Post-socialism is over
Trade reallocation between the EU and Russia

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Recent political background: post-socialism is over, crisis in Ukraine

2014 marks the 25th anniversary of political changes in the former communist countries. Yet, it seems that 'post-socialism' is over. We have now entered a new period of high political and economic instability. The recent events in Ukraine, including the Russian intervention in Crimea and in Ukraine's South and Eastern regions, raise multiple questions about the future trade relations between Russia and EU countries. It is therefore important to discuss their possible consequences for the EU trade with Russia, as EU is the main trade partner of Russia.

In this paper, we investigate the trade trends, structure, and main partners of Russia between 1992 and 2012. We can observe in detail the dynamic of the sectorial trade for Russia since 1992, and we can discuss the possibility for Russia the reallocate (or not) the trade flows from and to the EU. For the EU, we discuss the efficient and feasible sanctions on Russian economic sectors.

The aim of the paper is to discuss trade perspectives for Russia in the next decade. We are using historical data for trade over last twenty years and we aim to underline the vulnerabilities of trade relations with Russia. The global picture shows that Russian economy is very linked to the evolution of its exports, and especially the fuel sector exports. Almost all the GDP trend can be explained by the oil sector exports (see graph 1).

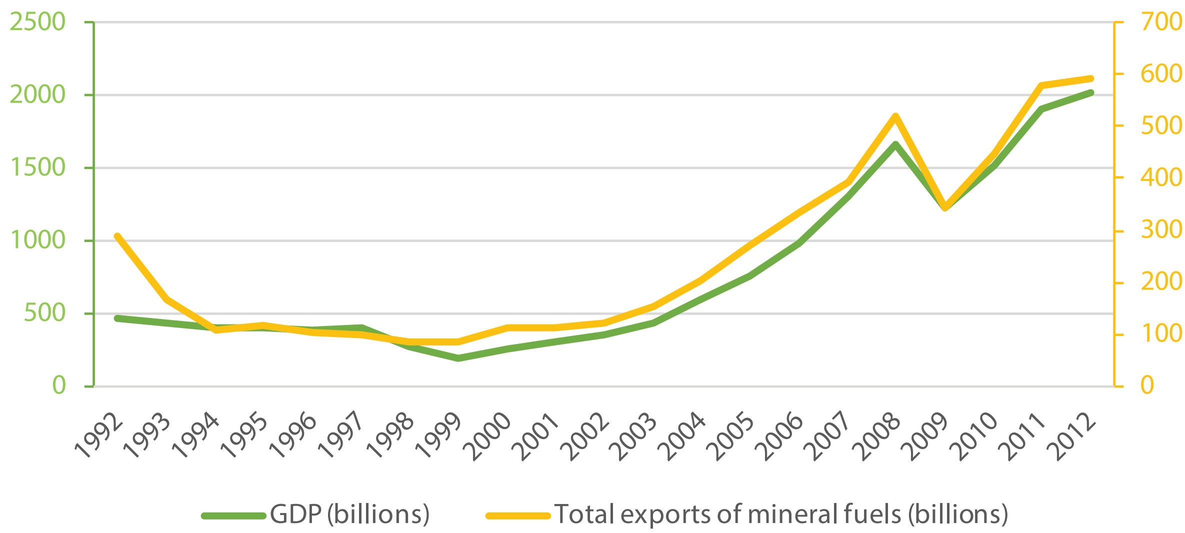
Trade overview: Russia is highly dependent from the EU

The EU is Russia's main trade partner. During The Yeltsin Presidency, Russian exports to the EU have increased from less than 10% to almost 50% of total Russian exports (see graph 2). The trade reallocation was fast and has allowed Russia to increase substantially its trade surplus (see graph 7). Since 2000, the trade openness (at around 50% of GDP) and the EU share in trade are stable (around 45% of total exports). The lack of deeper economic reforms and trade diversification has stopped further trade development in Russia. Today, Russia mainly remains an oil economy.

For the EU, the situation is asymmetric: Russia represents only 7% of total EU exports (4th partner) and 11% of its total imports. EU has a very diversified trade and is able to export high value added products.

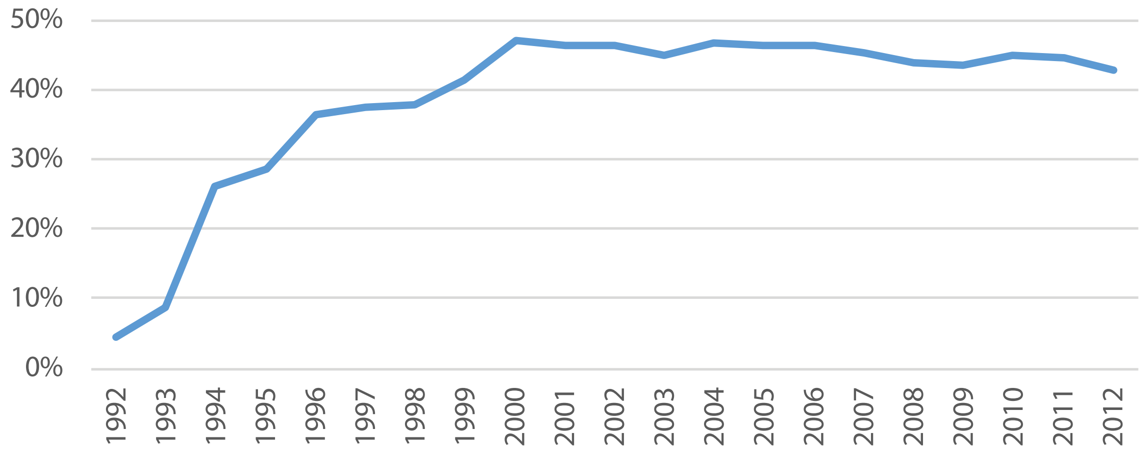
Within the EU, Germany is by far the main trade partner of Russia. Italy, Netherland and France are somehow important but not as a single partner (see graphs 3 & 4). The former trade

Graph 1: Evolution of GDP and total exports of oil and gas in Russia, 1992-2012



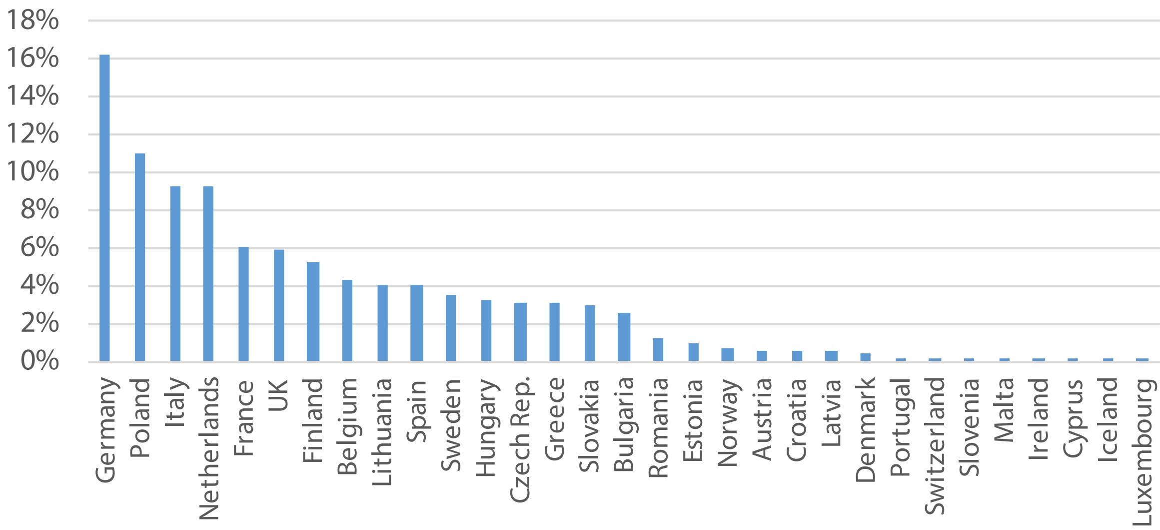
Sources: UN COMTRADE, all values expressed in current US $

Graph 2: Share of exports to EU in total Russian exports, 1992-2012



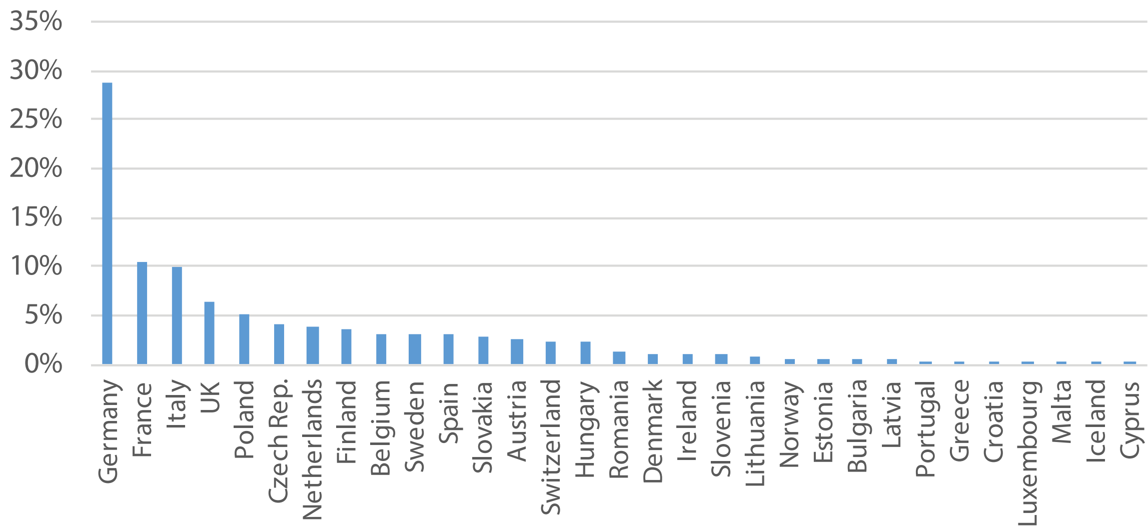
Sources: UN COMTRADE

Graph 3: Share in total European imports from Russia in 2012, by countries



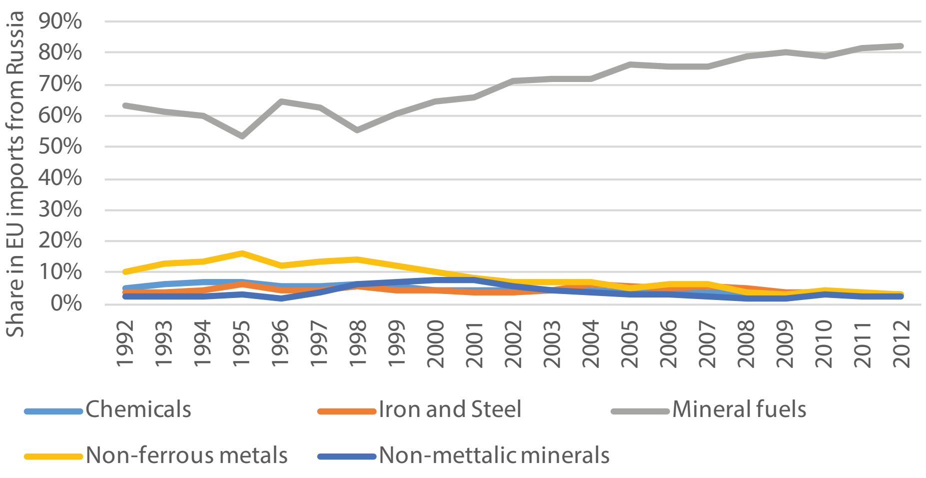
Sources: UN COMTRADE

Graph 4: Share in total European exports to Russia in 2012, by countries



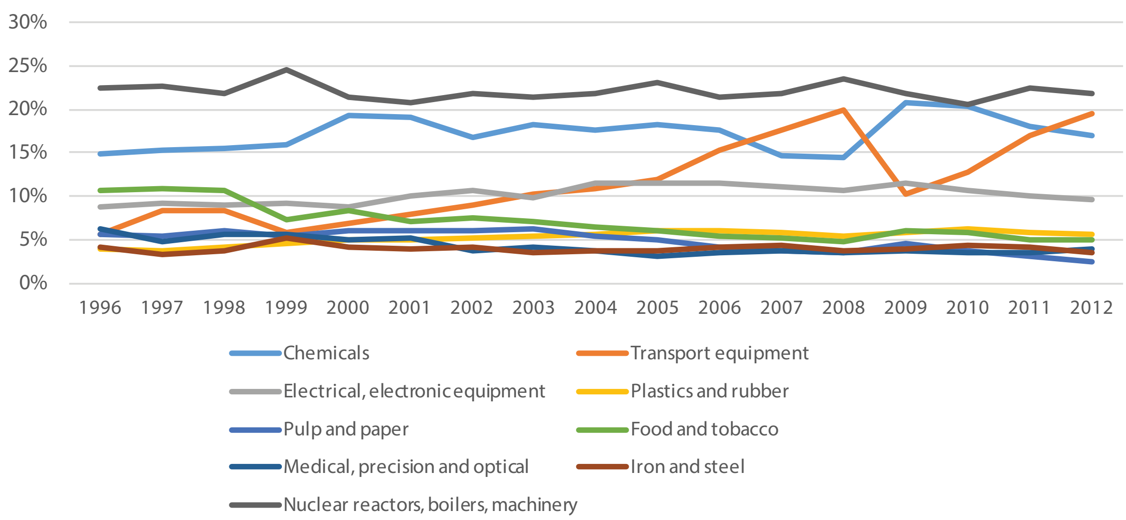
Sources: UN COMTRADE

Graph 5: Evolution of the structure of main Russian exporting sectors to EU, 1992-2012



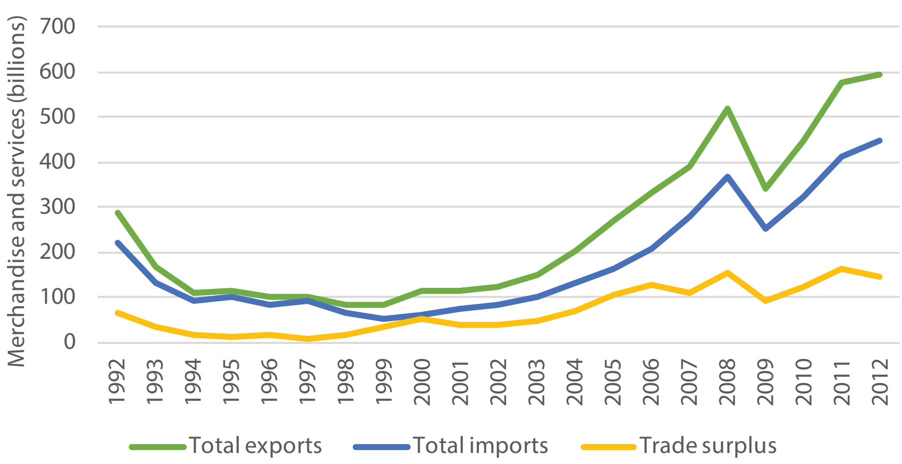
Sources: UN COMTRADE

Graph 6: Evolution of the structure of main Russian import sectors from EU, 1996-2012



Sources: UN COMTRADE

Graph 7: Evolution of total exports, imports and trade surplus (merchandise and services): 1992-2012



Sources: WDI, World Bank, all values in current US $

partners from the USSR period are still present, such as Poland, the Czech Republic, Lithuania, Slovakia or Hungary, but on a lower scale. Hence, in all scenarios on possible trade sanctions against Russia, Germany will be in the centre of the decisions.

Trade specialization: Russia dependence on oil and gas

When we look at trade data, the first surprising fact is that Russian trade structure remains very stable since 1994. The main evolution is coming from the energy sector (oil and gas). The oil and gas sector has increased its share in total exports and represents more than 80% of total exports to the EU in 2012. This is essentially due to energy price increase. Russia is mainly an oil and gas rent economy. Oil, compared to gas, is largely dominant in all trade relations.

Other sectors, mainly metals and mineral sectors, have progressively decreased their share in the Russian exports. Russia faces a deep 'Dutch disease' phenomenon. The oil and gas sectors dominate all its exports and made all other productions uncompetitive. Russian economy is addicted to energy and therefore very dependent on EU for its exports, especially for the fuel sector.

The structure of Russian imports from the EU across sectors is also relatively stable in time, but much more diversified. Half of the imports from the EU are in machinery (and nuclear equipment) sector and durable and semi-durable consumer goods (electrical and transport equipment sectors) (see graph 6). Russia is very dependent on EU for those technologies and is not able (or not competitive) in producing most of them.

Rouble devaluation and trade

Russian interference in the political turmoil in Ukraine led to a sharp devaluation of the rouble. Since the beginning of the Crimean crisis in February the Russian currency lost about 10 percent of its value against the US dollar. And without the intervention of the Russian central bank, the rouble would have devalued even more sharply. Could this depreciation support international competitiveness of Russian exports? It is very unlikely.

Russian exports are outrageously dominated by fossil fuel trade (see graph 5). But oil and other commodities exports (as metals) are traded in dollars on global markets, and thus are not positively affected by more affordable rouble. At the same time Russian imports become more expensive. One of the first direct consequences of the current Ukrainian crisis should be a serious deterioration of the Russian trade surplus balance vis-à-vis the EU.

Trade perspectives: what can be the road?

Since the 1990s, Russian economy has become very globalized, the trade openness is over 51% of GDP (2010-12) and the economy is highly dependent from oil exports. It is therefore impossible for Russia, on the short or medium term, to diversify exports both in terms of sectors and/or partners. For Russia, the EU needs to remain the main trade partner. This is particularly true for natural gas as necessary infrastructures (especially pipelines) freeze trade reallocation at the short run.

Russia is trying to establish new energy partnership with China, but the agreement on gas will take time and resources to be a real alternative for Russia. Russia has no possibilities and interests to reallocate trade relation from EU toward the

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CIS. Russia largely gains from trade with the EU: the Russian merchandise trade surplus in 2012 is about 195 billion and is over 107 billion with the EU (see graph 7).

The EU is not so much vulnerable to a 'trade war' with Russia. For the EU it will be possible, but somehow costly, on the medium term to diversify both in terms of partners and sources of energy. This will be the main challenge for the EU energy policy in the next decade. On the energy issue, the EU independence is at stake.

The main geopolitical concern about the EU-Russia trade involves also natural gas. About 30 percent of gas consumed in EU is provided by Russia, which used in recent years the fear of gas supply disruptions as political weapon (2005, 2009). To some extent EU member states may replace Russian gas delivery to be less vulnerable. In the short term, alternative supply – via LNG from Algeria, Nigeria or Qatar, or piped gas from Norway – or coal substitution, could at least partly replace Russian gas.

In both cases, additional economic or environmental costs will be associated with, even partial, Russian gas replacement. Price of further potential LNG imports should be about 30 % more expensive than current price of gas delivered by Russia. But in the longer run increased renewable facilities (in particular wind), US LNG exports and, most of all, energy efficiency improvements should relax the energy dependency constraint that weigh on many EU member states. Several incentives currently undertaken in EU are pushing in this direction.

What are the feasible sanctions for the EU?

As the political and military situation may deteriorate in Ukraine and in former CIS countries, it is very important to discuss the possible sanctions that EU can impose on Russia. In the energy sector, Russia is very vulnerable to trade sanctions imposed by EU, but most of them are difficult to implement. The oil market is open and the EU has no possibilities to block Russian exports. EU Sanctions in the gas sector are more feasible, but are not as powerful as oil on Russian economy. Probably the most efficient sanctions will be in the financial sector, since Russian banks are very vulnerable. The financial approach will most likely be the most powerful in order to bring back Russia to reasonable and peaceful relations with Ukraine and the EU.

In the long run, the issue for the EU is what can be done to protect European independence from Russian energy and its new political influence and regional destabilization. This is the main task for EU energy and trade policies in the next decade. ■