

# The effect of Russia's accession to the WTO on Russian trade

**Petra Karvonen**

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Author(s) Petra Karvonen			
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<p>Abstract</p> <p>The theme for the thesis was generated during the author's internship in a company aiming to enter the Russian markets and as well, on the interest how Russia's WTO membership would affect its trade in general.</p> <p>The objective of the thesis is to analyse Russia as a country in international markets and what have been the implications of Russia's WTO membership after two years from the accession. The thesis also clarifies the World Trade Organization's policies and procedures. The thesis uses academic literature and web publications for the study.</p> <p>Russia's WTO negotiations lasted for record-breakingly long. Although the WTO membership application process seemed to make Russia free its trade policies gradually more than before, upon and after accession, Russia has taken a variety of measures to protect its domestic industries against the WTO agreements dispelling most of the hopes of bringing predictability to trade and business operations in Russia. Additionally Russia's economic growth has slowed down and it has great structural modernization and renewals ahead especially among the areas of economy, politics and society.</p> <p>The WTO membership was estimated to bring GDP growth of approximately three per cent in short-term and 11 per cent in long-term for Russia in normal conditions. In the present situation where political conflicts affect the outcome, Russia is not expected to receive the estimated growth. Additionally it is more than likely that the benefits, obligations and responsibilities the WTO accession usually actualises are to be expected to appear in a longer than normal time span in the case of Russia.</p>			
<p>Keywords</p> <p>International trade, Russia, World Trade Organization, accession to the WTO, free trade,</p>			
<p>protectionism, trade agreements, multilateral trade, PESTEL-analysis</p>			

## CONTENTS

1	INTRODUCTION .....	6
2	INTERNATIONAL TRADE .....	7
2.1	Free trade theorems.....	7
2.1.1	Absolute advantage.....	7
2.1.2	Comparative advantage .....	8
2.1.3	Factor-proportions theory .....	8
2.1.4	National competitive advantage .....	9
2.2	Why countries trade?.....	10
2.2.1	Gains from trade .....	11
2.3	Trade Agreements.....	12
2.3.1	Multilateral trade agreements .....	12
2.3.2	Preferential trade agreements.....	13
2.4	Protectionism.....	13
2.4.1	Tariffs.....	13
2.4.2	Non-tariff Measures .....	15
3	THE WORLD TRADE ORGANIZATION .....	18
3.1	The WTO at present .....	18
3.2	The decision making process in the WTO .....	19
3.3	The WTO mission and values .....	19
3.4	WTO dispute settlement .....	20
3.5	Most Favoured Nation and National treatment .....	21
3.6	Commercial instruments .....	22
3.6.1	Dumping and anti-dumping.....	22
3.6.2	Countervailing duties .....	22
3.7	The WTO accession process.....	23
3.8	Criticism towards the WTO.....	24
4	IMPLEMENTATION OF THE RESEARCH.....	25
5	PESTEL-ANALYSIS OF RUSSIAN FEDERATION.....	27
5.1	Political factors.....	27
5.2	Economic factors.....	28
5.3	Social factors .....	31
5.4	Technological factors.....	33
5.5	Environmental and geographical factors .....	33
5.6	Legal factors.....	34

6	RUSSIA AS A MEMBER OF THE WTO .....	36
6.1	Russia's WTO accession process .....	36
6.2	Russia's WTO commitments.....	36
6.2.1	Market access for goods.....	36
6.2.2	Market access for services .....	37
6.2.3	Other commitments.....	38
6.3	Expectations and results of Russia's WTO membership .....	38
7	CONCLUSIONS .....	43
	REFERENCES .....	46

## APPENDICES

APPENDIX 1 Balance of payments of the Russian Federation: current account and financial account

## 1 INTRODUCTION

The thesis addresses international trade, the World Trade Organization and the Russian Federation as a country and as a WTO member.

The topic of the thesis was generated from the interest towards Russian markets and how Russia's WTO membership would effect on trade, while the author was completing an internship in a firm pursuing to enter the Russian markets. The research aims to understand the complexity of the factors affecting to trade decisions and how challenging it is to combine a country's national objectives together with any trade organization's objectives. The thesis also considers the reasons why countries participate in international trade.

Additionally the research problem concentrates on Russia's accession to the World Trade Organization. The possible future effects of the membership will be taken into consideration too. The aim of the study is to clarify if Russia's membership to the WTO has had any real effect on the country.

The theory part of the thesis introduces some of the basic concepts of international trade such as free trade and the different forms of protectionism as well as discussion on why countries trade and how they are able to benefit from trade. The next chapter introduces the WTO as an organization and analyses its vast line of operations, like the decision making process inside the WTO and how disputes are solved in the organization. The chapter also introduces the main procedures of how a country can become a member of the WTO.

Russia and its current atmosphere is analysed through its political, economic, social technological, environmental and legal factors. During this chapter Russia's accession process to the WTO is examined as well as the repercussions are analysed after two years from the accession. To conclude the research the last chapter gathers the themes together with a summary of the whole thesis and its outcomes. The theory is based on literature concerning the above mentioned subjects as well as on academic articles and web sites.

## 2 INTERNATIONAL TRADE

International trade can be defined to be the exchange of goods and services between countries making more commodities available than would be otherwise possible in international markets. This chapter addresses concepts of free trade, absolute and comparative advantage, factor endowment and national competitive advantage, different types of trade agreements, protectionism, tariffs and non-tariff measures.

### 2.1 Free trade theorems

Free trade is most commonly defined as the absence of tariffs, quotas or other barriers to trade any government could ordain and by such, allowing each country to specialize in the good or goods it can produce most efficiently with the given resources and in relation to the other countries (Irwin 2008). Researches have proved trade openness to make markets more competitive by reducing prices and raising incentives to innovate while also boosting productivity (Heydon & Woolcock 2012, 23).

Theories of free trade from an economic perspective started to emerge in the 18th century. Prior to the 18<sup>th</sup> century it was widely believed that free trade would lead to international peace, which does not differ much from today's opinion, as free trade is perceived to promote peaceful international relations as well as freedom, prosperity and security. (Heydon & Woolcock 2012, 18, 23, 24)

#### 2.1.1 Absolute advantage

One of the pioneers of political economy, Adam Smith (1723-1790), introduced the concept of absolute advantage in the 18<sup>th</sup> century in oppose of mercantilism. Mercantilism suggests that a country should discourage its imports and encourage its exports to be able to increase its wealth whereas absolute advantage promotes the basic idea that every country engaged in trade should also benefit from it. (Sawyer & Sprinkle 2006, 24)

When explaining the basic idea of absolute advantage, usually a two-country-model is applied. In other words, there are two countries, A and B, which produce two goods, good C and good D. According to the labour theory of value, the cost of the commodity is defined only by the amount of labour it requires to be produced. (Sawyer & Sprinkle 2006, 24, 26, 27)

For example, given the same resources, country A can produce 5 pieces of good C and 10 pieces of good D. Accordingly, country B can produce 2 pieces of good C and

15 pieces of good D. This suggests that when labour is the only factor of production and as both countries have the same amount of resources country A has the absolute advantage in producing the good C and country B has the absolute advantage in producing the good D. In short, absolute advantage means the ability to produce a good using fewer resources than the other country. (Sawyer & Sprinkle 2006, 24, 26, 27)

### 2.1.2 Comparative advantage

Comparative advantage created by David Ricardo (1772-1823), a British political economist in the 19<sup>th</sup> century, developed the idea of absolute advantage further on by discussing the reasons for trade for a country that has the absolute advantage in the production of both goods in the model of two countries (Heydon & Woolcock 2012, 15).

Let's assume from the basis of the example in the previous chapter, that country A has comparative advantage in producing both goods. In this case, given the same resources a worker from country A can produce three times more of good D and five times more of good C than a worker from country B. This indicates that country A should specialize in producing good C because its degree of absolute advantage is higher in the production of good C, and country B should specialize in producing good D because its degree of absolute disadvantage is lower with good D. By definition, comparative advantage is the ability of a country to produce a good with lower costs than another country. This relative advantage benefits both countries more in total if both countries concentrate on producing the "better" product for themselves and export it to the other country. (Sawyer & Sprinkle 2006, 26, 29)

### 2.1.3 Factor-proportions theory

The factor proportions theory examines what causes comparative advantage. The theory, also known as the Heckscher-Ohlin model, argues that a country's comparative advantage is based on its initial resource endowments like capital, entrepreneurship, labour or land, and how the country is able to utilize these resources. The model takes into consideration only labour and capital when comparing countries between themselves with capital-to-labour ratio. (Sawyer & Sprinkle 2006, 61-62)

In the theory, the capital-to-labour ratio ( $K/L$ ) expresses the amount of capital per unit of labour used to produce a good. A good produced with a lower capital-to-labour ratio is a labour intensive good, as a good produced with a greater capital-to-labour



ratio is capital intensive. In a larger scale, a country can be either capital abundant which means it has a higher K/L ratio, or, labour abundant with a lower K/L ratio in comparison to other countries. Whether a country is relatively labour or capital abundant compared to other countries makes the comparative advantage more realistic. A country, in order to benefit, should export the good whose production uses the country's relatively abundant factor of production and import the good which utilizes the relatively scarce factor of production. (Sawyer & Sprinkle 2006, 63, 65)

#### 2.1.4 National competitive advantage

The theory examines the question why some countries gain greater international success than other countries (Porter 1991, 102). The model introduces four interdependent elements which as a whole contribute to a country's conditions, opportunities and weaknesses in national and international markets. These factors are introduced in next chapters.

Factor conditions consist of workforce, land, natural resources and capital. A country's industries benefit if they are able to utilize either cheap or uniquely high quality factor conditions. In addition, the competitive advantage of factor conditions depends on how efficiently the factors are used; more efficiency means more benefits. Within demand conditions there are three important areas relating to a country's national demand: the demand structure inside a country's national markets, size and growth of the demand in a country's national markets and the internationalization potential and process of a country's national goods and services. (Porter 1991, 102, 104, 115)

Relating and supporting industries indicate if a country has logistics companies or supporting industries that are globally competitive and if the companies are able to support the industry or industries a country is pushing towards international markets. Firm strategy, structure and rivalry define what kind of organisational form a country's companies have. Moreover it also takes into consideration any local rivalry because high local rivalry may lead to weak global rivalry which usually is seen as a disadvantage to a country. (Porter 1991, 130, 138)

Figure 1 explicates why the model is also called Porter's diamond model. A country succeeds in an industry where it is able to create dynamic and challenging national environment and inspire its companies towards improvement and innovation. A country is more likely to succeed in the segment or industry where its basic factors consist of the national competitive advantage diamond with the least expenses. The diamond model is a system where each factor strengthens the others but if one area of the

diamond is dysfunctional it has a negative effect to the whole model. (Porter 1991, 100-101)

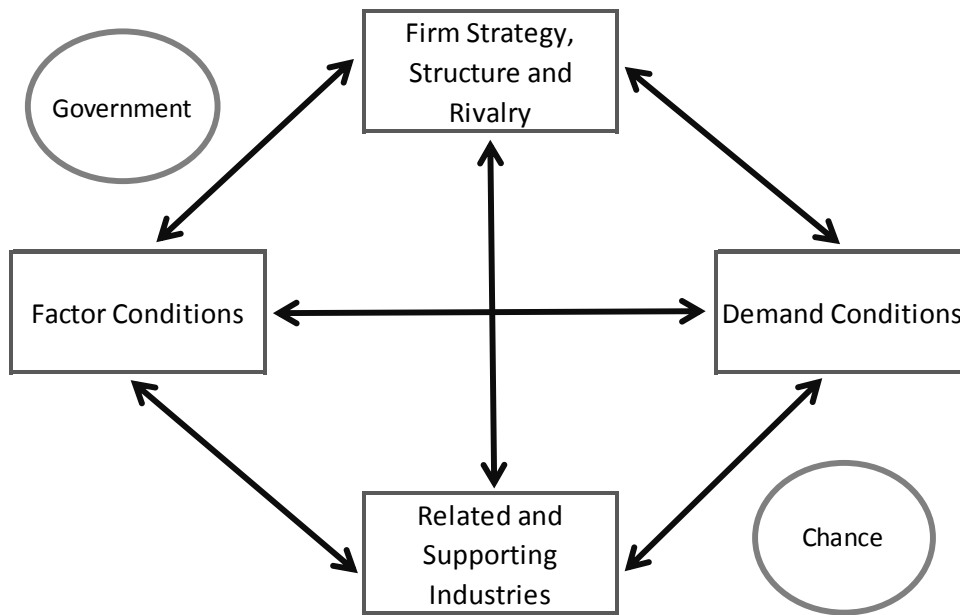


FIGURE 1. Porter's diamond model with basic advantage elements a country can possess. (Porter 1991, 100)

In addition, there are two variables affecting the outcome of the theory. The first one is chance. There are uncontrollable happenings outside the influence of companies or even countries such as pure inventions, technical breakthroughs, wars, external political events, great changes in foreign trade demand, natural disasters. These events can create unstable markets which can unexpectedly shift the competitive advantage from one country to another. The second variable is the role of the state. Political decisions affect to a country's basic advantages. For example, any restrictions on competition affect a country's inner competitive situation or any form of rationing alters a country's national demand conditions and government procurements can revitalize local industries. All in all, political factors can either benefit the national advantage or distort the competition inside a country leading to a weaker position in international markets. (Porter 1991, 101)

## 2.2 Why countries trade?

In 2007 when the U.S. mortgage markets crashed, its consequences ultimately triggered a globally wide financial crisis. The fragile recovery from the crisis continues with Europe being in recession with a risk to throw the world economics into a new downturn. This connection, originating from a national problem inside one country

and ending in an international crisis, points out how the world has diminished in size, and how nations have become more attached to each other than ever before through trade in economic commodities, money flows and international investments (IMF 2012; IMF 2009; Krugman, Obstfeld & Melitz 2012, 32). Observable is the fact that the two major financial crises, Asian financial crisis in 1997-1998 and the global financial crisis 2008-2009, have failed to trigger the feared protectionist responses (Heydon & Woolcock 2012, 29).

Trade occurs because in normal conditions a country is not capable of producing all the goods it needs or wants to consume. International trade makes the total world output of goods larger than what it would be if countries would only practice interregional trade, trade between regions within a country. So, in this sense, all countries are better off if they are involved in international trade. (Sawyer & Sprinkle 2006, 21-22)

Moreover, there are huge masses of money circulating among trade in goods and services. World's production of goods and services as a whole is estimated to increase 3.3 per cent from previous year up to nearly 58 trillion USD in current prices. The percentage of trade across national borders remains at the level it has been since 2008 with approximately 30 per cent: the world trade in goods and services are estimated to be over 18 trillion USD. (Krugman, Obstfeld & Melitz 2012, 10; IMF 2013)

### 2.2.1 Gains from trade

Researches have shown that a country taking part in international trade uses its resources more efficiently. In practice, this means that businesses move their resources from the less lucrative industries towards the industries which have comparative advantage. Long-term gains are obtained through economies of scale meaning that as the production of a good increases, the cost per unit decreases. In addition, long-term gains can be obtained from technology transfer, which means that the movements of resources, like labour or technology, increase the output of the economy which in turn increases the rate of economic growth. The process occurring over time is also known as the dynamic gains from trade. Short term gains, or static gains from trade, occur when the increase in world production and consumption result from specialization and trade according to comparative advantage. (Heydon & Woolcock 2012, 23, 24, 524; Sawyer & Sprinkle 2006, 48, 94)

Moreover, trade can benefit the smaller countries more than the bigger ones due to increasing returns to scale. When the output of an industry increases, the unit costs

of production decrease. If this occurs in a small country, it makes the industry more efficient allowing it to compete in world markets. International trade, through greater competition, increases also the quantity of goods as well as the quality and the variety of the goods offered in the markets and lowers the price of the goods the public is able to consume. So, international trade can be an effective way to enhance country's competition inside its domestic markets as well as outside it by optimizing the use of resources a country has. (Sawyer & Sprinkle 2006, 48)

### 2.3 Trade Agreements

A trade agreement is a contractual arrangement concerning trade relationships between nations. Trade agreements aim to reduce barriers to trade between participating countries or custom areas and increase both economic welfare and economic integration. Trade agreements have to ensure that each nation taking part to an agreement will gain at least as much as it loses; otherwise there would be no incentive to join any agreement. (Krugman, Obstfeld & Melitz 2012, 237)

#### 2.3.1 Multilateral trade agreements

Multilateral trade agreements involve more than two countries. The first significant multilateral negotiations began after the Second World War when group of 23 countries started the negotiations under a provisional set of rules now known as the General Agreement on Tariffs and Trade (GATT) and later on taking shape as the WTO. The most current multilateral negotiations are still on-going; the WTO's Doha round started in 2001 including 142 countries. The multilateral trade negotiations aim to reduce tariffs and non-tariff barriers to trade among the countries of GATT or the WTO. (Krugman, Obstfeld & Melitz 2012, 195, 237)

The critics of multilateral trade negotiations have argued that the more countries there are involved in the negotiations the more time consuming the process is and make the reaching of a consensus more challenging. On the other hand, when a multilateral agreement is reached it covers more countries than any other agreement and is the cause why a multilateral agreement is a very powerful instrument of international trade. By the purest definition of multilateralism the agreement should be shaped by all nations without any kind of discrimination involved between the participants. However, there has always been some form of preferential approaches of bilateralism in the trade policy shaping the multilateral agreements. (Heydon & Woolcock 2012, 62, 98, 237, 522)

### 2.3.2 Preferential trade agreements

Preferential trade agreements, or in short PTAs, are exceptions to most-favoured-nation principle (MFN) created by the WTO. Preferential trade agreements can be bilateral, between two countries or regional, between custom territories. Generally, in a PTA the member country grants better market access to their partner than to a non-member. Good examples of preferential trade agreements are the European Union (EU) and the North American Free Trade Agreement (NAFTA). (Heydon & Woolcock 2012, 60, 404, 405)

PTAs include;

- Partial scope agreements, in which trade barriers are reduced only for a small range of specific goods.
- Free trade agreements, or FTAs, in where partner countries eliminate tariff barriers between each other but retain different MFN tariffs against the rest of the trading world.
- Custom Unions, where member countries agree on common external tariffs. (Heydon & Woolcock 2012, 405)

## 2.4 Protectionism

In the next chapters barriers to trade, such as tariffs and non-tariff measures, are discussed more in depth.

### 2.4.1 Tariffs

A tariff is defined as a financial charge in the form of a tax imposed on a good when it is transported from one customs area to another. Tariffs can be referred also as custom duties. Import or in some cases export tariffs are one of the oldest trade controls used to interfere with trading flows. They are used to or as;

- protect local industries
- raise public sector revenue
- correct market distortions
- improve terms of trade
- redistribute income
- achieve certain macroeconomic objectives, such as balanced trade
- instrument of foreign policy

There are several ways in which tariffs can be calculated. Specific tariffs are calculated based on a unit of measure such as the weight or volume of the goods and ad valorem tariffs are calculated as a percentage of the value of the goods. Mixed tariffs are calculated as an alternative between an ad valorem and a specific duty. Compound tariffs are calculated as an ad valorem duty to which a specific duty is added or, less frequently, subtracted. Technical tariffs (sometimes referred to as technical duties) are calculated based on specific contents, the duties payable by its components or by making reference to the duties applicable to certain related items. (WTO 2013c)

If a country decides to use trade controls, tariffs are the favoured form because they are perceived as the most transparent and relatively beneficial in comparison to the other trade controls. Since tariffs are expressed as certain proportion of the price of the imported good and paid the moment the goods cross the border, their additional proportion is directly proportional to the level of the trade distortion in the economy. For example, the non-tariff measures usually need specific economic models in order to compare the distortions of trade. (Heydon & Woolcock 2012, 68-69)

However, import tariffs make the goods imported into a country relatively more expensive compared to the goods manufactured within the country. This shifts the allocation of productive resources in the economy or the country towards domestically produced goods which usually prevents the economy to maximize its total production value at world prices. Additionally, consumption choices are distorted when domestic goods are protected against real international competition. This leads eventually to the inefficient use of the comparative advantage and to the loss of welfare. (Heydon & Woolcock 2012, 68-69)

Tariff liberalization is expected to lead to more effective allocation of resources and towards healthier consumption patterns. Different kinds of negotiations have managed to reduce the amount of different tariffs. For example, the multilateral negotiations under GATT resulted in industrialized countries' average tariff on manufactures to drop from 40 per cent to under five per cent during a span of half a century. Even though reductions in applied tariffs have been made through unilateral, multilateral and preferential reforms there are still significant differences between applied and bound rate tariffs which ultimately can cause more protectionism. In general, applied tariffs are low in high-income countries where as many developing countries impose notable tariffs especially and including on imports from other such countries. (Heydon & Woolcock 2012, 29, 67, 83)

#### 2.4.2 Non-tariff Measures

Non-tariff measures, for short NTMs, express the existence of a policy or policies, other than ordinary tariffs, that may have economic effect on international trade in goods. NTMs, usually issued by governments, are intended to protect public health or safety, for example by implementing food inspections. (Heydon & Woolcock 2012, 91, 92)

Under the United Nations Conference on Trade and Development (UNCTAD) Multi-Agency Support Team (MAST) has categorized the NTMs as follows;

- Technical measures;
  - Sanitary and Phytosanitary Measures (SPS)
  - Technical Barriers to Trade (TBT)
  - Pre-shipment inspection and other formalities
- Non-technical measures;
  - Contingent trade protective measures
  - Non-automatic licensing, quotas, prohibitions and quality-control measures other than for SPS or TBT reasons
  - Price-control measures, including additional taxes and charges
  - Finance measures
  - Measures affecting competition
  - Trade-related investment measures
  - Distribution restrictions
  - Restrictions on post-sales services
  - Subsidies
  - Government procurement restrictions
  - Intellectual property
  - Rules of origin
- Exports;
  - Export-related measures (UNCTAD 2012)

The challenge with NTMs is that they are widely perceived as arbitrary, obstructive and non-transparent. For instance, informal payments are usually expected or required to start or continue the process of the goods crossing the border. Additionally,

there are a continuously changing variety of policies per product; if one NTM is eliminated a new appears instantly to replace it. (Heydon & Woolcock 2012, 92)

#### 2.4.2.1 *SPS and TBT*

Sanitary and Phytosanitary Measures as well as Technical Barriers to Trade are both technical measures which mean that they both are designed to protect public safety or health or the environment. These qualities make them routine regulatory activities of governments. As a general rule, TBT are usually used for manufactures and SPS for agriculture together with TBT. (Heydon & Woolcock 2012, 93)

TBT include product and process standards, technical regulations such as labelling, traceability requirements or tolerance limits for residues or restricted use of substances, and conformity assessment procedures certifying that imported goods correspond to national technical standards. As an example, in the case of agricultural goods, SPS can be used in halting the goods at the border for long enough that the inspection causes the goods to spoil. In addition, governments can refuse to explain to traders the necessary steps to have their goods cleared through the border. Used for wrong reasons these measures can designate disguised restrictions on international trade. (Heydon & Woolcock 2012, 94, 95)

#### 2.4.2.2 *Quotas*

Quotas are governmental policies restricting the import of a certain good(s) to a certain quantity or a value. For example, a country imposing a quota imports only a certain amount of the good annually. Quotas can be permanent, seasonal or temporary and they are an extreme form of protectionism banned under international trade rules. (Sawyer & Sprinkle 2006, 157-159; UNCTAD 2012)

However, quotas still exist because of the following reasons;

- Countries that are not members of the WTO are free to impose quotas.
- New members of the WTO are allowed to maintain their valid quotas during a transitional period.
- Some countries defy the international trade rules in case of some specific goods usually because of a particular national importance.
- MFA or the Multifibre Arrangement involving the textile and apparel industry have a system of bilateral quotas for imports and exports in which each country is allowed to receive or send only a specific quantity of textile or apparel items



- Agricultural products were outside the WTO scope until recently. Especially developed countries use quotas to protect the farmers from low-cost imports.
- Voluntary export restraint (VER) is a “voluntary” agreement by a country to limit its exports to another country up to a certain quantity. (Sawyer & Sprinkle 2006, 157-159)

#### *2.4.2.3 Subsidies*

A subsidy is a direct or indirect financial contribution granted by a government or public body benefitting a particular industry, company, group or geographic area. A significant government subsidy has the potency to alter the pattern of trade between countries into something it never would be without the government interference. (Sawyer & Sprinkle 2006, 168-169; UNCTAD 2012)

#### *2.4.2.4 Rules of origin*

Rules of origin laws assist in determining the country of origin of a good, or in other words, it defines what country has actually produced the good. The rules of origin laws are essential in implementing trade policy instruments such as anti-dumping, countervailing duties or safeguard measures. (Sawyer & Sprinkle 2006, 210; UNCTAD 2012)

### 3 THE WORLD TRADE ORGANIZATION

The General Agreement on Tariffs and Trade (GATT) and its Uruguay Round negotiations between 1986 and 1994 (WTO 2013a) were the foundation on which the WTO in its present form was created. Officially, the WTO was established and became operational in the beginning of 1995 after the Uruguay Round Final Act, consisting of the WTO Agreement and the ministerial declarations, entered into effect (Björklund & Puustinen 2006, 67).

#### 3.1 The WTO at present

The WTO headquarters are located in Geneva, Switzerland and its Director-General is Pascal Lamy. By July 2014, 160 countries had become members of the organization and currently countries such as Belarus, Iran, Iraq and Syria are in the midst of the accession process. (WTO 2013a)

The current round of multilateral trade negotiations began in 2001 from Doha. The negotiations include issues about trade in agricultural products and trade in services, problems with the implementation of the existing WTO agreements of developing country members, market access for non-agricultural products, rules on anti-dumping duties, subsidies and regional trade agreements, dispute settlement and special and differential treatment for developing country and developed country members. The negotiations should have concluded in January 2005 but this or later deadlines were not met and the negotiations still continue. (Van den Bossche 2008, 89-90)

During 5-7<sup>th</sup> of December 2013 the ninth Ministerial Conference held in Bali produced the Bali Package which is perhaps the first major agreement between the WTO members since the establishment of the organization. The agreement pursues trade streamlining in the form of trade facilitation which aims to simplify customs procedures by reducing costs and improving the speed and efficiency of the customs process as well as reduce bureaucracy and corruption and utilize technological advances. Additionally, the package agrees on the process how to handle a specific import quota when the quota is constantly under-filled. (WTO 2014a)

Moreover, the Bali Ministerial Conference adopted decisions on the WTO regular work, such as agreeing not to bring non-violation cases to the WTO dispute settlement process or to charge import duties on electronic commerce. Furthermore it was decided to give special attention to issues of small economies and reaffirm the com-

mitment to Aid for Trade which is an initiative to assist especially the least developed countries. (WTO 2014a)

### 3.2 The decision making process in the WTO

The ministerial conference leading the WTO assembles at least twice a year while between these gatherings, the decision making power is with the General Council assisted on specific areas by the Dispute Settlement Body (DSB) and the Trade Policy Review Body (WTO 2013b).

The actual decision making process is based on consensus. Since it is considered to be crucial for the legitimacy and credibility of the WTO, some negotiations have been prolonged for a very long time in order to reach consensus. To change the key operating principles, like the Most Favoured Nation (MFN) the member countries have to be unanimous. Decisions related to agreement interpretations and specific exceptions require the votes of the majority of three quarters and issues relating to amending provisions or approving a new member state require the majority votes of two-thirds. (Björklund & Puustinen 2006, 59, 60)

### 3.3 The WTO mission and values

According to the WTO mission statement, the WTO is a forum for its member states for negotiating international trade topics guaranteeing equal procedures for all, and consequently improving economic growth and progress within the WTO legal and institutional framework and agreements. The WTO Agreement's 16 articles define the organization's tasks and activities which include the following;

- *Trade negotiations* comprise of the WTO agreements on goods, services and intellectual property with specific rules on liberalization and permitted exceptions. The goods, service and intellectual agreements form the basic guidelines for settling disputes while in under constant development for example, in the latest WTO negotiations the Doha Round.
- *Implementation and monitoring* means that the WTO oversees how the member state's governments implement the WTO rules and in which manner. There are special councils and committees established for this purpose.
- *Dispute settlement* is the method with which the member states can protest if they think their rights have or are being violated. Every case is analysed inde-

pendently by experts according to the interpretations of the agreements in order to assure an equal trade flow and enforce the trade rules.

- *Building trade capacity* is directed especially for the developing countries. They receive extended time frames for carrying out agreements and commitments and WTO helps to develop their trade capacity as well as technical standards and such with the assistance of different projects like Aid for Trade. (WTO 2013b)

The two vital principles the WTO applies, are the MFN principle and national treatment policy which both are against the discrimination of a country or a product over another (WTO 2013b). However, even though the WTO aims to lower trade barriers with custom duties and such, the organization does not require all barriers of trade to be removed. For example WTO allows counter-measures towards unfair trade practices like dumping. (Björklund & Puustinen 2011, 89)

WTO also reaches out to different organizations and parliaments, the media and general public on diverse aspects in order to increase collaboration and knowledge of the WTO. WTO differs from other organizations, like the WHO or ILO, with its Dispute Settlement Body. In addition, WTO works towards more predictable and transparent trade circumstances as well as fair competition which all normally result in increased employment and investments and benefit the consumer. As already mentioned before, WTO strives to support the less developed countries and countries in transition to market economies because after all, they constitute three quarters of the members of the WTO. The organization also makes an effort to enhance the environmental protection together with public, animal and plant health. (WTO 2013b)

### 3.4 WTO dispute settlement

The dispute settlement is a system for the resolution of trade disputes between member states. It aims to a quick settlement because it is essential to the efficient functioning of the WTO as well as to the sustenance between the rights and obligations of the member countries. The dispute settlement system also provides security and predictability to the multilateral trading system. (Van den Bossche 2008, 171)

If a dispute occurs, it is at first attempted to settle through consultation where parties try to find a solution through discussion and mediation. If the dispute is not solved in consultation in 60 days the complainant can request adjudication by the panels and

Appellate Body after which a subject special panel is set up to compose a report of the dispute. Next the final panel report is introduced to the parties as well as all the other WTO members and if there are no objections within 60 days, the Dispute Settlement Body's ruling or recommendation becomes official. The parties still have a right to appeal after the ruling. It can take up to a year to settle a dispute through adjudication (excluding appeals) although countries can at any time settle the dispute by themselves. Nearly 37% of all dispute cases reach the full panel process. (WTO 2014c)

The Dispute Settlement Body also oversees how the rulings are fulfilled. The "lost" party has a certain time frame in which it should carry out the changes stated in the ruling. If it fails to do so there are different kinds of sanctions, such as compensations like tariff reductions, due depending on the seriousness of the violation or the disregard of the ruling. (WTO 2014c)

### 3.5 Most Favoured Nation and National treatment

The Most Favoured Nation (MFN) treatment obligation prohibits a country from discriminating between other countries (Van den Bossche 2008, 321). If a country grants another country a special favour, like lower customs duty rate for a certain good, it has to grant it for all the other WTO countries too (WTO 2014b).

However there are exceptions to the MFN rule even with strict conditions. The WTO countries are allowed to partake to free trade agreements applying only to goods traded within the group causing discrimination against goods coming outside the agreement. The WTO members are allowed to grant developing countries special access to their markets and raise trade barriers against products considered to be traded unfairly from specific countries. (WTO 2014b)

National treatment obligation prohibits a country from discrimination against other countries (Bossche 2008, 321). The national treatment clause obliges the WTO countries to treat foreign products and local products equally. However this rule applies only after the product has entered the country's domestic markets. Therefore it is possible that before the product enters the country it can be charged with, for example, an import duty. (WTO 2014b)

### 3.6 Commercial instruments

Commercial instruments are usually used in two ways; to face allegedly unfair trade practice as defined in the GATT or to provide some form of protection towards a country's domestic markets. Commercial instruments include anti-dumping, countervail measures against subsidies and safeguard measures. (Heydon & Woolcock 2012, 107)

#### 3.6.1 Dumping and anti-dumping

Dumping can be defined as international price discrimination. It means the bringing of a product onto the market of another country or customs territory at a price less than the normal value of the product. In the WTO law dumping is not forbidden. (Van den Bossche 2008, 508)

Nevertheless, in response of dumping WTO members can take anti-dumping measures if after an investigation it is proved that there actually is dumping, the domestic industry producing the like product in the importing country is suffering injury, the extent of dumping can be calculated and there is a causal link between the dumping and the injury. Usually the anti-dumping actions mean charging extra import duty on the particular product in order to even out the price difference between the imported product and the domestic one. (Van den Bossche 2008, 513, 514; WTO 2014d)

#### 3.6.2 Countervailing duties

In the WTO countervailing measures disciplines the use of subsidies and regulates the actions countries are allowed to take against the use of subsidies. There are two kinds of subsidies by the WTO classification: prohibited subsidies where a government targets export goods or goods using domestic input for subsidization which affect international trade directly. Actional subsidies are not prohibited but they are subject to challenge if they cause adverse effect to the interest of another WTO country. (WTO 2014d)

A WTO member country can use the dispute settlement procedure against determining of countervailing measures. It can also execute its own investigation and impose extra duty, known as countervailing duty, on subsidized import harming domestic the domestic producers. (WTO 2014d)

### 3.7 The WTO accession process

The first step in the accession process takes place when the candidate country sends a request to the WTO to become a member. After this the General Council establishes a Working Party composed of WTO members. Any WTO member can join the Working Party at any stage of the negotiations. The Working Party studies the candidate country's trade regime to examine whether it is compatible with WTO rules. In those areas where they are not in compliance, the candidate country must amend its laws or adopt new ones to bring the trade policy in line with WTO rules. Importantly, the applicant must inscribe WTO rules into its national legal system. (WTO 2013a)

In parallel to this process, the applicant negotiates bilaterally with Working Party members to open its market further to imports of goods and services. Once all the bilateral agreements are signed, the results will be compiled and combined into two documents: the goods and services schedules. At the time of accession, all tariffs and commitments on goods and services are offered on the same terms to all WTO members under the principle of Most Favoured Nation. (WTO 2013a)

Once the candidate country has amended its trade laws to meet WTO standards and has signed all its bilateral agreements, the Working Party is ready to adopt the accession package which contains five documents:

- Working Party report outlining all the reforms undertaken by the acceding country and its commitments
- The goods schedule: list of bound and applied tariffs on industrial and agricultural goods
- The services schedule: list of commitments in terms of market opening in services
- The Protocol of Accession containing the terms it has negotiated to become a member, and which have been accepted by all other members of the WTO in the General Council or at a Ministerial Conference. The Protocol includes annexes for the commitments made by the new member for market access in goods and in services.
- A decision taken by the General Council or the Ministerial Conference. (WTO 2013a)

After the Working Party adopts the accession package, it is forwarded to the General Council or the Ministerial Conference for final adoption. The applicant becomes a

member 30 days after the WTO is notified of ratification in the candidate country (WTO 2013a).

### 3.8 Criticism towards the WTO

Since the beginning of the 2001 Doha Round, there has been discussion and constant pressure about the development and improvement of the WTO's set of rules. It appears that the old problems among agriculture and service sectors dating back to the Uruguay Round are still unresolved and together with the new global surroundings that create challenges such as the rapidly fluctuating economic structures, weigh down the power of the WTO. (Björklund & Puustinen 2006, 48, 557)

The WTO has been accused of favouring the interests of transnational companies and that in their current form the WTO agreements lead to the deterioration of public services, the weakening of the already vulnerable countries, destroying the environment and weakening the real wages and labour standards just to mention few (George 2001, 11-12). The rise in the activity of the non-governmental organizations is connected to the expansion of trade negotiations and thus it is inevitable that WTO has been forced to alter its mode of action. As a result of the diverse criticism WTO has for instance established an environmental committee and Aid for Trade. In essence, the WTO represents a compromise between the ideal of open world trade and the real life practice. (Björklund & Puustinen 2006, 557, 566, 567)



#### 4 IMPLEMENTATION OF THE RESEARCH

As a definition qualitative research is an umbrella term which covers a selection of interpretive techniques which all seek to describe, decode, translate and otherwise come to terms with the meaning, not the frequency like in quantitative research, of a certain phenomenon in the social world. In essence, qualitative researchers are interested in understanding the meaning people have constructed; how people perceive their world and the experiences they have in that world. (Merriam 2009, 14)

Conducting research always involves choosing a study design that corresponds with the research question. Additionally, it should be considered whether the design comports with the writer's worldview, personality and skills so that the researcher is able to make a sensible decision as to the design choices available when designing and implementing a research study. (Merriam 2009, 1) Qualitative research generates understandable information and primarily answers to question why and how by using, for example, in-depth interviews, focus group discussion, observation, content analysis and life histories. Qualitative method is typically used for providing thorough understanding of the research issue or process and its contextual influence. (Hennink, Hutter & Bailey 2011)

In qualitative research, the researcher's primary instrument for data collection and analysis is the researcher him/herself. This means that as a human instrument the writer is able to adapt and response to the ideal means of collecting data. However, the human instrument has faults and biases which might impact the study but rather than eliminating the possible biases and such it is more beneficial to identify and monitor the subjectivities to see how they may be shaping the research outcome. (Merriam 2009, 15)

Qualitative research utilizes a variety of ready-made materials which can be analysed the same way as all other material used or generated in qualitative research. The majority of the data analysed in this study originated from the internet. As the researcher's own conceptual framework for the internet shifts depending on the research goals and of the research question, the challenge is how to narrow down the vast range of choices internet offers in order to avoid for example previous studies that might guide the current research project (Silverman 2011, 113). It is up to the writer to decide which sources can be considered as reliable and whether the electronic sources, which are accessible anybody to edit, are valid.

This study was conducted mostly with the methods of qualitative research by gathering primarily secondary data. The data was collected from sources considered to be professional and accessible for anyone, which contributes also to the reliability of the research. The electronic and digital data used were verified from multiple sources before using the information obtained from these sources. Quantitative data was used when analysing Russia from an economic perspective.

Time and time management has been a limitative factor during the whole span of the thesis process. Also the lack of primary data decreases the professional side of the thesis but the primary data issue is related to the time management problem. Nevertheless, it should not make the study less reliable because the sources used in the thesis are regarded to be up to an academic level.

## 5 PESTEL-ANALYSIS OF RUSSIAN FEDERATION

PEST-analysis is a method for examining and analysing factors effecting to the operational environment or any organization. Initially PEST-analysis was developed to support companies in designing competitive strategies but it also suits for the purpose of country analysis. The model has different variations, like PEST, STEP and PESTEL. For analysing Russia PESTEL form is used including chapters of political, economic, social, environmental, technological and legal factors. (Puusa, Reijonen, Juuti & Laukkanen 2012, 41)

### 5.1 Political factors

Russia, officially Russian Federation, is a federation comprising of 83 federal subjects. The federal subjects have 21 administrative sub-regions called republics, 46 oblasts, 9 territories or krajs, 4 autonomous districts or okrugs, 1 autonomous province (the Jewish Autonomous Oblast) and 2 federal cities, Saint Petersburg and Moscow. In addition Russia is divided into 8 federal districts which all have a representative (Plenipotentiary Representative) appointed by the President in order to ensure that the President's constitutional prerogatives come true and that the federal subjects act according to the laws of the federal district. (Autio, Alho, Esilä, Filppula, Kaasalainen, Kairento, Kekki, Laakso, Lumijärvi, Matilainen, Nurmilaukas, Rinne, Ruohonen, Smirnoff, Stenholm, Stepanova, Tiirikainen, Tiri & Vimpeli 2009, 9)

Russia is a semi-presidential organization where the President is the head of the state and the Prime Minister is the head of the government. The President chooses and appoints the Prime Minister. The President is elected by the people for six years at a time and for two consecutive terms at maximum. The President of Russian Federation is currently Vladimir Putin and the Prime Minister Dmitri Medvedev. The federal government is divided into three branches; legislative, executive and judiciary. (Autio et al. 2009, 9; FRCC 2014)

After the elections in December 2011 there are four parties in the Russian parliament (the State Duma); United Russia, Communist Party of the Russian Federation, Political party LDPR and A Just Russia. Suspicions of electoral fraud and malpractice discoveries lead to unforeseen protests and demonstrations after the elections in December 2011. The protests ultimately led to new laws which complicate the actions of the non-governmental organizations (NGOs) in Russia. (Lipponen, Mäki-Leppilampi, Nissinen, Lehtovirta & Kotilainen, 2013, 12, 13)

The current economic policy in Russia strives to create incentives for investments and the monetary policy tries to restrain the rate of inflation in order to support saving and investing. One of the main goals is the improvement of the business environment and increasing the investment attractiveness towards Russia. One of President Putin's goals during his current presidential term is to lift Russia in the World Banks Doing Business comparison from the 122<sup>nd</sup> position to 20<sup>th</sup> position. (Lipponen et al 2013, 10)

## 5.2 Economic factors

Europe's debt crisis is slowing down the growth of Russia, as it is overwhelmingly the most important market area Russia has had and will have for years to come (Table 3; Sutela 2012, 150). Moreover, Russia is likely to be hit hard by the ongoing crisis with Ukraine. The legality of the events in Ukraine have been under dispute by all part-taking sides but after Crimea's secession referendum in favour of joining Russia and Putin signing a bill to absorb the area to Russia, the EU and the U.S. issued the first sanctions towards Russia. The most recent troubles and the war-like state in Eastern Ukraine may have Russia face a third round of sanctions if the fragile ceasefire will not hold. The happenings have greatly damaged the relations of the West and Russia as the Western Countries have commented Russia not to respect any international laws or treaties. (BBC 2014)

Currently, Russia is the seventh largest country in the world behind the U.S., EU, China, India, Japan and Germany when measured by gross domestic point (CIA Factbook 2014). In 2012 Russia's GDP was over 2 trillion US dollars (Table 1) and GDP per capita was over 14 000 US dollars even though its economic growth has declined from the previous year. In 2013 Russia's GDP grew 1.5% and the International Monetary Fund (2014) has projected Russia's GDP growth in 2014 to be 2.0% and in 2015 2.5%. The World Bank (2014) however has revised its Russia's growth forecast for the year 2014 from 2.2% down to 1.1% largely due to the Russia-Ukraine crisis.

TABLE 1. Economic key figures of Russian Federation 2008-2012; total GDP, GDP growth, GDP per capita, export and import % of GDP. (World Bank Database 2014a)

Indicator Name	2008	2009	2010	2011	2012
<b>GDP in trillions (current US\$)</b>	1,66	1,22	1,52	1,90	2,01
<b>GDP growth (annual %)</b>	5,25	-7,82	4,50	4,29	3,44
<b>GDP per capita (current US\$)</b>	11 700	8 615	10 709	13 284	14 037
<b>Exports of goods and services (% of GDP)</b>	31,31	27,94	29,22	30,36	29,44
<b>Imports of goods and services (% of GDP)</b>	22,07	20,50	21,14	21,80	22,14

TABLE 2. The breakdown of merchandise trade of the Russian Federation in 2012. (WTO 2014e)

MERCHANDISE TRADE (%)			
<b>Share in world total exports in 2012</b>	2.88	<b>Share in world total imports in 2012</b>	1.80
<b>Breakdown in economy's total exports</b>		<b>Breakdown in economy's total imports</b>	
By main commodity group (ITS)		By main commodity group (ITS)	
Agricultural products	6.0	Agricultural products	13.3
Fuels and mining products	71.3	Fuels and mining products	2.9
Manufactures	19.6	Manufactures	80.1
By main destination		By main origin	
1. European Union (27)	45.1	1. European Union (27)	33.9
2. China	6.4	2. China	15.4
3. Belarus	4.0	3. Ukraine	5.5
4. Turkey	3.0	4. United States	3.8
5. Japan	2.9	5. Belarus	3.6

As seen from Table 2, the export and especially import volumes of goods and services to and from Russia are quite low with both figures being under 30 per cent. This indicates Russia to be quite self-sufficient, but in addition it reveals Russia's economic integration level in relation to international markets to be low. Russia's economic growth pace has slowed down, not because of any current trends in energy industry or among other commodities but because of its unilateral structure, as it is observable from the export and import breakdown in Table 3, and lack of competition in the Russian economy.

In terms of balance of trade (Appendix 1), Russia has trade surplus as its exports in goods and services exceed the imports with nearly 28 million US dollars in the first quarter of 2014. This signifies that Russia has positive net sales and so through savings it can invest the income abroad in order to create foreign assets. Additionally the

current account balance (CAB) surplus indicates Russia to be a net creditor to the rest of the world meaning that Russia is able to offer loans to other countries and thus profit itself from it. However, on a yearly level from 2011 to 2013 the CAB has been declining on average 30 million US dollars and it only remains to be seen if in the end of 2014 Russia imports more than it exports turning the BOT into deficit. The cause can be found from the import of services which are growing more steadily than the other variables. (Appendix 1; Heakal 2013)

In addition, significant is that the Bank of Finland's Institute for Economies of Transition, BOFIT's, baseline forecast shows the uncertainty to increase already in the end of 2013, despite of the crisis in Crimea. (Rautava 2014, 4) Political uncertainty also drives away additional investments to Russia although the state has the potential to revive industries with its own investments (Kurronen 2014, 5). In 2013, for the first time ever, Russia became the third largest recipient of foreign direct investment (FDI) obtaining a 94 billion US dollar inflow into the country. The 83% jump in FDI inflow is by the most part explained by a great company acquisition between the BP and Rosneft but also because of the active role of the Russian Government's Direct Investment Fund among international actors. (UNCTAD 1/2014, 7) The RDIF, established in 2011 by the Russian Government, is a 10 billion US dollar fund to promote equity investments primarily in the Russian economy (RDIF 2013). Nevertheless, there have been estimates that Russia has lost around 70bn USD in capital outflows since the beginning of the year (FT 2014).

Moreover, Russia is an oil state and its currency is tightly bound into the world market value of oil (Figure 3) which means that Russia's GDP development follows the fluctuations of the global oil prices. As it is observable from Figures 2 and 3 the price of crude oil and the worth of ruble against the US dollar show a quite coherent line of development. The cheaper the oil prices are, the more worthless the national currency, ruble, is. (Nemtsov & Milov 2009, 71) Over the last six months ruble has weakened notably against the US dollar (Figure 2) and is likely to weaken even more and speed up dollarization which both are the result from capital outflows and the short and long term effect of the Crimea crisis (Kurronen 2014, 6) Inflation, measured by the consumer price index, reveals the annual percentage change in the cost for the average consumer of acquiring a basket of goods and services that may be changed at specified intervals, in this case, yearly. The rate of inflation in Russia in 2012 was 5.1% decreasing from 2011 by 3.3 percentage points. (World Bank Database 2014b) There is a possibility that Russia's economy goes to a stagflation as its economic

growth is in slowdown and if the inflation escalates by the weakening of ruble (Kurronen 2014, 2). These adverse factors cause uncertainty in the future.



FIGURE 2. Development of the value of the Russian ruble against US dollar from October 2013 to March 2014. (Nordea Markets 2014)



FIGURE 3. The development of crude oil price from November 2013 to April 2014. (Nasdaq 2014)

### 5.3 Social factors

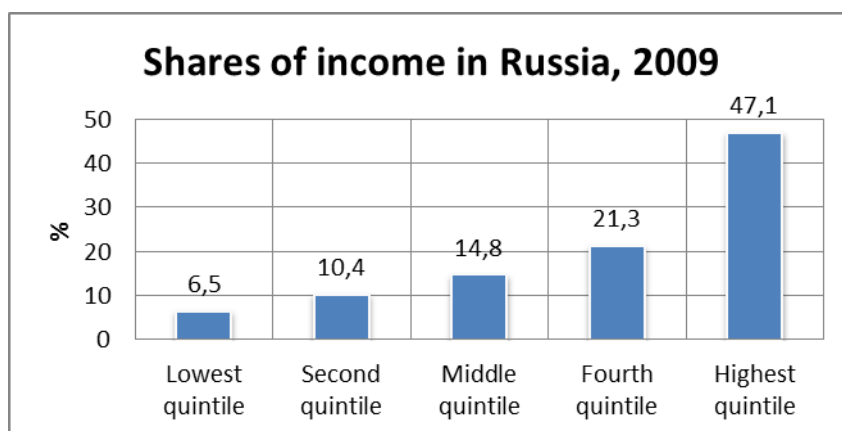
Russia's population was 143 million in 2012 according to the Russian Federation's Federal State Statistics Service (2013). The labour capacity was in 2012 75.67 million

people of whom approximately 8% are unemployed (FSSS 2013). The life expectancy on average is calculated to be 64 years for men and 76 years for women (CIA Factbook 2014).

In Russia the taxation does not level out the distribution of income but all earned income is subject to 13% flat tax. This causes the huge differences in incomes especially between the richer areas like the city of Moscow and the oil producer districts and the poorest areas of North Caucasus and Southern Russia. For example, the wages in Moscow are three to four times higher than in the periphery. (Lipponen et al 2013, 9)

Together with China and Brazil, Russia belongs to the upper middle income class which means that the average general income is between 4,036 USD and 12,475 USD (World Data Bank 2013). The income share held by the highest 20% in Russia is nearly 50% of all income obtainable as seen in Table 4. According to a normal distribution, an U-shaped curve would be observable, meaning that the middle class would collect the majority of income. The distorted curve representing Russia indicates that wealth is distributed unevenly, mainly as a result of the privatizations in the 1990's although the general welfare has increased in the 21<sup>st</sup> century Russia. Another defining characteristic among Russian population is that there is no culture of savings; many believe that Russia will not remain stable in the future and this leads people to spend money while they are able to. (Ericson 2011, 306, 308)

TABLE 3. Percentage share of income held by subgroups of population indicated by quintiles in Russia, 2009 (World Data Bank 2013)





Since the Soviet Union era, Russia's population has been declining affecting the Russians in two ways. Firstly, on average the male population is deceased too early at the age between 50 and 60 years, and secondly, the birth rate is too low. Especially in modern day Russia the rate of birth is approaching corresponding figures of Europe with 1.6 children per family. In 20 years' time Russia's population is beginning to border the population of Germany if its yearly population decrease is between 600 000 and 900 000, and if not solved it will threaten the long-term economic backbone of the country. (Luukkanen 2008, 126, 127, 227)

#### 5.4 Technological factors

Russia's long term objective is to move from raw-material economy towards more versatile economic structure. The government's innovation strategy pursues to modernize the manufacturing industry and increase the sector of high-tech as well as to increase the exports of the high-tech sector and strengthen Russia's international position in R&D. In 2011 Russia used 1.1% of its GDP to research and development. (Lipponen et al 2013, 10; World Bank Database 2014)

The modernization program focuses especially in communications and space technology, nuclear technology, medicine, energy efficiency and to strategically important information technology. So far the largest projects are the Moscow's "Silicon Valley" Skolkovo innovation village and the establishment of the state owned nanotechnology investment company Rusnano. (Lipponen et al 2013, 10)

Internet and IT-service sectors as well as the telecommunication sector increase in size in a rapid speed in Russia. The quantity of internet users is over 60 million people and the use of mobile phones is well above the average of Europe. The internet has become a popular place to do shopping, obtain services and search for information. (Lipponen et al 2013, 9)

#### 5.5 Environmental and geographical factors

Comprising the width of almost the whole northern Eurasia, by territory, Russian Federation is the biggest country in the world; the distance from the most Western corner of the Baltic Sea to the Chukchi Peninsula's most Eastern tip is well over 9,000 kilometres including 11 time zones. The Ural Mountains divide Russia clearly to a European and Asian parts. (Juntunen 2009, 7)

Russia benefits from its huge territorial size; its natural resources are exceptionally vast. It is one of the biggest, if not the biggest, gas and oil producers in the world and it possesses alone about 27% of the world's gas reserves, 20% of the world's forests and fresh water reserves and 16% of the world's mineral reserves. However, the climate prevailing in Russia impacts on daily infrastructure and its lagging development but additionally to the way Russia is able to utilize its natural resources. (Niinivaara & Smith 2011, 237)

Russia's Economic Strategy up to the year 2030 aims at improving environmental effectiveness of energy policies. For example, Russia's objective is to reduce energy use by 40% among its industries. It is estimated that the modernization process could create 300 000 new jobs in the environmental sector. Financial incentives are used in the forms of carbon taxation, cap-and-trade schemes for emissions and green taxes to influence consumers. (OECD 2014)

## 5.6 Legal factors

The biggest obstacles for doing business in Russia are weak legal protection, widespread corruption, additional bureaucracy and protectionism. The strong role of executive power, the weakness of national institutes and the significant share of state-owned companies in the economy have created a type of an inner circle economy instead of free competition. The dissolution of these structures is possibly only if the independence of the judiciary is augmented. (Lipponen et al 2013, 13)

The legislation in Russia has been developed and changed significantly in recent years. Already, the basic legislation is quite comprehensive but the multifaceted nature of the standards as well as the partial contradictions can lead to ambiguities in the interpretation of the laws. Russia's WTO talks contributed to the acceptance and implementation of the international regulations in Russia. Changes and improvements have already been made, for example in customs clearance and certification legislation. (FRCC 2014)

The battle against corruption started simultaneously with the market reforms as the first act against corruption in 1992 was signed. Yet in Russia, the conditions for corruption have been quite natural due to the fact that for the majority of the citizens earnings have been moderate. On top of that there has not been, at least according to the Western world's standards, a normal state of justice and the legislation re-

quired, so as a result the arbitrary decision making power of the officials has been crucial. (Kuorsalo, Suosiluoto & Valkonen 1999, 123)

The Corruption Perceptions Index ranks and measures the level at which a country's public sector corruption is perceived to be. Russia, in 2013, was the 127<sup>th</sup> country out of 176 countries scoring 28 points out of 100, whereas for example Finland scored 90 points thus being the least corrupt country with Denmark in the world according to International Transparency's variables (Transparency International 2013). Yet, the rankings do not tell the whole truth. The misuse of power is not only about a threat, it brings an opportunity to buy everything one can get with money; university degrees, driver's licences, passports, an acquittal (Ericson 2011, 259).

The foreign companies reaching for a position inside the Russian markets corruption and bribery is about choices; will they act according to the company's own moral standards or circle around the grey area as appears to be the habit of the business making culture in Russia. Perhaps the most frequently used corruption example relating to Russia is Ikea, which has halted its investments in the country since 2009 as a result of anticorruption campaigning (FT 2013) although Ikea's founder Ingvar Kamprad has admitted that the company could not have been able to open even the first store in Russia if it would have followed the law to the point (Ericson 2011, 263).

## 6 RUSSIA AS A MEMBER OF THE WTO

On 22 August 2012 Russia became 156th member of the World Trade Organization, (WTO 2012) which means that all of the world's current major economies are part of the WTO (Connolly 2012, 6). Russia's accession process started during the era of GATT in 1993 and continued until 2011 when the working party completed its work of 18 years and thus the longest membership negotiation process to date in the WTO (WTO 2013b).

### 6.1 Russia's WTO accession process

Russia applied to the WTO in June 1993. Its accession process was elongated by several incidents outside and within Russia affecting its domestic politics. For example, the South Ossetia conflict in 2008 together with the fact that Russians felt a lack of respect from the US foreign relations policy towards Russia contributed to colder relationships between Russia and the United States as well as with EU. Additionally the attitudes in Russia in relation to joining the WTO became more negative which lead to the establishment of a customs union between Russia, Belarus and Kazakhstan. (Ericson 2011, 188)

However, one after the other of the CIS countries, including Moldova, Armenia and others together with the unofficial member state Ukraine, have joined or are in the process of joining the WTO (Nemtsov & Milov 2009, 51). During the negotiations Russia pointed out how much it emphasizes the neo-integration of the former Soviet states which brought additional issues to the membership negotiations. By the time Russia joined the WTO, simultaneously with Samoa and Montenegro, the WTO member countries' share of the world trade was 97 percent. (Sutela 2012, 348, 354)

### 6.2 Russia's WTO commitments

In order to promote open trade and increase its integration into the world economy Russia agreed to apply all the WTO provisions and invoked only few specific transitional periods. All together Russia concluded 30 bilateral agreements on market access for services and 57 concerning the market access of goods (WTO 2011).

#### 6.2.1 Market access for goods

The finalized binding tariff ceiling on average for Russia will be 7.8%, when in 2011 the same average was 10% for all products. The average tariff ceiling for products

will be 10.8% (in 2011 13.2%) and for manufactured goods 7.3% (2011 9.5%). Russia has agreed to lower its tariffs on a wide range of products. Average duties after full implementation of tariff reductions will be:

- 14.9% for dairy products (current applied tariff 19.8%)
- 10.0% for cereals (current applied tariff 15.1%)
- 7.1% for oilseeds, fats and oils (current applied tariff 9.0%)
- 5.2% for chemicals (current applied tariff 6.5%)
- 12.0% for automobiles (current applied tariff 15.5%)
- 6.2% for electrical machinery (current applied tariff 8.4%)
- 8.0% for wood and paper (current applied tariff 13.4%)

Final tariffs will be bound at zero for cotton and information technology (ITA) products (current applied tariff on ITA products is 5.4%). The final bound rate was implemented on the date of accession for more than one third of national tariff lines with another quarter of the tariff cuts to be put in place three years later. The longest implementation period is 8 years for pork and 7 years for motor cars, helicopters and civil aircraft. (WTO 2013a)

Tariff rate quotas (TRQs) are applied to beef, pork, poultry and some whey products. Imports entering the market within the quota will face lower tariffs while higher duties will be applied to products imported outside the quota. The in-quota and out of quota rates are listed below with the out of quota rates in parentheses:

- For beef 15% (and 55%)
- For pork zero (and 65%). The TRQ for pork will be replaced by a flat top rate of 25% as of 1 January 2020.
- 25% (and 80%) for some selected poultry products
- 10% (and 15%) for some whey products

Some of these quotas are also subject to member-specific allocations. (WTO 2013a)

### 6.2.2 Market access for services

Russia made specific commitments on 11 services sectors and on 116 sub-sectors. On telecommunications, the foreign equity limitation (49%) would be eliminated four years after accession. Russia also agreed to apply the terms of the WTO's Basic Telecommunications Agreement. (WTO 2013a)

Foreign insurance companies are allowed to establish branches nine years after Russia accedes and foreign banks are allowed to establish subsidiaries. There is no

cap on foreign equity in individual banking institutions, but the overall foreign capital participation in the banking system of Russia is limited to 50%. On transport services, Russia made commitments in maritime and road transport services, including the actual transportation of freight and passengers. On distribution services, Russia allows 100% foreign-owned companies to engage in wholesale, retail and franchise sectors upon accession to the WTO. (WTO 2013a)

### 6.2.3 Other commitments

Export duties are fixed for over 700 tariff lines, including certain products in the sectors of fish and crustaceans, mineral fuels and oils, raw hides and skins, wood, pulp and paper and base metals. Quantitative restrictions on imports, such as quotas, bans, permits, prior authorization requirements, licensing requirements or other requirements or restrictions that could not be justified under the WTO provisions are eliminated and not re-introduced. Upon accession Russia accepted to eliminate all industrial subsidies programmes or modify them to follow the WTO Agreement on Subsidies and Countervailing Measures. Agricultural subsidies are gradually reduced to USD 4.4 billion by 2018. (WTO 2013a)

Russia will be accountable to the other WTO countries through the DSB of the manner it handles its commitments and likewise, Russia can dispute the way other countries adhere the WTO rules towards Russia. (Connolly 2012, 6, 16) So far, Russia has been involved in dispute cases as a third party on eight occasions, as a respondent twice and as a complainant once. The complaint was made against the European Union and it is about cost adjustment methodologies and certain anti-dumping measures on imports from Russia. (WTO 2013a) Additionally in the future, if Russia joins other organizations such as the OECD, the WTO agreements have to be taken into consideration during the accession process to avoid possible contradictions.

## 6.3 Expectations and results of Russia's WTO membership

There are estimates that the first two or three years of the membership can be quite expensive due to the lost revenue and the cost of possible changes due to conforming policies and procedures to correspond the WTO agreements. The World Bank has evaluated the WTO membership to increase 3.3 percent Russia's total GDP during the first three years than in the option of being outside the WTO. However, the calculations are based on normal trading conditions. As Russia's economic growth has been slowing down and as EU, Russia's largest non-energy based trading partner is in recession, it seems unlikely for Russia to reach the forecasted rate of

growth. (RT 2013) The level of trade in commodities after the membership has not experienced any significant changes as it is observable from the Figure 4. Since Russia joined the WTO in August 2012 there has been only minor fluctuations in trade which are more likely to be caused by normal seasonal changes. Additionally, as discussed previously in chapter 4.2 the GDP growth rate in Russia has been downward.

To get perspective on what Russia's economic direction following the accession could be, comparisons are made with a country similar to Russia. China, who joined the WTO in December 2001, has become through structural changes a more open, stabile, predictable and transparent economy (WTO 2014f). China and Russia both have developed from closed economies towards more market-oriented ones but still have kept their somewhat unpredictable nature. Since the accession, China's GDP growth has been 10.1% on yearly average. Moreover China's foreign trade (Figure 5) has increased since its WTO membership and currently it is one of the world's largest exporter and importer. (WTO 2014g)

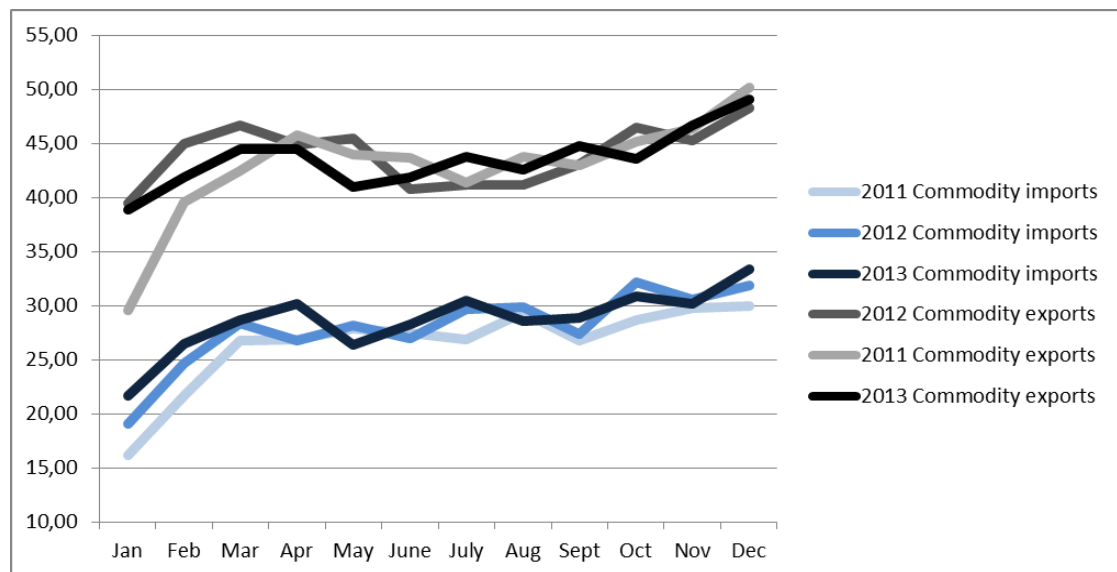


FIGURE 4. Russian Federation's commodity trade from 2011 to 2013. (Bank of Russia 2014)

For a start, the advantage of the membership to Russia comes from goods and services as the enhanced competition benefits consumers and increases the general welfare. The membership might not considerably affect Russia's exports on energy and raw materials because even before the accession the mentioned commodities did not encounter import duties. In long term, after the effects of increased competi-

tion to the business making and trade environment have actualized Russia's GDP would be on average 11 percent higher than without the WTO membership. (Sutela 2012, 350, 351) However, it has to be considered that at this stage of the accession with not even two years past, sudden or unexpected changes are not due yet and as the long term effects of the Crimea conflict is yet to be undiscovered, the estimate above might be too positive.

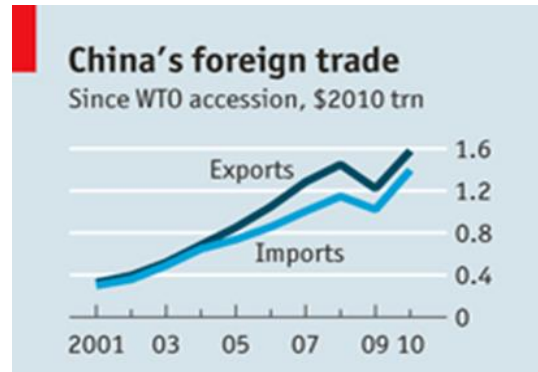


FIGURE 5. China's foreign trade development after the WTO accession. (The Economist 2011)

Russia's WTO membership was hoped to bring predictability to trade and business operations in Russia. Nevertheless, right after the membership came into force Russia raised tariff rates of certain products from wood to livestock and meat products over the agreed level and introduced several protectionist actions which were intended to compensate its domestic industry the increased competition brought by the WTO membership (Lipponen et al 2013, 14). The food and agriculture sectors have suffered the most after the accession as the industries have not yet become competitive enough to be able to resist the growing imports. During the first year after Russia's accession the import of dairy products increased significantly; for example the import of butter rose nearly with 50 percent. (RT 2013) Also the price of pork has dropped by 30 percent caused by the increase in imports of inexpensive meat (DW 2013).

Upon accession in August 2012 Russia lowered duties on car imports but in already in September 2012 imposed a recycling fee on the car imports in order to compensate the decreased duties. (DW 2013) This protective action made the EU to use the dispute settlement method against Russia only after few months Russia's accession. Together with Japan, EU is claiming that the recycling fee Russia imposes only to imported motor vehicles is inconsistent with the WTO agreements. In comparison, it took the EU six years to launch its first dispute case against China. (WTO 2014c) The



Prime Minister of Russia, Dmitri Medvedev, has stated that Russia needs to learn how to fully utilize the opportunities of the membership, including conflict resolution procedures (The Moscow Times 2013). Additionally, the export business trains the companies involved towards higher productivity and thus to be more cost-efficient (Sutela 2012, 353). Russian companies have not been able to take full advantage out of the WTO membership because the companies are lacking knowledge and information of the effects of the accession. It is estimated that the Russian companies receive complete benefits only three to five years after the WTO accession. (Talous-sanomat 2013)

Russia's trade policy has so far emphasized protective measures against imports than to enhance exports. Methods of protective actions include go local campaigns, environmental controls, supporting R&D, workforce targeted education and state aid. (Sutela 2012, 353) Moreover, there are 25 domestic industries or sectors defined as strategically important (oil, gas, nuclear industry, arms production, fisheries, airspace and media) which Russia is protecting its own economic interests with various methods (DW 2013).

Previous examples show that when a country joins the WTO the benefits distribute to almost all households, but especially most to the middle-income class and the poor. In this sense, it could be said that the WTO membership reduces poverty. Likewise, the membership benefits all areas, especially those able to allure the most FDI. These areas are predicted to be North-West Russia, St. Petersburg and Russian Far East. The overall production grows but not all Russian companies profit from it. The benefits go to the production of non-ferrous metals, iron, steel, chemistry and petro chemistry. Most likely the losers are among the wood-processing industry, light industry and engineering industry. In addition, the cities build around only one company are problematic which could be solved with social policy renewals and the promotion of mobility. (Sutela 2012, 351, 352)

Russia has vast modernization and renewal of structures ahead of it among the broad areas of economy, politics and society in the near future though currently it is slowly, on its way towards modernization. In Russia, many hope that the WTO membership would benefit the country in the domestic reform by stabilizing the economy with attracting more foreign investments (Connolly 2012, 6). The country also needs innovation and small businesses (Ericson 2011, 226). Russia's long-term challenges also include a shrinking workforce, corruption, and underinvestment in infrastructure (CIA Factbook 2014). In Russia the learning of all WTO rules and testing them out

will go on for years to come. In addition, the country undoubtedly will want to measure and explore its authority in the WTO. The next big challenges Russia goes towards after the WTO accession are the forming of a FTA with the EU and joining the OECD (Sutela 2013, 353).

## 7 CONCLUSIONS

The biggest question about the future of the WTO and multilateral trade agreements is when will the Doha round end? If the negotiations go on still for several years how will it affect the creditability of the WTO. Even though the Doha negotiations go through significant subjects it is vital for the organization to be able to come to a decision at some point and when it does what the results will be. It is possible that the number of PTAs and FTAs increase drastically consequently complicating the WTO actions and its development if enough countries see that the WTO does not have the necessary power to guide international trade. Also the current economic situation with its delicate fluctuations can make some countries act hasty in order to attempt to save their economies from further damage. How the total world trade will develop and for how long is it possible for the economic growth to continue and how these questions affect the dynamic of world trade are topics for further research.

Analysing Russia unfolded an image of a country pursuing to get back its historical position as a great power but which is weighed down by its past structural complexity. To a large extent Russia's future will depend on its success on modernising the state policies and economic composition. It is quite obvious that Russia has always had strong leaders, like at present, who take the nation to the direction of their visions regardless if it actually benefits the country as a whole. Nevertheless, Russia has considerable influence in the international markets especially in the field of oil and oil related articles, and its actions reflect over its trade partners.

The estimated economic gain Russia should receive through the WTO membership should be incentive enough to carry out the obligatory changes in trade related issues expected from members. However now when the calculations project a slowing economic growth, with only approximately one per cent add to Russia's GDP in 2014, it might affect to the speed the WTO reforms are fulfilled negatively. Moreover it is quite certain that the situation with Ukraine will not simplify the means Russia can turn its economy into greater upswing. In this fragile situation the WTO membership can bring Russia unexpected value as it has an impartial negotiation channel as the WTO is capable of bringing disagreeing parties into the same negotiation table. Whether or not the WTO can be of help is up to Russia.

Another issue is that when Russia inevitably faces the huge challenges in modernization and reformations will its economic structures be strong enough to hold up with the change which inevitably will sway the existing composition. Or as a familiar alter-

native from its history, will Russia perhaps triggered by some internal power struggle, develop towards completely opposite direction and thus break, at least from the point of view of Western world, its progress and close up again as a form of self-protection. Russia's history in general, affects the country still for quite long; Russia inherited USSR's dysfunctional economic and to some extent social structures which at least still are a burden restraining the country's development. When Russia finally joined the WTO it laid certain expectations towards the country. Russia is anticipated to open up its economy and by doing so it will be under examination of its actions. A different matter will be if Russia as a state is ready for any closer external review. Up to a certain point Russia's accession to the WTO helps it to clean its image and create a picture of a more communicative Russia.

As Russia's economy is edging stagnation, the consequences of the events in Ukraine, which cannot be avoided when forecasting the future development of any area relating to Russia, can for example have significant effect on tourism and travel in Russia as it might be perceived unattractive or insecure country to visit and so lose significant income. This affects directly to the CAB negatively and can turn the currently still growing service imports into downturn and the CAB into deficit. Moreover, as the EU and USA are negotiating a free trade agreement known as the Transatlantic Trade and Investment Partnership (TTIP), it can weaken Russia's position as a trading partner with the TTIP countries. If the FTA between the US and EU actualizes, for instance it is possible, that the EU will not acquire oil from Russia anymore as it can acquire the needed fuels from the US and its shale gas and oil supplies.

At the moment with the crisis in Ukraine, Russia seems indifferent of the effects of the imposed sanctions or cooled of relations with its trading partners as its leaders are reasserting their position inside the nation. At present the sanctions already issued do not seem to affect the Russian economy directly but under the threat of more sanctions Russia's PM Medvedev has stated that in order to minimize the effects of the sanctions Russia is ready to develop the cooperation with Asia further. Additionally, as Russia's FDI rose dramatically in 2013 it is not likely to do the same kind of surge this year due to current events but even a small rise in FDI inflow could assist the Russian economy into a weak growth. In a summary, economically the biggest challenges Russia currently faces are the renewal of its economic structures and final overall consequences from the still unsolved Ukraine crisis.

In a way the Ukraine conflict could have not come at a worse time. Despite the Ukraine situation Russia's economy was in downturn but now as the crisis is causing the most harm to Russia's own economy it might be harder to detect the positive effects and benefits of joining the WTO, if there even are any. There is even the possibility that Russia will not receive any of the benefits of the WTO accession in its current state or they will show in much longer time span than expected. It is also possible that Russia attempts to use the WTO as a political tool against the countries imposing sanctions to the country. Moreover, Russia has already articulated the possibility of bringing the Ukraine crisis in front of the WTO dispute settlement method.

Carrying out further research five or ten years from now would give insight on what are the main areas Russia concentrates on developing as speeding up economic growth and restraining the growth of inflation simultaneously is not possible. Other questions remain too. How and in what time frame Russia succeeds in fulfilling its membership obligations and does it have the motivation to do so. If Russia does not receive the expected benefits of the membership like the steady increase in its GDP growth what are the consequences. Additionally, how Russia will handle the process of joining other organizations it was targeting to join, like the OECD. Could it even be possible that Russia isolates and detaches itself from the WTO and its main trading partners or will it understand that respectful long-term cooperation is one of the key elements towards economic stability? It remains only to be seen what are the issues Russia concentrates to pursue or protect in the WTO and how will its economy develop over the next years in the current economic and political environment.

Finally when reflecting the time span the study has been made, there have been countless of events relating to Russia and undoubtedly affecting the subject. Therefore it is good to consider that if everything happened is not mentioned, there has been a need to limit the informational inflow and try to outline the subjects which relate the closest to the research.

In regard of being biased towards Russia, it is nearly impossible not to have an opinion about Russia. However, in order to understand and analyse Russia you have to be somewhat passionate and biased because in order to do a research you need to be critical to your own opinions as well as to the information you gather. Altogether, the whole thesis experience has been thorough and even though the time management of the project is nothing to be proud of, the learning process has been worth it.

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APPENDIX 1: BALANCE OF PAYMENTS OF THE RUSSIAN FEDERATION: CURRENT ACCOUNT AND FINANCIAL ACCOUNT

(Millions of US dollars)

	Q1 2014 (estimate)	Q1 2013	2013	Q1 2012	2012	Q1 2011	2011
<b>Current account</b>	<b>27,6</b>	<b>24,3</b>	<b>32,8</b>	<b>39,3</b>	<b>71,3</b>	<b>29,8</b>	<b>97,3</b>
<i>Goods</i>	51,4	48,0	180,3	58,8	191,7	46,9	196,9
<b>Exports</b>	<b>122,9</b>	<b>125,2</b>	<b>523,3</b>	<b>131,0</b>	<b>527,4</b>	<b>111,7</b>	<b>515,4</b>
oil	41,3	43,2	173,7	N/A	180,9	N/A	N/A
oil products	25,5	25,5	109,3	N/A	103,6	N/A	N/A
natural gas	18,2	18,1	67,2	N/A	62,3	N/A	N/A
other	38,0	38,3	173,1	N/A	180,6	N/A	N/A
<b>Imports</b>	<b>-71,6</b>	<b>-77,1</b>	<b>-343,0</b>	<b>-72,2</b>	<b>-335,8</b>	<b>-64,7</b>	<b>-318,6</b>
<i>Services</i>	-10,8	-10,5	-58,6	-8,3	-46,6	-5,6	-33,5
<b>Exports</b>	<b>16,3</b>	<b>15,2</b>	<b>69,9</b>	<b>13,1</b>	<b>62,3</b>	<b>11,6</b>	<b>58,0</b>
transport	4,7	4,5	20,7	N/A	19,2	N/A	N/A
travel	3,0	2,5	12,0	N/A	10,8	N/A	N/A
other services	8,6	8,1	37,1	N/A	32,4	N/A	N/A
<b>Imports</b>	<b>-27,1</b>	<b>-25,7</b>	<b>-128,5</b>	<b>-21,4</b>	<b>-108,9</b>	<b>-17,2</b>	<b>-91,5</b>
transport	-4,0	-3,7	-17,5	N/A	-16,4	N/A	N/A
travel	-10,4	-9,4	-53,5	N/A	-42,8	N/A	N/A
other services	-12,8	-12,6	-57,5	N/A	-49,7	N/A	N/A
<i>Primary income</i>	-11,6	-11,7	-79,8	-10,2	-67,6	-9,9	-60,4
<i>Secondary income</i>	-1,4	-1,5	-9,2	-0,9	-6,1	-1,7	-5,7
***							
	Q1 2014 (estimate)	Q1 2013	2013	Q1 2012	2012	Q1 2011	2011
<b>Financial account</b>	<b>-21,2</b>	<b>-17,6</b>	<b>-20,4</b>	<b>-28,2</b>	<b>-55,7</b>	<b>-27,4</b>	<b>-88,7</b>
<i>Direct investment</i>	N/A	-25,1	-15,6	1,5	1,8	-0,2	-11,8
Net acquisition of financial assets	N/A	-65,7	-94,9	-11,3	-48,8	-15,9	-66,9
Net incurrence of liabilities	N/A	40,6	79,3	12,8	50,6	15,7	55,1
<i>Portfolio investment</i>	N/A	1,2	-11,6	7,7	17	5,6	-15,3
Net acquisition of financial assets	N/A	-4,3	-11,9	1,4	-2,3	0,5	-9,8
Net incurrence of liabilities	N/A	3,0	0,4	6,3	19,3	5,1	-5,4
<i>Financial derivatives</i>	N/A	-0,2	-0,3	0,2	-1,4	0,8	-1,4
Net acquisition of financial assets	N/A	2,1	8,5	6,5	16,7	3,2	16,4
Net incurrence of liabilities	N/A	-2,3	-8,8	-6,3	-18,1	-2,4	-17,8
<i>Other investment</i>	N/A	13,9	-14,9	-33,0	-43,1	-23,6	-47,7
<i>Reserve assets</i>	N/A	-4,9	22,1	-4,6	-30,0	-10,1	-12,6

(Bank of Russia, 2014)