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Foreign Trade and Foreign Direct Investment Development in Russia

The foreign trade and FDI interrelation is considered as complementary categories. Carrying out trading liberalization and opening-up policy are directed to promote comparative advantages use in transition countries. The import liberalization, accompanied with import of new technologies through FDI attraction, stimulate growth of domestic production, and improve balance of payments.

Зовнішня торгівля і ПІІ розглядаються як додаткові категорії. Завершення лібералізації торгівлі і проведення відкритої політики спрямовано на підтримку використання порівняльних переваг у трансформаційних країнах. Лібералізація імпорту, супроводжувана імпортом нових технологій шляхом залучення ПІІ, стимулює зростання внутрішнього виробництва і поліпшує платіжний баланс.

The interdependence of trade and foreign direct investments (FDI) exists in the framework of the integrated production, selling and supply system of transnational companies. The diverse informational networks penetrate all levels of large companies. The international producing and selling systems competition, based on FDI use, is distinctive feature of modern trade development. The degree of an opening-up economy, indicators of capital accumulation and savings characterize economic and political stability of a society. FDI inflow stimulates trade growth, positively influences incomes increase in a society.

The aim of the paper is to analyze the foreign trade and FDI effects on economic development in Russia. Application traditional and neoclassical approaches allow making a conclusion that international trade plays the important role in maintenance of trade relations between the countries and it can be considered as one of factors of economic growth (HUSTED, MELVIN, 2000). We shall assume that foreign trade and FDI are complementary categories (DOHRN, 1996). Trade liberalization and opening-up economy policy promote FDI inflow growth.

The comparative advantages use by East European countries is provided through various institutional channels, including bilateral trade agreements between individual economies in transition and Western European countries or country groups and participation in work of the international organizations. Trade development results in competition growth of goods, services and factors of production. Trade and net FDI increase affect on institutional structure of a society. International legal, economic norms, rules, organizational behavior are transferred through international trade relations.

1. Foreign trade and foreign direct investment effects on economic development in Russia

World international trade development is considered to be more dependent on FDI attraction. Stability, a constancy and predictability of trade relations is promoted by foreign capital inflow increase. Transition countries are in a widespread process of restructuring as they attempt to provide market development of their economies. Market institutions and market price system are still in the process of creation. The inefficient systems of production, low return on investment, worsening of living standards are typical features of transition economies. The major part of industrial sectors uses trade restrictions and energy subsidies. The World Trade Organization (WTO) access relates to the top priority task for benefits maximization by participation in global trade relations in majority of transition countries.

According to the traditional trade approach foreign capital inflow results in foreign loans increase. In case of unemployment, lack of domestic savings foreign loans can lead to growth of output and income volume in transition countries. Foreign loans positively affect the balance of payments accounts.

In terms of trade theory approach foreign loans are considered the significant factor in comparison with rates of production fall. Foreign loans can be accompanied by small income decrease, deterioration of trade conditions in case of the foreign capital shortage in addition convertible foreign currency need. The net effect of foreign loans in GDP will be positive until the opposite effect begins significant. The state intervention in trade relations, external effect as a result of fluctuations in the financial and commodity markets also influence state policy in this area.

SAWYER, SPRINKLE (2003) point out that the size of changes in the current account on exports depends on the magnitude of the change in income, real exchange rate, size of the income elasticity of demand for exports, and size of the price elasticity of demand for exports. Changes in a country's imports level occur if domestic income changes or the real exchange rate changes.

Trading liberalization in East European countries is accompanied by capture of a market share of western companies as a result of providing policy on sales increase and FDI attraction. BULATOV (2001) suggests a hypothesis that the positive balance on current account in 90[th] years XX[th] in Russia demonstrates the excessive savings in comparison with investments. It is explained by capital flight financing, a significant part of savings absorption by budget deficit, capital outflow to shadow economy. It is negatively reflected in the balance of payments of the country.

The significant part of budget deficit is financed through FDI inflow in the majority of the countries. It reflects in the increase balance on current account side. Foreign investment inflow into the countries stimulates export growth. Domestic production receives stimulus growing faster.

The financial assets reduction took place on current account and capital account from 1996 to 1998 in Russian balance of payments. It means the trade transactions reduction of goods and services, transfer liabilities (Table 1).

Table 1

The balance of payments of the Russian Federation

Parameter	1996	1997	1998	1999	2000	2001	2002
Balance of payments on current account:							
(bln US $)	11,7	2.0	0,6	24,5	45,8	33,5	31,8
Per cent to GDP	2,8	0,5	0,3	12,7	17,7	10,8	9,4
Export of goods (bln US $)	90,5	89	74,8	75,5	105	101	106
Import of the goods (bln)	68	71,9	58	39,5	44,8	53,7	60,7
External duty (% to GDP)	39,7	38,4	70,2	95,8	66,2	53,6	…
FDI, net (bln US $)	1,6	1,6	1,4	1,1	–0,4	–0,1	0

Source: Transition report update. – EBRD. – 2003. – May.

The various approaches to research the reasons of economic recession, foreign trade, FDI and their roles in improvement of an economic situation in the countries Central and the East Europe are existed.

The expenditures policy based on modified demand for domestic, imported goods, and policy of reduction (or increase) expenditures is directed to maintain the balance of external and internal operations. This kind of policy is considered to be basic strategic directions of international trade development in transition countries.

The existence of distortions, connected with closed economy functioning, relates to the main problem an open economy foundation.

2. Foreign trade policy in Russia

Country's foreign trade policy determines government role to affect its trade relations with the rest of the world. SAWYER, SPRINKLE (2003) argue: "Given that a country gains from trade, one would expect free trade to dominate most countries' international trade policy and there would be no barriers to free trade. However, this is not the way it is with most countries' international trade policy". The currency convertibility relates to the problem of foreign revenue transfer for export by national in a foreign currency recalculation. Otherwise there is no stimulus for foreign export which is import the country – recipient. Quantitative restrictions decrease and world price setting define initial measures of successful trade liberalization. Exchange rate fluctuations affect not only the level of short-run output in the economy, but also the composition of that output in the long-run. This may have a non-trivial impact on the mix of production in the economy between tradable goods and non-tradable goods (SAWYER, SPRINKLE, 2003).

Introduction of quantitative restrictions concerns worse type of the state intervention in a trade policy. MILL wrote: «There is the most well known among false theories the protection doctrine of domestic industry. It means full prohibition or reduction with the help of high duties on import of those foreign goods which can be made inside the country» (MILL, 1981). Restrictions result in the huge losses reflected in balance of payments. The size of damage from import prohibition and duties is estimated as excess of the price on which the corresponding goods to be made inside the country above the price on which they can be imported. Tariff application results in import reduction in case of the state intervention. As alternative policy tariff increase could be devaluation. It influences output production, market assets.

AFONSEV (1997) considers that the political economy mechanism of tariff regulation which emerged in recent institutional setting as a more or less natural response to the crisis environment will possibly serve as an important factor contributing to dismantling tariff barriers to imports in the improved economic conditions. The most important idea in this context is that the wide-scale liberalization will likely to be an endogenous product of successful micro- and macroeconomic adjustment rather than that of exogenous efforts of «benevolent» politicians or political advisers.

The opening-up policy, import and export barriers elimination, full foreign trade and FDI liberalization in most cases results in alignment internal and the world prices. Unprepared liberalization can cause destruction of some sectors of national economy, lead to prevalence import-substitution development strategy in comparison with export-substitution. Domestic market goods saturation causes a reduction of prices on some domestic goods and increases their competitiveness. Creation of new kinds of competitive production and search of the new markets stimulate competition between producers, reduces production costs, and promotes increase in the income of export. Improvement country's investment climate induces firms to expand sales and to increase profitability. The increasing demand stimulates investments, promotes development of products differentiation, increase their competitiveness. Less developed countries and CIS countries are interested in a deepening integration into world economy. Trade liberalization in transition countries is accompanied by market share conquering, sales expanding and FDI attracting by the western companies. Trade restrictions elimination is necessary to provide with structural reforms.

Foreign trade and FDI expansion among countries, reorientation from export of the raw material, traditional kinds of the goods and natural resources on high-tech kinds of production promotes improvement of trade balance, increases size of net exports, expands trade and economic relations in the field of cooperation and specializations. Low production costs and presence of relative comparative advantages of trade specialization stimulate export growth of consumer goods. Export increase of competitive kinds of production acts as a source of increase in export incomes.

Russia's foreign trade structure demonstrates the natural resources predominance. The positive trade balance is formed exclusively due to exports of crude oil and natural gas (See figure

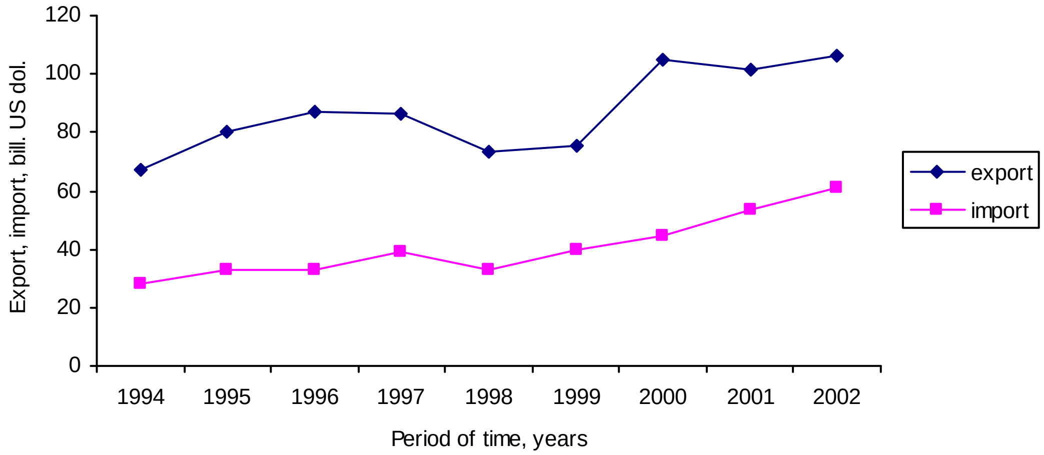

Fig. 1. Exports and Imports Russia

Source: It is constructed on the basis of data Countries of transition 2000, WIIW Handbook of Statistics, 2003, Transition report update, 2003.

The cumulative FDI inflow in Russia is presented in figure 2. FDI to and from Russia increased not on significant level in 2002. The sluggishness of global economy affects the global flows reduction and results reduction capital inflows in East Europe.

Carrying out the state protectionist policy is based on use of import duties, effective development of the domestic industry, use country's comparative advantages. Import-substitution policy, high-tech development through greenfield investments will stimulate domestic production restoration. Investments into capital-intensive production will stimulate economic growth.

3. Conclusions

The foreign trade and FDI interrelation is considered as complementary categories. The trade balance analysis shows that the significant part makes up labor-intensive production in export of CIS countries. The high share of unqualified labor is distinguished feature of Russia's economy. The absence of effective accounting mechanism among countries negatively influences mutually beneficial trade relations development in CIS. This process limits real commodity circulation, causes uncontrolled outflow of significant volumes of raw materials, and products.

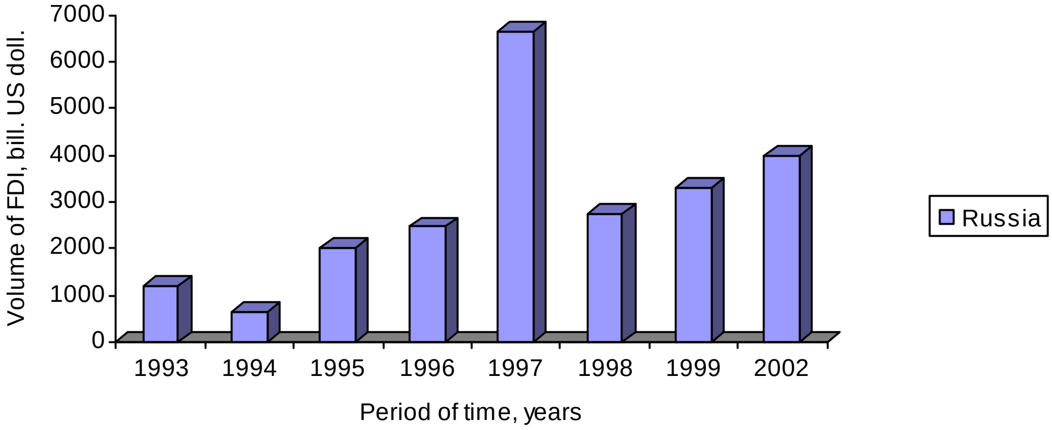

Fig. 2. The cumulative FDI inflow in Russia
Source: Countries of transition 2000. WIIW Handbook of Statistics, 2001, P. 448.

Carrying out trading liberalization and opening-up policy are directed to promote comparative advantages use in transition countries. Import-substitution policy stimulates domestic production restoration in Russia.

The balance of payments analysis confirms that countries which succeeded to attract large FDI inflow at early transformation stage have better economic positions comparing to the rest.

The foreign trade policy improvement and FDI attraction are directed to protect domestic production, promote trade balance improvement, net exports growth. The import liberalization, accompanied with import of new technologies through FDI attraction, stimulate growth of domestic production, and improve balance of payments.

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