TEXTILES AND APPAREL

IN-DEPTH REVIEW OF STRATEGICTRADE SECTORS IN UKRAINE

USAID COMPETITIVE ECONOMY PROGRAMIN UKRAINE (USAID CEP)

SEPTEMBER, 2020

Contacts:

Olesya Volska-Zaluska
Deputy Chief of Party
USAID CEP

Evgenia Malikova
Contracting Officer’s Representative
USAID/Ukraine

TEXTILE AND APPAREL

IN-DEPTH REVIEW OF STRATEGIC TRADE SECTORS IN UKRAINE

Authors: Iryna Kosse, Veronika Movchan
Survey team: Iryna Fedets, Viktoria Zhovtenko, Yevhen Anhel, Julia Baziuchenko, Oksana Kuziakiv
Editor: Igor Burakovsky

Project Managers: Miles Light and Anna Gladshtein

Acknowledgements: The authors would like to thank the USAID Competitive Economy Program in Ukraine team of Mario Bordalba Layo, Anna Gladshtein and Miles Light for their helpful comments and encouragement. We are grateful to numerous officials of the Ministry for Economic Development, Trade and Agriculture for their insights and enthusiasm for this project. Several parts of the Government of Ukraine were extremely helpful in providing data, including the Tax Service, the Customs Service, the Statistical Service and the Ministry of Finance. We thank numerous public and private organizations in Ukraine for the provision of their time and insights, including the National Bank, the Antimonopoly Committee, the Delegation of the European Union, the Ukrainian Chamber of Commerce, the Turkish-Ukraine Business Association, the Association of Small and Medium Enterprises of Ukraine. We are extremely grateful to sector representatives for taking part in the survey and sharing their sector development visions.

This report was made possible from the support of the American People through the United States Agency for International Development (USAID) under the Competitive Economy Program in Ukraine (via the subcontract # CEP-2019-134).

USAID Competitive Economy Program in Ukraine (USAID CEP) promotes a strong, diverse, and open economy of Ukraine by enhancing the business environment for small and medium enterprises (SMEs), improving competitiveness in promising industries, and enabling Ukrainian companies to benefit from international trade.

This Research Conducted by:

INSTITUTE
FOR ECONOMIC RESEARCH
AND POLICY CONSULTING

Table of Contents

List of abbreviations

CMT	cut, make and trim
FTA	free trade area
GVA	gross value added
MFN	most favored nation
PE	private entrepreneur (short for a physical person – entrepreneur)
RCA	revealed comparative advantage
SME	small and medium-sized enterprises
UAH	Ukrainian hryvnia
USD	United States dollar

I. Sectoral Impact Assessment in Textiles and Wearing Apparel

Executive Summary

The manufacturing of textile and apparel generates 0.4% of gross value added in Ukraine, and all sector producers are small and medium-sized enterprises. Although the textile sector has been surpassing the average growth rate of the industrial output over the last six years, the industry has been declining over the latest two years.

The Ukrainian textile and apparel sector is an essential link in the global production of clothes. More than 15 well-known Western brands produce apparel in Ukraine. About 90% of apparel production is based on a tolling scheme. Still, domestic brands have also been developing.

The critical challenges for the sector development are the extensive shadow activity, including also smuggling and grey imports; low wages and inadequate skill level undermining the sector's productivity and competitiveness; and the dependence on imported inputs.

Apparel producers face significant competition from imports. Therefore, industry players are extremely cautious towards the FTA with Turkey. They are afraid that Turkish apparel will flood the Ukrainian market. At the same time, producers working on toll schemes do not expect any major changes in the sector after the conclusion of the FTA.

The modelling results suggest that there will be no 'flood' of the Turkish imports on the Ukrainian market. However, the sector will not be able to gain from the FTA without productivity improvement and significant changes in the sector's organization.

Summary table

Indicator	Value	Year of observation
Value added, % of GVA	0.4	2018
SMEs value added, % of sector total	100	2018
Real output growth, % CAGR	1.97	2019
Hired employees, thous.	90.4	2018
Average monthly wage, UAH	4955	2018
Exports, USD bn	0.88	2018
Exports, % of domestic production	52	2017
Imports, USD bn	1.9	2018
Imports, % of domestic consumption	69	2017
Ukraine RCA, world	0.46	2018
Ukraine RCA, Turkey	0.19	2018

Sources: Ukrstat, WITS, authors' estimates

1. The general situation in the sector

1.1. Domestic production

Value-added. According to the IER estimates based on the official data, the textile sector in Ukraine generates ca. 0.4% of the gross value added in 2018 (see Table 1). Officially, all value-added in the industry is produced by small- and medium-sized businesses.

Table 1: Value added in the textiles sector*, 2013 – 2018

	2013	2014	2015	2016	2017	2018
Value added, UAH bn	4	5.2	6.2	7.9	9.5	12.7
Value added, % of output	41.7	45	38.1	40.1	39.1	40.6
Value added, % of GVA	0.3	0.4	0.4	0.4	0.4	0.4
Value added produced by SMEs, % of total	100	100	100	100	100	100
Value added produced by PE, % of total	13.3	10.0	9.6	11.6	15.3	14.3

Source: Ukrstat
*Note: * based on information for private companies*

The Ukrainian textile sector is an essential link in the global production of clothes. More than 15 well-known Western brands produce apparel in Ukraine: Adidas, Benetton, Esprit, Hugo Boss, Zara, Mexx, Marks & Spencer, C&A, Asos, New Balance, PVH, Triumph, Saint James, Next, s.Oliver, Triumph, and Tommy Hilfiger.[1]

The most of manufacturers work on the Cut, Make and Trim (CMT) basis.[2] According to Ukrlegprom, the association representing registered apparel manufacturers, about 80-90% of apparel production in Ukraine is done on a CMT basis, mainly for European clients. For example, the Vorskla factory in Poltava uses the tolling scheme for 28 years and manufactures clothes for German, French, and Belgian clients.[3] Producers interviewed by the IER estimate the share of the tolling scheme in apparel production at 70-80%.

The manufacturing using the tolling scheme is a low margin business and is vulnerable to price competition from lower labor cost countries. Designers, brands and private label producers may use local CMT manufacturers either to outsource production or to expand capacity during peak periods. CMT producers should respond quickly and reliably to orders and deliver small quantities. They sign direct manufacturing contracts with production divisions of foreign clothing companies and retailers or rely on intermediary services of textile agents. The advantage of Ukrainian manufacturers is that

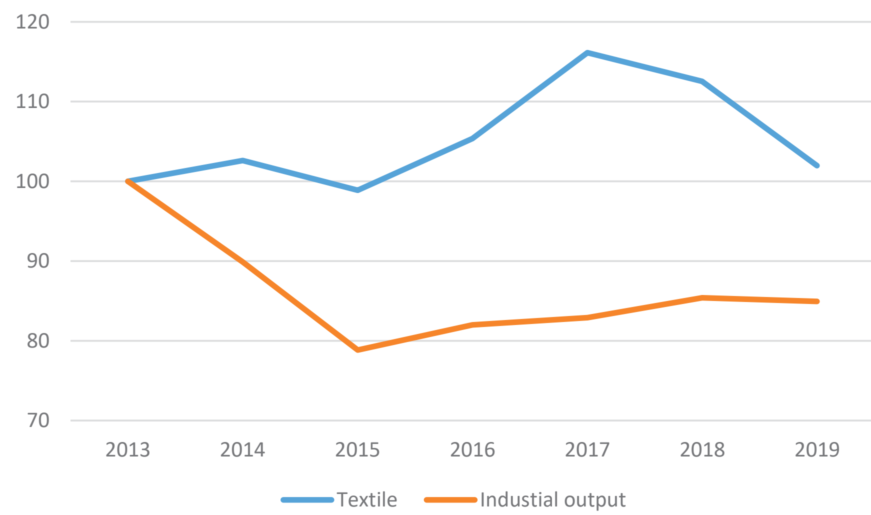
[1] https://aucc.org.ua/eksportniy-viklik-dlya-ukrayinskoyi-legkoyi-promislovosti/, https://life.pravda.com.ua/health/2017/09/15/226466/
[2] This term is used in sales of appropriate services in garment industry. CUT the fabric/leather, MAKE up garments, TRIM them with the provided trimmings such as zips, buttons and decorative elements.
[3] https://zmist.pl.ua/analytics/fabrika-vorskla-stil-pochali-pracyuvati-na-jevropu-shche-do-togo-yak-ce-stalo-meinstrimom

the products can be delivered to EU destinations within three days. Ukrainian companies do not need to maintain a large inventory stock of products.[4]

Still, some Ukrainian apparel manufacturers offer full-cycle production, create their own collections, and have their retail outlet networks. Among them are Arber Fashion Group, Voronin, Volodarka, Bukvica, RITO, LESYA (menswear); Andre Tan, Nui Very, Vovk, MustHave, Goldi, byME, AnnaFoxy, Soho CHIC (women's wear); Bembi (children's wear), Berserk Sport (sportswear).[5] The most popular women clothing brands in Ukraine are VOVK, H&M, Zara, Next, and GAP.[6] The competition with the imported products forces companies to look for non-price advantages (own collections, sophisticated production, etc.).

The sector produces fabric, apparel (including from fur), carpets, and ropes. Although the textile sector has been surpassing the average growth rate of the industrial output over the last six years, the industry has been declining in 2018-2019 (see Figure 1).

Figure 1: Real output trends, 2013-2018



Source: Ukrstat

Company size. In 2018, the total number of officially registered companies in the textiles sector reached 14.5 thousand, and 12.2 thousand of them were registered as PEs (84%). However, the share of PEs in the sector's value added is quite small, 14.3% in 2018.

According to Ukrlegprom business association, there are 2.5 thousand producers of apparel, leather, and footwear in Ukraine, 12% of them are medium enterprises, 25% are small enterprises, and the rest are micro-enterprises.[7] There are relatively low entry barriers, mainly because of the low capital intensity of the sector.

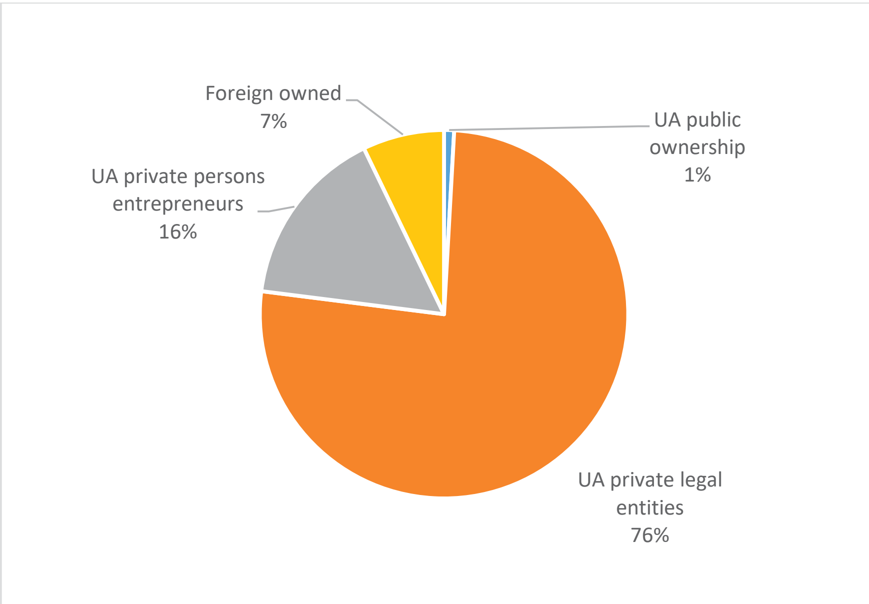
Ownership structure. The textile and wearing apparel market in Ukraine is mostly represented as private legal entities. The sector is entirely privately owned; the share of public companies is only 1% (see Figure 2).

[4] Sector Selection Assessment Report. Competitive Economy Program. USAID Ukraine. February 15, 2019.
[5] https://texty.org.ua/articles/89021/V_Ukrajini_aktyvno_rozvyvajutsa_vlasni_brendy_odagu-89021/
[6] https://pro-consulting.ua/ua/issledovanie-rynka/analiz-rynka-odezhdy-i-franshiz-odezhdy-v-ukraine-2019-god
[7] https://ukrlegprom.org/ua/news/pro-derzhavnu-pidtrymku-legkoyi-promys/

The share of foreign ownership in the market is also small (7%). One of the recent investment announcements was about the Chinese textile company YUYUE Home textile co. Ltd, which in 2016 chose Rivne oblast as a place for its flax processing plant. It plans to invest USD 20 m over five years.[8] The Chinese investor intends to have a full production cycle here, from growing flax to its processing and production of linen. The plant will employ a thousand workers.

In 2015, Danish PVN Holding invested in its subsidiary Danish Textiles in Lviv USD 1 m to buy equipment.[9] In 2016, Danish company HRT Textiles opened a factory in Ivano-Frankivsk for the production of children's clothes.[10] That was their second factory in Ukraine, and the first one opened in Lviv.

Figure 2: Ownership structure in the manufacturing of textile and wearing apparel, 2018



Source: Ukrstat

Market concentration. According to our estimates, the top-8 companies in the "Manufacture of textiles" sector hold only 8% of the market. Top-8 companies of the "Manufacture of wearing apparel" sector hold 12% of the market. The market mostly consists of small companies and thus is highly competitive.

The apparel sector is geographically concentrated in the city of Kyiv, Lvivska, Zakarpatska, Khmelnitska, Dnipropetrovsk, Kharkiv, and Zhytomyr regions.[11]

Access to finance. Companies are mostly relying on their funds. Most companies are SMEs who, due to insufficient quality of financial documentation and overall management, are not considered by banks as credible borrowers and thus have problems getting bank loans.

Informal sector. Informality is the issue for the manufacturing of textile and apparel. But the estimates of the level of the informal activities in the industry vary significantly. According to our estimates, the informal sector constitutes up to three-quarters of the market for textiles. In the

[8] https://aucc.org.ua/eksportniy-viklik-dlya-ukrayinskoyi-legkoyi-promislovosti/
[9] https://lviv.depo.ua/rus/lviv/sokalskiy-rayon-sered-lideriv-za-kilkistyu-inozemnih-02032016171700
[10] http://www.mvk.if.ua/news/41184
[11] State Statistics Service of Ukraine.

"Manufacture of textiles" sector, the informality index is 68.6,[12] and in the "Manufacture of wearing apparel" sector, the informality index is 78.2. In the "Manufacture of leather and related products" sector, the informality index is 78.2. The 2019 World Bank Enterprise Survey reports that in the industry of garments, 81% of firms say competing against unregistered or informal firms that is almost twice as much as the manufacturing average.[13] Ukrlegprom claims that smuggled goods and shadow production account for 25.4% of the market.[14] The estimates of the IER interlocutors are at around 50% for the market of apparel and 20% for textiles.

1.2. Employment

Sector's role as an employer. The textile and apparel sector employs more than 90 thousand people (see Table 2). Ukrlegprom estimates that an additional 42 thousand people are working as PEs.[15] Some sources give the number of total employment in the sector, official and unofficial, at more than 220 thousand people.[16] Globus Fashion Ukraine (another industry association) believes that 80% of apparel manufacturers work in the shadow and that the real number is about 500 000 people.

Table 2: Employment in the textiles sector*, 2013 – 2018

	2013	2014	2015	2016	2017	2018
Number of hired employees in the sector, thous.	90.4	75.5	72.3	77.4	81.9	90.4
Hired employees working in sector SMEs, %	100	100	100	100	100	100
Hired employees in the sector, % of the total in the economy	1.1	1	1.1	1.2	1.2	1.3
Average monthly wage, UAH	1708	1994	2630	3205	4254	4955
Average monthly wage, USD	213.7	167.7	120.4	125.4	159.9	182.2
Real average monthly wage, index, 2013=100	100	102.2	90.8	97.1	112.5	118.2

Source: Ukrstat
*Note: * based on information for private companies*

Wages. In 2018, the official wage in the textile industry was 33% lower than the Ukraine private sector average (see Figure 3). According to the job vacancy portal ua.trud.com, in August 2019 – May 2020,

[12] Percentage of household GVA in the total CVA adjusted for FOP.

[13] See: https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/ukraine#informality

[14] https://ukrlegprom.org/ua/news/media-znovu-skhvyliuvalo-pytannia-humanitarnoi-dopomohy-ta-sekond-khendu/

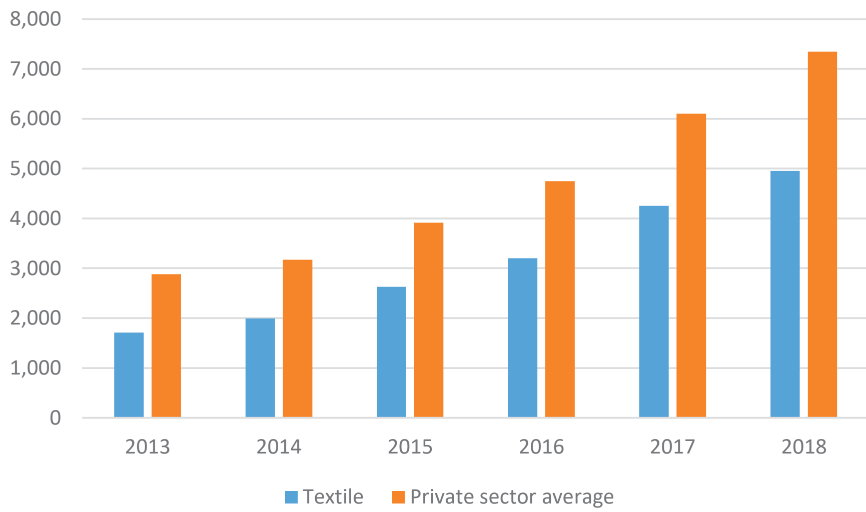
[15] https://ukrlegprom.org/ua/news/pro-derzhavnu-pidtrymku-legkoyi-promys/

[16] https://aucc.org.ua/eksportniy-viklik-dlya-ukrayinskoyi-legkoyi-promislovosti/

sewists earned UAH 10,000 – 15,000.[17] In September 2016, the Center for Social and Labor Research interviewed 51 workers of 8 textile fabrics in Ukraine. According to their research, the worker's salary differs in "dead" and "hot" seasons: average UAH 2778 in the "dead" season and average UAH 3647 in the "hot" season. Workers usually work overtime to meet the deadline. In the "hot" season, the overtime work was up to 4 hours per day.[18]

The situation changed over time. For example, in 2019, half of the workers of LESYA's factory received more than UAH 10,000. With the wage raise in October 2019, that share increased to 70%.[19] However, the seamstresses still complain about low wages and bad working conditions at the factories.[20]

Figure 3: Average monthly wage, 2013-2018



Source: Ukrstat

Labor turnover. In 2018, 26.2 thousand people quit their jobs in the sector "Textile production; production of apparel, leather, leather products, and other materials".[21] That constitutes 35% of the total number of officially employed persons in the sector. For comparison, in 2017, 35% of the total number employed in the industry were hired, and 34.9% were fired. That means that more than a third of people working in the textile sector change their jobs each year. Apparel producers interviewed by the IER estimate the labor turnover at 20%.

Due to the seasonality of the apparel market, some factories, mainly producing outerwear, work non-regularly for 2-3 months in a row. That also contributes to labor turnover in the sector.

[17] https://ua.trud.com/ua/salary/2/4523.html
[18] https://life.pravda.com.ua/health/2017/09/15/226466/
[19] http://www.zvyagel.com.ua/?p=16878
[20] https://hromadske.ua/posts/ya-ne-kuplyu-futbolku-z-mas-marketu-bo-znayu-yaki-kopijki-za-neyi-zarobila-shvachka-istoriyi-zhinok-na-virobnictvi

[21] In addition, 0.6 thous. people were fired due to liquidation of job positions. Movement of workforce. 2018. Ukrstat

1.3. Sector development assessment

Assess to inputs. In Ukraine, a few fabric producers are insufficient to cover domestic demand.[22] The four largest woven fabric mills in Ukraine are Cheksil (Chernihiv), Cherkasy Silk Factory (Cherkasy), Texterno (Ternopil), and Vladi (Kharkiv). Much of the woolen production is used for military and other uniforms rather than consumer products. The two cotton-processing fabric mills (Cherkasy Silk Factory and Texterno) cannot compete with Turkmen textile/fabric producers because of price subsidies for raw cotton. As a result, they are operating below capacity. Apparel producers interviewed by the IER also named Edelvika, Goldi, Textile-Contact as domestic textile producers.

Apparel manufacturers complain that it is difficult to find a supplier who could guarantee the stable quality of its fabric.[23] The same problem is with the clothing accessories. A survey of designers and apparel brands conducted in 2017 showed that 100% of respondents buy fabrics. The main costs in apparel production are for the fabric, design, and sewing. The low purchasing capacity of the Ukrainian population and small production volumes do not allow the producers to invest in advertising or PR.[24] n Ukraine, only a limited variety of fabric is available, and sometimes the quality is not adequate for many markets, especially exports to the EU. Another problem is that there is no production of machinery for the textile and apparel sector in Ukraine.

Small to medium garment manufacturers often buy fabrics at wholesale markets in Odesa, Khmelnytskyi, and Kharkiv. They produce for domestic and regional markets as fabric from this source is not EUR-1 eligible and does not satisfy demands for fabric traceability for children's apparel. The fabric must be either of EU or Ukraine origin to be EUR-1 eligible. Since 2018, under the Pan-Euro-Med protocol, Turkish fabric may also qualify as EUR-1 if Ukraine completes the FTA with Turkey and passes other required legislation.[25] Under the Pan-Euro-Med protocol, Ukraine can export to the EU goods produced from foreign inputs duty-free.[26]

Difficulties in finding reliable suppliers created a demand for the creation of an online marketplace of Ukrainian manufacturers of apparel, footwear, textile, and leather. One such marketplace is UTEX,[27] which aims to solve three major problems of the Ukrainian textile sector: search for verified specialists and partners, convenient method of communication; market consolidation; standardization of the production process, communication, and management.[28]

Workforce availability and skills. Companies interviewed by the Competitive Economy Program complained that the industry has a bad reputation among young people, and it is difficult to recruit workers.[29] Sewing operators are thought to be low-paying, dead-end jobs. A severe drain is a migration of Ukrainian labor to Poland and other EU countries.

Ukrlegprom claims that low productivity and a deficit of qualified personnel are among crucial barriers to sector development.[30] The productivity of Ukrainian apparel producers is about 60% of the labor

---

[22] Sector Selection Assessment Report. Competitive Economy Program. USAID Ukraine. February 15, 2019.
[23] https://poltava.to/news/51934/
[24] Cross-government Research of the Fashion Industry and its Applicability for the countries of Eastern Europe, Case of Ukraine. 2018. https://ucf.in.ua/storage/docs/06122018/Fashion%20industry%20research%20UCF%20%D0%B1%D1%80%D0%BE%D1%88%D1%83%D1%80%D0%B0%20%D1%83%D0%BA%D1%80.pdf
[25] Sector Selection Assessment Report. Competitive Economy Program. USAID Ukraine. February 15, 2019.
[26] https://aucc.org.ua/eksportniy-viklik-dlya-ukrayinskoyi-legkoyi-promislovosti/
[27] https://utex.com.ua/
[28] UTEX was designed within the framework of the EU4Business initiative and financed by the EBRD. https://cases.media/case/utex-ukrayinskii-marketpleis-virobnikiv-odyagu-vzuttya-tekstilyu-ta-shkiri
[29] Sector Selection Assessment Report. Competitive Economy Program. USAID Ukraine. February 15, 2019.
[30] https://aucc.org.ua/eksportniy-viklik-dlya-ukrayinskoyi-legkoyi-promislovosti/

productivity in the best practice factories in China, Bangladesh, India, or Pakistan.[31] The use of modern equipment can explain some differences in productivity, but the rest is due to the non-optimal production organization. The growth of the industry is also constrained by insufficient skills to manage the design process properly, partly caused by an outdated university curriculum. Key types of specialists that are currently missing in the industry are qualified middle and top managers, marketing specialists, prototypes' developers, engineer-technologists, sewing machine technicians, qualified quality assurance staff.[32]

There are 14 universities and about 220 technical colleges and vocational schools providing studies in the light industry programs. Among the most known are Kyiv National University of Technologies and Design and Kyiv Light Industry College. However, there are no training programs for industrial engineers in the sector. Employees are mostly provided introductory training in enterprises, and some companies offer further improvement courses of employee skills. Apparel producers interviewed by the IER suggest the following training scheme: the Employment Center signs an agreement with the factory to train workers that the factory needs, the Employment Center pays for the worker's theoretical studies at college, and the factory provides premises for practical training.

E-commerce. Ukraine may utilize the growth of e-commerce in the EU to its advantage. Ukraine's immediate proximity to the EU allows it to deliver goods quickly and reliably. Ukrainian apparel production focuses on smaller-scale production, and online suppliers usually place small orders to avoid the need to store and accumulate unsold goods. Ukrainian producers already have good trade relations with some of the EU countries with the most substantial growth of e-commerce.[33]

Standards. To strengthen the competitive position of Ukraine as a place for outsourcing services for mass apparel production, companies in the sector need internationally acknowledged social responsibility certification (WRAP, STeP, etc.) or labor standards. For example, the Stebliv factory of the Yaroslav Concern underwent an ILS audit by Walt Disney that checks compliance with international labor standards.[34] Global clothing companies position themselves as socially responsible suppliers and require the same approaches to running the business from independent manufacturing contractors.

The sector is in the process of harmonization of industry standards with European ones in the framework of the DCFTA. Old Soviet GOSTs in the industry have already been canceled, while many new standards have not yet been adopted and fully implemented.

Waste disposal. According to the head of LESYA firm Mykola Sychenko, the company uses circa 40 t of fabric per month, and 12% of that amount is wasted.[35]

Second-hand clothing imports. Second-hand clothing is yet another topic. In 2017, Ukraine was the third biggest importer of second-hand clothes in the world, behind Pakistan and Malaysia, and in 2019, it even became the biggest second-hand importer in the world.[36] The primary source of second-hand imports is the EU: Poland (31.5% of the total imports), Germany (23.5%), Switzerland (10.8%), and Great Britain (10.6%).[37] It is claimed that the second-hand importers could abuse the customs rules shipping new products under the 'second-hand' HS code.

---

[31] Sector Selection Assessment Report. Competitive Economy Program. USAID Ukraine. February 15, 2019.
[32] Ukraine: Roadmap of Development of Apparel and Footwear Industries. JAA for EBRD, 2017.
[33] Ukraine: Roadmap of Development of Apparel and Footwear Industries. JAA for EBRD, 2017.
[34] https://www.eurointegration.com.ua/articles/2018/05/31/7082431/
[35] http://kiev-chamber.org.ua/uk/17/1602.html
[36] https://ukrlegprom.org/ua/news/u-chernigovi-bulo-prodovzheno-rozmovu-pro-legku-promyslovist-z-prezydentom-ukrayiny/
[37] 2017 data.

Moreover, second-hand clothes could also be imported as humanitarian aid for distribution among poor people and later sold in specialized stores or online. According to Ukrlegprom, that creates unfair competition in the domestic market.[38] At the same time, second-hand clothing is among the cornerstones of the circular economy.

2. Foreign trade

2.1. Exports and imports

Both imports and exports of textile products have increased over recent years. However, the share of textile imports in the total imports reduced from 3.7% in 2016 to 3.3% in 2018 (see Table 3).

Table 3: Foreign trade in the textiles sector*, 2013 – 2018

	2013	2014	2015	2016	2017	2018
Value of exports, USD bn	0.83	0.82	0.67	0.71	0.79	0.88
Exports growth, % year-on-year		-1	-19	5	13	11
Exports, % of total exports	1.3	1.5	1.8	1.9	1.8	1.9
Value of imports, USD bn	2.33	1.78	1.31	1.44	1.62	1.9
Imports growth, % year-on-year	n/a	-23	-27	10	12	17
Imports, % of total imports	3	3.3	3.5	3.7	3.3	3.3
Trade balance, USD bn	-1.49	-0.96	-0.64	-0.74	-0.82	-1.02

Source: Ukrstat/WITS
*Note: * based on information for private companies*

The manufacturing of textile and apparel is export-oriented, with over half of the output exported. At the same time, domestically, producers face significant competition from both official imports, including imports of second-hand products and smuggling. As discussed, the sector is also highly reliant on imports of inputs, so the share of imports in intermediate consumption is 70% (see Table 4). The industry is heavily dependent on the import of most fabrics and accessories (from China, Turkey, EU countries).

Table 4: Export orientation and import dependence of the textiles sector, 2017

	% of exports in domestic production	% of imports in domestic absorption	% imported inputs in intermediate consumption
Manufacturing of textile	53%	78%	70%

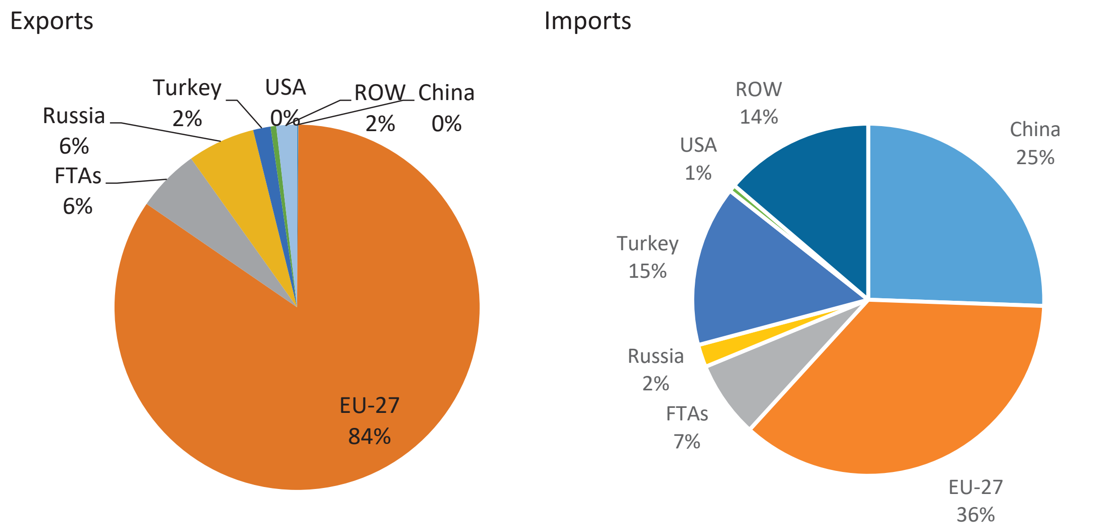
[38] https://aucc.org.ua/eksportniy-viklik-dlya-ukrayinskoyi-legkoyi-promislovosti/

Manufacturing of wearing apparel	51%	54%	71%
Manufacturing of textile and wearing apparel	52%	69%	70%

Source: Ukrstat

Nearly all the apparel manufacturers get their fabric from four sources outside Ukraine: Europe, principally Italy and Poland; Turkey; the Far East – China, Malaysia, Indonesia, and others; India and Pakistan.[39] The EU is also the leading destination for Ukrainian textile exports (see Figure 4).

Figure 4: Key trade destinations, 2018



Source: WITS

Ukraine benefits from the DCFTA with the EU; duties on some textiles and apparel (HS 5601, 6303, 6307) were reduced from 12% to 0%.[40]

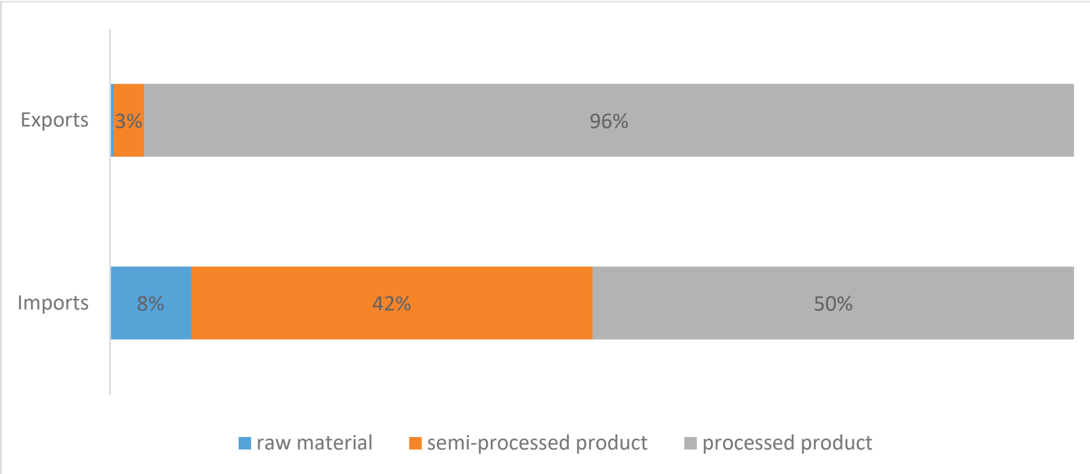
In 2018, the biggest share of Ukraine's textile exports was in wadding (7%), men's trousers (6%), made-up textile articles (5%), bedding (5%), and textile furnishing articles (4%). To Turkey, Ukraine exported mostly wadding (93%). In 2018, Ukraine mainly imported worn clothing (8%), woven fabrics (5%), T-shirts, singlets, and other vests (2%), and wadding (2%). From Turkey, Ukraine imported mostly knitted or crocheted fabrics (5%), jerseys, pullovers, and cardigans (4%), men's trousers (4%), T-shirts, singlets, and other vests (4%), and nonwovens (3%).

2018 data show that processed products make up most of the Ukrainian exports of textile products and half of Ukraine's imports. Ukraine also imports a significant share of semi-processed materials (see Figure 5).

---

[39] Sector Selection Assessment Report. Competitive Economy Program. USAID Ukraine. February 15, 2019.
[40] International Trade Center https://trademap.org/

Figure 5: Trade by the level of processing, 2018



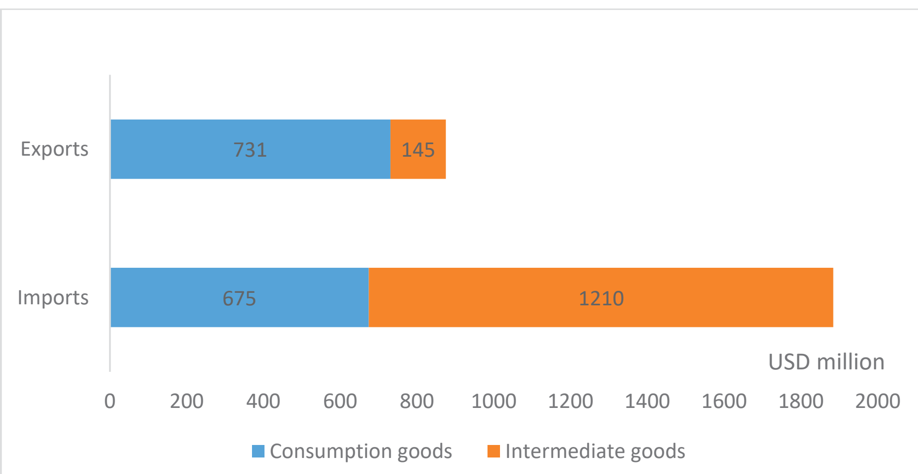
Source: WITS

Processed products make up 99% of Ukraine's textile exports to Turkey and 60% of its imports from Turkey. Semi-processed goods constitute 40% of Ukraine's imports from Turkey and 1% of its exports to Turkey.

In 2018, the share of consumption textile products exported by Ukraine (83%) was much larger than the percentage of consumption textile products imported by the country (36%). That indicates that overall textile exports have more added value compared to total imports (see Figure 6).

Ukraine exports to Turkey mostly intermediate goods (94%), and imports from Turkey mainly consumption goods (52%). The rest of Ukraine's imports from Turkey is intermediate goods.

Figure 6: Trade by the end-use, 2018



Source: WITS

Ukrlegprom estimates that half of textile, apparel, and footwear imports from Turkey, China, and Poland are not officially registered and do not pay customs duties and VAT.

2.2. Revealed comparative advantage

At the sector level, Ukraine does not have a comparative advantage in exports of textile and wearing apparel both globally and on the Turkish market. Instead, Turkey has a definite revealed comparative advantage in exports of textile and apparel (see Table 5).

Table 5: Revealed Comparative Advantage on the sector level

	2013			2018		
	Textile & wearing apparel	Textile	Wearing apparel	**Textile & wearing apparel**	Textile	Wearing apparel
Ukraine RCA						
World	0.32	0.46	0.24	0.41	0.38	0.49
Turkey	0.04	0.19	0.04	0.26	0.01	0.38
Turkey RCA						
World	4.37	3.98	4.68	4.14	4.16	3.87
Ukraine	3.68	4.28	6.59	3.73	4.82	5.34

Source: WITS, own calculations

At the level of six digits of Harmonized Nomenclature (HS), Ukraine features some products with revealed comparative advantages. No.1 product with the highest RCA both on the world market and in Turkey is wadding. Globally, other top products with RCA>1 include both wearing apparel (anoraks, trousers) and textile for home, like textile furnishing articles and blankets. In Turkey, these are textile packaging and carpets.

Between 2013 and 2018, Ukraine lost a comparative advantage on the Turkish market in several products, in particular pile fabric.

Table 6a: Revealed Comparative Advantage of Ukraine, top-5 products

HS 2007	**Description**	**2013**	**2018**
	World		
560122	Wadding; other articles of wadding, of man-made fibres	3.85	20.83
620191	Men's/boys', anoraks (incl. ski-jackets), wind-cheaters, wind-jackets & similar articles (excl. of 62.03), of wool/fine animal hair	5.92	16.64
630491	Textile furnishing articles other than bedspreads (excl. of 94.04), knitted/crocheted	2.82	13.94
610461	Women's/girls' trousers, bib & brace overalls, breeches & shorts (excl. swimwear), knitted/crocheted, of wool/fine animal hair	4.72	10.72
630120	Blankets (excl. electric) & travelling rugs, of wool/of fine animal hair	7.22	7.47
	Turkey		
560122	Wadding; other articles of wadding, of man-made fibres	0.43	20.80

HS 2007	Description	2013	2018
630532	Flexible intermediate bulk containers of a kind used for the packing of goods, of man-made textile materials	0.12	4.18
570242	Carpets & other textile floor coverings, woven, of pile construction, made up, of man-made textile materials	0.00	2.42
600121	Looped pile fabrics of cotton, knitted/crocheted	51.88	0.00
600191	Pile fabrics & terry fabrics, knitted/crocheted (excl. of 6001.10-6001.29), of cotton	32.62	0.00

Source: WITS, own estimates

Globally, Turkey has the highest comparative advantage in exports of carpets, as well as different kinds of warp knit fabric and yarn (see Table 6b). Similarly, the top-5 Turkish products with the highest RCA on the Ukrainian market are various yarns and hand-made lace, i.e. intermediate products.

Table 6b: Revealed Comparative Advantage of Turkey, top-5 products

HS 2007	Description	2013	2018
World			
570242	Carpets & other textile floor coverings, woven, of pile construction, made up, of man-made textile materials	76.03	74.00
600522	Warp knit fabrics. incl. those made on galloon knitting machines (excl. of 60.01-60.04), of cotton, dyed	47.25	59.37
540269	Synthetic filament yarn other than sewing thread (excl. of 5402.61 & 5402.62), mult./cab., not put up for retail sale	71.07	59.31
600521	Warp knit fabrics. incl. those made on galloon knitting machines (excl. of 60.01-60.04), of cotton, unbleached/bleached	66.89	56.33
551120	Yarn other than sewing thread of synthetic staple fibres, containing <85% by weight of such fibres, put up for RS	44.95	54.14
Ukraine			
520526	Cotton yarn, single (excl. sewing thread), of combed fibres, containing 85%/more by weight of cotton, measuring <125dtx. but not <106.38dtx. (>80 metric number but not >94 metric number), not put up for retail sale	0.00	38.08
580430	Hand-made lace in the piece/in strips/in motifs, other than fabrics of 60.02-60.06	7.57	38.08
520613	Cotton yarn, single (excl. sewing thread), of uncombed fibres, containing <85% by weight of cotton, measuring <232.56dtx. but not <192.31dtx. (>43 metric number but not >52 metric number), not put up for retail sale	33.33	38.08

HS 2007	Description	2013	2018
520527	Cotton yarn, single (excl. sewing thread), of combed fibres, containing 85%/more by weight of cotton, measuring <106.38dtx. but not <83.33dtx. (>94 metric number but not >120 metric number), not put up for retail sale	0.00	38.08
550931	Yarn other than sewing thread, of synthetic staple fibres, containing 85%/more by weight of acrylic/modacrylic staple fibres, single yarn, not put up for retail sale	29.05	37.97

Source: WITS, own estimates

3. Trade regime issues

3.1. Trade regime for exporters to Turkey

The sector tariff protection in Turkey is moderate compared to, for instance, Turkish tariffs on agricultural and food products, but still nontrivial. The weighted average import duties faced by Ukrainian exporters of textile products are 3.9% for textiles and 11.7% for wearing apparel. The average MFN duties in Turkey are higher for textile (6.8%) but comparable for apparel (11.0%). There are almost no zero import duties in the sector, while the maximum applied rate is 12%.

Apparel producers interviewed by the IER noted that the Turkish market is extremely competitive and very saturated, and Turkish companies do not let foreigners in. The Turkish market has the following advantages: they have the full cycle from threads to fabrics to clothes, they have traditions in the textile and apparel sector, and they have a competitive labor market and thus can hire the most efficient workers.

As in the case of exports to the EU, to export to Turkey, Ukrainian manufacturers should adhere to product labelling standards. They might be required by customers to comply with the Turkish version of REACH (registration, evaluation, authorization, and restriction of chemicals).[41] Manufacturers exporting protective clothing should also comply with specific requirements for these products established in technical regulations. There are also voluntary testing standards and specifications.

3.2. Trade regime for importers from Turkey

The tariff protection of the Ukrainian textile and wearing apparel is very similar to the rates applied by Turkey. According to our estimates, the weighted average import duties applied by Ukraine towards Turkey in the textile and apparel sector are 5.29% for textiles and 11.83% for wearing apparel. Ukraine's MFN average is 3.81% for textile and 11.16% for apparel.

Technical regulations faced by the Turkish exporters to Ukraine are also similar, as both Ukraine and Turkey have been aligning their technical rules to the EU norms and practices. In Ukraine, Turkish manufacturers exporting personal protective equipment and textile fibre have to comply with the respective technical regulations. The proper product labelling also has to adhere. There is also a standard package of documents required for imports, including customs declaration, foreign trade contract, transportation documents, etc.[42]

At the same time, there are non-tariff barriers related to financial matters. Textile importers from Turkey interviewed by the IER told that Turkish producers demand full advance payment. Turkish

[41] See: https://www.turkreach.com.tr/
[42] Customs Code of Ukraine https://zakon.rada.gov.ua/laws/show/4495-17#n2229

banks do not authorize transactions without advance payments due to high risks in Ukraine. Another issue is the full advance payment of VAT and customs duties for imported goods in Ukraine. The informant told IER that Turkish investors create companies in Ukraine to offer the service of deferred payments to Ukrainian importers of Turkish products.

4. Impact of the FTA with Turkey

Industry players are extremely cautious towards the FTA with Turkey. They are afraid that Turkish apparel will flood the Ukrainian market.[43] The Turkish government supports the Turkish textile industry, and textile holds second place in Turkish exports (in 2017, its share in the total exports of Turkey was 9.4%, and the value was USD 27 bn). In particular, the most prominent association of light industry producers in Ukraine, Ukrlegprom, is against the FTA with Turkey.[44] It fears competition from Turkish textile and apparel producers. Ukrlegprom suggests setting zero import tariffs for all raw materials and keeps current duties for the final products – apparel, footwear, and rugs.

Apparel producers interviewed by the IER note that the FTA with Turkey will negatively affect big textile producers in Ukraine. However, factories working on tolling schemes will not be affected. "If I decided to open a new business now, with the FTA with Turkey, I would not do it because the business will die." Another informant said, "You cannot sign any agreements with a country that is so highly developed". At the same time, the respondents think that Ukraine is not an attractive destination for Turkish investors and that Ukrainian textile and apparel producers are not efficient enough for Turkish investors. Turkish factories are quicker in sewing clothes than the Ukrainian ones. Therefore, respondents assume that Turkey will regard the Ukrainian market only as a consumption market.

The sector representatives interviewed by the IER have limited knowledge regarding the opportunities of the Pan-European-Mediterranean Convention on the Rules of Origin (PEM Convention), and as a result, do not expect any particular gains associated with the establishment of the FTA and the opportunity to use the PEM to build value chains. However, the European Business Association name the manufacturing of textile and apparel among sectors expected to gain the most from the application of the PEM Convention.[45]

We considered several policy shocks to assess the impacts on FTA with Turkey on Ukraine, including:

- The reduction in trade costs due to reduced time required to import or export goods, both on the Ukrainian and the Turkish sides;
- The reduction of non-tariff barriers on goods by both Ukraine and Turkey;
- The mutual elimination of tariffs between Ukraine and Turkey; and
- The reduction of barriers on foreign providers of services for selected categories of services, not including tourism and hospitality sector.

As the level of trade barriers in the sector is moderate, both direct effects of the sector's barriers liberalization and indirect impact generated by the reallocation of resources in the response of the deep liberalization FTA are essential for the modelling outcome.

The model shows that in the case of deep liberalization FTA, the output could reduce by 6.5% for textile and by 10.2% for apparel, mostly driven by the reallocation of resources within the economy due to the access to the Turkish goods market. Still, the manufacturing of textile will benefit from the

[43] http://kiev-chamber.org.ua/uk/17/1602.html
[44] https://ukrlegprom.org/ua/news/chlen-pravlinnya-ukrlegprom-vzyav-uchast-u-zustrichi-z-prezydentom-pid-chas-jogo-robochoyi-poyizdky-hmelnychchynoyu/
[45] https://eba.com.ua/konventsiya-pan-yevro-med-perevagy-ta-perspektyvy-dlya-ukrayiny/

liberalization of the Ukrainian market and the reduction in non-tariff barriers on goods in Ukraine. However, this positive impact is insufficient to counteract resource reallocation. In the deep liberalization FTA scenario, exports decrease by 6.6% for textile and, more significant, 11.7% for apparel. Imports of apparel are estimated to increase by 4.3% due to the tariff liberalization as well as the reduction in non-tariff barriers and time-in-trade costs for the sector's products. In contrast, the imports of textile will stay unchanged. As a result, domestic supply will down by 6.0% for textile and 8.6% for apparel.

5. Conclusions and recommendations

The manufacturing of textile and apparel generates 0.4% of gross value added in Ukraine, and all sector producers are small and medium-sized enterprises. The sector has been performing better than the industry on average, but in 2018-2019, its output featured a downward trend.

Ukraine plays a vital role in the global manufacturing of clothes with many well-known Western brands that produce apparel in Ukraine. About 90% of apparel production is based on a tolling scheme. Still, domestic brands have also been developing.

The critical challenges for the sector development are the extensive shadow activity, including also smuggling and grey imports; low wages and inadequate skill level undermining the sector's productivity and competitiveness; and the dependence on imported inputs. The industry is also facing a challenge of alignment of international standards, including not only technical but also labor standards and social responsibility certification.

Apparel producers face significant competition from imports. Therefore, industry players are extremely cautious towards the FTA with Turkey. They are afraid that Turkish apparel will flood the Ukrainian market. The most prominent association of light industry producers in Ukraine, Ukrlegprom, is against the FTA with Turkey. It suggests setting zero import tariffs for all raw materials and keep current duties for the final products – apparel, footwear, and rugs.

At the same time, producers working on toll schemes do not expect any substantial changes in the sector after the conclusion of the FTA.

The modelling results suggest that there will be no 'flood' of the Turkish imports on the Ukrainian market. However, the sector will not be able to gain from the FTA without productivity improvement and significant changes in the sector's organization.

To facilitate the sector's development, we recommend focusing on the following issues:

- The updating of educational programs to match sector demand. Key types of specialists that are currently missing are qualified middle and top managers, marketing specialists, prototypes' developers, engineer-technologists, sewing machine technicians, qualified quality assurance staff;
- The development of vocational training in close cooperation between the Employment Centers and employers;
- The development of clusters uniting manufacturers, providers of services, in particular IT solutions for the sector and creativity industry, and the educational establishments;
- The improvement of quality control and standard compliance to increase competitiveness;
- The organization of awareness-raising campaign on the practical aspects of new opportunities, e.g. the Pan-European-Mediterranean Convention on the Rules of Origin.