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# TRANSFORMATION OF GLOBAL VALUE CHAINS IN RUSSIA AND THE BALTICS AMID COVID-19: PROSPECTS FOR REGIONALIZATION AND IMPLICATIONS FOR ECONOMIC POLICY

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*Although Russia and the Baltics have historically been economic partners, the economic relations between them are tense today. Nearly stagnating bilateral trade contributes little to the development of either side. The Baltics-Russian bilateral trade conducted within global value chains (GVCs) and operations of multinational companies is much more resistant to geopolitical and economic shocks than traditional international trade. For instance, the accession of Estonia, Latvia, and Lithuania to the EU and NATO in 2004 and the introduction of reciprocal EU-Russia sanctions in 2014 did not curb GVC activities between Russia and the Baltics. The article discusses factors in the transformation of the Baltics-Russian GVCs amid COVID-19. The research aims to prove regionalisation to be a viable prospect for the transformation of global value chains in Russia and the Baltics. In the medium term, regionalisation is possible as (1) part of global trends towards GVC transformation in the industries in which Russia and the Baltics traditionally specialise; (2) a response to the long-term structural challenges faced by Russia and the Baltics in creating a new generation of internationally competitive firms; (3) a result of companies tackling the effects of the pandemic against the background of historically stable relationships; (4) a product of strong social contacts and soft power. GVC regionalisation will be driven by individual companies, regional (local) governments, and Russian-Baltic cross-border cooperation initiatives. Finally, repercussions for Russian and Baltic politics are discussed alongside GVC regionalisation benefits for all the parties involved.*

## **Keywords:**

global value chains, Baltic states, Russia, COVID-19 pandemic.

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## **Introduction**

Global value chains (GVCs) have been at the centre of the discussion of the global economy since the early days of the COVID-19 crisis [1]. The suspension of production in China as part of anti-epidemic measures compromised the supply stability for European and American companies, the problem is known as “contamination through the supply chain” [1]. At the same time, discussions on the transformation of global chains and the consequences for global production had been on the agenda long before the pandemic began<sup>1</sup> [2; 3]. The shocks associated with the spread of the COVID-19 pandemic have thus become a catalyst for the transformation of GVCs.

Although earlier literature has noted that exposure to external shocks is characteristic of small countries with a high intensity of participation in foreign trade<sup>2</sup>, later studies have indicated that vulnerability to external shocks is characteristic of all the countries intensively involved in GVCs, regardless of their size [4]. Thus, both the Baltic states, Estonia, Latvia and Lithuania, with their small open economies whose catching-up development was largely associated with the transformation of their positioning in global production networks [5, p. 32–33; 6, p. 23–24; 7, p. 26–31], and Russia with its large, resource-based economy and persisting problems of the transformation period and the export portfolio that is limited in terms of high value-added manufacturing goods [8, p. 10–12] could be attributed to such countries. Despite the differences in the size of the economies, their resource endowments, and structural features, common challenges remain for the Baltic states and Russia in the context of integration into global production: a small share of firms operating in foreign markets, a low share of technology leaders, low productivity, and the need to reposition themselves in global chains. The close foreign economic relations between the Baltic states and Russia have been inherited since the times of the Soviet Union, however, over the past three decades, the political relations of the countries have experienced difficult times, while foreign economic cooperation has not contributed to solving the common challenges of transformation and repositioning in global production networks.

The article aims to discuss the prospects for the transformation of GVCs in Russia and the Baltic states and to identify the factors contributing to such transformation at the present stage by considering the accumulating challenges,

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<sup>1</sup> International Production Beyond the Pandemic, 2020, *UNCTAD World Investment Report 2020*. URL: [https://unctad.org/en/PublicationsLibrary/wir2020\\_en.pdf](https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf) (accessed 05.08.2020).

<sup>2</sup> *Small States: Meeting Challenges in the Global Economy*, Report of the Commonwealth Secretariat, 2020, World Bank Joint Task Force on Small States. URL: <http://www.cpahq.org/cpahq/cpadocs/meetingchallengeinglobaleconomy1.pdf> (accessed 05.08.2020).

the catalyst of which was the COVID-19 pandemic<sup>3</sup>. The paper shows why the regionalization of GVCs as a consequence of the COVID-19 pandemic can be considered a “window of opportunity” for transforming economic cooperation between Russia and the Baltic states and discuss the implications for Russian economic policy aimed at supporting the regionalization of chains and expanding cooperation with the Baltics.

The peculiarities of the GVCs in Russia and the Baltics are assessed by using modern methods of analysis typical of research in the field of international and regional economics, including statistical analysis of data from the *EORA-GVC Database*, *TIVA OECD*, and *AMNE OECD*, which make it possible to identify the structural features of value chains of Russia and the Baltic states, as well as the specifics of the activities of Russian and Baltic multinational companies in host economies.

### **Features of global value chains in Russia and the Baltic states**

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The Baltic states are actively involved in GVCs and have vertically and geographically fragmented production mainly focused on their neighbouring markets [5, p. 27–28; 9, p. 5–9; 10, p. 9–10]. Despite the continuing lag in the level of development of some countries within the Baltic region, it should be noted that the way Estonia, Lithuania, and Latvia integrate into GVCs generally corresponds to that of their neighbouring countries: Germany, Sweden, Finland, and Poland (Fig. 1). The assumption is based on a similar level of backward linkages<sup>4</sup>, the dependence of export-oriented industries on imported components and semi-finished products (on average for the Baltic region<sup>5</sup> — 25.3%, for the Baltic states — 27.0%), as well as on the similar level of forward linkages<sup>6</sup> using export value added in the production of third countries: Baltic region countries — 19.6%, and Baltic states — 17.5%.

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<sup>3</sup> By regionalization of value chains in this article, the authors understand the geographic reorientation of value chains from global markets to macroregional markets, including the replacement of global suppliers and buyers with counterparties from the domestic macroregion, the search for networks of suppliers and networks of buyers in the markets of neighboring countries.

<sup>4</sup> Backward linkages — foreign value added embodied in a country’s gross exports, % of a country’s gross exports.

<sup>5</sup> In this research the Baltic region countries are understood as Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Poland, Sweden.

<sup>6</sup> Forward linkages — domestic value added embodied in foreign exports, % of the country’s gross exports.

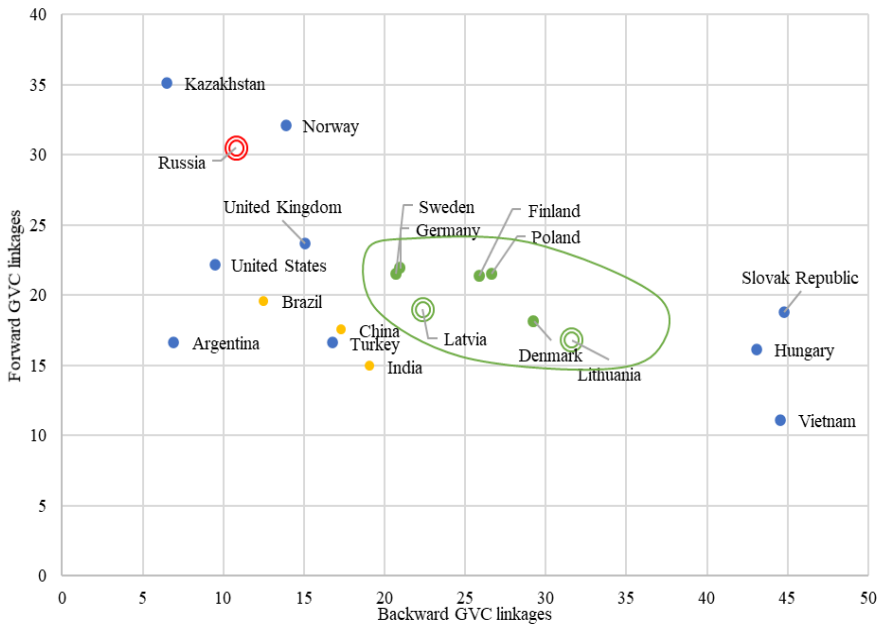


Fig. 1. Positioning of Russia and the Baltic states in GVCs, 2015

*Note:* Data for the last available year was used.

*Source:* Authors' calculations, data from TiVA OECD.

Russia, by contrast, is somewhat aloof (on the “periphery”) in its participation in GVCs [8, p. 7–8]: it differs from the Baltic region countries, on the one hand, by too-short backward linkages (10.8% against 25.3%), and on the other hand, by too-long forward linkages (30.5% against 19.6%).

Over the past decades, economic cooperation between Russia and the Baltic states has passed through several stages largely determined by tense political relations which to a significant extent shaped the current nature of the interaction. The Baltics were actively integrated into the economic space of the USSR before leaving the Soviet Union in 1990 [11, p. 88–89; 12, p. 10–11]. The period from the 1990s to the mid-2000s was characterized by the shift of the Baltics' economic focus from Russia to Western Europe. This was primarily associated with the formation of new foreign trade partnerships, the search for new markets (in the early stages), and later, the preparatory stage for the accession of the Baltic states to the European Union (EU) in 2004. Thus, while in 1991, over 45% of the total imports of Estonia, Latvia, and Lithuania were of Russian origin [13, p. 38], at the beginning of the 2000s, the share of Russian origin products in imports was 11% in Latvia, 14% in Estonia, 27.4% in Lithuania. At the same time, studies have shown a slow reorientation of mutual foreign trade of the former Soviet territories and the preservation of the linkages formed in the Soviet era. The explanations for this phenomenon are, for example, the inertia in infrastructure development (including roads and railways, telecommunications networks, logistics operators,

and the business community) to access other markets, lower competitiveness of these economies compared to that of the Nordic countries and Germany, and the presence of historically formed inter-firm ties [14, p. 88–89; 15, p. 9–10; 16, p. 37–38]. The high importance of “colonial linkages” as a factor in international trade is confirmed by studies of the countries of the former Soviet Union, as well as of the former Austro-Hungarian Empire, British Malaya, and Czechoslovakia [15; 17, p. 92–93].

The slow pace of the reorientation of foreign trade of the Baltic states to the markets of the EU countries can also be explained by the high significance of the historically established ties for the EU countries. Thus, the founding members of the EU were primarily focused on the creation of an integrated internal market and supported the development of trade relations among themselves rather than with the countries that joined the EU later [18, p. 1339–1349].

Before 2004, many observers noted that the accession of the Baltic states to the EU and NATO would help restructure historically tense relations with Russia. However, Europeanization did not contribute to a positive scenario [19, p. 1]. Since 2004, the policy of the Baltic states in relations with Russia has been determined primarily by the common foreign economic policy of the EU countries, as well as by the policy of cross-border cooperation [13, p. 37; 12, p. ten]. For the Baltic states, although the accession to the EU established *de jure* grounds for expanding international trade with Russia, *de facto*, there have been no changes. After the onset of the global financial and economic crisis, the 2004–2008 period of some expansion of mutual trade between the Baltic states and Russia gave way to a period of cooling of bilateral relations.

The 2014 Ukrainian crisis resulted in the imposition of mutual economic sanctions between Russia and the Baltic states and determined a further cooling of foreign economic relations. The fact that the Baltics have been the main supporters of sanctions against Russia led to a significant reduction in the volume of mutual trade between the countries compared to that with other EU countries [20, p. 1504–1505].

Changes in the general framework for relations between the Baltic states and Russia and the associated effects of “trade diversion” [12, p. ten; 13, p. 36–37] in the reorientation of foreign trade to the EU countries were weakly connected with cooperative relationships within GVCs. The volumes of value added imported by the Baltic states from Russia for subsequent export had been gradually growing from 2000 to 2019 increasing by 10.4 times by the end of the period against the background of the recession resulting from the global financial and economic crisis of 2008–2009 and the introduction of the mutual sanctions. This more than tenfold growth was ensured, primarily, by the increase in imports of energy resources (by 18.5 times) for export-oriented industries of the Baltic states, as well as products of the agro-industries (by 9.9 times) and chemical and steel industries (by 8.9 and 8.5 times, respectively; Fig. 2).

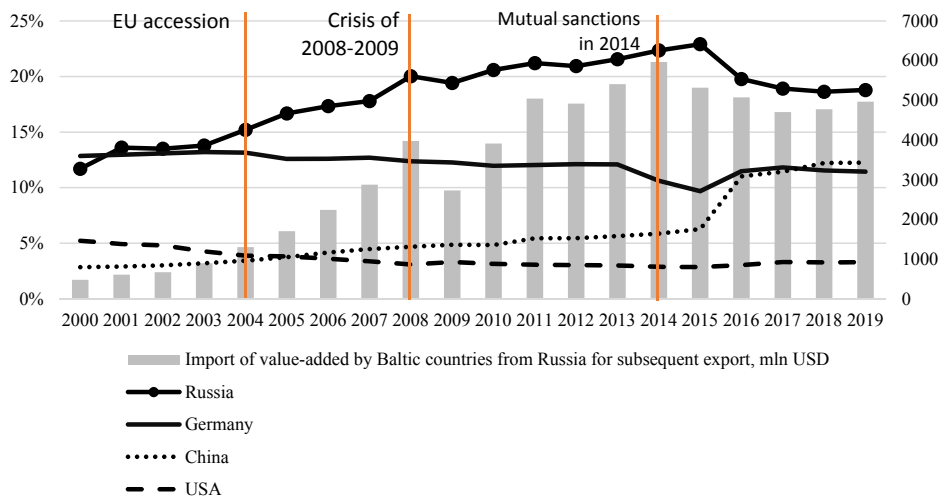


Fig. 2. Participation of the Baltic states in the backward GVC linkages: the *left axis* — the share of value added from Russia, the USA, Germany and China in the imports of the Baltic states for subsequent exports, 2000—2019; *right axis* — value added from Russia in imports of the Baltic states for subsequent export, mln USD

*Note:* Data for the three global GVC hubs (China, Germany and the United States) are given for comparison.

*Source:* authors' calculations, data from *EORA-GVC Database*, *World Bank*.

Russia also increased the volume of value added imported from the Baltic states within the GVC, which in absolute value increased by 7.4 times in 2000—2019. However, this effect was associated with a general increase in imported value added and in relative terms did not lead to an increase in Russia's importance as the Baltic states' partner in the backward GVC (Fig. 3).

It should be noted that the introduction of mutual sanctions in 2014 had a moderate impact on trade volumes. The fact that there was no sharp decline should be attributed to the permission to continue foreign trade in products subject to sanctions, the contracts on which were concluded before the period of their introduction [21, p. 13].

In addition, against the general background, Russia's imports from countries that did not impose sanctions also decreased. This was a consequence of the depreciation of the ruble and, accordingly, of the increase in the cost of imports, which is consistent with the research results [22, p. 307]. The lack of pronounced reorientation from countries that have imposed sanctions on other countries may also be the evidence that in reality (at least in 2015—2019) there was no substitution of trade channels. Although there is some evidence of a shift in supply channels (e.g., the re-export of goods from Belarus that were subject to the Russian trade embargo, such as fruit and shrimp [23, p. 6—8]), this does not change the general conclusion that Russian exports have decreased in all directions [21, p. 13].

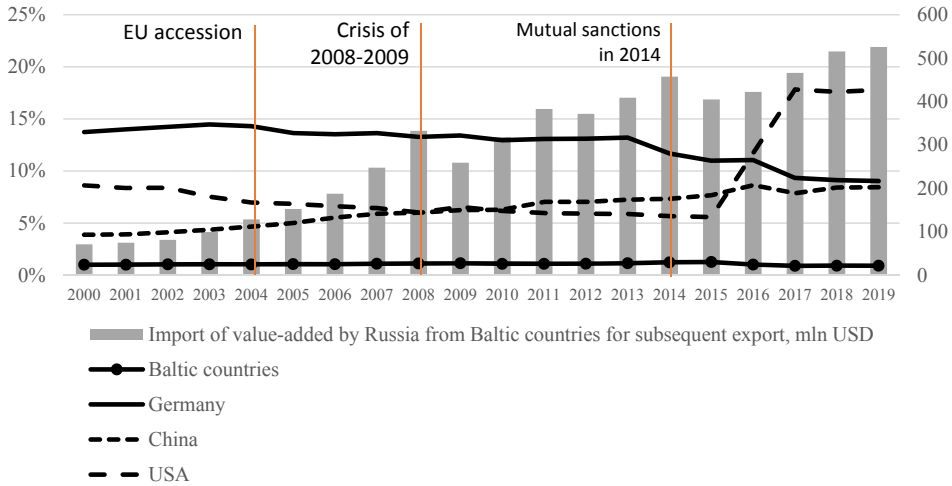


Fig. 3. Russia's participation in the backward GVC links: the left axis is the share of value added from the Baltic states, the USA, Germany and China in Russia's imports for subsequent exports, 2000–2019,%; right axis — value added from the Baltic states in Russia's import for subsequent export, mln USD

*Note:* Data for the three global GVC hubs — China, Germany and the United States — are given for comparison.

*Source:* authors' calculations, data from *EORA-GVC Database*, *World Bank*.

Thus, the results obtained generally indicate the stability of bilateral cooperative economic relations to geopolitical shocks and a significantly greater (compared with traditional international trade) resistance to economic shocks.

This sustainability is due to two factors: sectoral and organizational (with the participation of multinational companies [MNCs]) the peculiarities of GVCs.

With the view of the significant cross-country differences in resource endowments and sectoral structure of Estonia, Latvia, and Lithuania, economic cooperation between Russia and the Baltic states within the GVC has developed basing on bilateral economic interests in sectors with comparative advantage. As a result, the sectoral structure of trade between Russia and the Baltic states within GVCs differs significantly from the commodity structure of the traditional non-chain merchandise trade largely based on the legacy of Soviet economic links. In Russian merchandise imports from the Baltic states, products of electrical and power engineering and equipment prevail (approximately 40%), and in the imports to the Baltic states from Russia, oil and oil products (approximately 65%) prevail. The sectoral structure of trade between Russia and the Baltic states within the GVC is distinguished by a significantly higher level of diversification, it also reflects the sericitization of the manufacturing sector in the GVC (participation of services in production and foreign trade in goods) [24, p. 2–3]. In the imports to the Baltic states from Russia within chains, oil and oil products continue to account for a significant share (47%), but another 27% is accounted for by trade in



services, including wholesale trade and transportation services (23.2% in total), as well as business services requiring a high level of human capital<sup>7</sup> (3.8%). In Russia's imports from the Baltic states within the chains, the share of services is even higher (40.4%), it includes trade and transport services (23.9%), as well as services requiring highly skilled labour (8.4%; Fig. 4). The high contribution of the service sector to the exports of the Baltic states reflects, on the whole, a higher orientation of these countries toward trade in services [25, p. 293–294].

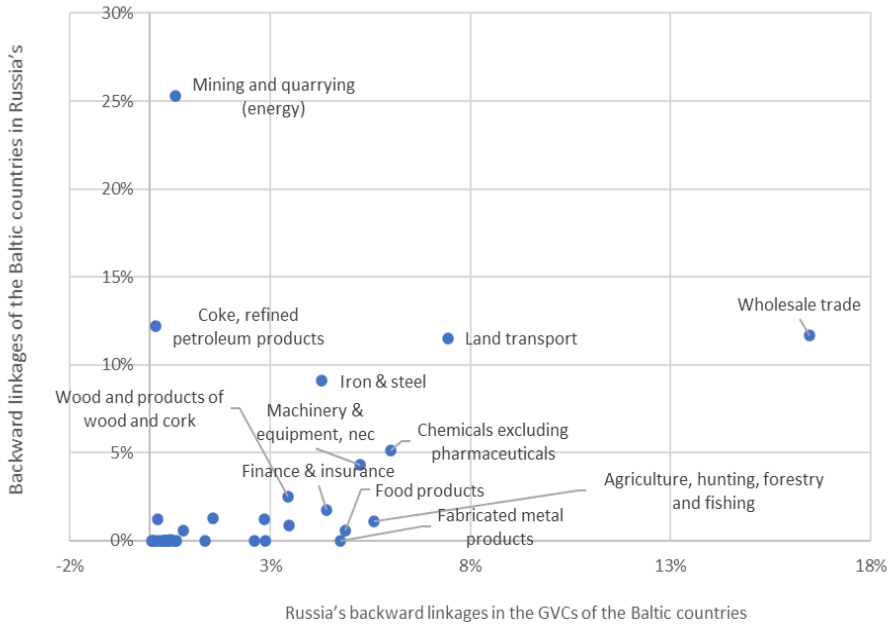


Fig. 4. Trade in value added in GVCs between Russia and the Baltic states by selected commodity groups, 2015,%

*Note:* Backward linkages of the Baltic states in Russia's GVCs — value added of the industry created in Russia and used in the exports of the Baltic states,% of gross value-added imports from Russia for use in the exports of the Baltic states; Russia's backward linkages in the GVCs of the Baltic states — value added of the industry created in the Baltic states and used in Russian exports,% of gross value added imports from the Baltic states for use in Russian exports.

*Source:* Authors' calculations, data from *TiVA OECD*.

In 2000–2017, the services not related to industrial production increased in terms of added value in the global chains of Russia. This is the evidence of the expanding cooperation between the parties in the non-production sector, as well as the indirect evidence of the growing role of “soft power” in economic cooperation. Thus, in 2000–2017, the value added from the Baltic states in the Russian education increased by 14.4 times; in the sphere of health and social services, by 11.7 times; and in the sphere of real estate services, by 9.2 times.

<sup>7</sup> Including research and development, ICT services, finance and insurance services.

Imports of added value from Russia to the Baltic states increased 22.4 times in education, and 14.2 times in real estate services. High growth rates in mutual value-added trade in the sector of services show that the formation of industrial ties between the countries is largely due to the bi-directional movement of the population between Russia and the Baltic states, as well as the presence of national diasporas.

The high level of ‘servitization’ of trade within the GVCs of Russia and the Baltic states determines the significantly lower volatility of value-added trade from geopolitical and economic shocks and at the same time is a growth point for the transformation of chains in the region and the increase in the share of value added.

GVCs are often organized by the activities of multinational companies<sup>8</sup>. MNCs are involved in international production through horizontal (within one industry) and vertical (in related industries) investment projects. They also develop interaction with independent companies abroad through other types of industrial cooperation (i. e. contract manufacturing, franchising, licensing). Thus, the boundaries of multinational companies and GVCs largely intersect but do not coincide [26, p. 54–55].

Our estimates show that the extent of the presence of Russian multinational companies in the markets of Estonia, Latvia, and Lithuania, as well as that of Baltic MNCs in the Russian market, has changed somewhat over the past two decades. The introduction of mutual sanctions in 2014 did not significantly affect the change in the market positions of MNCs on both sides (Fig. 5). Thus, in 2005–2016, the average share of Russian MNCs in the Estonian market was 1.6%; in the Lithuanian market — 7.3%; and in Latvia — 4.9%. The share of Baltic MNCs in the gross output in Russia was 0.6%. Structural changes in the composition of MNCs of host economies observed in 2005–2016 resulted from the use of comparative advantages by companies in the markets of partner countries. Among the MNCs of the Baltic states, the structure of the output of MNCs of Estonia in Russia has significantly diversified: enterprises in the food industry, production of building materials, paper and paper products, and furniture have appeared, while the contribution of MNCs in the transportation and storage services industry has decreased. Russian MNCs have diversified their representation in Latvia including projects in the fields of hotels, financial and insurance activities, and telecommunications technologies.

<sup>8</sup> Multinational enterprises in the global economy. Heavily debated but hardly measured, 2018, OECD. URL: <http://www.oecd.org/industry/ind/MNEs-in-the-global-economy-policy-note.pdf> (accessed 05.08.2020).

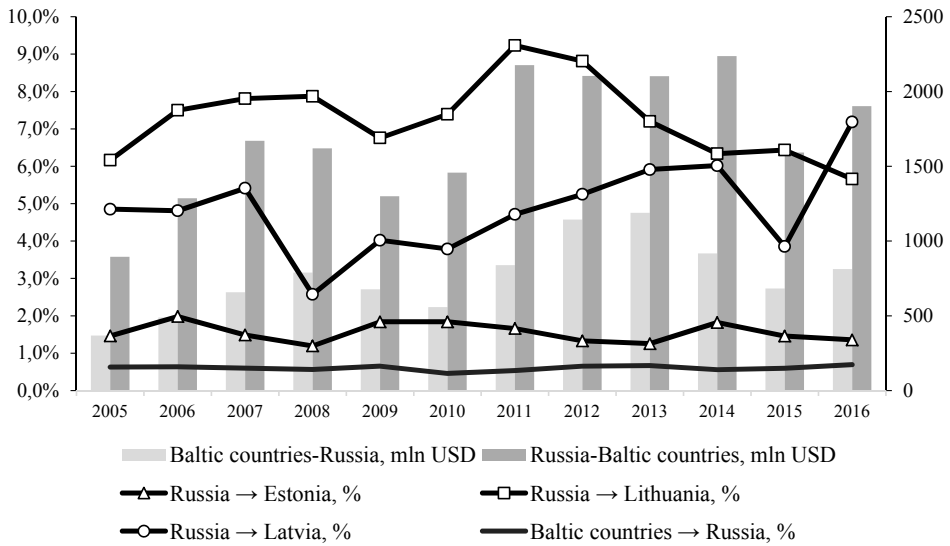


Fig. 5. Contribution of MNCs to the gross output, Russia — Baltic states, 2005–2016, %

*Note:* The analysis period is limited by the availability of data in *AMNE OECD* database.

*Source:* authors' calculations, data from *AMNE OECD* database.

Based on the estimates obtained, we conclude that the activities of MNCs are more resilient to geopolitical and economic shocks than foreign trade is. At the same time, the absence of any pronounced trends in their activities in the markets of the Baltic states and Russia should be attributed to that fact that the actions of MNCs were initially determined by their investment strategies in the absence of pronounced support of the host economies, and, in a later period, by contrast, by the growth of protectionist measures and tension in foreign economic cooperation. This finding generally corresponds to other conclusions on the relationship between the Baltic states and Russia (e. g., [27, p. 1277–1278]) stating that investment flows between them are synchronized with the economic cycles of the partner countries, therefore, the changes in international trade are translated into the results of investment flows only through the prism of investment cycles.

### **Prospects for the transformation of global value chains in Russia and the Baltic states**

By the beginning of 2020, the economic relations between the Baltic states and Russia were characterized by the continuing regime of mutual sanctions as a result of the Ukrainian conflict. Although the warming of relations between

Russia and the EU has rarely been an issue for discussion in the academic literature and on the foreign policy agenda, experts have noted that manufacturers in Estonia, Latvia, and Lithuania are extremely cautious about the prospects of expanding foreign economic contacts with Russia and thus primarily rely on other foreign markets [12, p. 10–11; 28; 29]. Among the most promising prospects for the country's enterprises Russian literature names those in the markets of the Eurasian Economic Union countries, East and Southeast Asia, and Africa. This may indirectly indicate the lack of visible prospects for expanding cooperation with Western markets [30, p. 46].

The economic crisis caused by the consequences of the COVID-19 pandemic could be a shock that changes the mood of both parties and contributes to the transformation of GVCs in Russia and the Baltic states.

A possible long-term effect of the COVID-19 pandemic is the changes in the level of uncertainty perceived by companies and the public. To reduce risks within the chains, coordination between their individual links will be strengthened. Thus, one of the expected GVC transformations is the regionalization of value chains [3]. This can be the result of both the withdrawal of MNCs from global chains and building their own chains at the regional level, and the transfer of existing capacities to an MNC's home region. At the same time, new multinational corporations may emerge that, due to their scale, will be more prepared for the risks and shocks in global production. An increase in the perceived level of risks for the population can determine the growth of interest in neighbouring territories (interestingly, this is already being observed) and the desire to operate and receive services in the nearest territories.

We highlight several reasons why the regionalization of GVCs as a consequence of the COVID-19 pandemic can transform the foreign economic cooperation between Russia and the Baltic states.

1. The analysis demonstrates that the value chains between Russia and the Baltic states are predominantly organized in industries with intensive use of local raw materials (agro-industries, steel and chemical industries). International experience shows that such chains, as a rule, are organized according to a regional rather than a global principle<sup>1</sup>. Hence, the most realistic scenario for their transformation is an increase in regionalization. Their growth points are increasing market segmentation.

2. Prospects for the growth of regional value chains in Russia and the Baltic states are also found in industries generally characterized by a global organization. These are primarily the power and electrical engineering and equipment manufacturing industries. A mutually beneficial strategy could be to increase the added value in production through industrial cooperation, pulling the elements of global chains to the Baltic region.

3. Despite the relative success of repositioning the Baltic states in the GVC [5, p. 32–33; 9, p. 5–9; 10, p. 9–10] and the absence of positive changes for Russia [8, p. 6–8; 26, p. 73–74], these countries are characterized by generally similar problems of participation in chains, for example, a significant gap between the technological level of the main layer of companies and that of leading companies, a low share of firms operating in foreign markets, and serious challenges to increasing labour productivity. The increased risks of working in distant markets may force firms in Russia and the Baltic states to reconsider their geographic priorities.

4. Regionalization of the value chains of Russia and the Baltic states can occur under the influence of business initiatives without critical shifts in foreign economic relations. This follows from the experience of chain development in the countries in the previous two decades. In addition, any shifts in interregional cooperation between Russia and the Baltic states are possible only with a significant lag, while business decisions can be made much faster.

5. The steady growth of mutual trade in services between Russia and the Baltic states demonstrates the continued interest of their population in neighbouring territories, which is explained by the attractiveness and demand for services in the border areas, including in the fields of culture, education, tourism, and real estate, not only by national diasporas but also by titular ethnic groups of respective territories. The growing global uncertainty and the maintaining attractiveness of services in the border areas can strengthen the countries' interest in cooperation in the service sector.

While at the national level the discussion of expanding foreign economic cooperation between Russia and the Baltic states can be restrained by the complexity of interstate political and economic relations, the available data and discussion in the expert and academic literature make it possible to determine the high potential for the development of cross-border cooperation between the two territories.

Although in 2012–2019 no increase was observed in the importance of the Baltic states as a market for Russian exports in general, it was seen in certain border areas, in particular, St. Petersburg, Leningrad, and Kaliningrad regions. Notably, after the introduction of mutual sanctions as a result of the Ukrainian conflict in 2014, the share of the Baltic states in the exports of these regions increased: for the Leningrad region, from 2.9% to 10.0%, and for the Kaliningrad region, from 3.5% to 6.0% (Fig. 6).

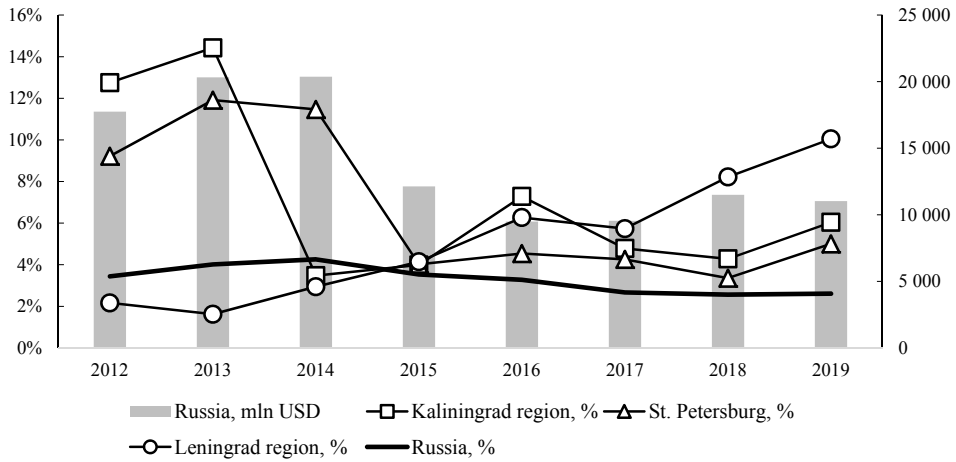


Fig. 6. The share of the Baltics in gross exports of Russia and chosen regions: left axis — % of gross exports; right axis — USD million, 2012–2019

Source: authors' calculations, data from the Federal Customs Service of the Russian Federation.

The high importance of the regional level of interaction in the Baltic Sea region is determined, in particular, by a special type of a territorial community that formed as a result of the end of the Cold War— a transboundary macro-region, the emergence of which shows that regional cooperation is reaching a new level [31, p. 129]. Consequently, many cross-border projects start on the basis of interaction between regional and local authorities [32, p. 349–350]. It is important to say that the priority projects were formed based on more than the principles of exchange and were formed not only in the field of economics but also in the scientific and technological sphere [11, p. 88–89; 32, p. 352]. This is especially significant in the context of discussing the prospects for expanding regional value chains of Russia and the Baltic states because industrial cooperation in such chains to increase the contribution of added value includes not only agreements on industrial cooperation and subcontracting but also cooperation schemes in research and development activities in the early stages of chains.

The expansion of economic cooperation between Russia and the Baltic states in the new conditions will be largely supported by a further qualitative increase in non-industrial formats of cooperation. In the context of tense relations between Russia and the Baltic states, political confrontation, often demonstrative, depletes the possibilities of official diplomacy [33, p. 113–114]. Hence, the use of «soft power» can become an effective tool for the development of relations, including such formats as humanitarian funds and cooperation in the fields of science, education, culture, health care, and environment protection [32, p. 354; 33, p. 113–114, 34, p. 110;]. In our opinion, the «soft power» potential has been underexploited. At the level of individual organizations, only a few institutions

are singling out the Baltic states as geographic priorities for their strategic development. For instance, at the level of the leading Russian universities, one of such organizations is the Baltic Federal University, which defines its strategic development through the prism of its location on a special territory bordering the countries of the Baltic region. However, finding similar examples among the universities of St. Petersburg, which have strong innovation, research, educational, and cultural potential, is difficult. In addition, greater international cooperation is required to address social issues (largely reinforced by the consequences of the COVID-19 pandemic) in the fields of environment protection, education, health-care, and medicine, which can enhance the cooperation between Russia and the Baltic states.

The prospects for expanding economic interaction and harnessing the potential of “soft power” between Russia and the Baltics in the context of regionalization of value chains require discussing the implications for economic policy. The prospects for the regionalization of chains can form a new round of growing interest in cooperation on both sides and will thus provide a revision or, rather, an expansion of the economic policy’s toolbox of all parties involved.

### **Policy implications**

The study of foreign economic relations between Russia and the Baltic states suggests a high level of stability of ties and a weak response to economic and geopolitical shocks. The Baltic states, being an integral part of the Soviet Union, were well integrated into the system of foreign economic relations of the USSR. The developed infrastructure, including hard (e.g., roads, railways, ports) and soft one (e.g., business communities, inter-firm ties, national diasporas), largely determined the preservation of relations between Russia and the Baltics, which in the modern period can be generally described as tense. In particular, in 2000–2019, the mutual trade within GVCs constantly expanded largely due to the activities of multinational companies.

The COVID-19 pandemic has intensified the challenges in global manufacturing and temporarily disrupted value chains. The impact of the COVID-19 pandemic on the global economy has been significantly stronger than that of previous crises, including the global financial and economic crisis of 2008–2009 [35]. Along with the temporary effect of chain disruption, there is an expected long-term effect associated with the restructuring of models of global production and international cooperation.

New challenges for global production can become a factor in the structural transformation of economic relations between Russia and the Baltic states. From the possible scenarios of recovery and changes in GVCs, the most likely scenario is the regionalization of chains in Russia and the Baltic states, including the building of their own chains at the regional level in traditional industries

(agro-industries, steel industry, mechanical engineering, chemical industry) and relocation of available capacity into the home region (e. g., in the automotive industry, chemical industry, wood processing).

We also observe the expansion of the prospects for regionalization within the framework of non-economic cooperation to address global challenges provoked by the COVID-19 pandemic, including those in the fields of education, environment protection, health care, and medicine. Such cooperation, in our opinion, can become an instrument of «soft power» and contribute to the development of economic relations.

Considering the experience of foreign economic interactions between Russia and the Baltic states, and the persisting difficulties in relations at the interstate level, new challenges in the transformation of chains make it possible to formulate consequences for state policy aimed at transforming the structure of the Russian economy and repositioning in global production.

1. At the level of individual Russian regions of the northwest, we advise considering the implementation of a policy aimed at developing production potential, supporting mutual direct investments, and building regional value chains with the Baltic states. To date, an argument could be that only in the Kaliningrad region is the expansion of border ties a priority of its socio-economic development. We posit that this practice can also be transferred to the other territories of the Russian northwest.

2. As the prospects of the lifting of the regime of mutual sanctions between Russia and the EU remain uncertain, the development of cooperation in industries not under this regime is especially important for the regionalization of GVCs. This is primarily related to industrial cooperation in the field of research and development, as well as the provision of services that require highly skilled labour. For these purposes, we advise considering the possibility of developing networks of international cooperation in the field of industrial knowledge and technologies, including on the basis of leading universities in the Baltic states and the border regions of Russia.

3. The role of «soft power» in the establishment of economic cooperation between Russia and the Baltic states in the new conditions has significantly increased. Additionally, expansion of interaction with business, national diasporas, and an increase in the role of socially oriented non-profit organizations are considered directions for its further improvement. First, we recommend developing tools for the formation and strengthening of cross-border ties of business communities, including the consolidation of ties between national entrepreneurs and representatives of national diasporas abroad; attracting business to the implementation of social functions; supporting social projects and joint initiatives of representatives of diasporas. As for the regional-level tools, we recommend developing regional programs to support small and medium-sized businesses'



initiatives to enter the Baltic states' markets, as well as socially oriented business initiatives in the fields of education, culture, art, to expand cooperation between Russia and the Baltics.

4. To expand cooperation, we recommend increasing the number of mutual entry points of Russia and the Baltic states. First, concerning Russia, it is necessary to spread the practice of the Kaliningrad region, as a region strategically oriented toward cooperation with the Baltic states, to other regions of northwest Russia. It is important to consolidate at the level of strategic priorities, to expand interaction with the Baltic states on the infrastructure, to support small and medium-sized businesses in the border areas, large scientific and educational centres, and cultural centres. This will set a framework for the development of specific interaction programs, for example, international competitions for start-ups and innovative entrepreneurship, joint development projects in the fields of educational, medical, tourism services, and the formation of relevant clusters in border areas.

5. The potential for the development of cooperation between Russia and the Baltics and accumulated successes of individual regions in cross-border cooperation determine the possibility of processing certain elements of economic interaction between the northwest regions and the Baltic states, with subsequent use in other Russian border territories.

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