanted them to, to implement the strategy and the economic policy. It worked. It was consistent with the planned economy as a whole and it was rather effective in its own way.

When the Soviet Union collapsed, the Russian economy suddenly found itself faced with a huge number of domestic economic problems. The attention of the Russian authorities at the time had to switch focus from a foreign economic policy to domestic economic crises, the first economic reforms, economic instability and a dramatic worsening of the conditions that the population lived in at the time. Foreign economic policy was a secondary matter and not a priority.

During early transition the main priorities of foreign economic policy were foreign debt settlements and integration within the former Soviet Union. What Russia faced as a result of its heritage of the 1990s was that some of the key soviet foreign trade institutions like the centralised planning system were dismantled. With this system quantitative analysts, who based their estimates on the input-output models of Gosplan were also gone. During the 1990s, little new emerged to replace these missing links.

Thus, we had a transition model where the old institutions disappeared, but they were not replaced by new institutions. The new institutions in the nineties simply did not appear because it was not one of the priorities for the authorities.

In a highly simplified manner we could consider three different models of foreign economic policy models for Russia: the Soviet model, the Western model and the new Russian model. These models overlap in certain aspects. At the same time they are very different. The main difference between the new Russian model and the Soviet model is that we have huge institutional gaps. Today, Russia lacks a number of institutions which existed in the Soviet Union, for instance plans delivered and delegated to manufacturers. At the same time it does not have such market institutions as partnerships with businesses or the trade facilitation schemes that we talked about earlier.

As a result we have a model with huge gaps which politicians did not realise existed. The main gaps are the inconsistencies and lack of relationship between foreign, domestic and trade policy. The institutions that would implement decisions in domestic policies are very weak or absent.

In practice, we have little ability to quantify the economic decisions that are being made. We lack the necessary instruments and tools and the culture of interaction between the policy makers and the economists. The objective setting practices remain undeveloped. We have a huge spaghetti bowl of thousands of agreements between the countries of the former Soviet Union. We do not even have a register of those agreements. Over 20,000 such agreements were concluded in the last 15 years. Many of them contradict each other and the principles of market economy. Many of them have not been revised. Many of them have been forgotten and not been implemented.

Russia inherited from the Soviet Union a strong negotiating culture – trade diplomacy, procedures – and Russia has good potential in this area. However, the decisions that are being made are very difficult to implement because the mechanisms of managing the implementation process are lacking or very weak, especially due to the fact that the old system of foreign trade in Russia was based on the direct management of enterprises and manufacturers from the ministries. When this
system disappeared we found that we lacked mechanisms of interaction between the ministries, the authorities and the businesses.

Some businesses obviously – the big businesses especially – develop their own channels of communicating with the authorities and the ministries, but small and medium-sized enterprises do not have such channels. At the same time, most of their import and export goes through their small and medium-sized enterprises and trade and investment in this area are very difficult. There are huge barriers that Russia is not able to dismantle or overcome at the moment.

The Russian crisis of 1998 was partly the consequence of the 1990s, partly the contagion of the Asian crisis. The rouble was not devalued, although an attempt was made in 1997, and this was one of the mechanisms of the crisis of 1998. The Russian economic authorities at the time overlooked early warning signals of this crisis, mainly because they did not have the necessary analytical infrastructure to pay appropriate attention to and take into account trends in international trade.

Many changes have taken place since 1998. However, they were rather piecemeal. At the beginning of this decade the government did not have WTO accession as a priority. The process was started in 1993 but it was more or less suspended. Now it has been reactivated and we think we are in the final stage of negotiations for accession. We now have much more intensive cooperation with the EU and we have new initiatives on the territory of the former Soviet Union. We have customs alliances and other initiatives. Russia is now more active in terms of cooperating with OECD countries, it is represented in the OECD very extensively and better than any other non-member country, and it is now part of the G8.

We had a restructuring of the state foreign trade bodies and most of the foreign trade mandates are within one ministry, the Ministry of Economic Development and Trade. The idea was to overcome some of the barriers between international and domestic economic policies, which we inherited from the collapse of the Soviet Union.

Nevertheless, we have had very little progress in foreign trade performance. The Russian share in global trade is still going down; the Russian share of exports is not growing; and the share of manufacturing in Russian exports is not growing. Integration processes in the former Soviet Union are complex and very slow-moving. In fact, there is a lack of progress. Progress is happening, but the results are not clear and not dramatic.

Russia does not have answers to such challenges as reorientation of trade and investment from Europe to Asia. It does not have any clear policy response. Asia is becoming a huge trading power. Russia is not doing well in FDI. On the volume of FDI per head of population we are ahead of China; but they are mainly in the energy and commodities sector. Processing industries and manufacturing are lagging far behind. Russia needs foreign direct investment in these areas.

Russia needs to diversify economic risks. Many Russian companies must enter global markets, not as exporters but as investors. It means that the Russian companies need to become transnational, as are their counterparts in China, India and other developing countries.

Russia is facing many challenges but we have no clear strategic policy response for them. We have a huge list of problems. We also have big institutional gaps that are still not filled in Russia and which are preventing the government from solving the existing problems effectively. That is why we need to develop a strategy and that is why we have this agenda to develop the strategy.

We need to leave behind the idea that the negotiating process in Russia is a target in itself. Winning negotiations does not mean that you are pursuing the best economic policy. We need to make sure that we can have good agreements and can implement them. We need to leave behind the idea that the negotiating process is the be-all and end-all of foreign economic relations. We are still unable to negotiate the dismantling of international economic barriers. Daniel Bolschun was talking about them, but there are more than have been mentioned here. The main enemy of
Russia in international trade is Russia itself. Internal barriers only exacerbate Russia’s problems in its trade in the international arena.

The problem of global challenges and risks is that foreign and domestic economic trade decision making to confront global and domestic challenges is not happening. It is very difficult for us at today’s level of analytical capacity to evaluate how we can estimate, evaluate and forecast the impact of the possible weakening of the US dollar’s role in global transactions, or how to meet the challenge of east and south-eastern Asia becoming a dominant economic force.

Russian economic policy is, again, still fragmented, although most of the decisions are made in one ministry. Institutions are another problem. For example, we have a dramatic shortage of analytical potential. There have been improvements recently. We worked on a 10-year Russian/Chinese trade programme and our analytical studies did much better than our Chinese counterparts. The Russian side was much more active. We offered various methods of evaluating the development of this programme and mutual trade. Our Chinese colleagues were unable to respond in a similar fashion. However, this is not a daily occurrence. We are not able to evaluate even key aspects of Russian trade policy with modern quantitative tools.

Another problem is the interaction between businesses and state authorities. We do not have good channels for communicating with small and medium size enterprises; only large companies have such channels of communications with state and government bodies.

What can a new economic strategy do? This was not a priority for a long time. We need to re-think the whole policy framework. The last six years have dramatically changed Russian export potential and investment potential. On the other hand, we have radical changes both inside Russia and in other countries in the world and these changes are not always fully taken into account in current foreign economic policy processes.

But before any foreign trade strategy is brought to the implementation phase, we need to develop some of the key institutions related to this policy area.

During the forthcoming discussion, I would like very much for our Russian colleagues from the various ministries and international experts to share their opinions on possible approaches to Russia’s new foreign economic strategy, taking into account all the problems we have faced in recent years. We would be particularly interested in your comments on those new questions which Russia needs to consider, but for which she has not yet developed any clear answers. I will name only some of these questions because many others will be mentioned later in detail.

Almost three-quarters of Russian trade is with European countries. At the same time, less than 5 per cent of incremental global value added based on PPP is produced by the EU. Two-thirds of incremental global value added on PPP basis is produced by non-OECD countries. Just about 50 percent incremental global value added on PPP basis is generated by fast growing Asian economies and these are the destinations, where still too little of Russia’s trade goes. If Russia wants to move her exports up the value-added chains, she should look for alternatives to the European market, which is slow growing and too difficult to penetrate.

Is Russia ready and willing to leave Europe and move up the value-added chains in other markets? For instance shall we export more to the North American market, which we do almost no trade with today; or shall we expand to Asia and Latin American markets?

Three-quarters of Russian trade is with Europe, in accordance with several scenarios of global economic development, one of which we developed ourselves in our centre. The European share of global GDP could go down to 20 per cent in the long run. At the same time, Europe and Asia together can reach 70 per cent of global GDP.

If Asia with time becomes dominant in global trade, European and Asian countries could consider a new Eurasian trade and economic architecture. Such a possibility may become very important for Russia because, in many respects, Russia is a link between Europe and Asia. For instance, we probably cover one-third of all Asian territory. Many communication lines and transport arteries go
through Russia. Apart from huge resources, we have about 50 per cent of all natural resources of Europe and Asia as a continent. Russia is the largest country, which has deep roots in Europe and Asia, perhaps equally. Russia always culturally communicated and learned from both, and is capable of having a productive dialogue with both Europe and Asia.

Is Russia prepared to take up these challenges and to integrate and help to create this huge economic power and market? We are unable to answer those questions today and, therefore, are unable to formulate our strategy for the medium-term, not to mention the long-term, future. Today, our strategy could be only a list of questions, which will have to be answered in sequence. But it is not a strategy by any reasonable standards. A strategy in Russia is viewed as a list of targets, goals and priorities and a list of methods to achieve those priorities and fulfil those targets and goals.

At the moment we cannot formulate a comprehensive list of our goals and priorities, at least in order to develop a clear algorithm for the next few years. If today we tried to make decisions in many of those spheres, by not having such answers and priorities we would find that we missed various priorities and did not take them into account and, therefore, we missed real opportunities. Experts who are working on our trade strategy at the moment think that the strategy should not be a strict inflexible algorithm. It should rather be a road map.

But still we need to move forward from just asking questions. We know that we have some of the answers. For other questions we know when approximately we can get the answers. For example, a road map would help us to formulate steps that would allow us in due time to understand what our integration with the EU should look like. A road map could also help us to see what steps we need to take in order to define Russia’s future role in the new Asian economic architecture or the long-term future of Russia as an energy exporter. In other words, we are talking about a road map as a new approach to formulating a strategy rather than determinism, which is more typical of Russia’s policy culture.

### An evidence based approach to developing a Russian international policy strategy: the role of analysis of trade statistics

_Sergey V. Chernyschev_ 32

I would like to support Mikhail Dimitriev: we cannot attempt to solve all the problems here, but we need to fix and define our long-term tasks and goals by trying to work out a road map, which would help us to define long-term goals.

I will briefly give you some figures to illustrate the various positions delineated by Mr Dmitriev. Figures often speak for themselves. Let’s look at our place in international trade. Russian trade turnover grows very fast and has reached US$ 400 billion. We have a positive trade balance. We export US$ 145 billion and imports were half of that – goods and services. We all know how we reached that level, and that was by the export of energy.

Russia’s share in international world trade is now fast approaching the former Soviet Union’s share of global trade, which it had about twenty years ago. Contributions to international organisations are determined by the place a country takes in international ratings.

The former USSR’s share of global trade in UN terms was 2 per cent and Russia is not far from that now. It is around that figure, mainly thanks to energy exports. Any new movement in trading services is very important and the Russian role in trading in services is important to us. Many experts see this area as being one of the solutions and diversification scenarios for Russia, which is the strengthening of the Russian role in the global services trade.

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In telecoms services we have made progress. This was mainly done through the mechanism of Russian presence in foreign companies and in international sourcing, which is the movement of people and not just services and trans-border trading and services – computer and engineering services – using the unique experience that my colleague mentioned that the former Soviet Union had in many areas of the world. The Soviet Union had a good track record in turnkey construction projects, among others, and Russia is beginning to resurrect those skills. There has been some progress in that.

Recently we saw a slowing down of the growth of energy exports, which means a loss of about 2 per cent of the growth of GNP – and perhaps going down another 1 per cent in the near future. However, the slowing of growth of exports of oil and gas, for instance, is not compensated by the growth of exports of manufacturing products. Machine building and the export of machinery and equipment fell by US$ 600 million. Our negative trade balance in machinery and equipment was over US$ 45 billion in 2005.

We should remember that our overall trade balance is US$ 125 billion in the black. To compare we can see that we are 19th or 20th in the world, depending whether we look at export or import. In relation to GDP, however, we are a little closer to world leaders. Our position according to WTO data is growing. We were 19th at the beginning of this decade and we were 14th in 2005. In other words, we are trading less. Most of our manufacturing is realised in the domestic market and the domestic market is growing, and the trend there has changed. It had been changing from 2000 after the collapse of 1998. The economy bottomed out in 1998/99 and had been growing from 2000. This is an export trade structure.

You can see that from 2000 to 2005, which is a very short period, we had quite forecastable changes. For instance, energy exports grew substantially from 50 per cent to 64 per cent. All other areas were more or less static. We know very well who our export sales leaders are. Russia traded rope, wax, leather, iron and it looks as though we are doing the same today. Another commodity was canvas. We seem to be in the same boat now. We sold a lot of iron and a lot of metal. There was no oil then, but now we sell oil rather than rope or timber.

I thought these figures would be useful to show you. This is our turnover trade balance in absolute terms between us and our key trading partners. This is a trade balance, export plus import. These figures are growing and, according to studies and forecasts, they look very similar. We see the curve going up in 2002 due to the beginning of the growth in energy prices. This is variations of growth rates – again, trade growth rates, export plus import. These factors are more difficult to analyse because the larger the physical volume of trade, by definition the growth percentage is lower, even if it is the same in absolute terms or even grows in absolute terms.

Nevertheless, we see here that for some of our key partners the rate of growth change is chaotic. Turkey is leading here, because of fluctuations in the volume supply of energy products.

For export dynamics the general trend is up, but there are considerable fluctuations. In absolute terms we have the same key major trading partners and we can see that the growth trend after 2003 is even more marked.

In terms of total turnover, the EU is responsible for half. We used EU15 data rather than EU25 because we did not have the data at the time. The EU25 figure is about 60 per cent if we base our calculation on EU25. This is our largest trading partner by far. The former Soviet Union without the Baltic states, the CIS, which is going down but gradually. At the end of 2005 it was 15 per cent or a little over. South-eastern Asia, the Pacific region, as you see, that is stable, slightly less or slightly more than the CIS.

These again are absolute figures of trade volumes with our trading partners. As you see, within five years their list has not changed and it is the same and mainly in the same countries: Turkey, China, Poland, Britain, Switzerland and Finland. However, the volume of trade with these partners has grown substantially although not all these figures are accurate. It is well known that our trade
with Holland is overestimated by a wide margin. This is because of our statistical approach. The export is calculated according to the value of contracts rather than by the country of destination. Many contracts for the export of energy are concluded with Dutch registered parties or parties based in offshore regions. We, however, have started a new activity, together with customs and our statistical agency, of reviewing the data about the volumes of trade with different countries. We hope to have more reliable figures in the not-too-distant future.

The structure of foreign trade in January and August 2006 is mostly the same. Whether we like it or not, our geographical priorities at least are clear, but we need to think whether we want to maintain that focus or whether we want to change our global trade focus. Whatever we do, we must tread very carefully. We do not want to throw out the baby with the bathwater! By contemplating new markets, where our competitors want to enter too, we do not want at the same time to lose our old traditional partners. Our work on our strategy includes giving the right signals to the world trading and economic community.

Strategic choices of Russian international economic policy

Ksenia Yudaeva

Our current plan regarding foreign policy strategy is different from what we discussed in the spring. We have reviewed our conceptual approach to the strategy. Having reviewed that, as Mikhail Dimitriev said, we have moved to target indicators to Russia, which are not very obvious. The main purpose now is to give a description of how we see Russia’s position in foreign policy and the structure of foreign trade in various areas over the last 10 or 15 years and, on the basis of all that, to discuss what targets and instruments we could use and write a kind of road map for the instruments and the changes that we would carry out in our strategy.

Before I talk about the various strategic choices, since our discussions is devoted to quantitative analysis, I would like briefly to mention the figures that we have used in preparing this document. In developing a foreign trade policy for Russia we felt it would be necessary to understand the overall development tendencies and position Russia in the global order of trade for the next 10 to 15 years. We do not only want to look at the possibilities for foreign trade policy in order to understand its position, but also to look at the limitations related to the tendencies of development in other countries.

We did not have a multi-data instrument to use for this forecast. We could forecast only for trade in goods. We are now trying to find ways of doing forecasts in services and investment, but our forecast was based on the basic gravitational model using the given statistics for world trade that we had.

We also hope to move to the Global Trade Analysis Project (GTAP) and, at a later stage when we look at changes in our tariff policies, using that model we will be able to do some experiments on the relative influence this has on the Russian area.

We can compute possible changes, using this gravity model, on the assumption that we are going to develop as an average normal country, increasing its GNP, bearing in mind that other countries in the world will develop in a similar way. Our share of energy in GNP is going to cut back. Nonetheless, it will remain rather large over a particular period of time, until 2025.

There is the possibility of cutting that back by seeing an increase in the export of manufactured goods and machinery. The structure of imports is something that will not change. We talk about the great dependence of Russia on trade with Europe. The share of western Europe will steadily decrease, essentially through growth in trade with China and neighbouring countries in that region. But this share of trade between Russia and China will not grow as fast as we often believe. We see an increase with the CIS and also with eastern Europe. With imports the picture is
not much different. The European share will slowly decrease, thanks to the increase of CIS and China.

Let me talk now about the strategic position of Russia and its strategy for trade policy. We have prepared a background paper on the activities of Russia in the last ten to fifteen years in that area and we are discussing the various instruments that can be used in order to implement various visions. This is to show that we should have a differentiated policy, depending on how we see future development.

I will now talk about the basic aspects of our policies. Most of these areas are not exclusive; you can have combinations of them. But one must understand in any event that movement towards one sector is limited by another trend in another direction. If we move towards a combination we would not move forward as a whole.

The first version here is how Russia can develop its strategies. We are saying that all the developed countries, which developed through export development, did that by penetrating developed countries’ markets. You can say this about Europe after the war, now it is Japan, China and other countries that have followed this strategy.

There are some exceptions, for example, Australia. Many people have noted that the growth in the Australian economy was very closely linked to an increase in export of its resources, first to the growing German market. By doing this it has helped Japan to catch up on America and most Asian countries like China and India are such large markets. At an OECD conference recently it was said that south-south trade is becoming very important for developing countries’ economies and no less important than the south-north trade, and that the main role in that was played by China, which has become a northern country. Its market would lead to an increase in general economic growth, but one must understand that moving to these various trade markets opens up opportunities and various strategies have to be considered. Competitive forces have to be faced by Russian companies.

If we orientate ourselves to developed markets, then we are competing on labour costs, but when we go to developing countries, if our costs are higher we can then compete in capital investment projects, where we can use our advantages with highly qualified and scientific staff. We must understand that our basic competitors will be companies from developed countries that are also supplying goods to these developing markets. But in other developed countries, where the energy factor does not increase greatly and there is a very great increase in energy requirements and raw material demand, since Russia is a developing economy, we would orientate ourselves to greater activity in the markets of developing countries.

From the geographical point of view, Russia will cut back its trade development with Europe. If we have a reduction in European trade, then we would see an increase in Russian services and other trades in the American markets and also a considerable increase in Asia. Recently in Moscow, during a conference on China, we heard someone raise a very interesting topic. This economic process that is taking place all over the world means that there is a return of economic growth rates to Russia so that Russia may become a link country in Eurasia, so there will be a whole new development there.

We have to look at developments in the energy sector and here we have various trends. We are more actively developing alternative energy sources to insure ourselves against a drop in the price of hydrocarbons because alternative sources of energy will move forward.

When we look at hydrocarbons we can continue our present policy exporting these using varied instruments to develop other forms of energy consuming products, but there is no structural choice to be made here. It would depend on the priorities. It will be necessary to build infrastructure in various areas.
We say much about diversification of the Russian economy and Russian exports. We saw the response made by the President to our people because two or three times yesterday he mentioned the whole business of diversification.

There is then the question of in which direction to diversify. On the basis of the figures I discussed earlier, you can see that the main political instrument cannot be used to develop all possibilities. We could bet on industry or the services area and we could also look at developing various industrial sectors such as the energy consuming sectors, or energy related to services.

Certain choices arise in the concrete implementation of our exports and infrastructure. We could have a strategy where Russia exports goods and services that are also sold on the domestic market. Or we could go the Chinese way and develop production here, essentially aimed at export. We have not yet gone that way in Russia because many developing countries are using that strategy very successfully to develop their exports and to accelerate their economic development.

We looked at certain areas in Russia. We could use the same principles everywhere but we have picked out certain areas because, for example, the agricultural sector has specific priorities related above all to economic security. Here we could either follow the European way, that is where one is supporting agricultural producers by making sure that we produce the most important necessary goods on our own market, or we can put our money into developing specific sectors which are competitive on the world markets and can therefore be exported.

We have been looking at many sectors. Here we can see different trends and different conditions. For the former Soviet Union and contemporary Russia the idea was that you would focus on one territory or one city. There was great vertical integration. The present trend is that certain Russian companies that have to have access to the market are turning their vertical chains of production into global chains.

The approach today is such that we are trying to build global chains. It is not with the intention of dealing only with one sector, but to try to get into the transnational area. That is the path that we have not yet tried to implement, but we have to think whether we should go that way. If we were to do that we would have to change our approach to foreign trade.

Traditionally, large companies have dealt with export activities and, essentially, our support activities are orientated to large companies. If we want to change things here we would have to create instruments to deal with import and export for SMEs.

In regard to migration, we are not interested in demographic policies. We look at it from the point of view of the need to attract immigrants in order to increase the numbers. We look at migration as an instrument for improving the quality of human potential and improvement in needed qualifications.

There are various approaches here including trips undertaken by Russian citizens or foreign citizens. In Russia today, essentially, we base ourselves on improving Russian education and therefore creating qualified potential in our country. Ever since the time of Peter the Great foreigners have come into the country, bringing in their skills, which has led to certain areas seeing greater progress than before, when there were not the appropriate staff.

In terms of management, we see from all our researches that Russia has a great lack of management staff. Therefore, we could use that way forward in order to make a rapid improvement in the amount of human capital.

As far as Russian government policy is concerned we do not have anything like this happening, but we know that in India a great deal was done on the basis of a diaspora that formed. The same also applied to China.

One can therefore talk about many different choices. We must talk in terms of low barriers, both for qualified and unqualified labour, so here priorities have to be decided as to what kind of
barrier to set up. Here, one can talk about short or long-term contracts. There are various ways to attract both qualified and unqualified labour.

Since ours is a large country, in setting up a foreign trade policy one can use different forms of centralisation of policies. In particular one can either have polar approaches or use certain advantages and trade more with certain countries, or have a central market and try to level out the regional differences in the structure of trade.

The last factor, in relation to positioning Russia in terms of finances and trade, is recent developments on stock exchanges. Russia has used the international markets. Russian companies prefer to move into international markets. But now there is a movement to develop our own exchanges or markets, but we should not then concentrate just on Russia, which should develop its own markets and integrate with regional markets. That kind of policy would make sense and will be very promising in the medium and long term.

All these strategies which offer choices and which we prepared for this meeting today are things that we would like to hear comments on. We would like to hear the opinions of our Russian colleagues and our international colleagues on our forecasts for future strategy. We would welcome all your comments.

Sometimes these choices change, well life moves on. A clear example of this is energy. I do not know whether this is spontaneous or a deep thought, but these alternative ways forward are brought forward in respect of our distribution. They are very reasonable and already exist, and I think this will be the basis of our negotiating position and that we will have, therefore, some discussions on our energy policies with partners.

Comments on the Russian trade strategy

Douglas Lippoldt 34

I would like to thank the organisers for having granted me the opportunity to make a few comments. The invitation was to comment on and discuss the draft Russian trade policy framework. However, since the background document is not available, I would like give a spontaneous reaction in general terms to the issues raised in the preceding presentation on the trade policy framework and then to elaborate a bit.

In general terms, listening to the presentations we have just heard from our Russian colleagues, I appreciate their efforts to make a structured assessment of Russian trade policy and examine ways to enhance it. Having heard the various choices that were being contemplated, my reaction is to underscore the importance of establishing sound framework conditions for the economy and to think about what actions can be taken to facilitate entrepreneurial activity in Russia and remove impediments.

During the 1990s, Vladimir Gimpelson in the Higher School of Economics and I did a lot a work on the assessment of Russian labour market issues. One of the things that struck me is that, when looking at SME development in Russia, after the launch of the economic transition, there was initially some uptake, but then the numbers flattened. I have not looked at these numbers for the last couple of years, but when you compare this with some of the other countries in transition that were pushed by EU accession processes to focus on getting the framework conditions in place, there is a real contrast in the evolution of small and medium size enterprise development. In OECD economies the SME sector tends to be a major engine of growth.

Why did SMEs in Russia struggle to develop? Was it the economic framework conditions? Establishing the appropriate framework conditions should be a primordial concern for policy makers. We should be looking at these with respect to Russia.

34 Trade Department, Organization for Economic Co-operation and Development.
An interesting OECD research initiative during the mid-1990s (with some follow-up in the years since) was the so-called "Jobs Study". This described a core set of framework policies for the enhancement of the labour market in OECD member countries. The situation in Russia may differ, but it might be instructive to look at that study and consider the types of policies appropriate to the situation in Russia. The list might start with points about macroeconomic stability, but then become more specific about the conditions faced by businesses and the labour force.

I was struck over the course of this year by the range of assessments of the implications for Russia of WTO accession. When I spoke with various experts in Moscow on the issue of WTO accession, or with trade analysts in Geneva, or in conducting our own research in the OECD, the story on accession was quite positive. Across the board, there is generally a favourable assessment of the economic implications of WTO accession, albeit with some variation depending on the modelling assumptions. The big study that the Higher School of Economics did for the ministry indicated modest gains, some others pointed to larger gains (e.g., one pointed to 7.3 per cent added to household consumption under certain scenarios). Moreover, I am glad to see WTO accession progressing because it has some important implications for the Russian economy that go beyond exports or imports. It is also a driving force for domestic restructuring.

Indications of the need for trade policy reform can be found by consulting investors on their experience. The OECD recently conducted an investment policy review in Russia and in parallel a survey was conducted in conjunction with the ministry and the Foreign Investors Advisory Council. It was really striking to look at what the foreign investors in Russia were saying. Seventy-eight per cent view the Russian macroeconomic situation as positive. But when you start asking firms about the framework conditions for doing business in Russia, as investors but also as traders, only 25 per cent feel that Russia has been effective in integrating with the global economy. If you ask the same multinational firms about China, 97 per cent feel that China has been effective in this regard, so something is not right with the conditions in Russia. I want to emphasise that 60 per cent of the respondents in Russia feel that there would be an immediate positive effect on their businesses if there were WTO accession.

I will not dwell much more on general institutional concerns. We have looked at several specific issue areas this year and I would like to share my personal assessment with respect to market access, standards, service sector liberalisation and intellectual property rights (IPR).

First I would like to note a cross-cutting issue: civil service reform. The civil service reform that has been under discussion in Russia is also a key issue for trade. In the popular press, I found two points highlighting this. One came from Minister Greff with respect to the Federal Customs Service. He was quoted as saying "What can you expect of someone who earns 4,000 to 5,000 roubles a month while clearing goods of hundreds of millions a day ...?" This comment captures an image of the challenges that the Russian Federal Customs Service is facing in restructuring.

The second point we touched on yesterday. Maxim Medvedkov, the lead negotiator for WTO accession, was quoted in the press on a point about human resource development in the Russian government; that of the 120 state employees the government has sent abroad for training related to WTO issues since 1994, they could only identify 25 who remained in government service as at March 2005. These two points provide an indication of the situation facing those striving for civil service reform. Unless there is some institutional continuity and further development of the capabilities of the state through more effective employment of human resources, improving the economic conditions will remain particularly difficult. If the state is not functioning closer to its potential, then it will be difficult to close the gap with the more developed countries.

Now, with respect to market access: The previous speaker mentioned the GTAP database. Keep in mind that the tariff data in there are from 2001, and the reform of the Russian tariff system that came into place in 2003/2004 has changed the situation with respect to protection levels. Tarr et al. (2005) have prepared an excellent assessment of the tariff reform and I would recommend this to anyone who is interested in the issue. From their study, a key concern that I came away with is
the potentially negative role that specific tariffs play by impeding trade in certain products and in rendering the system less transparent.

When I discuss market access issues with various experts on the situation in Russia, I am also struck by the degree of concern with the customs clearance process and trade facilitation issues. We have heard about border delays and in some cases corruption. There is an urgent need to advance the customs modernisation, which has been positively assessed in its initial stage by some observers. I hear many stories about continued frustration with the clearance process.

With respect to standards, the law on technical regulation that came in 2003 is applauded by some knowledgeable observers. They see it as a positive step. Nevertheless, there is a long rollout period over seven years and the system remains complex and cumbersome. On the other hand, there are still complaints about the arbitrary application of a variety of norms. There was the recent case of food safety concerns with respect to wine from Georgia and Moldova; there are complaints from meat suppliers being blocked out of the Russian market; there was the unusual case of the cell phones which were blocked upon import last spring, first for health and safety concerns and then on that grounds of IPR concerns, only to be returned to the owner, minus 50,000 phones that had supposedly been ground up. Last week, I saw in the Moscow Times that perhaps 30,000 of the phones may have resurfaced in Siberia. A large firm may be able to deal with such uncertainty, but for a smaller business it can be devastating. We should not minimise the impacts.

With respect to services trade liberalisation, I would like to note that services constitute an important input for other sectors of the economy. Restrictions on access to the market for service provision in Russia can negatively affect business in the sector but also in manufacturing and agriculture. By potentially negatively influencing the cost, variety or quality of service sector inputs to Russian firms, this situation can render those firms less competitive.

We looked across several dimensions of restrictions on banking trade, compared to the average degree of impediment on financial services trade in OECD countries. If you look at the country scores on the trade restrictive index that we expanded, it is clear that Russia remains a fairly restrictive economy in this sector. The way I like to look at this is that it means Russian manufacturing firms that have a need for financial services are at a competitive disadvantage compared to firms in OECD countries. When you talk about developing export orientation and choices about which markets to enter, Russian firms stand at a disadvantage because of this trade restrictive situation. If you look at access to banking services, the excellent presentation by Daniel Bolschun this morning was very informative.

With respect to IPRs and patent laws in particular, it seems that some international firms see some positive developments in Russian law. The problems cited by investors and others are not primarily centred on the IPR laws on the books in Russia, despite the potential for their improvement. The main problems rather come in the application and the effective enforcement of those laws. In the investor survey that I mentioned earlier, two-thirds of the firms cited mentioned concern about intellectual rights as being among their top ten concerns in Russia. The IPR situation during 2006 was further complicated by uncertainty. After spending ten years building an intellectual property law framework in Russia, the initiative to revise this framework with the new Part 4 of the Civil Code raised a variety of concerns related to the future situation.

In the same investor survey cited earlier, firms were asked to describe what is particularly strong about the Russian economy. One of the top things they listed was the human capital, as being a real strength of the Russian economy. Later on in the survey, when investors were asked if they planned to do any research and development in Russia, only 2 per cent said “yes”. One factor determining whether foreign firms exploit this Russian human capital is whether they can protect their intellectual property, in terms of doing research and development. Thus, inadequacies in the area of IPRs can have implications for the ability of a country to reach its potential in other areas.
A counter example is Singapore, which has focused on intellectual property protection and is attracting hundreds of millions of dollars of investment in research and development. Moreover, with respect to policy formation, one of the frequent complaints from people operating in the Russian business environment is a lack of timely, adequate and systematic consultation with economic stakeholders, including with respect to IPR issues.

In conclusion, I would like to underscore that in each of the four specific areas, discussed above, Russia has made progress. However, there are still significant perceived inadequacies (e.g., tariff peaks and mixed tariffs; trade restrictiveness in telecoms, banking and insurance; arbitrary or underdeveloped standards and practices in some areas; and IPR enforcement). Responding to these concerns will require further investment and commitment from the authorities to reform a range of trade-related institutions. Progress in WTO accession will play a role in this regard. Success in these efforts will advance Russia’s integration into the global economy, which is clearly in the economic interest of Russia as well as those of its economic partners.

Comment by Mr Chernyschev: 35 I have one small clarification. By chance, I know the history of the discussion on IPR so I presume that other people have known it as well at least for four or five years. It was all public. There is a fundamental discussion in Russia between those who believe that there must be a package of IPR legislation and others in Russia and internationally who strongly believe that this should be decided otherwise, by putting everything into one place, in Part 4 of the Civil Code. Nothing has been done secretly. This is not a surprise, it is something that people have known for years.

You quite rightly said that regulatory issues are the most important challenges we confront in acquiring investment and promoting trade. That gives me the opportunity to speak about two factors of foreign economic strategy. Those exogenous to the strategy and others that are endogenous to the strategy. In exogenous factors I include regulatory reform. This is something that is important to the country’s development, not only to foreign trade. Our own economic operators suffer equally from regulatory headaches. That is important and we try to deal with it not only to be more comfortable with others but because we want more favourable business conditions in Russia ourselves.

Competitiveness is another good example. We cannot trade before we have something with which to trade. Here again, that depends on many factors exogenous to our main topic.

Comments on the Russian trade strategy and relevance for Ukraine

Mr. Martin Raiser 36

I am not quite sure how much interest there is in this room about the implications for Ukraine of Russia’s trade strategy. They are obviously very interesting for me. I notice that in your figures, Ukraine, which should probably be third or fourth among Russia’s trading partners, did not even appear in the graph. I am going to keep my remarks fairly brief and then we can see whether some elaboration in the discussion is required.

I should like to make five points. The first point is the synchronisation of WTO accession. This is currently a very hotly-debated topic, with Ukraine looking to have the edge over Russia and Russia suggesting that it should wait until Russia is ready, and Ukraine debating internally whether it should or not. My view is that this is a non-issue. Ukraine should get ready and not wait for Russia and, once they are ready and the WTO is ready to accept them, they could make the generous gesture of telling Russia: “If you are almost ready, why don’t we wait until you are ready and we go in together. We are ready, so the clock is ticking and you have until August 2007. After that we will go in because we are done.” That would be my advice to Ukrainian policy makers. In that way they can indicate to Russia that they have no interest in getting in before

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36 Lead Economist for Ukraine and former Country Manager for Uzbekistan, World Bank.
Russia, and they have no interest in influencing the conditions under which Russia gets in. They have an interest in getting in fast and they do not want to be held up by the processes of Russia’s negotiations.

If that is acceptable to the Russian members around this table, I could take that advice back and pass it on when I next meet members of the Ukrainian government.

The second issue of debate is whether Ukraine should aim for a free trade area or for a customs union with Russia. There, the debate is more complicated because there are good cases for both. Generally, economists tend to think that the case for a free trade area is probably stronger. However, there are reasons that have been explored in other regional contexts, why countries that aim for a deeper type of integration may want to aim for a customs union because of the regulatory and institutional harmonisation that comes with that.

To the extent that Ukraine would want that kind of deeper integration with Russia, the issue would have to be debated in an open-ended manner. However, there is a complication in that Ukraine simultaneously wants that deeper integration with the European Union. Unless it looks as though Russia and the European Union were going to move to that kind of deeper integration, it seems to me that you cannot have both. You cannot harmonise your regulatory standards and follow a pattern of deeper institutional integration with both the EU and Russia if those two institutional standards that you are trying to integrate towards are different. Therefore, my advice to the Ukrainians at this stage would be: until you have made up your mind, it is probably better to go for free trade areas with both. That is because they are not likely to get anything else from the EU at this stage, but also because at least the policy option is open.

To me, that is a compelling argument, regardless of whether or not you believe there is an economic case to be made for a customs union.

By the way, the free trade areas that already exist within the CIS are so horribly badly enforced that the notion that things would somehow get better if you moved to an even more complicated enforcement like a customs union, strikes me as trying to jump ahead of yourself, so perhaps one should look at enforcing what already exists. Then, when one has found out that one can work with and trust one another, then move ahead.

That brings me to the third point. I would strongly subscribe to what a lot of people have already said. The key constraints to trade development in both Russia and Ukraine have very little to do with trade strategy per se and more to do with so-called behind-the-border issues. This is reflected in the area of Russia/Ukraine relations in the recurrence of trade wars, which are not based on trade policy per se but rather on an attitude of “oh, well, you do not have the same standards; we will block your meat exports,” and then “we will retaliate and block your chicken exports,” and so on. These are very wasteful and I would recommend to both countries to abstain from them in the future.

The fourth point is a short word on energy, the largest product that is traded between Russia and Ukraine. It seems to me that we now have an opportunity to bring this to a different type of relationship.

The essence of the relationship is characterised by the fact that Ukraine has a hold on Russia in terms of energy transit and Russia has a hold on Ukraine in terms of energy supply, so there is a more or less symmetric hold-up problem in that relationship. The economic solution to hold-up problems is vertical integration, so the economic solution to this problem would be for Ukraine and Russia to form a consortium dealing in energy supplies to Ukraine and energy transit to Europe.

In fact, this is exactly what has happened over the past years, only that this vertical integration has happened on the back of taxpayers, through shadowy companies that deal with both the transit and the supply of energy into Ukraine. It would be in the interests of both governments to
throw out those shadowy companies and establish vertical integration, based on a balance of cooperation within a government-to-government framework.

It strikes me that the idea of an energy transit consortium that has recently been revived would be a framework in which to think about that, with the added benefit that the balance of power could be verified by a third party in this instance, either the Europeans who have an interest in transit, or an international financial institution (IFI) that could underwrite this kind of agreement and use that agreement as a legal basis against which to supply some investment in the upgrading of the necessary transition networks. We may come back to this in the later session.

My fifth point is: what are Russia’s opportunities, seen from the perspective of Ukraine? I come back to the point that I missed Ukraine in the chart of Russia’s major trading partners, which it still is.

I do not have a clear answer, but it seems to me that there are three questions to ask, taking as a basis that trade relations are very close and that these are mutually important trading partners.

The first for Russia is this. Should Ukrainians buy German, Chinese or Russian machines? At the moment the Ukrainians would say they buy German machines if they want quality and Chinese machines if they want price and they certainly would not look at Russian machines. That is not necessarily the best solution. In fact if you have technological linkages, it may not require a full upgrading of Russian quality to the level of Germany for it to be able to compete and deliver a better quality than the Chinese machines and, therefore, higher profit. Ukraine should be an interesting market for Russian machine producers and may be a step toward the entry into OECD markets.

Ukraine could be Russia’s outward processing zone. Given relative wages at the moment, which are about twice as high in Russia as in Ukraine, but with very similar economic characteristics – and otherwise close cultural and language linkages – it may make sense for Russia, instead of importing Ukrainian labour, to think about exporting capital to Ukraine and processing goods in Ukraine that are exported under a Russian flag. This strategy has worked very well for Germany with its neighbouring countries in eastern Europe – admittedly with much higher wage gaps, but at least it is an idea that is worth pursuing.

The final question is: can Ukraine and Russia at some point develop into something similar to France and Germany? Could we get to a much greater degree of intra-industry trade between these countries? It is already clear that one of the impediments of all CIS countries is the lack of intra-industry trade. It is one of the characteristics of the trade patterns of CIS countries, that they have so much less of it than OECD countries. If there is intra-industry trade, it tends to happen within the CIS, so the question is what can be done to strengthen this and to build on that strength.

I do not have an answer to any of the three questions I have just asked and I close with that. Thank you.

Comment by Mr Chernyschev: Technological progress generally and for Russia and Ukraine in particular, has to be done with foreign investment and good-quality foreign investment. We have figures showing that foreign investment is growing more quickly in both countries, but the quality of it is still lacking. Most of it goes to the retail trade networks and construction, not to machinery.

As you said, Russia still has potential in technologies, but to develop those to the market stage we need investment and experience from abroad. This is something that both economies still lack. It is one of the challenges that Mr Dmitriev also mentioned in his presentation.
The Russian system of export support and other instruments of regulation of international trade

Galina Balandina

I would like to start with the subject of export support and regulation of foreign trade. The key problems in the area of exports in Russia we think are the low competitiveness of Russian-manufactured products. The next and very important problem, connected with the first one, is the underdevelopment of financial markets, in particular long-term credits at interest rates comparable to those prevailing within the markets of Russia's trading partners. This is a huge problem for our manufacturers and exporters. We see also that administrative barriers are too high and small and medium export businesses have huge problems overcoming these barriers.

Another problem is the exogenous factors: the increase in international competitiveness and the restrictions towards Russia in overseas markets, which we hope will be removed when Russia joins the WTO. Another problem is the poor awareness of what is happening in the world and the lack of information about the terms and conditions and atmosphere in international markets, which Russia wants to enter with its products.

This is a general assessment which was announced by our Minister for Trade and Economy, Mr Greff, at the meeting of the competition advisory body of the Russian government. Our ministry defined these as the major challenges that Russia has to overcome to become a significant player in international markets.

Our partners make a different assessment of the situation. On those issues that we regularly look at and discuss, we as a ministry and our political partners see that one of the first problems for exporters is the VAT rebate. This factor makes exported goods and products much more expensive to export. There is poor information and not enough information. Another problem is the lack of marketing research capability and difficulties with finding competent companies that provide these types of services. Where they exist, they are very expensive.

What instruments do we use to overcome these difficulties? Discussions take place at the highest level. What should the role of the government be? How proactive should it be in helping Russian companies to become successful in terms of foreign trade? Even knowing what tools, mechanisms and instruments are used by our main trading partners to support exports of the main developing countries, we have not tried all those widely accepted and proven instruments. At the moment we follow the policy of limited intervention by the government.

The key instruments that are being used are financial government assistance. For example, we subsidise interest rates for exporters. The government, via its agent banks, uses financial guarantees. Exports to countries that are Russia's debtors are used to help to reduce their debt towards Russia in order to finally reduce their foreign debt. However, these mechanisms are not sufficient and they are not used very effectively either. Exporters complain that the bureaucratic procedures are too cumbersome and time-consuming; they spend too much time getting the required documents together in order to use the instruments offered by the government effectively. We have some ways to improve the situation in this area – one of them is joining the WTO – but in order to do that these instruments should be aligned with other existing international instruments so that they fulfil the requirements of WTO and OECD.

We use a wider range of instruments for smaller exporters, apart from subsidising interest rates. Small businesses may use such mechanisms as their cost rebates. For instance, they can be compensated for the costs they incurred in certifying their products and in regard to international exhibitions their costs could be compensated from the central budget and the budgets of the regional authorities. All these instruments are not working to their full potential and are not as effective as they should be. Although the treasury has considerable amounts allocated for this each year, not all of them are taken up each year. From 2007 the amendments introduced into

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the tax code will come into force. This is another attempt to simplify the procedure for rebates for export VAT. How effective these measures are time will only tell, but at least we are trying to find solutions for these problems.

We have introduced a series of measures to minimise the export duties and to bring them down to zero for those goods which are processed to one degree or another in Russian territory. In the medium term we plan to leave export duties to cover such commodities as energy and scrap metal, and we plan to increase the export duties on unprocessed timber. In regard to timber exported as logs from Russia, the target is to gradually raise the export duties so that by 2009 they would be prohibitively high.

Of course, we support all presentational measures from the federal budget. We compensate exporters for participation in international exhibitions. We have seen considerable positive results from conducting investment fora in Russia and overseas, but we see that many opportunities remain to widen our scope of assistance to exporters in order to help them promote their products in international markets. That would make their products recognisable and would instil confidence in overseas buyers, clients and consumers of Russian products.

We introduced legislation on special economic zones in 2005 and that legislation is still being worked on. However, there are now three types of special economic zones in Russia and by the end of this year we hope that our legislators will pass a law covering another type of economic zone, namely those situated in ports. That will combine opportunities for the processing of some goods and to carry out trade transactions, for example bonded warehouses.

In export, more than anywhere else, we could demonstrate a lack of strategic decision making. We are willing to widen the service that the government extends to businesses in this area. However, it is not quite in line with the development of a free economy and the minimisation of state intervention in economic activity.

A key instrument of government regulation in foreign economic activities is customs tariffs. The most sensitive goods and commodities for Russia have already been defined in terms of Russia’s desire to join the WTO. Tariffs have been fixed in bilateral agreements with over fifty countries. Therefore, we are not now looking at customs tariffs as a fiscal instrument but, on the other hand, it looks as though we will not be able to use them to their full potential as a regulating instrument because our manufacturers will be in a weaker position because of these tariff negotiations.

In this connection we are developing very actively intensive protection measures for our manufacturers. If we encounter discrimination from our partners or retailers in Ukraine, unfortunately for us one of those partners is to introduce such measures. But what can one do? Ukraine is one of our main competitors – in fact our main competitor – and the circumstances were formed in the former Soviet Union where, in manufacturing terms, we were competitors or had similar manufacturing bases. We are not very optimistic in Russia about Ukraine joining the WTO. We are monitoring the process of Ukrainian accession very closely and understand that those tariff compromises that Ukraine felt able to agree to would impact negatively in terms of our trade with Ukraine. If Ukraine lowers the custom tariff and Ukrainian goods and services are replaced by imported goods and services, we understand where the market for these goods is – it is in Russia. Our obligations in terms of free trade would be to not impose customs duties on those goods.

At the beginning last year, when we were negotiating the single economic area, we tried to put in insurance measures, for instance selective duty mechanisms, so that the forecast input from Ukraine could meet competition and counteraction from Russian manufacturers.

I will have to name, but I will not comment on, problems that we encounter with such instruments as technical regimes, hygiene, sanitary and veterinary regimes and requirements. During the years when Russia was developing new foreign trade legislation in new economic
circumstances, the main motto was that our legislation should be in line with GATT and WTO guidelines or practices. If you look at our framework legislation on foreign trade regulation, from the point of view of WTO it is ideally drafted.

The problem now is how to adapt these instruments to the sectoral and geographical interests that exist in Russia. Are those instruments sufficient to change or create a new economic policy for Russia and how would that be used in the future?

I will say a few words now on the future customs union. You probably know well that the political decision to create a fully functioning comprehensive customs union between Russia, Belarus and Kazakhstan has been approved. After the first round of negotiations with representatives of these countries, immediately after the Sochi arrangements and declarations of our presidents, we understand that a fully functioning customs union will require the demolition of some national approaches or views and maybe even institutions. Although in Europe and Asia our aim is unification and harmonisation, different states, in pursuing their national interests, do not pay too much attention to the interests of others in this area.

We think of Belarus as a country that is the most discriminatory to Russia in its markets. More often than any other state it uses instruments to discriminate against Russian exports. There is no doubt that it is very difficult not only to put together but to carry out an efficient policy. We are now trying to create a road map to effect a customs union with Belarus and Kazakhstan. They know what a customs union is as a phenomenon, but it is a question of how to implement a single customs tariff.

Russia and Kazakhstan agree that national tariffs are to be based on different terms and conditions. How will those countries take into account each other’s interests? We do not have answers to these questions yet but they are questions that need answers and we will try and find them.

I apologise for a less than systematic presentation, but I wanted to raise the issues again and comment on the subjects that have been raised today. This simplifies my task because our discussion is moving very smoothly towards those subjects that we plan to discuss in the afternoon. Thank you very much.

Comment on the Russian trade strategy

Christopher Beauman 39

Thank you very much for the opportunity to make some brief comments, which are a response particularly to a paper on strategic choices for Russian international policy, based on our experience in the Bank and, particularly, my personal experience of the Russian steel industry.

I wanted to say that this is because any strategy needs to be based on strength and there is no doubt that Russia has strengths in certain sectors, including the steel industry.

Second, I picked up the page in the presentation on strategy on production chains and the issue of building production chains controlled by Russian companies.

You will have noted in the steel sector the very important developments in investment by companies like Severstal, Novolipetsk and so on. These need to be seen as part of a vertical integration into the global economy, building on the competitive strengths of the Russian economy. This is already happening. The reason I emphasise this is that there is a danger in discussions between trade policy experts of concentrating too much on the framework of trade and not giving enough emphasis to the fact that a very substantial part of world trade, as I am sure you know, takes place within multinationals. Trade within multinationals is much easier than trade outside because you are selling to someone you know and trust.

39 Senior Advisor, European Bank for Reconstruction and Development.
When I say it is easier, you have to create the multinational first and that is not easy. The potential for Russia to do that, based on its competitive advantage and the often higher value markets downstream in the United States and Europe or the growing markets if we are talking about China, is immense. But of course it is not easy because it requires relevant human capital, not the human capital of being a brilliant rocket scientist, but the human capital of international management.

This has not been a huge strength of Russian industry and there should be more emphasis on it but I think it will begin to happen. We have seen in the steel sector the enormous strides made by Mr Mittal. I was in Moscow when it became clear that Mr Mittal had succeeded in his venture of taking over Arcelor, as compared with the alternative strategy proposed by Severstal with Arcelor.

The kind of international sophistication that these leading multinational enterprises bring is dependent obviously on experience in international markets, a variety of international markets – developed countries and emerging markets – dependent of course on good English – that is a common language – and it will need to be created, in some cases using Russians and in other cases using people hired by Russian companies.

Another instrument here is the international public offerings, which get Russian companies known and that has been a huge development particularly in London – it is happening all the time.

I dealt simply in terms of the strategy, if you are thinking in terms of Russian external economic relations. If, however, you are thinking in terms of building up the volume and value of Russian exports, it is essential that you also put this in the context of the flows of Russian investment outside Russia. You can make investments and just let them sit there as portfolio investments, like many Arab states did, but the relevant thing about building exports, of course, is to link it into industrial strategies and, in some cases but not all, those will be industrial strategies based on Russian competitive strengths and will, therefore, increase Russian exports. Whether they are semi-finished goods or finished goods does not matter. People are surprised when I say that, in many cases, the margins on semi-finished steel are higher than the margins on finished steel. It is simply a question of demand and supply, but that can change from year to year. It is a question of industrial strategy and vertical integration, which many companies are achieving within Russia, but now I suggest that more and more they need to achieve it outside Russia.

Policies toward agriculture

Csaba Csaki 40

I would first like to express my appreciation for being able to be here and talk about Russian agriculture.

In my thirteen years at the World Bank I have been dealing with Russian agricultural policies with varying degrees of intensity. At the very beginning I led the first agricultural team to the Soviet Union from the World Bank at the end of 1991.

My last engagement was a World Bank study about two and a half years ago, which I produced with John Nash and other colleagues from the bank. We focused a lot on various policy issues. Therefore, I have some background. Of course, I do not say that I know Russia well, but at least I have some experience.

Let us summarise what we are talking about, because it is important when discussing agricultural issues.

Russia has over 200 million hectares of agricultural land, which is over 10 per cent of global land resources and 53 per cent of it is arable land. Comparing the potential, the contribution to GDP of 5 per cent is relatively minor although 11 per cent of active labour is in agriculture. It is important

40 Former Senior Advisor for Agricultural Policy, Europe and Central Asia Region, World Bank.
to compare these two numbers, because they show the very low productivity of labour in agriculture, which also shows other potential.

The next two numbers are quite important. Food and agriculture contributed to 2 per cent of Russian exports and 18 per cent of Russian imports. Russia is one of the largest food and meat importing countries in the world. In the late 1970s and early 1980s I was in charge of developing the first general equilibrium model for centrally planned agriculture systems, as part of a global agricultural trade model and I was modelling Soviet agriculture as well. At the time, one of our main conclusions was that there was a huge loss because of importing a lot of grain and using it extremely inefficiently inside the Soviet Union. At least this changed. The grain imports were substituted for meat imports, which is alone a gain for the country. There was also the question of what else could be done.

The current output level is about 25 per cent less than the pre-transition level. The next two numbers are quite interesting and that leads to some political conclusions. Currently the private farms, subsistence farms or what we call household farms, use about 10 per cent of the agricultural area, while their contribution to the total agricultural output is 57 per cent. That is again quite interesting. Looking at this, nobody can dream about the extremely high productivity of private agriculture. This is not the case, at least as I see it. Basically, household farms use the collective farms as a kind of skeleton and a tax shelter, and produce a lot of livestock products based on feed produced on the large farms. That is the framework.

In regard to policies, if we look at the federal regulations and policies, in the first instance we think that things are more or less in order. There are relatively small policy-related distortions. We can say that Russia has achieved the basic framework for a market-based agricultural sector, even with relatively low subsidies, if we look at what is surfacing on the federal level, especially for the major tradable crops and commodities.

However, if we go one step further we have to recognise that there are serious policy issues that are still around and under the surface. First, the legal framework of Russian agriculture is very, very fuzzy. There are many very significant holes. One is the disconnection between federal and regional levels, especially legally. There is no clear linkage between the federal agricultural policies and the regional agricultural policies and, of course, the land laws are also in a mess – mainly presidential decrees determine some things, but not all the regions follow – they have different regulations.

On the federal level there is a continued state domination of some markets. There is still a system of state procurement for state purposes, which covers over 50 per cent of milk, for example, and 30 per cent of eggs. However, there are not very high levels of federal subsidies; the 2004 number was about 0.7 per cent of GDP, so it is not an alarming figure. It is how they are implemented and allocated that very often works against the operation of the market and creates distortions. They are often ad hoc and not very transparent.

As we have heard from many speakers today, there have been attempts to introduce protectionism. We can see the discriminatory use of trade policies, particularly with regard to agricultural commodities like meat, Georgian wine, Moldovan wine, etc.

Of course, the bigger problems and difficulties come at a regional level. The reality is that much of the agricultural policy is made at that level. There is a missing legal link, which would guarantee the transparency of the regional agricultural policy measures with the federal measures and which would make them consistent at the federal level. This can be a problem within the WTO also. If somebody looked at this carefully and went to some of the oblasts they could see that, at the regional level, there are explicit prices and trade distorting policies. There are often even barriers to good movement between one oblast and another. There are margin controls and all sorts of things.
At the regional level the policy framework is much worse than at the federal level, in terms of trade barriers, price controls and regional subsidies. All of these create very significant distortions in the structure at regional level.

The most distorting thing is the wide use of regional commodity schemes, which are old-fashioned instruments – the exchange of inputs for goods and taking this out of the market.

Finally, I would mention that there have been some changes, but still the policies, both federal but more on the regional level, favour large enterprises. There are various reincarnations of collective farms, while the small farmers and household farms do not get a clearly designed, well thought out and developed policy framework.

This is a very serious problem for the agricultural policy framework, especially if we look at the potential, and if we assume that the huge potentials should be utilised, since I believe that Russia has all the potential to be self-sufficient, as a minimum. Not only that, but it can be an agricultural exporter – not meat at the beginning, but grain definitely. There have been some instances of that. Russia, however, could be self-sufficient in meat and export meat as well.

People are always talking about global tendencies, but they tend to forget about Russia and Ukraine. I am always telling them, “please do not forget the huge potential that is still there; and you can grow everything without real environmental risk.” It is a temperate climate with reasonably good soil. You just need better technology, better incentives and a policy framework.

There are a few critical issues. First, I feel that there is a need – and you might not like my use of the American term – but there is a need for a Russian farm bill with two objectives. One would be to really settle relationships between federal and local agricultural policies, for the longer term. The other would be to give some stability to the support programmes for a few years so that they are not the subject of annual bargaining. It is very difficult for the farmers but it should be like the US farm bill or the EU Common Agricultural Policy. I do not want to propose their support level, but the instruments could be copied. I understand that an agricultural bill is being discussed in Russia and, hopefully, in regard to the support programmes there has been a solution. This is important.

As an addition there should be a transparent support system with improved institutions. Support should come mainly in the form of the provision of public goods to the settling of marketing institutions and market services, rather than price support and direct intervention. The support system should focus on market type measures, which would be easier under the WTO. There should be some decoupling efforts of the market support. Under Russian circumstances, I can accept direct support to the smaller farmers or other areas. The support system should focus more on private individuals in farming and market development and that should be the objective of revamping the agricultural support policies beyond creating transparency and a more solid framework.

It is very important that the country should move from an ad hoc compensation system of losses, which are national disasters, to a more long-term system such as crop insurance, or anything that is transparent and not subject to subjective decisions. There should be a framework framed before the disaster, not after.

Finally, the Russian agricultural policy does not incorporate rural development policies. I do not say you should give big support to rural development, but it would be very useful to start a debate on what kind of rural development policy Russia needs and to link this with agricultural policies. This is one avenue when you have a lot of money anyway, so when you want to support the rural areas in a WTO setting, rural development policies should be looked at more carefully and there should be a rural development strategy for Russia.
Statement by Mr Demiyanenko

Good afternoon everyone. I would like to thank my colleague for the deep knowledge he has just demonstrated of the economics of our agriculture, and not to deviate from the topic of our seminar, which is foreign economic policy, I will try to paint a picture of how things stand and respond to his comments.

There is a national project in agriculture today, which envisages resolving some problems, which we have just heard about from Mr Csaki.

The economy is structured so that, at the present time, it is only in large bodies that things are developing and it is difficult for the private farmer to survive. Problems have been mentioned in relation to export, but for domestic problems it is the very high cost of credit, the very difficult conditions for distribution and packing and so on. One of the purposes of the national project is to create cooperatives, which will bring farmers together. There will be credit cooperatives and processing cooperatives. This resolves a number of questions. First, there will be some financial stability; secondly, we try to bring the farmers together so that the profits from processing their agricultural products go to them. That is the sort of structure the cooperative will have so that they produce finished products.

This is being developed now within the national structure and is leading to substantial inflows of money. We are also working on the law on agriculture. I think it has been through the first reading and is now in the second reading. This plans to cover support measures for producers and the rules for such support, so this covers the point raised by the previous speaker.

Coming back to the topic of our seminar, which is economic and foreign policies, domestic product and export very much depend on resolving the problems we face. I have mentioned already a number of these, but we also heard about these just before lunch. There, we heard some mention of the discrimination in the market to our producers by markets in other countries. One can even say that there are different standards to the products coming from our people. For example, when our inspectors verified foreign products for their export to Russia, if you do not know the results of that verification in two or three weeks, then in the press we already hear talk of trade barriers. But, when recently three of our enterprises were verified by European inspectors, we had to wait nine months for the results of those inspections.

What sort of competition can you talk about under such conditions? It is no secret what problems we are facing with the EU, particularly the grain quotas. We tried to sell grain to the European Union and we could in fact go into more detail on all that. During the last three or five years, there have been fairly stable harvests, despite the climatic conditions; but nonetheless we sell many millions of tons on the market and, whether the world economy likes it or not, we are nonetheless producers of grain for the world market because of our climatic and natural conditions, the land and water resources are there.

Recently there has been a great distance between Russia and European countries. We have nonetheless taken the decision to turn our grain exports towards the east and we are doing serious work to sell one or two million, not through the Black Sea ports but through the Baltic ports to Europe. We do see movement here. We are working in parallel with our oil exporters, moving in the same sort of direction.

Let me point out that with respect to regulation of our imports and exports, unlike what happens in the EU, where this regulation is based on decades of experience, we have only had a few years’ experience in regulation. It is only in 2001 that we took our first steps to regulate the import and export of agricultural products.

The first and most positive example is sunflower oilseed. We became exporters of that oil because of the measures taken by the government in 2001. Other types of crops then came into the
picture. There was the meat of fowl, meat and other products, which are positive examples of exports that are taking place.

**Policies toward the energy sector**

*Dejan Ostojic* 

Thank you, Mr Chairman. I am very pleased to have this opportunity to share with you a few views from the World Bank on Russia’s energy policy. I have to admit that preparing for this seminar presented the dilemma of how to address this distinguished forum, because obviously the people attending this seminar are not energy specialists and for them to hear the technicalities of energy issues and energy trade would not be very productive. On the other hand, energy issues are themselves very complex and broad. We can talk about oil or gas or coal or electricity, or various aspects of energy and nowadays because of very strong relations between energy and the environment, there are a number of issues related to the Kyoto Protocol and climate change and the use of alternative and renewable energy resources, which are also related to the questions of energy policy and how this sector is developed.

Last, but certainly not least, particularly in the context of Russian energy policy, there are issues of energy efficiency. This is another area which itself could consume quite a bit of time. I do not think it would be very productive to go in all those directions, so I will just remind you of the key and somewhat unique features of the energy sector. I will then summarise some of the key challenges and opportunities that Russia has in this area. Then perhaps we could give one hypothetical example of how these issues work in terms of regional energy trade, in the context of the present policies pursued by Russia.

In regard to the main features, what makes energy so different to the other areas we have discussed today? There are four key dimensions that we need to bear in mind when we talk about energy issues. The first key dimension is the concentration of energy resources. The geographical and geological conditions are essential in understanding the opportunities and how these opportunities can be exploited. This is obviously something that is very important for Russia because of its huge energy reserves and the potential in that area.

The second feature of energy is that it has a stronger natural monopoly character, in terms of how energy resources are produced, transported and delivered to consumers. This is particularly related to the transport of natural gas and electricity through energy networks such as gas pipelines and power lines. We can also say that, in the case of Russia, there is also a strong element of natural monopoly in oil transport because a lot of Russian oil is exported through pipelines. The physical limitations of energy networks create conditions for possible market segmentation and the use of market power in energy trade.

The third important feature here is the volatility of energy prices, which are related mainly to the price of oil in the world markets which, in spite of its own limitations, is probably the most free energy market. This is again because of the natural monopoly characteristic of energy and the limited possibility for direct competition of gas versus gas or electricity versus electricity. In most cases we are talking about competition between different types of energy (which is also called fuel substitution) such as competition between coal and gas or between electricity and gas, etc. That is an important element to keep in mind because oil and its derivatives are the main possible substitute for other types of energy and the price of oil, which is quite volatile, is a key driver in setting other energy prices.

Oil is now at a fairly high level, but it was not that long ago when people were speculating that the world would be flowing with oil and that the price would stay at US$ 12 or US$ 15 per barrel. More recently, people were concerned that it will not stop before reaching US$ 100. Nowadays it

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42 Senior Energy Specialist and Regional Infrastructure Coordinator for Ukraine, Belarus and Moldova, Europe and Central Asia Region, World Bank.
is a bit more stable than over the last couple of years, but it is anybody’s guess where the price of oil will go in the future.

The fourth dimension we have to keep in mind when talking about energy are the large investments that need to be put up-front in energy infrastructure in order to be able to serve consumers in the future. To pay back or recover investments in energy takes a long time, as does building energy infrastructure. Therefore, ensuring adequate financing for new (or replacement) capacities in the energy sector requires mitigation of risks, including increasingly difficult political, regulatory and environmental risks.

What are the key challenges that Russia is facing in terms of improving the situation in its energy sector and getting energy more efficiently to the markets? There are mainly three areas or key challenges that Russia faces. The first one is related to the economic price or the cost recovery pricing of energy resources domestically in Russia. This is obviously very important in the context of energy trade because it is quite difficult, although it is possible through the segmentation of the market, to separate this issue from the pricing of energy exports. In fact, we can show later on that pricing below the cost recovery level in Russia would have huge potential implications on the ability of Russia to play a major role in the future in the energy trade.

If we assume that Russia will gradually – as is already evident – bring prices to the cost recovery level in the domestic market, then the second key concern will be the issue of transparency and how good the corporate governance is in the energy sector in Russia. As prices go up, obviously issues of transparency, accountability and governance in the sector will become more and more important. Related to that is the question of how effectively Russia will manage the issues of a social safety net to protect those that are more vulnerable from the price increases in the energy sector.

The third challenge will be to know how to create a competitive environment to facilitate bringing all those investments and using those investments most efficiently in meeting the developmental needs of the energy sector in Russia. We now have a situation in which a major chunk of the energy sector in Russia is still controlled by the state. This level of concentration of course provides the ability to mobilise large investments. On the other hand, however, this increases the challenge of effectively using these investments and could cause delays in meeting investment needs.

If we have this set of challenges – again repeating the prices, the governance in the sector and competition – then the question is where are these major opportunities? What can be achieved? What should Russia aim to achieve by addressing these challenges? The largest potential that Russia has at the moment and that will be unleashed by proper pricing policies will be significant increases in energy efficiency in Russia. The biggest resource in the energy sector in Russia is not necessarily oil and gas that is sitting in cold, very difficult areas for extraction but, potentially, the energy savings that can be unleashed by reducing the energy intensity of Russian industry, including the energy industry. That is probably a very important element of the transformation of the Russian economy towards becoming more technologically advanced, more productive and also addressing issues of balancing the overall picture between the energy sector and other sectors of the economy.

Without proper pricing signals and necessary investments in changes of technologies in industries that are heavy energy consumers, it will be very difficult for those industries to catch up and become competitive in the world market.

In terms of creating and freeing potential for trade and export in Russia, that is probably an area where a lot of spare capacity is held up and which can be freed by proper pricing policies. Pricing is not the only element but it is a key policy measure.

The second opportunity obviously is to improve financial viability in energy enterprises. I am not talking about only the financial viability of Gazprom, although that also has room for improvement.
of financial viability, but of the whole spectrum of energy enterprises, going to the level of utilities serving consumers in Russia in district heating and other sectors. Improving the financial viability and creditworthiness of those companies is also essential because without that they can not mobilise the necessary capital and attract the necessary investments that are, in many cases, well overdue.

The last but not least question of opportunity for Russia is to mobilise long-term investments and put them into proper use. This is the only way for Russia to ensure in the long run that it remains in the position it enjoys now in the world energy market. The position that Russia enjoys should not be considered as being secure. The current situation will not continue indefinitely and adequate policies and relatively large investments need to be made to maintain the position in the long run.

This summarises the three areas where we see key challenges and opportunities for Russia.

There is a case study to see how this so-called dual pricing of energy could have an impact on prospects for the gas and electricity trade in the Black Sea energy market. You recall that when we spoke of competition in energy supply, typically there is competition between different types of energy. Here, we use the case of the dual-pricing of natural gas to assess how this may impact the future electricity trade in the Black Sea region. It is obviously an area where Russia can do much more than it is currently doing.

The first figure below shows what we call here the Black Sea electricity market. It comprises three currently disconnected trade areas: (a) Russia, Ukraine, Moldova and Georgia; (b) Romania and Bulgaria; and (c) Turkey. These three markets are disconnected because each operates as a separate power system without synchronous interconnection with the other two markets. The Romanian and Bulgarian market is a part of the larger south-eastern Europe electricity market which is interconnected with the European electricity market (UCTE).

**Figure 1: Black Sea Electricity Market**

What will happen in the case of connection of these markets? If one does a very simple economic analysis based on the assumption that the current dual pricing of natural gas (between the price of gas in the Russian market, versus the price of gas in Turkey or in Europe) will continue in the next 10 to 20 years, than the results of this hypothetic scenario are shown in Figure 2. The main
result is huge increases in exports of electricity from Russia to all those countries, i.e. electricity exports from Russia, which were about 14 terawatt hours in 2005, increase to something like 150 terawatt hours in 2020. There is, accordingly, an increase in imports from Ukraine, Turkey and other countries. It is all driven by the price differential between gas in the Russian domestic market and the price of gas exports.

**Figure 2: Electricity trade, 2005 and 2020**

The benefits of such electricity imports – in terms of annual cost savings of importing countries – would increase from about US$ 0.5 billion in 2010 to US$ 3.3 billion in 2020. That is essentially the transfer of the economic benefit from the Russian market to the importing countries.

Of course, such a scenario assumes an appropriate level of investments in power infrastructure (generation, transmission and distribution). The investment needs for the next ten years of the above hypothetic scenario are shown in Table 1.

**Table 1: Investment needs in power infrastructure (US$ billion), 2006-15**

<table>
<thead>
<tr>
<th>Country</th>
<th>Generation (Low Trade)</th>
<th>Generation (High Trade)</th>
<th>Transmission</th>
<th>Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>2.5</td>
<td>1.2</td>
<td>0.3</td>
<td>1.0</td>
</tr>
<tr>
<td>Georgia</td>
<td>0.3</td>
<td>0.1</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Moldova</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Romania</td>
<td>6.7</td>
<td>3.8</td>
<td>0.4</td>
<td>2.2</td>
</tr>
<tr>
<td>Turkey</td>
<td>25.3</td>
<td>19.4</td>
<td>2.5</td>
<td>15.0</td>
</tr>
<tr>
<td>Ukraine</td>
<td>11.7</td>
<td>7.8</td>
<td>1.4</td>
<td>7.2</td>
</tr>
<tr>
<td>Russia</td>
<td>69.1</td>
<td>81.3</td>
<td>9.0</td>
<td>40.0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>115.8</strong></td>
<td><strong>113.7</strong></td>
<td><strong>13.8</strong></td>
<td><strong>65.9</strong></td>
</tr>
</tbody>
</table>

The largest investments are needed in power generation and these are shown for two levels of electricity trade: (a) Low Trade, which assumes no changes in the current low level of power
trade; and (b) High Trade, which is based on the scenario shown in Figure 2. The total investment needs in power generation are very similar in both cases – about US$ 116 billion and US$ 114 billion over the next 10 years. However, it makes a big difference for Russia, because its investment needs in power generation are about US$ 69 billion in the low trade case, which compares to about US$ 81 billion in the high trade case.

The question is whether the above high trade case is likely to happen? Most probably not for it is not really in the interest of the Russian energy sector to create competition between its export of electricity and its export of gas. Even if something like that happened, the question would be how this economic benefit would be shared between exporters and importers. Obviously, in dealing with any of those issues the key question is the Russian energy pricing policy and, particularly, how Russia will price its gas domestically versus pricing it in the export markets.

Then there is the question of competition with other energy suppliers, e.g. competition with gas from the Caspian area, or an increase in the production of electricity from nuclear power plants in Europe and so on.

A question that is very interesting, but that we do not have time for here, is who would invest in this trade-related infrastructure. Obviously, the player who has the most to benefit from the trade would be expected to invest the most. Then we come to a key issue, which should be at the heart of energy policy: how to economically and commercially separate investments that are needed to serve the domestic market from those that are needed to export outside Russia.

We have to understand that there is a concern that Russia first of all ensures a reliable supply at home, before ensuring that it benefits as much as it can from exports. This is not an easy task at all. In the short run we may see some difficulties in Russia in meeting electricity demand. Even in this coming winter there are some questions as to how the domestic electricity demand will be met. Furthermore, a similar situation may be evolving in the gas sector as well.

Obviously the pressure on the Russian energy sector to invest is increasing. The question of how these investments will be mobilised and how they will be related to trade issues are high on the agenda and a priority for the policy makers.

Thank you for your attention.

**Statement by Mr. Sergei Nikitayev**

I absolutely agree with the previous speaker on many issues, starting from his first statement. When we talk about energy, it either takes a lot of time and talks in huge detail or one says nothing at all. I would like to thank him for such a detailed and clear presentation on some of the issues that are priorities today. I would like to emphasise that the order of words in the title of my ministry, the Ministry for Industry and Energy, is important.

The first presentation of the seminar mentioned a gap between academics and politicians. Academics, with their recommendations, are sometimes behind the times as far as politics is concerned. For the gas market the situation now is much more interesting in many areas than they envisaged. For example, we are now considering the possibility of three pricing mechanisms in Russia, rather than two regulated long-term and support contracts, and another option in the mid-term to bring our domestic gas prices for all consumers to average European Union prices. In other words, the prices would be the same as at the border, minus transport logistics costs. It would still be lower than Germany for instance, but not several times lower.

Another important issue is the structure of the fuel and energy balance of the country’s resources. There is a certain shift being observed towards more coal and nuclear power to produce electricity and to lower the share of gas in the generation market.

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43 Ministry of Industry and Energy, Russia.
I would like to conclude my remarks on energy here and go back to the main subject of our seminar, which is foreign trade strategy. An interesting thing that speakers have mentioned today is the setting of goals and definitions and defining aspirations. Those difficulties are not accidental, they are fundamental difficulties. They arise not because of a lack of information but because the trade priorities, goals and targets are not defined outside of the trade industry itself, so that those strategic choices that we discussed earlier need to include the one that was not mentioned, and that is the choice between trade policy and industrial policy. There are two obvious options here. Either we choose the situation where industrial policy is serving and supporting the trade policy, or the trade policy is there to support the industrial policy.

I support the second option, namely that the trade policy, in my view, should be defined on the basis of the country’s industrial policies. I think that this view is not just because I work for the Ministry of Industry and Energy, not the Ministry of Trade, and I do not want to go into detail now because we will have an opportunity to discuss this. We need to look at what we define as industrial policy and we need to remember that energy policy is an integral part of industrial policy, so we need to decide on our priorities in our industry and energy sectors and develop an appropriate strategy for development. We should then define and institute the dialogue between the state and private business. This aspect, the dialogue between government and business, is no less an important aspect than the first one, namely the definition of the state, what industry sees as a priority and what it sees as a priority trade industry.

One thing is clear: the system we have is a market economy and the government does not plan to change that. Therefore, when we talk about strategy, we say that we can define the state interest and say what business efforts should be in this area. Business can view it – and it does in some ways – as a state guarantee, as a government guarantee to their business.

Business on its part should be a good partner to the state. In other words, if the state guarantees that the economy will be a stable market economy and that this is the course of the government, its business should assist the government in pursuing this policy. Businesses should have their own strong strategic business policies. If an industry does not have businesses which are capable of a dialogue and negotiation with government, we cannot even talk about any development of government strategy.

When we talk about public-private partnership, there should be a common understanding of goals, of views as to how those goals should be achieved and the diversification of risks.

We have three categories of issues in relation to deciding priorities. First, we have to bear in mind Russian national interests. The second is the multiplier effect that an industry can have on other industries: if one is developing ship building, one would do it not just because Russia has always been and will continue to be a power on the sea – not only a power that builds ships but one that is able to use them effectively for its economic development – but the multiplier effect would be that the ship building industry would stimulate other industries to which it is linked, from metallurgy to electronics, to instrumentation industries and other hi-tech industries.

The third category is the social consequences. We need to take into account the education of their labour force and various other issues about labour resources. Answers to all these questions would help us to decide whether Europe or Asia are our priorities, because we need to answer some specific questions. Do we need an aviation industry? Do we need car manufacturing? In other words, does the government need to assist those industries? If such choices are made, then we can look at the situation in the domestic and international markets and decide what their demand is likely to be and the structure of this demand and we can then compare this demand with the manufacturing capacity in the world, to see whether there is any imbalance. We can review our own options and opportunities and see how we can cover and correct such an imbalance and see what we could do to use this situation if there is an imbalance and then look, define and develop the measures that would get us to a position in the market where we are an important power to fill those gaps.
In order to do that we need a competitive industry. We need to upgrade the manufacturing base. We need technological innovation. Any new product or service, in order to penetrate a market, needs to be based on modern, sound practices.

One of the main indicators in all industry strategies is a share of the world market.

Our target definition of objectives and indicators is important. Taking the aircraft industry or any industrial market, we see that there are several big players. One can compete successfully with them only if one is a major force oneself. We need to understand fully that this is the market principle we have to deal with.

Another issue closely tied to this is wide cooperation, international cooperation, cooperative use of assets and other cooperative links and networks. In aircraft industry terms, these would be arrangements and agreements such as a supply agreement with Airbus, for example. If one supplies raw materials then one needs to build this relationship in such a way that it will allow for the supply of equipment in the future. What is important here is joint development programmes. In the aircraft industry, in order to penetrate such a market one needs to come with a new product, for instance a new mid-range solution. To provide such a solution, one needs cooperation at the international level. One cannot do it in isolation. Certification of any product is a difficult issue and to do it alone for one country – to penetrate politicised markets such as aviation – would be very difficult.

It appears that we are now talking about export support as though it is least important; of course it is not. However, the instruments for export support have to be developed specifically, for specific industries, for specific targets and goals. General schemes do not work effectively, as experience shows us.

The main challenge is not so much trade flows but an imbalance between export, import and manufacturing dynamics. This is something that we are trying to resolve with the help of industry-specific strategies. If we do develop a single trade strategy in the end, it should be a strategy capable of coordinating these strategies that are formulated within the framework of industrial policy.

**Summary of the discussion:**

**Comment by Mr Dimitriev:** In terms of polemics your comments were very stimulating. After the break we will need to go back to the beginning of our discussion and see how the experiences we discussed yesterday could be applied in this situation that we have just discussed. Then I would like us to discuss how we could deal with the key problems of Russian trade strategy. We must ensure that this document does not answer only those questions that we are able to answer, but it must provide guidelines for us to answer questions tomorrow that we cannot answer today.

What elements in international practice are most up-to-date for developing and institutionalising Russia’s new foreign economic policy? I would like to hear what our international experts think about that. Such advice would be of great help to us. To the Russian participants, I would invite those of my colleagues who have not been able to intervene earlier to make some brief comments. We have here representatives from a number of bodies and organisations. They are closely involved in external economic policies and, sooner or later, in Moscow we are going to be discussing an official draft of Russia’s foreign economic strategy. Today, in an informal discussion, it would be very interesting to hear what problems we will face in various areas of foreign economic policy.

**Comment by Mr Maslov:** Thank you. I am going to speak off the cuff. I do not have a report, but I would like to say something about the work of the Ministry of Transport. I have only been

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44 Director, Center for Strategic Studies, Russia.
45 Ministry of Transport, Russia.
working there for a few months but, nevertheless, I have a view of the situation. Much was said of great interest today about the development of industrial sectors in the economy of our country. Each of these has medium and long-term development plans, going up to the years 2010, 2020 and even further. As it seemed to me, unfortunately, interaction in developing these plans in each of the ministries has not taken into account the interests of other ministries or areas because these are of interest both in terms of dependency and inter-dependency.

Coming back to this seminar and the policy that we are developing in a number of bodies – and we are hoping for more contact between these authorities – we would like to set up regular meetings so that we have a more concrete view of what is going on and of implementation, as we did in setting up a domestic policy, which was very rich in nature but, unfortunately, not well implemented.

In developing these policies we must also take into account our domestic problems.

I would like to stress the significance of the need for joint work here, not only because I represent the Ministry of Transport, but because of the importance of infrastructure.

The development of industry, energy and any other agricultural sector will, one way or another, depend on the success of the development of the transport sector. We have to develop ports and airports and find ways of expanding the movement of traffic, in order to use all the opportunities that will arise in our country. We have to increase domestic production and use all structural possibilities. A lot of these are hypothetical, but from the point of view of the future they are very important in stimulating economic activity and in helping business, exporters and so forth.

Transport is a very important area. Partners in business and government will bear all this in mind when they develop their strategy for economic policy.

Another item I would like to bring up in facing the tasks we are going to look at within our strategy is to do things on the spot, as we used to say under Soviet rule. That is to say, to get people to work more efficiently, because all this is very much developed in the UK and America, but these are old mechanisms that are constantly being improved. I can see that, in connection with the British representation in Moscow that is implementing that British strategy, which is done on the basis of its embassy there.

I am not going to go into the details of the organisation there. They are organisations that are subordinate to the Ministry of Trade, but there are people round here who are also involved in the whole development of the economic potential of Russia through their representatives abroad. The Americans have done the same in the Soviet Union by having people on the spot. We had a sort of monopoly in foreign trade, but we had our own people on the spot in London, for example. We have to define the role of these representatives. This is a role that has changed somewhat and in implementing the work we have to do now, this is a role that cannot be over estimated. It is a role that has to be followed when doing our economic development. These are bodies that have to remain, but perhaps not in the same shape or form. I think they will be necessary in the work that we are doing in our representation abroad.

Comment by Mr. De Souza: Thank you for the opportunity to make a statement on behalf of the European Commission. I am afraid I will not be able to use a disclaimer before what I am going to say.

Both the European Commission and the European Union Member States have traditionally been supportive of the comprehensive and non-discriminatory integration of Russia into the world economy. We have been doing this both directly by the actions of the European Commission and of its several support programmes that we have had in Russia, notably in the case of WTO accession. As you all here certainly know, we have basically closed all the outstanding relevant

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46 Economic and Financial Officer, Russia Desk, DG-ECFIN, European Commission.
issues that the European Union has concerning the entrance of Russia into the World Trade Organization.

We have supported several different programmes of information and training of your own officers at the federal and local level, concerning the likely and prospective effects of accession to the WTO. We have also been supportive of the comprehensive non-discriminatory entrance of Russia into the world economy via organisations upon which we, the European Union and the European Commission, have leverage.

This organisation, the EBRD – and the European Commission is part of its board – is one of the cases in point. We systematically support the projects of trade facilitation that emanate from the EBRD. We also do that via the investment banks that are instruments of the development policy of the European Union, namely the European Investment Bank.

We are in the process of approving the third mandate for the European Investment Bank, which has an envelope of investment for the Western CIS of around €4 billion. We shall have a substantial component of energy and transportation infrastructure here and infrastructure is necessary for an effective integration of Russia into the world economy as a whole, not only to any specific area of the globe.

In regard to the level of trade or economic interrelations between the European Union and Russia, we are one of your most important external partners and we will remain so in the foreseeable future. It is of course very relevant and necessary to look at prospective developments in terms of the degree of interrelations in trade between Russia, the EU and other partners. But when you look at the current level of trade and FDI investment, for instance, this trade is fundamentals based. Russia trades a substantial share of its exports with the European Union because it is economically logical and rational to do so. If you use fairly simple frameworks – like gravity equations – to analyse the degree of trade relations, you do not have any indication that Russia is overtrading at any substantial level with the European Union, quite the contrary. This level of trade is fundamentals based.

I will not enter here into a debate about the future share of GDP that the European Union will have in the world economy in one or two generations from now, but I would like to point out – not being very original – that it is very difficult to forecast the future. When you do that, it is usually relevant to play round with scenarios. For instance, certain regions of the planet might not keep their current high growth rates.

Also, when you try to model what will be the share of relations in the economic sphere that Russia will have with the EU in one or two generations from now, it is relevant to keep in mind what this European Union is going to be. In one generation from now we could be talking about a European Union that would include Turkey, which is a very large emerging market that is substantial in terms of trade relations for Russia. So, when you play around with projections, it is usually useful to have different scenarios and to consider the relevant counterparts in the future – not whether you are a 25 member states EU, but eventually one with 30 or 32 Member States.

In relation to the future Russian strategy concerning foreign trade, I would like to point out two questions that are of considerable importance for the European Commission. One is in a sector that is of strategic importance for both the EU and Russia, and that is the energy sector. We would point out that the level of commitment in terms of supplies for different regions of the planet – let us say between the European Union and the eventual development of an Asian market, which is something that is strategically necessary for you – should not be via sacrificing one of your traditional partners for the development of those new markets.

Energy is a strategic sector for the European Union and this is something that should be kept in mind when you consider eventual supplies to other parts of the globe and what this might imply in terms of the shares of your supplies that go to those new or developing partners.
The second question that is relevant for us is when you speak about a trade diversification strategy. When you look at what sectors would be relevant for a successful diversification strategy, the sectors in which you find revealed comparative advantages, what is the ownership structure of those specific sectors? We may come to a situation in which the sectors that you might eventually identify in your own strategy as relevant for the future diversification of your external relations are mostly state owned. If you are considering the need to increase the competitiveness or the capacity of "going abroad" of those sectors, it is perhaps useful to consider if this is the optimal ownership structure for such a successful strategy.

It is also relevant for you to consider what would be the role of foreign ownership in such a process. We have many examples of development of competitiveness in countries that rely to a substantial degree on the opening up to foreign direct investment and foreign ownership in several sectors. The reason why this is so is intuitive. FDI brings in technology and managerial expertise. It brings in the linkage of a country to already existing productive chains in the global economy. They are not bringing only the money.

Any idea of eventually turning Russia into a linkage between Asia and Europe would necessarily imply the existence of an infrastructure that would enable you to perform this linkage role. The construction of infrastructure implies a truly substantial need for investment. That is why you might consider opening up a discussion on FDI, which is a relevant question.

Comment and question by Mr Dimitriev: I have a follow-up question to Robert Rogowsky. At the moment in terms of Russia/North American trade both partners are mutually insignificant. Do you feel there is any viable scenario under which this could change and both trade partners could become far more important to each other? I mention this because, as David Tarr rightly pointed out, there are effects that are not captured by existing models, which have to do with the scale effects of investment and technology. As soon as Russia trades, for example, with Pakistan or with Brazil, this is a very different kind of trade, compared to Russia’s trade with the United States or western Europe, because the latter is more technology intensive and engages more competitive market. Normally this relationship involves direct foreign investment with huge technology transfers, both management technology and innovation which has a lot of positive externalities for the economy, which is the recipient of investments. So, the same volumes of trade for Russia and the United States may mean a huge difference as compared to the same volumes of trade between Russia and China. Do you see that Russia’s trade with North America may become more significant in the future?

Response by Mr. Rogowsky: Fortunately, I can start off with the disclaimer. I guarantee these are not the government’s views, these are my views.

Thank you for the question. I wish I had anticipated it before because it is a profound question. My first glib answer is: if you can make a whole bunch of really cheap goods like the Chinese, yes, we will buy them all, because we seem to have a tremendous appetite for anything that is price competitive. So the Chinese strategy is a very effective one, targeting largely the United States. That has been the export policy for any number of countries. In fact it has been a development policy for many countries to develop an export sector, targeting the United States and the EU but largely the United States.

One of the troubles I think with Russia is that you do not have those kinds of industries. You have industries that have been targeted to a very different audience, an audience to which Russia is a more technology advanced provider. That puts you, when you open up to a broader world market, in direct competition with the United States for trade in goods. I mentioned a factoid that I had heard from a speech made by President Clinton that, in terms of consumer goods, the United States has had a trade deficit every year but two since the republic began. I cannot verify it, but the president said it, so I am accepting it. That means that we generally sell better at

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47 Director, Center for Strategic Studies, Russia.
48 Director of Operations, United States International Trade Commission.
higher production input areas, higher value added and we have never been terribly competitive at 
regular consumer goods. For Russia, I do not think that would be a good strategy, to try to 
compete with China in the world market.

You would see more trade with the United States in a strategy that focused on creating an 
environment where large multinational corporations of European or American heritage could 
develop productive and profitable ventures in Russia, like John Deere. Then you would start to 
see a lot of intra-business trade and then you would see a lot of trade in terms of services and 
inputs being provided to the production in those multinational corporations. That is where you will 
tend to see the kind of trade that is of relatively high value added, a little further up the economic 
food chain, where there would be a much stronger connection between Russia and the United 
States. That would be my guess, as a superior strategy, about the way you might want to make 
an economic connection with the United States.

Comment and question by Mr Dimitriev:49 I have a follow-up question for Peter Dixon. There 
is a lot of speculation in Russia that 50 years ago Australia developed and picked a successful 
export strategy, when emerging Japan became a huge consumer of raw materials delivered by 
Australia, whereas Australia was consuming Japanese processed goods. The comparative size of 
the Japanese economy then to the Australian economy was very much the same as the 
comparative size of the Chinese economy to Russia’s economy and the comparative advantages 
are very much the same.

Do you think that Russia can somehow replicate the successful Australian export strategy of 50 
years ago by exporting raw materials to China and importing Chinese processed goods, while also 
picking some export opportunities in services and hi-tech sector as well, just as Australia is doing 
now? Can history repeat itself, or is this a very wrong way of looking at things?

Response by Mr Dixon:50 Thank you for the question. I do not think I will be able to handle it 
as well as Robert Rogowsky has just handled his question!

Australia has huge natural resources. It was a very obvious idea that we should export first to 
Japan and now with the movement of steel to Korea and China we are exporting mineral 
resources to those countries. Of course there is a cost, which is that our manufacturing industry is 
quite underdeveloped. If you are really good at exporting something, then the rest of your 
economy will tend to be import competing, so our manufacturing industries have always lagged 
behind.

For facilitating Russian diversification of its exports, probably the best thing that could happen 
would be a collapse of energy prices. Australian manufacturing looked best when energy and 
mineral prices fell. Then our exchange rate fell quite dramatically giving us relief from the Dutch 
Disease. So being blessed with mineral resources and being able to export them to Japan – well, 
it is not clear to me that that was actually very good for the development of the Australian 
economy. Australia was the richest country in the world, you know, in 1890, but by the 1970s 
Australia was not even in the top twenty; so in this period of relying heavily on mineral and 
agricultural exports we fell behind. I do not know whether there is a lesson in there. In the last 
thirty years with rapid growth in manufacturing exports, Australia has grown quite strongly and 
has re-entered the top twenty.

Comment and question from Mr. Dimitriev:51 Let me now start a discussion with our Russian 
colleagues. Galina Balandina said something very interesting about the prospects related to the 
development of external regulation. She said that clearly we are moving to a situation when 
customs tariffs will lose their fiscal role and that they may also lose their role in trade regulation. 
Therefore, there is a very serious question here. The present state of customs regulation in Russia

49 Center for Strategic Studies, Russia. 
50 Principal Researcher and former Director, Centre of Policy Studies, Monash University. 
51 Director, Center for Strategic Studies, Russia.
is based on the assumption that it plays a fiscal role. The budget has received great import from customs duties. If customs are no longer giving the greatest input to the federal budget and, if we gradually stop them playing any significant regulatory role, why should we have this kind of onerous system at all; why shouldn’t we undertake a radical transformation of the customs administration which would prevent it from being an obstacle to business?

Do the representatives of the customs administration see a major challenge in all this?

Response by Ms Balandina: It is a very interesting question. Thank you for allowing me to reply to it.

The fiscal role in customs tariffs is that 42 per cent of the budget came from external economic activity. Customs payments are not just import duties but also export duties, particularly on energy sectors. This great proportion in the budget is due to the energy vectors being exported.

Looking at ways and means of doing this, this is a very important routine problem for Russia today because even insignificant customs payments – compared to the 1990s – the present ones are not fully collected. We are aware that in regards to some kind of goods grey schemes of importation are used in 70 per cent of all imports. For example, in regard to digital cameras and certain types of electronic equipment this is a big problem not from the point of view of filling up the federal budget, but from the point of view of the unequal competitive conditions among importers and Russian producers. The import VAT rate is 18 per cent and it is not in any way a fiscal role, it is simply a countervailing role that it plays to the VAT that is collected. If you do not collect the VAT, then this gives the imported goods a great advantage and this is a very major problem that we are facing.

From the point of view of simplifying customs procedures, I do not think that today this is a very serious problem. The customs people have changed greatly in recent years and the progressive new technologies that are based on automatic processing of data, simplification of documents and all that, are bearing fruit. Five years ago, we could not dream that the customs people would pass goods through in one day. Of course the present problems are not just customs problems, there are also problems facing business in Russia and we cannot be silent about them.

In foreign trade today we do not have an appropriate legal position, we have a criminalisation of the economic sector and we have to take that into account.

A good balance between lightening customs procedures and payments and the effectiveness of your controls – we know what to do. This is information technology that we need and interaction between the tax and the customs people and between customs people in Russia and in foreign countries. It is also about having prior information of upcoming supplies and the possibility, therefore, of controlling these before the goods are brought into the country and, also, transferring the control time to the time when the importer can have access to the goods. You cannot do all that in one instant. It is tremendous work for the financial authorities and it is linked up with technical re-equipment of the customs people, which needs far more resources than the credits that we have been given by the World Bank. We have to train staff, which is also an expensive and very long process.

It seems to me that we should not be pessimistic either, despite the picture we are looking at today. It is not very satisfactory from the point of view of meeting the interests of trade. It is not just the burdensome procedures but the fact that we do not have equality among all the different people participating in this picture – whether you can bring goods in without payment, or with lower levels, then it distorts the competitive rules. It also leads to corruption and there are a lot of negative consequences. But we have to find ways to go forward and we need time and steadiness so that all these understood instruments can be implemented. I think it needs time. The government’s plan at least, which was approved in 2005, is the strategy for development of

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52 Director of the Department of Regulation of International Economic Relationships, Ministry of Economy of Russia.
customs for the next years leading up to 2010, which is the time at which we are going to have to achieve a level that meets the needs of Russia.

**Comment by Mr Terekhov:** The previous speaker has said quite a lot already, so I will just add something. She masters all these details, but let me add that customs are transparent to business. They promote business. They cooperate together. All standard documents are discussed with business. Business is also interacting with the customs and informs them of producer prices. Let me give you an example.

The technical things, the electronics and digital cameras she talked about, the real import is something which has moved out of the grey area, as has the documentation we get coming in for imports compared to earlier periods. Imports have now increased by a factor of three. I am talking of mobile phones.

Mr Lippoldt said that there were delays and that things were held up, but that information was in the press and you should not believe it every time because the value that was held up was about US$ 5 apiece and I remember the radio telephones from Finland were competitive here. Possibly it was not such a grave situation. I am talking about mobile phones costing US$ 150 apiece, so you cannot compare that with the other value that was given. If you look at the press, it is not always necessarily correct. The customs are open, they are fully informed and there are no problems on this whole subject of interaction with business.

**Comment and question from Mr Dimitriev:**

I have a question now for our representative from the Ministry of Foreign Affairs. The Ministry of Foreign Affairs has representatives in a number of countries and we are in a country where this trade representative is available. If you telephone the representative in the British Consulate in the United States and ask what the conditions are for an investor in some specific small town in Scotland or elsewhere, then the consulate representative in a few minutes can either directly give you detailed information or put you in touch with someone who will give you that detailed information. This sort of potential has been supported by a very widespread information network.

Could this sort of infrastructure be set up in Russia and could it be made open not just for large businesses but for SMEs as well?

**Response by Mr Krestyanov:** As for trade representatives, it has developed as dealing with the monopolistic foreign trade we used to have and, in being eliminated, it lost its raison d'être at least in that area. Nonetheless, this organisation is continuing to implement a number of important functions. We began some time ago to be very much aware that economic services in embassies and trade were duplicating work. They were working in a rather chaotic way between the trade missions and the embassies and they were actually getting in each others’ way. We discovered that some time ago.

In the Ministry of Foreign Affairs we brought up the question of the need to reorganise these trade representations. This Bank has, in part, already been done. Trade representatives in more than 50 countries have been reformed into trade embassies. This is something that we only did last year, so it is quite early days. By the end of this year we will review how it is working.

A decision was taken that trade representatives in a number of large countries, for example the UK, France and Belgium – because Belgium is a large country from the point of view of foreign trade – will be conserved as independent structures, although they have always been part and parcel of embassies. Trade representatives have always been a part of the embassy.

The other question of course is where they had autonomy and decision making. That they did have, but the autonomy is now reduced to a minimum. It is a unit within the embassy, but they also have an important role to play. That is as far as trade representatives are concerned.

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53 Director, Center for Strategic Studies, Russia.
54 Deputy Director of Economic Cooperation Department, Ministry of Foreign Affairs, Russia.
As for setting up a system for informing people about the procedures that you have to implement when doing trade in whatever region, this is a question that has nothing to do with the Ministry of Foreign Affairs. I think these consular officials in the Foreign Office of Great Britain are not really the initiators. They do not support that function. They are users of the system and are a link transmitting from an interested regional authority to the interested user, so they are a transfer body. The Ministry is happy to be that kind of intermediary. Unfortunately we have a lot of problems in regions.

I think I have answered the question. Now let me give you my views on the issues we are discussing today. Russia has moved to liberalising its economic links and we had thought it was the right way to go forward. But liberalism can be in varying degrees. In principle there is not a single country in the world that would apply the principle of liberalism 100 per cent without any kind of reference to its internal problems.

In this connection the foreign ministry is not the main operator in the development of foreign trade, but we are prepared to support any liberalisation of trade, providing that the significant economic and political interests of Russia are protected.

The EU representative raised the question of diversification in exports of Russian energy. It was quite correctly emphasised that the level of supplies to new markets should not damage traditional users of energy resources from Russia. The converse is also true, that the level of consumption of the European Union and the attempts of the European Union to diversify their sources of supply should also not cause damage to the traditional supplier. So if we observe that balance, then there is a way of resolving the problem. If one partner says receiving energy from one source is a threat to my security and, therefore, I am going to diversify energy supply sources, then the other partner has the right to say, “the concentration of my supplies to one person is a threat to my source and, therefore, I am going to diversify my exports”.

We must try to develop competition on the home market and Russia has already demonstrated that it is willing to do this. At the same time, we have strategic sectors in Russia, where competition must, without doubt, be limited. Such strategic sectors are also in existence in our partner countries and we also see that Gazprom expressed an interest in purchasing a gas grid in the UK. Then it was stated by the Prime Minister that this was a political matter, it had strategic significance for the UK and that special rules would be applied to this deal. To what extent this meets the requirements of Britain under the WTO and to what extent that is the domestic legislation of the UK, we do not know. We have not analysed that question.

I just want to say that each country has its specific interests and special areas that it considers to by strategic and the wish to defend those strategic interests cannot be considered to be a lack of desire to move towards liberalising its economy. So the development or the liberalism in the Russian economy and policy will be comparable with the steps that are taken by our trading partners towards us as well. Thank you.

Comment by Mr Valukov: I would like to mention something about the document which was presented by the Center for Strategic Research. This material is a good basis for further work and to prepare a document on the external foreign trade policy of Russia one must be fairly clear about this document. This, judging from the first statement, could be the national interest and how to defend it.

In designing national interest we must look at possible threats to it, which could be defined by an algorithm, based on the kind of choices we have. This may not be suitable, but it does seem to be built on the principle of protecting one’s national interest, and this could be a kind of guideline document for both corporations and government structures. However, undoubtedly in this document there is one positive quality: it not only defines economic approaches but also food

55 Security Council, Russia.
security. We could also add to that other sectors of the market, where it would be necessary to stress energy security, which has been talked about to a great extent here.

The third desire is that this must be closely linked to present economic development policies as adopted by the government. It also has to tie in with the economic doctrine of Russia that is in force now and then the document will have the right to exist and will be viable.

If I were developing the document I would suggest that particular attention be paid to cross-border cooperation and cooperation of border territories. Somehow that has been forgotten.

Another important element is the behaviour of exporters in the market of transport services. Russia is a very particular country and its transit potential is huge. This potential has not yet been tapped and it could be used to a much, much greater extent.

Specific tactical measures are required to develop international transport corridors. To illustrate this point I would name Kazakhstan. It is necessary to start talking to Kazakhstan about using a trans-Siberian route, to China via Kazakhstan to the west, and Russia could deliver to the east and to the south of China. This is a possible scenario.

I hope that a lot of what we have heard here will be very important and useful for fine-tuning this document.

**Comment by Mr Chernyschev:** This is really a reply to my colleague from the Ministry of Industry and Energy. Looking at the relation between trade and industry in a wider context, we are talking about the structure of this state machine – ministries and departments. What are their roles? It is not a secret to anybody. In fact it is a banality. But foreign trade always brings about conflicts of interest between manufacturers and consumers. Regulators all over the world always regulate on behalf of industries.

A colleague cited the aviation industry. I will use the same example to illustrate my thought, because today the subject is widely debated at all levels of government and in society at large. The Ministry of Industry says the aerospace industry should exist and nobody is against that, but the transport ministry says our air carriers have a problem in replenishing their aircraft park and domestic industry cannot supply enough for our airlines. It asks the Ministry of Transport to do something about it. There are more interesting examples, however, because the manufacturer and the consumer can work in the same industrial sector, for example, we are at the end of our anti-dumping investigation on ferrous manganese, which is used during the casting process.

We have producers of ferrous manganese and consumers and for them protective measures are not beneficial, to say that that will influence the price that they pay. What is the way out of the situation? What role should the Ministries of Commerce and Industry play? As we say in Russian, “who are the judges?” This is a new subject for foreign economic relations and, if we do not find answers to all these questions here that is understandable, but they are very worthwhile questions.

I understand that there is very little time and, therefore, I will be very short. The document we are discussing should be a document for the public and I have already mentioned why. This is not an internal government document. Perhaps an internal version should be produced later, but the main purpose of the document is to make it public, to state foreign economic policy, aims and goals very clearly and ways they can be achieved, so that business knows what is expected of it.

We cannot and should not run the risk of biting off too much. When we talk about WTO, I participated in those debates on the very first day and I recall that all subjects related to economic policy were strictly relevant for the WTO accession process. All our debates in the country have a direct relationship with foreign economic policy and our economic life at large, but some are elements of our strategy and some are outside.

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56 Director of External Economic Relations Department, Ministry of Economic Development and Trade, Russia.
Perhaps this internal conflict should be sorted out in the following way. The aims and the goals should be formulated appertaining to the foreign economics part, whereas the aspects that impact on other spheres of economic life should be dealt with as a wish list or elements that are missing and need to be developed later.

There should be a strategy in this particular sector of the economy because we see that the sector is missing a policy that my colleague mentioned. Perhaps the matter should be tackled in this way.

Comment by Mr Dimitriev:57 I have two short comments on the expert group that took part in drafting the document you have been given. To avoid misunderstanding: if we are talking about foreign economic policy, then we normally talk about trade policy or foreign investment policy, automatically assuming that at this level the instruments of foreign economic policy can be used just as any other instruments of industrial policy. There is no conflict here between the terminologies. We are just separating the policy goals.

Clearly, foreign economic policy instruments can achieve goals that do not pertain to industrial policy. If we want to use export duties to increase budget revenues, that falls directly under budgetary policy and foreign economic policy and perhaps has very little to do with industrial policy. So, the fact that we do not mention industrial policy often enough is because this strategy is focused on regulating the foreign economic sector, which does not mean that we cannot use these instruments to achieve wider goals.

My second comment is to do with the nature of the strategic choices that the document presents. This is a sort of a road map and the Russian government can choose from the options available. The map is true and correct for any rambler who has not yet arrived at the place for which the map has been drawn up! He can use this map to improve competitiveness or standard of living or GDP; or this wanderer can use the same map to diversify exports or increase the share of exports in GDP; or he can use such a road map with totally non-economic priorities, with security priorities. Or he might have a very specific idea as to which sectors have to be supported and why.

In any case, the purpose of the document submitted here is to show the range from which we can choose. The purpose is to show where we have alternatives for using our resources. If we spend more here, that means that over there we will be limited in our choice.

Therefore, depending on priorities at any particular stage of formulating state policy up to 2020, it is very difficult for us to have specific forecasts about what policy makers will want to use as their priorities in 2016. However, we are trying to provide a kind of map, a guidebook, which will show them where they may arrive if they follow a particular vector and which measures and instruments they would need to take along to achieve what they wish to achieve. This is the logical status of the document that we are submitting. Given this approach, there is no contradiction at all between some people saying we must have certain sectors of industry and other people saying we must trade with these particular countries; and others saying, let us liberalise everything altogether. This is just a map, a guidebook. The policy makers will move in a particular direction that they will select.

Comment by Mr. Lippoldt:58 I have three short points. It has been over a decade that I have been working with Russia and I continue to be impressed with the immense and rich diversity of Russia in human and natural resources. We have to think about how policy can help remove obstacles to the realisation of the maximum potential of this huge economy. Somewhere in the trade policy strategy it would be helpful to endorse the removal of economic impediments as an objective. If you look at the World Bank’s Doing Business database you can find some of the impediments that have been identified, including in relation to trading across borders.

57 Director, Center for Strategic Studies, Russia.
58 Trade Department, OECD.
Last time I looked the Russian Civil Service, in terms of its size it was fairly modest and the state was not oversized in terms of its staffing. When one discusses plans for industrial policy and intervention in various industries, it needs to be kept in mind that there is a limited state capacity here. One may find it hard to imagine the diverse and complex potential of the various sectors of the Russian economy. The state needs to be careful not to impede the ability of enterprises to innovate and capitalise on this innovation in specific ways that policy may not predict. Government institutions might aim to provide framework conditions that facilitate development, providing essential protections as necessary for the public good (e.g., safety), but avoiding interventions that constrain the realisation of economic potential in all its broad diversity.

There was a suggestion that the trade policy framework could be made a public document. In my opinion, that is an excellent suggestion, so that all who are considering Russian foreign economic policy can have a chance to see the policy direction and intention.

The final point is that international trade policy discussions now extend in scope beyond consideration of simple border measures such as tariffs and quotas. For example, in the context of Russian WTO accession there are elements dealing with, among other issues, liberalisation of services, trade liberalisation and protection of intellectual property and the standards that apply not just at the border but throughout the economy. It is important to think of the tremendous domestic benefit that can come from these types of economy-wide reforms that go well beyond what happens at the border.

Comment by Mr. Tarr: 59 I would like to comment on the strategy. I would like to come back to the questions I discussed yesterday about raising non-traditional exports in Russia. We all have that as a core objective to a lot of what is underlying this work. There are a lot of people who, at one point, thought about picking winners, people like Larry Westfall, who eventually opposed that strategy; or Danny Rodrick who talks like he is in favour of a lot of interventions but opposes picking winners. Not only does the state not have enough information, as Doug Lippoldt has mentioned, but you turn entrepreneurs into rent seekers when you start picking winners. Would you rather have entrepreneurs or somebody who lobbies the state? If you start picking winners you turn a lot of entrepreneurs into lobbyists. That doesn't mean there is not a lot the state in Russia can do. There is still a lot to be done in terms of developing non-traditional exports and it should be doing this in my view.

A lot of it concerns behind-the-border issues, which are in many cases more difficult. I really appreciated the intervention of Galina Balandina. I learnt a lot about what is and will be available in Russia. In some cases we learn that some things are not working very well. It would be useful to investigate further the problems in the mechanisms and see how we can improve those mechanisms.

In many of these cases, the things that remain, that can be done, are not stroke-of-the-pen type laws, but require the development of institutions and trying to figure out how things can work better.

Trade facilitation and customs modernisation are part of those, as has been mentioned. There has been a good bit of work on customs modernisation. These are project type activities which require considerable resources in terms of roads and ports and fixing transportation networks and dealing with fundamental administrative problems sometimes in facilitating the flow of goods. We have talked about production networks and production sharing and multinational investment. Multinationals are not investing much in Russia as a production platform for exports to other countries. That is something that multinationals do in a lot of places in the world, but in order to get them to do it in Russia you need two things. You need an environment that is favourable to it, but also trade facilitation and efficient customs procedures that allow goods to come in and out of the country without significant delays.

59 Consultant and Former Lead Economist, World Bank.
Improving the environment for investment, for production sharing and dealing with trade facilitation are very complementary procedures for improving non-traditional exports.

Finally, I will mention again the business services regime and allowing foreign direct investment in banking, insurance, telecommunications and transportation that lowers the cost of doing manufacturing business and allows non-traditional exports to have lower costs of production and compete on world markets more effectively.

Comment by Mr. Rogowsky. You asked me about trade with the United States. Trade does follow investment and investment is terribly important. My impression in Washington and the United States as a whole is that there is a tremendous enthusiasm for investing in Russia, when there is comfort that they can invest in Russia.

If you look at the Doing Business Report – I have not seen the one on Russia, but I spent time on the one on Mexico and the one on Brazil – if you read the outline from the World Bank and fix those things, Americans will flood into Russia – I can guarantee that.

When you talk about your industrial policy, often we look at what industries we can support and how we get exports into other markets. However, industrial policy in a developing country should be about productivity. It should be about that in a developed country. You should label your efforts to be about increasing productivity.

I highly commend a book by William Lewis, formerly of the McKinsey Global Institute, *Studying Productivity*. He looks at Russia but also at the United States. Read the United States and see how they develop a productive economy. It is based on a very simple thing: all policies in principle are intended to maximise consumer welfare. That is what drives the policy. Industrial is about keeping businesses from digressing from the initiative to maximise consumer welfare. That, happily, is the same policy that maximises productivity.

I know this is not easy. I will borrow from the military theorist Aaron Clauset, who said that in war all things are simple, but simple is difficult. Policies are simple but they are also difficult and I understand that. I commend these to you. I suggest that the idea be about productivity.

In many conferences I have talked to people about trade strategy. Always trade strategy is export strategy. How do we get more exports? I would love to see some country, maybe Russia, have a trade strategy be an import strategy – how can we get more imports? If you open it up and figure out a way to get more imports, you not only will get more technology and heterogeneity but you will also get a lot more investment in as well.

Question for Mr. Dixon: You mentioned that when Australia was growing, based on raw materials, it was not the best period for Australian growth. However, after that, as far as I know, Australia pursued the export diversification strategy, or what you call on the trade commission website, degrees of volatility of terms of trade strategy – which in my mind is very similar to export diversification. What instruments did you use?

Response by Mr Dixon: I do not think this was a particular strategy. I think it just happened. There was a reduction in protection, which helped. It also happened because for a while world markets for our mineral products dried up. Prices of raw materials have gone down. I know that energy prices have gone back up again, but agricultural prices fell quite sharply. There was no real intention to have a diversification policy, but it was just natural market forces. The best thing the government did was to reduce protection and get out of the way, as my colleagues here have been telling us: let the government get out of the way and it will all happen naturally. It did not need a particular policy.

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60 Director of Operations, United States International Trade Commission.
61 Principal Researcher and former Director, Centre of Policy Studies, Monash University.
Part IV: Concluding Remarks
Statement by Ksenia Yudaeva

I would like to thank all the participants at this two-day seminar. It has been a very interesting discussion and there has been wonderful material.

Yesterday, when we looked at the analysis of decision making, there seemed to be two models: European and American. It is the European model we are partially using in Russia. As far as I am concerned, the results of the discussion means that we Russian representatives should discuss whether it is time for Russia to move more towards the American model. I know that our model has been developed out of a lack of resources, but yesterday weighty comments were made about the advantages of the American models. Perhaps in a strategy for 15 years we could move towards greater development of the analytical way of supporting decisions. This is necessary because this evening, when talking about strategy and what our target would be, we will have to see where we are moving to.

Robert Rogowsky told us to think about moving toward very concrete purposes. Even to move economically forward we must carry out a very serious complex analysis and, if we take into account all questions related to security, this will all be serious work. I do not have the feeling now that we truly understand, in terms of choices, which way we should go. We must discuss how to move in various directions. We have a view of some of these ways forward, but on others we require more information in order to develop the analytical elements in Russia, before adopting decisions.

This evening’s discussion was not only focused on strategic choices but also on questions of the presence or absence in Russia of the necessary instruments to implement our policies. We were saying that there are some instruments, but they perhaps do not work so well, so we have to understand how to improve them. What instruments do we not have? It was said that it is necessary to have coordination between the various bodies and authorities so as to create proper policy. We heard this topic coming up, because when we thought about what instruments we needed we also thought that there should be a coordinating role in that process.

One of the purposes of the seminar was to begin to coordinate experience when developing the possibilities. When we start writing the section on instruments, we will have to set up an inter-ministry committee to coordinate things.

Then there was the question of instruments such as trade representatives who would play the role of obtaining information to back up business and coordination of business goals. All that is very interesting.

In our discussion this afternoon we have heard about institutions and received a lot of interesting information on that. How will we act in the future in our work on these documents? We will bring together all the materials and use these to add to our selection. Our work will relate to institutional changes and instruments that will be necessary in order to create and implement our foreign trade policy. We will try and set up a road map in the future, some way of improving our instruments.

We must also have feedback on that in order to discuss it. Of course, our discussion today has been very useful in that respect.

There has been much discussion here and in the corridors about trade, but there was not a lot of talk about investment. It seems that there are no clear transport resources. We need to study the whole question of transport networks. That has been omitted in what we have written and we should do something about that.

There was also a comment on the financial markets. Thank you for your attention.

62 Director of Research, Center for Strategic Studies, Russia.
Statement by Lawrence Bouton

I would like to reiterate my thanks to the presenters for their excellent presentations in the last two days, but even more I would like to thank the people who asked questions. The questions raised during the course of the last two days have been excellent and very deep and have brought out discussion of the issues.

In some ways we have already had a series of concluding statements around the table and they bring out two key issues. One is the institutional capacity to undertake the policies being discussed today. Here, again, we had two possible models: a US model which has an in-house capacity and a European model, which has a contract-out capacity to undertake the trading process. In some sense the donor community can contribute to Russia’s efforts to develop the capacity in the educational system.

More fundamentally, the current state of the institutional capacity in Russia raises a question about the complexity of the policies being contemplated. If, for example, as Douglas Lippoldt raised, you are interested in pursuing a deep, broad-ranging industrial policy, the real question is whether the civil service has the capacity to carry out that policy. Does it have the capacity to carry out a complex trade policy? If you do not think it does, then perhaps the real solution is to have a much simpler set of instruments in the course of conducting trade policy.

The other point that has come out over the two days is that trade is ultimately the competitiveness of the country, a point raised by Robert. It is a question of how to increase the competitiveness or productivity of the private sector and basically how to make sure that the entrepreneurial sector has the incentives to undertake innovations to make Russians competitors.

If we take this view, it really expands the notion of trade policy way beyond a simple discussion of tariffs and export taxes. It gets into the issues that David and others have raised, that fundamentally trade policy is a much wider, broader set of policies. It addresses the whole issue of behind-the-border barriers. If your exporters cannot get access to the credits they need to export, then maybe trade policy also is financial policy. If your exporters cannot get their goods to the markets because the transportation of the structure is not well developed, then maybe trade policy is really transportation policy. If your traders spend their time waiting at the border, to pass through customs, then maybe trade policy is about customs modernisation. Fundamentally, we should take a much broader view of trade policy in addressing the needed domestic reply response in Russia.

Statement by Libor Krkoska

We have been discussing the Russian Foreign Trade Strategy and how to use empirical analysis in policy decision making. We have seen quite a few different models, ranging from the US to the EU model. I believe that you will have a specific Russian model that may resemble some parts of the US and European models but which will be unique.

One of the issues raised here was that you need to discuss the strategy with the stakeholders. I would like to point out that the EBRD is one of the important stakeholders. We are one of the largest investors in Russia and the one that is probably the most active in all areas of the economy – financial institutions, infrastructure, general industry and dealing with car makers as well as gas and oil companies – so we are dealing with all those companies that are involved in trade and investments. As a result we have an extensive, unique database of information about all the issues that should be addressed by the Russian foreign trade strategy if it is to result in the expansion of trade, its diversification and move towards higher value added products and services. Probably the least we could do in helping you to formulate successful foreign trade

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63 Senior Economist and Trade Coordinator for Europe and Central Asia Region, World Bank.
64 Senior Economist, European Bank for Reconstruction and Development.
strategy is to make a list of practical impediments to trade and provide it to the Russian participants of the seminar. It is very easy for us to compile all this information.

We can also provide practical help by doing projects related to trade and trade facilitation. My colleague was talking about the Trade Facilitation Programme. We have a range of instruments and we are willing to be innovative and welcome new projects to help with trade expansion and export promotion in Russia. As you know, our policy is that all our projects have to be financially viable. Our focus is on practical trade facilitation on a sustainable and commercial basis. This is the first of the four main points I would like to make about the strategy. In every single one of our projects that deal with trade barriers or tariffs in Russia, we make sure that in our financial modelling these projects are financially viable even if the barriers to trade did not exist. That is quite important and we have a large number of such projects.

The second point is about the institutions. The importance of institutions could not be stressed more. One example which shows the shortcomings of evidence-based foreign trade modelling which emphasises tariff protection is what happened in the new EU Member States a few years ago when they joined the European Union. One of the widely accepted predictions was that there would be very little impact on foreign trade, because these countries already had virtually free trade with the European Union. But once the border controls were removed and custom control was essentially eliminated there was a considerable jump in traded in terms of percentage points of GDP and that was between two blocs that had free trade. Imagine what would happen if all those institutional barriers to trade were removed between Russia and the European Union or Russia and the United States! That would lead to a quite significant increase in trade.

I would also like to highlight the importance of predictable and uniform enforcement of contracts. Trade policy is not only about tariffs and trade barriers, it is also about creating an environment that enables investors and traders to engage in trade. If foreign partners are sure that the contracts will be enforced in a uniform and predictable way, they will also want to trade with you. Then strategy and diversification of trade from commodities where you have an advantage, namely natural resources, would be very easy to implement because you would have a large number of trading partners willing to accept trade related risks.

My last point concerns the importance of education and the utilisation of human capital and moving to trade in higher value added goods and services. If you want to use the existing high level of human capital within Russia, you have to make sure there are necessary incentives to do so. What could easily happen is that you would have vertically integrated companies with high value added products that would rely on high levels of human capital, but the benefits of the high value added part of the production chain would materialise outside of the country. To avoid this from happening there have to be sufficient commercial incentives for companies to engage in such activities within Russia and to reinvest their profits in the country in higher value added products.

I would like to thank everybody for coming here. It has been a very interesting discussion and we would be more than happy to help our Russian partners with similar discussions in the future.

Statement by Mikhail Dmitriev

I would like to add a few words about the significance of this meeting. We have had a number of seminars in Moscow where we have discussed similar questions, but this is the first seminar, whether in or outside Russia, where the representatives of Russian authorities or experts have had discussions with international organisations and individual countries on specific long-term strategic problems related to the choice for the country, when this choice is going to be taken and when it will have an effect on the future.

65 Director, Center for Strategic Studies, Russia.
Questions of trade have a very large component of positive externalities which can be useful even if the decision relates to Russia and other countries. For example, Russia is one of the key players in the energy sector. It is still a very capital-intensive country and large volumes of foreign investment can still come to the country. I met representatives of the global leadership forum this year. It is a sort of global meeting point for institutional investors who are putting money into infrastructure the world over and the amount of deals is measured by many tens of billions of dollars. This year, they are having a forum devoted to the 100 top infrastructure projects of the world. When I said we were working over new strategy for the development of Siberia, what was proposed to me was to prepare six investment projects just in Siberia for this meeting. Just for Siberia they were ready to consider six out of one hundred top projects in the world. That indicates the proportions that the Russian economy can represent in terms of global investment in infrastructure, energy and commodities.

Each of you, my dear experts, who spoke at this conference, made a personal choice to come here and have spent a lot of time preparing your statements and taking part in this two-day seminar. We are very, very grateful for that because we will transfer that knowledge into our much more informed policy choices.

Dear Russian colleagues, it is unusual to have such a seminar in London and not in Russia. This was a tactical move. We thought that in Moscow we would not have two days to have such a full discussion, so I am very grateful that you have taken these two days from your hardworking timetable, to come here and not only listen to what others are saying but to talk about your own position.

Since we are only just beginning our work on our strategy, we heard a lot that was new and useful. This will facilitate our future work. From the words I have had with people in the corridors, the level of understanding of the problems has increased greatly. We have heard a number of very challenging ideas and we shall have to prepare responses to them. A big thank you to everybody. Within a short period we should be able to deliver a foreign economic policy blueprint which may facilitate important policy decisions both for Russia and her major trade partners. Thank you very much.