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EURASIAN ECONOMIC INTEGRATION AND THE POSSIBILITY OF INCREASING SERBIA`S EXPORTS TO RUSSIA

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Abstract: The purpose of this paper is to determine the effects of Serbian participation in the Eurasian economic integration processes on the export to the Russian Federation. The general hypothesis is that these benefits far outweigh the gains provided by the formal aspects of the agreement (customs rates, exemption lists, etc.). These assumptions are proven by statistical analysis and construction of an extended gravity model. The gravity model has determined the effects of several factors on Russia's imports. These are the size of import markets and the distance from Russia, as common elements, but also dummy variables related to membership in Eurasian integrations, the BRICS and the SCO. The model and coefficients were then applied to the Russian Federation's imports from Serbia, and the results showed that Serbia's accession to the EAEU could increase exports to Russia by almost a third. These expected positive effects are not the result of amendments to the agreement, but of the additional opening of a large Russian market to partner countries for the sake of strengthening alliances and influence in these countries.

Keywords: Eurasian integrations, commodity trade, Serbia, Russia, gravity model.

Introduction

A trade agreement strengthening is a crucial component of the contemporary global economy. These agreements are considered beneficial

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in many economic aspects: trade, FDI, growth, unemployment, and other impetus to the improvement of partner countries' economies. The ultimate objective of these agreements is to reduce the barriers to the circulation of goods, services, capital, labor, and more.

The reasons for the involvement of countries in economic integration processes are very different. Some see trade agreements as a basis for strategic alliances, and hence implicitly as a form part of security arrangements. International trade is the most preferred economic factor to grow and deepen the integration process of countries. Smaller open economies, such as Serbian, see trade agreements with larger partners as a way of obtaining more security for their access to larger country markets (Whalley, 1998, p. 63).

Despite the multidirectional foreign economic policy of Serbia, the main feature of its foreign trade is the constant, rapid growth of the trade deficit and a limited number of export partners. A new, particularly aggravating circumstance is the increasing trade protectionism that has been growing dramatically since the global financial crisis. It is vital for small open economies and their corporations to have access to large markets such as the EU, China, the USA, and Russia. Potentially, any increase in export volume and access to new markets has a great significance for the Serbian economy.

Serbia has had special trade relations with Russia since the period of the former Federal Republic of Yugoslavia (FRY) and signed free trade agreements in 2000. Serbia is joining the wider Eurasian integration processes with the agreements with Belarus from 2009 and Kazakhstan from 2010, which were by then in the Customs Union with Russia. The new agreement with the Eurasian Economic Union (EAEU), in the formal sense, offers Serbia only slightly more favorable conditions for free trade than those that Serbia already has had based on three existing agreements. The list of products exempted from the free trade regime when imported from Serbia is slightly expanded, almost identical to previous agreements. At first glance, the new form of co-operation seems to reflect more political rapprochement than the financial benefits of increasing exports.

In this paper, on the contrary, the hypothesis that the benefits of Eurasian integrations (EAI) far outweigh the gains expected from the formal aspects of the agreement (tariffs, quotas, lists of exceptions, and the like) is advocated. The agreement between Serbia and the EAEU signed at the end of 2019 can significantly strengthen economic ties with Russia and increase

exports to this large market. This hypothesis includes the assumption that Serbia's involvement in the Eurasian integration process has a special, much greater impact on economic relations with Russia than the 2000 bilateral free trade agreement with Russia. This is indicated by data showing strong growth in exports of Serbia, Armenia, Uzbekistan and other countries to the Russian market, not since the signing of the FTA agreement with Russia, but since inclusion in broader forms of integration or agreements that preceded the EAEU.

An indicator of this hypothesis is the fact that the Russian Federation does not need imports from the Eurasian integration member states. The Russian economy has been developing and diversifying rapidly since 2000. Industrial production far exceeds partner countries in terms of volume, diversity, and technological level. Agriculture has been achieving amazing results since 2009 and is approaching food self-sufficiency opportunities. However, Russian imports from Belarus, Kazakhstan, Uzbekistan, and even Serbia are disproportionately large in relation to the strength of these economies. Every step of the member states deeper into integration seems to lead to Russia opening up most of its huge market to partner countries. This is done not because of the economic need for goods from these more developed economies, but for the sake of strengthening alliances and influence in these countries. It is, therefore, a non-economic factor and the informal impact of the EAI accession on exports to Russia.

The aim of this study is to quantify and measure this informal impact of the EAI membership on Russian imports of goods from partner countries. The next goal is to apply the obtained coefficients to Serbian exports to Russia in order to determine its potential increase.

The single-country gravity model will be applied to the imports of the Russian Federation. The model will be extended with three dummy variables for regional economic integrations: Eurasian integration forms (EAI), Brazil, Russia, India, China and South Africa group (BRICS), and the Shanghai Cooperation Organization (SCO).

The survey includes data for the period 2000-2018. The composition of data is the panel data. More precisely, these are two panels with two different samples of trade partners with Russia. The first sample includes data on Russian imports from 15 countries with which it is connected by some form of integration. The second sample was expanded with the largest 20 import partners not included in the first sample, i.e., a total of 24 countries.

Literature review

Theoretical assumptions about the importance of economic integration agreements are the subject of a relatively small number of books and papers, given the growing number and importance of these forms of international cooperation. Some of the most significant are Whalley (1998), Kohl (2013), Czerewacz-Filipowicz and Konopelko (2017), and others. They explore the different motives and interests of countries in joining regional economic integrations. The findings of these and other studies can be reduced to the following advantages of economic integration:

- reduce costs for both consumers and producers;
- improved availability of goods and services;
- increase trade between the countries involved in the agreement;
- encourage employment;
- ensure the more dynamic economic development of member states;
- provide new employment opportunities based on market expansion, technology sharing, and cross-border investment;
- provide political cooperation among member countries.

The theoretical basis of the methodological approach of this research is broad and branched. Since the gravity equation was introduced by Tinbergen (1962) and Linnemann (1966), it has been used in hundreds of papers for estimating the determinants of bilateral trade. This concept was further developed, among others, by Anderson (1979), Bergstrand (1985), and Helpman et al. (2008).

To analyze the effects of regional integrations, researchers typically add dummy variables for participation in regional arrangements (Hamilton and Winters 1992, Frankel and Wei 1993, Eichengreen and Irwin, 1998). A positive coefficient on dummy variables indicates that two countries, both of which participate in the same preferential arrangement, trade more with one another than predicted by their incomes, population, and distance.

Some of the most comprehensive works on the Eurasian integration processes are the papers of Vymyatnina and Antonova (2014), Czerewacz-Filipowicz and Konopelko (2017), Wilson (2017) and Vinokurov (2018). The most significant empirical research that combines the same subject and methodology as this research are the papers of Head and Mayer (2014), and

Baier, Bergstrand, and Feng (2014) who used the gravity equation with EIA dummies to determine the welfare gains from EIAs.

Economic relations between Russia and Serbia

Serbia in the Eurasian economic integration processes

'The chronology of Serbia's free trade agreements demonstrates that during the entire period following the collapse of Yugoslavia, Serbia conducted a multidirectional foreign economic policy, developing relations with both its western and eastern partners' (Lisovolik, Chimiris, 2018, p. 6). Serbia has been a member of the Central European Free Trade Agreement (CEFTA). It has preferential customs regimes with the European Union, the United States, and the Eurasian Economic Union. Also, Serbia has concluded bilateral free trade agreements with Turkey and the members of the European Free Trade Association – EFTA (Norway, Switzerland, Iceland, and Liechtenstein) (Development Agency of Serbia, 2017). Serbia is also a beneficiary of Japan's preferential duties on importation to Japan.

The motives for joining economic integration are very different in large economies that are at the center of integration processes and in small, less developed countries. Serbia, as a typical representative of this second group, cannot stay out of international economic flows. Its motive to get involved in all available integration processes is perhaps the most conventional objective. Namely, the country's participation in any trade negotiation is triggered by the 'idea that through reciprocal exchanges of concessions on trade barriers there will be improvements in market access from which all parties to the negotiation will benefit' (Whalley, 1998, p. 71).

The EAEU commenced operations on 1 January 2015, but its origin can already be seen as early as in the first part of the 1990s (Eurasian Customs Union – EACU), through the Eurasian Economic Community (EurAsEC), the Commonwealth of Independent States Free Trade Area (CISFTA), etc. The elements identified as priorities in the process of creating the EAEU are enabling the free movement of capital and financial market integration, the unification of business principles, enabling freedom of movement, the unification of tax systems, and monetary policy (Czerewacz-Filipowicz, Konopelko, 2017, p. 36). 'The EAEU provides for free movement of goods,

services, capital and labor, pursues coordinated, harmonized and single policy in the sectors determined by the Treaty and international agreements within the Union' (EAEU, 2015). A free trade agreement with the EAEU countries will grant free access to new markets and could improve the terms of trade with the Russian Federation. The result of the EAEU so far is the growth of the volume of trade in goods by the EAEU member states in 2017 and 2018 after a significant fall in 2016 (Eurasian Development Bank, 2017, 2019).

The intergovernmental free trade agreement between Russia and Serbia (then the Federal Republic of Yugoslavia) signed in August 2000 was Russia's first agreement with a country outside its region aimed at liberalizing the foreign trade regime. Serbia's strategic goal was to increase employment, achieve production and financial stability by stimulating and expanding mutual trade relations (Stanojevic, 2014, p. 263). The agreement stipulates that goods that can be proven to originate from Serbia (more than 50% of the content from Serbia) are not subject to customs duties when intended for the Russian market unless exempted from the free trade regime. Serbia then joined the wider Eurasian integration processes. It signed a free trade agreement with Belarus in 2009 and Kazakhstan in 2010, as members of the Customs Union with the Russian Federation.

The Free Trade Agreement between the Republic of Serbia and the Eurasian Economic Union and its member states was signed on 25 October 2019 and ratified on 24 February 2020. This agreement complements the free trade agreement signed in 2000. Also, the list of products from Serbia that can be exported to the territory of the EAEU duty-free was expanded. Conveniences are provided for the export of some types of cheese, alcoholic beverages (fruit brandy and brandy), and cigarettes originating from Serbia to the EAEU market. Quotas for exports of goods that are not on the list of exceptions have also been increased. The free trade agreement with the EAEU replaced the existing free trade agreements that Serbia had with Russia, Belarus, and Kazakhstan. This document enables Serbia to export about 95.5% of domestic products to the EAEU countries without paying customs duties.

Therefore, the agreement with the EAEU offers Serbia somewhat more favorable conditions for free trade than those that Serbia already has based on the existing agreements. An alliance with the EAEU will also give Serbia a platform for entering new markets of the CIS countries, Armenia and Kyrgyzstan. The establishment of a free trade agreement between Serbia

and the EAEU countries could promote the so-called 'second-level import substitution' (Lisovolik and Chimiris, 2018, p. 24), which means that with dropping shares of third countries on the markets of Serbia and the EAEU, more opportunities open up for increasing the share of national manufacturers and service providers. Lisovolik and Chimiris (2018, p. 23) highlight another potential advantage: 'entering into an FTA with the EAEU will expand (Serbia's) opportunities to enter new markets in Asia, such as the ASEAN, with which the EAEU is building trade alliances.'

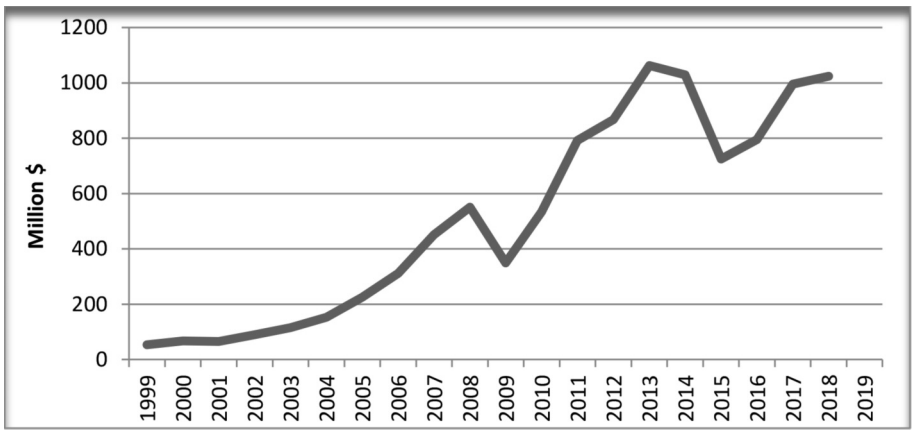
Key features of trade between Serbia and the Russian Federation

Russia has been one of Serbia's principal trade partners for several years. Their successful trade dates back to the time of the former FRY but has become increasingly important in recent years. The Russian Federation is the first Serbian partner on the import side and the fifth on the export side. Serbia's principal imports included oil, natural gas, aluminum, copper wire, and ferrous and non-ferrous metal products. Due to large energy imports, Serbia has a constant trade deficit.

Serbia's exports to Russia have been constantly and rapidly increasing since 2003 and especially since 2010 (Figure 1). If we compare this trend with previous data on Serbia's inclusion in the EAI processes, it can be noticed that the increase in exports did not occur after the signing of the agreement with Russia, but a sharp jump was recorded after the agreement with Belarus and Kazakhstan (Figure 1). It seems that participation in the Eurasian integration processes, at least in the case of Serbia, has a much greater positive impact on economic relations with Russia than bilateral agreements with this country.

From $50-60 million during the 1990s and early 2000s, Serbia's merchandise exports to the Russian Federation in 2013 reached almost $1,100 million. Since then, there has been a sharp but short-lived decline on two occasions, and in the period 2017-2019, Serbian exports to Russia again reached $1 billion (Figure 1). The cooperation agreement with the EAEU from December 2019 should encourage new export growth.

Figure 1. Serbia's exports to Russia 2004-2019 (million $)



Source: Author according to UN Comtrade – https://comtrade.un.org/data

Serbia's exports to Russia are dominated by textile and agricultural goods, medicines, paper, and pneumatic tires. The following table shows Serbia's exports by the most important product groups to Russia and total exports by groups for 2019. Product group classification according to the Harmonized System (HS) of the United Nation Conference of Trade and Development (UNCTAD) was used.

Table 1. Serbian export of selected commodity group

Commodity group UNCTAD classification	**Export to Russia (mil. $)**	**Total exports (mil. $)**	**Share (%)**
Dairy produce; eggs; honey	35.22	108.05	32.60
Fruit and nuts	173.25	610.20	28.39
Pharmaceutical products	72.49	290.17	24.98
Apparel and clothing accessories	101.66	461.84	22.01
Vegetables	22.26	129.38	17.21
Pneumatic tires	76.65	742.76	10.32

Source: Author according to UN Comtrade

Exports of dairy products, eggs, and honey to Russia make up more than a third of the total Serbian exports of these products, fruit exports about 29% of total exports, pharmaceutical products about 25% of total Serbian exports.

Assessing the Impact of the International Integration Processes on Russia's commodity imports

Russia's commodity import factors – model variables

The gravity model of trade is one of the most common approaches in modern econometrics, and it will be used as the basic quantitative method of this research. The dependent variable in the gravity model is most often exports, while the key independent variables are usually the size of the economies in the trade relationship and the distance between them. The most common are dummy variables such as common language, former colonial status, and the like. This research includes the basic elements of 'gravitational' attraction, but it is set up significantly different.

The model determines the factors of Russian imports from certain countries so that the dependent variable is Russian imports (expressed in millions of $, according to the UN Comtrade). The first independent variable is the size of the market from which Russia imports goods, expressed by their nominal GDP in a million $, according to the World Bank (World Bank indicators, 2020). Data on trade and GDP are expressed in nominal terms following Baldwin, Taglioni (2006), who suggested that deflating nominal GDP and trade by a price index is a mistake because the gravity equation is obtained from the expenditure, and not demand, functions and therefore it requires nominal data. Another independent variable is the distance between Moscow and the capitals of the partner countries.

To analyze the effects of regionalism, investigators typically add dummy variables for participation in regional arrangements (Eichengreen, Irwin, 1998; Frankel and Wei 1993). Three dummy variables related to international arrangements are included in this model.

Those are:

- Eurasian economic integrations which imply the Eurasian Economic Union (EAEU) and its previous forms, whose influence is at the center of research,
- The BRICS community, as an acronym for member countries: Brazil, Russia, India, China, and South Africa,
- The Shanghai Cooperation Organisation (SCO), in 2001 the Republic of Kazakhstan, the People's Republic of China, Kyrgyzstan, the Republic of Tajikistan, and the Republic of Uzbekistan, India and Pakistan in 2017.

The variable related to the Eurasian integration processes is referred to as EAI because the analysis does not refer only to the EAEU, which is only the latest form or stage of these processes but to a whole series of previous integration phases. The first form of integration after the collapse of the USSR was the CIS, which involved free trade between all members of the former state, but in many cases, this rule did not work. Some countries have irrevocably separated from Russia not only politically but also economically. The first organization the already formed and independent states joined was The Eurasian Economic Community (EAEC or EurAsEC), which was founded in 2000 and lasted until 2014 when it grew into the Eurasian Economic Union. It was a regional organization between Russia, Belarus, Kazakhstan, Kyrgyzstan, and Tajikistan. Uzbekistan joined the EurAsEC in 2006 but suspended its membership in 2008 (EurAsEC official website). After that Russia, Ukraine, Belarus, Kazakhstan, Armenia, Kyrgyzstan, Moldova and Tajikistan signed the Free Trade Agreement of the Commonwealth of Independent States (CIS FTA) on 18 October 2011. The Customs Union (2010-2014) included the same countries. In 2014 Moldova signed the Association Agreement with the European Union and the establishment of the Deep and Comprehensive FTA. That is why Russia has introduced import duties and import bans on some Moldovan products. In 2014 Uzbekistan joined the CIS FTA. The EAEU included the former CIS FTA members. Then Armenia joined in 2015, and in the same year, an EAEU trade agreement was concluded with Vietnam. In 2016 Ukraine and the European Union started applying a Deep and Comprehensive Free Trade Agreement. Russia signed a decree suspending its CIS FTA with respect to Ukraine from 1 January 2016, and other member countries impose customs checks on goods entering the EEU from Ukraine. In 2018, new free trade agreements will be reached with China and Iran, then with Serbia and

Singapore in 2019, and in 2020 Indonesia will join. The effects of the agreement after 2018 cannot be measured because the latest data on Russian imports are available for this year, with the participation of Serbia already included in EAI since 2011, i.e., since the entry into force of the free trade agreement with the Eurasian Customs Union.

These details are listed because dummy variables change in individual countries depending on participation in international integrations with Russia.

Model specifications

In this research, the single-country gravity model will be applied to the imports of the Russian Federation. It is used to calculate the impact of selected factors (GDP, distance and participation of partner countries in international integration processes with Russia) on commodity imports of Russia. The research covers the period 2000-2018. The extended gravity equation takes the form as follows:

$$lnImp_{rjt} = \beta_0 + \beta_1 lnGDP_{jt} + \beta_2 lnD_{rj} + \beta_3 EAI_{jt} + \beta_4 BRICS_{jt} + \beta_5 SCO_{jt} + e_i \qquad (1)$$

The subscripts *r* stands for Russia, *j* for the trade partner of Russia and *t* for the time period, respectively. Imp_{rjt} denotes the imports of Russia from country *j* in year *t*, GDP_{jt} is GDP of a partner country in the year *t*, D_{rj} is the distance between Moscow and a capital city of a partner country, and EAI_{jt}, $BRICS_{jt}$ and SCO_{jt} are dummy variables for partner country *j* participation in given international integrations in the year *t,* and e_{ij} is a random error term. Dependent and independent variables except dummy variables are in logarithmic form.

The first variant of the model includes all 15 countries involved in three international integrations with Russia. The sample includes 285 observations. Independent dummy variables are given a value of 1 in the year following the accession of individual states to international organizations of which Russia is a member. Upon abandonment of these arrangements, such as the cases of Uzbekistan, Ukraine and Moldova in the EAEU, the value of the variable for the following year is 0. For example, Ukraine has dummy variable 1 in the period 2011-2016, Moldova in the period 2012-2015, in accordance with stated participation in EAI.

The second variant includes 24 countries exporting to Russia. This includes the 20 countries with the largest volume of exports to Russia and all countries from the first model. Several countries are in both groups, such as China, Belarus, Kazakhstan, Ukraine, India, and Vietnam. The economies of Germany, the United States, France, Italy, the UK, Japan, South Korea, Turkey, Poland, etc., are added. The sample includes 456 observations.

Results and discussion

The results of testing the gravity model are two model variants, referring to two different samples of Russia's import partners.

Table 2. Results

Variables	(1)		(2)	
	Coefficients	*Standard Error*	*Coefficients*	*Standard Error*
Intercept	7.21***	0.75	0.88	0.75
ln GDP	0.81***	0.04	0.91***	0.05
ln D	-1.42***	0.09	-0.51***	0.10
EAI	0.80***	0.15	0.84***	0.20
BRICS	0.55**	0.22	-1.23***	0.25
SCO	0.42***	0.14	-0.31*	0.18
Regression Statistics				
Multiple R	0.85		0.72	
R Square	0.72		0.52	
Adjusted R Square	0.72		0.51	
Standard Error	0.98		1.27	
F	145.40		95.69	
Significance F	0.00		0.00	
Observations	285		456	

Notes: ***, ** and * represent significance at 1, 5 and 10 percent, respectively.
Source: Author's calculation

The variable related to the size of trading partners, as usual, has a positive impact on Russia's merchandise imports, while geographical distance has an expected negative impact.

Both models show the correctness of the initial assumption of the research, which is a significant positive impact of Eurasian integration – variable EAI on Russia's imports from partner countries. In the first variant of the model, which includes all partner countries in different integrations, the EAI coefficient has a significantly higher value than BRICS and the SCO, 0.8 versus 0.55 and 0.42.

In the second variant of the model, which includes all of Russia's major trading partners, membership in the BRICS and the SCO shows a negative impact. Eichengreen and Irwin (1998) analyzed the situation in many research with dummy variables of regional integrations when the coefficient for the other and each subsequent regional integration variable is negative. This is not an unusual result of such research, 'indicating when only one member of the pair participates in a particular preferential arrangement is taken as evidence of trade diversion vis-a-vis the rest of the world' (1998, p. 34).

In addition, in comparison (sample) with large exporters to Russia, such as the EU countries, the importance of these two integrations is not pronounced. Involvement in the Eurasian integration processes, however, even in this combination shows a significant positive impact, more precisely even greater than in the first variant, with a coefficient of 0.84.

All variables are statistically significant with a *p-value* lower than 0.05 and 0.01. The coefficient of determination (R^2) in the first model has a significant value of 0.73, which indicates that the included variables explain as much as 73% of Russian imports. In the second model, which includes all major Russian import partners, R^2 is only 0.51, which is a reflection of the diversity of economies included in the analysis and does not explain Russian exports sufficiently. The significance of this model is that it also shows a significant positive impact of Eurasian integration, despite the fact that the group includes more dominant countries in terms of import volume that are not in any integration arrangements with Russia.

Potential Commodity Exports of Serbia to the Russian Federation

The projected Serbia`s export to Russia will be marked with Imp_{rs}¢. It will be calculated using data of the GDP of Serbia in 2019 (GDP_s¢) and *ln* distance between Belgrade and Moscow.

$$lnImp_{rs'} = \beta_0 + \beta_1 lnGDP_{s'} + \beta_2 lnD_{rs} + \beta_3 EAI_{st} + \beta_4 BRICSs_t + \beta_5 SCOs_t + e_i \quad (2)$$

The coefficients obtained in the first variant of model have been applied to Serbia's exports to the Russian Federation. Variables *BRICS* and *SCO* are omitted, so that the projected export of Serbia to Russia takes the following form:

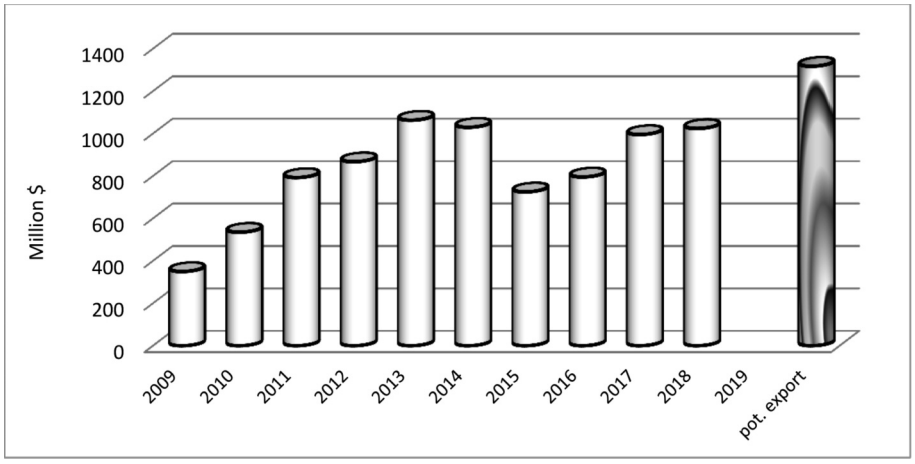
$$lnImp_{rs'} = 7.21 + 0.81\ lnGDP_{s'} - 1.42\ lnD + 0.80\ EAI + 0.98 \quad (3)$$

that is:

$$lnImp_{rs'} = 7.21 + 0.81*3.94 - 1.41*1.44 + 0.80*1 + 0.98 \quad (4)$$

$lnImp_{rs'}$ is 7.21 which is 29% higher projected (potential) exports in 2020 than $lnImp_{rs}$ 6.93 in 2018, the last year for which data are available. Shown in real value (*exp*), potential exports are about $ 1317 million (Figure 2).

Figure 2. Real and Potential Serbian commodity export to Russia



Source: Author's calculation

Conclusions

The main purpose of this paper was to examine the potential increase of Serbian export to the Russian Federation, as a consequence of more intensive involvement in the Eurasian integration processes. The assumption is that the benefits of regional Eurasian integration outweigh the benefits of the formal legal aspects of the agreement, as Russia opens up a part of its vast market to partner countries, not because an economic need for goods from these less developed economies, but to strengthen alliances and strengthen influence. The impact of Eurasian integration on the volume of Russian imports from partner countries is thus greater than its involvement in other economic integrations. It is, therefore, a non-economic factor and the informal impact of the EAI accession on exports to Russia.

By using the gravity model of international trade, which was applied to two different samples of trading partners, the coefficients of the selected variables that influence Russian imports of goods most were determined. According to the results, imports intensify with a higher level of income of Russian trading partners, and greater distance from the trading partner weakens imports, which is common. What is most important for this research is that the coefficients of both resulting models showed a significant positive impact of Eurasian integration on Russia's import. The membership in these integration processes has a far greater positive impact than inclusion in other integrations. This strong impact does not weaken even compared to large exporters to Russia, such as the EU countries.

According to the created model, the obtained coefficients were applied to Serbian exports to Russia. This procedure has shown that deeper involvement in Eurasian integration enables an increase in Serbian exports to Russia by a third compared to current exports.

This is not the result of the aforementioned new provisions of the agreement with the EAEU. A duty-free export permit for several additional products will further increase Serbian exports, which is not included in this study. In this research, only the informal effect of more intensive involvement in Russian regional spheres of influence was singled out and analyzed. These expected positive effects are not the result of amendments to the agreement, but of the additional opening of a large Russian market to partner countries for the sake of strengthening alliances and influence in these countries.

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