

## Chapter 67

# Foreign Trade in Russia: Existing Distortions and Potentials of Regional Competitiveness in View of Liberalization

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### ABSTRACT

*Until recently only one of the largest economies – Russia was not among the WTO members. Russia's accession into the WTO drew out hidden structural problems of national economy, low competitiveness of domestic producers, dependence on fossil-fuel exports, and regional disparities. The paper aims at overview of the existing distortions of Russia's foreign trade and their potential threats to sustainable economic development and national economic security in view of the running trade liberalization. Regional implementations of trade liberalization are investigated on the case of the Stavropol Krai, one of the southern regions of Russia with an average level of economic development. The Gravity model is implemented to analyze trade activities of the region; the Boundary Effect Model is utilized to evaluate the effects of trade liberalization on separate industries. Simulation allowed distributing regional commodities on their competitiveness depending on export quota and boundary effect, and accessing aftermaths of export expansion and import substitution.*

### INTRODUCTION

Russia's accession into the WTO in whatever way will have an impact on every industry of national economy. Reduction of import custom duties and escalating competition with foreign producers will make things difficult for the majority of Russia's companies, currently providing over 40% of gross output and 60% of employment in manufacture

and agriculture. Lower import duties will cause budget revenues shortfall.

The main issues of trade and its influences on production and consumption were researched by many authors. Particularly, Tinbergen J. (1981) developed the first national comprehensive macro-economic model and applied dynamic models for the analysis of economic processes. The Gravity Model, first used by Tinbergen, explains relation-

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ships, which can arise between two countries or regions, where trade costs increase with distance (Feenstra et al., 2001). Porter M. (2008) developed the competitive strategy and addressed the competitiveness and economic development of nations, states, and regions. Krugman P. (2000) introduced a new vision into trade theory and explained trade between countries by diversification of consumers' choices of brands, and by economies of scale.

Issues of trade integration and liberalization were researched and even put into practice by Hallstein W. (1969) in the European Economic Community, and Devereux M. (1999). Effects of trade liberation for multi-regional trade were studied by Boehringer C. and Rutherford T. (1999), and Estevadeordal A. et al. (2008). For the purposes of the current research we have also addressed Aron L. (2013), the Director of Russian Studies at American Enterprise Institute, who investigated the contemporary issues of Russian political economy and foreign trade; Smutka L., Ishchukova N. and Burianová J., who studied comparative advantages in trade between Russia and the Czech Republic (Ishchukova & Smutka, 2013; Smutka & Burianová, 2013); Ivolga I. and Timofeeva V. (2014), who researched the contemporary issues of food security in Russia. Methodical approaches to analysis of international trade have also been obtained from the works of Bielik P., Smutka L. and Horska E. (2012), who studied development of mutual agricultural trade of Visegrad Group countries.

There are various assessments of major consequences of Russia's accession into the WTO, conducted by Russian and foreign economists. The most known are the ones by the Ministry of Economic Development of the Russian Federation, World Bank (Tarr & Volchkova, 2010), and Russian Academy of Sciences (Gusev, 2012). According to the results of those researches, Russia's GDP may increase in long-term from 1% to 4%. As for the short-term, the GDP expectations vary from (-0.4%) to (+1%). However, those

expectations are primarily related to export of natural resources. Moreover, such optimism is unsupportable in view of the following reasons:

1. Barriers to export of the majority of mineral raw materials and chemical commodities were low (or absent at all) even before Russia's accession into the WTO.
2. Growth of export of agricultural commodities, food, machineries and other manufactured goods is restricted by the existing institutional problems, including custom and VAT procedures.
3. Market promotion of domestic products is problematic because of their low competitiveness, limited capacities of state support, and existing international technical regulations and quality requirements.

Regional particularities of trade liberalization in Russia in view of accession into the WTO were studied by Dyumulen I. (2010). We have also addressed works by Gusev A. (2012), Khusainov B. (2011), and Turlubekov B. (2011) for a wider view of Russia-WTO issues with respect to Custom Union of Russia, Belarus and Kazakhstan. Regional applications of trade liberalization were addressed in the works of Ivolga A. (2014) and Jelocnik M. (Jelocnik & Ivolga, 2012). However, the final trade, economic, and social effects of trade liberalization for Russia are not well-defined. That is especially hard to estimate those effects for separate regions of Russia, since every region has its own set of competitive advantages, which predetermines various effects of trade integration on its local economy. Investigations of existing distortions, weaknesses, advantages, and potentials of separate regions in view of trade liberalization provide an opportunity to take a close look at their competitiveness on the international market, as well as to elaborate ways to a more sustainable development of regional economy and trade (Heijman & Schipper, 2010).

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