

Heli Simola: Protectionist pressures growing also in Russia

Although Russia's top leadership has in recent months and in various international fora stressed the disadvantages of economic nationalism, the country has been among the first to increase its own protectionist activities. Russia of course is not alone in seeking to defend its domestic production. In fact, the WTO among others, is concerned about a growing tendency to protectionism across the globe. The announcement at the G20 meeting last autumn on refraining from measures that hamper trade seems to have been forgotten in the deteriorating economic situation.

Import duties and favouring of domestic producers

In the case of Russia, increased protectionism is most highly visible in import duty increases. Thus far, duties have been raised on cars, farm machinery, certain metal products, foodstuffs and rubber products. The increases have generally been in the range of 5 to 15 percentage points, but some have been much larger. The aim has been to give a boost to domestic industries suffering from softening demand and financing problems. Moreover, the Economy ministry estimates that the domestically produced versions of these products are adequate in terms of competitiveness and quality.

In connection with foreign trade transport, domestic enterprises gained an advantage versus foreign companies at the start of February when charges were initiated on trucks registered in EU countries, Switzerland and Turkmenistan. The fee – less than EUR 10 per 24-hour period – is not so high as to notably weaken foreigners' competitive position, but the added bureaucracy could be a greater burden to transport companies. And in Russia other non-tariff trade barriers are readily put in place as needed to throw sand in the wheels of foreign trade and transport.

Domestic products are also favoured in public sector acquisitions. For example, government offices have an extra 12 billion roubles (EUR 270 m) earmarked for car purchases, and the intent is to spend it on domestic makes. Consumers are set to benefit from 2 billion roubles in interest support on loans for buying domestic cars. Still unclear is whether the support will also apply to foreign makes that are assembled in Russia. Rail transport fees for domestic cars are also slated for reductions as an offset to the increases in import duties for the benefit of customers in Russia's far east.

Sergey Shvetsov, a member of the central bank's board, has indicated that the central bank has advised Russian banks to channel credit to domestic producers and that compliance would also impact the banks' access to central-bank finance. There have been public claims to the effect that government aid should increasingly focus on the banking sector because the effects of measures aimed at boosting domestic demand would leak out of the country. Moreover, eg Vladimir Yakunin, who heads the railroad company RZD, has demanded temporary restrictions on rouble convertibility. And there have been attempts to protect the domestic labour markets by reducing foreigners' work permit quotas.

Risk of growing protectionism

Russian protectionist measures cannot yet be characterized as extraordinary. If the economic slump is protracted, there is clearly a risk of further measures. Import substitution is seen as a key short-term factor in reviving domestic industry, as was the case after the 1998 crisis.

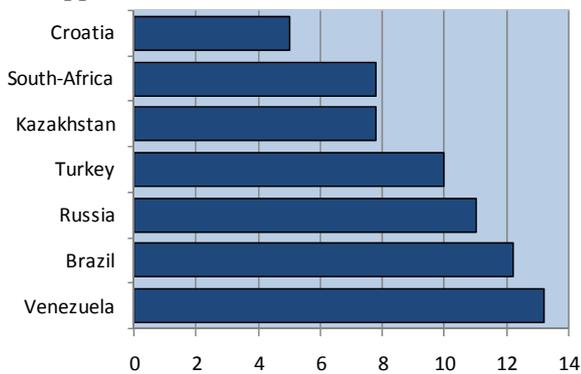
The rouble depreciation of recent months certainly promotes import substitution, but its potential as an engine of growth is now considerably more limited than was the case a decade ago. First, the rouble's slide has not been nearly as pronounced. Between August 1998 and February 1999, the rouble depreciated more than 70% against the dollar, compared with one-third between August 2008 and February 2009. Moreover, taut capacity restraints on the economy now hinder any jump-starting of domestic output.

If domestic industry is unable to achieve the desired shot of competitiveness from the weaker rouble, there is a danger of calls for stronger protectionist measures. Both import duties and other protective measures are in Russia's kit of crisis-prevention tools. If protectionism in general increases in the global economy, this will also boost the pressure for protecting domestic industry in Russia. Other countries' protectionist initiatives have in fact already been used to rationalise further protection and, as a handy rationale, the economics ministry has compiled a long list of such initiatives by many countries.

Trade barriers already exist

Russia has not since the turn of the millennium decidedly opened up its economy; the average level of import duties is still 11%. By international standards these are in the mid-range, as illustrated in figure 1. In its WTO negotiations, Russia has committed to reducing the average duty by three percentage points.

Figure 1. Average import duty in Russia and some other upper middle-income countries, %



Sources: WTO, World Bank.

There are other trade barriers in addition to duties. According to a study by the Finnish foreign ministry in 2005, Finnish companies encounter the most barriers in trade with Russia. Problems arise for instance in customs procedures and certification. A follow-up survey conducted last autumn produced generally similar preliminary results. Even by international standards Russia has ample room for improvement: the World Bank efficiency study ranked Russia's border procedures 138th in a group of 151 countries.

As WTO negotiations elongated, protectionist pressures were increasing in Russia in sympathy with the weak competitiveness of Russian domestic industries, even before the international financial crisis erupted. A notable reduction in dependence on imports and increased substitution of domestic products are among Russia's goals set out in a development programme running to 2020. The share of imports in the country's consumption is to be reduced from the present ca 50% to 20% in the course of the next decade. Included in the toolkit are the above-mentioned protectionist measures, viz import duties and support of domestic producers. To supplement these, it is intended to make domestic industries more competitive and raise their level of value added. The objective itself is well advised, as it would help diversify Russia's output and broaden the foundations for eco-

nomie growth, but protectionism is not necessarily the best means to this end.

As an example of a protectionist measure of questionable effectiveness one could cite the increase in export duties on timber. The final hikes, now postponed to the start of 2010, will effectively end timber exports. The matter is not of great consequence for the Russian economy as a whole; but at the regional level, cession of timber exporting is viewed as highly problematic. For example, in the Karelian Republic, making timber exporting unprofitable could result in losses of thousands of jobs.

The downside of protectionism

Even though Russia's domestic production could benefit to an extent from protectionist measures, there are negative consequences. In the short-run, an increase in import duties would evoke inflationary pressures even beyond the present high rate and reduce consumers' purchasing power. As regards eg many foodstuffs - which carry a weight of 40% in the CPI index - Russia is highly dependent on imports. Although the inflation and purchasing-power effects are already being felt, with the weakening of the rouble, any increases in duties would only add to the pressure on prices. Consumer protests regarding higher duties have so far been seen in marches in the streets of Russia's far east, where car imports from Japan are important also in terms of livelihood.

Extension of import-duty hikes to numerous investment goods could hamper the development of domestic production capacity, as foreign technology becomes more expensive. Increases in duties on certain raw materials and components could also weaken the position of domestic products by raising production costs, if sufficiently high-quality substitutes are not available. But so far there have been no signs of these kinds of increases. Import duties have thus far been placed only on products that are already abundantly produced in Russia, and duties on many products have been reduced.

However, it may be difficult to give up realised duty hikes, most of which are to be temporary, even when the economy recovers. Pressures to protect domestic industries could further complicate Russia's protracted negotiations with the WTO. In the long run, however, tighter integration with the world economy is of great importance to Russia, in terms of both a more efficient economy and greater competitiveness.

Heli Simola is a BOFIT economist.