Following our general discussions in Part II, we go on to examine specific areas of cross-border interaction between FSU countries. We begin by looking at the most traditional area of economic cooperation – cross-border trade. Our objective is to examine the survival of former Soviet economic ties – whether the FSU countries still maintain significant trade links with each other, or, conversely, have they moved to trading more actively with extra-regional countries. Literature so far has documented a decline in internal trade while nevertheless claiming that trade was still too extensive vis-à-vis the predictions of the gravity model (a kind of ‘inverse border effect’) even where the terms of trade were less attractive. We re-examine this problem by applying a very recent dataset and estimating the gravity model for trade relations within the CIS.1

The Soviet Union had been a highly integrated state of 15 republics with uniform infrastructure, technology and other determinants of trade. After the dissolution of the USSR, all countries went through severe structural shocks and deep economic crises. It took a decade for FSU countries to become integrated into the world economy and trading system. Despite all formal efforts (see Chapter 4 for details), trade ties between the CIS countries have dissipated rapidly. Between 1995 and 2009, intra-regional trade shrank from 30 per cent of total trade in the CIS to 16 per cent. Over the same period, intra-regional trade among landlocked Central Asian countries fell by a dramatic 58 per cent. Now, the CIS is signatory to dozens of bilateral and multilateral trade agreements within and extending beyond the region.2 In most cases, the agreements have not been implemented. The most recent integration attempt was the Troika Customs Union, launched in 2010, which has resulted in real policy changes, the adoption of a unified tariff rate and rapid progress towards closer integration.
Gravity modelling should provide an insight into the relative impact of key multilateral trade agreements and groupings in the CIS. Applying a gravity model on a sample set of 162 countries covering the period between 1995 and 2008, we attempt to assess the dynamics of intra-regional trade in the region and explain their consistency with three hypotheses: home bias effect, holding together regionalism and holdup effect. Finally, we present a simulation of potential trade and assess the extent to which the CIS and all its groupings overtrade or undertrade with each other and the world.

Stylized facts on trade in the former Soviet Union states

Conventional empirical assessment of regional trade agreements employs a gravity modelling approach, which enables the researcher to arrive at an econometric estimation of bilateral trade flows and assess the impact of dummy variables. Since the dissolution of the Soviet Union there have been numerous studies on various aspects of disintegration and re-integration. In summarizing existing literature, we would suggest that there are three main drivers of international trade dynamics in post-Soviet countries.

The first one, the home bias effect, is a widely discussed phenomenon in macroeconomics and international finance. It was McCallum who first showed that, for the United States and Canada, inter-provincial trade is 20 times larger than international trade, where other determinants of trade are constant. The home bias in trade was later documented among OECD countries. According to this theory, given that the post-Soviet countries all inherited similar economic structures and are located far from the rest of the world, they should have traded more with each other. Continued, albeit declining, intra-regional trade can be explained by this effect.

Another effect is a holding together regionalism that is defined as regional integration projects emerging in a group of countries which have recently belonged to a single political entity and have very extensive infrastructural, economic and social ties between one other. Djankov and Freund empirically reinforced this idea by showing that past links limit the reorientation of trade in the former Soviet states.

For most countries, relationships between landlocked and transit countries are a potential cause of holdup, that is, opportunistic behaviour by the transit country makes upstream countries poorer and less likely to invest in technology. From this point of view, analysis of trade relations between coastal Russia and landlocked Central Asian is highly relevant.