THE COMPETITIVE POWER OF RUSSIA'S LIGHT INDUSTRY VALUE CHAINS AND DEVELOPMENT PROSPECTS

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The Gaidar Institute for Economic Policy has analyzed the state of Russia's light industry and made a comparative analysis of the competitive power of production chains of Russian manufacturers and their principal foreign competitors.

The analysis shows low degree of integration of Russia's light industry into the international value chains. However, some sub-sectors already have (or can embody) competitive advantages over their principal competitors in the international market. These sub-sectors are the manufacture of synthetic textiles, wool textiles, linen textiles and respective finished products thereof. Additionally, narrower light industry segments were identified, which have some properties making these segments worthwhile of being developed and supported. The obtained results were used for making recommendations on a comprehensive economic policy in the industry.

State of the industry

Russia's light industry is presently highly competitive, comprising a big number of small and medium-sized enterprises. Besides, no companies with state participation are operating in the industry. More than 29,000 enterprises and 49,000 self-employed entrepreneurs are operating in the industry, of which only 8% are large ones[1]. Some 400,000 persons are employed in the industry. In 2013, the volume of shipped goods was Rb 245bn in the textile and clothing manufacturing sector and Rb 47bn in the leather, leather products and footwear manufacturing sectors, accounting for mere 1.12% of the volume of products manufactured by Russia's manufacturing sector during the same period. Additionally, the domestic market of light industry products has substantial capacity (in terms of sales and consumption volume) estimated at Rb 2,6 trillion annually, or 25% of the retail non-food market in Russia. This is the biggest segment of retail non-food market, superseding the motor vehicle industry, electronics, pharmaceutics, etc.

In addition to domestic competitors, domestic manufacturers are facing severe competition with foreign-made products in both the quality and the value of finished products.

Russia's light industry is facing the following key problems:

- Russian enterprises depend heavily on import supplies of raw materials. For example, basically the entire volume of raw materials for manufacturing cotton textiles is imported from other countries, while there is no fine-quality wool in this country which is needed to manufacture worsted textiles and fine long linen;
- physical and functional depreciation of technical facilities and fixed assets. In 2011, depreciation of fixed assets in the textile and clothing manufacturing sector was 41.6% while the leather, leather products and footwear manufacturing sector saw a 42.6% depreciation;
- the lack of skilled personnel and low-labor costs. In 2013, wages of those employed in all business lines in of "Textile and clothing manufacturing" and "Manufacturing of leather, leather products and footwear" were Rb 13,500 and Rb 14,700, respectively, the lowest level compared to other types of economic activity nation-wide (which was Rb 29,800);
- a big percentage of parallel imports and counterfeit products. In 2013, parallel imports and counterfeit products accounted for around 35%, according to expert estimates[2].

Over the past two decades, Russia's light industry has been distinguished by further lagging behind the world's leaders and losing its significance for the national economy. Russia's light industry is falling out of the respective segment of global economy, being unable to embody the available competitive advantages. If the current situation remains unchanged in the long run, the industry would lose the still available competences and run out of its resource base, thereby making the objective of reaching a competitive level unattainable and economically worthless.

In the meantime, subsidization of interest rates on loans remains the sole measure of state support in the light industry. However, despite the fact that this instrument provides a certain degree of support to light industry enterprises, the latter run into difficulties while attempting to raise the required amount of

1 Enterprises with an average of 250 employees or more and a corporate revenue of Rb 1bn or more.

2 The materials of the LegpromForum 2014, International Light Industry Forum.

funds: such loans are issued against a collateral which most enterprises can provide in the form of in-house production facilities. Since this type of ownership (most assets are located in the regions) is low-liquid, it is quite often that enterprises either cannot obtain loans or, if they can, such loans are insufficient.

Development prospects

The complex situation with Russia's light industry enterprises facing severe competition with foreign producers of raw materials and finished products makes it necessary to discuss ways of improving the state of industry and, in particular, the worthwhileness of launching an import substitution policy.

In global practice, the implementation of a policy of import substitution industrialization often produced negative results, and is frowned upon nowadays. However, there are examples of positive effect of import substitution on economy at large (enhanced productivity, development of new technologies) and its structure (introduction of new industries) which are acknowledged by the world academic community. The successfully implemented practices in India, Brazil, Turkey, Vietnam, etc. is a good illustration of this.

The outcome of public import substitution policy hinges largely upon how it is undertaken (analysis of country's competitive advantages, goals and instruments which were used in practice). It is therefore important to point out that an import substitution policy has fairly good chances to be successful when it is introduced on the basis of economical rather than political discussions.

At present, two principal working models of successful import substitution policy can be distinguished, namely cooperating with foreign partners and integrating the national economy into the global value chains, as well as creating new competitive production facilities through publicly promoted demand for their products (setting out the entire value chain or its initial stage on the national territory). Both models can be applied to Russia's light industry.

Development prospects for a given industry segment are virtually based on the criteria of either currently available competitive advantage of the production chain as a whole or a part thereof (for example, low-cost raw materials, advanced production technology, low-cost workforce, etc.), or the prospects for moving in the shorter run towards a competitive level through external (for example public) intervention.

The Gaidar Institute for Economic Policy made analysis[1] of certain segments Russia's light industry, showing that some of the segments have such competitive advantages over Russia's principal competitors in the international market. More generally, these segments are as follows:

- manufacturing of synthetic textiles and finished synthetic textile products,
- manufacturing of wool textiles and finished wool products,
- manufacturing of linen textiles and finished linen products.

For example, the level of costs on the basic raw materials in Russia is currently comparable by basic components of synthetic textiles production (*Fig.* 1) with that in China, but higher than that in India. Russian companies have advantages in fuel and energy costs over their foreign competitors, whereas the latter have advantages over the former in labor remuneration. The current situation can be improved substantially by curtailing the costs and enhancing the quality of raw materials. Furthermore, the Russian economy can easily attain this, because Russia has developed chemical industry. To do this would require cooperation between respective enterprises of light and chemical industries whereby the latter will provide the former with a full range of cheap (below the international level) raw materials, as well as the chemical fiber production technology and chemical fiber textile production process will gradually be improved. It is this role that the state can commit itself to, for example, through guarantees to chemical enterprises which will show their willingness to restructure their production to meet the light industry's needs. Cost reduction is expected to be attained through the economy of scale as soon as the output of chemical fibers reaches a level allowing light industry enterprises to be provided with a full range of raw materials.

The situation with wool fabrics production (*Fig.* 1) is similar in general to that in the synthetic textiles segment. Russian manufacturers have a substantial advantage over Chinese counterparts in the cost of basic raw materials used for manufacturing. The level of costs in this component is comparable with that in Italy, the principal competitor in this area. Furthermore, Italy has the highest labor costs while China has the lowest ones among the three countries. Russia has advantage over its competitors in energy resources costs. This case is featured by an average lower quality of domestically manufactured wool textiles compared to that of foreign competitors, which may be attributed to both outdated equipment and the peculiarities of Russian animal farming[2]. This implies that high priority measures of public

1 Costs at all sections of the value chain were calculated for Russia and its principal competitors (China and Italy were selected as such).

2 For example, the New Zealand sheep whose wool is globally recognized as top quality product are bred in much better conditions than those available in Russia: mild, equable climate, vast pastures, plentiful land, the government is especially focused on environmental protection.

	Chain component	Costs on the basic type of raw materials	Costs on other types of raw materials	Fuel and energy costs	including:				Equipment maintenance and operation costs	Wages with social insurance contributions
					Oil products	Natural gas	Electric power	Water		
Synthetic textiles	Level of costs in Russia (as a percentage of final value / US$ per unit)	39% / 0.52	-	5% / 0.07	0.2% / 0.002	1.4% / 0.018	2.9% / 0.039	0.3% / 0.003	-	9% / 0.11
	Level of costs of the principal competitors (as a percentage of final value / US$ per unit)	China: 45% / 0.55 India: 36% / 0.34	China: 5% / 0.06 India: 9% / 0.08	China: 12% / 0.15 India: 14% / 0.13	China: 0.4% / 0.005 India: 0.4% / 0.004	China: 3.2% / 0.040 India: 3.2% / 0.035	China: 6.9% / 0.085 India: 6.9% / 0.076	China: 0.6% / 0.008 India: 0.6% / 0.007	China: 15% / 0.18 India: 23% / 0.22	China: 3% / 0.04 India: 2% / 0.02
	The possibility to enhance Russia's indicators up to global indicators	yes	-	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	yes	no
	Chain component	Costs on the basic type of raw materials	Costs on other types of raw materials	Fuel and energy costs	including:				Equipment maintenance and operation costs	Wages with social insurance contributions
					Oil products	Natural gas	Electric power	Water		
Wool textiles	Level of costs in Russia (as a percentage of final value / US$ per unit)	44% / 0.77	-	5% / 0.08	0.2% / 0.003	1.1% / 0.020	1.7% / 0.030	0.6% / 0.010	-	6% / 0.10
	Level of costs of the principal competitors (as a percentage of final value / US$ per unit)	Italy: 47% / 0.79 China: 61% / 1.37	Italy: 5% / 0.08 China: 3% / 0.07	Italy: 11% / 0.19 China: 6% / 0.13	Italy: 0.6% / 0.008 China: 0.3% / 0.006	Italy: 2.8% / 0.046 China: 1.5% / 0.033	Italy: 4.2% / 0.070 China: 2.2% / 0.050	Italy: 1.5% / 0.025 China: 0.8% / 0.018	Italy: 15% / 0.25 China: 8% / 0.19	Italy: 17% / 0.29 China: 1% / 0.03
	The possibility to enhance Russia's indicators up to global indicators	There is an advantage available at present stage	-	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	yes	There is an advantage only over Italy at present stage

Fig. 1. Synthetic and wool textiles manufacture chains of costs

policy in this segment can include the support of technical upgrade projects at wool processing enterprises, as well as the promotion of research on the selection and quality enhancement of Russia-made wool. Additionally, the state should promote production streamlining (clusterization, achievement of the economy of scale effect, and cooperation between various stages of the manufacture process), as well as technical upgrade of respective enterprises, imports of technologies and development of domestically enhanced technologies to improve the quality of manufactured products.

In the linen textiles manufacturing, Russia have advantages over its principal competitor Italy in the level of costs in all key sections, namely costs on basic raw materials, labor costs, and costs on energy resources. Furthermore, certain light industry enterprises show high enough energy resource costs, up to 20%. Supporting the upgrade of enterprises with a view to enhancing the energy efficiency of manufacture can become a measure of state support which could help address this problem. Overall, the current state of this segment allows one to say that it is quite worthwhile, even now, to encourage Russian enterprises to penetrate into international markets and get integrated into the global supply chains, cooperate with foreign companies, and it should increase substantially the output of linen textiles and linen products, which is quite moderate today compared with that in other segments of Russia's light industry.

Analysis of the production chains' sections of other light industry segments (cotton, knitwear manufacture) and their comparison with foreign competitors (*Fig.* 2) shows that domestic enterprises are unable to compete internationally in the near term, because they have to import raw materials (for example, Russia has no cotton manufacturing because of weather conditions) and higher labor costs compared to the principal foreign competitors (China, India, Turkey).

Those segments of Russia's light industry which have, based on a survey, embodied or potential competitive advantages, account for a substantial share of total output in the industry[1] which in the mid and the long run can be increased by virtue of following the proposed development guidelines.

The methodology applied for analyzing the competitiveness of supply chain sections draws on the data on quite a variety of industry segments which can have a heterogenic internal structure. There are smaller light industry segments exhibiting certain characteristics which make these segments worthwhile of being developed and supported and cannot be identified while analyzing aggregated statistics. Unlike the foregoing strategic guidelines, such "growth points" are developed for tactical purposes of retaining the existing competences and material and financial resources. The following can be referred to as the "growth points" of Russia's light industry:

Making a government contract to be awarded as part of a competitive tender with the priority given to domestic manufacturers under terms and conditions providing them with a minimum permissible profitability.

Nowadays, the government contract accounts for a substantial share of domestic production which varies within a range of 10 to 20%, as a given sub-sector requires. The motivation for awarding domestic enterprises with a contract on the manufacturing of certain type(s) of products is first of all based on national security grounds (providing minimum necessary volumes of domestically manufactured finished textiles, cloths and footwear). Additionally, the products involved require no intricate finishing and swift response to changes in fashion trends, which a weak competitive power of domestic production is often attributed to.

Providing support to domestic leather manufacturers supplying to the domestic market.

Providing support to leather manufacturing enterprises is first of all motivated by their manufacturing the sole type of raw materials in the light industry whose demand can be met by domestically. Additionally, the processing of leather raw material also can produce various types of fertilizers, food supplements (proteins).

Providing support to domestic manufacturers of children's apparel and footwear.

At present, children's products are highly competitive in quality and price among domestically manufactured products in the light industry. This is first of all attributed to exclusive quality requirements established by respective national industry standards. Russia-made products in this segment have recently been under the pressure from manufacturers of China and Turkey. In this case, the support to domestic manufacturers is intended to retain the competitive power of this industry segment.

Providing support to domestic manufacturers of special purpose clothing and footwear.

The need to support the manufacturing of special purpose clothing and footwear is driven by the fact that design and complex finishing (traditionally weak components in the industry in Russia) are not critical for this industrial segment. It is worthwhile for many Russian corporate customers of special purpose clothing to purchase domestically manufactured products,

1 Totally, about 67% of textiles manufacture (in kind). The materials of the LegpromForum 2014, International Light Industry Forum.

	Chain component	Costs on the basic type of raw materials	Costs on other types of raw materials	Fuel and energy costs	including:				Equipment maintenance and operation costs	Wages with social insurance contributions
					Oil products	Natural gas	Electric power	Water		
Cotton textiles	Level of costs in Russia (as a percentage of final value / US$ per unit)	39% / 0.53	-	5% / 0.07	0.2% / 0.002	1.4% / 0.019	2.9% / 0.040	0.3% / 0.004	-	9% / 0.12
	Level of costs of the principal competitors (as a percentage of final value / US$ per unit)	China: 45% / 0.49 India: 36% / 0.29	China: 5% / 0.06 India: 8% / 0.07	China: 12% / 0.13 India: 14% / 0.11	China: 0.4% / 0.004 India: 0.4% / 0.004	China: 3.2% / 0.036 India: 3.2% / 0.030	China: 6.9% / 0.077 India: 6.9% / 0.064	China: 0.6% / 0.007 India: 0.6% / 0.006	China: 15% / 0.16 India: 23% / 0.19	China: 3% / 0.04 India: 2% / 0.02
	The possibility to enhance Russia's indicators up to global indicators	Only in the long run, highly unpredictable	-	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	yes	no
	Chain component	Costs on the basic type of raw materials	Costs on other types of raw materials	Fuel and energy costs	including:				Equipment maintenance and operation costs	Wages with social insurance contributions
					Oil products	Natural gas	Electric power	Water		
Knitted textiles	Level of costs in Russia (as a percentage of final value / US$ per unit)	44% / 2.45	-	5% / 0.25	0.2% / 0.011	1.1% / 0.063	1.7% / 0.094	0.6% / 0.033	-	6% / 0.31
	Level of costs of the principal competitors (as a percentage of final value / US$ per unit)	China: 61% / 0.70 India: 55% / 0.42 Italy: 47% / 0.49	China: 3% / 0.03 India: 4% / 0.03 Italy: 5% / 0.05	China: 6% / 0.7 India: 8% / 0.6 Italy: 11% / 0.11	China: 0.3% / 0.003 India: 0.3% / 0.002 Italy: 0.5% / 0.005	China: 1.5% / 0.017 India: 1.9% / 0.015 Italy: 2.8% / 0.028	China: 2.2% / 0.025 India: 2.8% / 0.022 Italy: 4.2% / 0.043	China: 0.8% / 0.009 India: 1.0% / 0.008 Italy: 1.5% / 0.015	China: 8% / 0.10 India: 15% / 0.11 Italy: 15% / 0.15	China: 1% / 0.01 India: 1% / 0.01 Italy: 17% / 0.18
	The possibility to enhance Russia's indicators up to global indicators	Only in the long run, highly unpredictable	-	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	There is an advantage available at present stage	yes	no

Fig. 2. Cotton textiles and knitted textiles manufacture chains of costs

because this makes the quality control easier (besides, it is easier for domestic manufacturers to customize the manufacturing process to the specific requirements of Russian customers).

Providing support to domestic manufacturers of technical textiles and nonwovens.

The demand for technical textiles has to date been met 17% by domestic and foreign manufacturers. However, it should be pointed out that import of technical textiles accounts for about 70%[1]. Russian manufactures are competitive as to certain types of technical textiles; an illustration of that is technical textiles which are used for manufacturing car seat belts, touristic belts, alpinist belts and cargo lifting belts, etc.[2] Most prospective segments of technical textiles and nonwovens in Russia are construction textiles, geotextiles, medical textiles, machine building textiles, protective textiles[3].

State support measures

It follows from the highlighted problems and the international experience in developing the light industry that the role of the state in the process of import substitution industrialization in the industry can be selection of priority investment projects which comply with specified long-term development guidelines and short-term points of growth and retain competences. State support in the form of subsidies must be provided to those of the selected projects which show best qualitative characteristics and business plan figures.

A second element of public policy which can help strengthen the competitive power of Russia's light industry products and subsequently possible import substitution is reduction of transaction costs in the industry by virtue of developing the respective institutional environment. This includes two principal components as follows:

1. Balanced institutional development
- promoting cooperation between the light and agricultural industries with regard to supplies of hides for domestic leather and footwear industries, adequate-quality cotton and wool for Russian textile manufacturers, as well as with regard to enhancing the quality of raw materials;
- promoting cooperation between the light and chemical industries with regard to supplying to manufacturers the required quantity of chemical fibers with exclusive characteristics;
- introducing a state security of loans issued to light industry enterprises, giving priority to projects on technical upgrade of enterprises;
- introducing a 5-year tax break for light industry enterprises, provided that one of the following terms is met: an enterprise must undertake a technical upgrade to reduce production costs down to the world's best practices; an enterprise must manufacture products with advanced characteristics enabling it to compete at the international level;
- introducing a compulsory labeling of light industry products and labeling checking procedures, as well as mandatory destruction of confiscated counterfeit or smuggled products;
- promoting interaction (and cost reduction) between developers of finished products in the light industry or production technologies and businesses;
- promoting cooperation between enterprises operating in the light industry and the related branches;
- collecting a comprehensive statistical database on the situation in light industry and related branches, including information on average costs in various production segments;
- widening the dialogue between enterprises and government authorities;
- regular performance measurement of state support and updating the respective policy documents.

2. Enhancing Russia's light industry infrastructure
- training skilled specialists to meet manufacturers' needs (cooperation between educational institutions and businesses, training abroad and exchange of experience, etc.);
- promoting domestic manufacturing of the required equipment and the establishment of respective foreign production facilities in Russia, as well as attracting Russian and foreign investment (purchase of technologies, domestic research and development, provision of support to investment in respective projects, etc.);
- promoting research and development in key areas;
- encouraging Russian manufacturers of raw materials to cooperate with domestic enterprises operating in the light industry;

The decision-making on national policy aimed at fulfilling the foregoing goals, measures of import substitution industrialization in the light industry should

1 Technical textiles – a global market overview // Michael Janecke, 2011

2 Textile versus metals // Expert [electronic resource] Access mode: http://expert.ru/2013/06/17/tekstil-protiv-metalla/

3 Global markets for technical textiles // Michael Janecke, 2014

be based on a weighted decision on their economic worthwhileness.

In particular, cooperation with foreign partners should take account of political risks: economic depen-dence on partners' decisions and the possibility to freeze the production in the face of unfavorable political situation. It is worthwhile to be integrated into the global value chains which begin with reliable political partners.

It is essential to gradually relax state support and transit to a competitive manufacturing in the global market. Manufacturing needs protection at start-up, however, it will have no incentives to enhance productivity and quality of products with ongoing support. Any type of support should have foreseeable deadlines, otherwise it would end up in resource waste.

Furthermore, it is essential to monitor the production efficiency in terms of both internal (organizational) efficiency (costs control, production profitability, achieving the stated goals) and efficiency in the global market (comparing the value of manufactured products with global prices of similar products).

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It is possible and economically worthwhile to implement polices of import substitution industrialization for the development of a series of segments of Russia's light industry. The following elements of import substitution industrialization must be implemented on a compulsory basis; a) economic criteria for the selection of priority projects\sub-sectors\types of products; b) a schedule for cutting back state support and discontinuing the same in the foreseeable future, c) efficiency and global competitiveness control procedures.

A most viable is the model designed to support most competitively prospective industry segments which in the long run will be able to compete with top foreign-made products, as well as given key "growth points", which will help maintain and enhance competences and material resources and develop the industry in the mid run. In doing so, the best possible efficiency of state policy should be achieved by carrying out polices aimed at developing infrastructure, education and science in Russia's light industry, as well as those aimed at ensuring a balanced institutional development.