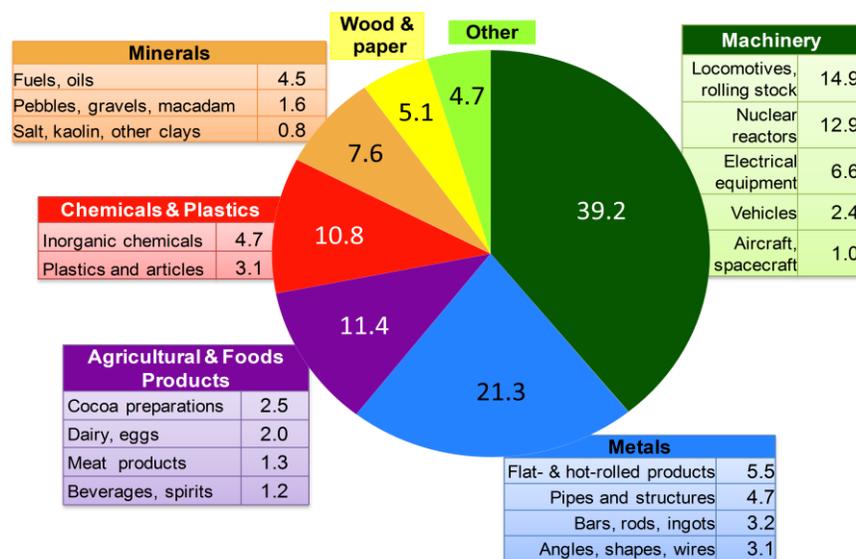


Likely Russia's Trade Response if Ukraine Signs Association Agreement with the EU in November 2013

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Russia is the main single country trade partner of Ukraine. It accounts for about ¼ of total exports of goods and services of Ukraine. Ukraine's exports of goods to Russia are dominated by machinery and equipment, metallurgical products. Agricultural products and foods, chemicals and plastics as well as mineral goods are also dependent of Russian market.

Structure of Ukraine's Exports of Goods to Russia, 2012, % of total



Source: UN Comtrade database, Ukraine's State Statistics Service

Ukraine rejected Russia's offer to join Customs Union and is heading towards initialing the association agreement with the EU. In response, Russia restricted Ukraine's exports of select products (such as chocolate, pipes, etc.) and tightened customs controls of all Ukrainian exports in August 2013. The latter move virtually blocked Ukrainian exports to Russia for a couple of days.

Since Ukraine's import duties with the EU will be either removed or lowered compared to current duties between Russia and the EU, Russia is worried that its market will be flooded with European, Turkish and other goods through Ukrainian territory (so-called re-imports). As a result, Russia is considering protective measures (both tariff and non-tariff barriers). These restrictions, if imposed, may cost Ukraine about \$8 billion (\$6 billion to \$10 billion), and may have negative consequences for both Ukraine's economic growth and its external liquidity position.

Below is presented sensitivity analysis of Ukrainian exports.

Machinery and equipment – Severe impact

Except for nuclear reactors, locomotives and spaceship equipment, Russia may significantly restrict Ukraine's machinery exports. In particular, trade restrictions may be imposed on railway rolling stock, aircrafts equipment, transformers and their parts, buses and cars, etc. Overall, export of these commodities may decline by 40-50%.

Metals – Significant impact

Ukrainian metallurgical products account for about ¼ of the Russian market. Russia has already canceled import quotas for Ukrainian pipes in 2H 2013. In addition, several Russian companies (Severstal, Eurasia, etc.) are expected to run on new production capacities over the next few years, which will intensify competition on the Russian market. Hence, Russia may impose tight import barriers to protect its local producers.

Minerals – Moderate impact

Ukraine has six oil-refining plants. But the industry heavily depends on imported raw materials, mainly from Russia. Correspondingly, a number of plants belonged to Russian crude oil companies. Following the reduction of import duties on fuels, oil-refineries worked using tolling schemes (when Russian crude oil was imported as a raw material for processing with finished product transported back to and sold in Russia). However, as Russia raised export duties on crude oil, even this scheme became unprofitable. Ukrainian oil-refineries were stopped and some of them sold. As a result, both oil-refining and exports of gasoline products dropped significantly in 2013. Exports of this commodity group are unlikely to be resumed in 2014.

Exports of pebbles, gravels, macadam accounted for 1.6% of total exports in 2012. Ukrainian goods account for almost a half of Russia's consumption of these commodities. The reasons are Ukraine's proximity to Russia and relatively lower railway transportation tariffs in Ukraine. An increase in import barriers by Russia may result in 10-15% reduction in Ukraine's exports of these commodities.

Exports of **coal** accounted for about \$37 million in 2012. For the first six months of 2013, export of this commodity almost tripled (to \$22.8 million) compared to the respective period last year. Russia has already signaled it may ban export of coal, except for coke. Though it represents around 0.2% in total exports to Russia, it may contribute to an adverse impact of Russia's trade restriction on the Ukrainian economy.

Agricultural and food products – Severe impact

Ukraine's chocolates and cocoa products, milk and dairy products, meat, cheese, beverages and spirits are under the threat of new Russia's restrictions. In August, problems with customs clearance at the Russian border were announced by Obolon (soft beverages and beer), Inkerman and Global Spirits (wine), Milkiland (dairy), select vegetable and fruit producers. For several years already Russia periodically bans Ukraine's exports of cheese. In spring, it introduced restrictions on Ukraine's exports of poultry following its rapid growth since the beginning of 2013. As the share of Ukrainian agricultural and food products for Russian market is rather small, Russia may significantly restrict Ukraine's exports of these commodities. Although Ukraine has been actively diversifying its exports (to African and Asian countries), it may lose up to 80% of the Russian market, which may become a severe blow for the Ukrainian food processing industry.

Chemicals and Plastics – Modest Impact

Chemical industry is unlikely to be severely affected by Russia's trade restrictions. Titanium dioxide is among key chemical products exported to Russia. Though Russia has titanium deposits, it does not produce it and purchases from abroad. Thus, Crimea Titan accounts for 30% of the Russian market of titanium dioxide, while Zaporizhzhia Titanium - Magnesium Plant holds 80% of the Russian ilmenite market. In addition, most chemical enterprises exporting to Russia

belongs to Dmytro Firtash Group DF. Mr. Firtash is known for having good relations with Russia (in the past, he negotiated preferential natural gas prices for his chemical enterprises).

There are relatively few producers of plastics and articles of plastics in Ukraine since Ukraine is very dependent on imports of basic polymers. Moreover, most of these producers are either controlled by Russian companies (e.g., Lukoil, TNK) or have close ties with Russia (e.g., Stinol concern belongs to Firtash's group DF).

Despite these facts, Russia still may reduce purchases of these commodities by about 5-10%.

Overall, Ukraine may lose from \$6 to \$10 billion if Russia imposes trade restrictions.

Appendix.

Exports of goods to Russia	2012 actual		Potential loss	
	\$ thousand	% of total	%	\$ thousand
02 Meat and edible meat offal	227,287.1	1.3	70	-159,101.0
04 Dairy products, eggs	356,043.1	2.0	80	-284,834.5
18 Cocoa and cocoa preparations	441,665.2	2.5	90	-397,498.7
19 готові продукти із зерна	137,515.5	0.8	50	-68,757.7
20 Vegetable, fruit, nut, etc food preparations	170,073.9	1.0	50	-85,037.0
22 Beverages, spirits and vinegar	206,797.5	1.2	70	-144,758.2
25 Salt, sulphur, earth, stone, plaster, lime and cement	464,308.6	2.6	10	-46,430.9
27 Mineral fuels, oils	796,571.4	4.5	80	-637,257.1
28 Inorganic chemicals	822,857.1	4.7	5	-41,142.9
29 Organic Chemicals	152,352.7	0.9	5	-7,617.6
38 Other Chemicals	58,334.9	0.3	5	-2,916.7
39 Plastics and articles thereof	550,514.7	3.1	10	-55,051.5
44 Wood and Wood Products	84,781.6	0.5	20	-16,956.3
48 Paper and articles thereof	724,820.1	4.1	10	-72,482.0
69 Ceramic products	207,696.4	1.2	60	-124,617.8
72 Iron and steel	2,328,945.5	13.2	60	1,397,367.3
73 Articles of iron or steel	1,110,105.1	6.3	60	-666,063.1
84 Nuclear reactors, boilers, machinery	2,270,637.8	12.9	-	0.0
85 Electrical, electronic equipment	1,159,666.1	6.6	30	-347,899.8
86 Locomotives, rolling stock	2,635,580.9	14.9	80	2,108,464.7
87 Vehicles other than locomotives	431,240.8	2.4	75	-323,430.6
88 Aircraft, spacecraft, and parts thereof	182,605.4	1.0	30	-54,781.6
89 Boats	88,568.0	0.5	30	-26,570.4
90 прилади та апарати оптичні, фотографічні	141,264.0	0.8	30	-42,379.2
94 Furniture	219,499.4	1.2	70	-153,649.6
Total Goods	17,631,749.5	100.0		7,265,066.2
Services				
Transportation	3,900,000		0	0
Business Services	500,000		70	350,000
Other Services	1,000,000		70	700,000
Total Services				1,050,000
Total				8,300,000