

An appeal for a reorientation of Russian trade policy

Presentation at the German-Russian Chamber of Commerce

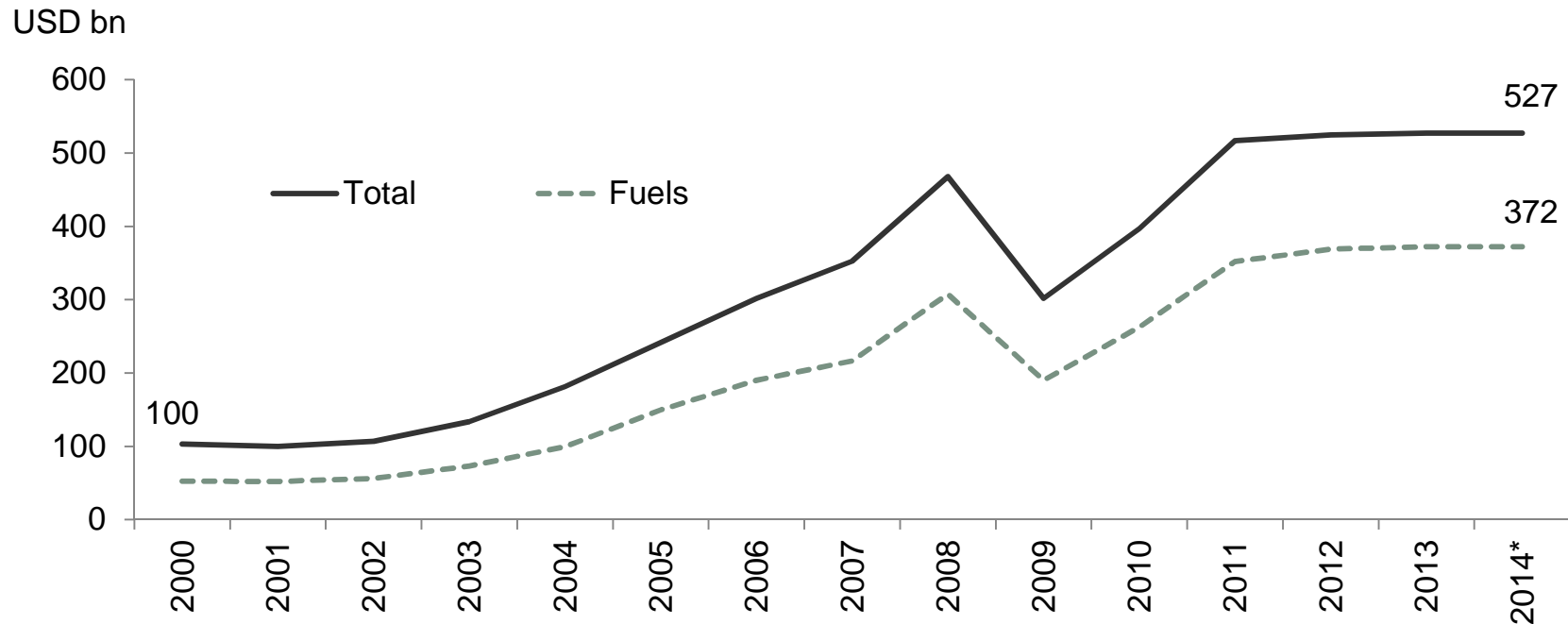
Dr Ricardo Giucci, Berlin Economics
Moscow, 25 November 2014

Part I:

An appeal for a reorientation of Russian trade policy

1. Overview of Russian foreign trade
2. Analysis of potential
3. Russia`s trade policy
4. An appeal for a reorientation of Russian trade policy

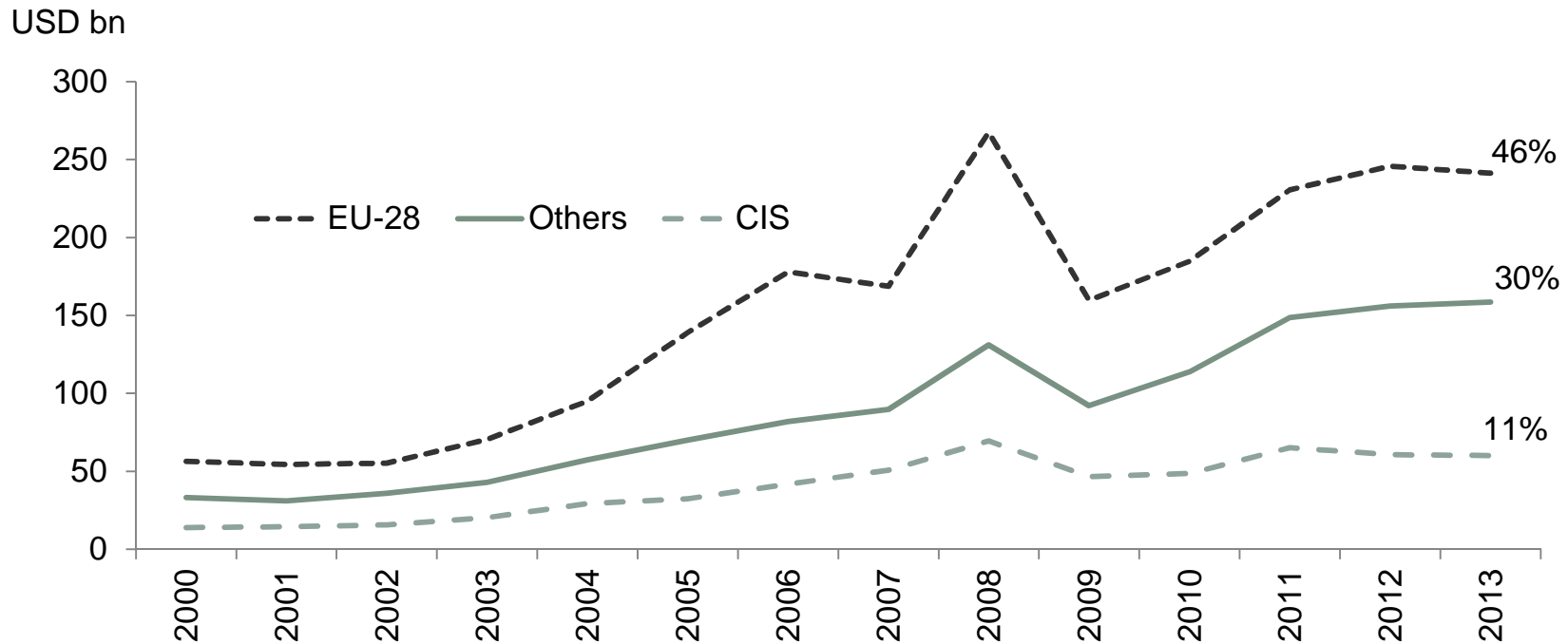
1. Overview: Russia's exports



Source: UN Comtrade, *Estimate: Growth rate in H1-2014 continues the whole year

- ➔ **Strong export dynamics until 2011; stagnation since 2012**
- ➔ **Dominating role of energy exports: 71% of total (2013)**

Export structure by region



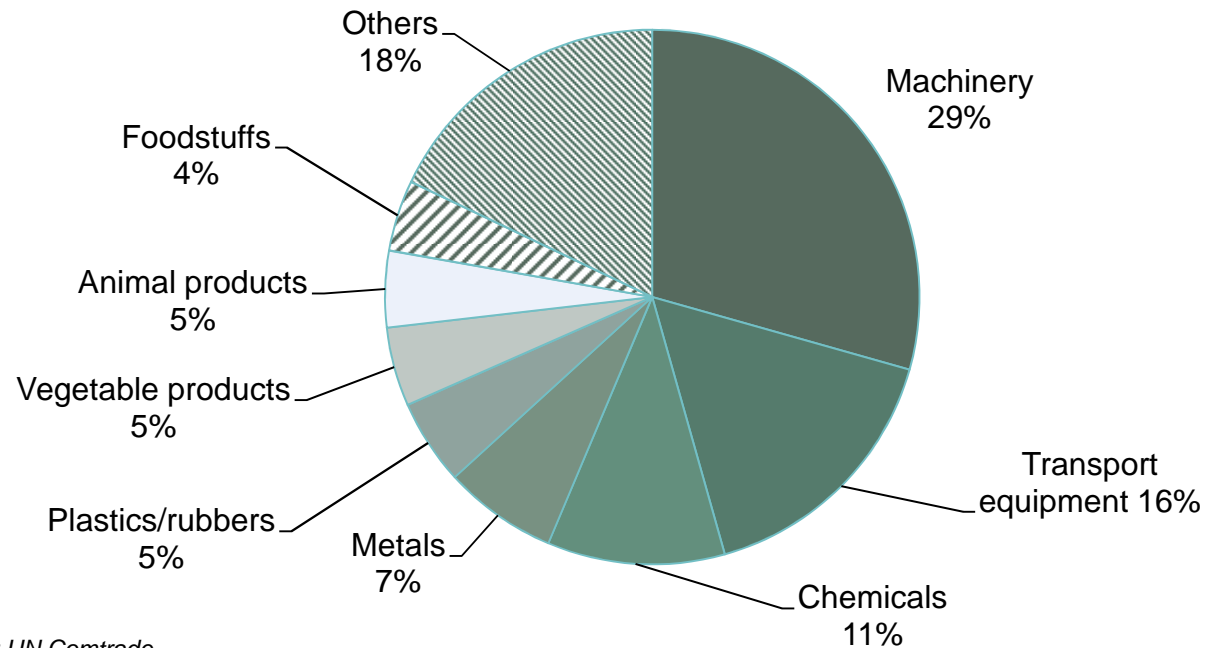
Source: UN Comtrade

➔ **EU is the most important export market (46% in 2013)**

➔ **Limited relevance of CIS market (only 11%)**

Overview of Russian imports

Imports by sectors, 2013

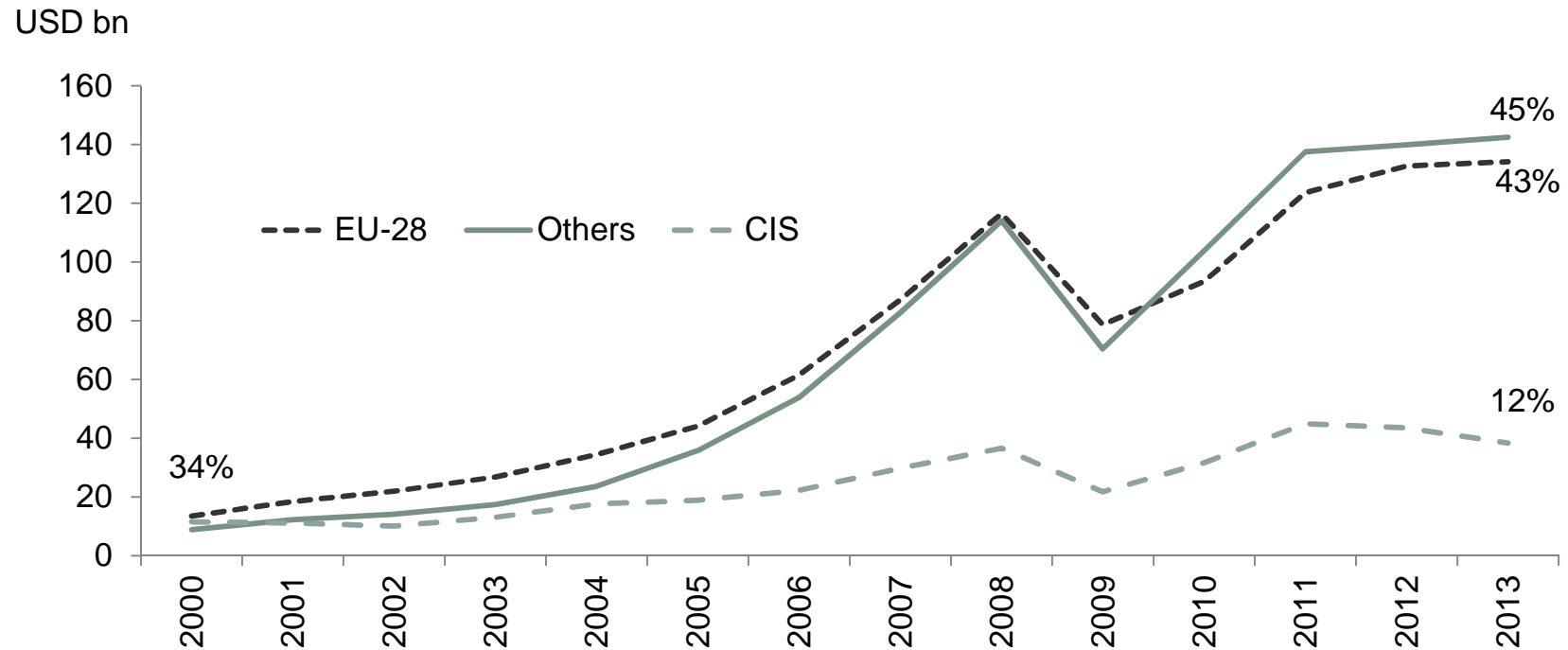


Source: UN Comtrade

➔ **Diversified import structure, mostly capital goods incl. machinery, transport equipment, chemicals > 50%**

➔ **Foodstuffs with 14% also significant**

Import structure by region



Source: UN Comtrade

➔ **EU with 43% (2013) most important source of imports**

➔ **Small and decreasing significance of imports from CIS countries**

Conclusions

Goods structure

- Exchange of energy for technology

Regional structure

- EU clearly the most important trading partner
- Small and decreasing significance of CIS countries

Degree of openness

- Exports 25% of GDP, Imports 15% of GDP
- Degree of openness = $\frac{\text{Exports} + \text{Imports}}{\text{GDP}} = 40\%$
- In comparison: DE 73%, IT 48%, UA 79% und CN 45%

➔ **Potential for increase in trade**

➔ **Potential more exports and imports; both important**

2. Export potential: CIS and EU

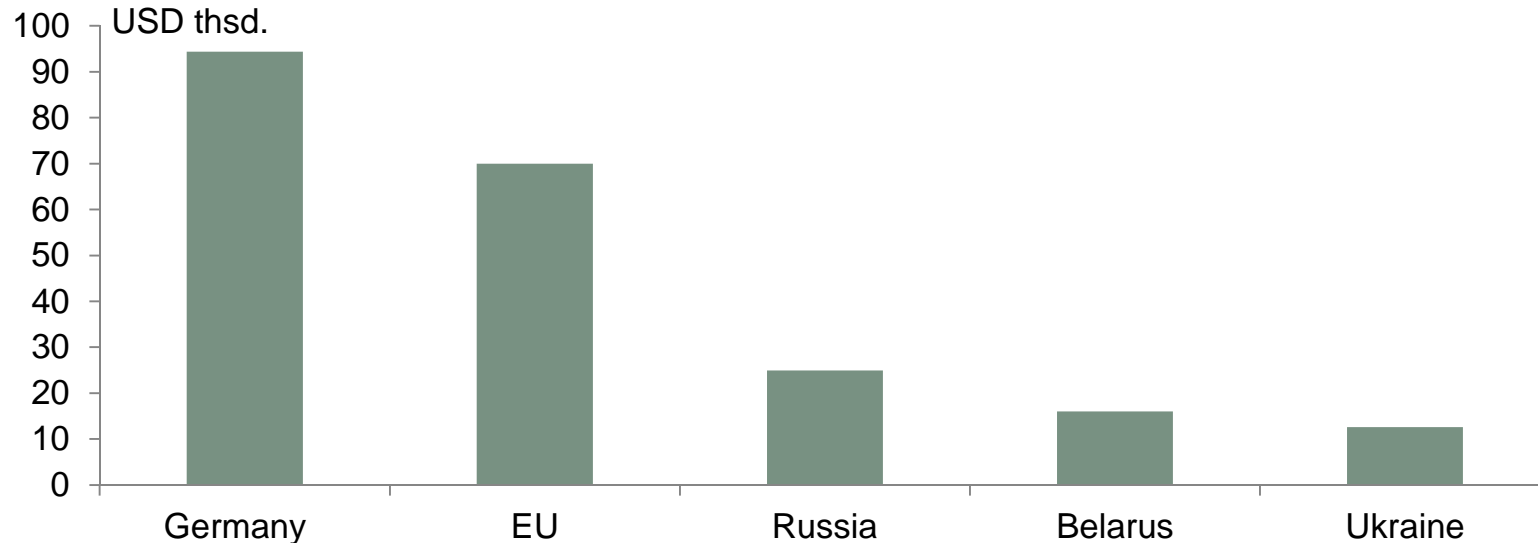
	GDP, USD bn	% of RU GDP
RU	2,118	100%
CIS excluding RU	675	32%
EU	17,371	820%

- Important for RU long-term: Diversification of exports beyond energy
- Pre-requisite: **Increasing** the market size for RU firms
- Reason: Market size \uparrow \rightarrow Specialisation \uparrow , minimum efficient scale can be achieved \rightarrow International competitiveness \uparrow
- Where is potential to increase the market? Little in CIS, a lot in EU

➔ **Significant potential for long-term increase of RU export to EU in non-energy sector**

Import potential: CIS and EU

Labour productivity in manufacturing sector, 2012



Source: Own calculations, Eurostat, World Bank and national statistics agencies

- Low labour productivity in RU → Modernisation is necessary
- How? Through import of state of the art technology
- Where from? Not from CIS, but from the EU/Germany

➔ **Significant potential for higher RU imports from EU**

3. Russian trade policy: Priority CIS/Customs Union

Trade policy priority since 2012: Expansion of Customs Union in CIS

Problem 1: Regional priority on CIS, despite low potential

Problem 2: Customs Union is not an attractive **instrument** for CIS countries

- Customs Union has very high tariffs („protectionist“ customs union)
- Customs Union demands exclusivity, restricts trade with other countries

Weighted average tariffs, 2011

RU 9.9%

UA 2.7%

MD 3.7%

GE 1.9%

As a result: If UA/MD/GE were to enter the Customs Union

- Massive rise in protectionism against other trading partners
 - Cancellation of various FTAs, re-negotiations with WTO
- Significant reduction in exports and imports

➔ **Negative impact on UA/MD/GE**

UA: Welfare -4%, MD: GDP -10%

Russian trade policy towards the EU

2012: Joining WTO; generally positive, also for trade with the EU

But: Simultaneous increase in protectionism

- Scheduled tariff reduction in around 200 cases (e.g. refrigerators, cheese, used cars) de facto not implemented
- New non-tariff barriers like „recycling fee“ for cars (2012), ban on pork imports from EU (2013), etc.

Since Ukraine crisis 2014: Further increase in protectionism

- Import restrictions on agricultural products from the EU
- Ever clearer drift towards autarky in RU

➔ **High and rising protectionism towards the EU has become a main feature of Russian trade policy**

Overall assessment of Russia's trade policy

Thesis: Mismatch between potential and current trade policy

	Regional focus	Instrument	Overall
Potential	EU	FTA	Trade ↑
Current policy	CIS	Customs Union	Protectionism ↑

Evaluation of the current Russian trade policy:

- No sensible priorities, not in the economic interest of Russia
- Moreover: Current policy contributes to numerous trade disputes
 - CIS countries: Trade disputes with UA, MD, GE
 - EU: Trade disputes in numerous sectors

➔ **Problematic trade policy – a reorientation is needed**

4. Appeal: Extension of CIS free trade agreement

Although declining, CIS market for Russia still important

➔ **Goal: Intensification of free trade in the CIS region**

How?

- Short-term: Keeping CIS-FTA of 2011 in place; DCFTA is not a reason to cancel/suspend a FTA (see Part II)
- Medium-term: Deepening of CIS-FTA through introduction of:
 - Trade in services and energy
 - Public procurement and IP protection
- Strengthening of institutional framework of CIS-FTA
 - No trade restrictions on the basis of questionable reasoning
 - Ensure objective arbitration in case of disputes

Trade liberalisation with the EU

Regional priority should be trade with the EU

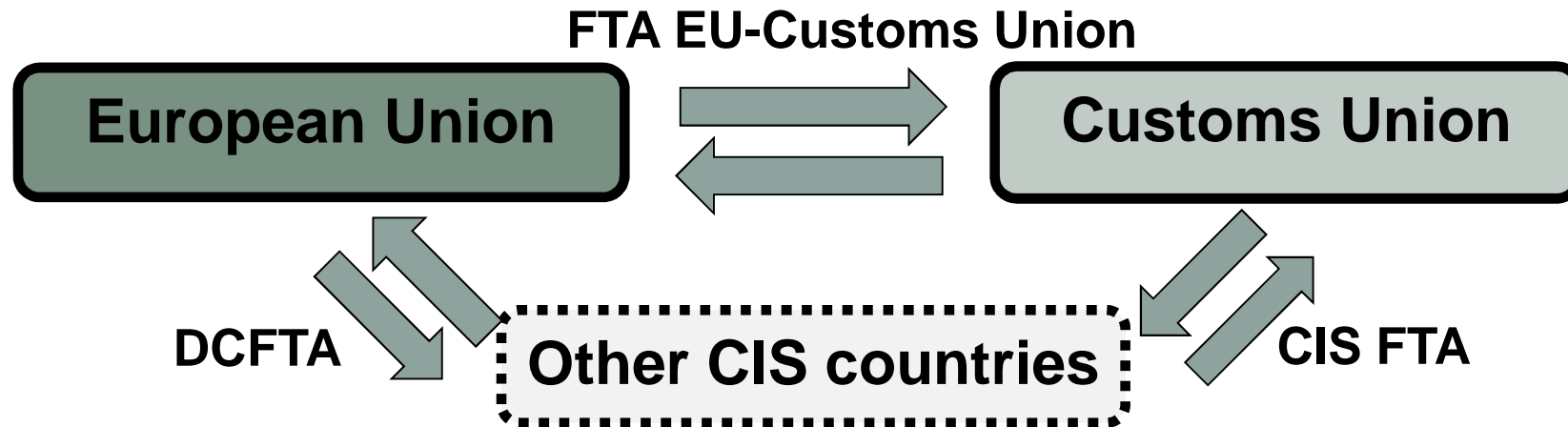
➔ **Goal: Reduction of trade barriers with the EU**

How?

- Reduction of tariffs
- Discontinue use ad hoc, non-tariff barriers
- Continuing dialog with the EU regarding the harmonisation of technical regulations and standards

Long-term goal: Conclusion of a FTA with the EU

Trilateral: Vision Lisbon-Vladivostok



Vision possible? Yes

Required instrument? Free Trade Agreements

Required construction? 3 parallel FTAs

- 2011: Multilateral CIS FTA
- 2014: DCFTA between the EU and UA/MD/GE
- Missing part to achieve vision: EU-Customs Union FTA

Perspectives for a EU-Customs Union FTA

- Significant trade potential for both sides
- However, also serious challenges; see Part II

Outlook: A reorientation of trade policy is needed

Russia's macroeconomic policy

- Solid fiscal policy: Public debt only 14% of GDP
- Good monetary policy: Introduction of „Inflation Targeting“
- Liberalisation of capital movements

➔ Professional macroeconomic management

Exception here: Trade policy

- One-sighted regional priority and questionable instrument
- Rising protectionism, drift towards autarky

Appeal

- Trade policy should correspond to high standards of RU macro policy
- Trade policy should be motivated by economic, not political factors
- Reorientation of trade policy important to:
 - Enable continuation of good macroeconomic management
 - To progress with economic reforms and modernisation of the country

Part II: Explanation of selected theses in detail

Thesis 1: Little potential for trade with CIS

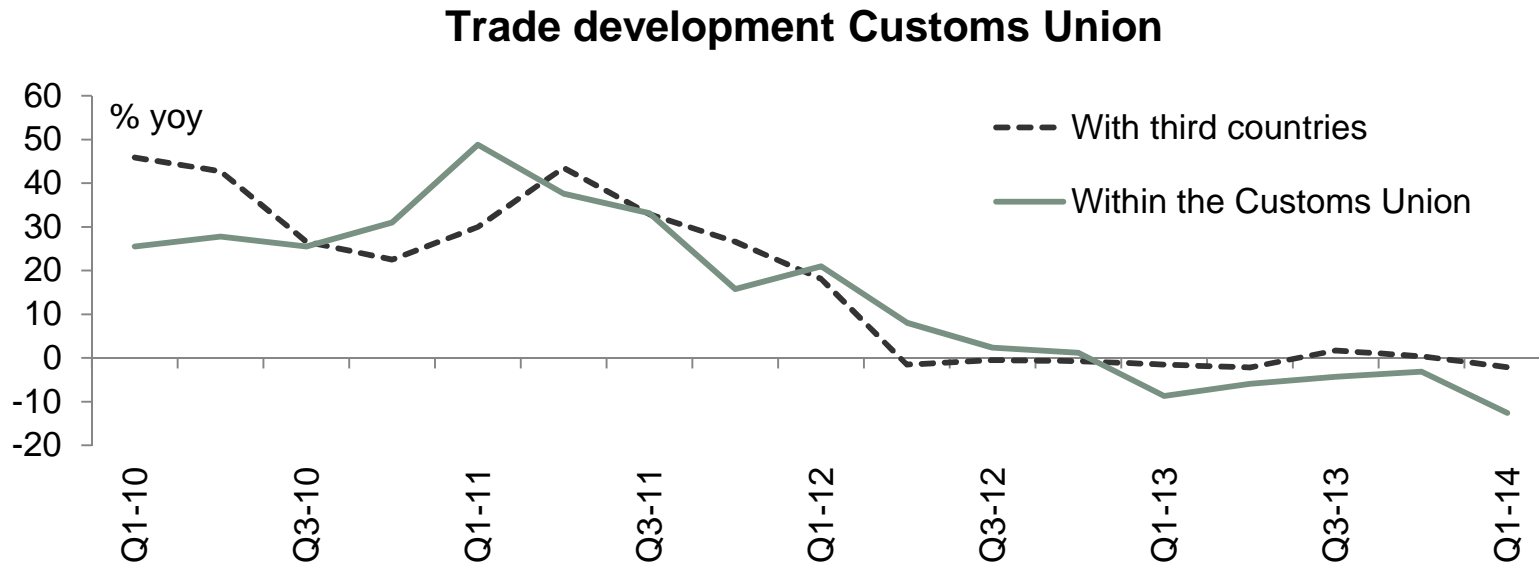
Thesis 2: DCFTA fully compatible with CIS FTA

Thesis 3: Vision Lisbon-Vladivostok

Thesis 4: FTA EU-Customs Union has great potential

Thesis 5: Protectionism not good for RU

Thesis 1: Little potential for trade with CIS



Source: Eurasian Economic Commission

- Customs Union: Trade barriers largely dismantled
- Original hope: Dynamic trade development
- Reality: Trade in Customs Union develops worse than trade with third countries

➔ **Empirical evidence for little potential in CIS**

Thesis 2: DCFTA fully compatible with CIS FTA

In general, in theory and practice

- FTAs are bilateral agreements
- Therefore, parallel FTA are compatible with each other

What applies generally, also applies to DCFTA

➔ **Thesis: DCFTA and CIS FTA are compatible**

However, compatibility has been questioned based on 3 objections

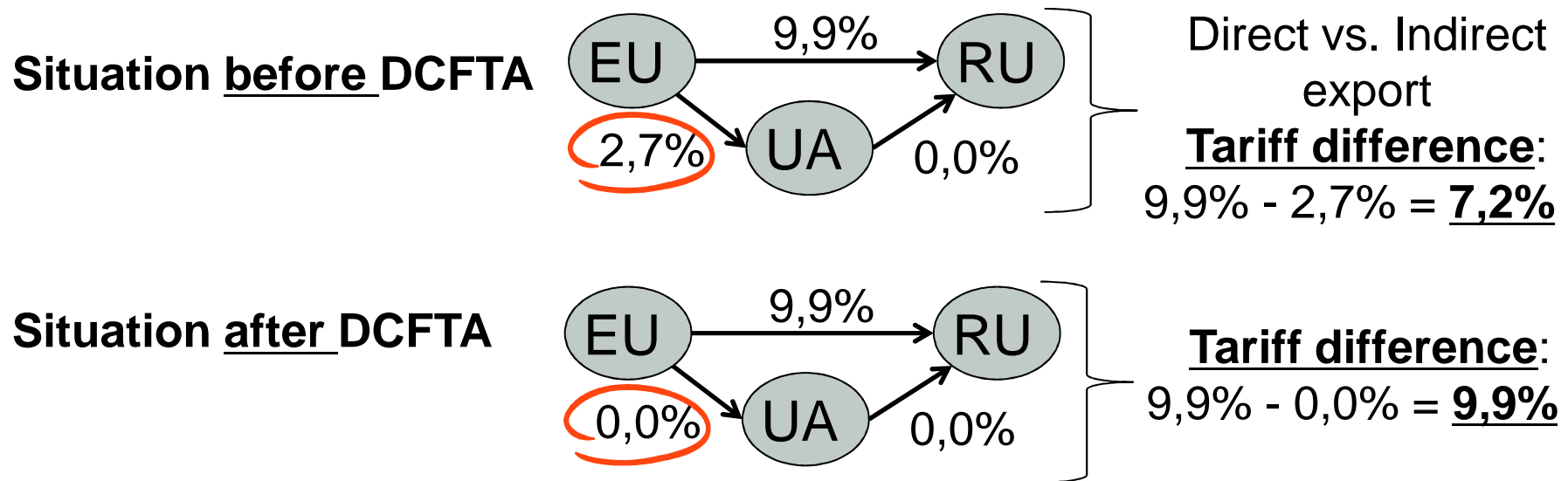
- Relabeling
- “Floods” of cheap imported goods
- Technical regulation/standards

Coming up: All 3 objections are refuted

Objection 1: „Relabeling“

Objection: DCFTA → EU goods duty-free in UA → EU goods then relabelled in UA → As UA goods duty-free to RU

Counter objection: Comparison of situation before and after DCFTA



➔ **DCFTA: Tariff difference barely changes, no incentives to start a costly relabeling business**

Objection 2: „Import flood“ from Ukraine

Objection: DCFTA → UA cannot compete with the EU firms → massive increase of Ex from UA to RU → „import flood“

Counter objection:

- DCFTA: Reduction of many UA tariffs does not happen overnight but is gradual (up to 10 years of transition period)
- Also, the principle behind trade policy measures:
 - First, something has to happen; facts
 - Only after that the affected country can react
 - Otherwise: Widespread possibility for protectionism

Therefore:

- RU should wait and see if „import flood“ from UA actually happens in certain areas
- If it does happen, safeguard measures are grounded and legal

Objection 3: Technical regulation/standards

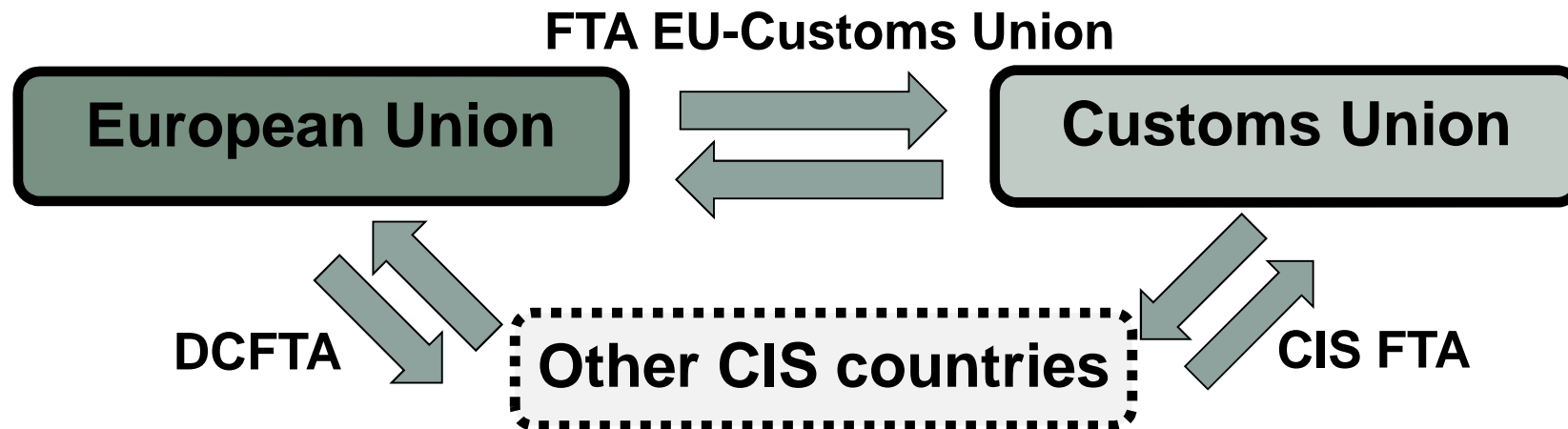
Objection: DCFTA → Introduction of EU standards in UA
→ UA firms can no longer export industrial goods to RU
→ value added chains in RU-UA industrial complex interrupted
→ negative impact on UA, but also on RU

Counter objection:

- UA companies can produce a part of their output according to GOST standards and export to RU, even after the implementation of DCFTA
- DE has EU-standards, but its companies are still successful exporting goods like machinery to RU
- 2013: DE exports to RU (incl. machinery) USD 38 bn

➔ **Technical regulations do not prevent UA-RU trade**

Thesis 3: Vision Lisbon-Vladivostok is feasible



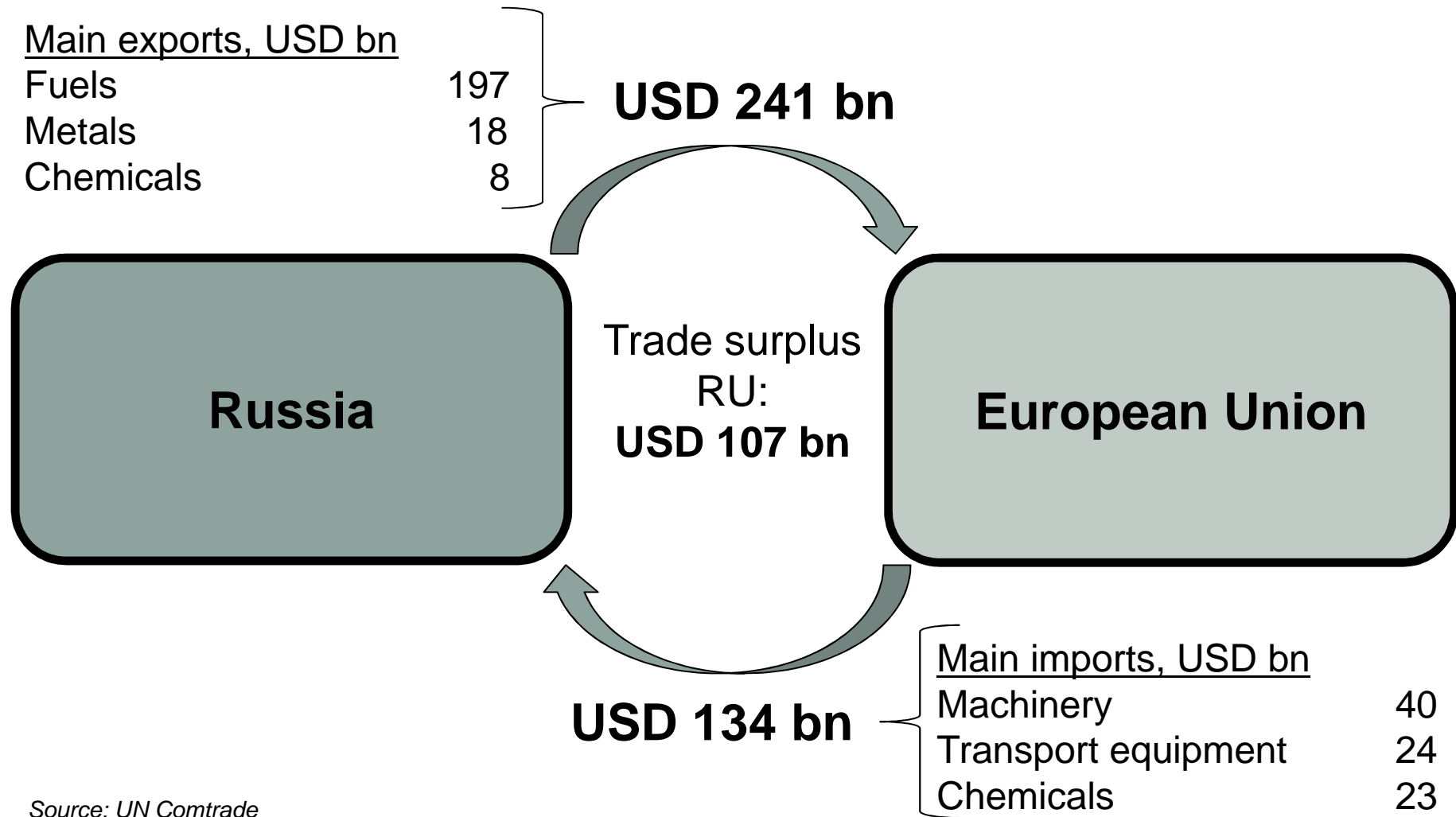
Vision possible? Yes

Required instrument? Free Trade Agreements

Required construction? 3 parallel FTAs

- 2011: Multilateral CIS FTA
- 2014: DCFTA between EU and UA/MD/GE
- Missing part: FTA between Customs Union and EU

Thesis 4: FTA EU-Customs Union has great potential



Source: UN Comtrade

Interests for FTA EU-Customs Union

EU: Basically great interest

- Bilateral trade deficit with RU USD 107 bn
- EU exports goods that would benefit from a FTA

➔ Positive effect, both short and long-term

RU/Customs Union: Mixed interests

- Long-term: FTA would contribute significantly to the modernisation of the country; very positive
- But short-term:
 - No direct effect on exports, since energy is not dependent on FTA
 - Increased competitive pressure on domestic industry

➔ **FTA in the long-term very interesting for both partners; however, short-term incentive for RU rather low**

The path towards an EU-Customs Union FTA

Step 1: Analysis

- Study on the impact of a FTA on the Customs Union and EU
 - If high competitive pressure on certain sectors: What to do, how long transitional arrangements?
 - Dialogue between trade experts of EU and Customs Union
- ➔ **Solid analytical basis to prepare process**

Step 2: Decision for trade liberalisation

- EU: Opening of protected markets
 - RU/Customs Union: Fundamental decision for a gradual trade liberalisation
 - Main argument in RU: Long-term economic interests of the country should take priority
- ➔ **Modernisation of RU requires a modern trade policy**

Thesis 5: Protectionism not good for RU

Theory: Protectionism \uparrow \rightarrow Specialisation \downarrow \rightarrow Welfare \downarrow

Empirical evidence: Countries with high protection grow on average slower than open economies

➔ **Protectionism: Negative effect on welfare/GDP**

Further negative effects of protectionism

- Protectionism \rightarrow Prices for foodstuffs \uparrow \rightarrow Inflation \uparrow
- Possible response: Price controls

➔ **Possible worsening of business climate**

- Protection \rightarrow Stagflation (Stagnation + Inflation)
- Possible response: Political influence on central bank interest rate policy

➔ **Possible restriction central bank independence**

➔ **Protectionism is not good for RU**

Part III: Annex

A1. RU exports by sectors, 2013

A2. Exports by countries, 2013

A3. RU imports by sectors, 2013

A4. Imports by countries, 2013

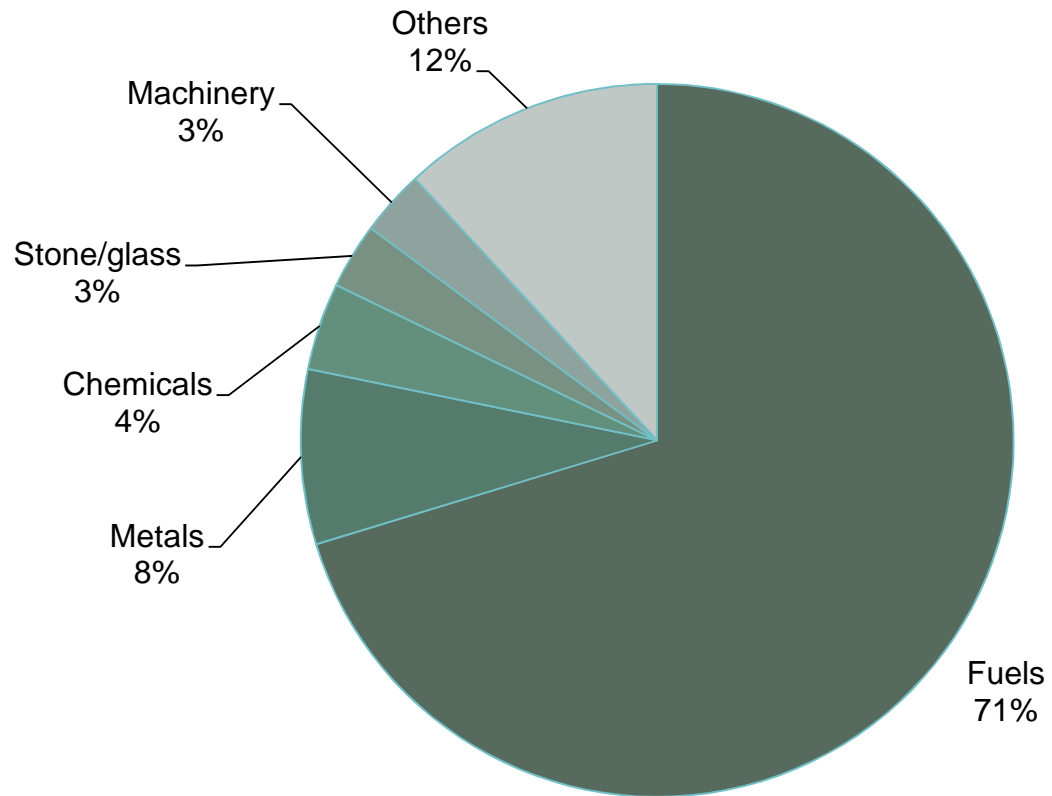
A5. Trading volume and main groups with CIS

A6. Trade within the Customs Union

A7. Thesis: Customs Union is an expensive instrument for RU

A8. Belarus and the DCFTA: Opportunities instead of risks

A1. RU exports by sectors, 2013

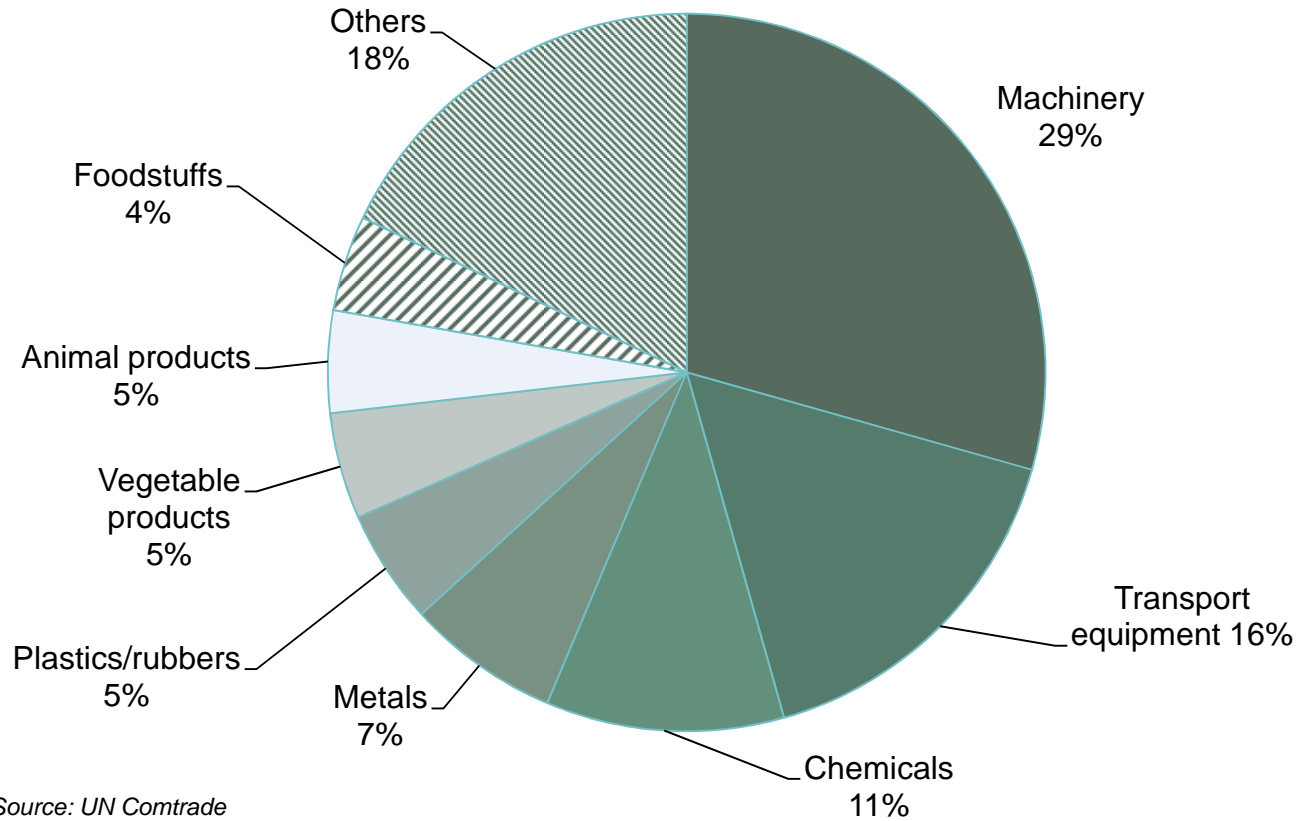


Source: UN Comtrade

A2. Exports by countries, 2013

	Exports 2013	Share in region	Share in total	Comment
EU	241	100%	46%	82% Fuels
NL	69	29%	13%	86% Crude oil and oil products
IT	29	12%	6%	
DE	23	10%	4%	
CIS	60	100%	11%	35% Fuels
KZ	17	29%	3%	
BY	17	28%	3%	
UA	15	25%	3%	UA only 3% of total exports
Others	159	100%	30%	
CN	36	22%	7%	
JP	20	12%	4%	
TR	15	10%	3%	
not specified	67	100%	13%	More than 99% natural gas
Total	527		100%	71% Fuels

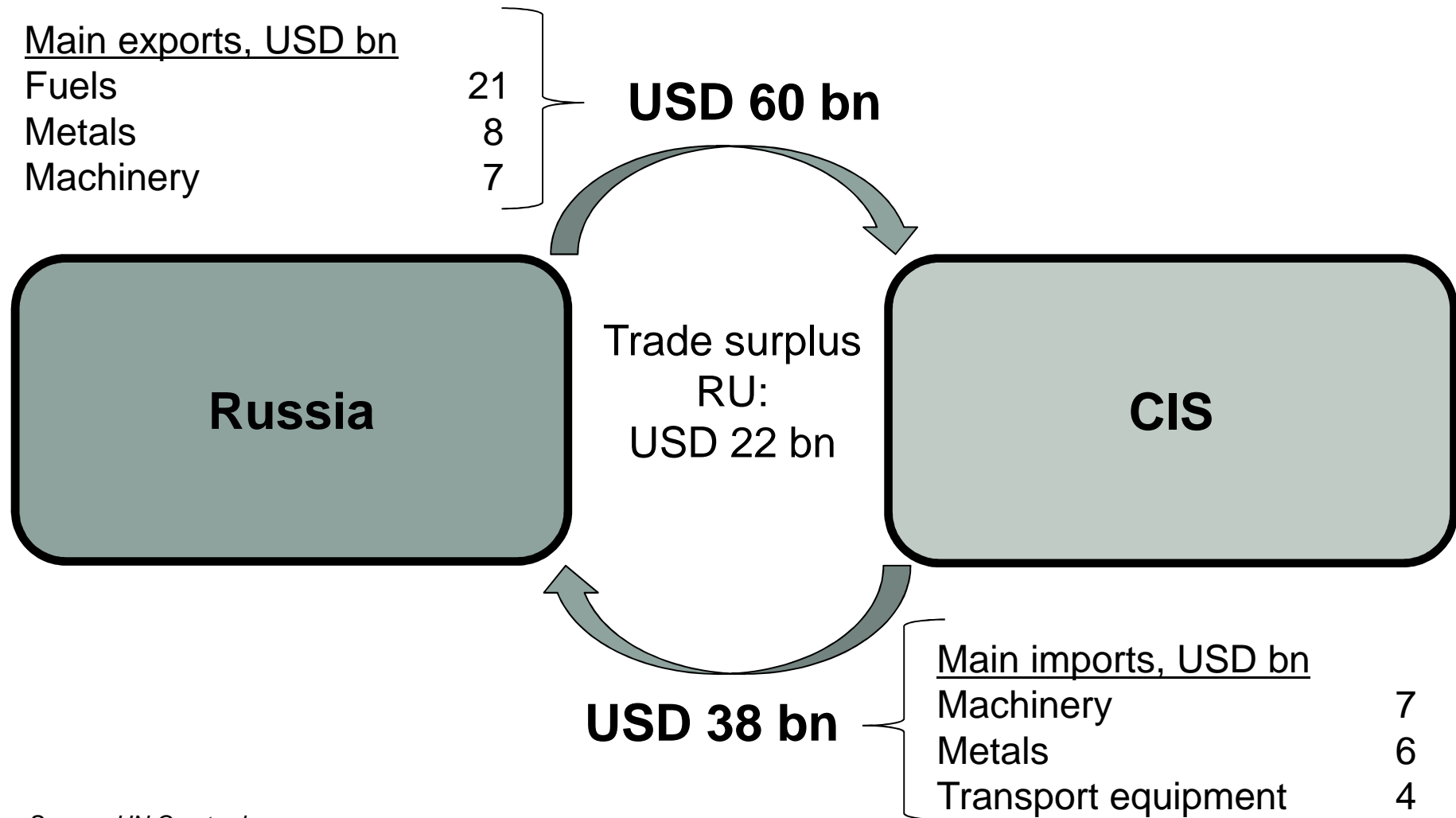
A3. RU imports by sectors, 2013



A4. Imports by countries, 2013

	Imports 2013	Share in region	Share in total	Comment
EU	134	100%	43%	
DE	38	28%	12%	Machinery and transport equipment > 50%
IT	15	11%	5%	
FR	13	10%	4%	
CIS	38	100%	12%	
UA	16	41%	5%	UA only 5% of total imports
BY	14	36%	4%	
KZ	6	15%	2%	
Others	142	100%	45%	
CN	53	37%	17%	China most important source of imports
US	16	12%	5%	
JP	14	10%	4%	
Total	315	100%	100%	

A5. Trading volume and main groups with CIS



Source: UN Comtrade

A6. Trade within the Customs Union

Russia

- Exports: USD 34 bn, 6% of total
- Commodity structure:
 - Fuels 42%
 - Metals 14%
 - Machinery 11%

Belarus

- Exports: USD 18 bn, 48% of total
- Commodity structure:
 - Animals and animal products 19%
 - Transport equipment 16%
 - Machinery 16%

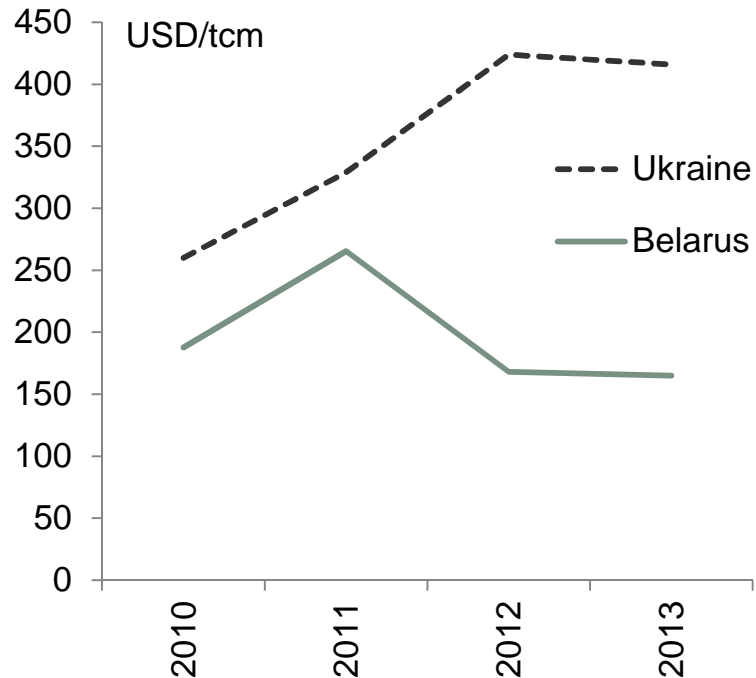
Kazakhstan

- Exports: USD 6 bn, 7% of total
- Commodity structure:
 - Minerals 27%
 - Metals 24%
 - Fuels 11%

Source: Own calculations based on Eurasian Economic Commission data for Belarus und Kazakhstan und UN Comtrade data for Russia

A7. Thesis: Customs Union is an expensive instrument for RU

Natural gas import prices



Thesis: RU needs to provide financial incentives to CIS countries to join the Customs Union → Expensive instrument

UA, support package of 17 Dec 2013

- Gas price subsidy: USD 3 bn/year
- Loans: USD 15 bn/year

➔ **Total: USD 18 bn/year**
(ca. 10% of UA GDP)

BY, ongoing financial assistance

- Gas price subsidy: USD 5 bn/year
- 2015: 50% oil export duties to BY; USD 1.5 bn/year
- Loans: ca. USD 1.2 bn/year

➔ **Total: USD 7.7 bn/year**
(also ca. 10% of BY GDP)

A8. Belarus & DCFTA: Opportunities instead of risks

	Ex to UA, % of total	Ex to UA, % of GDP	Im from UA, % of total	Im from UA, % of GDP
Belarus	12%	6%	5%	3%
Russia	3%	0.7%	5%	0.7%

BY: UA second-largest trading partner, after RU

- Is BY concerned by DCFTA EU-UA?
- No, BY doesn't seem to have any reservations towards DCFTA
- Instead: BY sees opportunities regarding the DCFTA
- Concretely: BY invests in machinery sector in MD in order to gain better access to third country markets

➔ **BY perspective regarding DCFTA: Opportunities instead of risks**

Contact

Dr. Ricardo Giucci
giucci@berlin-economics.com

BE Berlin Economics GmbH
Schillerstr. 59, D-10627 Berlin
Tel: +49 30 / 20 61 34 64 0
Fax: +49 30 / 20 61 34 64 9
service@berlin-economics.com
www.berlin-economics.com
Follow us on Twitter @BerlinEconomics

