

## NEW DEVELOPMENTS IN RUSSIA-EU TRADE WITH AGRICULTURAL GOODS: INFLUENCES OF TRADE INTEGRATION

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### Summary

*Trade of agricultural products in the last decades has become more and more globalized. The global trading system is now both freer and fairer than ever before, boosting global prosperity, making significant contribution to global economic development. Main goal of the paper is to analyze the current state of Russia-EU trade of agricultural products. The period of analysis includes 2001-2011. The analysis involved main exporting and importing countries for each analyzed product group. Sub-goals include an overview of the WTO threats and opportunities for Russian agriculture, and trade with agricultural products globally, as well as comparison of main consequences of WTO accession for such CIS countries as Kazakhstan, Ukraine, Kyrgyzstan, Georgia and Moldova. This is also, related to state support of agricultural production in Russia and CIS and its influence on volumes, directions, structure and effectiveness of international trade with agricultural products.*

**Key words:** *international trade, agricultural products, European Union, World Trade Organization, trade integration, Russia, Commonwealth of Independent States*

**JEL:** *F13, F15*

### Introduction

Currently most of the regulatory functions on the global market of agricultural products are implemented by the World Trade Organization (WTO). This global organization unites the majority of the countries, including the main agricultural producers, exporters and importers. However, international trade with agricultural products is still rather far from full liberalization despite the progress achieved in international trade by agricultural production carried out within the framework of the WTO after many rounds of negotiations. Such issues as state regulation of trade, further perfection of sanitary control rules, decrease of custom duties and administration of tariff quotas on imported agricultural production

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would affect the character, structure, directions and dynamics of trade with agricultural products in future. [10]

Until recently only one of the main global producers of agricultural products – Russia was not among the WTO members. Russia's accession to this global trade system in 2012 and membership of some CIS countries in WTO can change the structure and main tendencies of trade with agricultural products significantly. This is especially related to EU-CIS and USA-CIS trade with agricultural products since agriculture is supposed to be one of the most “sensitive” spheres influenced by trade agreements within CIS and Russian accession to WTO.

Many Russian experts foresee that the majority of Russian agricultural industries cannot equally compete with foreign producers. The dependence on import deliveries is critically high. Local agricultural and food products cannot identify customer in foreign and local Russian markets. Russian experts anticipate the decrease of the share of local agricultural producers on the internal market which, in turn, will affect the employment in related industries. Food processing industries, especially meat and dairy, are expected to be the most impacted.

Additionally, trade integration can bring not only damages, but also advantages. Along with a wide range of disadvantages to Russian agriculture resulted from Russia's accession to the WTO, many experts reasonably observe a series of opportunities, especially in the sphere of agricultural export. Russia is a traditional exporter of agricultural products to CIS, EU and USA, and WTO membership can provide easier access to foreign markets for Russian agricultural producers. Trade integration is also a process actively developed nowadays among Russia, Belarus and Kazakhstan (agreement on customs union) and among Russia and Ukraine - the second biggest CIS agricultural producer. [6] These processes, supported by Russia's membership in WTO, will influence significantly the character of international trade with agricultural products in the region.

### **Material and Methods**

The current state of EU-CIS international trade is analyzed on the example of main goods having the biggest ratio in the structure of bilateral trade turnover. Special attention is paid to agricultural products, since agriculture is one of the most “sensitive” spheres influenced by trade integration, including trade agreements within CIS and membership of some of CIS countries in WTO. The period of analysis was 2001-2011. The analysis involved main exporting and importing countries for all analyzed goods.

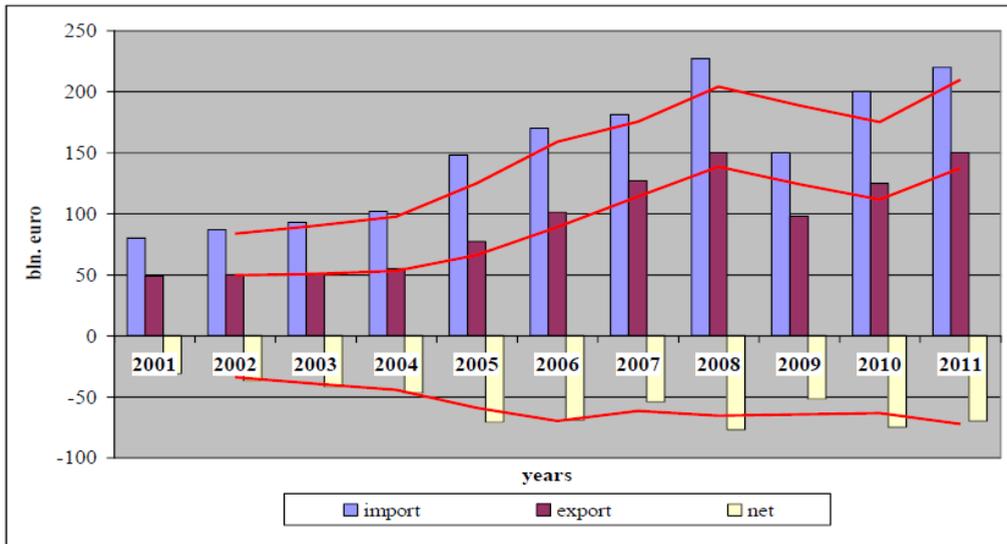
Methods of quantitative and comparative analysis were implemented. The data summarized for 4 CIS countries were compared to EU-27 data. Trade data for this research are from Final Report “International trade and international cargo flows in 2011” by VLANT consulting company. An alternative source is the “Commodity trade between EU-27 and CIS countries, 2000-2010” by Eurostat.

**Results and Discussion**

International trade during post-crisis 2009-2011 was developing multi-directionally. As a consequence of the significant growth of global prices for raw goods, the increase of global trade monetary value in 2011 was 19%. This was lower than 2010 (22%), when international trade experienced active volume recoveries after the economic crisis of 2008-2009s. However, such significant growth should be primarily explained by the growth of global prices – as the quantum index of international trade in 2011 increased only 5% (14% in 2010). This was substantially lower than the pre-crisis levels when the sustainable growth of international economics volumes was observed – up to 10% annually during the preceding decade.

The indicative trend of the post-crisis international economic development is the advanced growth of interregional trade, observed in 2006-2011, even despite the economic recession. This shows the strengthening differentiation of labor at the macroeconomic level. The highest increase of exports was observed for the regions specialized in raw goods supplies. The best import dynamics were in the developing countries (as a result of global imports appreciation) and again the same “raw” regions – as a result of growth of their revenues on the global market, and enlargement of their effective demand. [11]

**Picture 1.** Interregional EU-27-CIS trade in 2001-2011 (in bln. €)



Source: International trade and international cargo flows in 2011 (final report), Consulting company VLANT, 2012, access at <http://vlant-consult.ru>

EU-CIS trade flow remained one of the world’s biggest from 2009-2011, although South-East Asia – East Asia trade flow, the most dynamic one in last decade, was progressively reaching similar levels [1]. Commonwealth of Independent States is the relevant EU-27 trade partner. The annual volume of interregional trade almost tripled – from €109.7 bln. in 2000 to €330.0 bln. in 2011. However, a significant drop of exports and imports in

2009 was recorded as a result of global economic recession. Following rapid (up to 30% annually) growth of interregional trade volumes in 2009-2011, let us forecast the recovery of export and import volumes at 2008 levels even in 2012, as well as the achievement of a horizon of €250 bln. imports and €170 bln. exports in 2013.

In 2001-2011 (except «crisis» 2008-2009), the annual increase of EU-27 imports from CIS countries was 10.1%. Such a high level can be explained primarily by the growth of imports volume from Russia as well as imports increase from Kazakhstan, Azerbaijan and Ukraine.

Russia’s share in the structure of foreign trade turnover between EU-27 and CIS countries remains significant, including the period of global economic recession and considering the non-membership WTO status of Russia until 2012. Russia’s share is 79% of EU-27 imports from CIS countries and 71% of EU-27 exports to CIS countries. The structure of Russian exports to the EU is homogenous during the last decades – over 78% of Russian exports to EU-27 is mineral fuel (2011). EU-27 exports to Russia are much more diversified, mainly consisting of machineries, equipment and transport vehicles (44% in 2011).

**Picture 2.** Dynamics of EU-27 imports from some of the CIS countries in 2001-2011 (in %)



Source: Nilson, A. (2011): *Commodity trade between EU-27 and CIS countries, 2000-2010*, Eurostat, Statistics in focus, Vol. 40, access at <http://epp.eurostat.ec.europa.eu>

During the same period of 2001-2011, the annual average increase of EU-27 exports to CIS countries was 13.9%. The given increase was provided primarily by the growth of exports to Russia, Ukraine, Belarus and Kazakhstan.

Incomplete recovery of European demand for CIS raw goods (especially fuel), caused by the financial and economic difficulties and growth of international competition on the European market, until now prevents the recovery of “EU-27-CIS” trade flow volumes up to the pre-crisis levels. The highest growth rates can be observed for grain and coal sectors. The significant increase is noticed for non-metallic mineral raw materials and

other fuels. However, despite the general increasing trend, some of the commodity groups demonstrated negative dynamics: pipeline gas, oil and iron ore.

CIS countries after USSR collapse developed multi-directionally, but in general they were primarily oriented to European Union as the largest market for their products. Many partnership trade agreements between CIS and EU countries were concluded during 2001-2011.

**Picture 3.** Dynamics of EU-27 exports to some of the CIS countries in 2001-2011 (in %)



Source: Nilson, A. (2011): *Commodity trade between EU-27 and CIS countries, 2000-2010*, Eurostat, Statistics in focus, Vol. 40, access at <http://epp.eurostat.ec.europa.eu>

At the moment, the EU Commission actively supports its partners in trade development, for example, through partnership and collaboration agreements. Most of the Central Asian countries within CIS are the beneficiaries of the Global System of Preferences (trade) of EU-27 countries, as well as active participants of integration in the frameworks of World Trade Organization (WTO) [1].

The WTO membership experience of Kazakhstan can be recognized as one of the most successful amongst CIS countries. Kazakhstan is one of the biggest Russian trade partners in the CIS, which is why the study of its experience can be very valuable. According to World Bank data, investments in agriculture are in second place according to their effectiveness, after oil production in Kazakhstan. The reforms in Kazakhstan started in the same period of the country's WTO accession. The state provides the following privileges to stimulate the development of domestic agricultural production and food processing: cheapening of combustibles and lubricants, lowering of interest rates on credits in second level banks, leasing for special machinery and processing equipment. Purchasing of seeds is subsidized by 40%, their production – from 40% to 100%. The government supports the project related to growing of fruit trees, production of mineral fertilizers and development of pure-strain

stock-breeding. The volume of state support of agriculture had grown 5 times since 2002 and had reached \$924 mln., including \$146 mln. for subsidies, and \$355 mln. for credit programs. Related institutions were also established: JSC “KazAgro”, JSC “KazAgroFinance”, and JSC “Fund of financial support for agriculture”. [8]

It is also necessary to investigate the WTO membership experience of another large post-soviet economy – Ukraine. The main problem for Ukraine is how to support domestic agricultural producers. Liberalization of the trade regime had caused the active interpenetration of the domestic Ukrainian food market with imported agricultural and food products. Since WTO accession, the growth of import volume of agricultural product has reached 11%. The growth of import volume was caused by import deliveries of meat (43% in the structure of increase). Volumes of meat deliveries have grown up to 6.5 times since the country’s WTO accession. It is especially necessary to distinguish the growth of import deliveries of grain and sugar – traditional domestic products in Ukraine.

In 2009 Ukraine had introduced extra custom duties to support the national payment balance (13% for 63 goods, including meat, fish and alcohol). As such measures contradicted WTO rules, the Government of Ukraine shortened the list, leaving only industrial products (automobiles and refrigerators). The volume of state support of agriculture decreased twice in 2010, and budget financing was stopped for seven programs.

In 2009 the Decree of the President of Ukraine “About the report of the Government about the results of WTO membership” was accepted. The document contained measures and trade procedures aimed to protect domestic producers on the domestic market from dumping and subsidized imports, as well as activities to stimulate the increase of domestic goods supply on the domestic market.

The excessive liberalization and openness of the Ukrainian domestic market are testified by the data on the GDP structure. During 2000-2004 the total export and import steady exceeded 100% (export exceeded import). [3] Since 2006 the opposite picture had been observing: import exceeded export, i.e. the national economics had transferred to the import-dependent model of foreign trade relations.

Accordingly, the macroeconomic consequences of WTO accession for Ukraine testify that the membership in this international organization has not brought the expected positive results in economics. Agriculture turned out to be exceedingly exposed to the influence of the negative factors of the global crisis because of the high dependency on the external trade.

In 2005-2011 import volume of vegetables and fruits to Ukraine had sharply increased (\$860 mln., growth of 4.2 times compared to 2005). Additionally, the volume of import of fruits and vegetables had increased by 77%. It is especially important to note the growth of import of agricultural products traditionally produced in Ukraine. In 2005-2011 import of potatoes, cabbage, onion, carrot, tomatoes and cucumbers increased by 18.5 times (up to 190 thousand tons), apples, pears, cherries and apricots increased nearly fivefold (up to 210 thousand tons). Since January 2011 Ukraine (according to the undertaken WTO obligations) cancelled the

import duties on alcohol beverages. Consequently the domestic production of grape wine decreased for 41.3%. Import volume of pork increased by 2.9 times, the import share of this product on the domestic market reached 40%.

Thus, during three years of WTO membership, Ukraine has lost more than it has gained. This should be the subject of initiation of negotiations on correction of WTO obligations for Ukraine.

Kyrgyzstan's experience of WTO membership can be recognized as one of the most negative. Kyrgyzstan officially entered the WTO on December 20th, 1998. The negotiations lasted about 2.5 years. The first thing attracting attention is the precipitation of Kyrgyzstan's entry. According to experts' estimates the country's rapid entry to this organization remains the single precedent of its kind. It has caused negative consequences because of the insufficient due diligence accession obligations. For example, Kyrgyzstan had not preconditioned the status given to a developing country, thereby losing the related preferences.

Establishing of the equal conditions for domestic and foreign products on the national market became one of the most negative consequences for Kyrgyzstan. This negatively rebounded upon the domestic industry in the period of reconstruction. International experience shows the strict dilemma for such countries as Kyrgyzstan – “goods or investments”. Kyrgyzstan's accession to WTO closed the domestic market for investments, opening it for imported products. This led to the growing raw-material orientation of the Kyrgyzstan's economic and prolonged recession in its various sectors, including agriculture (which share in the national economic is 80%). Entering WTO, Kyrgyzstan was obliged to cancel export subsidies for domestic agricultural production, to refuse to implement licensing and quotas for agricultural imports, and to charge import products with no more than 10% custom fee. Currently Kyrgyzstan, in spite of their long membership in WTO, has one of the worst economic indicators throughout the CIS.

Georgia entered to WTO slightly later than Kyrgyzstan (in 2000), and more because of political reasons than out of economic necessity. The haste of which Georgia accepted the offered obligations has led to difficulties in completing undertaken obligations. For example, the sectorial initiatives in agriculture were not implemented because of the contradictions with the International Monetary Fund (IMF), as well as the special custom tariffs for agricultural raw materials and machinery was not introduced.

For Moldova the process of WTO accession became longer than for Georgia and Kyrgyzstan (8 years of negotiations, accession in 2001). However, this long period can be explained by the absence of a clear economic policy of the Government of Moldova, and not the detailed working out of the accession conditions. The state support of agriculture – the main pillar of Moldova's economy – became one of the most difficult. Moldova was able to defend the necessity of subsidies for agriculture, but undertook the obligation to shorten the volume of support on 16% during four years. [5]

During the first years after Moldova's accession to WTO, the situation in agriculture

worsened: growth rates slowed, the production volume decreased by 14%. Starting from 2005, the situation became steadier. The annual growth reached 1-2%. By entering the WTO, Moldova planned to gain wider access to the global market of agricultural production, especially for its main export product – alcoholic beverages. Largely these expectations became true – the export volume increased twofold since WTO accession, especially to non-CIS countries. Processed food products became the main part of import volume.

Membership of some of CIS countries in WTO and recent Russian accession to this global trade system can change the structure and main tendencies of EU-CIS trade significantly. This is especially related to EU-CIS trade with agricultural products, since agriculture is supposed to be one of the most “sensitive” spheres influenced by trade agreements within CIS and Russian accession to WTO. [2]

World trade in agricultural products in 2010 increased 12% compared to 2008 and reached record highs. EU-27 stood as the largest importer of agricultural products in the world. Increased trade in agriculture was due to product demand from major emerging economies compared to previous years. World agricultural trade reached an all-time high, at least 12% (expressed in Euros) above the previous record set in 2008. The impact of the economic crisis led to a contraction of 6% in global agricultural exports in 2009 but they rebounded by 20% in 2010.

The EU as well as other top exporters all benefited from buoyant markets. Following the slump in 2009, the EU, the US and Brazil bounced back with over 20% growth in exports, to reach record levels in 2010. The EU’s trade balance improved to the extent that it emerged from recession as a net exporter in 2010, for the first time since 2006. The €6 billion agricultural trade surplus is largely due to expansion in the value of exports, driven by stronger demand for final products, as the EU’s key trading partners come out of recession and higher prices for commodities and intermediate goods.

The EU remains by far the world’s biggest importer with imports worth €83 billion in 2008-10, well ahead of the US. EU imports grew by 9% in 2010 though they remain 5% below the peak of 2008, when they reached €88 billion. This is a result of the sharp drop of over 12% in 2009 after two years of very strong growth of over 13% per year. The EU’s share of global imports was over 19% in 2009. US imports grew strongly by 17% in 2010, having suffered a less severe decline (just 5%) than the EU in 2009.

The EU’s trade balance continued to improve in 2010 to the extent that it switched from being a net importer with a trade deficit of €2.5 billion in 2009 to a net exporter, for the first time since 2006, with an agricultural trade surplus of over €6 billion. The surplus is largely due to growth in the value of exports after the contraction of trade in 2009 linked to economic crisis and the drop in commodity prices. The EU and the other top exporters all benefited from buoyant export sales. Following the slump in the value of agricultural exports in 2009, (8% for the EU and 10% for the US), last year they both bounced back with spectacular growth of 21% and 24% respectively. For the past 3 years, the EU and the US have been roughly neck and neck as the world’s leading agri-food exporters.

## Conclusions

The EU's export profile has changed little in recent years. Final products and other products together account for 69% of the value of EU exports in 2008-10, while intermediate products and commodities represent 20% and 9% respectively. 12 of the top 14 exports were final products, the exceptions being wheat (a commodity), milk and cream and odoriferous substances (other products).

It is possible to forecast that in the mid-term, the structure of EU-27-CIS foreign trade turnover will not get changed significantly. CIS-EU trade flow will primarily consist of raw commodities. Its largest constituent will remain oil. There will be also relevant (but not comparable to oil in their sizes) shares of pipeline gas, coal, petrochemicals and iron ore. CIS deliveries would be mainly formed by Russia. Ukraine and Kazakhstan would also become big suppliers. The main CIS importer among EU-27 countries will be Germany, followed by Italy. The Netherlands and Poland will increase their shares in EU-27 imports from CIS countries. [4]

Export of agricultural products from EU-27 to CIS countries will grow in the mid-term. The growth will be caused by a number of reasons, particularly:

1. Continuing liberalization of inter-regional trade within CIS, as well as a result of multilateral EU-CIS agreements.
2. Russia, which is the largest economy of the region, accessed to WTO.
3. Low competitiveness of CIS domestic agricultural producers comparing to EU and US farmers, supported by their governments (especially in food production and high-level food processing where added value is the largest).
4. Incomparably lower volumes of state support for domestic agricultural producers not only in CIS-countries, but even in Russia, that does not provide sufficient protection of inter-regional market and do not allow to develop effectively high-quality food processing and food production in CIS-countries. [7]

WTO and trade liberalization obviously bring a set of opportunities for an accessing country. WTO is based on an equality of rights and obligations. This means that EU countries are obliged to open their domestic markets for CIS agricultural and food products. However, most of the CIS-countries, including Russia, cannot fully benefit from these opening opportunities. The state is not able to support the massive expansion of domestic farmers to European markets. Transition period can take long time. If CIS and Russia do not use new opportunities today, better times may not come at all.

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