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Foreign Trade Activities of Russian Companies Over the Last 6 Months of 1991

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Given the beginning of radical economic reforms in Russia, there are a considerable obstacles to follow and to analyze the situation. Nevertheless, the major obstacles in the process of reforms had concentrated in the certain area, namely in foreign trade activities of Russian companies. Therefore, this is a matter of great importance both for foreign trade relationships and for comprehensive analysis of economic dynamics in Russia.

BRIEF SUMMARY OF ECONOMIC DEVELOPMENT IN 1991

According to the published statistics, the amount of foreign trade has diminished considerably: exports of goods and services have gone down by 29%, compared to 1989, imports — by 46%. The decline in exports of oil and non-ferrous metals is especially alarming. The exports of timber have dropped by 1/3. As regards imports, the most drastic decline was in consumer goods. Against the general fall in the amounts of foreign trade, we should mention the following trends. Obviously, this decline is the immediate result of the overall crisis of the state economy. However, parallel to this decline, commercial structures, especially Joint Ventures, are gaining in force. In 1990 they accounted for 1.7% of Russia's annual exports and 2.2% of its imports.

NEW WAYS TO ESCAPE NATIONAL TAXATION

Escaping excessive taxes on hard currency earnings is one of the tendencies characteristic of Russian commercial structures dealing in foreign trade. First, they tend to open abroad off-shore companies designed to keep the currency part of their earnings from taxation. This method of escaping national taxation is well-known in the world. However, under Russian conditions it has some specific features. Because the ruble is non-convertible, the state took 70% of the hard currency earnings. In return for the currency the companies received rubles exchanged at an irrationally high commercial rate (1.8 rubles for $1), which was 20-40 higher than the market rate. This practice was only abolished in late 1991.

Secondly, the companies started to resort to different kinds of "cooperative" agreements with their foreign partners. For example, a computer exported to Russia was first dismantled, and then brought to the country as a set of parts, in which case the import taxes were 3 times lower. In addition to this, Russian businessmen began to use actively the widely-known principle of "transferred" prices. Prices for such transactions were, as a rule, understated, thus, a certain portion of currency earnings was removed from taxation.

Thirdly, ventures (JV) started to act as intermediaries in foreign trade relations. The participation of JV in the process speeds up and partly eases foreign trade operations. The following mechanism is at work. Russian exporting-company sells its goods to the JV for rubles on the condition that the JV will deliver in return Western goods for the equivalent sum. The JV then buys the goods with its own hard currency. JV's are more active as intermediaries, because with the falling currency rate of the ruble, conversion operations have become more difficult. Moreover, such operation are profitable for JV; they get good commissions both in rubles and in hard currency.

In autumn of 1991 foreign trade transactions guaranteed by commercial banks which have licenses for hard currency operations became more wide-spread. It became possible to evade the so-called commercial rate (1.8 rubles for $1). Russian importing company transfers rubles to the account of the bank according to the current market rate which fluctuates at a daily basis. The bank then signs a contract with a foreign company to deliver goods to Russia with the bank's guarantee. Meanwhile, the bank finds a Russian company which wants to sell its goods to the bank for rubles. These goods will then be sent to the foreign company as a payment for the imported goods. As a result, only goods cross the border, real export-import transactions are carried out inside the country.

THE STRUCTURE OF PRICES AND COMPETITIVE ADVANTAGES

Over the last 6 months the specifics of Russian foreign trade was largely determined by the national structure of supply and demand. Compared to Western countries, the prices for raw materials in Russia were unrealistically low, while the prices for finished goods were very high. Indeed, they were so high, that the relation of these 2 sets of prices sometimes reached incredible dimensions.

To have a clear estimation of this economic phenomenon, we should compare the relation of prices in Russia to the similar relation in the West. For example, if

we take the relation of computer to fuel prices in the West for 1 unit, the similar relation in Russia will be 60 times higher (on the outdated PC/XT), 20-25 (on PC/AT 286), 15-20 (on PC/AT 386 and PC/AT 486 accordingly). Electronics (color TV-sets and VCR's) and fuel is another example: the proportion in Russia is 10-15 times higher than in the West.

The prices on clothing estimated in the same way give the result of 10-20 times depending on the quality of the goods (while the relative prices on lower-quality goods are higher).

· Comparing the prices on the above-mentioned goods with the prices on non-ferrous metals, we get the same results. The only difference is that the proportion is 3-3.5 times lower than in the case with the fuel.

All these considerations lead us to the following conclusion. In spite of all the changes in the currency sphere, Russia's traditional advantage (its richness in raw materials) together with the vast deficit of finished goods make foreign trade increasingly attractive both for national and international entrepreneurs.

THE RUBLE: INTERNAL AND EXTERNAL DEVALUATION

Over the last 6 months of 1991, foreign trade activities in Russia were strongly affected by inflationary process; to be exact, by the combination of the upward price movement at the home market and the external devaluation of the ruble.

The preliminary data available on the growth of consumer prices and the changes in the currency exchange rate in 1991 show the following trends. While the overall inflation in cash circulation for 1991 was roughly 800%, the prices went up mainly in November-December of 1991. The currency exchange rate for the ruble was speedingly falling all through the second half of the year. While in summer 1991, the exchange rate in non-cash transactions was around 30 rubles for $1, in September it went up to 50, in November −70, and from December onward more than 100 rubles for dollar. Thus the rate of external devaluation of our national currency outpaced the rate of its internal devaluation; And as a result, in autumn of 1991, the so-called "real" currency rate of the ruble started going down.

However, these developments did not cause ruble earnings of state exporting-companies to increase; because these companies still had to exchange at the commercial rate of 1.8 rubles for $1. This explains why the decline of the "real" currency rate did not stimulate exports from the state sector.

As it was expected, the drop of the "real" currency rate of the ruble mostly hit state enterprises importing goods. They had to diminish their demand for practically all goods previously imported.

As regards the role of the new market structures in these developments, first, they are yet unable to replace the collapsing state sector of the Russian economy. In the last 6 months JV and cooperatives accounted for only $60-70 mon of the monthly exports from Russia.

Secondly, the decline in the "real" currency rate of the ruble has negatively affected the selection and the quantity of goods previously exported by these companies. And it also forced many importers out of the foreign trade market. Moreover, sometimes the purchased goods were not sold right away, but were stored to wait for prices to increase.

Thirdly, sharp fluctuations in the "real" currency rate of the ruble, constant changes in business conditions, legal uncertainty, and lack of experience in foreign trade operations were the main reasons for Russian exporting companies to unite their efforts with importing companies and set up new export-import structures. These companies similar to the Japanese are most likely to form the basis for Russian non-state foreign trade sector. Experience proves that such foreign trade companies are not only capable of adopting to the extremely difficult business conditions during the economic crises but also getting high returns on their investment.

The basic comparison of prices at commodity exchanges in Russia with prices at Western exchanges shows us the following. The coefficient for prices on diesel fuel is 4.0 (i.e. 4 rubles invested in Russia bring the return of $1 in the West). The same coefficient for black oil is 6.0, for gas −7.0, for "Bent" oil and aluminum −15.0, for lead and nickel −20.0, for ferrous metals −39.0, for sugar −60.0.

This means that by investing one ruble in Russia in export-import operations, these commercial structures can gain up to 100−120 rubles, if they sell those metals and products at Western exchanges and then import goods that are in short supply in Russia. It should also be noted here that now such operations mostly involve non-ferrous and refined metals.

FOREIGN TRADE AND NEW LEGAL REGULATIONS

The decree published on November 15, 1991 "On the liberalization of foreign trade in Russian Republic" was a significant event for Russian foreign trade. Naturally, over the last 1.5 months of 1991 this decree could not bring any visible results. However, it formed a good basis for the future development of Russia's foreign trade.

First, the decree lifted up practically all existing bans on international trade. It announced the legalizations of hard currency transactions and introduced the measures to make the ruble convertible within the country.

A closer look at the articles of this decree leads us to the following conclusions. First, the legal basis set by the decree makes it possible for more companies and enterprises to get involved in foreign trade operations. There is only one restriction: a license is required to export some goods (traditional Russia's export items-oil, metals, timber). This license can be obtained at exchanges and auctions.

Parallel to the abolishment of the above-mentioned bans, a free currency exchange rate for the ruble was introduced. There will be no restrictions for opening ruble checking accounts for foreign companies. More currency exchange agencies will be opened. Beginning from the summer of 1992, no foreign currency will be accepted for payments on the territory of Russia. Some experts consider that this might cause concern on the part of foreign investors who are not used to dealing in rubles and have a certain fear of working with our national currency.

Nevertheless, only determined position of Russia's leadership on this subject and introduction of stable legislation can help to gradually restore the undermined trust towards the ruble. Finally, this decree cancelled the law "On currency regulations", "On customs tariffs" and other documents of the former USSR which were contradicting it.

Nearly at the same time, the Russian government published other regulations concerning foreign trade. At the very end of 1991, 2 decisions "On licensing and quoting of export and import of goods (services) in Russia in 1992" and "On the introduction of an export tariff on certain goods exported from Russia".

The main novelty was the attempt to introduce market elements in the system of quoting and licensing. According to these regulations quotas and license will be sold through auctions on a competitive basis. The issue of licenses for exports of

most goods will be based on quotas. These quotas will be either fixed by the Russian Ministry of Economics and Finance and will then be given to state enterprises who will not have the right to sell them. Or the quotas will be given to the Committee on Foreign Economic (set by the Foreign Ministry of Russia) and then be sold through auctions.

The quota must be accompanied by a special certificate confirming the right of is owner to obtain the export license. The new regulations allow free trade of these certificates. There will be two versions of certificates: "country" certificates (specifying the name of the country to which goods will be exported) and "open" certificates (with no specification). The duration of the certificate is limited to 3 months.

The mechanism outlined in these regulations is, of course, far from ideal. To buy licenses before making foreign trade deals is risky, for there is no guarantee that the deal will be eventually concluded. Besides, the acquisition of a license by one company makes it harder for other potential exporters to sell their goods abroad. Buying a license before concluding a contract is also risky, because it might be impossible to buy it. This will entail the violation of the contract with all the consequences for Russian and foreign partners. According to the government's decision "On introduction of the export tariff on certain goods exported from Russia", all companies, including JV and foreign firms, must pay export taxes. The amount of these taxes is set in ECU's, but it can also be paid in rubles at the current market rate determined by the Central Bank of Russia.

Speaking about the new laws which will regulate foreign trade operations of Russian companies, we should also mention the decree of the Russian President "On formation of the Republic's currency reserve in 1992". To ensure the Republic's hard currency reserve this decree stipulates the obligatory selling of 40% of the hard currency earnings at the special commercial rate. Moreover, from January 1 1992, in order to from internal currency market, all companies, irrespective of form of ownership, must sell additional 10% of their hard currency earnings at the market rate.

The new regulations differ from the union law existing in 1991 in one more respect. Now JV are also obliged to sell part their hard currency profits.

According to the same document, all legal entities in Russia which have accounts in Western banks must transfer the money to their accounts in Russian banks.

Analysis shows foreign trade mechanism is far from stability. For the first instance, the discussion among Russian Federation and regions on the issue of property is not finished yet. Therefore, instruction of Federative ministries on export quotas will definitely rise sharp protests from regions and, after that, some unpredictable events could happen (Far Eastern Regional Association has already expressed to Moscow it's disagreements on fishing quotas). Then, still now we don't have single, but some exchange rates, being used for different purposes. Unfortunately, that situation will be impossible to overcome at least 2-3 years, because of deep differences among Russian and world prices structure. Finally, in certain areas administrative control was not reduced, but on the contrary, was expanded. It will cause massive illegal practice of Russian exporters. The example of foreign trade mechanism shows complexity and discrepancy of radical economic reform in Russia.