



# 8

## Economic Implications of Brexit for the International Competitiveness of Russia

Krzysztof Falkowski

### 8.1 Introduction

The ongoing process of the UK leaving the European Union provides a good opportunity to consider to what extent, if at all, the UK's exit from the European Union (widely known as "Brexit") will affect its relations with Russia and, in particular, the competitiveness of the Russian economy. While the conditions of this "divorce" remain unclear, one thing is certain: the UK will still be a member of many international organisations after Brexit, including the World Trade Organisation, which will have consequences for its foreign trade policy. By exiting the EU, the UK will regain its autonomy in shaping mutual economic relations with third countries, including Russia.

The main aim of this chapter is to outline the possible economic consequences of Brexit for the international competitive position of the

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K. Falkowski (✉)

Collegium of World Economy,

SGH Warsaw School of Economics, Warsaw, Poland

e-mail: [kfalkow@sgh.waw.pl](mailto:kfalkow@sgh.waw.pl)

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Russian economy. The first part of the study provides a concise analysis of Russia's competitiveness in international trade considering four basic categories of goods, as classified by the Organisation for Economic Cooperation and Development (OECD) based on their technological advancement. For this purpose, two indicators are applied: Balassa's Revealed Comparative Advantage (RCA) index and the Lafay Index (LFI) of international trade specialisation. The analysis is conducted for the 2000–2016 period to ensure that the identified comparative advantages can be considered on a long-term basis. Subsequently, in the following three sections of this chapter, bilateral economic relations between Russia and the UK in the fields of trade, investment and labour migration are discussed in a concise way depending on the availability of data. In each section, the potential effects of Brexit on the competitiveness of the Russian economy are examined.

This chapter puts forth a thesis that, due to the extent of mutual economic cooperation and the competitive profile of the Russian economy, Brexit will have little influence on Russia's competitiveness in the world economy. Moreover, as shown by the limited effects of Western sanctions imposed on Russia in 2014, it seems that political relations between Russia and the UK will be far more important to Russia's future competitive position than the UK's upcoming exit from the EU.

## 8.2 Russia's Competitive Profile in Contemporary International Trade

Economists use a variety of different methods to assess the competitiveness of economies in international trade, which is understood as the ability to achieve greater benefits (than other countries) from both their own and foreign factors of production under the conditions of an open economy (Weresa 2014). This includes the ability to develop, produce and sell products and services that are more attractive in terms of price or quality than those exported by other countries. As a result, a country plays an increasing role in the trade of such goods internationally (Carbaugh 2017). Methods used to assess the international competitiveness of economies have been reviewed by researchers including Startiene and Remeikiene (2014).

In this chapter, the following two indicators are used to assess the competitiveness of the Russian economy in international trade: Balassa's Relative Comparative Advantage (RCA) index (1965, 1989) and the LFI of international trade specialisation (1992).

The values of the first indicator were determined based on the logarithmic form of the original formula by Balassa (1965, 1989), according to the following formula:

$$RCA_{ij}^K = \ln \left( \frac{\frac{x_{ij}^K}{X_j^K}}{\frac{x_i^j}{X^j}} \right)$$

where:

$RCA_{ij}^K$ —the RCA index of country  $K$  in goods category  $i$  as compared to country  $j$  or group of countries  $j$

$x_{ij}^K$ —exports of goods category  $i$  from country  $K$  to country  $j$  or group of countries  $j$

$X_j^K$ —total exports from country  $K$  to country  $j$  or group of countries  $j$

$x_i^j$ —exports of goods category  $i$  from country  $j$  or group of countries  $j$

$X^j$ —total exports from country  $j$  or group of countries  $j$

$i$ —goods category

$K$ —analysed country

$j$ —other countries (rest of the world).

The use of the logarithmic form of the above formula allows for the symmetry of the positive and negative  $RCA_{ij}^K$  indices in the range around zero, which facilitates their interpretation (Falkowski 2017a). One can say that a country possesses a RCA in trade in goods category  $i$  only if the share of this category in the country's total exports is higher than the share of goods category  $i$  in total global exports, so when  $RCA_{ij}^K > 0$ .

The value of the second indicator, the LFI of international trade specialisation (1992)—which is widely used to assess the nature of a country's foreign trade balance and indirectly also its international competitiveness—was determined in accordance with the following formula:

$$\text{LFI}_{ij}^K = 100 \cdot \left( \frac{x_{ij}^K - m_{ij}^K}{x_{ij}^K + m_{ij}^K} - \frac{X_j^K - M_j^K}{X_j^K + M_j^K} \right) \cdot \frac{x_{ij}^K + m_{ij}^K}{X_j^K + M_j^K}$$

where:

$\text{LFI}_{ij}^K$ —the LFI of country  $K$  in goods category  $i$  as compared to country  $j$  or group of countries  $j$

$x_{ij}^K$ —exports of goods category  $i$  from country  $K$  to country  $j$  or group of countries  $j$

$X_j^K$ —total exports from country  $K$  to country  $j$  or group of countries  $j$

$m_{ij}^K$ —imports of goods category  $i$  from country  $j$  or group of countries  $j$

$M_j^K$ —imports of country  $K$  from country  $j$  or group of countries  $j$

$i$ —goods category

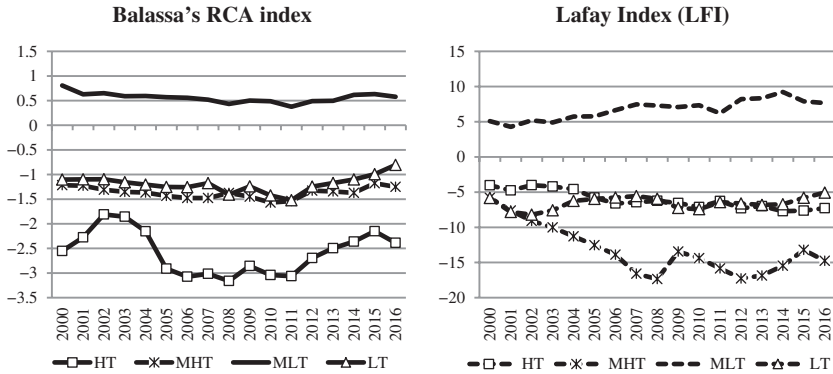
$K$ —analysed country

$j$ —other countries (rest of the world).

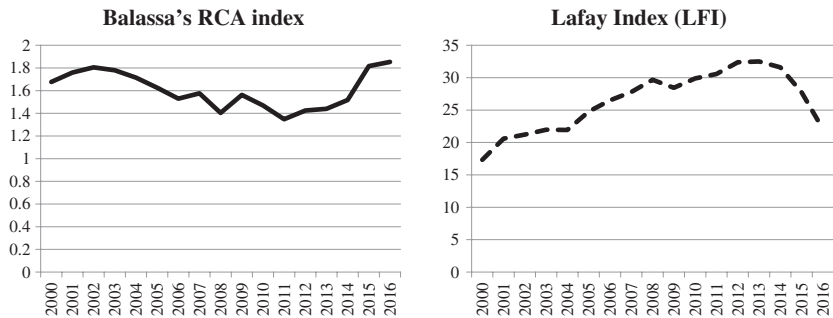
In this case, one can say that a country's international trade shows comparative advantages when the value of the indicator for goods category  $i$  is positive ( $\text{LFI}_{ij}^K > 0$ ), which means that the country has a trade surplus for goods category  $i$ .

Based on the values of the RCA and LFI indices for the 2000–2016 period, Russia's competitiveness in international trade was evaluated within the four basic categories of goods according to the OECD classification based on their technological advancement. Such an approach makes it possible to assess the country's international competitiveness with respect to high-tech, medium-high-tech, medium-low-tech and low-tech goods (OECD 2011; Hatzichronoglou 1997).

When analysing the RCA and LFI indices (Fig. 8.1) for Russia, it can be observed that the country's competitiveness in international trade is low. The only RCAs it possesses are with respect to medium-low-tech goods, which include raw materials and their processed derivatives, in the trade of which Russia has consistently been highly competitive internationally (Fig. 8.2). In the case of the other three goods categories according to the OECD classification, i.e. high-tech, medium-high-tech and low-tech goods, Russia did not have any RCA in the analysed period, as evidenced by the negative values of both the RCA and LFI indices. Moreover, Russia is highly uncompetitive in the



**Fig. 8.1** Russia's RCA in the trade of high-tech, medium-high-tech, medium-low-tech and low-tech goods, 2000–2016 (HT—high-tech goods, MHT—medium-high-tech goods, MLT—medium-low-tech goods, LT—low-tech goods; *Source* Own elaboration based on data from the United Nations Commodity Trade Statistics Database)



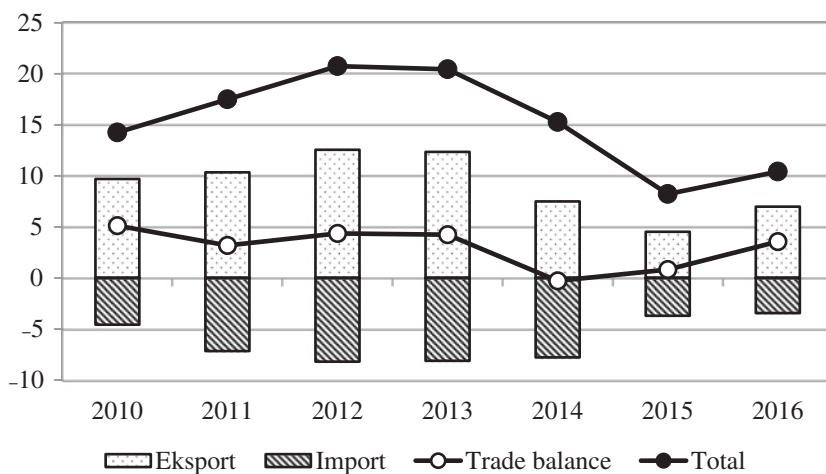
**Fig. 8.2** Russia's RCA in the trade of mineral fuels, lubricants and related materials, 2000–2016 (*Source* Own elaboration based on data from the United Nations Commodity Trade Statistics Database)

trade of high-tech goods. From the point of view of the specific features of contemporary international trade and the growing role of high-tech goods (Wu et al. 2017), this fact should be viewed as particularly worrying not only with regard to Russia's future role in the world economy but also the country's further development. It is necessary to mention the so-called resource curse affecting Russia (Falkowski 2013, 2017b),

meaning the country's exclusive international specialisation in the trade of mineral fuels and their derivatives. This makes the country vulnerable to price fluctuations on international markets.

### 8.3 Russia–UK Trade from 2010 to 2016; Potential Changes After Brexit

The volume of trade between Russia and the UK was subject to significant fluctuations during the analysed period of 2010–2016 (Fig. 8.3). While bilateral trade initially grew from USD 14.3 billion in 2010 to USD 20.7 billion in 2012 (an increase of 44.8%), from 2013 onwards it started falling, at first slightly, then dramatically. In 2013, total trade turnover was USD 20.5 billion; by the end of 2016 it had shrunk to USD 10.4 billion, declining by nearly 50%. A key reason was sanctions that the EU, including the UK, imposed on Russia in 2014 in connection with the annexation of Crimea and the beginning of a conflict in eastern Ukraine where Ukrainian separatists were formally supported by



**Fig. 8.3** Russia's trade with the UK, 2010–2016 (USD billion) (Source Own elaboration based on data from the United Nations Commodity Trade Statistics Database)

Russia. Another, more important, reason was Russian counter-sanctions imposed on EU member states.

As a result, Russia's trade balance with the UK deteriorated dramatically in 2014 and 2015 (Fig. 8.3). While in 2008 the positive balance of trade was USD 7.3 billion, followed by USD 5.1 billion in 2010, in 2014 the value of Russian imports from the UK exceeded that of Russian exports to that country for the first time in the twenty-first century. Consequently, Russia recorded a negative trade balance with the UK at around USD 300 million. In 2015, the situation improved slightly for Russia, with a positive balance of around USD 800 million.

In 2016, as shown in Fig. 8.3, Russian exports to the UK and total trade turnover as well as the trade balance were all up on the corresponding values for 2015. However, the same cannot be said of the value of Russian imports from the UK, which fell by about USD 3 billion. Russia's imports from the UK began declining in 2013.

The structure of Russian exports to the UK from 2010 to 2016—within the four basic goods categories classified by the OECD based on technological advancement—shows that medium-low-tech goods figured most prominently among Russia's exports, especially the *Coke, refined petroleum products and nuclear fuel* subcategory (Table 8.1). However, the value of such exports dropped sharply from USD 4.7 billion in 2010 to USD 1.4 billion in 2016. Meanwhile, the value of Russian medium-low-tech exports in the *Basic metals and fabricated metal products* subcategory increased from USD 0.3 billion in 2010 to USD 1.1 billion in 2016.

Russia exports a marginal volume of high-tech goods to the UK. Under the OECD classification, these include the following subcategories: *Aircraft and spacecraft; Medical, precision and optical instruments; Office, accounting and computing machinery; Pharmaceuticals*, and *Radio, TV and communications equipment*. Such exports peaked at around USD 120 million in 2012 and 2013, but then fell again, largely because Russian high-tech goods are uncompetitive on international markets.

Russian imports from the UK in the 2010–2016 period (Table 8.2) were dominated by medium-high-tech goods, especially *Motor vehicles, trailers and semi-trailers* and *Machinery and equipment, n.e.c.*; and high-tech goods, especially *Pharmaceuticals* and *Medical, precision and optical*

Table 8.1 Russia's exports to the UK by type of goods, according to the OECD classification, 2010–2016 (USD million)

Category	Subcategory	2010	2011	2012	2013	2014	2015	2016
HT	Aircraft and spacecraft	9.9	11.3	85.3	82.2	45.0	14.1	8.4
	Medical, precision and optical instruments	13.5	22.8	22.1	25.6	29.1	24.4	21.0
	Office, accounting and computing machinery	2.7	1.4	1.3	3.8	4.0	7.0	5.2
	Pharmaceuticals	0.6	0.3	1.2	0.3	3.1	1.3	1.5
	Radio, TV and communications equipment	9.3	9.7	9.1	10.0	8.4	9.2	6.9
<b>HT Total</b>		<b>35.9</b>	<b>45.5</b>	<b>119.0</b>	<b>121.9</b>	<b>89.6</b>	<b>56.1</b>	<b>42.9</b>
MHT	Chemicals excluding pharmaceuticals	310.7	188.2	209.5	120.7	150.9	142.6	102.4
	Electrical machinery and apparatus, n.e.c.	13.4	6.4	5.9	16.2	14.2	17.3	8.9
	Machinery and equipment, n.e.c.	20.6	11.5	15.5	23.3	19.6	28.7	21.4
	Motor vehicles, trailers and semi-trailers	0.6	0.4	1.7	2.8	1.8	3.6	4.6
	Railroad equipment and transport equipment, n.e.c.	0.1	0.2	0.2	0.4	0.4	0.6	1.1
<b>MHT Total</b>		<b>345.4</b>	<b>206.6</b>	<b>232.8</b>	<b>163.4</b>	<b>186.8</b>	<b>192.8</b>	<b>138.2</b>
MLT	Basic metals and fabricated metal products	297.2	593.1	4158.7	840.3	894.3	404.4	1099.1
	Building and repairing of ships and boats	2.8	8.9	–	0.1	–	0.4	56.9
	Coke, refined petroleum products and nuclear fuel	4749.9	5568.5	3789.2	6060.8	4007.0	2561.8	1426.6
	Other non-metallic mineral products	8.5	6.4	5.7	5.9	7.2	8.9	16.7
	Rubber and plastics products	1.2	1.8	1.9	4.5	5.4	11.2	10.8
<b>MLT Total</b>		<b>5059.5</b>	<b>6178.7</b>	<b>7955.5</b>	<b>6911.6</b>	<b>4914.0</b>	<b>2986.7</b>	<b>2610.1</b>

(continued)



Table 8.1 (continued)

Category	Subcategory	2010	2011	2012	2013	2014	2015	2016
LT	Food products, beverages and tobacco	60.2	71.3	68.7	76.6	70.0	53.4	36.6
	Manufacturing, n.e.c.	4.9	4.9	8.8	5.4	6.9	6.1	5.6
	Textiles, textile products, leather and footwear	4.4	2.4	7.3	4.5	2.6	17.0	5.6
	Wood, pulp, paper, paper products, printing and publishing	142.6	152.2	134.3	126.2	159.8	150.3	143.2
	<b>LT Total</b>	<b>212.2</b>	<b>230.7</b>	<b>219.0</b>	<b>212.7</b>	<b>239.3</b>	<b>226.9</b>	<b>190.9</b>
	<b>Other Total</b>	<b>4042.7</b>	<b>3688.4</b>	<b>4035.6</b>	<b>4945.2</b>	<b>2074.1</b>	<b>1061.3</b>	<b>4014.8</b>
	<b>Export Total</b>	<b>9695.7</b>	<b>10,349.9</b>	<b>12,561.8</b>	<b>12,354.7</b>	<b>7503.8</b>	<b>4523.7</b>	<b>6996.9</b>

Source Own elaboration based on data from the United Nations Commodity Trade Statistics Database

Table 8.2 Russia's imports from the UK by type of goods, according to the OECD classification, 2010–2016 (USD million)

Category	Subcategory	2010	2011	2012	2013	2014	2015	2016	
HT	Aircraft and spacecraft	0.7	30.8	62.1	6.2	1.4	17.5	–	
	Medical, precision and optical instruments	230.7	248.9	337.3	305.9	295.0	174.3	148.2	
	Office, accounting and computing machinery	36.1	26.4	27.5	19.8	14.4	8.5	10.3	
	Pharmaceuticals	533.6	626.8	606.2	816.6	490.5	433.2	418.7	
MHT	Radio, TV and communications equipment	46.6	64.0	71.2	56.0	228.5	33.7	46.9	
	<b>HT Total</b>	<b>847.8</b>	<b>996.9</b>	<b>1104.3</b>	<b>1204.5</b>	<b>1029.7</b>	<b>667.2</b>	<b>624.1</b>	
	Chemicals excluding pharmaceuticals	551.6	946.1	1048.1	890.3	697.1	530.6	552.8	
	Electrical machinery and apparatus, n.e.c.	252.9	332.6	420.5	411.4	1161.8	336.0	160.5	
	Machinery and equipment, n.e.c.	578.6	1181.0	1392.5	1228.1	956.1	463.7	517.8	
	Motor vehicles, trailers and semi-trailers	1167.5	2280.0	2697.7	2761.3	2107.6	808.6	726.2	
	Railroad equipment and transport equipment, n.e.c.	0.5	2.2	2.3	3.5	4.3	2.6	1.4	
	<b>MHT Total</b>	<b>2551.1</b>	<b>4741.9</b>	<b>5561.1</b>	<b>5294.6</b>	<b>4926.9</b>	<b>2141.4</b>	<b>1958.7</b>	
	MLT	Basic metals and fabricated metal products	227.1	277.5	273.6	236.5	281.6	150.1	129.8
		Building and repairing of ships and boats	9.2	36.5	40.6	59.0	29.3	26.0	3.7
Coke, refined petroleum products and nuclear fuel		76.4	67.0	82.6	64.0	64.1	45.7	38.1	
Other non-metallic mineral products		39.5	47.8	55.5	72.4	66.9	34.8	34.7	
Rubber and plastics products		140.9	202.5	210.0	199.6	184.4	116.2	122.9	
<b>MLT Total</b>	<b>493.1</b>	<b>634.4</b>	<b>662.4</b>	<b>631.5</b>	<b>626.2</b>	<b>372.8</b>	<b>329.3</b>		

(continued)

Table 8.2 (continued)

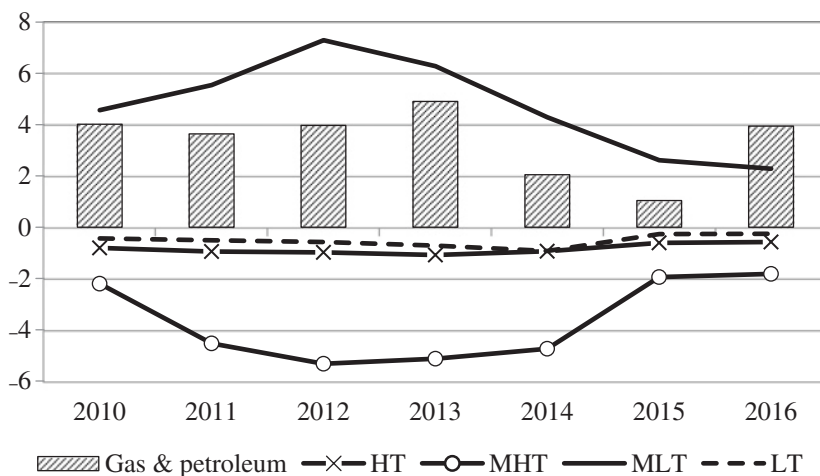
Category	Subcategory	2010	2011	2012	2013	2014	2015	2016	
LT	Food products, beverages and tobacco	399.0	517.3	582.1	601.3	543.6	314.1	306.0	
	Manufacturing, n.e.c.	35.4	43.4	38.7	41.7	50.0	46.3	36.9	
	Textiles, textile products, leather and footwear	38.2	47.0	62.8	75.7	64.8	35.5	27.8	
	Wood, pulp, paper, paper products, printing and publishing	175.0	132.7	113.6	213.7	509.1	102.7	76.1	
	<b>LT Total</b>	<b>647.6</b>	<b>740.3</b>	<b>797.2</b>	<b>932.4</b>	<b>1167.4</b>	<b>498.6</b>	<b>446.7</b>	
	<b>Other Total</b>	<b>27.8</b>	<b>49.4</b>	<b>66.6</b>	<b>43.5</b>	<b>27.8</b>	<b>20.0</b>	<b>73.4</b>	
	<b>Import Total</b>	<b>4567.4</b>	<b>7162.8</b>	<b>8191.6</b>	<b>8106.4</b>	<b>7778.0</b>	<b>3700.1</b>	<b>3432.2</b>	

Source Own elaboration based on data from the United Nations Commodity Trade Statistics Database

*instruments*. At the end of the analysed period, the value of Russian imports of such goods decreased, leading to a decline in the country's overall imports from the UK.

If we look at the balance of trade between Russia and the UK from 2010 to 2016 (Fig. 8.4), it is clear that Russia had a positive trade balance only in medium-low-tech goods, a category in which it consistently possessed RCAs (as demonstrated in the first part of this study). Likewise, Russia's trade balance was positive in crude oil and natural gas. This positive trade balance declined markedly in 2014–2015, due to a smaller volume of trade in these goods rather than a significant decrease in world oil prices.

Russia repeatedly recorded a negative trade balance for the other three OECD categories, i.e. high-tech, medium-high-tech and low-tech goods. The trade balance in medium-high-tech goods was especially unimpressive, especially from 2011 to 2014. Meanwhile, an overall decline in the value of bilateral trade led to a “flattening” of the trade balances in all three categories in 2015–2016.



**Fig. 8.4** Balance of Russia–UK trade in individual goods categories, according to an OECD classification based on technological advancement, as well as in gas and oil, 2010–2016 (USD billion) (Source Own elaboration based on data from the United Nations Commodity Trade Statistics Database)

In analysing the structure of Russia's trade with the UK, a different perspective can be taken with a classification of goods according to the UN Standard International Trade Classification Rev. 4 or SITC Rev. 4 (Tables 8.3 and 8.4).

Taking into account all Russian exports to the UK in 2010–2016, as shown in Table 8.3, *Mineral fuels, lubricants and related materials* (Section 3) dominated until 2015, accounting for 85.5% of Russia's total exports to the UK in the peak year of 2013. In 2016, *Commodities and transactions not classified elsewhere in the SITC* (Section 9) represented 49% of total Russian exports to Britain.

As reflected by the data, the structure of Russian exports to the UK showed no significant diversification during the analysed period. Except for Sections 3 and 9 as well as *Manufactured goods classified chiefly by material* (Section 6), all the remaining categories played an insignificant role in exports. The share of goods from Section 6 increased more than threefold over the analysed period, from 3.8% in 2010 to 12.2% in 2016.

Meanwhile, Russian imports from the UK (Table 8.4) were dominated by *Machinery and transport equipment* (Section 7), whose share ranged from 43.1% of total imports in 2016 to 58.7% in 2014. *Chemicals and related products, n.e.s.* (Section 5) also played a significant role, accounting for 15.8% of total imports in 2014 and 29.4% in 2016.

This analysis of the structure of Russia's trade with the UK shows that Russian exports were dominated by low-value-added and labour-intensive goods rather than capital-intensive and low-cost products. The key role was played by *Mineral fuels, lubricants and related materials* (Category 3), goods in which Russia is unquestionably competitive internationally, as evidenced by its strong RCAs.

On the other hand, Russian imports from the UK were dominated by highly processed, high-value-added and capital-intensive goods rather than labour-intensive, medium-high-tech products—mainly *Machinery and transport equipment* (Section 7).

To sum up, the structure of Russian–UK trade by type of goods should be described as unfavourable for the Russian economy, chiefly because of unfavourable terms of trade and a strong dependence on the

**Table 8.3** Russian exports to the UK by type of goods, according to the SITC Rev. 4 classification, 2010–2016 (%)

Code	Section	2010	2011	2012	2013	2014	2015	2016
0	Food and live animals	0.2	0.3	0.2	0.2	0.4	0.7	0.6
1	Beverages and tobacco	0.1	0.2	0.2	0.2	0.5	0.5	0.3
2	Crude materials, inedible, except fuels	2.3	1.1	0.7	1.1	3.8	3.6	1.6
3	<b>Mineral fuels, lubricants and related materials</b>	<b>74.5</b>	<b>85.4</b>	<b>57.7</b>	<b>85.5</b>	<b>78.2</b>	<b>77.7</b>	<b>32.7</b>
4	Animal and vegetable oils, fats and waxes	0.3	0.3	0.2	0.3	0.2	0.2	0.0
5	Chemicals and related products, n.e.s.	2.1	2.0	1.9	1.1	2.0	3.3	1.6
6	Manufactured goods classified chiefly by material	3.8	6.6	12.4	6.7	6.4	10.2	12.2
7	Machinery and transport equipment	0.6	0.6	1.0	1.1	1.3	1.8	1.6
8	Miscellaneous manufactured articles	0.3	0.3	0.3	0.3	0.5	1.1	0.5
9	Commodities and transactions not classified elsewhere in the SITC	15.8	3.4	25.4	3.4	6.7	0.9	49.0
Total (%)		100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source Own elaboration based on data from the United Nations Commodity Trade Statistics Database

**Table 8.4** Russia's imports from the UK by commodity according to the SITC Rev. 4 classification, 2010–2016 (%)

Code	Section	2010	2011	2012	2013	2014	2015	2016
0	Food and live animals	3.6	2.4	1.9	2.2	2.2	2.4	2.8
1	Beverages and tobacco	5.3	5.2	5.5	5.4	5.0	6.3	6.4
2	Crude materials, inedible, except fuels	0.8	0.7	0.6	0.5	0.4	0.6	0.6
3	Mineral fuels, lubricants and related materials	1.3	1.0	1.0	0.8	0.8	1.3	0.7
4	Animal and vegetable oils, fats and waxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5	Chemicals and related products, n.e.s.	24.5	19.7	16.9	19.9	15.8	26.8	29.4
6	Manufactured goods classified chiefly by material	10.2	7.2	6.3	6.1	6.7	8.0	8.0
7	<b>Machinery and transport equipment</b>	<b>47.5</b>	<b>55.8</b>	<b>58.6</b>	<b>56.4</b>	<b>58.7</b>	<b>46.3</b>	<b>43.1</b>
8	Miscellaneous manufactured articles	6.6	8.0	8.9	8.6	10.4	8.3	7.4
9	Commodities and transactions not classified elsewhere in the SITC	0.1	0.0	0.3	0.1	0.0	0.0	1.6
Total (%)		100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source Own elaboration based on data from the United Nations Commodity Trade Statistics Database

prices of energy raw materials on international markets. Moreover, the structure of Russian–UK trade closely matches the competitive profile of the Russian economy. Russia exports to the UK goods in which it possesses RCAs (medium-low-tech goods), while importing those in which it has no RCAs (especially medium-high-tech goods).

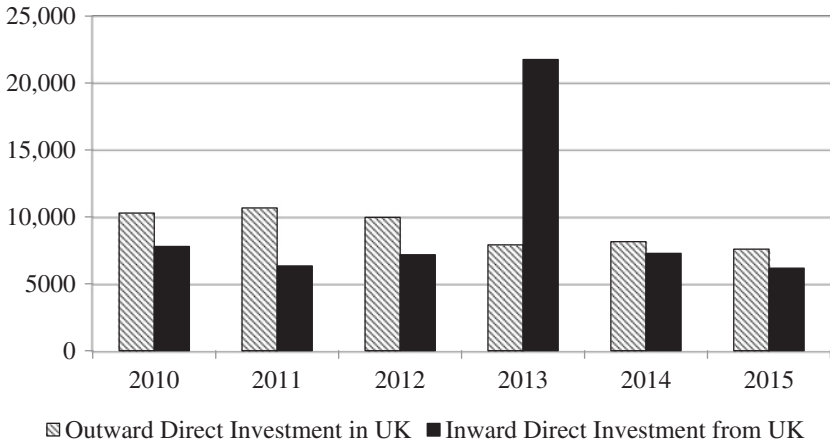
As it remains unclear what rules will govern the UK's commercial relations with other countries in the future, it is difficult to clearly identify the possible consequences of Brexit for Russia's competitiveness in trade with Britain. However, considering that Russia and the UK are not key trading partners for each other, Brexit should not affect the international competitiveness of the Russian economy. This assertion seems all the more justified since Russia's biggest RCAs in international trade are in energy raw materials, weapons and military aircraft of which the UK is not a significant importer. This would mean that any potential changes in trade conditions for these goods after Brexit are unlikely to affect competitiveness. On the other hand, Russia imports ready-made, highly processed medium-high-tech industrial goods that do not add to the country's competitiveness.

## **8.4 Investment Cooperation Between Russia and the UK in 2010–2015; Potential Changes After Brexit**

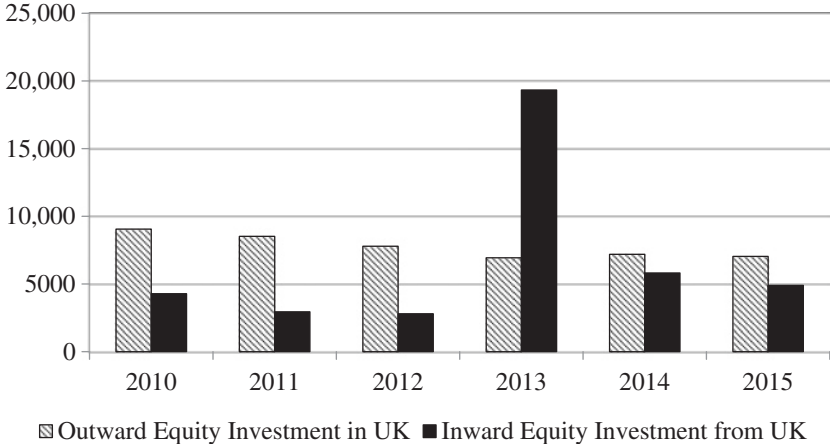
Another important area of economic relations between Russia and the UK is investment cooperation. The mutual importance of Russia and the UK as investment partners has been relatively high for years. The UK, alongside the Netherlands, Cyprus and Germany, has traditionally been a major investor in Russia, while Russia is a major investor in the UK where Russian capital is mostly invested in real estate and shares of companies listed on the London Stock Exchange.

When analysing mutual direct investment (Fig. 8.5) and equity investment (Fig. 8.6) in 2010–2015 (with 2015 being the latest year for





**Fig. 8.5** Russia–UK direct investment, 2010–2015 (USD million) (Source Own elaboration based on the International Monetary Fund data)



**Fig. 8.6** Russia–UK equity investment, 2010–2015 (USD million) (Source Own elaboration based on the International Monetary Fund data)

which IMF data is available), it should be noted that Russian investment in the UK was consistently higher than British investment in Russia. The only exception was 2013 when British direct and equity investment in Russia was nearly three times as high as Russian investment in Britain. The spike in UK investment in Russia that year was due to an IPO of oil company Rosneft as well as investment by the British-based Royal Dutch Shell group in projects including LNG (Russia Direct 2017; Santander 2016).

In 2014 and 2015, UK investment flows into Russia declined, especially compared to 2013, due to geopolitical tensions between Russia and the West over Ukraine and an economic crisis (decreased attractiveness of shares of Russian energy companies as a result of falling oil prices on international markets). For instance, in the aftermath of EU sanctions imposed on Russia, Royal Dutch Shell had to stop working with Gazpromneft in a shale oil development project. Consequently, in 2015 the UK was ranked a distant 11th among the largest foreign investors in Russia, with 2.9% of total FDI.

As regards capital flows (both direct and portfolio investments) between Russia and the UK, no major changes should be expected post-Brexit. The countries' bilateral political relations will be far more important (e.g. the question of keeping Western sanctions against Russia or Russian counter-sanctions in place) than the UK's exit from the European Union unless there is a major decline in the attractiveness of the UK economy and Russian investors lose interest in investing in Britain. But such a scenario is practically impossible due to the strength and importance of the UK economy.

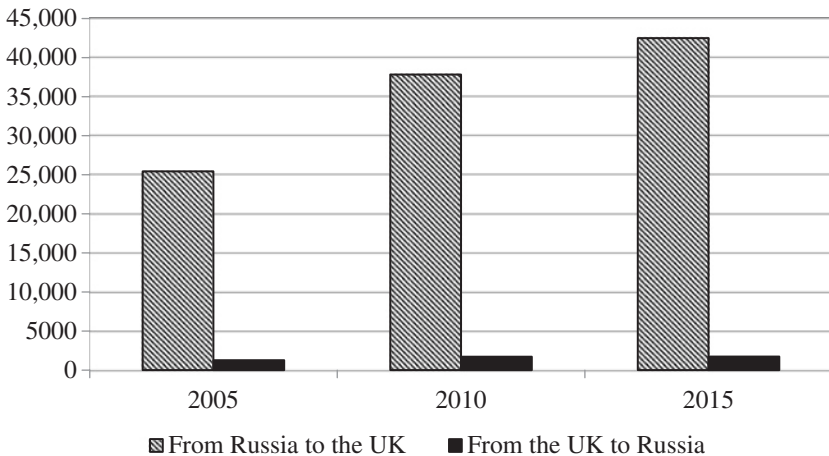
Significantly, UK investment in the extraction of Russian energy raw materials, particularly natural gas, and sales of technology for extracting deeply buried gas deposits, decreased markedly as a result of Western sanctions imposed on Russia (Falkowski 2015). This undoubtedly had a negative effect on Russia's competitiveness given its comparative advantages in the extraction and export of energy raw materials (Falkowski 2013, 2017b) .

## 8.5 Migration Between Russia and the UK from 2010 to 2016; Potential Changes After Brexit

Another important dimension of relations between countries is the flow of labour. Recently, its significance has grown tremendously in both Europe and elsewhere.

In the case of relations between Russia and the UK, there is a clear imbalance in this area. As shown in Fig. 8.7, the UK is a far more attractive destination to settle and find a job for Russians than Russia is for Britons. Considering the total migrant stock, the number of Russians who officially emigrated to the UK increased from 25,439 in 2005 to 42,491 in 2015 (up by 67%). To compare, the number of British citizens who immigrated to Russia rose from 1267 in 2005 to 1741 in 2015 (an increase of 37.5%).

Likewise, no significant changes should be expected in terms of population migration after Brexit. The current visa regime is highly likely to continue in the future, while labour market access will be regulated



**Fig. 8.7** Russia–UK total migrant stock in 2005, 2010 and 2015 (number of people) (Source Own elaboration based on United Nations data)

by bilateral agreements. Therefore, the countries' bilateral political relations will be of key importance. Nevertheless, the growing migration of young and well-educated Russians to the UK may have a negative impact on Russia's competitiveness.

## 8.6 Conclusions

The international competitiveness of the Russian economy is low and does not reflect the country's potential. This is a direct consequence of the policy of abandoning transformation and modernisation in the economic and social system inherited from the former USSR. Russia's competitive profile in international trade is predominately based on mineral resources, especially energy, which makes the economy dependent on volatile price developments in international commodities markets. As shown by the analysis in this chapter, Russia possesses RCA only in the trade of medium-low-tech goods, which include raw materials and their processed derivatives. Russia does not have any advantages in low-tech, medium-high-tech and high-tech goods.

In view of the above, the impending exit of the UK from the EU should have little effect on Russia's international competitiveness. Although Russian–UK trade is dominated by Russian exports of mineral fuels, lubricants and related materials, Britain is not a significant importer of such goods. On the other hand, Russia imports from the UK ready-made, highly processed medium-high-tech industrial goods that meet domestic demand but do not add to the competitiveness of the Russian economy. It does not seem reasonable to expect that the existing commodity structure of mutual trade could change anytime soon, not even in the medium term.

Brexit will have even less impact on investment cooperation between Russia and the UK, which will chiefly depend on macroeconomic developments in these countries and government policy towards foreign investment. In this context, a potential significant change in the economic situation in the UK could affect the country's investment attractiveness and thus Russian investment, especially portfolio investment. But such a scenario has no basis in fact today. In Russia, in turn, much

will depend not only on the macroeconomic situation but also on the Kremlin's policy towards foreign investors in sectors such as raw materials and mineral resources, which are key to the country's international competitiveness. Nor should any serious changes be expected in population migration between Russia and the UK as a result of Brexit.

In conclusion, due to the scale of mutual economic cooperation and the competitive profile of the Russian economy, Brexit should have little impact on Russia's international competitiveness. Much more important for Russia's future competitiveness will be macroeconomic factors, but, above all, efforts to modernise its economy and reorient it towards one based on knowledge and technology rather than raw materials.

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