

MEMBERS BRIEFING WITH PHILIP MERRILL, PRESIDENT AND CHAIRMAN OF THE EXPORT-IMPORT BANK

On June 30, the Council held a briefing with Philip Merrill, President and Chairman of the Export-Import Bank of the United States. He briefed Council members on recent developments at Ex-Im Bank and the status of current projects, as well as his impressions of the Russian economy in mid-2003.

Recent Developments at the Ex-Im Bank

Mr. Merrill began his presentation by describing some significant changes at the bank. Reflecting President Bush's three guiding principles for government agencies—that they should be citizen-centered, results-oriented, and market-driven—the Ex-Im Bank is emphasizing its customer relations. The Ex-Im Bank is working to ensure that customers have a regular relationship manager. The bank established a single export-finance group devoted exclusively to, and accountable for, managing its transaction relationships and delivering its products globally. Additionally, a group will monitor loans and guarantees, as well as the bank's insurance products.

“AFTER ONLY A DECADE OF MARKET REFORM, THE BANK NOW ISSUES NON-SOVEREIGN LOANS TO RUSSIAN COMPANIES.”

The Ex-Im Bank is making improvements in its internal functionality to effect positive change for its customers. Currently, Ex-Im Bank is working to improve its cycle time, to make it easier to do business while achieving faster results. The bank completes about 2,500 transactions a year. Mr. Merrill also explained that the bank is simplifying its applications for the 2,000 small-business exporters it supports each year. Its goal is to process 80 percent of the short- and medium-term transactions within 20 business days.

As the economy continues to change, the bank will likely expand support for



Council President Gene Lawson (left) listens as Philip Merrill (right), President and Chairman of the Export-Import Bank, briefs Council members on the bank's role in Russia.

knowledge-based, high-technology, and service industries while continuing to support basic manufacturing industries. The bank is working with exporter and financial groups to help meet private-sector needs in these areas.

Mr. Merrill stated that it is necessary to take into account that the United States is the home of the most creative economic drivers in the world, such as biomedicine and microelectronics. As a result, the high-tech share of U.S. manufacturing output increased from nearly 10 percent in 1980 to almost 17 percent today. At the same time, the traditional economy has been propelled by building airplanes, tractors, pipelines, and energy facilities. Still, the manufacturing sector dropped from 37 percent to 22 percent of the total economy, and the service sector has climbed from 50 to 66 percent of the economy.

Ex-Im Bank Involvement in Russia

Ex-Im Bank has a portfolio valued at \$1.5 billion invested in Russia, and the bank has pending projects totaling \$750 million. The bank has supported exports ranging from medical imaging

machinery to mining equipment, as well as more than \$100 million in commercial bank credits for private-sector transactions during the last few months alone.

In moving away from transactions that are supported by sovereign guarantees, the bank has actively sought partnership with private-sector entities. After only a decade of market reform, the bank now issues non-sovereign loans to Russian companies. Last year, the bank established an innovative facility for Delta Leasing, a Russian leasing company, which provides a valuable leasing alternative for U.S. companies exporting capital equipment to small- and medium-sized Russian businesses.

Russian business is likely to be enhanced, due to the fact that the OECD country risk experts group upgraded Russia last week from 5 to 4 in its risk classification. As a result, Ex-Im Bank will lower the minimum premium for Russian transactions.

Mr. Merrill stated that the bank has been most actively involved in Russia's oil and gas industry, which comprises almost 50 percent of the bank's portfolio. The bank's involvement in Russia's energy

sector has been consistent with President Bush's National Energy Policy, which calls for diversifying sources of oil by strengthening global alliances and international relationships.

The Ex-Im Bank is considering medium- and long-term financing for pipeline projects and three Russian oil companies-LUKoil, Yukos and Sibneft. While the Russian government will have a role in designing and implementing these key projects, most lenders, including the Ex-Im Bank, would prefer that they be privately owned and operated.

The Russian Economy

Despite the vastly improved investment climate, Mr. Merrill expressed his concern regarding Russia's economic reliance on energy. It is vital that Russia replace its commodities-dependent economy with a diversified economy suitable for sustainable, stable long-term growth.

In order to expand and diversify its economy, Russia will need better public governance, a stronger rule of law, an ability to enforce contracts, and broad-based private ownership. Moreover, as recent history has demonstrated, oil-dependent economies have had difficulty pursuing political as well as economic reforms. Russia should diversify its economy now, while it is earning substantial energy revenues. It is important to focus on investments, such as infrastructure projects, housing, and optics that will most benefit the Russian economy in the long term.

Along with the inflow of foreign currency associated with Russia's energy exports, the government of Russia must develop a banking system that effectively intermediates between savers and investors, and ensure that corporate governance and transparency are enhanced.

Conclusion

Mr. Merrill reinforced the reasons why Russia is a strategic market for U.S. investors and exports. In his state of the nation address, President Putin declared that he wanted the Russian economy to double in size between 2000 and 2010, which implies seven percent average annual growth.

During the next 10-15 years, Russia will need to undertake a massive modernization of its economy and infrastructure. The potential for U.S. companies to supply technology, capital equipment and services is enormous. Mr. Merrill stressed the Ex-Im Bank's commitment to help U.S. businesses tap into the potential of the Russian economy, and to help Russian companies access the goods and services they need to grow their industries.

Question and Answer Session

Please comment on the potential commercial cooperation between Russia and

“MR. MERRILL STATED THAT THE BANK HAS BEEN MOST ACTIVELY INVOLVED IN RUSSIA'S OIL AND GAS INDUSTRY, WHICH COMPRISES ALMOST 50 PERCENT OF THE BANK'S PORTFOLIO.”

the United States with regard to developing countries.

The Ex-Im Bank has experience in co-financing projects in difficult situations, such as in Afghanistan. The Ex-Im Bank is open for business with all countries but requires assurances.

You mentioned that the Ex-Im Bank portfolio in Russia is \$1.5 billion. In which sectors is it primarily allocated?

Right now, 80 percent of Ex-Im Bank's portfolio is allocated in the energy, construction and airline sectors of the Russian economy. The bank would like to invest money in smaller business in Russia as well.

Where do you see the most attractive areas to invest in Russia?

One-third of the Russian economy is military oriented. The best places to invest in Russia are ones where Russians have skills and in which they are competitive and transferable such as optics and the space programs. Also, Russians have wonderful construction skills, making the construction sector a smart choice. The Ex-Im Bank invests in places that help to build a civil society and democracy in Russia. ■

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NEW RUSSIAN CUSTOMS CODE SIGNED INTO LAW

■ ■ *Alexander Bychkov, Partner, Baker & McKenzie, Moscow*

On May 28, 2003, President Vladimir Putin signed the new Customs Code of the Russian Federation, to take effect on January 1, 2004. It represents a stride forward compared with the existing Customs Code in terms of legal technicalities, the nature and scope of regulation as a normative act of direct implementation, and the streamlined and system-based approach to overall customs legislation.

The new Customs Code also puts a legislative seal on many of the practices already in effect, which are based on applicable regulatory legal acts issued by the Russian government and State Customs Committee.

Due to the fact that the application of certain provisions of the Customs Code is at the discretion of customs authorities, and the Customs Code contains a number of references to subordinate regulations by the government and/or State Customs Committee, it is not possible to view the new statute as liberalizing customs legislation in any revolutionary

“IT REPRESENTS A STRIDE FORWARD COMPARED WITH THE EXISTING CUSTOMS CODE IN TERMS OF LEGAL TECHNICALITIES, THE NATURE AND SCOPE OF REGULATIONS AS A NORMATIVE ACT OF DIRECT IMPLEMENTATION, AND THE STREAMLINED AND SYSTEM-BASED APPROACH TO OVERALL CUSTOMS LEGISLATION.”

manner or imposing any perceptible restrictions on the freedom of action enjoyed by the customs authorities. But the more detailed definition of the rights and duties of those parties under their supervision makes the conduct of the authorities more predictable, and offers more opportunities for business entities to uphold their lawful interests in their relations with customs officers.

It should also be noted that apart from legalizing existing practices, the Customs Code has introduced a number of highly noteworthy new legal developments, the

more important of which are summarized below.

Customs Control Functions

Once the Customs Code takes effect, all activities related to customs supervision will no longer be subject to licensing. Customs carriers, temporary-storage warehouse owners, customs warehouse owners, customs brokers, and banks and other lending institutions acting as customs payment guarantors may only go into this kind of business upon being recorded in the corresponding register.

An applicant seeking this status is entitled to be granted it once it meets the applicable conditions listed in the Code. These include (for all of the parties specified above, except lending institutions and insurers) an obligatory deposit of up to 50 million rubles in order to secure future customs payments, and civil liability insurance cover equal to at least 20 million rubles. The applicants also have to meet other eligibility requirements depending on the activity they intend to pursue. No fee is required for inclusion in

the register or the issuance of an appropriate certificate.

A recorded party may be struck from the register (by means of a decision of the customs

authority to recall its certificate) because it no longer meets any of the conditions set out in its original, or because it has defaulted on any of those obligations imposed by the Code, or has been repeatedly held administratively liable for customs offenses. A de-registration decision is subject to approval by the national State Customs Committee, and it comes into force 15 days after being issued; it may, however, be challenged in the courts.

Customs Procedures

Customs clearance. The Code streamlines most customs procedures. The

maximum time allowed for customs clearance is now only three days, down from ten. The Code also prescribes an exhaustive list of the documents that need to be presented for customs clearance purposes.

Special summary procedures for customs clearance.

Parties that have engaged in foreign economic activities for at least three years and have maintained a set of accounting records as required by the Russian State Customs Committee qualify for special summary customs clearance procedures. These procedures, which are on offer to importers, include, among others, the submission of so-called “periodic customs declarations” (i.e. a customs declaration for a period of time, rather than per each delivery), the release of goods upon the presentation of data required to identify the merchandise, performance of customs clearance at the premises of the party benefiting, and storage of imports at their own warehouses.

Customs clearance venue. Goods may now undergo customs clearance at any location where customs authorities are situated rather than solely in the area where the party seeking the clearance is based or has its state registration. The Russian government may only designate specific customs checkpoints for goods arriving on Russian customs territory for individual categories of supplies.

Temporary storage. The customs authorities may no longer designate the warehouse where goods are to be placed for temporary storage. An importer may keep its merchandise at its own warehouse or any other warehouse upon depositing security for any future customs payment. Only individual categories of goods can be subject to restrictions in this regard.

Declarations. Just as under the existing Customs Code, only Russian residents, as a rule, may declare goods. Yet in certain cases, a foreign party may also do so

directly—for example, where it has the right to dispose of the goods on Russian customs territory, other than in the context of a foreign trade transaction involving a Russian entity.

Advance declaring. In an important new development, the Code gives the legislative green-light to, and provides detailed regulation for, the declaring of goods prior to their arrival at a customs terminal.

Release of goods for circulation. The Code reduces the maximum period allowed for the release of goods in accordance with the declared customs regime to three business days after the acceptance date of the corresponding customs declaration, submission of the requisite documents, and presentation of the merchandise to the customs authorities. Even if customs payments have not been completed by the time of declaration, this does not constitute grounds for a refusal to release the corresponding goods.

Customs Regimes

Types of customs regimes. Goods that are subject to customs clearance will in all cases qualify for one of the following types of customs regimes: basic, economic, closing, or special. This is the first time that Russian customs legislation has classified the different existing customs regimes in this way. The significance of this change boils down primarily to the organization of the Code being put in better order and the substance of customs regimes being regularized with greater precision.

Basic customs regimes comprise the release of goods for domestic consumption, exports, and international customs transit. Economic customs regimes encompass the processing of goods on Russian customs territory, their processing for domestic consumption, their processing outside Russian customs territory, temporary imports, customs warehouses, and free warehouses/free customs zones. Closing customs regimes range from re-imports and re-exports to the destruction of goods and their renunciation in favor of the state. Special customs regimes include, among others, temporary exports, duty-free trade,

and supply movement.

Declaration of customs regimes. The new Customs Code contains a closed list of the documents that are required to be submitted in order for goods to be released and treated in accordance with the regime declared. A customs authority may now only require that a participant in foreign economic activity produce those documents and that information that may be necessary to confirm the conditions for the treatment of the merchandise in line with the regime sought, as well as the observance of the regime pursuant to the applicable requirements set out in the Code.

Customs warehouse. Another landmark new opportunity granted by the Customs Code is the sale of goods from a customs warehouse. In such cases, the buyer assumes the rights and obligations of the party that placed the goods in storage at the warehouse.

Processing of goods. The processing of goods on customs territory is still subject to authorization from the appropriate customs authority. Such goods are conditionally exempted from any customs payments. The Code simplifies the procedure for processing merchandise in order to perform repairs as part of warranty services, and cancels processing under customs control as a separate customs regime.

Special customs procedures. Individual Code chapters deal with the movement of vehicles across the Russian customs border, and with the movement of merchandise by individuals, by international mail, by pipelines, and by power transmission lines.

Customs Payments

Types of customs payment and payment procedures. The list of customs payments under the new Customs Code is shorter than before, and includes only import and export duties, VAT on imports, excises, and customs fees. The

charges levied for information and consulting services, for preliminary decision making, and for bidding at customs auctions are a thing of the past. All remaining types of customs payments are together called “customs dues.”

“THE STATE IS ALSO REQUIRED TO MAKE UP FOR LOSSES THAT ARE CAUSED BY INACCURATE INFORMATION THAT IT PROVIDED AS PART OF CONSULTING SERVICES.”

A payer may at its own choice pay customs duties and taxes either in Russian rubles or in foreign currency in accordance with applicable foreign exchange regulations. Procedures for both making payments and securing them are much more detailed than before. Insurance organizations may also now act as guarantors of customs payments.

A full exemption from customs duties and taxes is granted unless the value of the goods imported to Russian customs territory for personal use (except vehicles) exceeds 65,000 rubles.

Oversight of the customs value of goods. Where the customs authorities have reason to believe that the declared customs value of merchandise is inaccurate, and should the customs value not be determined within three days of the declaration’s issue date, the goods are to be released based on the declared value, but only upon provision of security for such future customs payments as may be ordered additionally if the customs value is later corrected and increased.

Other Issues

IP protection. The Customs Code includes a special chapter setting out measures to be taken in respect of intellectual property. The clauses in question largely reproduce the relevant provisions of Russian State Customs Committee acts, and aim to prevent any movement of counterfeit goods across the Russian customs border. In order to improve

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WTO WORKING GROUP MEETING WITH WORLD BANK ECONOMISTS

On May 19, the Council held a WTO Working Group Meeting featuring Harry Broadman, Lead Economist for Europe and Central Asia Regional Operations at the World Bank, and David Tarr, Lead Economist in the World Bank's International Trade Group. They provided an analysis of structural reforms in Russia, the costs and benefits to Russia of WTO accession, and the role the international community plays in assisting Russia's accession.

The WTO Priority

Mr. Broadman began his presentation by stating that Russia considers WTO membership an important step toward integration into the international economic system. Today, Russian officials — most visibly President Putin himself — repeatedly and increasingly emphasize the government's commitment to WTO accession. Also, the major trading powers have come to realize the importance of Russia's accession. Undoubtedly, the accession discussion is a critical component of Russia's transition to a market economy and will help “lock-in” hard-won reforms.

Mr. Broadman said that Russia's application for accession to the WTO appears to be in its final phases and could be completed by the end of 2003. He stressed that there still remain key challenges, both technical and political, not just between Russia and the WTO members, but—perhaps more important—within Russia itself.

Linkage between Structural Reform and WTO Accession

Mr. Broadman spoke about Russia's record on structural reforms. Significant progress in macroeconomic stabilization in Russia — such as fiscal, monetary and exchange-rate policies — demonstrates the authorities' commitment to growth and participation as a trading partner in the international marketplace. In the area of structural reform, Russia succeeded the most in foreign trade liberalization. As early as 1992, following the breakup of the Soviet Union, Russia adopted the



World Bank economists Harry Broadman (right), Lead Economist for Europe and Central Asia Regional Operations, and David Tarr (left), Lead Economist in the International Trade Group, outlined the latest progress and remaining challenges facing Russia's WTO accession bid to Council Research Director Keith Bush (center) and Council members.

view that growth must stem from greater integration in the world economy. As a result, tariffs were significantly lowered, quotas reduced and import subsidies diminished. Currently, Russia's average tariff rate is lower than the average tariffs in most developing countries — Russia's MFN average tariff is about 11 percent. However, major structural reform challenges remain, and they will determine the incentives and constraints on Russia's accession to the WTO and the gains from membership.

Since 1992, through the mass privatization programs, cumulatively more than 140,000 enterprises in Russia have been privatized. According to official statistics, the private sector currently accounts for at least 70 percent of GDP. However, Mr. Broadman explained that ownership change through privatization did not lead to a competitive change. Therefore, increasing competition is now a principal reform objective. Russia's underdeveloped and uncompetitive services sector comprises the weak point of the economy. Unfortunately, there is still little recognition of the importance of the services sector for Russia's economic future.

Mr. Broadman said that the 1998 crisis is evidence that market incentives do work in Russia. Devaluation fostered substantial import-substitution and export-promotion opportunities for Russian firms. Indeed, market pressure from the 1998 crisis prompted changes in business practices more effectively than past government programs. Mr. Broadman listed the major key structural issues on the agenda for reform as follows:

- Restructuring and liberalizing the services sector — from telecommunications and banking to transport and legal services (among others);
- Countering insider dominance — combined with “hardening budget constraints” — to curb asset stripping, facilitate outside investors, and foster restructuring;
- Strengthening competition policy enforcement to reduce structural barriers to entry, abuse of horizontal and structural dominance, and anti-competitive mergers;
- Protecting intellectual property rights more effectively;
- Strengthening the judicial system;
- Implementing International Accounting and Auditing Standards; and,
- Modernizing FDI policy.

Russia's WTO Accession Process

Mr. Broadman summarized the history of Russia's WTO application process. In 1994, Russia tabled the formal Memorandum on the Foreign Trade Regime, which is a requirement for all applicants and presents an analysis of the country's trade and investment regime. In 1995, Russia began the formal process of responding to questions by incumbent members, known as “the Question & Answer phase.” Russia's accession negotiations began in 1996, both the form of Working Party meetings and bilateral consultations. Since then, the following

steps have been taken in the course of accession:

- Offers on market access, services and tariff reductions have been tabled;
- Bilateral consultations are in full swing with more than 50 countries;
- Amendments to more than 40 major laws are slated to be drafted to bring them into conformity with WTO principles;
- Tariffs for some one-third of 11,000 total categories of goods remain to be negotiated, with agriculture, machinery and equipment, furniture, pharmaceuticals, and chemicals among the sectors where progress has been slowest;
- Negotiating certification and standardization requirements in the area of non-tariff barriers are being negotiated; and,
- Intensive discussions have been held concerning protection of domestic producers through agricultural and energy subsidies, and restrictions on foreigners' access to the services market.

Mr. Broadman explained that WTO accession is a very long and complicated process for all applying countries, and Russia is not unique in this respect. All applicants have to go through several stages:

- ① **Fact-Finding.**
- ② **Identification** of changes in legislation and other regulatory requirements needed for WTO accession.
- ③ **Enactment** of new laws or legislative amendments, and putting in place changes needed in the regulatory regime.
- ④ **Negotiation** of various commercial issues raised by all WTO members, including formal commitments continued in the final Working Party Protocol.

Currently, Russia is in the second stage of the accession process. One of the toughest challenges the country faces is to create mechanisms and

incentives for interagency coordination and consensus building. As there is no single and powerful "honest broker" at a ministerial level who is the chief trade negotiator (similar to the USTR or European Trade Ministers), wrestling the vested interests represented by line agencies, as well as directly by powerful business lobbies (including auto, agriculture, aluminum, banking, insurance, telecom, and civil aircraft) is thus an exceptionally difficult challenge for Russia.

Costs/Benefits of WTO Accession

Mr. Tarr presented the results of a study on potential consequences of Russia's WTO accession conducted by a team of World Bank economists. The study estimated aggregate gains to the economy as well as the impact on employment and output. The study also provided an assessment of which sectors will expand and which will contract as a result of WTO accession.

According to the study, the Russian economy will gain approximately eight percent of the value of consumption from WTO accession in the medium term, and in the longer term potential gains are expected to be much larger.

The sources of the overall gains for the economy are estimated as following:

- ① **Improved market access** with resulting gains from improved treatment in anti-dumping, but given bilateral MFN status, improved access will not be the main source of WTO accession benefits.
- ② **Tariff reduction** will lead to improved resource allocation. Trade liberalization will induce resources to shift to sectors that are more highly valued at world prices. More important, tariff reduction will lead to productivity gains from the import of higher quality technologies. Mr. Tarr also noted that Russian tariff rates are not high by the standards of developing countries, though they are higher than in most industrialized countries-based on State Customs Committee data, Russian tariffs amount to 1.6 percent of GDP or about

7 percent of the value of imports.

③ **Foreign direct investment liberalization in the services sector** will encourage multinational service firms to enter the Russian market. Improved access to telecommunications, banking, insurance, transportation, and other business services should lower the cost of doing business in Russia.

④ **Potential growth effects** should improve the investment climate and expand the capital stock.

Mr. Tarr emphasized that the main source of WTO benefits for Russia will be the removal of barriers to FDI in the services sector-the endogenous productivity impact will account for about 67 percent of the overall gains from accession.

Discussing the employment effects of joining the WTO, Mr. Tarr said they expect the following sectors to expand employment the most: non-ferrous metals, ferrous metals, chemicals, gas, and telecommunications. Sectors such as food processing, light industry, machinery and equipment, construction materials, and scientific services are expected to contract the most.

Mr. Tarr emphasized that Russia's accession to the WTO cannot occur without the support of the international community. As Russia gradually meets initial requirements, key members in the WTO should resist the temptation to raise the bar. He stressed that providing strong support for Russia's reform effort is crucial. It will ensure that the current reform momentum in Russia is maintained and, more critically, will help the Russian government resist the strong protectionist lobby.

In conclusion, Mr. Tarr said that the international community should facilitate Russia's accession by providing aid for trade liberalization in order to help Russia meet WTO requirements. Experience shows that developing countries have incurred substantial costs in tailoring their laws to meet international standards. ■