

## Russia's Trade Performance in Transition Period

*The paper is examined that the existence of Russia's competitive advantages can generate trade growth in the country. The export oriented sectors development in the economy provides the rise of foreign trade gains, which should cover the budget deficit, the purchases of new kinds of goods, and know-how development. The proposed government policy should be directed to support and stimulate the export-oriented branches development.*

*У статті розглянуто, що існування порівняльних переваг може забезпечувати зростання торгівлі в країні. Розвиток експортно-орієнтованого сектора економіки забезпечує отримання торговельного прибутку, який повинен покривати дефіцит бюджету, закупівлю нових видів товарів й розвиток НДOKP. Запропонована політика держави, яка націлена на підтримку та стимулювання експортно-орієнтованих галузей.*

The trade development accelerates the economic growth, provides stimulus to new forms of productivity, enhances specialization, and leads to a more rapid pace of job creation. The expansion of free trade promotes inflow of goods and services, the increase of competition in domestic market, access to a new markets, the dissemination of knowledge and technologies. The share of merchandise trade relative to value added is growing dramatically in the world, and is characterizing the integration of global economy through trade.

The recent global trade deceleration effects in the change of the world trade structure of commodities and services. The recession of the world trade rate affects in slowing down the high technology branches development. The existence of trade impediments, including high tariffs, tariff escalation, tariff rate quotas, and trade practices prevents countries from receiving trade benefits. The share of industrial commodities increases in the whole volume of global trade. The World Bank survey forecasts optimistic future global prospects, the rise of world demand, expansion of trade relations in the world, growth world savings, population, and investment in education.

The Russian integration into the international trade system is based on the reduction of restrictions of export products and services, the expansion country openness, and the improvement of the national production competitiveness. Trade liberalization provides lower restrictive barriers, especially in services markets, the change of legal rules, norms, the improvement trade relations, and the income growth. Countries that fully liberalized trade and investment in finance and telecommunications grow faster in comparison with closed economies. The analysis of the basic trade policy concepts, the de-

termination of the economic prospects of the rise of Russian foreign trade, the geographical patterns and policy conclusions are considered in the paper. The question of future Russia's WTO joining relates to the solution of the problems of the adoption international legal system, the establishment international trade mechanism, combining the country interests and international community ensuring an effective development outcomes, and WTO accession.

### **1. The basic economic approaches in the modern trade theory**

The question of the trade policy's role in the countries economic development is related to the one of the vital scientific problems in Economics. Scientists make attempts to elaborate the optimal trade policy rules and to estimate the future world trade perspectives. International trade has strong effects on the distribution of income within countries, so that it often produces losers as well winners (KRUGMAN P.R., OBESTFIELD M., 2000). Economists argue the following concept, and consider that trade has not differences from many other forms of economic change, which are normally regulated. The similar countries produce with similar factor proportions, and this trade will not involve the income-distribution effects characteristic of more conventional trade. Some scientists explain the increasing the divergence of per capita incomes as a result of international division of labor and long-term specialization of countries in trade.

Other researchers follow the concept considering the state policy role in the trade performance. The welfare effects of trade and industrial policy under oligopoly can be reached in case the government is able to set its policy in advance of firm's production decisions, and if government policy commitments are credible. The assumption that each firm does not take into account the effect of its

own actions on the profits of other domestic competitors (EATON J., GROSSMAN G.M., 1986).

It is widely recognized by researchers that scale economics play a crucial role in explaining the post-war growth in trade among the industrial countries. Trade depends on the allocation of production resources in the country. The resource-abundant country can lose from international trade under decreasing returns on skills, and can gain from trade under increasing returns on skills. Development paths of the countries converge in the case of decreasing returns but may diverge under increasing returns (TROFIMOV G., 2000). The traditional gains from increased specialization and exchange across countries, trade in intermediate inputs brings efficiency gains that lead to an outward shift in the production frontier for final goods in each country. The decision of companies to spread production across countries results in aggravation of the position of low-skilled workers, and put in consideration to wage subsidies for low-skilled workers (FEENSTRA R.C., 1998). Additional gains from trade are determined from reductions in aggregate delivery costs owing to scale economies (CUKROWSKI J., FISCHER M.M., 1999).

The tariff and untariff methods are related to the important instruments of international trade policy. The existence of the untariff barriers provides arbitrary form of country behavior, and creates uncertainty in trade relations.

Researchers point out that a country may have an incentive to use tariffs under imperfect competition when price exceeds marginal costs, so that a country which imports such goods pays a rent to the foreign firm (unless the firm happens to earn only normal profits). (BRANDER J.A., SPENCER B.J., 1981). Tariff peaks make damages to the economic development of poor countries. Fully one-third of exports of the poorest development countries face tariff peaks in at least one of the four major markets, the United States, Japan, Europe, or Canada (Global Economic Prospects, 2002).

The analysis of the above mentioned approaches confirms the importance of the modern trade theory at present time. The result of the functioning Soviet planned economy was the predominance of trade relation among the former Soviet republics, small trade flows with the rest of world, the development of specialization rather than diversification within the republics. Since the collapse of the Soviet Union the Russian Federation starts providing the integration policy into the world trading system. Russia has country-specific advantages, and is interested in reorienting its trade toward market economies, in receiving potential trade benefits. The elaboration an effective trade policy provides gains from increases trade specialization and exchange of goods across countries transmit new growth to countries through robust demand. Gains from trade of inter-

mediate inputs result to an outward shift in the production frontier for final goods in the countries, and contribute economic growth.

## **2. Russia's foreign trade performance and structure**

The assessment of the results of world economic development demonstrates the improvement of economic situation in Russia at the end of the XX-th century. The expansion of consumer and investment demand, the rise of import goods deliveries stimulate the growth of GDP, industrial production, fixed capital formation, trade surplus, and the increase of the real incomes of population in the country. Economic growth is accompanied with stabilizing ruble exchange rate, and fast increase of trade surplus. Leading economists and international forecasts foresee the future economic growth in case of proceeding the economic reforms in transitional countries and high world oil prices (Fig. 1).

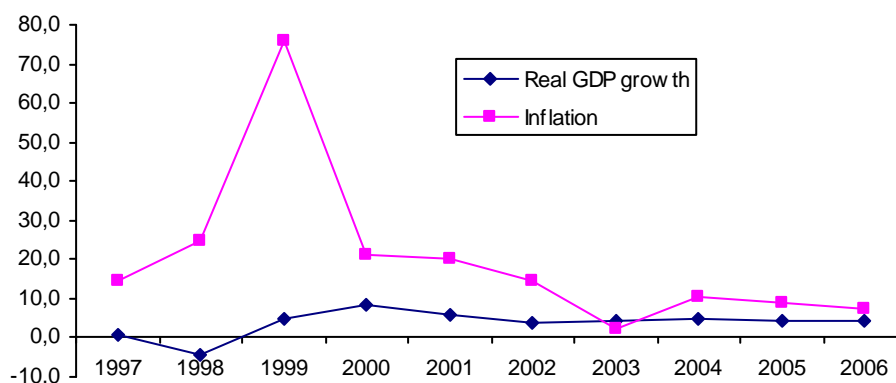
Nevertheless of the marked positive tendencies in Russia the World Bank study highlights the existence of the following basic economic problems: the domination of the large firms, mostly dealing with in raw materials, low productivity growth, and an absence of the effective mechanism of the implementation economic reforms (The Economist, 2002).

The analysis of Russia's balance of payments data in 2000-2002 demonstrates current account surplus. Trade surplus expands to a record \$ 60 billion or 25 % of GDP in 2000 (Tab. 1). Decline in income from export of goods is compensated for by rising services export in 2001.

The financial account analysis depicts the reduction of capital flight from country. Foreign direct investment (FDI) is the most acceptable instrument from the point of the stability of the balance of payments in Russia. FDI growth stimulates the development of machinery, transport sector, food services in Russia. The liabilities of the rest investments are decreased in the balance of payments.

The empirical assessment OGUSTU (2001) of the supply export function and the demand function from FDI and other parameters demonstrates the statistical significance of results. It confirms the reintegration process of the former Soviet Union countries. FDI inflow influences the trade diversification, and promotes the development of the bilateral economic relations among countries.

The model for predicting the potential effects of FDI of PANTELIDIS, KYRKILIS (1995) is aimed to determine the necessary conditions for export promoting FDI, import substituting FDI, import complementary FDI, and export reducing FDI in Eastern European countries. These conditions specify the relationship between the transformation process and country's trade openness. The implication of the research depicts that the host country production should be internationally competitive in order to avoid any balance of payments problems.



NIS\* - Azerbaijan, Kazakhstan, Russia and Ukraine

Fig. 1. Economic Outlook in NIS\* (average, percent)

Source: Economist Intelligence Unit

The negative net errors and omissions demonstrate the improvement of unrecorded capital outflow. The recorded private capital net outflows and net errors and omissions amount to less than \$ 3.5 billion or under 5 % of GDP (i.e. the average 2001 level). The rise in foreign currency and gold reserves in the second quarter 2002 (by \$ 7 billion to \$ 44 billion) suggest further decreasing of capital outflows (Economic Developments, 2002).

In accordance with the Goskomstat data the foreign trade turnover in Russia exceeds \$141 billion

in 2001, and rises to 3.6 % in comparison with the level of previous year (Fig. 2). Russian economic performance has been influenced by the internal economic factors too. They include the increasing costs of the real economic sector simultaneously with the real wage rise, the quick increase of the price dynamics and tariffs of national monopolies. The slow down of the growth rate was caused by the correction of the restructuring programs aiming to provide entrance in to the new market segments in the country.

Table 1

Russia's Balance of Payments in 2000-2002 Q1, Billion US\$

	1999	2000	2001	2002 Q1
Current account	24.7	46.4	34.6	7.2
Trade balance	36.1	60.7	47.8	9.5
Exports, f.o.b.	75.7	105.6	101.6	21.9
Import, c.i.f.	-39.5	-44.9	-53.8	-12.3
Services balance	-4.3	-7.6	-8.5	-1.8
Exports	9.1	10.0	10.9	2.6
Imports	-13.4	-17.6	-19.4	-4.4
Investment income	-7.7	-7.0	-4.1	-0.5
Received	3.9	4.3	6.2	2.2
Paid	-11.6	-11.3	-10.3	-2.8
Other items, net	0.6	0.3	-0.7	0.0
Capital and financial account	-15.9	-21.0	-17.2	-5.5
Capital Account	-0.3	11.0	-9.4	-0.1
Received	0.9	11.8	2.1	0.1
Paid	-1.2	-0.9	-11.5	-0.2
Financial account	-15.6	-32.0	-7.8	-5.4
Direct investment to Russia	3.3	2.7	2.5	0.5
Portfolio investment to Russia	-1.2	-10.3	-0.7	-0.2
Other items, net	-17.7	-24.4	-9.6	-5.7
Net errors and omissions	-7.0	-9.4	-9.2	-1.1
Change in reserves	-1.8	-16.0	-8.2	-0.5

Source: Central Bank of Russia (29 December, 2001, 28 June, 2002)

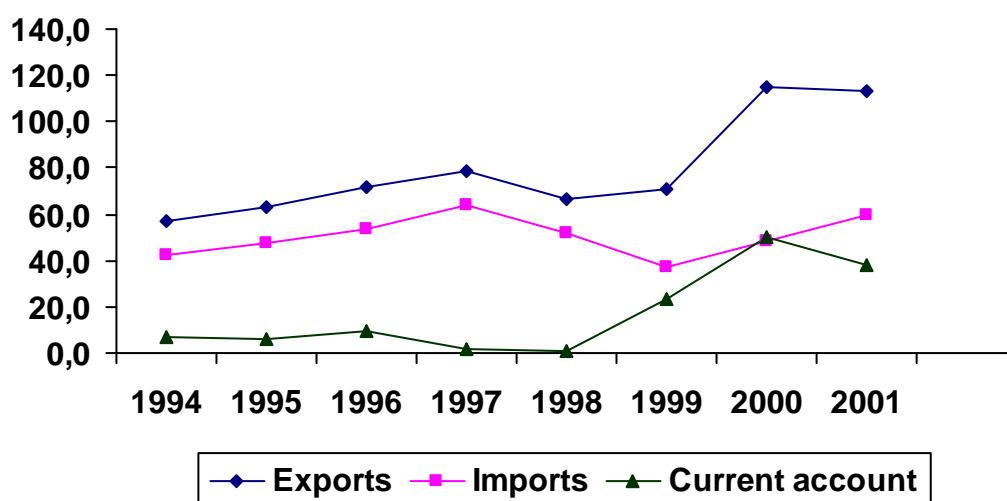


Fig. 2. The Export, Import and Current Account in Russia (Billion Euro)

Source: Goskomstat of Russia

The peculiarities of world conjecture and country development are reflected in the export decrease to 2.3 % in 2001 in comparison with previous year in Russia (Table 2).

The value of Russian trade turnover has amounted to the biggest magnitude in 2001 since the period from 1992-2001. The main Russian trade partners are the non-NIS. The share of these countries makes up 82 % in the total trade turnover, including export – 86 %, and import 73 % in 2001. The reduction of the oil prices, intermediate petroleum products, non-ferrous metals are compensated through the rise of the volume of petroleum and power supply sources deliveries. The machine and equipment export increases to 10 % and makes up 8.6 % in the export of non-NIS. The export of ferrous-alloys decreases to 12 %, rolled iron reduces to 23 %, copper – to 13%, nickel – 5, aluminum – 4 %. The share of chemical production reaches 6.8 %. The share of mineral fertilizers increases to 6 %, of artificial rubber rises to 6 %. The export of ammonia decreases to 5 %, methanol – 9 %. The export of timber and cellulose paper production rises to 6 %, and its share makes up 5 % in the export of non-NIS.

The Russian import of machines and equipment, food production and resources increases from non-NIS, and its share makes up 61 % in total import. The share of machines and equipment equals 37.2 % in total import, food production and raw materials – 23.6%. The chemical production purchases increase to 30 %, including decreasing of the share of import from non-NIS to 19.9%. The share of the rest goods is not significant and makes up 1/5 of the whole import from non-NIS countries.

The total foreign trade turnover makes up \$ 25.6 billion from NIS in 2001, including the export in-

creases to \$ 14.5 billion, and import decreases to \$ 11.1 billion. The main export item belongs to the fuel-power goods, their share decreases in the total export volume in 2001. The export of machines and equipment exceeds 23 %, export of chemical production rises to 17 %, including metal production – 31 %. The food deliveries and agricultural raw materials predominate in the import from NIS.

The share of fuel power goods increases to 1.2 %, the share of timber and cellulose-paper products rises to 0.3 % in the commodity structure of Russian export (Fig. 3). The growth of Russian export is caused by the stabilization of exchange rate, strengthening national currency, and the unification import duties. The export quota increases for oil, petroleum products, some kinds of timber production, mineral fertilizers, and decreases for natural gas in 2001. The high value of export in the total trade volume is provided by the price factor. The analysis of the dynamics of Russian export points out that the basic trade indicators are left behind the average world indicators. The Russian export share in the world export of raw materials and intermediate products makes up for oil – 8%; copper – 9 %; petroleum products – 15 %, calcium phosphates – 14 %, ferrous irons – 15 %, molybdenum – 15 %, mixed fertilizer – 15 %, sulphur – 17 %, diamonds for industrial purposes – 19 %, metals of platinum group (value assessment) – 23 %, nickel – 33 %, natural gas – 33 %, iron and concentrated products – 52 % in 2000. The Russian share in the world export of military equipment is equaled 30 % (Bulletin Foreign Commercial Information, 2002, NO 15).

Table 2

Foreign Trade Indicators in Russia in 2001

	Foreign turnover	Export	Import	Trade balance
Total (billion US \$)	141.9	100.7	41.2	59.5
Rate of increase (%)	3.6	-2.3	21.7	-
Non-CIS (billion US \$)	116.3	86.2	30.1	56.1
Rate of increase (%)	4.3	-3.4	35.2	-
CIS (billion US \$)	25.6	14.5	11.1	3.4
Rate of increase (%)	0.6	4.6	-4.3	-

Source: Bulletin Foreign Commercial Information (2002), N 37, 4 April, p. 2

The proportion of Russian machines, equipment and transport facilities doesn't exceed 0.4 % in the world export. In accordance with the estimations of the scientists the share of Russia's competitive production is equaled 1/1000 of the world export. The export of Russian high technology products makes up 0.3 % in the total volume of world trade (SPARTAK A.N., 2002). Russia is lagged behind the developed countries in growth rates of the export of finished products, especially know-how products. The comparison of basic foreign trade indicators demonstrates the reduction of the average

increase of GDP per head, the total productivity growth in GDP, the rate of commodity export growth, the share in the world export, and the commodity export share in GDP in Russia (Tab.3). The existence of the long duration unbalanced economy, the deformation of price mechanism, the discrepancy of the real sector needs and the volume of borrowing sources, the low rate of the real capital accumulation, and undeveloped financial-credit sphere prevent the progress of market economy development in Russia.

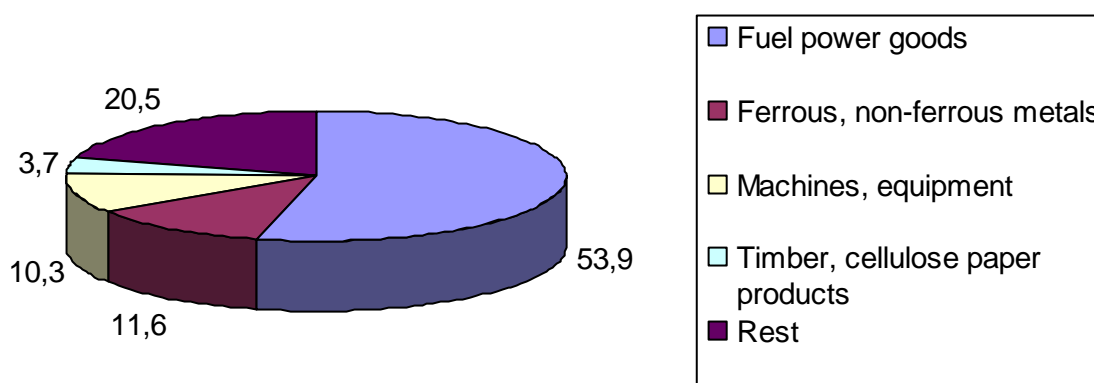


Fig. 3. The Commodity Structure of Russian Export in 2001 (commodity's groups, %)

Source: Bulletin Foreign Commercial Information (2002), N 38, 6 April, p. 2

The distinguished feature of Russian foreign trade is the high level of unorganized trade (shuttle

trade), which makes up 21 % of import and 1.5% of export, barter trade (KOSTUNINA, 2001).

Table 3

The Basic Foreign Trade Indicators in Russia

Indicators	1990	Estimated 2000
Average increase of GDP per head, number of times, 1990=1	6.2	4.0
Total productivity growth in GDP, number of times, 1990=1	5.4	3.8
Commodity export growth, number of times, 1990=1	11.92	6.92
Share in the world export, %	2.59	1
Commodity export share in GDP, %	7.8	35.7

Source: Constructed on data of Bolotin (2001)

The main causes of small share of machines and equipment in the total volume of the export are the reduction of the production, low competitiveness of output, the backwardness of production base, the long terms of learning to handle new machinery, the infringement of cooperation ties of former Soviet Union. The coefficient of export specialization shows the ratio of branch share in the commodity structure of export to its share in the industrial production structure. When this coefficient exceeds 1, it means there are existed competitive advantages in the country. The coefficient of export specialization of fuel industry equals 2.6, metallurgy – 1.4, chemical industry – 1.15, timber and cellulose paper industry – 1.05, light industry – 0.7, machinery and metal processing – 0.55 in Russia in 1998 – 2000 (SPARTAK A.N., 2002). The light industry, machinery, and metal processing have low coefficient of export specialization. There are competitive branches of high technologies, which include optic

electronics, telecommunication equipment, new materials, optic devices, and program software.

The development of services (including telecommunication, finance, transport and etc.) influences the competitiveness of the country. Russia's export and import of services don't make significant magnitude in the world trade of services. Russia takes 24 place in the world export of services and has 21 place in the world import of services. The modern rise of the internet trade affects its use in Russia. Growth of the internet trade provides the increase of the velocity of transactions, the reduction of intermediate costs, and stimulates the creation of new distribute networks. The commodity structure of the national export is considered the barrier for internet spreading. The total value of concluded transactions exceeds \$ 26.9 billion in Russia in 2000 (ZAHAROV, 2000). The shares of export indexes to GDP demonstrates the interdependence of the export and GDP values (Tab. 4).

Table 4

**The shares of export indices to GDP in Russia  
(1995=100 %)**

	1996	1997	1998	1999	2000	2001
Export	100.1	101.8	101.6	111.1	122.5	127.6
GDP	96.6	97.5	92.7	97.7	105.8	111.5

Source: *Business Foreign Commercial Information* (2002), N 45, 23 April, p.2

The adoption of stimulating export program is a key item of the foreign trade policy in Russia. The development of export specialization of competitive branches, trade diversification, and acceleration of the integration into the world trade system would provide the expansion and strengthening country foreign trade positions in the world markets.

### 3. Geographical patterns and terms of foreign trade

The share of the European Union countries trade makes up 36.9 % in the total volume of Russian trade turnover. The NIS share equals 18 % in the country structure of Russian foreign trade, countries of the Pacific Economic Cooperation Group (PECG) – 16.3 %, Central and East European countries – 13.7 %. The rate of Russian net export growth to the non-NIS exceeds the share of net export growth to the NIS. The main Russian trade partners are the non-NIS, which share equals 82 % in the total volume of trade turnover, including export – 86 %, import – 73 % in 2001 (Fig. 4).

Federal Republic of Germany is the main Russian trade partner. Germany's share in Russian trade turnover equals \$14.9 billion, Italy – \$9.1 billion, the USA makes up \$ 7.3 billion, China – \$ 7.3 billion, Netherlands – \$ 5.9 billion, Great Britain – \$ 5.3 billion, Poland – \$ 5.1 billion, Finland – \$ 4.4 billion, Turkey – \$ 3.8 billion, France – \$ 3.7, Japan – \$ 3.6 billion.

The shares of Belarus, Ukraine, Kazakhstan are estimated the biggest in Russian turnover with the NIS. The commodity structure is characterized the predominance of petroleum products, chemical products. The share of ferrous and unferrous metals is decreased.

The tariff regulation is considered one of the debatable questions. Some economists substantiate the necessity of tariff indication of services of natural monopolies. The opponents argue this approach, and consider that the abrupt rise of tariffs of natural monopolies could aggravate the perspectives of economic development. The tariff influences the inflation rise (SHARONOV, 2002). The general principal of tariff regulation should be the establishment of the different duties. Technology, equipment should have low duties, raw materials, half finished products – high duties, and finished products – the highest duties (MOVSESYAN, 2001). The petroleum and energy tariffs should be increased to the level of real economic costs (RUYBALKO, 2002). The Russian government decided on limits for price increases for natural gas, rail cargo, and electricity in 2003. The price regulation system is influenced in recent negotiations for WTO membership.

BOTCHIKOV (2002) compares the tariff domestic protection in Russia and in the Western Europe. The average tariff is equaled 16 % in Russia, and the following tariff is made up 27 % in the

European Union. The structure of tariff regulation is completely different in the Western Europe, and is directed on the higher level of protection economy. The WTO accession condition should be the protection mechanism establishment for the basic

branches, which could provide Russian economy adaptation through labor mobility rises, and stimulating capital movement to competitive economic sectors.

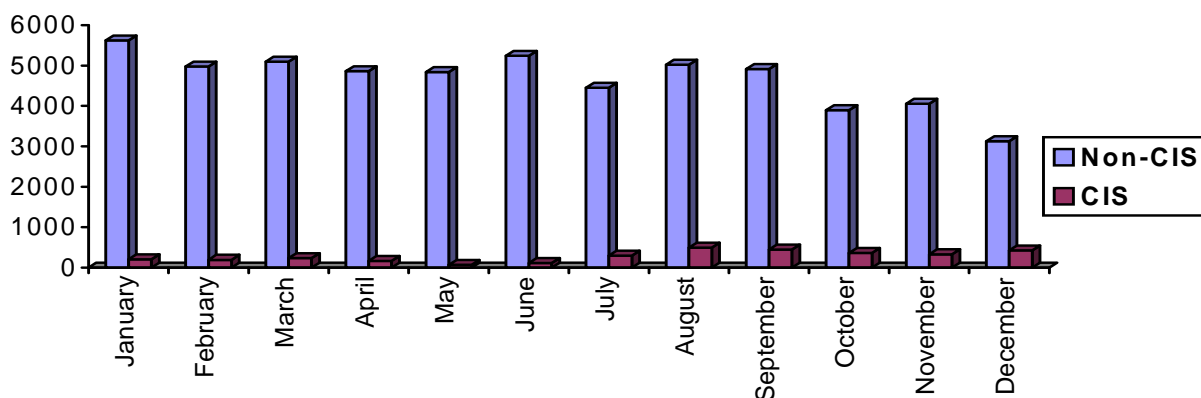


Fig. 4. Net export in Russia in 2001 (Mn US\$)

Source: *Bulletin Foreign Commercial Information (2002), N 15, 14 February, p. 2.*

The bringing into the line the national legislation, administrative rules of foreign trade regulation to the international principal and norms are considered the necessary conditions of the future Russia's WTO accession. The main Russian problems are the absence of normative legal base, lack of high educated staff, institutional infrastructure, and informational security. According to some estimates, Russia loses one to two billion dollars a year that it could be earned if various Production Sharing Agreements contracts had been approved, and made operational without delay (LAURILA, 2001). Russia's WTO accession requires the maintenance of national production competitiveness under the impact of competitiveness foreign products. The world experience depicts the existence of approximately 9-10 thousand custom duties, where 1.4 thousand rates in European Union has level above 12 %. The number of custom duties in the USA exceeds 900 (DYUMULEN, 2001). Using the world experience Russia should apply the different custom duties in order to protect the domestic market. The maintenance of national producers competitiveness under the influence of Russia's WTO accession relates to the vital problem which should be solved in coordination with internal policy interests. Russia's

integration into the sphere of multinational regulation international trade should be based on the combination of the branches development with competitive advantages, and should be directed on the protection of the development of the vitally important branches.

#### 4. The policy conclusions

The preparation of the special export enhancing government program should include the following policy oriented measures:

1. The reorientation of export specialization and stimulating the increase of the share of finished products.
2. The development of trade diversification into wider field of products.
3. The restriction of tariff rise on services and natural monopolies production, and the application of different tariffs for commodities.
4. The stimulation investment growth in export oriented branches.
5. The elaboration of special customs duty mechanism protecting the development of high technology branches.
6. The adoption custom code, a law on technical regulations and laws on intellectual property in accordance with WTO legislation.

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