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"They Can and Must Increase": An Analysis of U.S.-Russian Economic Relations in International Comparison

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Pressing the reset button in U.S.-Russian relations has moved into the spotlight since the Obama administration took office in January. Among the main topics of interest are nuclear arms reduction and non-proliferation, missile defense shields, the war on terror, and NATO enlargement. A topic which has seldom made headlines is economic relations, although an exception was a recent statement by John Beyrle, U.S. Ambassador to Russia, who claimed that "the volume of Russian-U.S. trade can and must increase."[1]

Economic ties are important in their own right but may also help to provide stability to the broader U.S.-Russia bilateral relationship.[2] This Issue Brief therefore takes a closer look at bilateral economic relations between Russia and the U.S., focusing on trade and direct investment. It turns out that current trade and investment levels between Russia and the U.S. are low and there is room for improving the status quo. At the same time there are many structural and institutional factors *a priori* impeding flourishing U.S.-Russian economic relations. Although their economic relations are sometimes even perceived as exceptionally low, it is noteworthy that on several measures they are not lower than U.S. economic relations with other major emerging markets.

STATUS QUO: TRADE

In recent years, trade between Russia and the U.S. has grown rapidly but it is still on a low level. Since 2000, U.S. exports to Russia have increased 22 percent per year on average while U.S. imports from Russia have risen 19 percent annually. Still, at $9.3 billion, Russia accounted for only 0.7 percent of U.S. exports and, at $26.7 billion, for only 1.3 percent of U.S. imports in 2008. Vice versa, the shares are slightly higher with the U.S. accounting for 3.3 percent of Russia's exports and 4.4 percent of Russia's imports.

To analyze trade in more detail, we broadly distinguish between inter-industry trade, where exported and imported goods differ, and intra-industry trade, where exported and imported goods are of the same kind. Given the largely differing industrial structure and resource endowments of Russia and the U.S., it is not surprising that U.S.-Russia trade is dominated by inter-industry trade.

Despite the fact that the overall level of trade is low, there are some surprises hidden in the data. Notably, Russia is one of the largest export markets for chicken, with 39 percent of total U.S.

Are the absolute volumes of trade between the U.S. and its trading partners converging or diverging?

What can business and policymakers do to strengthen U.S.-Russian economic ties?

How would Russian membership in the WTO impact economic relations?

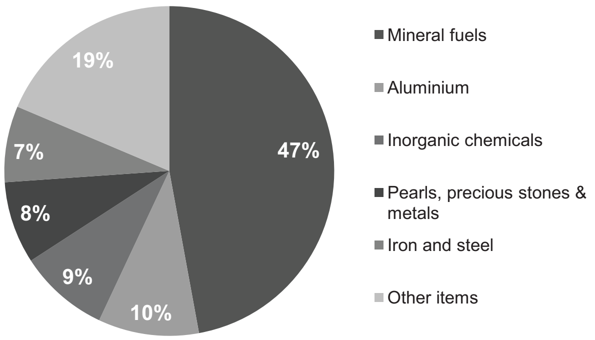

CHART 1: MAIN U.S. IMPORTS FROM RUSSIA, %

Source: U.S. Department of Commerce, DB Research

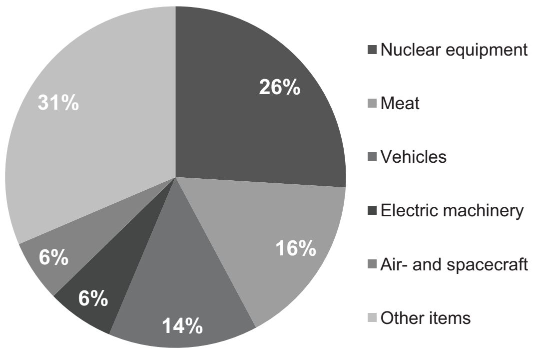

CHART 2: MAIN U.S. EXPORTS TO RUSSIA, %

Source: U.S. Department of Commerce, DB Research

chicken exports going to Russia in 2008. On the import side, Russia for instance accounts for 32 percent of U.S. fertilizer imports.

STATUS QUO: DIRECT INVESTMENT

Bilateral foreign direct investment (FDI) shows lower figures than trade: Russia accounted for only 0.5 percent ($12.9 billion) of the U.S. FDI stock abroad in 2007. U.S. FDI stock in Russia was heavily concentrated in the mining sector (73%) which is also the only one sector where Russia is comparatively important with Russia accounting for 7 percent of total U.S. FDI stock. Vice versa, data availability for the accumulated stock of FDI is still rather limited. Concerning FDI flows, the U.S. accounted for 2 percent of Russian FDI flows abroad in 2007. Evidence from media reports and expert assessments reveals that Russian FDI stock in the U.S. was dominated by the steel sector.

U.S.-Russian Economic Relations in International Comparison

To gauge whether U.S.-Russian economic relations are exceptionally low, it is worthwhile comparing them to U.S.-Russian trade and investment relations with Brazil, China, and India. Together with Russia, these are the four largest emerging markets and are often referred to as the BRIC countries. In addition, we will compare U.S.-Russian economic relations to U.S. relations with Turkey, another sizeable emerging market and a close U.S. ally. Starting with the absolute trading volume in current U.S. dollars, U.S. trade with Russia totaled $36 billion in 2008. This was more than ten times lower than total U.S. trading volume with China and about half of the trading volume with Brazil, but only slightly below trade with India and still larger than with Turkey. While absolute numbers are informative, they may be somewhat misleading as they do not take the economic size of the individual countries into account. U.S.-Russia trade is, for instance, five times rather than ten times lower than U.S.-China trade when measured as a percentage of GDP and U.S. trade with Turkey is about equal to U.S.-Russia trade in terms of GDP. Another way to quantify the size of FDI inflows is to express it in per capita terms. Per capita U.S.-Russia trade exhibits higher readings than India and Turkey coming only 21 percent lower than U.S.-China trade.

Finally, the dynamics of trade relations are an interesting aspect to gauge whether the absolute volumes of trade between the U.S. and its trading partners are converging or diverging over time. In fact, with regard to the average annual growth rates from 2000 to 2008, we observe a catch-up process between U.S.-Russia trade and the respective peer countries. U.S.-Russia trade even grew slightly faster than U.S.-China trade, much faster than U.S.-Brazil, U.S.-Turkey, and U.S.-India trade.

	Trade with U.S. in 2008, USD bn	GDP in 2008, USD bn	Population, m	Trade in % of GDP
Brazil	63	1573	192	4.0
China	409	4402	1328	9.3
India	44	1210	1190	3.7
Russia	36	1677	142	2.2
Turkey	15	729	70	2.1

	Trade per capita	U.S. FDI stock abroad, USD bn, 2007	Average annual growth rate of trade with U.S., 2000-2008
Brazil	330	41.5	10.6
China	308	28.2	17.3
India	37	16.6	15.7
Russia	254	12.9	18.8
Turkey	217	4.9	11.3

Direct Investment: U.S.-Russia In Comparison with the U.S. and Other Countries

Comparing direct investment from the U.S. to Russia with direct investment relations of the U.S. with other countries is slightly more difficult due to data constraints. With regard to the absolute stock of U.S. FDI, Russia ranked below Brazil and China, on par with India and above Turkey at the end of 2007. Looking at U.S. FDI as a percentage of GDP, Brazil leads with 3 percent, while the levels in

India, China, and Turkey are all close to 1 percent and hence on par with Russia. This again is evidence disproving the claim that U.S.-Russian economic relations are exceptionally low.

How to Enhance U.S.-Russian Economic Relations

Several structural factors constrain relations between the U.S. and Russia that are difficult to resolve. Among those are the large geographical distance, different languages, a relative lack of cultural ties and, not to be forgotten, the history of the Cold War. While economic relations have improved significantly since the end of the Cold War, a strong Russia lobby is still lacking within the U.S. and there are still few cultural and business exchanges taking place. Against this background, the U.S.-Russia Business Council has recommended the creation of a new bilateral Economic and Technical Cooperation Commission along the lines of the Gore-Chernomyrdin Commission of the 1990s.[3]

Despite these structural impediments, there are several ways to strengthen bilateral economic ties, beginning with U.S.-Russia inter-industry trade. Starting with oil, the low share of Russia in total U.S. oil imports (3% on average from 2000-2008) is surprising given that Russia is the second largest oil producer worldwide. While there are likely historical reasons for this fact, there are also technical reasons limiting U.S. oil imports from Russia, namely that U.S. oil refineries are not suited to process the particular type of oil (Urals) that Russia produces.[4] More direct investment by U.S. oil companies in Russia might render refineries for Russian Urals oil more profitable. In this context, reducing barriers to foreign direct investment in the Russian energy sector would also be crucial. It would also help to restart the U.S.-Russia energy dialogue, which has stagnated since 2005.[5]

Turning to the major U.S. exports to Russia, namely nuclear equipment and meat exports, progress on the 123 Agreement on nuclear cooperation between the U.S. and Russia could help to boost further U.S. nuclear equipment exports.[6] With regard to U.S. meat exports, resolving outstanding issues on sanitary measures may also help to increase U.S. exports further. Hence there is room to raise trade even in case the current inter-industry trade pattern remains in place.

Concerning intra-industry trade, as noted above, there have been only low-level exchanges of goods of the same kind between the U.S. and Russia. This is due to the fact that few Russian goods outside the energy sector are able to compete with American products or imported goods from elsewhere. Intra-industry trade could start to rise once Russia has modernized its industrial structure and adopted other measures to raise international competitiveness. The international competitiveness of Russia's economy has, for instance, been hampered by that country's weak business climate and institutional environment. Improvements in this direction could therefore help to encourage trade relations. Notably, this may also be conducive to increasing U.S. direct investment.

U.S.-based Russia experts as well as the U.S.-Russia Business Council have highlighted several other institutional impediments weighing on U.S.-Russian economic relations.[7] Therefore, a more active engagement of the new U.S. administration is recommended to improve the current situation.

First, the U.S. does not grant Russia the benefits of permanent normal trade relations (NTR) status, i.e., Russia does not, unlike the vast majority of other U.S. trading partners, enjoy non-discriminatory treatment in comparison to other trading partners. This is because Russia is still subject to restrictions under the Jackson-Vanik amendment included in the Trade Act of 1974.[8] It should be noted that there have not been any restrictions due to Jackson-Vanik in place for almost two decades as the U.S. president has waived these restrictions every year. However, the fact that Jackson-Vanik has been kept may have weighed negatively on U.S. companies' sentiment toward Russia. At the same time, Jackson-Vanik may have deterred and irritated Russian politicians and the Russian business community, undermining a more active economic exchange.

Second, Russia is neither a member of the WTO nor of the OECD. This implies that there is more institutional and legal uncertainty in Russia than in other countries, clouding foreign perceptions of Russia as a trade or investment location. Estimating the impact of WTO and OECD membership is challenging. There is some empirical evidence available for the impact of WTO membership on trade flows.[9] For Russia, non-WTO membership appears to have steered trade toward non-WTO members, i.e., away from the U.S. If Russia joins the WTO, exports to current WTO members could increase in the longer run by as much as 50 percent. At the same time, there might also be trade diversion away from current non-WTO members, i.e., the net effect for Russia remains somewhat uncertain.

Third, Russia has not ratified the bilateral investment treaty (BIT) concluded with the U.S. in 1992. The BIT would grant investments made by a U.S. investor in Russia or vice versa a number of guarantees including fair and equitable treatment, protection from expropriation, free transfer of means, and full protection and security.[10] Lack of a BIT is thought to have caused U.S. companies to invest in Russia via other countries, e.g., a European subsidiary, to enjoy better legal protection.[11] This would imply that actual direct investment by U.S. companies is understated in the official statistics. Experts from the U.S. commerce department estimate that total direct investments by U.S. companies in Russia are about 30 percent higher than official statistics show.

Conclusion

Given the importance of economic relations, this Issue Brief first analyzed current trade and investment relations between Russia and the U.S., finding that the level of bilateral economic exchange is low. Against this background we highlighted a number of reasons explaining why *a priori* not to expect particularly flourishing economic relations between Russia and the U.S. Subsequently, we identified a series of impediments to bilateral economic relations ranging from technical reasons and current trade disputes to more fundamental structural issues.

Having established that U.S.-Russian economic relations are low, we investigated whether they are exceptionally low in comparison to U.S. relations with other countries. The analysis found that there is no general trend distinguishing U.S.-Russia trade from U.S. trade with other large emerging market countries such as Brazil, India and Turkey. There is, however, evidence of a special trade relationship between the U.S. and China: U.S.-China trade is comparatively large across all dimensions. In the context of direct investment, the difference to other emerging markets is even less pronounced: U.S. FDI in Russia is on a par with China, India, and Turkey when measured as a percentage of GDP, and Russia ranks higher than these three countries when FDI is measured in per capita terms.

While this note has not least been motivated by the implicit causality linking political stability to economic interdependence, there is of course also a crucial link from political to economic relations. In fact, all the above-mentioned bilateral institutional arrangements that could stimulate economic exchange are highly dependent on political actors. To put it in a nutshell: starting a virtuous circle of economic and political relations between Russia and the U.S. requires a strong initial push by their respective administrations.

NOTES

1 Johnson's Russia List, "Russia's Membership of WTO will help repeal Jackson-Vanik Amendment," *Email Newsletter*, 30 April 2009, #26.

2 Samuel Charap and Andrew C. Kuchins, *Economic Whiplash in Russia. An opportunity to bolster U.S. – Russia commercial ties?* Center for Strategic International Studies (Washington D.C., February 2009): 11, 15.

3 The Gore-Chernomyrdin Commission was created in 1993 and ceased to exist in 1999. See also Charap and Kuchins (2009, p. 13) and Sarah Carey, "US economic relations and energy security," (Speech at the conference "Designing U.S. Policy toward Russia," Library of Congress, 27 March 2009), 3.

4 According to experts from the U.S. Commerce Department.

5 Russia Business Watch, "The U.S. Russia relationship in transition," Vol 16 No 3, Winter 2008-2009, 1.

6 Anders Aslund and Andrew Kuchins, "Pressing the "reset button" on US-Russia Relations," *Policy Brief*, Peterson Institute for International Economics. March 2009, 10.

7 See e.g. Aslund & Kuchins (2009), Charap & Kuchins (2009), Carey (2009), and Ariel Cohen and Daniella Markheim, "Permanent normal trade relations for Russia would benefit the U.S. and Russia," *WebMemo* No 1286, published by the Heritage Foundation, December 2006.

8 See Congressional Research Service, "The Jackson-Vanik Amendment: A Survey," 2005. Updated 1 August 2005 and Congressional Research Service, "Permanent Normal Trade Relations (PNTR) Status for Russia and U.S. – Russian Economic Ties," 2006. Updated 18 July 2006. The Jackson-Vanik amendment stipulates that countries are not eligible for permanent NTR status with the U.S. as long as they deny their citizens the right of freedom of emigration. While there were impediments to emigration during Soviet times, Russia started to grant freedom of emigration already in the early 1990s.

9 See Bogdan Lissovolik and Yaroslav Lissovolik, "Russia and the WTO – the gravity of outsider status," *IMF Staff Papers* Volume 53 No1, 2006. Note that WTO membership talks started already in 1993.

10 For the bilateral investment treaty see: http://www.unctad.org/sections/dite/iia/docs/bits/usa_russia.pdf.

11 See Aslund & Kuchins (2009, p. 10).

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