Interview: Alexander Markus – Chairman of the Board, German-Ukrainian Chamber of Industry and Commerce, Ukraine

"In 2016, Ukraine's economy showed a steady growth for the first time since 2013, while we see that new dynamics are moving the country forward on the road to recovery."

24.05.2017

Tags: Ukraine, German-Ukrainian Chamber of Industry and Commerce, Chamber of Commerce, German, Investment, Trade

Alexander Markus, chairman of the board of the recently set up German-Ukrainian Chamber of Industry and Commerce, provides insights into the new dynamics driving the growth of Ukraine's foreign trade as well as the chamber's strategic priorities to further enhance the thriving bilateral business relationship between the two countries.

Leveraging your experience as Delegate of the German Industry and Commerce in Ukraine and as Chairman of the Board of the German-Ukrainian Chamber of Commerce, what would you highlight as the most significant trends impacting Ukraine's bilateral trade with Germany?

In 2016, Ukraine's economy showed a steady growth for the first time since 2013, while we see that new dynamics are moving the country forward on the road to recovery. First, over the past two years, the focus of the country's economy has been shifting from heavy to light industries. Historically, the Ukrainian steel and coal industries were the country's main economic drivers, but the textile and clothing, processed food, electronics, and automotive sectors have been rapidly gaining in importance over the past years. As a matter of fact, in 2012, raw steel made up 29 percent of the total Ukrainian exports to Germany – but this share has now decreased to only 9.6

percent in 2016. In the meantime, automotive components amounted in 2016 to almost a fourth of all Ukrainian exports to Germany and around 30.000 workplaces located in Western Ukraine are now supplying components to the German automotive industry. In the meantime, clothing products stood as the third largest product category with around 9 percent of the total Ukrainian exports to Germany – just behind agriculture's 10 percent.

In parallel, Ukraine has started to climb up the added-value chain with processed and intermediate goods making up an increasing share of the overall exports of the country. While Ukraine used to mainly export commodities to Germany, food and feed exports have increased 34 percent from 2015 to 2016 while electrical equipment exports grew by 60 percent in the meantime. Nevertheless, this growth only applies to intermediary goods, as only an extremely limited number of Ukrainian products and brands are already available on the EU market.

On the other hand, this value shift has been impacting the socio-demographic profile of the country: salaries used to be higher in Eastern Ukraine (where the heavy industries are concentrated) than in the West – and this geographical breakdown has been reversing over the past two years.

Furthermore, German companies holding manufacturing facilities in Central European countries such as Czech Republic and Poland are now increasingly eager to leverage Ukraine's low production costs. In some Ukrainian regions, hourly wages now revolve around the €1.5 mark – all-inclusive. This means that Ukrainian manufacturing facilities, which are located at only a few hundred kilometers from the EU border, can now withstand the competition with those of most Asian countries, including China. Additionally, these German companies are also facing increasing difficulties to recruit well-educated professionals in the main Central European cities – and they start to perceive Ukraine's attractive and very affordable talent pool as a very promising option to consider.

What has been the impact of the EU-Ukraine Deep and Comprehensive Free Trade Agreement (DCFTA), which has been provisionally applied as from January 2016, on bolstering the growth of the Ukrainian economy and driving this trade shift?

In this regard, an aspect that should not be overlooked relates to the deteriorated relationship that Ukraine now holds with its Eastern neighbor, as Russia still stands as the largest export partner of the Ukrainian economy. As a matter of fact, Russia accounted for around 14 percent of all Ukrainian exports in 2016, while the share of the EU as a whole amounted to around 36 percent of the total. So far, no single EU member state has overcome Russia's importance for the country's overall exports. As a result, when the Russian Federation decided to suspend its own Free Trade agreement with Ukraine *[in retaliation of the implementation of the EU-Ukraine DCFTA, e.d.]* and set up technical barriers rendering almost impossible to export to Russia products manufactured in Ukraine – whether by local or international companies, it undoubtedly had a much more significant impact than the entry into force of the DCFTA *per se.*

[Featured_in]

The DCFTA will undoubtedly have a very positive impact on the Ukrainian economy in the mid-term, while we definitely see signs that the trade focus of Ukraine has already started to shift from Russia to the EU. In this regard, leveraging the DCFTA emerges as a very interesting growth option for Ukrainian businesses that used to massively export their products to Russia. In a way, Russia's policy toward Ukrainian products has been urging domestic companies to look westwards, although this trade shift will not happen be completed overnight.

Given that the country seems to be back to economic growth and Ukraine offers very competitive production costs, what are some of the remaining factors that still prevent German companies from further developing their activities in the country?

The first and foremost problem impeding the rapid growth of the country's FDI relates to the bad image that Ukraine still has in Germany and in many other European countries. Most of the time, Ukraine's presence in international media is linked with the military conflict affecting the Donbas region. Although the demarking line of this conflict area has not moved for more than two years and it is spatially constricted to the East of Ukraine, new foreign investors are reluctant to enter a country that is the scene of a military conflict. In the meantime, the country has not yet fully solved corruption problems regularly affecting both the economy and politics.

In the grand scheme of things, many German businesses still consider Ukraine a risky investment destination – but overlooking Ukraine's potential in this way however stands as a strategic mistake. First, companies can insure their investments to Ukraine – by German states or specialized institutions, which can greatly contribute to protect these businesses' interests. Second, Ukraine is rapidly becoming a more decentralized country: an increasing number of authorizations and regulatory approvals (such as construction permits for example) are now delivered at the regional level. Hence, international companies can now directly negotiate favorable conditions for their investments – at the local level. Given the current economic context, international investors are warmly welcomed and regional authorities are particularly eager to see foreign companies establishing or expanding their local footprints. Thanks to this ongoing decentralization process, regions are now incentivized to further differentiate themselves and become more attractive to foreign investors, and German companies’ feeling is that the investment context has been greatly improving since the implementation of this administrative reform.

Nevertheless, at the moment, a large share of German investments to Ukraine comes from companies that are already established in the country. The latter usually have a more accurate understanding of Ukraine’s reasonably limited risk profile, while they have already been benefitting from the great competitive advantages the country can offer.

This aspect really showcases the importance of the psychological factor in the recovery of Ukraine’s economy, as on one hand we see that already established German companies are expanding their footprint while on the other, newcomers are reluctant to enter the country.

Undoubtedly, it is now the best time to invest in Ukraine. In five years, production costs and local competition may have already increased, while the number of great business opportunities to seize may become more limited.

I was working in Poland at the beginning of the millennium and I now identify many similarities between Poland in the early 2000s and Ukraine in 2017. At that time, Poland’s economy had already slightly started to shift (both in value and focus) but it was still rather emerging. In less than twenty years, the country as a whole has tremendously changed and is now a Member State of the EU, which provides you with an overview that could lie ahead for Ukraine and foreign investors in the country.

[related_story]

For some years, Ukraine was at a crossroad in its history and we felt the country was somehow hesitant regarding the development path it should follow. This time is now over and it seems that Ukraine is firmly heading toward a clear direction, marked by the ambition to modernize the country and offer a brighter future to the new generations.

A few months after it was officially set up in October 2016, what is the importance of the healthcare sector in the activities of the Chamber and you strategic priorities moving forward?

The pharmaceutical and healthcare sectors hold a strategic importance in the German economy and they will definitely be crucial industries for the Chamber too. So far, we do not hold specific committees for the pharmaceutical and healthcare industries, but we will ready to set up dedicated structures as soon as companies express their interests in creating such platforms.

In the meantime, as a bilateral chamber of commerce, we also strive to help Ukrainian companies to enter Germany and address the administrative difficulties they may encounter. Pharmaceutical products probably stand as one of the most stringent business areas when it comes to certifications, rendering the help of the Chamber particularly strategic to Ukrainian companies. Nevertheless, regarding the export of Ukrainian pharmaceutical products to Germany, the second barrier is psychological: German patients and physicians could be still reluctant to use pharmaceutical products manufactured in Ukraine.

Moving forward, we hold three strategic priorities that will steer the action of the chamber over the upcoming years. First, our overarching objective is to continuously enhance the local business and investment frameworks to make it easier for German companies to develop their activities in the country. In this regard, we are following a very targeted approach and have been favoring high-level meetings with the Ukrainian government and local CEOs.

Our second priority relates to the improvement of the country’s image towards German investors and entrepreneurs. In this vein, an efficient way to overcome the negative perception of Ukraine that German investors get from mass media is to ensure German and Ukrainian business leaders meet together. We are then organizing business delegations of Ukrainian business leaders to Germany, and – once they get the opportunity to directly talk to their German counterparts – the latter then truly start to picture the great business opportunities that Ukraine has to offer.

Finally, our third priority is to convince both the central government and the regions to embrace a cluster-based development approach, which will bring together manufacturers, suppliers, research centers, and the local government with the idea to find solutions that will propel the local ecosystem as a whole. Fostering the development of this model would be particularly beneficial to the pharmaceutical sector, which requires close collaboration across the value chain in order to develop and manufacture high-quality products. In the same way, we are advising regions to focus on their strengths and prioritize the development of a limited number of industries, for which they already hold strong assets and companies. The region of Lviv, in Western Ukraine, has been a pioneer in the implementation of this approach, as – over the past decade – they have been successfully concentrating their efforts on the development of the IT and tourism industries. Looking forward, all Ukrainians regions already hold significant strengths they could leverage to replicate a similar approach. As the country is adopting a more federal economic structure, regions will have to develop their brand image and sharpen their attractiveness, which will ultimately benefit to the entire country and to local and international companies as a whole.

See more interviews