

Ukraine's exposure to the Russian market: Sector and regional view

At the end of the month, Ukraine is scheduled to sign a free trade agreement (DCFTA) with the EU in the context of the Association Agreement. Although this bilateral agreement poses no noteworthy economic risks to Russia or to any third party, the Russian Federation might nevertheless react by imposing trade restrictions on imports from Ukraine.

In view of this, it is important to quantify Ukraine's exposure to the Russian market at different levels. On national level 3.5% of Ukraine's output (i.e. gross production value) is sold to Russia. If expressed in terms of GDP, the exposure amounts to 8.3%, which is comparable with Estonia and Latvia, and significantly lower than Lithuania (13.4%). Thus, the national exposure is high, but not dominant.

The sector analysis reveals a mixed picture. Machine building has by far the highest exposure, with 22% of its output being sold to Russia. The exposure of metallurgy amounts to 14%, while only 3% of output of food processing is sold to Russia.

At regional level, Luhansk and Zaporizhzhya top the league table with each oblast selling 10% of their output to Russia. The exposure of Donetsk is much lower, amounting to 6% and the same as Poltava. Kharkiv, Ivano-Frankivsk and Zakarpattya all sell 4% of their production to Russia. Thus, while oblasts in the Eastern part tend to have a higher exposure than other regions, the differences are not that considerable.

These results provide a useful orientation for policy makers and international donors eager to support the country. In case of trade disruptions with Russia, we suggest to focus on those sectors and oblasts with the highest exposure.

Starting point

Ukraine and the EU plan to sign a Deep and Comprehensive Free Trade Agreement (DCFTA) at the end of this month. In reaction to this, the Russian Federation might disrupt or block imports from Ukraine. Although in our view there is no economic justification for this move (see our Newsletter 66/2014), a decline in exports to Russia would certainly hurt the Ukrainian economy.

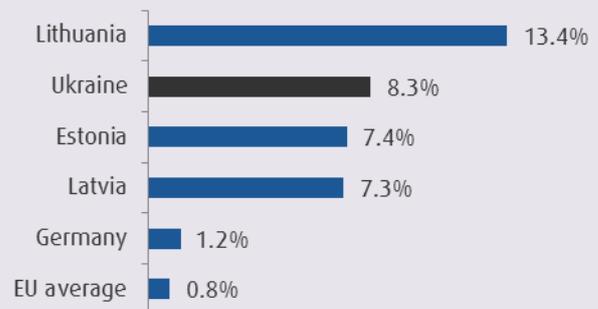
While this in principle is well understood, little seems to be known about the size of a possible shock to the Ukrainian economy as a whole, as well as to different sectors and regions of the country. Instead, the public discussion is often based on information about selected Ukrainian companies with a very large exposure to the Russian market. In

the following we present the results of our quantitative research on the topic, focusing at the national, sector and regional level.

Exposure of the economy to the Russian market

Export exposure is often presented as percentage of GDP. While such a ratio is not really appropriate – GDP is a value added variable while exports are not – in a first step we stick to this practice and present in the table below exports to Russia as percentage of GDP in different countries, including Ukraine.

Exports to Russia as % of GDP, latest available date



Source: MOODY'S (2014)

This suggests that Ukraine's exposure to the Russian market is significant and in scale comparable to Estonia and Latvia, but clearly lower than Lithuania's share. Thus, exposure is high but not dominant from a regional perspective.

Since export is not a value added variable, it is more appropriate to compare it to a country's output. In the case of Ukraine, this ratio amounted to 3.5% in 2013. Thus, from all goods sold by Ukrainian companies, 3.5% are sold to Russia.

Exposure to the Russian market on a sector level

Beyond the national level it is important to analyse the exposure of different sectors of the Ukrainian economy to the Russian market. The key question here is: What is the share of the sector's output that is sold to Russia? The main results of our analysis are shown in the table below.

Exports to Russia as % of sector's output (selection)

Machine building	22%
Metallurgy	14%
Food processing	3%
Agriculture	0%

Source: Authors' estimates based on UN ComTrade and Ukrstat data

The level of exposure varies strongly between sectors. Machine building is the sector with the highest exposure, amounting to 22%. Thus, 22% of output in the sector is sold to Russia. Obviously, disruptions in trade with Russia would have severe consequences for the sector.

The exposure of metallurgy is considerably lower and amounts to 14%. Indeed, while the metallurgy sector is very much export-oriented (62% of output is exported), only 21% of exports go to Russia. The exposure of food processing is rather limited (3%). This sector is mostly oriented on the domestic market (20% of output is exported) and only 15% of exports go to Russia. In the case of agriculture, the exposure to Russia seems to be rather negligible.

This analysis has a clear policy implication. In case of trade disruptions with Russia, efforts should mainly focus on those sectors with a high exposure to Russia, first of all on machine building. There is no sense in supporting sectors with a low exposure.

Exposure to the Russian market on a regional level

The same exercise can be applied at the level of oblasts. The results are presented below.

Exports to Russia as % of oblast's output



Source: Authors' calculation based on State Statistics Service of Ukraine

First of all, the variation of exposure between oblasts is much lower than between sectors. The highest exposure is featured by Luhansk and Zaporizhzhya, with 10% of output being sold to Russia.

As expected, oblasts in the Eastern part of the country tend to have a higher exposure than in other parts. However, the differences are not as big as one would have expected. In particular, it is interesting to note that only 6% of Donetsk's output is sold to Russia. This is the same share as Poltava in the center of the country. Kharkiv's share amounts to 4%, the same as Zakarpattya or Ivano-Fankivsk in the Western part of the country.

Conclusions

Many Ukrainian companies have a significant exposure to the Russian market. Consequently, the government should try hard to avoid trade disruptions with Russia, despite the current tensions in relations.

Should, however, Russia impose or increase restrictions on Ukrainian imports, then there will be a need for a rapid and decisive reaction. In particular, companies should - with the help of the government and of international donors - search for new markets, not only in the EU, but also elsewhere. Our analysis could be used as an orientation in setting priorities. Resources should be concentrated on companies belonging to the sectors with highest exposure, with machine building in the first place.

Authors

Dr. Ricardo Giucci, giucci@berlin-economics.com
Veronika Movchan, movchan@ier.kiev.ua

Note: The results presented here are based on the Technical Note TN/03/2014 "Ukrainian exports to Russia: Sector and regional exposure"

Download at: www.beratergruppe-ukraine.de

German Advisory Group

The German Advisory Group on Economic Reforms, which has been active in Ukraine since 1994, advises the Ukrainian Government on a wide range of economic policy issues and on financial sector development. The group is financed by the German Federal Ministry of Economics and Energy under the TRANSFORM programme and its successor.

Contact

German Advisory Group
c/o BE Berlin Economics GmbH
Schillerstr. 59, D-10627 Berlin
Tel. +49 30/20 61 34 64 0
Fax +49 30/20 61 34 64 9
info@beratergruppe-ukraine.de
www.beratergruppe-ukraine.de