How Important Are Russia's External Economic Links?

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Abstract
In this note, we review recent data concerning Russia's economic integration with other countries. We first analyze the general picture of Russia's economic integration with the rest of the world and the importance of foreign economic relations for the country. We then turn to China, an increasingly significant economic partner for Russia. The European Union remains Russia's most important trading partner and is by far the most important source of foreign direct investment to Russia as well as source of other financing. China's importance to Russia has also increased, especially with respect to merchandise trade.

1. Introduction

Russia-related geopolitical tensions have increased substantially over the past year. Russia's relations with Western countries have become strained as the risks related to the Ukrainian conflict have intensified. Instability has also increased inside the Eurasian Economic Union (EAEU),[1] including political tensions in Belarus, unrest in Kazakhstan, and border clashes between Armenia and Azerbaijan.

This note, premised on the notion that shocks related to foreign economic relations can have important effects on the Russian economy, explores some of the key characteristics of Russia's current foreign economic relations from the viewpoint of international trade and financial flows. The key finding is that Russia, despite its effort in recent years to reduce dependence on global economy and increase self-sufficiency, remains highly integrated with the rest of the world.

1 The Eurasian Economic Union consists of Armenia, Belarus, Kazakhstan, Kyrgyz Republic, and Russia.

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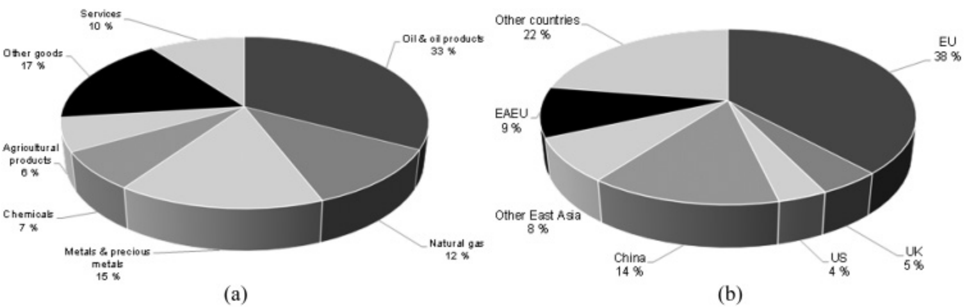
Figure 1. (a) Product structure (b) Geographical distribution of Russian goods exports in 2021



Source: *Central Bank of Russia, Russian Customs.*

The paper is organized as follows. In the Section 2, we analyze the general picture of Russia's foreign economic relations. In the Section 3, we take a more detailed look at the economic relations between Russia and China. The final section concludes.

2. Russia's foreign trade and cross-border financial flows

This section provides an overview of Russia's economic relations in a global framework. We examine Russia's foreign trade in aggregate, at the sector level, and briefly at the product level. We then discuss cross-border financial flows to and from Russia with an additional look at the banking sector.

2.1 Russia's exports

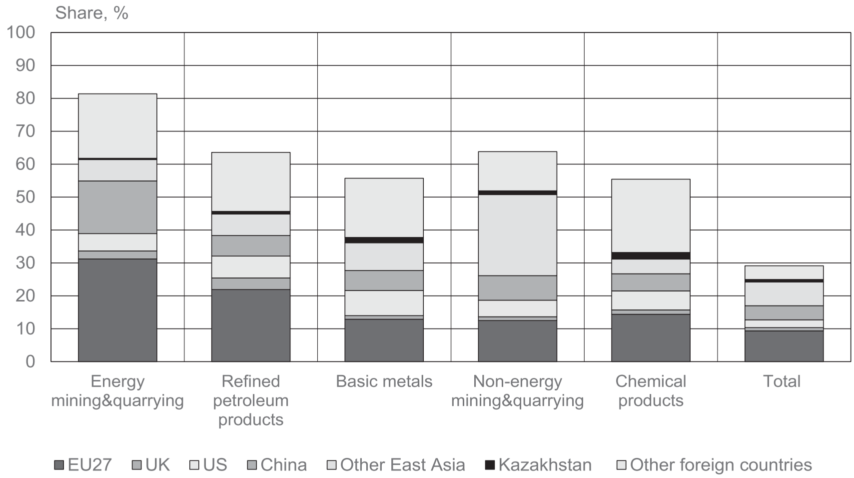
Russia's exports of goods and services amounted to US$ 540 billion (about 35 percent of GDP) in 2021. Crude oil, petroleum products, and natural gas accounted for nearly half of exports (Figure 1a). Other important export products were metals (including precious metals), chemicals, and agricultural products. The EU, UK, and United States together accounted for about half of Russia's goods exports in 2021 (Figure 1a). The EU remains Russia's main export market. The EAEU's share was 9 percent.

Between 50 percent and 80 percent of value-added goes to exports in Russia's key export sectors (Figure 2).[2] Western countries—and the EU in particular—are important export markets for Russia's energy mining and quarrying sector and refined petroleum products, whereas China and other East Asian countries[3] are the most important export markets for non-energy mining and quarrying products.

2 Based on 2018 data, the latest data available on the OECD TiVA database.

3 For this discussion, "East Asia" is the OECD TiVA aggregate for East and Southeastern Asia, but excluding China. Thus, it includes Cambodia, Hong Kong, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand, and Vietnam.

Figure 2. Exports as a share of value-added in Russia's key sectors in 2018 (%)



Source: *OECD Trade in Value-added (TiVA) database.*

Table 1. Geographical distribution of Russia's top ten export items in 2019 (%)

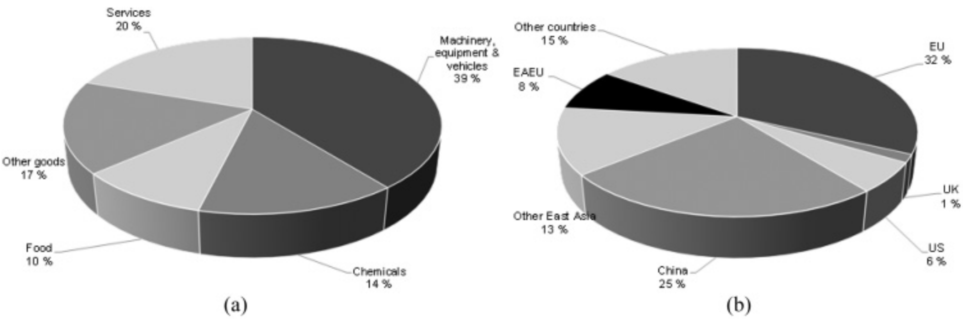
	EU	UK	U.S.	China	East Asia	EAEU	Other countries	Value (US$ bn)
Crude oil	50.3	0.9	1.8	27.6	9.3	5.4	4.8	122.2
Petroleum products	50.3	3.3	6.7	5.0	6.5	1.8	26.5	66.9
Natural gas	63.9	4.5	0.0	1.1	7.3	7.6	15.7	51.0
Coal	29.0	0.8	0.1	13.5	29.5	1.7	25.5	16.0
Wheat	3.2	0.0	0.0	0.2	3.8	2.7	90.1	6.4
Semi-finished steel products	22.4	0.0	3.7	0.1	1.1	3.2	69.4	6.1
Gold	0.0	92.5	0.0	0.4	0.1	4.7	2.3	5.8
Platinum	23.7	18.3	27.8	0.0	28.0	0.3	2.0	5.1
Aluminum	35.1	0.7	7.8	1.3	17.7	4.4	33.0	4.6
Sawn wood	15.3	1.4	0.2	55.7	8.5	1.4	17.5	4.5

Source: *World Bank WITS database, UN Comtrade, Russian Customs.*

Note: *The largest export market for each product is shaded. The items are based on HS4-level classification.*

The top ten export products, which include various energy commodities, wheat, gold, platinum, aluminum, and wood, accounted for about 60 percent of Russia's goods exports in 2019. The EU is Russia's main export market for energy raw materials and aluminum (Table 1). The UK, the hub of the global gold trade, accounts for nearly all of Russia's gold exports. The United States is an important export market for platinum. Over half of Russia's wood exports go to China, which is also an important export market for Russian crude oil. Coal and platinum are exported in large amounts to other East Asian countries. The EAEU countries are not main markets for any of Russia's top ten export products. Most wheat and steel products go to countries other than those examined here.

Figure 3. (a) Product structure of Russia's imports in 2021 (b) Geographical distribution of Russia's goods imports in 2021



Source: *Central Bank of Russia, Russian Customs.*

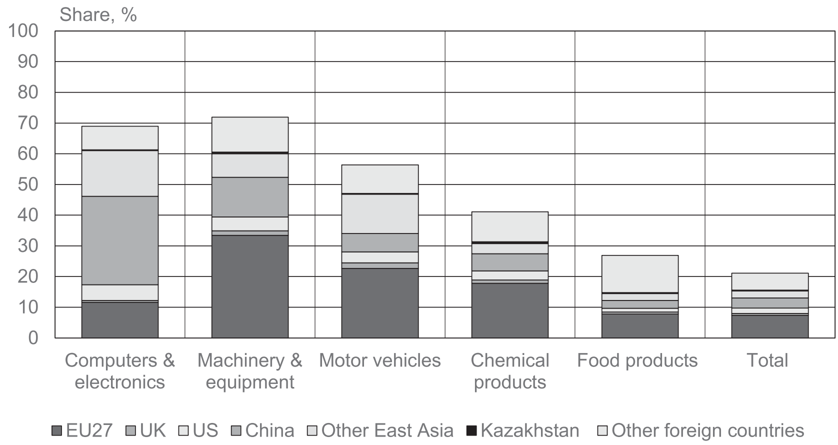
Although the share of the United States is relatively small in Russian exports, 55 percent of Russian exports are invoiced U.S. dollars (data from 2021:Q1–Q3). Perhaps the biggest reason for this is that oil is typically priced in U.S. dollars. The euro accounts for 29 percent of export invoicing in Russia's total exports. The dollar and euro also dominate export invoicing in Russia's trade with most emerging economies, including China and Turkey. Exports to EAEU countries are mainly invoiced in rubles (70 percent) and about half of Russian exports to India are priced in rubles (India is a key export market for Russian military technology).

2.2 Russia's imports

Russia's imports of goods and services amounted to US$ 380 billion (about 25 percent of GDP) in 2021. Machinery, equipment, and vehicles accounted for 40 percent of total imports (Figure 3a). Other key product groups in imports were chemicals and food. Services accounted for 20 percent of total imports (even despite continuing weakness in imports of tourism services). In Russia's goods imports, the share of the EU, UK, and United States was 40 percent (Figure 3b). China accounted for 25 percent and EAEU member countries for 8 percent of Russian goods imports.

In certain key manufacturing sectors, imports represented 55–75 percent of the value-added in the sector's final demand in 2018. The share of imports was highest in sectors of machinery and equipment, and computers and electronics (Figure 4). In the food sector, the share of imports was 20 percent. The EU is a particularly important provider of machinery and equipment and motor vehicles, while China and other East Asian countries dominate in imports of computers and electronics. Despite the import bans Russia imposed on select food categories in August 2014, the EU remains an important source of food imports

Figure 4. Imports as a share of value-added in Russian final demand in key manufacturing sectors in 2018



Source: *OECD TiVA.*

Table 2. Geographical distribution of Russia's top ten import items in 2019 (%)

	EU	UK	U.S.	China	East Asia	EAEU	Other countries	Value (US$ bn)
Medicaments	68.8	4.0	0.6	0.3	0.8	2.3	23.2	10.2
Telephone sets	5.3	0.1	1.2	68.9	14.1	0.2	10.2	9.0
Motor vehicles; parts and accessories	37.9	0.8	4.1	13.9	31.2	4.1	7.8	8.8
Motor cars and other motor vehicles	38.9	7.4	14.2	3.9	28.2	2.2	5.3	7.9
Automatic data processing machines	19.5	0.1	2.0	63.6	7.6	0.5	6.7	5.7
Aircraft n.e.c.	32.8	0.0	63.9	0.2	0.2	0.0	2.8	5.3
Vaccines, toxins, etc.	55.9	4.0	20.1	0.8	0.6	0.7	18.0	3.1
Taps, cocks, valves, and similar appliances	49.8	1.4	5.5	28.3	3.5	4.2	7.3	2.3
Bodies for motor vehicles	34.8	0.1	4.0	0.3	59.6	0.5	0.7	2.3
Machinery for the treatment of materials by a process involving change of temperature	64.4	0.8	2.8	11.4	7.6	0.9	12.2	2.2

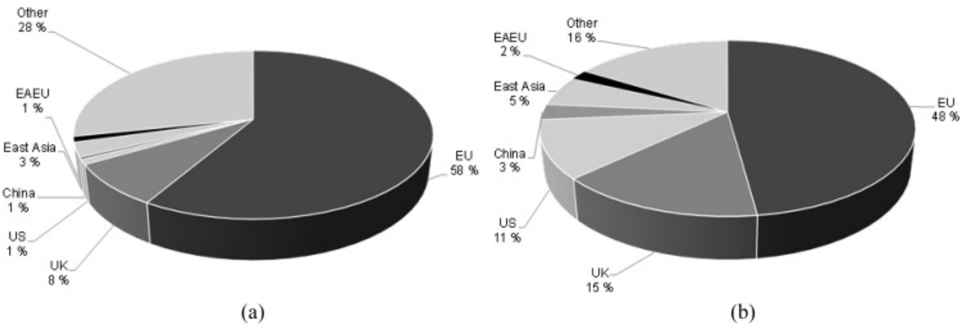
Source: *World Bank WITS database, UN Comtrade.*

Note: *The largest import market for each product is shaded. The items are based on HS4-level classification.*

for Russia. Belarus also is a big supplier of food imports for Russia, especially for product groups subject to import bans for Western countries.

The top ten import products (e.g., medical products, machinery, equipment, and motor vehicles) accounted for about one-quarter of Russia's goods imports in 2019. The imports of these top products largely come from certain regions (Table 2). The EU dominates Russian imports of medical products, machinery, and motor vehicles. The United States is the main source of imports in products related to the aircraft industry. China is by far the largest provider of telephone sets and computers. Other East Asian countries dominate the

Figure 5. (a) Geographical distribution of the FDI stock in Russia in 1H21 (Russia's official statistics) (b) Geographical distribution of the FDI stock in Russia in 2020 by ultimate investor (UNCTAD estimate)



Source: *Central Bank of Russia, UNCTAD.*

Note: *The UNCTAD estimate excludes the investments of Russian or unspecified origin (they accounted for 40 percent of the total FDI stock in 2020).*

imports of motor vehicle bodies. The share of the EAEU countries is small in all of Russia's top ten import products, ranging between 0 percent and 4 percent.

The U.S. dollar was used as the invoicing currency for 36 percent of Russian import transactions, slightly ahead of 31 percent for the euro (as of January–September 2021). While the dollar dominates as the invoicing currency for Russian imports from emerging economies such as China and India, the role of the yuan in imports from China seems to be growing. Most imports from the EU are invoiced in euros. The Russian ruble is used as the invoicing currency for the majority of Russian imports from EAEU countries.

2.3 Foreign financial inflows to Russia

The stock of foreign direct investment (FDI) in Russia was US$ 480 billion (30 percent of GDP) as of the end of June 2021. Official FDI statistics show that about 60 percent of that investment came from EU countries (Figure 5a), particularly from Cyprus (33 percent of the total). The share of China and other East Asian countries was 3 percent, while the United States and the EAEU countries accounted for about 1 percent of FDI stock each.

FDI statistics are, however, subject to large uncertainties. They depict cross-border financial flows that are often channeled through three (or more) countries for reasons both legitimate and illegitimate.[4] It is estimated that the bulk of FDI inflows to Russia are actually of Russian origin. These are funds that are merely round-tripped via foreign countries such

4 See, e.g., Damgaard et al. (2019). What Is Real and What Is Not in the Global FDI Network? IMF Working Paper No. 19/274.

as Cyprus in the EU or tax havens like the Bahamas and Bermuda. Many large Russian corporates are registered in offshore tax havens such as Cyprus.

Companies from other countries than Russia also use financial intermediaries. Estimates calculated by the United Nations Conference on Trade and Development (UNCTAD) suggest that the share of investment from Russia and unspecified sources (flows for which the ultimate source could not be identified) is about 40 percent of Russia's FDI stock. The EU is the largest source of FDI, even in ultimate investor terms, but the shares of the UK and the United States are much higher than in the official statistics. It appears that about 70–75 percent of the FDI stock in Russia is associated with the EU, UK, or the United States, either as the ultimate investor or as an intermediate country. The roles of Asian countries and EAEU countries are apparently much smaller.

As of the end of June 2021, the stock of foreign portfolio investment in Russia was US$ 180 billion.[5] The Central Bank of Russia (CBR) provides no detailed statistics of the geographical distribution of foreign portfolio investment.

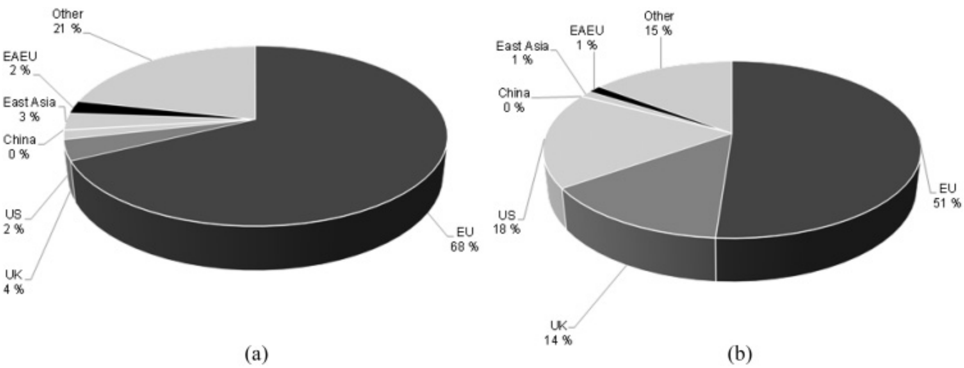
Russia's stock of foreign debt was US$ 480 billion (30 percent of GDP) at the end of 2021. The dollar's share of foreign debt was 42 percent, the euro's share 20 percent, and most of the remainder is ruble-denominated debt (as of the end of September 2021). At just US$ 60 billion, the level of the Russian government's foreign debt is relatively moderate by international standards. The value of Russia's ruble-denominated government debt that is held by foreigners was about US$ 40 billion and the value of foreign-currency denominated government debt US$ 20 billion. Foreign participants accounted for 20 percent of the ruble-denominated government bond market and 50 percent of the government eurobond market.

2.4 Russian financial flows abroad

The stock of Russian direct investment abroad stood at US$ 380 billion (25 percent of GDP) at the end of June 2021. CBR figures show the geographical distribution of Russia's outward FDI is similar to that of inward FDI (Figure 6a). The EU is by far the largest destination for outward Russian FDI flows, with Cyprus alone accounting for half of Russia's total outward FDI. This reflects the above-mentioned round-tripping of Russian investment via foreign countries back to the domestic economy. Among other individual countries, Switzerland's 6 percent share stands out. This partly reflects the fact that the Nord Stream consortium is based in Switzerland.

5 Portfolio investment refers to securities transactions in which the ownership or voting power after the investment remains below 10 percent. For FDI, the ownership or voting power exceeds 10 percent.

Figure 6. Geographical distribution of (a) Russia's outward FDI stock as of the end of June 2021 (b) Russia's outward portfolio investment stock as of the end of June 2021



Source: *Central Bank of Russia.*

The stock of Russia's outward portfolio investment was US$ 120 billion (8 percent of GDP) as of the end of June 2021. The geographical distribution of portfolio investment is similar to FDI distribution; the EU again accounts for the majority of investment (Figure 6b). The relative shares of the UK and the United States, however, are much larger for portfolio investment than Russian outward FDI.

2.5 Foreign liabilities and assets of the Russian banking sector

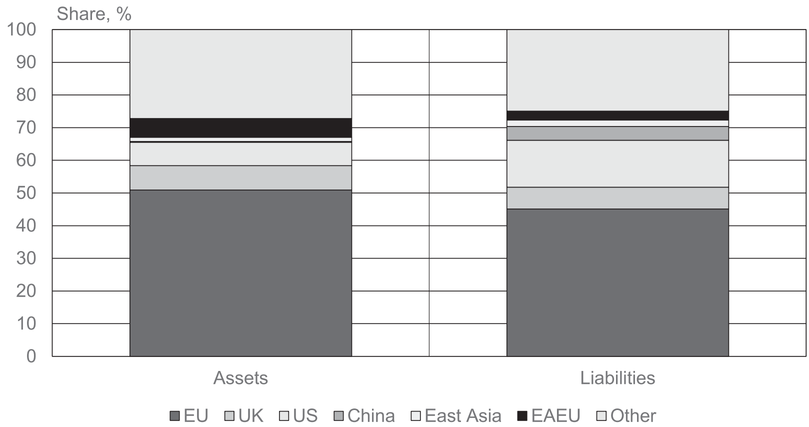
Foreign liabilities of the Russian banking sector stood at US$ 130 billion as of the end of June 2021. The share of the EU was nearly half, followed by the United States (14 percent) and the UK (7 percent) (Figure 7). China's share has increased in recent years to around 4 percent of the banking sector's foreign liabilities.

The picture is similar for the foreign assets of the Russian banking sector. The value of foreign assets was US$ 190 billion as of the end of June 2021. The EU accounted for half of the assets, while the combined share of the UK and the United States was about 15 percent. The share of the EAEU countries was 6 percent.

3. Russia's economic relations with China

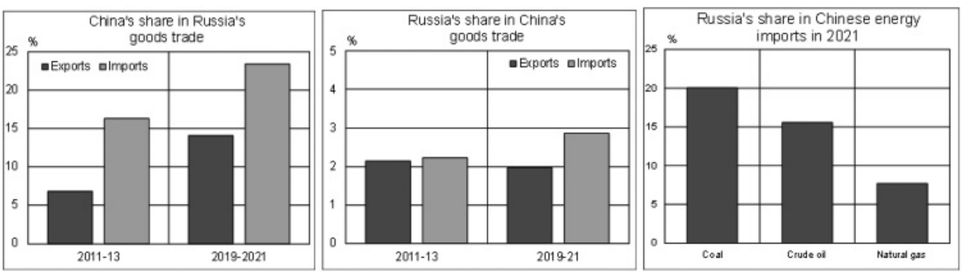
While Russia's relations with Western countries have deteriorated since 2013, economic relations between Russia and China have deepened. Nevertheless, the economic relationship between Russia and China is asymmetric. Russia is a far less important economic partner for China than vice versa. The sole exception is energy products. Russia is a significant—although not dominant—source of energy imports for China. There have been several

Figure 7. Geographical distribution of the international assets and liabilities of the Russian banking sector as of the end of June 2021



Source: *Central Bank of Russia.*

Figure 8. Relative shares of China and Russia in each other's trade



Source: *CEIC, Russian Customs.*

high-profile projects such as Power of Siberia natural gas pipeline and the Yamal liquified natural gas (LNG) project, where Chinese funding has been crucial. In general, however, the role of Chinese financing has not grown substantially in the Russian economy. The countries have also promoted use of their national currencies in bilateral transactions to reduce the role of the U.S. dollar. This has succeeded to some extent, but the limited convertibility of the yuan and the volatility of the ruble have hampered this trend.

3.1 Asymmetrical trade relations

China's share in Russia's foreign trade has increased substantially during the past decade and it has risen as the most important single trading partner for Russia (Figure 8). This mirrors the spectacular rise of China in global trade as China has become the world's largest goods exporting nation. In 2021, China accounted for 14 percent of Russian goods exports and 24 percent of imports. In contrast, Russia is not among China's top trading partners and Russia's share in Chinese trade has practically not changed during the past decade. In Chinese goods exports, it has been about 2 percent and in imports about 3 percent.

China imports mainly energy products from Russia. In these products Russia is a more important source of imports than in the overall trade. Russia's importance has grown in past years with the increasing transport infrastructure capacity for oil and natural gas between the countries and the growing LNG production in Russia (as LNG can be transported more flexibly to various markets). Transport infrastructure projects include the extension of the oil pipeline from Russia to China, the construction of the Power of Siberia gas pipeline, and the Yamal LNG project. Chinese financing has provided important support for these projects.

About 15 percent of Chinese crude oil imports and 8 percent of natural gas imports came from Russia in 2021. Russia accounted for about 20 percent of Chinese coal imports. Russia's share in Chinese natural gas imports can increase when the Power of Siberia pipeline will reach full capacity, and possibly further if other planned natural gas projects are realized.

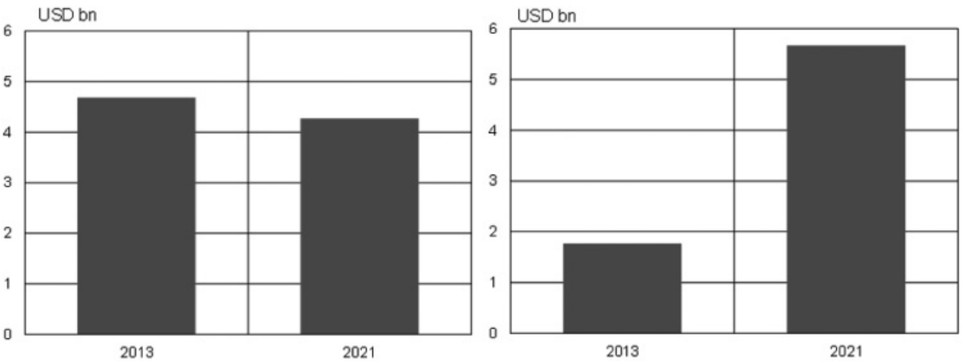
The Power of Siberia gas pipeline is currently slated to reach its full capacity of 38 billion m^3 per year in 2024. Gazprom also recently announced an agreement to supply an additional 10 billion m^3 gas per year to China. This arrangement, however, requires additional investments, so it is unclear when these shipments might start. Another gas pipeline (planned capacity 50 billion m^3) running from Russia to China via Mongolia has been discussed, but so far no official agreement has been reached on its construction. In any case, China has been quite careful in balancing and diversifying its oil and gas supply to avoid over-reliance on any single supplier.

3.2 Only modest increase in China's importance in Russian finance since 2013

Russia initially hoped to offset its loss of access to foreign financial markets from the 2014 Western sanctions with Chinese financing. Although subject to several uncertainties, the available data suggest this aspiration has been only modestly realized. Chinese state-related financial organizations have provided financing to projects considered beneficial to China's general interest. such as construction of the Power of Siberia pipeline and the Yamal LNG project. Some other Russian entities have also received Chinese financing, but China's role in financing Russia remains modest at the aggregate level.

Russia's official FDI statistics imply that the stock of Chinese FDI (including Hong Kong) in Russia has been nearly unchanged in recent years, accounting for only about 1 percent

Figure 9. (a) Chinese FDI stock in Russia (including Hong Kong, end of 2013, mid-2021) (b) Liabilities of Russian banking sector in China (including Hong Kong, end of 2013, mid-2021)



Source: *Central Bank of Russia.*

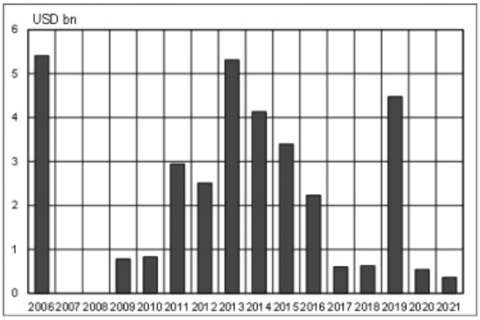
of FDI in Russia (Figure 9). The value of the China's FDI stock in Russia at the end of 2013 amounted to US$ 4.7 billion. It was almost unchanged at US$ 4.3 billion as of end June 2021. Using the alternative FDI statistics compiled by UNCTAD, the share of China in Russian FDI stock looks to have been in the range of 2–3 percent in 2020.

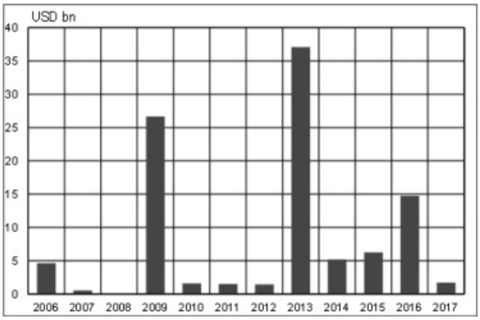
While China's importance to the Russian banking sector has increased somewhat, it is still quite limited. At end 2013, the amount of the liabilities of the Russian banking sector to China (including Hong Kong) was only US$ 1.8 billion. By mid-2021, it had tripled to US$ 5.7 billion, and accounted for about 4 percent of the foreign liabilities of the Russian banking sector.

Alternative data sources focusing on the Chinese perspective also point to similar trends in Chinese financing to Russia. The 2006–21 data from China Global Investment Tracker monitors significant Chinese investment abroad. The data suggest that there has been no systematic increase in Chinese investment in Russia (Figure 10). During 2006–13, the total value of investment flows was US$ 17.8 billion. For 2014–21, it declined slightly to US$ 16.4 billon.

AidData, which provides estimates on Chinese government-related development project financing abroad, suggests that the amount of finance flows from China to Russia began to decrease after 2013 (data on project values are not available for all projects). The apparent change, however, largely reflects the massive loan provided by China National Petroleum Company to Rosneft in 2013. In 2010–13, the total value of project financing was US$ 41.6 billion. In 2014–17, it decreased to US$ 28 billion.

Figure 10. Estimates of (a) Chinese investment inflows to Russia (2006–21) and (b) Chinese state-associated development financing to Russia (2006–17)





Source: *China Global Investment Tracker, AidData.*

3.3 Use of national currencies in bilateral trade has increased

Russia and China are both promoting increased use of their own currencies in international transactions and reducing dependency on the U.S. dollar. This shift is reflected in bilateral trade, Russia's foreign exchange reserves, and China's state-led financing of Russian projects. In Russian exports to China, the share of ruble and other currencies (apparently yuan) as the invoicing currency has increased from 3 percent to 15 percent in 2013–21. The euro has also strongly replaced the U.S. dollar. In Russian imports from China, the share of ruble and apparently yuan as the invoicing currency has increased from 6 percent to 31 percent in 2013–21. The use of yuan seems to have increased substantially in imports, while the share of ruble has stayed stable. The share of euro has increased also in Russian imports from China but is still only about 10 percent. In Russia's foreign exchange reserves the share of yuan has increased from practically zero to 13 percent by mid 2021.

According to AidData, the development financing from Chinese state-associated entities to Russia is also shifting to yuan. During 2010–13, just one relatively small project was financed in yuan—all the others were financed in dollars. During 2014–17, financing for several projects was disbursed in yuan, accounting for 20 percent of total financing (for projects where their value has been reported).

4. Concluding remarks

Despite its aspirations for greater economic self-sufficiency in recent years, Russia still has substantial economic connections to the global economy through international trade and financial markets. In trade, Western countries are still Russia's most important partners. The EU is the main export market for Russian oil and gas, and the key provider of Russia's imports of medical products, machinery, and motor vehicles. The shares of China and other

Asian countries have increased substantially in Russian trade. As for many other countries, China already accounts for the vast majority of Russian imports of electric equipment and electronics. In financial markets, Western countries continue to dominate Russia's international connections. EAEU members figure much less in Russia's trade and financial flows, but there are exceptions. For example, Belarus is an important supplier of food imports to Russia.

As China's role in the global economy continues to increase, we expect that its importance for the Russian economy will also grow. In contrast, China's importance to Russian financing has remained relatively modest, partly owing to China's own capital controls.