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Sectoral Analysis: Key Opportunities and Challenges

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In addition to modelling the economy-wide impact of potential FTA with Turkey, we did in-depth research of 8 sectors with the strong SME presence

1. Dairy Processing
2. Processed Fruits and Vegetables
3. Wood Processing and Furniture
4. Textiles and Apparel
5. Electrical Machinery and Parts
6. Information Technology
7. Tourism
8. Trucking

Dairy processing: sector overview

Indicator	Value
Value added, % of gross value added	0.4
SMEs value added, % of sector total	64%
Hired employees, thousand	51
Average monthly wage, UAH	6 969
Exports, USD billion	0.31
Exports, % of domestic production	17
Imports, USD billion	0.10
Imports, % of domestic use	4

- SMEs generate two-thirds of the sector's value added
- The sector is dominated by private ownership, mostly of Ukrainian origin; the share of foreign owned companies is 28%
- Market concentration is moderate: top-8 companies hold 32% of market
- The main challenge faced by the sector is the shortage of raw milk
- Other important barriers mentioned during interviews include quality concerns and a presence of counterfeit products on the market



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Dairy processing: expected FTA with Turkey

- The sector is competitive both globally and on the Turkish market (RCA>1)
- Key export destinations are the EU and FTA countries, the share of Turkey is 5%
- Key trade barriers in trade with Turkey:
 - Import duty of Turkey on Ukrainian products: 176%
 - Import duty of Ukraine on Turkish products: 10%
 - Food safety requirements
- The FTA with Turkey is expected to strongly expand sector's output backed by growing exports thanks to tariff liberalization.
- Key challenges to realize this potential are availability of raw milk and quality issues

Processed fruits and vegetables: sector overview

Indicator	Value
Value added, % of gross value added	0.2
SMEs value added, % of sector total	64
Hired employees, thousand	14.6
Average monthly wage, UAH	9,208
Exports, USD billion	0.37
Exports, % of domestic production	62
Imports, USD billion	0.27
Imports, % of domestic use	33

- SMEs generate two-thirds of the sector's VA
- The sector is dominated by foreign owned companies (62%)
- Market concentration is significant: top-8 companies hold 47% of market
- Interviews revealed the following impediments to sector development:
 - Lack of qualified labor force
 - Infrastructure deficiencies (lack of storages, cooling and freezing facilities, transport)
 - Access to finance
 - Access to raw materials



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Processed fruits and vegetables: expected FTA with Turkey

- The sector is competitive both globally and on the Turkey market (RCA>1)
- Key export destinations are the EU and FTA countries, the share of Turkey is 4%
- Key trade barriers in trade with Turkey:
 - Import duty of Turkey on Ukrainian products: 16%
 - Import duty of Ukraine on Turkish products: 5%
 - SPS requirements: compliance with food safety requirements of importing party
- The FTA with Turkey is expected to expand sector's output backed by growing exports thanks to tariff liberalization
- Key challenges relate to the availability of market infrastructure and qualified labor force

Wood Processing and Furniture: sector overview

Indicator	Value
Value added, % of gross value added	0.8
SMEs value added, % of sector total	88
Hired employees, thousand	110.3
Average monthly wage, UAH	5 585
Exports, USD billion	1.93
Exports, % of domestic production	49
Imports, USD billion	0.5
Imports, % of domestic use	57

- The sector is dominated by SMEs that generate 88% of value added
- Ukrainian private owners dominate in the sector; the share of foreign owned companies is 23%
- Market concentration is moderate: top-8 companies hold 27% of market
- Interviews revealed the following impediments to sector development:
 - Access to raw materials
 - Lack of qualified labor force
 - Informal economy

Wood Processing and Furniture: expected FTA with Turkey

- The sector is competitive both globally and on the Turkey market (RCA>1)
- Key export destination is the EU, the share of Turkey is 5%
- Key trade barriers in trade with Turkey:
 - Import duty of Turkey on Ukrainian products: furniture 2%, wood 1%
 - Import duty of Ukraine on Turkish products: furniture 1%, wood 0%
 - SPS requirements related to wood
- The FTA with Turkey is expected to contract sector's output due to increased import competition and higher costs of resources being competed away by expanding sectors
- At the same time, the use of Pan-Euro-Mediterranean (PEM) rules of origin allowing diagonal cumulation could stimulate trade in intermediate products

Textiles and Apparel: sector overview

Indicator	Value
Value added, % of gross value added	0.4
SMEs value added, % of sector total	100
Hired employees, thousand	90.4
Average monthly wage, UAH	4955
Exports, USD billion	0.88
Exports, % of domestic production	52
Imports, USD billion	1.9
Imports, % of domestic use	69

- The sector is comprised exclusively by SMEs that generate 100% of value added
- Ukrainian private legal entities account for 76% of the sector; the share of foreign owned companies is only 7%
- Market concentration is low: top-8 companies hold 8% of market
- Tolling scheme is actively applied
- Interviews revealed the following impediments to sector development:
 - Access to inputs
 - Lack of qualified labor force
 - Informal economy

Textiles and Apparel: expected FTA with Turkey

- The sector's RCA is below unity signaling about the sector's low competitiveness globally
- Key export destination is the EU, the share of Turkey is 2%
- Key trade barriers in trade with Turkey:
 - Import duty of Turkey on Ukrainian products: textile 4%, wearing apparel 12%
 - Import duty of Ukraine on Turkish products: textile 5%, wearing apparel 12%
 - Product safety requirements
- The FTA with Turkey is expected to contract sector's output due to increased import competition and higher costs of resources being competed away by expanding sectors
- At the same time, the PEM rules of origin could stimulate trade in intermediate products

Electrical Machinery and Parts: sector overview

Indicator	Value
Value added, % of gross value added	0.5
SMEs value added, % of sector total	77
Hired employees, thousand	50.4
Average monthly wage, UAH	8201
Exports, USD billion	1.18
Exports, % of domestic production	67
Imports, USD billion	2.76
Imports, % of domestic use	82

- The sector is dominated by SMEs that generate 77% of value added
- Ukrainian private legal entities account for 80% of the sector; the share of foreign owned companies is 14%
- Market concentration is moderate: top-8 companies hold 21% of market
- Interviews revealed the following impediments to sector development:
 - Outdated technology
 - Lack of qualified labor force
 - Access to finance



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Electrical Machinery and Parts: expected FTA with Turkey

- The sector's RCA is below unity signaling about the sector's low competitiveness
- Key export destination is the EU and other FTA countries, the share of Turkey is close to zero
- Key trade barriers in trade with Turkey:
 - Import duty of Turkey on Ukrainian products: 2%
 - Import duty of Ukraine on Turkish products: 4%
 - Technical barriers to trade: no mutual recognition of standards and conformity assessment
- The FTA with Turkey is expected to contract sector's output due to higher costs of resources being competed away by expanding sectors
- At the same time, the PEM rules of origin could stimulate trade in intermediate products. Mutual recognition of standards and conformity assessment could also boost trade

Information Technology: sector overview

Indicator	Value
Value added (VA), % of gross value added	2.1
SMEs VA, % of sector total	66
Hired employees, thousand	55.2
Average monthly wage, UAH	14746
Exports, USD billion	1.63
Exports, % of domestic production	57
Imports, USD billion	0.25
Imports, % of domestic use	21

- The country is home to more than 100 R&D offices of international companies
- Two thirds of IT value added are generated by SMEs
- The sector is privately owned, share of foreign owned companies is 17%
- Market concentration is low: top-8 companies hold only 10% of market
- Interviews highlighted the following challenges faced by the sector:
 - Lack of qualified labor force
 - Weak domestic demand



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Information Technology: expected FTA with Turkey

- The sector is competitive both globally and on the Turkey market (RCA>1)
- Key export destination is the EU and the USA, the share of Turkey is close to zero
- Key trade barriers in trade with Turkey:
 - General restrictions on the temporary movement of people
- The FTA with Turkey is expected to contract sector's output due higher costs of resources being competed away by expanding sectors. However, this impact is expected to be mitigated by technological advances and growing global demand
- Turkey is not a member of the EU's Digital Single Market, while Ukraine strives to join it. According to interviews with sector representatives, it is desirable to complete negotiations with the EU before opening up the IT sector within the FTA with Turkey

Tourism: sector overview

Indicator	Value
Value added, % of gross value added	0.6
SMEs value-added, % of sector total	96
Hired employees, thousand	214.0
Average monthly wage, UAH	3 234
Exports, USD billion	0.30
Exports, % of domestic production	14
Imports, USD billion	0.99
Imports, % of domestic use	47

- The sector is dominated by SMEs that generate 96% of value added
- Ukrainian private legal entities and private entrepreneurs account for 42% of the sector each; the share of foreign owned companies is 16%
- Market concentration is low: top-8 companies hold 11% of market
- Interviews revealed the following impediments to sector development:
 - Quality issues
 - Underdeveloped infrastructure
 - Cumbersome regulation



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Tourism: expected FTA with Turkey

- The sector's RCA is below unity signaling about the sector's low competitiveness
- Over half of exports come from the rest of the world, the share of Turkey is 3%
- Key trade barriers in trade with Turkey:
 - General restrictions on the temporary movement of people
- The FTA with Turkey is expected to slightly contract sector's output due to higher costs of resources being competed away by expanding sectors
- The interviews with business owners in the sector showed that they do not expect the FTA with Turkey to change much, as Ukraine and Turkey already allow visa-free entry for mutual tourists

Trucking: sector overview

Indicator	Value
Value added, % of gross value added	1.1
SMEs value added, % of sector total	98
Hired employees, thousand	113.4
Average monthly wage, UAH	4252
Exports, USD billion	0.3
Exports, % of domestic production	56
Imports, USD billion	1.46
Imports, % of domestic use	24

- The sector is dominated by SMEs that generate 98% of value added
- The sector ownership is split between Ukrainian private legal entities (59%) and private entrepreneurs (31%), the share of foreign owned companies is 1%
- Interviews revealed the following impediments to sector development:
 - Quality of roads / truck overloads
 - Low control of road safety
 - Dependence on fuel costs
 - Access to EU market / permits



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Trucking: expected FTA with Turkey

- The sector is competitive globally ($RCA > 1$)
- Key export destination is the EU, the share of Turkey is about 1%
- Key trade barriers in trade with Turkey:
 - System of transport permits
- The FTA with Turkey is expected to contract sector's output due to higher costs of resources being competed away by expanding sectors
- The interviews with business owners in the sector highlighted two expected positive developments: the FTA with Turkey may include market liberalization through the abolishment of the system of bilateral permits; the membership in the European common transit system would simplify the process of border crossing



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Summing up

- The potential FTA with Turkey will have diverse impact on Ukraine's sectors
- The largest gains are expected for agro-food sectors that currently face the most significant tariff barriers in Turkey. These gains depend on two assumptions: the FTA includes the sharp reduction of these tariffs; and businesses are able to capture these gains
- For many sectors, the model shows contraction of output, mostly driven by expanding sectors competing resource away (paying higher wages) from sectors that benefit less from the FTA
- The effective use of Pan-Euro-Mediterranean Rules of Origin Convention and joining the European common transit system could generate additional gains in trade with Turkey strengthening the overall positive impact of the FTA



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Thank you!



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