



# How to increase and diversify Ukrainian exports to China?

*Pavlo Iavorskyi, Svitlana Taran, Maryna Khorunzha,  
Oleksandr Shepotylo, Oleksiy Hamaniuk*

## *Executive Summary*

China is Ukraine's strategic international trade partner. It is one of the focus countries for Ukrainian exports according to the Export Strategy of Ukraine.

China is the most populous country and the world's second-largest economy in terms of nominal GDP. China is also a global leader in international trade, with total trade in goods and services exceeding \$5 trillion (in 2018, exports of goods and services amounted to \$2.6 trillion, imports - \$2.5 trillion). However, in the recent years China's trade openness demonstrated a tendency for decline as a result of changes in relations with the United States and reorientation of China's economic and trade policies towards the domestic market. Having started in 2018, the US-China trade war is likely to result in the reorientation of the US and Chinese trade flows, thereby increasing the presence of Chinese and US products on third markets, as well as increasing the presence of imports from third countries in the US and China.

The large size of the market, rapid economic development, and the anticipated reorientation of China's trade flows to the third-country markets create opportunities for intensification of bilateral trade between Ukraine and China.

China already plays a significant role in Ukraine's international trade. During 2017-2018, exports to China resumed growth (largely due to the increase in agricultural exports), although it has not yet reached the 2013 level. In 2018, China was the sixth largest market for Ukrainian exports of goods and the second largest source for Ukrainian imports of goods. The largest product groups of Ukrainian exports to China at the HS2 level are: Ores, slag and ash; Cereals; Fats and oils of animal or vegetable origin; Nuclear reactors, boilers, machinery and Food industry residues and wastes. Over the last five years, the share of agricultural and food products in Ukraine's export structure to China was increasing.

Ukraine imports the following goods from China: Electric machines; Nuclear Reactors; boilers, machines; Plastics, polymeric materials; Transport equipment and vehicles; and Ferrous metals. Moreover, Chinese imports to Ukraine are a few times higher than Ukrainian exports to China (in 2018, exports of goods from Ukraine to China amounted to \$2.2 billion, while imports of goods equaled \$7.6 billion).



Despite the large volumes of bilateral trade between Ukraine and China, there is still a number of issues that need to be addressed. Ukraine's export structure to China is highly concentrated and non-diversified. It is dominated by certain mineral and agricultural products, while many Ukrainian goods do not have access to the Chinese market (primarily agricultural and food products).

Trade in services has been negligible in bilateral trade with China so far, though its volume and share have been increasing in recent years. Ukraine exports to China mainly transportation, business (R&D) and travel related services. Ukraine imports from China mainly financial services, business and transportation services, and licensing services. Bilateral trade in telecommunications, computer and information services is also increasing.

China's trade regime is characterized by a large number of tariff and non-tariff measures for the sake of domestic market protection. According to the WTO, China's simple average Most-favored-Nation (MFN) applied tariff was 9.8% at the beginning of 2018 (15.6% for agricultural products and 8.8% for non-agricultural products). China has been gradually reducing tariff protection for consumer goods. For instance, another reduction in import tariff rates occurred in July 2018 for the following categories of goods: food; clothing, shoes and hats; furniture and tableware; cultural, sports and entertainment accessories, consumer electronics; detergents, cosmetics; medical goods. As a result, the simple average tariff rate fell from 9.8% to 7.8%.

In addition, non-tariff measures (NTMs) constitute a significant barrier for Ukrainian exports to China. The largest number of China's NTMs are sanitary and phytosanitary measures and technical regulations. In addition, a significant part of China's imports are subject to licensing (automatic or non-automatic), however, the country's government has been gradually reducing the list of imports subject to licensing. The NTMs application is also burdensome: import regulations are often complicated and opaque and can change rapidly, while their direct application may vary in different ports and regions, and there is a large number of regulatory authorities.

Due to various NTMs and regulations, access of Ukrainian producers to Chinese market remains very limited. In particular, Chinese market remains closed for many products of plant and animal origin from Ukraine.

Ukraine's involvement in the implementation of China's One Belt, One Road (BRI) investment initiative presents additional opportunities for intensifying the economic cooperation and bilateral trade with China. The analysis of the BRI impact on trade between China and Ukraine (based on the general equilibrium structural gravity model) indicates potential economic benefits Ukraine can gain by implementing the BRI. It will help reduce transportation costs for Ukrainian exporters and, consequently, increase Ukraine's exports to China, as well as Ukraine's overall welfare (which can be considered as real GDP growth per capita). In particular, it was estimated that a 15% reduction in transportation costs of Ukrainian exporters as a result of the BRI implementation may increase Ukraine's real GDP per capita by 0.5%. BRI shipping



routes may also bring significant potential benefits for exporters interested in faster transportation of their shipments.

This study identifies sectors of the Chinese economy most dependent on imported goods and materials, since they display the largest potential for Ukrainian exporters to integrate into the Chinese and global value chains. In particular, sectors with the largest contribution of imported raw materials and intermediate goods to Chinese exports (vertical integration index) include:

- Manufacture of computer, electronic and optical products,
- Manufacture of electrical equipment,
- Manufacture of machinery and equipment,
- Manufacture of textiles, clothing and leather products,
- Manufacture of basic metals.

The total “undertrade” of Ukrainian exports to China (the difference between the potential exports -estimated on the basis of the gravity model - and actual exports) was evaluated at about \$647 million in 2017, which is almost 30% of Ukraine's actual exports to China in the same year. Therefore, the bilateral trade displays considerable potential for its further intensification.

The study also identifies a list of products defined as promising for boosting exports to China. Methodologically, such promising products are identified according to several criteria: 1) positive revealed comparative advantages (RSA) in this product in Ukraine and negative – in China; 2) significant potential for increasing exports to the Chinese market based on the assessment of the gap between the current and potential export volumes, or undertrade. In line with this methodology, undertrade was calculated for a broad list of product groups, as well as separately for priority sectors defined as such by the Export Strategy of Ukraine. The analysis was based on the UN Comtrade data for 2017 at the HS4 level.

The study suggests a broad list of such 108 promising products for the potential increase of Ukrainian exports to China. The estimated undertrade for these products is \$132 million, which is 11.5 times higher than the actual exports of these goods to China (\$11.5 million). This is due to the fact that Ukraine was not supplying about 65% of these goods to China in 2017 at all.

The highest undertrade was estimated for: agricultural products, mainly vegetable products (\$58 million), metallurgical products (\$31.8 million), prepared food products (\$14.2 million), chemical and related products (\$9.2 million), wood products (\$6 million).

At the HS4 level, the following products have the largest undertrade volumes:

- Soybeans, whether or not ground (1201)
- Ferroalloys (7202)
- Seeds of rapeseed or rapeseed (1205)



- Oils and other products of high temperature distillation of coal tar (2707)
- Meat of bovine animals, frozen (0202)
- Semi-finished products of iron or non-alloy steel (7207)
- Wheat and wheat-rye mixture (meslin) (1001)
- Prepared foods of flour, cereals, starch or malt extract (1901).

Moreover, some of the promising products from the list already play an important role in Ukrainian exports to China, as well as possess the potential for further growth (estimated undertrade). They include: Soybeans, whether or not ground (1201), Bakery and flour confectionery, whether or not containing cocoa (1905), Oils and other products of high-temperature distillation of coal tar (2707), Builders' joinery and carpentry of wood (4418), Oilcake and other solid residues (2306).

Moreover, the study identifies a narrower list of promising products that fall under the priority sectors according to the Export Strategy of Ukraine – this list encompasses 20 product groups. The total undertrade volumes for these products was estimated at \$15.1 million, which is 8.5 times higher than their actual exports to China in 2017. In particular, the largest undertrade is recorded for such products as: Prepared foods of flour, cereals, starch or malt extract (1901), Cigars, cigarettes, cigarettes with tobacco or substitutes (2402), Fruit juices or vegetable juices (2009), Sugar from sugar cane or sugar beet (1701), Parts for railway locomotives or trams or rolling stock (8607), Bakery and flour confectionery (1905).

Consequently, Ukraine has a significant potential for increasing and diversifying exports to China by supplying promising products, many of which have not yet been exported by the Ukrainian companies to this market as of yet. The greatest potential in terms of estimated undertrade was evaluated for agricultural and food products. The significant undertrade between Ukraine and China can be explained by, first of all, the restrictive effect of tariff and especially non-tariff barriers, or other factors, such as low competitiveness of Ukrainian goods compared to similar goods supplied by other countries, consumer tastes and preferences, difficult and non-transparent business environment, etc.

Based on the results of our qualitative and quantitative research, the relevant public authorities are recommended to:

- Conduct a detailed analysis of non-tariff barriers affecting exports of the identified Ukrainian promising products to China, and undertake efforts to address them, conduct regular bilateral negotiations with the Chinese government on improving trading conditions for Ukrainian exporters of goods and services.
- Intensify cooperation with China as to obtain market access for important Ukrainian products as to diversify Ukrainian exports to China (preparation, approval and signing of international market access protocols for Ukrainian products, etc.).



- Pursue the adaptation of Ukrainian legislation, standards and practices in line with the EU legislation, standards and practices under the EU-Ukraine Association Agreement and DCFTA (in particular in such areas as technical barriers to trade, sanitary and phytosanitary measures), which is also supposed to simultaneously facilitate access to the Chinese market.
- Inform Ukrainian producers about promising goods for exporting to the Chinese market. Given the numerous requirements and complex procedures for entering the Chinese market, as well as limited information on Chinese market access requirements, share information and provide training for the Ukrainian exporters interested in the Chinese market. Provide consulting support to Ukrainian producers, assist them in finding partners and participating in international exhibitions, organize trade missions, etc.
- Consider possibilities for joining China's One Belt, One Road (BRI) investment initiative by identifying bilateral and Ukrainian infrastructure projects that would improve Asia-Europe ties and increase trade between Ukraine and China, as well as increase transit of goods from China to the EU. In particular, the New Eurasian Land Bridge BRI project focuses on several railway connections between China and Europe and aims at reducing transportation costs, increasing transport infrastructure capacity and reducing non-tariff barriers between trading partners.

Ukrainian producers and exporters are in turn recommended to:

- Consider those sectors of the Chinese economy, most heavily dependent on imported inputs (Table 2. Measures of China's openness to foreign trade).
- Take into account the most promising goods for the Ukrainian exports to China (Table 4. Top 30 Promising products at the HS4 level of Ukrainian Exports to China, 2017; Table C1. List of promising Ukrainian Exports to China in terms of export growth).
- Review pricing policies to enhance competitiveness of the identified promising products (Table 6. Value analysis of the promising products of Ukrainian exports to China, HS4, 2017).
- Before planning and engaging with export activity, get acquainted with the peculiarities of working on the Chinese market, tastes and preferences of local consumers, market access requirements for goods and services, doing business conditions, etc.