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Putin's Russia Will Always Stretch the WTO's Rules

By Chris Weafer

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Two years ago this month, Russia was formally admitted into the World Trade Organization (WTO) after almost 19 years of fractious negotiations. Since joining, Russia has set a record for the shortest time for a new member country to have a formal complaint filed against it.

If some Western politicians were to get their way, Russia could also be in line for the record of having the shortest tenure in the global trade body. Realistically, of course, that is not likely; the situation regarding Ukraine and tit-for-tat sanctions would have to get a whole lot worse before it even became a serious question.

But with Moscow having had its invitation to attend this year's G8 summit canceled and Australia making noises about excluding Russia from the G20 summit scheduled for Brisbane in mid-November, the question has to be asked "is Russia really serious about being a partner in the global economy, or would it be better off as an external supplier?"

That may seem like a stupid question, and I certainly don't see Moscow ever willingly wanting to leave any of the world's important trade and political bodies, but it is a fundamental question for investors and businesses working in Russia or looking at the market potential.

Perhaps a better way to phrase that question is "will Russia ever accept the membership rules for organizations such as the WTO, or will it constantly try to challenge and unilaterally interpret rules for its own benefit"? If the latter is the case, then it is the periods of calm that are the exception in the investment story rather than the periods of confrontation.

The implications from that include a persistent high risk premium that will keep asset valuations relatively low, volatility in earnings and economic performance, regular bouts of confrontation and a struggle to attract inward investment.

The evidence of the past six years indicates that the Kremlin and Russia's business leaders fully understand the value of membership in global trade bodies and economic blocks. They clearly comprehend that Russia's participation in these groups is an essential pre-requisite for the economy to modernize and diversify away from hydrocarbon dependency and risk.

Economic diversification, though, isn't the country's No. 1 priority at this time; the events in Ukraine show that clearly not to be the case. Others have written extensively about Russia's role in Ukraine, the Kremlin's view of its so-called near-abroad, and the cultural, religious and historic rationales for Moscow's foreign policy.

Suffice to say that these political objectives currently take precedence over economic priorities and a period of growth disruption. A large majority of Russians, it appears, deem higher inflation and some food item shortages this winter as an acceptable price to pay.

Nor will this problem be solved anytime soon. Investors, who were coming in ever increasing numbers before the Ukraine crisis firmly planted a stop sign in their path, will be a lot more cautious even when the crisis is deemed to have passed.

But as long as those nostalgic for the Cold War don't stage a resurgence, Russia will eventually get back on the development path it embarked on in the years leading up to its WTO entry.

It might be more apt to say, though, that Russia "was forced" rather than "embarked" on its quest for economic diversification. The greater obstacle to reforming Russia's economy is not Ukraine, but the Kremlin's reluctance to support reform efforts.

I have written in previous op-eds that, by the end of last year and after several years of low growth and several shocks, the Kremlin had finally accepted that Russia had exhausted its previous growth model based on oil wealth fueling a credit and consumer boom.

The economy needed a new model based on higher volumes of investment into infrastructure and into industries that can deliver long-term growth and diversification. Last year was a successful year for investment inflow even without the BP-Rosneft deal that boosted the numbers. But it was only the start of what needs to be a long program.

To place the importance of Russia's entry into the WTO into that context, we should recall what happened from 2008 to 2010. The price of oil collapsed and brought the ruble's foreign exchange rate down with it. The Central Bank burned through a large portion of its reserves trying to prevent debt defaults, and growth reversed from plus 5.2 percent (2008) to minus

7.8 percent (2009). The crisis led to several large protests in Russia's industrial cities.

The upshot of all that was an understanding that oil dependency is far too risky for the economy and for social and political stability. The only way to break out of that vulnerable position was to attract a large volume of investment and the participation of experienced foreign companies. This is the basis of successful growth in the auto sector, for example.

It was only after those disastrous years that the government got serious about WTO entry, which happened two years after the agriculture collapse, and about pursuing measures to improve the business climate. It was also around then that President Vladimir Putin ordered a focus on the World Bank's "Ease of Doing Business Survey" as a means to showcase progress to foreign businesses and investors.

But with Russia, it always seems to be a case of why take the easy road when you can take the hard road. The reform program is thus dusted off only during times of crisis, forcing Russia to rush to join organizations such as the WTO in an effort to attract investment and foreign expertise.

Testing the rules of membership will always be in Russia's nature. OECD membership, which until late last year was one of the Kremlin's key goals, has undoubtedly been delayed indefinitely — but not canceled.

A well-worn cliche states that every crisis is also an opportunity. Russia is the largest country on the planet, and yet it still imports almost 20 percent of food consumption. That is a result of a couple of decades of under-investment and neglect that will take a lot more than a policy statement to fix. But import substitution is now becoming a matter of national security rather than simply good economics. It is no coincidence that this is the sector in which the Kremlin choose to impose import bans — a small silver lining around an otherwise dark cloud.

This present crisis is certainly more severe and more unpredictable than anything we have experienced since the late 1990s. It would be foolish to try to guesstimate how long will the growth disruption last and how severe the fallout will be in the meantime, until there is greater clarity in geopolitics and in eastern Ukraine.

But the sanctions are a step sideways, perhaps even several, but not a step back. All we can hope for is that by the time Russia climbs out of this latest crisis there will be even greater enthusiasm and support for investment and business reforms.

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