

Prospects and Threats of Implementing the Export-Oriented Import Substitution Policy in the EEU Territory

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Abstract: - The article assesses the potential for deepening the integration of the Eurasian Economic Union (EEU) member countries using the example of the agro-industrial complex, identifies integration and disintegration trends, as well as problems that impede the strengthening of partnership relations. The authors have analyzed state support measures aimed at solving these problems. The present study shows possibilities and directions of deepening integration based on the Russia's export-oriented import substitution policy. It was concluded that the development and improvement of measures of state support for the food industry and the agro-industrial complex should be formed considering the assessment of such supportive policy from the perspective of trade in value added. The authors have analyzed possible use of integration tools for enterprises of the agro-industrial complex. The study identifies industries with stable export potential. The analysis of the EEU export-import flows by disaggregated product segments shows the availability of mutual exchange of finished products within the same commodity group, which can be considered horizontal cooperation, but not vertical cooperation.

Key-Words: - export-oriented import substitution, the Eurasian Economic Union (EEU), economic integration, agro-industrial complex.

1 Introduction

In connection with the transfer of significant competencies to the level of the EEU in the key areas of economy and regulation of foreign trade, there is a tendency to build a direct dialogue between the EEU and several developed and developing countries, as well as the possibility to move from the “Russia – foreign countries” model to the “EEU – foreign countries” model [1-3]. It is expected that the deepening of the Eurasian integration, the active development of interconnections within the EEU

framework, the functioning of a unified market and the involvement of the EEU member countries in the implementation of the Russian export-oriented import substitution policy based on regional value chains will contribute to the modernization and growth of economies, their productivity and welfare. In this regard, agriculture and agro-based industries can provide significant potential and wide opportunities to build value chains.

The policy of export-oriented import substitution is particularly important in the view of a serious complication of geopolitical conditions of the EEU

countries' development and the imposition of economic sanctions against Russia, which is the main driver of the Eurasian integration project.

In this regard, it seems important and relevant to assess the potential of integration and involvement of the EEU member countries in the Russia's export-oriented import substitution.

2 Literature review

Import substitution, as one of the main directions of the Russia's economic policy, starting from 2014, is perceived by the scientific community ambiguously. There is a broad discussion in economic literature about the need and effectiveness of the import substitution policy, often identified with the policy of protectionism. The position of "openness" of economy and "involvement" in the world economy [4] is based on a sufficiently reasoned scientific platform, but is an extreme, as well as its opposite position "self-support only" which is import substitution in the conditions of protectionism [5].

The expediency of foreign trade liberalization depends on many factors and on the specific situation in a given country at a given time [6], the strategy of "import for export" has no effect on the companies' and the industry growth performance outside their involvement in the global value chain, just like the assertion that foreign direct investment brings new technologies to the country, which is only partially true [7].

Several authors adhere to the view that Russia did not and does not have any reasons to pursue the policy of import substitution, and the failure of this policy will become beneficial to the country's economy, since the policy of import substitution cannot lead to the modernization of economy and acceleration of economic growth due to its negative impact on competition and performance. In case of successful realization of the import substitution policy, only certain sectors would benefit if the economy as a whole slows down [8-9]. The mechanisms of strategic import substitution are described in the work of Berezinskaya and Vedev [10]; the import substitution policy from the perspective of state planning is analyzed in the article by Manturov, Nikitin and Osmakov [11].

The issues of the import substitution policy influence on the competitiveness of Russian enterprises and the dynamics of sectoral development

of the Russian industries in the initial period of import substitution were highlighted in the works of Kheifets [12], Idrisov and Ponomareva [13], Idrisov [14], and Sukharev [15-16]. In addition, Russian practice in the food industry and agro-industrial complex shows examples of successful import substitution with subsequent export growth. The economic integration of Russia and its participation in economic partnerships are described in the works of Golovnin, Zakharov and Ushkalova [17] and Kheifets [18-20]. Lessons for Russia based on the foreign countries' experience are analyzed in the article by Zagashvili [6]. World experience of import substitution policies in different countries shows that such a policy can be effective, and even with its limitations can form a new structure of economy [13].

The role of the agro-industrial complex as a generator of economic growth, its current status and opportunities have been analyzed by Kuzovleva and Sukharev [21]. The role of the agro-industrial complex in the "sanctions" confrontation between Russia and the Western countries and the development of the agro-industrial complex under sanctions, as well as the effect of embargoes in foreign trade, production and market-consumer measurements, considering the effect of cheapening, are addressed by Frumkin [22]. All this leads us to conclusion that the most important goal of selective export-oriented import substitution in Russia, considering its high dependence on commodity exports, should be diversification of production and export of products in accordance with the existing competitive advantages and demand in the world market [23].

3 Results

The analysis of potential for deepening integration and involving the EEU country members in the Russia's export-oriented import substitution in the present study was carried out on the basis of statistical materials of the Federal Service for State Statistics of Russia, the Federal Customs Service of Russia, the World Bank, the Eurasian Development Bank, statistical data, analytical materials and published reports of the EDB Centre for Integration Studies.

One of the key indicators characterizing the deepening integration in the EEU area is the mutual trade, the intensification and diversification of which are significant factors in cooperation potential between the member countries of the integration association [24].

During 2015 and 2016, there was a further reduction in trade turnover within the EEU. The strongest decline in the mutual trade happened in the first half of 2015, when this indicator fell by 26.1%. In 2016, the volume of mutual trade of the member countries of the EEU declined by 6.7% with an increase in physical volume by 0.4% and amounted to 42.6 billion US dollars. It is worth noticing that the volume of mutual trade shows a negative trend since 2013. The growth of mutual trade in 2016 was noted in Armenia, domestic exports slightly increased in Belarus and Kyrgyzstan, a significant decline in domestic exports was marked in Kazakhstan. Domestic imports significantly decreased in Kyrgyzstan, Kazakhstan and Belarus (Table 1).

Country	Domestic exports	Domestic imports
Armenia	+53.04	+8.74
Belarus	+2.25	-10.68
Kazakhstan	-23.49	-13.79
Kyrgyzstan	+4.43	-23.19
Russia	-7.87	+1.00

Source: [25].

Table 1 Change in the mutual trade of the EEU member-countries in 2016 in % compared to the level of 2015

However, the reduction in trade with third countries in 2016 was more intensive than the reduction in mutual trade. According to data for 2016, the volume of foreign trade turnover of the EEU member-countries with third countries decreased by 12% (69.6 billion dollars), while exports decreased by 17.5% (65.4 billion dollars), imports – by 2% (4.2 billion dollars) compared to the level of 2015. The volume of exports to third countries still significantly exceeds the volume of mutual trade. In 2016, external exports exceeded the volume of all the mutual trade of the EEU member-countries by 7.3 times.

China is the largest trading partner of the EEU: in 2016, this country accounted for 15.4% of the EEU's foreign trade, which is 1.8% greater than in 2015. The shares of Germany, the Netherlands, Italy and the USA are also significant. In 2015-2016, the signs of a "Turn to East" became more apparent in foreign trade of the EEU member countries. Thus, in 2016, the share of the EU member-countries in the EEU's foreign trade turnover decreased by 2.3%, while the share of APEC countries increased by 1.8% and amounted to 31.5% [26].

The rapprochement with the East is characterized by negotiations on the conclusion of free trade

agreements with Iran, India, Egypt and Singapore, first round of negotiations with China to conclude a non-preferential trade agreement and the entry into force of the Free Trade Agreement with Vietnam [25].

In 2017, there were signs of increasing the degree of commodity diversification in mutual trade with the trend of increasing the share of exports of metals, machinery and equipment and reducing share of mineral resources. The decline in the share of energy carriers is largely due to the reduction in oil supplies to the Republic of Belarus by the Russian Federation caused by oil and gas disputes between the countries [25]. At the same time, mineral resources continue to dominate in exports to third countries and the volume of exports of products with high added value is much lower than in exports within the integration association.

Food and agricultural raw materials have a significant share (16.1%) in the commodity structure of mutual trade of the EEU member-countries. For instance, in conditions of the Russian embargo, a significant portion of food goes to the territory of the Russian Federation from the CIS countries. In 2017, the share of imports of foodstuffs and agricultural raw materials from the CIS countries in the total volume of imports was 19.1%, but already in the first month of 2018 it fell below the 2016 level (18.1%) and amounted to 17.4% [27].

The volume of mutual trade in food and agricultural products in the EEU as a whole decreased in vegetable products and ready-made foods, including alcoholic and non-alcoholic beverages and tobacco, live animals and products of animal origin slightly increased and the volume of trade in fats and oils of animal and vegetable origin increased by 9% (Table 2).

The crisis in Russia had a significant impact on the reduction of mutual trade, since Russia has the largest economy among the EEU member-countries and ensures the highest level of participation in trade, given that the export-import operations of the EEU member-countries are almost entirely oriented toward the markets of Russia.

The reasons for a decrease in trade of the EEU member-countries are very different, the most important ones are: the influence of price factors, due to the prevailing share of energy resources in the international trade of the EEU; the global economic growth slowdown (2.438% in 2016 against 2.734% in 2015) [28]; preservation and extension of the sanctions regime and the response measures of Russia

as a key player in the EEU's trade; negative trend in GDP and industrial production of the two largest participants of the EEU – Russia and Belarus; decrease in the exchange rates of the national currencies against the US dollar. Despite the fact that

in 2016 – early 2017 the negative dynamics of mutual trade did not stop, the rate of decline was lower than for the trade with third countries. Thus, to some extent, the EEU acts as a shock absorber for the negative impact of external shocks.

Name of product	Armenia	Belarus	Kazakhstan	Kyrgyzstan	Russia	EEU, total
Live animals; products of animal origin	-37.5	2.8	-31.2	-47.6	1.2	0.7
Vegetable products	× 2	-28.5	-7.6	70.8	-4.2	-11.2
Fats and oils of animal or vegetable origin and the products of their cleavage; ready-made edible fats	-	-9.4	-41.2	x 8.2	13	8.9
Finished food products; alcoholic and non-alcoholic beverages and vinegar; tobacco and its substitutes	46.6	-25.2	-3.7	-34.7	0.6	-5

Source: [25].

Table 2 Dynamics of mutual trade in food and agricultural products of the EEU country-members for 2016, y/y, %

The analysis of vertical intra-industry trade plays an important role for evaluation of the prospects of integration processes and the development of production cooperation. To assess the dynamics of mutual trade and identify commodity groups (industries) that have the potential to build up mutual intra-industry trade and potential cooperation options, the Grubel-Lloyd index is used, which is calculated according to the formula [29]:

$$I = 1 - \frac{|X - M|}{X + M} \quad (1)$$

where I is the Grubel-Lloyd index; X is the volume of goods export; M is the volume of goods import.

The index helps to determine which commodity groups are beneficial for intra-trade relationship development. The values of the Grubel-Lloyd index range from zero to one, the value $I = 0$ characterizes the absence of mutual trade flows, and $I = 1$ means a complete coincidence in the volume of mutual trade flows. With the value of the index $I > 0.33$, one can speak about the presence of intra-industry trade. If the index takes values from 0.10 to 0.33, it characterizes the potential for intra-industry trade development, and if the index value is lower than 0.10, in this case the intra-industry trade is almost absent [30].

An important prerequisite for deepening the integration of the EEU countries in the agricultural sector is its rapidly growing potential in Russia, which has already come in second place among the large commodity groups of Russian export. At the same time, in 2017, the export of food and agricultural raw materials to world markets increased by 21.5% to

\$20.3 billion and its share in the value of non-primary exports amounted to 15.2% (in 2016 it was 15.3%) (Sukharev 2015), outperforming the export of arms. According to the government, in four years, Russia plans to supply more food products to the world markets than to import it into the country. That is, Russia will become a net exporter of foods [31].

The assessment of intra-trade among the EEU member-countries on the basis of Grubel-Lloyd index in accordance with the methodological approaches to analysis of integration processes in the Customs Union and Unified Economic Space [25] indicates the presence of intra-industry trade in “cocoa and cocoa products” commodity group (0.33) and a high potential for development of intra-trade in such commodity groups as: “live animals” (0.31) “oil seeds and fruits” (0.30) “cereals” (0.29) “animal products” (0.29) , “various food products” (0.28), “dairy products, eggs” (0.27), “coffee, tea, spices” (0.27) (Table 3).

However, the analysis of export-import flows by disaggregated product segments shows the availability of mutual exchange of finished products within the same commodity group, which can be considered horizontal cooperation, but not vertical cooperation [29-30]. Thus, within the framework of “cocoa” product group, the EEU countries trade mainly in chocolate, the share of which in this commodity group exceeds 99%. For example, in 2017 Russia imported from Kazakhstan, while both countries import cocoa beans and cocoa butter from other countries (Cote d'Ivoire, Indonesia, etc.). It

should be noted that the largest producer of chocolate and chocolate products is the Nestle company.

Product groups	The Grubel-Lloyd index				
	Armenia	Belarus	Kazakhstan	Kyrgyzstan	Russia
Vegetables, roots, tubers	0.15			0.19	0.10
Fruit, nuts	0.10				
Cocoa and its products	0.19		0.33		
Various food products	0.20		0.11		0.28
Alcoholic and nonalcoholic beverages, vinegar	0.23			0.17	
Live trees and other plants		0.11			
Oil seeds and fruits; straw and forage		0.18		0.30	
Ready-made products from meat, fish		0.21	0.14	0.13	
Fats and oils of animal and vegetable origin		0.23	0.21		
Live animals			0.31		
Dairy products, eggs, honey			0.27		0.15
Cereals			0.29		
Ready-made products from grain cereals flour, starch, milk			0.20		
Other products of animal origin				0.29	
Live trees and other plants, bulbs, roots, cut flowers				0.25	0.24
Ready-made products from grain cereals flour, starch, milk				0.16	
Products of vegetable, fruits and nuts processing				0.13	
Tobacco and industrial tobacco substitutes				0.17	
Meat and edible meat co-products					0.21
Coffee, tea, spices					0.27
Shellac, gums, resins, other vegetable juices and extracts					0.21

Source: [25].

Table 3 Potential for increasing mutual trade and cooperation in the food industry and agro-industrial complex by commodity groups

As for “tea, coffee and spices” commodity group – there is also a mutual exchange of finished products, mainly tea. The raw materials for production of tea is imported from Sri Lanka, India, China, which is further packed at tea-packing factories placed in the territory of the EEU countries. In particular, the Unilever company (which owns Lipton, Brooke Bond and Beseda brands) exports its finished products to the EEU countries. Whereas, according to this method, the important export-oriented sectors of the Russian food industry and the agro-industrial complex do not have potential for integration development.

In the opinion of the authors, it is necessary to develop the integration of the EEU member countries not in the sectors with equal export-import flows

between the EEU countries, but in the sectors oriented to the world market. According to the Federal Customs Service, in 2016-2017 the main export-oriented industries were: in the group “products of animal origin” – “fish” (85%), “meat and meat products” (7%); in the group “vegetable products” – “cereals” (81%) and “seeds, grains, medicinal plants” (7%); in the group “food, beverages and tobacco” – “food industry waste and animal feed” (21%) and “tobacco” (16%). Moreover, in the first two groups, the export destinations were foreign countries and mainly commodities with low added value were exported to those countries. The main export countries in the “food products” group were CIS countries.

For a number of products of the food industry and agro-industrial complex, the volume of national production now exceeds the volume of consumption. Exports of such products has become a prerequisite for further growth of production and preservation of investment attractiveness. Thus, the volume of poultry meat production increased from 1997 to 2016 by more than 7 times (from 630 thousand tons to 4631 thousand tons). Since 2005, the import of this product has been reduced by almost 6 times (from 1318.3 thousand tons to 223.7 thousand tons) and exports has been increased (the volume of which in 2016 amounted to 121.4 thousand tons) [27]. By 2020, it is planned to increase the volume of export by 3 times and export 370 thousand tons of poultry meat [32]. Stable export potential is shown by sugar-beet industry, grain production, milling industry, oil and fat industry, products with high marginality, production of poultry meat and eggs, confectionery industry.

4 Discussion

The policy of export-oriented import substitution with the formation of production chains in the space of the Eurasian Union may have a chance of success, provided that the foreign trade barriers are removed and selective import substitution is carried out with concentration of efforts in individual industries [23]. It is expected that the deepening of the Eurasian integration, the active development of interconnections within the framework of the EEU, the functioning of the unified market and the involvement of the EEU member countries in the implementation of Russian export-oriented import substitution policy will contribute to the modernization and growth of the economies [33]. It is obvious that the Russian economy has the necessary resources to implement the policy of import substitution [21]. However, it is impossible to ignore the presence of constraints to the import substitution.

Among the essential problems of import substitution, we cannot but notice the lack of sufficient demand for some types of Russian import-substituting products and the reduction of competition in the Russian market [4, 12], as well as the continuing high import dependence in the manufacture of certain types of agricultural products. In the production of sugar beet, the share of the import content is 60%, in the structure of the cost

price of potatoes, carrots, cabbage this share amounts to 75%, and in the structure of vegetable crops the share of imported seeds is 65%, of potatoes crops – 53%, of maize crops – 34%.

Several barriers to integration today pose a challenge to the regional fragmentation of production: institutional and administrative barriers, a low level of investment and innovation activity, periodically arising contradictions and tensions between the countries. One of the main reasons for the growth of disintegration processes in the EEU at this stage is the aggravation of relations between Russia and Western countries and their allies, whilst Russia's partners in the EEU – Belarus and Kazakhstan have clearly indicated their intentions to maintain close economic contacts with those countries [34]. This is due not only to national-political, but also purely economic reasons, primarily the need to diversify market outlets. As a result, Russia's bilateral relations with its EEU partners are low and the integration tendencies are closely intertwined with disintegration tendencies.

From our point of view, the most significant among the internal factors are:

- (1) the continuing decline in real incomes of population, especially in Russia and the Republic of Belarus, the decline in living standards; weak consumer confidence, leading to a gradual change in the consumption pattern; the reduction in household consumption expenditure on final consumption and the low consumer activity;
- (2) the unequal distribution of the EEU's economic benefits between the member-countries [35]. The main beneficiaries are Russia's partners due to reorientation of export flows (from China instead of the Russian Far East to Europe through Kazakhstan) [34].

The contradictions of relations between the member countries of the integration project, which arose earlier, prioritized in late 2016 – early 2017. This refers to the new challenge in the form of tension exacerbation between the Republic of Belarus and the Russian Federation. Russia's embargo led not only to a change in the volume of supplies, but also to almost complete reorientation of the Republic of Belarus to the Russian market, in effect replacing the import of sanctioned goods to Russia [34]. According to the Federal Customs Service and the analytical

reports of the Eurasian Economic Commission, Belarus' imports of milk and cream has increased by 987.5 times compared to 2010 (from 56 tons to 55.3 thousand tons), cheese and cottage cheese – by 4.5 times (from 510 tons to 2.3 thousand tons), yogurt and kefir – by 425 times (from 0.4 tons to 170 tons), butter – by 7 times (from 1.7 tons to 12 tons). A major exporter of dairy products from the Republic of Belarus is Russia, whose share in the total volume of exports of dairy products was 94% in 2015 (50.5% in 2010). In 2014 and 2016, the share of milk and dairy products has increased from 49% to 75.5%; the share of processed meat and fish products was 58%. Moreover, the share of vegetables, meat and meat products has doubled. At the same time, Belarus's exports to the world market have decreased by 2.2 times.

The results obtained allow concluding that the initiators of the formation of the regional value chains can become large producers of agricultural products and foodstuffs. The formation of the regional value chains in this case will be determined by the following target settings:

- (1) enterprises' productivity and efficiency growth due to redistribution of knowledge, transfer of technology and reduction of production costs;
- (2) cost reduction due to attracting labor from the EEU countries with lower labor costs or relocation of some agricultural enterprises to the EEU member countries with more suitable natural and climatic conditions for several branches of agriculture;
- (3) reduction of X-inefficiency of agricultural enterprises and food industry due to increased competition with a greater specialization.

5 Conclusion

It is obvious that import substitution will lead to modernization of the economy, an increase in productivity and welfare growth only if the national production becomes competitive in the world market. An essential condition of this is the export orientation. Further development of import substitution policies must be based on the country's involvement in global or regional value chains. At the same time, agriculture and the agro-industrial sector can provide significant potential and wide opportunities for building value chains. The results show that the EEU's beet-sugar industry, cereal

production, grain processing industry, fat and oil industry, high margin products, poultry meat production, and confectionery industry have sustainable export potential. The analysis of the EEU's export and import flows by the fragmented product segments leads to the conclusion that there is a mutual exchange of finished products within the same commodity group, which can be considered horizontal cooperation, but not vertical cooperation.

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