

Russian Services Sector WTO Commitments and Their Implications

David G. Tarr

New Economic School, Moscow

Conference of The Higher School of Economics and
The International Centre for Trade and Sustainable
Development

Moscow, October 11, 2012

Plan of the talk

1. What has Russia agreed in the area of services as part of its WTO accession commitments?
2. How do these commitments compare to other acceding countries?
3. What are the estimated gains of services sector commitments and the impacts on the manufacturing sector and services sectors themselves?
4. Who should gain or lose from the services sector commitments?

1. Russia's has made substantial commitments in services.

These commitments are typical of the Transition countries that have acceded to the WTO

- The Russian Federation has made a substantial offer that the WTO members have found acceptable and attractive.
- but the offer is not unusual.
- **The offer is typical of the commitments of the Transition Economies that have acceded**

Russia has made significant commitments in services sectors—but typical commitments

- Russia has made commitments in 116 services sub-sectors. Prominent examples include:
 - **Telecoms—**
 - 49% maximum foreign equity restriction removed 4 years after accession.
 - Foreign-owned telecommunications companies may operate in any telecommunications sector.
 - Russia agreed to remove the Monopoly restriction on fixed-line long distance telephone services, and this has already been removed
 - Agreed to apply the terms of the WTO's Basic Telecommunications Agreement. This includes agreement to establish an independent telecommunications regulator separate from the Ministry of Communications to avoid conflicts of interest.
 - **Transport services**
 - the Russian Federation made commitments in maritime and road transport services, including the actual transportation of freight and passengers.

Russia has made significant commitments in services sectors—but typical commitments

- **Distribution services**

- Russia would allow 100% foreign-owned companies to engage in express delivery, wholesale, retail and franchise sectors upon accession to the WTO.

- **Audio Visual Services**

- Russia will also open its market to foreign *audio-visual service* suppliers in motion picture distribution and projection services and sales of television and radio programs to TV and radio stations.
- Russia will also allow foreign audiovisual companies to operate as 100% foreign-owned entities.

Russia has made significant commitments in services sectors—but typical commitments

- ***Energy services, environmental services and computer and computer-related services***
- Russia has made substantial commitments to open its services markets in these areas
- **Professional Services**
- National treatment and market access provided for wide variety of professions (such as lawyers and accountants), and for wholesale and retail trade and courier services

Substantial insurance sector commitments

- Quota on maximum share of foreign banks or insurance companies increased from 15% to 50%.
- Branches of foreign insurance companies allowed 9 years after accession.
- 100 percent foreign ownership of non-life insurance companies will be allowed upon accession to the WTO.
- Russian prohibition of foreign participation in mandatory insurance lines as well as Russian restraints on the number of licenses granted to foreign life insurance firms will be phased out during the five years after the date of accession.
- Russian insurance sector has been very concerned about adverse competitive impacts.

Chinese post WTO accession experience in insurance

- China agreed to fully open its rather closed insurance markets by January 2005 (except foreign companies could hold a maximum of 50% in the life insurance market).
- Like in Russia, this was a controversial policy commitment within the insurance sector. Fear of loss of the market.
- What happened between 2001 and 2005?
- (i) FDI led to extremely positive results for consumers of insurance services in China. Total premiums more than doubled between 2001 and 2005.
- (ii) large increase in employment of skilled workers (e.g., actuaries, statisticians) in the sector. Wages grew.

Chinese post WTO accession experience in insurance

- (iii) very strong growth of both domestic Chinese and foreign insurance companies operating in China;
- (iv) continued dominance of the market by Chinese companies; acquisition of foreign capital by Chinese companies through strategic partnerships.
- (v) entry by foreigners through either joint ventures or strategic investment in Chinese companies; and
- During this time, the total number of insurance companies increased from 41 to 78, and the number of Chinese companies increased from 20 to 41.
- Source: Richard Daniel Ewing, "Life Insurance Market Heats Up," ChinaBusinessReview.com, May-June, 2006. 48-53.
- Datamonitor, 'Non-Life Insurance in China: Industry Profile,' November 2005.

Banking and Securities

- Russia has agreed to bind most existing market access arrangements and to offer some additional liberalization.
- These commitments include:
- allowing 100 percent foreign ownership of banks and other non-insurance financial institutions;
- allowing cross border provision of numerous services including asset management services, credit cards and other types of payments;
- allowing foreign investment companies to own and trade the full range of securities available in Russia, including state securities and bullion, and to participate in the financing of privatization of state owned enterprises.
- In addition, Russian restraints on the share of the sector captured by foreign banks will increase from about 15 percent of total investment to 50 percent.

Branch Banking issue

- Russia was willing to allow subsidiaries of international banks.
- the U.S. Treasury has been attempting to assure branch banking is permitted in all countries admitted to the WTO.
- The Russian central bank maintained that it could not regulate or supervise branches adequately and that depositors would therefore be at risk.

Counterargument

- Theory suggests and experience has shown that multinational banks have more of their reputation on the line with a branch, and this will provide greater incentive to avoid default.
- Moreover, since the capital requirements for a branch are based on the parent bank, a branch is a very powerful competitor
- So allowing branches means access to considerably more capital in the host country
- This is the greatest advantage of allowing branch banking, but it was also the greatest concern of the central bank of Russia-- since greater competition from branches implies greater potential adjustment costs for Russian banks.
- But protecting banks present in Russia comes at a cost of greater access to capital for Russian businesses.

Branch banking is the “rule”

- Of the 150 countries in the World Bank database on "Banking Regulation and Supervision" for 2003, branch banking was prohibited in only 18. The 18 countries prohibiting branch banking were: Russia, Kazakhstan, Azerbaijan, Belarus and Ukraine from the CIS plus Bolivia, Botswana, Columbia, Costa Rica, Macedonia, Malaysia, Mexico, Nigeria, Papa New Guinea, Philippines, Serbia and Montenegro, Trinidad and Tabago and Zimbabwe. The remaining 132 countries, including all OECD and EU (25 at the time) countries allow branch banking.

Chinese compromise example

- China allows branches, but China imposes a large minimum asset requirement on the parent bank. The de facto consequence of this is that China only allows rather large multinational banks to enter.
- This both protects incumbent Chinese banks against many new entrants, but also means that the foreign entrants are likely to be relatively safe and in need of little supervision or regulation.

Mr. Putin was influential

- Mr. Putin declared that branch banking was a deal breaker for Russian WTO accession. Based on its bilateral agreement with the U.S., Russia succeeded in avoiding a commitment on branch banking, becoming the only non-LDC acceding country to avoid such a commitment. Russia will lose the benefits from greater foreign direct investment. The US has indicated it will reopen discussions on this issue upon consideration of Russian membership in the OECD.
- Nonetheless, multinational banks, operating as subsidiaries, have greater market access and national treatment rights under the bilateral U.S.-Russia agreement and Russia should benefit from greater involvement of multinational banks in Russia over time.

2. Services Commitments Compared

- **Russia has made substantial commitments.**
- But all acceding countries to the WTO since 1998, have assumed a rather high and comprehensive level of commitments, in terms of sectors included. (See WTO, 2005, table 5 for details).
- http://www.wto.org/english/thewto_e/acc_e/acc_e.htm#work
- Based on a simple measure of breath of commitments, Russian commitments are typical of non-LDC acceding countries, especially the Transition countries.
- And Russia has been able to avoid a commitment to accept branches of foreign banks, unlike all other non-LDC acceding countries.

Table 5: Sector Specific Commitments in Services of Members that have Acceded to the WTO

	Ecuador	Bulgaria	Mongolia	Panama	Kyrgyz Republic	Latvia	Estonia	Jordan	Georgia	Albania
Professional services	x	x	x	x	x	x	x	x	x	x
- Legal services	x	x		x	x	x	x	x	x	x
- Accountancy services	x	x	x	x	x	x	x	x	x	x
- Taxation services	x			x	x	x	x	x	x	x
- Architectural and engineering services	x	x		x	x	x	x	x	x	x
- Medical services		x			x	x	x	x	x	x
Computer and related services	x	x		x	x	x	x	x	x	x
Research and development services		x			x	x	x	x	x	
Other business services	x	x	x	x	x	x	x	x	x	x
Postal services			x		x			x	x	x
Courier services			x		x	x	x	x	x	x
Telecommunications – valued added	x	x		x	x	x	x	x	x	x
Telecommunications – basic	x	x			x	x	x	x	x	x
Audiovisual services				x	x			x	x	
Construction services	x	x	x	x	x	x	x	x	x	x
Distribution services	x	x	x	x	x	x	x	x	x	x
Educational services		x		x	x	x	x	x	x	x
Environmental services	x	x		x	x	x	x	x	x	x
Financial – insurance	x	x	x	x	x	x	x	x	x	x
Financial – banking and other financial services	x	x	x	x	x	x	x	x	x	x
Health services	x				x	x	x	x	x	x
Social services		x			x	x	x	x	x	
Tourism services	x	x	x		x	x	x	x	x	x
Recreational services	x	x			x	x	x	x	x	x
Transport services	x	x		x	x	x	x	x	x	x
- Maritime transport					x	x	x	x	x	x
- Air transport	x	x		x	x	x	x	x	x	x
- Rail transport					x		x		x	
- Road transport	x				x	x	x		x	x
MFN Exemptions	x	x		x		x	x	x	x	x

	Oman	Croatia	Lithuania	Moldova	China	Chinese Taipei	Armenia	FYROM	Nepal	Cambodia	Saudi Arabia
Professional services	X	X	X	X	X	X	X	X	X	X	X
- Legal services	X	X	X	X	X	X	X	X	X	X	X
- Accountancy services	X	X	X	X	X	X	X	X	X	X	X
- Taxation services	X	X	X	X	X	X	X	X		X	X
- Architectural and engineering services	X	X	X	X	X	X	X	X	X	X	X
- Medical services	X	X	X	X	X		X			X	X
Computer and related services	X	X	X	X	X	X	X	X	X	X	X
Research and development services		X	X	X		X	X	X	X		X
Other business services	X	X	X	X	X		X	X	X	X	X
Postal services				X				X			
Courier services	X	X	X	X	X	X	X	X	X	X	X
Telecommunications – valued added	X	X	X	X	X	X	X	X	X	X	X
Telecommunications – basic	X	X	X	X	X	X	X	X	X	X	X
Audiovisual services	X				X	X	X				X
Construction services	X	X	X	X	X	X	X	X	X	X	X
Distribution services	X	X	X	X	X	X	X	X	X	X	X
Educational services	X	X	X	X	X	X	X	X	X	X	X
Environmental services	X	X	X	X	X	X	X	X	X	X	X
Financial – insurance	X /	X	X	X	X	X	X	X	X	X	X
Financial – banking and other financial services	X	X	X	X	X	X	X	X	X	X	X
Health services	X /	X	X	X	X	X	X		X	X	X
Social services		X	X			X	X				
Tourism services	X	X	X	X	X	X	X	X	X	X	X
Recreational services		X	X	X		X	X	X	X	X	X
Transport services	X	X	X	X	X	X	X	X	X	X	X
- Maritime transport	X	X	X	X	X						X
- Air transport	X	X	X	X	X	X	X	X	X	X	X
- Rail transport		X	X	X	X	X	X	X			X
- Road transport		X	X	X	X	X	X	X			
MFN Exemptions		X	X	X	X	X	X	X	X	X	X

Note: For more information please see Annex 4 of this Note.

3. Large Estimated Gains to Russia of Services Liberalization

- We estimate that the gains to Russia from its cumulative commitments over time to accede to the WTO will be about 3.3 percent of the value of its GDP in the medium term (within three years of accession). This is about \$49 billion based on 2010 GDP.
- In the long term (about 10 years), these gains would be about 11 percent of Russian GDP (about \$162 billion based on 2010 GDP). This includes benefits of improved investment climate from WTO accession.
- This will lead to a general increase in wages, that varies with skills.
- about 70 percent of total gains come from access to more and better services from increased FDI in business service.

Large Estimated Gains to Russia of Services Liberalization

- **Substantial econometric evidence that better access to business services increases the productivity and competitiveness of manufacturing, agriculture and services themselves.**
- **Our estimates of substantial gains for Russia from services liberalization through WTO accession are consistent with those empirical studies conducted on many countries.**

Impact of accession on services sectors

- Our model assessments: Many of the business sectors expand employment and output, (new FDI output in Russia is part of Russian GDP)—telecommunications and financial services expand.
- Transportation sectors also expands due to increased demand for their services from increased external trade.
- Russian skilled workers may not have the same interests as the capital owners—as multinationals enter the industry in these sectors, they hire Russian skilled workers, raising their wages. Thus, skilled workers should favor FDI liberalization.

Capital owners in Russian business services

- Multinationals often look for a local joint venture partner.
- Russian firms that become part of joint ventures will likely increase the value of their investments.
- Russian capital owners in business services who remain wholly independent of multinational firms, will likely see the value of their investments decline. These are the losers in the accession process.

WTO accession a unique and important opportunity for Russia to adopt an open economy growth strategy—which importantly includes openness to FDI in services

- All the development miracle countries of the world used an open economy export oriented growth strategy, e.g., Singapore; China; Taiwan, China; Hong Kong; South Korea, Chile, Mauritius.
- Business as usual leads to one-sided lobbying from vested interests only and excessive protection for what is in the country's best interest
- WTO accession brings the international community into the lobbying, resulting in much greater liberalization and movement toward an open economy growth model of development.
- Diversification, modernization and growth will be stronger if the reforms are complemented by improvements in the business climate for all firms.