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Opportunities to increase Ukrainian export competitiveness in the European Union market

Summary. The National Export Strategy (NES) of Ukraine in 2017 is aimed at increasing the competitiveness of exports. The EU market is identified as a priority market. The purpose of the study is to define the directions of trade cooperation between Ukraine and the EU, which will allow to increase Ukrainian export competitiveness in the EU market and will be mutually beneficial for the trade partners. To solve this problem, the current model of trade cooperation between Ukraine and the EU has been analyzed and characterized. The results of the study indicate that the priorities of national trade policy within the context of EU trade are: stimulation of the production of niche products of the food and beverages industry; support of qualitative integration of the domestic machinery into European value chains; promoting the development of European technologies mastering and intra-branch trade upbuilding in the aerospace and aviation parts and components industry.

Key words: market, competitiveness, export, National Export Strategy, globalization

Introduction

Ukraine is a “newcomer” among the main subjects of world trade space. It is just forming a foreign trade model that is adequate to the objective processes of globalization and international economic regionalization. The majority of theories of international trade (the theory of comparative advantages of D. Ricardo¹, the Heckscher–Ohlin theorem², the theory of the product life cycle³, Porter’s national Competitive Advantage Model⁴, etc.), using different arguments, prove that foreign trade a priori benefits both the exporting country and the importing country. However, to grant the truth of what

¹D. Ricardo: The principles of political economy and taxation, Dover Publications, Mineola NY 2004.

²R. Findlay: Eli Heckscher, international trade, and economic history, MIT, Cambridge MA, London 2006.

³R. Vernon: International Investment and International Trade in the Product Cycle, Quarterly Journal of Economics 1966, No 80(2), p. 190.

⁴M.E. Porter: On competition, Harvard Business School Publishing, Boston MA 1998.

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has been said, trading partners should have the sufficient and comparable level of competitiveness. A country will benefit from international trade even with a negative foreign trade balance provided that its economy is sufficiently competitive and favorable for foreign investment. As a result, both countries become richer, create better jobs and produce more goods and services in areas where they have competitive advantages⁵.

Methodology

The main purpose of this study is to describe the model of the trade relations between the EU and Ukraine in order to increase Ukrainian export competitiveness. This model is regarded as a perfect sample of commercial relations in response to the deepening economic integration and under the free trade area. The important component of the model is “sensitive goods”. These are the commodities with high level of competition between the European and Ukrainian producers within the priority export sectors. The list of such goods should be taken into account before the adoption of trade policy measures. Therefore, trade dimension of competition between the EU and Ukraine, emerging from the understanding of their economic interests, is designed to mutually benefit both sides.

Development

Today the principle of mutual benefit in international economic relations is the main and the most general principle of law, on which a whole international cooperation is built⁶. But currently export of the EU countries is much more competitive than the Ukrainian one. The competitiveness of exports is one of the most important indicators of competitiveness of the country. Among the main determinants of export performance UNCTAD experts highlight the access to foreign markets. The main indicator reflecting this is the export share of the country in international markets⁷. To that end, Table 1 provides an overall picture of the competitiveness of exports of Ukraine and the EU in the main commodity groups.

The EU countries are among Top 20 in the world market in the terms of export volumes of each commodity group. According to Export Strategy of Ukraine (ESU)⁸ there are several important EU markets that offer untapped export potential opportunities. Among them are Germany, France and Ireland. These countries have significant competitive advantages both in the spheres of trade in traditional products of Ukrainian

⁵M. Cox, R. Alm: Myths of Rich & Poor, [in:] *Debating Democracy*, B. Miroff et al. (Eds.), Houghton Mifflin, Boston, MA 1999, pp. 320–326.

⁶O. Mikichurova: Implementation of the principle of mutual benefit in the process of Ukraine’s integration into the European Union, *Legea Si Viata* 2015, No 4/3(280), pp. 57–62.

⁷M. Fugazza: *Export Performance and its Determinants: Supply and Demand Constraints*, United Nations, New York, Geneva 2004.

⁸Export Strategy of Ukraine: Strategic Trade Development Road Map 2017–2021, <http://me.gov.ua/Documents/Detail?lang=uk-UA&id=e6ab10fa-0ad9-4fe4-b8be-32f570693b64&title=EksportnaStrategiaUkraini-DorozhniaKartaStrategichnogoRozvitkuTorgivli2017-2021> (access: 30.09.2018).

Table 1. Comparison of Ukraine's and the EU's export position in 2016

Commodity group	Place of Ukraine among the exporting countries	The EU countries that are in Top 20 in the world market in the terms of export volumes of the commodity group (ranking)
Agricultural products	26	the Netherlands (2), Germany (3), France (6), Spain (8), Belgium (9), Italy (10), Poland (18)
Automotive products	67	Germany (1), Spain (7), France (9), Belgium (11), Italy (12), the Czech Republic (13), Poland (15), the Slovak Republic (16), Hungary (17), Sweden (18), the Netherlands (19), Austria (20)
Chemicals	63	Germany (1), Belgium (4), the Netherlands (6), France (7), Ireland (8), Italy (10), Spain (12), Austria (19), Denmark (20)
Clothing	58	Italy (3), Germany (5), Spain (8), France (9), Belgium (10), Germany (18), Denmark (20)
EDP and office equipment	56	the Netherlands (4), Germany (5), the Czech Republic (11), Ireland (18), France (19), Hungary (20)
Food	26	the Netherlands (2), Germany (3), France (5), Spain (7), Belgium (9), Italy (10), Poland (17)
Iron and steel	11	Germany (3), Italy (6), France (9), Belgium (10), the Netherlands (12), Spain (15), Austria (19)
Machinery and transport equipment	45	Germany (2), France (8), the Netherlands (9), Italy (11), Spain (15), Belgium (17), the Czech Republic (18), Poland (20)
Miscellaneous manufactures	43	Germany (2), France (7), Italy (8), the Netherlands (9)
Office and telecom equipment	57	Germany (8), France (13), Italy (14), the Netherlands (15), Belgium (17)
Pharmaceuticals	58	Germany (1), Belgium (3), France (5), the Netherlands (7), Ireland (8), Italy (9), Spain (10), Denmark (12), Austria (14), Sweden (15), Hungary (19), Poland (20)
Textiles	64	Germany (3), Italy (5), Belgium (12), France (13), the Netherlands (15), Spain (17), the Czech Republic (20)
Raw materials	63	the Netherlands (6), Germany (12), Belgium (19)

Source: drafted by the authors based on World Trade Organization: Trade and tariff data, <https://www.wto.org> (access: 20.10.2018).

export and in the spheres, which now are not export-oriented in Ukraine (high-tech goods).

Ukraine demonstrated the best position by exporting commodity groups with low added value (iron and steel products – 11th place, agricultural products – 26th place, food products – 26th place). Instead, Ukraine's positions on external supply of such commodity groups as automotive products (67th place), chemicals (63rd place), EDP

and office equipment (56th place), machinery and transport equipment (45th place), office and telecom equipment (57th place) testify to the low level of competitiveness in the production of high-tech goods.

The current model of trade cooperation between Ukraine and the EU is characterized by significant disproportions in the technological dimension: primary products, low-technology and resource-based export are dominant in the Ukrainian export structure, medium and high technology import from the EU countries are twice as high as from Ukraine. In order to consider the actual and possible in the future model of the trade relationship between the EU and Ukraine, we will take into account the commodity-economic dimension of competition with an emphasis on the export component. It includes quantitative indicators of volumes, dynamics, commodity and geographical structure of foreign trade. Instead, the technological dimension, which includes the supply of goods and services to the counterparty (logistics), the procedures for documenting the export-import operations, will not be the subject of this study⁹.

The main indicators of the foreign trade between Ukraine and the EU countries in the dynamics are presented in Table 2. Despite the negative trends in the import and export indicators for 2013–2015, it can be argued that the openness of the domestic economic system for the trade with the EU become higher and stronger. Its dependence on the sales of goods in the European market has grown. The catalyst for this, among other things, was the trade preferences accorded to Ukraine due to the provisions of AA/DCFTA.

Table 2. The dynamics of the main indicators of the foreign trade between Ukraine and the EU countries

Year	Import (USD thous.)	Share (%)	Export (USD thous.)	Share (%)	Trade balance (USD thous.)
2011	25 585 757	31.54	17 942 345	26.26	-7 643 412
2012	26 019 278	31.27	17 044 240	24.82	-8 975 038
2013	26 801 186	34.88	16 866 113	26.65	-9 935 073
2014	20 815 290	39.63	17 085 078	31.61	-3 730 212
2015	15 544 862	42.48	13 026 397	34.14	-2 518 465
2016	17 099 468	44.00	13 495 534	37.12	-3 603 934

Source: drafted by the authors based on State Fiscal Service of Ukraine: Customs statistics, <http://sfs.gov.ua> (access: 25.10.2018).

The increase in the number of business entities that granted the right to export livestock products to the EU countries shows the attractiveness of the EU market for Ukrainian producers. This provides opportunities for the continuation and acceleration

⁹I. Burakovsky: Ukrainian exports: the results of 2016 and future vision, <http://www.ier.com.ua/ua/publications/articles?pid=5503> (access: 20.10.2018).

of such processes and, in the long run, to substantially improve their qualitative dimension.

Current qualitative dimension of Ukrainian export could not be considered satisfactory (the figure). The main part of Ukrainian export consisted of the ferrous metals (19.9%), electric machines (11.9%), grain crops (9.5%), fats and oils of animal or vegetable origin (8.9%). The most imported commodity groups were: mineral fuels; oil and products of its distillation – 14.8%; nuclear reactors, boilers, machines – 14.1%; means of land transport, except for railways – 8.5%.

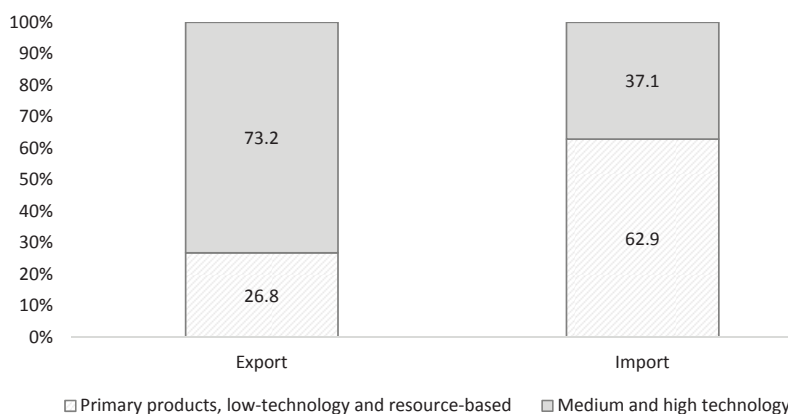


Figure. Technological cross-section of the trade between Ukraine and the EU countries

Source: drafted by the authors based on State Statistical Service of Ukraine: Cooperation between Ukraine and EU Countries, External economic activity, Publications, <http://www.ukrstat.gov.ua> (access: 25.10.2018).

Taking into account the priorities defined in the ESU a matrix of export-oriented sectors of the Ukrainian economy was drawn up. The matrix was developed according to the following criteria: the sector represents economic interest for Ukraine in accordance with the ESU; a commodity group has a big share in the EU import from third countries; Ukraine has significant competitive advantages in the production of the commodity group (Table 3).

Based on the analysis of the foreign trade indicators by the commodity groups within the export-oriented sectors, products with a high level of competition between the EU's and Ukrainian producers were identified. Table 4 shows that there is a list of "sensitive goods" within each of the considered sectors. The import share of such commodity groups from third countries to the EU does not exceed 20%. At the same time, this product group occupies more than 0.1% of the total export from Ukraine. It means that these goods can become the object of competition between the EU's and Ukrainian producers. Therefore, this list should be taken into account for the mutual consideration of the partners' positions. For example, bilateral consultations are necessary before the adoption of trade policy measures, concerning preferences for the listed commodities.

Table 3. Matrix of export-oriented sectors of Ukrainian economy

Sector	Commodity group	Priority according to the ESU	Existence of export during the last 3 years	Big share in the EU import from third countries	Competitive advantages
Food and beverages industry	foods made from meat, fish or crustaceans, shellfish	+	+	+	natural and climatic conditions, raw material base, human capital, well-established production and experience
	sugar, sugar preparations and honey	+	+	+	
	cocoa and food preparations with cocoa	+	+	+	
	cereals and cereal preparations	+	+	–	
	vegetables and fruits, nuts prepared	+	+	+	
Machinery	reactors, vapour generating boilers, auxiliary plant; parts	+	+	+	raw material base, production base
	electrical machinery, apparatus and appliances, NES; video and audio equipment	+	+	+	scientific base, labor force
Aerospace and aviation parts and components, including aircraft	aircraft and associated equipment; spacecraft, etc.	+	+	+	raw material base, production base, scientific base, labor force

Source: drafted by the authors based on State Fiscal Service of Ukraine: Customs statistics, <http://sfs.gov.ua> (access: 25.10.2018); UNCTADstat: Datacenter, <http://unctadstat.unctad.org> (access: 26.10.2018).

The model of trade cooperation between Ukraine and the EU should be based on the trade policy, which not only takes into account the competitive advantages of the parties, but also allows them to realize their integration capacity. For the implementation of the main directions of the agreed foreign trade policy, the sectors identified as priority by ESU were selected. However, for their inclusion in the mutually beneficial model it is not enough for Ukraine only to increase the export of commodity groups that meet the criteria of Table 3. Increasing the competitiveness of Ukrainian export should take into account opportunities for implementing the integration capacity, which is opened by the free trade area between Ukraine and the EU.

Table 4. Commodity groups with a high level of competition between the EU's and Ukrainian producers

Commodity group	Share in the EU import from third countries (%)	Commodity group share in the Ukrainian export (%)
Food and beverages industry		
Butter and other fats and oils derived from milk	2.99	0.1
Birds' eggs and eggs' yolks; egg albumin	2.52	0.13
Barley	3.4	1.83
Meal and flour of wheat and flour of meslin	4.16	0.20
Sugar confectionery	12.14	0.29
Chocolate	8.26	0.37
Margarine and shortening	8.97	0.14
Machinery		
Agricultural machinery (excluding tractors) and parts	19.63	0.1
Motor vehicles for the transport of persons	17.25	0.1

Source: drafted by the authors based on State Fiscal Service of Ukraine: Customs statistics, <http://sfs.gov.ua> (access: 25.10.2018); UNCTADstat: Data center, <http://unctadstat.unctad.org> (access: 26.10.2018).

Given the limited financial resources and the lack of capacity of state institutional support in the field of export development, it is proposed to consider as the first vectors of the trade policy of Ukraine the following: food industry; machinery; aerospace and aviation ports and components.

Food industry: niche products orientation

The food industry is one of the most important export sectors of Ukrainian economy. It possesses an abundant resource base, human capital, established production and experience in food processing¹⁰.

Based on the market conditions development of Ukrainian food industry towards the EU is possible through production and processing of the niche products. According to the results of the market survey the cultures and commodities with the largest export potential in the EU include¹¹: fruits and vegetables, their processed products (for instance, vegetable purees for baby nutrition); berries; organic and bio-crops and

¹⁰Export Strategy of Ukraine: op. cit.

¹¹W. Cohen: Organic food sector in Ukraine set for takeoff, <https://www.kyivpost.com/business/organic-food-sector-ukraine-set-take-off.html> (access: 30.10.2018).

products from them (not just corn or other trendy grains, namely niche hemp or flax); so-called healthy products: flax seeds, bran, flakes etc.; nuts; beans.

Given the growing interest of the EU in organic products, this niche may help Ukraine to develop its export competitiveness. With vast tracts of farmland, 30% of the world's coveted black soil, relatively cheap labor and geographical proximity to the EU – Ukraine has competitive advantages that could and should make it a major organics producer. Today, due to relatively low investment needs most organic producers in Ukraine are small processing enterprises and farms. In 2016 there were 390 organic farms and 421,200 ha of organic farmland. These numbers grew significantly in recent years, although just 1% of the country's total farmland is currently organic¹².

Further development of organic production is limited by numerous challenges. The main problem is that Ukrainian producers have to refer to European law, which does not apply in Ukraine. Therefore, some enterprises use the term for products which do not comply to standards of the EU¹³.

The next problem is that Ukraine does not currently have a law governing organics, leaving the door open for confusion among consumers and fraud among producers. While the vast majority of organic producers – around 80% by some estimates – focus on export and seek EU certification, domestic sellers frequently make misleading or outright false claims, branding their products as “natural,” “eco” or “bio,” although it is unclear what, if anything, these labels mean. The legal vacuum enables unfair competition from companies making empty claims and confuses consumers, who often do not distinguish meaningless buzzwords from certifications that carry weight, such as the Ukrainian Organic Standard or Euro-leaf¹⁴.

There are also many economic constraints that limit the domestic market of organics. Due to higher production costs, organics tend to be more expensive than conventional products. That is why many Ukrainians are either unwilling or simply unable to pay more for specific quality. Financial limitations also impact producers. Transitioning from conventional to organic production can take up to three years and requires upfront investment. During the transition period, profitability can fall, placing stress on small and medium-sized businesses. More investment is needed to assist farmers switching to organic production. Because of this lack of investment, they cannot plan three to five years ahead. They have to survive. While some government programs have been introduced – especially in the regions – to compensate producers making the switch, many farmers are unaware of these. This transition period, along with generally higher variability in organic crop yields, can create supply-side issues, and producers often struggle to reliably provide the volumes needed by larger clients. Distribution is particularly challenging for small producers, who by some estimates grow up to 90% of the fruit

¹²Ibidem.

¹³Export Strategy of Ukraine, op.cit.

¹⁴W. Cohen, op.cit.

and vegetables sold in Ukraine. Organic products spoil more quickly than conventional products, requiring particularly efficient logistics¹⁵.

There are also such obstacles as: the lack of qualified specialists (agronomists or processing technologists); non-compliance with growing technologies; the absence of serious domestic market for some types of products due to the low purchasing power of the population (i.e. the increased risk of relying exclusively on exports); logistical challenges. To realize the export potential of the niche products of the food sector of Ukraine such factors are of vital importance: cooperation of small and medium-sized producers in order to form batch of goods; systematic support of the government. Lack of information remains a key issue behind scandals involving products falsely labeled as organic, with high demand creating a temptation to fudge the facts to get the higher sale price for organics¹⁶. It is with this understanding that the government support provides for the relevant information support and the establishment of stable framework conditions, at least for the medium term¹⁷.

Machinery: qualitative integration into European value chains

In ESU Ukraine is positioned as an important industrial producer of machine building products at the international level. However, the specificity of machinery export to the EU is that its basis is made up of components and spare parts, not the final product. The key consumers of Ukrainian products are Germany (relative weight in export is 33%) and Hungary (relative weight in export is 27%). These two states account for 60% of Ukrainian machine-building exports to the EU. Among the other countries, to which Ukrainian machine builders supply the largest share, are Poland (relative weight in export is 6%), Romania (relative weight in export is 6%), the Czech Republic (relative weight in export is 6%) and Slovakia (relative weight in export is 4%)¹⁸.

High competition, complex and expensive certification process for products remain major obstacles to the EU market access. At the same time, the growth of automotive and telecommunication sectors in the EU is the key driver of increase of domestic export to the EU. The best conditions for the accelerated modernization and integration of producers into European value chains have been developed in the western territories of Ukraine, where the channels of raw materials import, components and equipment were traditionally established more efficiently. Already, they are actively developing a cluster of electric goods production for the EU motor industry¹⁹. This allows us to make optimistic assumptions about the possibilities of developing well-established channels of trade cooperation between Ukraine and the EU countries and gradually

¹⁵Ibidem.

¹⁶Ibidem.

¹⁷O. Trofimtseva: Eksport do Yevropejs'koho Soiuzu: vikna mozhlyvostej [Export to European Union: windows of opportunity], <http://agritrade-ukraine.com/ua/nasha-diyalnist/nashi-publikatsiji/494-eksport-do-evropejskogo-soyuzu-vikna-mozhlyvostej> (access: 30.10.2018).

¹⁸State Fiscal Service of Ukraine, op. cit.

¹⁹V. Movchan: Scho dala Ukraini ZVT z YeS [What did FTZ with the UE give to Ukraine], <http://www.ier.com.ua/ua/publications/comments?pid=5376> (access: 30.10.2018).

turning them into more promising in terms of participation in global networks of creation of value added forms of industrial cooperation. For example, creation of a joint system cluster in the field of machine tool building would allow the production and development of new high-precision types of machine tools with numerical software, which could become highly competitive in the world market. This would have a positive impact on the growth of economic scientific and technical capacity both of Ukraine and the EU countries, increasing their volume of high-tech export and a decrease in the level of dependence on imports of this type of products from third countries.

Aerospace and aviation parts and components, including aircraft: mastering of European technologies and intra-branch trade upbuilding

For many years, Ukraine's industry has been providing parts and components to the aviation and aerospace industries, including engines, radars, avionics and missiles, in particular to Russian enterprises for final installation in finished products. The deterioration of the geopolitical situation in the region has affected the trade of such components, with exports of "aircraft, spacecraft, and parts thereof" (HS 88) amounting to only USD 78.9 million in 2016, or about 0.22% of Ukraine's exports of goods²⁰. Export to the EU countries accounted for 3.3% (USD 2.6 million)²¹.

The Ukrainian aerospace industry has considerable potential for future growth, particularly capitalizing on the existing expertise and knowledge in the aircraft industry, including valuable aerospace industrial assets, including specialized enterprises in the area of radar and electronic warfare technology, competencies in the design, configuration and production of air defense systems. In addition, there are production centers and design houses for the missile industry in Ukraine, as well as significant competencies also exist in the field of aero engine design and engine production. Although, the sector has large capacity for further growth, particularly through accumulated knowledge and experience in the field of aviation industry, partner relations with the EU countries are poorly developed. As one indication of this is low rate of intra-industry trade²². In 2016 it was 0.29, that is, only a third of trade with the EU fell on trade. Intra-industry trade is the initial form of vertical integration and stimulates the exchange of new technologies with the EU²³. Therefore, first step towards developing a competitive aeronautics industry in Ukraine is to transfer the existing production to European standards. This will increase the scope of intra-industry trade, develop partnerships with the leading EU producers and increase the share of Ukrainian exports in the EU market.

Conclusions

The low competitiveness of Ukrainian export compared to the European one forms the current model of trade cooperation between Ukraine and the EU. Its main feature is the

²⁰Export Strategy of Ukraine, op.cit.

²¹State Fiscal Service of Ukraine, op.cit.

²²Export Strategy of Ukraine, op.cit.

²³Ukrainian State Fiscal Service, op.cit.

disproportion in technological terms. Commodity export from Ukraine is represented mainly by primary, low-technology and resource-based products. Whereas medium and high technology import and products with high added value countries are mainly imported from the EU to Ukraine. Conservation of such a model is not only viewed as having little or no future, but also threatens to exhaust the dynamics of raw materials exports, inhibit the development of new competitive export markets, reduce the incentives for foreign investment in the medium- and high-technology industries of the national economy.

The transition of the current model of trade between Ukraine and the EU into a mutually beneficial dimension requires active policy in the two directions. First, creation of favorable institutional conditions for the development of domestic business in the export-oriented sectors of the economy. Second, consultations before the adoption of trade policy measures related to the creation of preferences for the export of goods with a high level of competition between Ukrainian and European producers. In addition, the model of foreign trade should create the preconditions for the realization of their integration potential. Taking into account the state of the export-oriented sectors the opportunities to develop Ukrainian export competitiveness were identified. Among them: niche orientation of the food and beverages industry; integration of the machinery into European value chains; the development of European technologies and intra-branch trade in the aerospace and aviation parts and components industry.

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