Idrisov G.

Winners and losers in terms of trade lottery for Russian industry

Russian manufacturing industrial development in late 2014 – early 2015 has been splitted: depending on the output dynamics industries may be divided into two groups. One group (the "losers") shows a stagnating dynamics in spite of the substantial price growth caused by the exchange rate pass-through, whereas the other group (the "winners") has a positive dynamics with the compatible price growth. The main characteristics for that splitting are the import dependence and export orientation. Industries that depend heavily on imports and supply products only to domestic market suffer most.

The situation monitoring in Russian industry in late 2014 – early 2015 is an important agenda for the news blocks, analytical and expert releases, meetings of Russia's government. The assessment of terms of trade effects, the introduction or renewal of financial or technological sanctions, the continuing geopolitical tensions in East Ukraine effect on the prices and output of the Russian manufacturing and, even more generally, the development economy as a whole,[1] are the subjects of deep analytical work for the economic policy decisions to be made.[2] Designed and approved by government *"Priority measures to ensure sustainable economic development and social stability in 2015"* is a culmination of this work which contains top-priority measures aimed at supporting Russia's economy, but it doesn't contain a more elaborated agenda of structural measures, i.e., actions diversifying and enhancing the competitiveness of Russia's economy for making development more stable and sustainable.

The key developments that affect the current changes in Russia's real sector can be roughly structured into three major groups (arranged chronologically):

1. Escalation of the geopolitical tensions, increasing risks for doing business (spring, 2014);
2. Financial and technological sanctions against Russia and the response food sanctions (spring and the summer, 2014);
3. Terms of trade shock (fall, 2014).

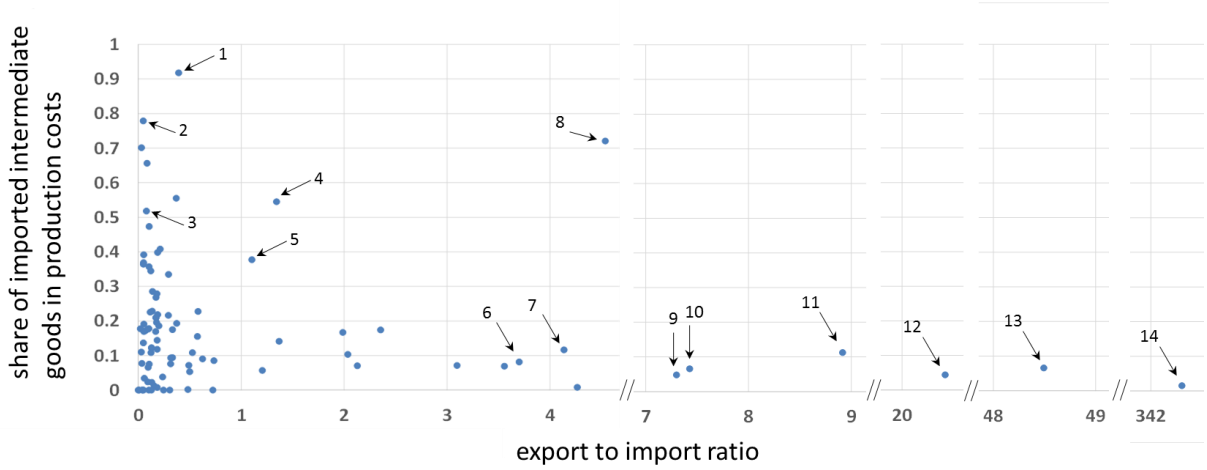
In the summer of 2014, it was considered as temporal macroeconomic changes, and expectations were based on the need to wait a short period of geopolitical tensions. That period was characterized by a slight contraction of investment, a slight upturn in production due to decline

[1] See the comparison of current socio-economic development projections for Russia in Drobyshevsky S, Petrenko V., Turuntseva M., Khromov M. Socio-economic development forecasts for 2015: Ministry of economic forecasts '-3', Gaidar Institute '-7' \\ OMES, No. March 2015, pp. 5–7.

[2] Since early 2015, first Deputy Prime Minister, Igor Shuvalov, and Deputy Prime Minister, Arkady Dvorkovich, have weekly industry-specific meetings for most important issues.

in import from Ukraine, sanctions and response sanctions. However, the industry had nothing to do but adjust to new macroeconomic conditions rather than wait, facing drastic changes in the terms of trade and the ruble's devaluation, the lack of prospects for short-term recovery, limited access to credit resources, and high consumer inflation.

As the result, a complex mix of factors[3] makes some industries winners under the new terms of trade, whereas others - makes losers. A simplified but fairly accurate identification of the winners and the losers requires just two factors: industry dependence on imports of intermediate goods and the export to import ratio (Fig. *1*).



Note: OKVED (Russian economic activity classification) and TNVED TS (Russian adopted HS) groups are putted together based on the ISIC, the International Standard Industrial Classification of all Economic Activities

Reference code:
1 – OKVED: Manufacture of audio-visual equipment (32.3); TNVED TS: Microphones, loudspeakers, headphones, earphones, … (8518)
2 – OKVED: Manufacture of motorcycles and bicycles (35.4); TNVED TS: Motorcycles (including mopeds) and bicycles with auxiliary motor, … (8711)
3 – OKVED: Manufacture of pharmaceuticals (24.4); TNVED TS: Quaternary ammonium salts and hydroxides, lecithins and phosphoaminolipids, … (2923)
4 – OKVED: Processing and canning of fish and seafood (15.2); TNVED TS: Frozen fish, … (0303)
5 – OKVED: Mining of non-ferrous metal ores, except uranium and thorium ores (13.2); TNVED TS: Ores and concentrates (2602)
6 – OKVED: Production of iron, ferro-alloys, steel, rolled products (27.1); TNVED TS: Pig iron and spiegeleisen in pigs, blocks or other primary forms (7201)
7 – OKVED: Tanning and dressing of leather (19.1); TNVED TS: Tanned or crust skins of sheep or lambs, … (4105)
8 – OKVED: Manufacture of tobacco products (16.0); TNVED TS: Cigarettes, cheroots, tobacco or nontobacco cigarillos and cigarettes (2402)
9 – OKVED: Manufacture of steam generators, nuclear reactors (28.3); TNVED TS: Nuclear reactors; fuel elements, non-radiated, for nuclear reactors; isotope separators (8401)
10 – OKVED: Manufacture of coke (23.1); TNVED TS: Coke and semi-coke of hard coal, lignite or peat, agglomerated or non-agglomerated; retort carbon (2704)
11 – OKVED: Production of precious metals (27.4); TNVED TS: Silver (including silver plated with gold or platinum), unwrought or semi-wrought, or in powder (7106)
12 – OKVED: Mining, benefication and agglomeration of hard coal (10.1); TNVED TS: Hard coal; briquettes, pellets and solid fuels of similar type produced chiefly of hard coal (2701)
13 – OKVED: Chemical and fertilizer mineral mining (14.3); TNVED TS: Unroasted pyrites (2502)
14 – OKVED: Crude petroleum and natural gas production (11.1); TNVED TS: Crude petroleum and raw petrochemicals from bituminous minerals (2709)

[3] For more details see OMES, No. 1–4. January–March 2015, Gaidar Institute

Data source: The Federal State Statistics Service (Rosstat), the Federal Customs Service, the author's calculations.

Fig. 1. The share of imported intermediate goods in production costs[4] and the export to import ratio

The mechanism of how these two factors divide manufacturing into winners and losers can be easily illustrated by the law of one price for tradable goods, under which the prices of exported Russia-made goods should be well explained by world prices less transportation costs and foreign trade costs, and the prices of imported foreign-made goods should be explained by world prices plus transportation costs and foreign trade costs[5].

In other words, under the new terms of trade, industries with substantial costs on imported intermediate products and mainly produce goods for the domestic market (the upper left-hand corner of Figure 1) will suffer most by the "bottom-up" pressure by input prices. Indeed, the industries which manufacture motor vehicles, machinery, pharmaceuticals, electrical appliances appeal most for support. They can be conventionally considered as losers. Whereas export oriented industries that less dependent on import inputs are facing better conditions (lower right-hand corner of Figure 1)). Even a small fluctuation/fall of world prices for such industries as ferrous and non-ferrous metallurgy, chemical and petrochemical industries, manufacturers of leather is not comparable with ruble depreciation, resulting in the released "top-down" pressure of prices, increased profitability of export supplies, and a good output dynamics. The exception here are the oil and oil products production and, partly, natural gas, whose situation can hardly be considered a positive after the fall of global USD-denominated prices.

The lower left-hand corner of Figure 1 shows mostly industries whose products are for some reasons non-exportable and their inputs are mostly produced domestically. For example, the construction materials industry, cable industry, and shipbuilding industry are most sensitive to price growth of other domestic manufacturers. They ask government to freeze the domestic prices of metals and chemical products (i.e., the products made by the industries in the lower right-hand corner of Figure 1)). Whether they are the winners or losers depends on their bargaining power under other-than-market forms of price control.

The industries (the upper right-hand corner) which are most integrated into global value chains, depending largely on imports and oriented on exports (manufacturers of tobacco products or fish products), on the one hand, are sensitive to the bottom-up pressure of prices, and on the other hand they have increased profitability from exports. They have the single incentive which

[4] The share of costs on imported raw commodities, materials, bought-in items in total costs on raw commodities, materials, bought-in semi-finished products and component parts for the manufacture and sales

[5] In the real economy, the law of one price may not hold true, which in most cases is regarded to different levels of competition in various markets, different reseller margins, manufacturer's discrimination options of consumers.

consumers tend to resist, i.e., to increase, under the law of one price for tradable goods, their domestic prices by approximately the same value as the ruble depreciates. If such industries happen to do so, they feel themselves relatively good under the new terms of trade, if they don't, a gap develops between the profits from supplies to the domestic and foreign markets. It is worthwhile noting that in a market-driven economy, when there are no other-than-market forms of price determination and protectionism, it is industries of this type, being deeply integrated into the global value chains, that are less sensitive to the dynamics of Russia's terms of trade, making their development stable and sustainable. The foregoing suggests that in order to achieve a more stable development of Russia's economy with both low and high oil prices, as many as possible industries (the upper left-hand corner in *Fig. 1)* should move towards the upper right-hand corner. At present, the integration into global value chains is one of a few opportunity for a stable industrial development[6].

Of course, the specific financial wellbeing of a specific industry, its industrial production and prices are influenced by many factors, however, given the recent worsening of the terms of trade, the analysis made allows one to identify groups of interests, their motivation, applications and requests which they express in various ways – from expert to government meetings. The understanding of these underling reasons is one crucial step to form economic policy measures to diversify and enhance the competitive power of Russia's economy.

[6] About the need for Russia's industry to integrate into the global value chains see Kaukin A., Russia's light industry competitiveness and development prospects // Ekonomicheskoe Razvitiye Rossii, No.3, 2015, pp. 51–57.