CHAPTER 9

UKRAINE

Evaluation of policy developments

- Ukraine's agriculture has a potential to become an important contributor to global supplies of selected commodities, in particular grains and oilseeds. However, it needs a healthy macroeconomic background as well as consistent and predictable policies stimulating efficiency-driven agricultural output growth, allowing for efficiency-based land market transactions, creating more off-farm employment opportunities and improving rural public services.

- The level of support to agricultural producers (the PSE) remains low, but increased during the last three years as a result of growing transfers from consumers and taxpayers.

- Taxing effects on consumers are due to high level of tariffs on selected imported commodities and to tightening of border protection in particular on sugar and poultry.

- Growing transfers from taxpayers are facilitated by high rates of economic growth, but as budgetary support to agriculture remains dominated by input subsidies and output payments, the efficiency of these transfers is low with no significant impact on producer welfare.

- Some progress in reallocation of budgetary support to general services is commendable, but more needs to be done to enhance the long-term competitiveness of Ukrainian agriculture.

- The government needs to invest more in public infrastructure and to improve the functioning of public institutions providing services to the private sector. This can be done without imposing additional cost on taxpayers through reallocation of budgetary support from input subsidies and output payments to general services.

- Land reform is yet uncompleted. Lifting of the moratorium on agricultural land sales should be a priority for both the government and the newly elected parliament.

- Ukraine's WTO negotiations are advancing and membership by 2007 seems feasible. Consistency, transparency and predictability of trade regulations and the adherence to WTO rules and disciplines, would provide a more stable framework for domestic and foreign agents, thus reducing risk and encouraging investment.

- WTO membership could also play a key role in disciplining domestic agricultural policies, making them more predictable to the advantage of producers and consumers. In particular, as Ukraine will not be allowed to apply export subsidies, market price support policies driving prices above world market levels will not be a feasible option in a longer term.

Summary of key policy developments

1. In 2005 the law On State Support to Ukrainian Agriculture came into effect. The law provides a broad framework for increased budgetary support to agriculture and introduces new market intervention mechanism such as minimum and maximum prices for selected crops. Significant implicit support continues to be provided through tax exemptions and privileges. Some input subsidies have been replaced by direct payments. *Ad valorem* tariffs decreased, but prohibitive specific tariffs on selected commodities remained unchanged. Free Economic Zones were abolished and tariff quota for raw sugar imports was not announced, thus increasing effective border protection against imports, in particular for poultry meat and sugar.

- Support to producers (%PSE) was 3% in 2003-05 and increased from implicit taxation at minus 10% in 1995-97. This compares with the OECD average support of 30% in 2003-05.
- The 2003-05 average disguises considerable increase in the level of support in Ukraine from implicit taxation at minus 7% in 2003 to support of 12% in 2005.
- There are strong differences in trade and domestic policies across commodities as demonstrated by strong variations in Producer NPC by commodity ranging from 1.79 for poultry to 0.84 for oilseeds.
- Prices received by farmers were on average 2% lower than those received in the world markets in 2003-05. A negative market price support was compensated by positive transfers from taxpayers. Payments to producers remain dominated by output and input-based payments, accounting for 68% of the total.
- Consumer support (%CSE) was very low at 1% in 2003-05, but there is a visible switch from an implicit support in 2003 to an implicit tax in 2005.
- Support provided to general services for agriculture accounted for 44% of the TSE in 2003-05.
- Total cost to the economy (%TSE) increased to 1.39% and was higher than the OECD average of 1.14% in 2003-05.

Figure 9.1. PSE level and composition over time

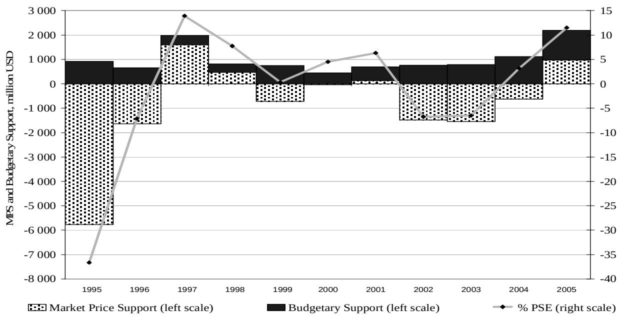


Figure 9.2. Producer NPC by commodity, 2003-05 average

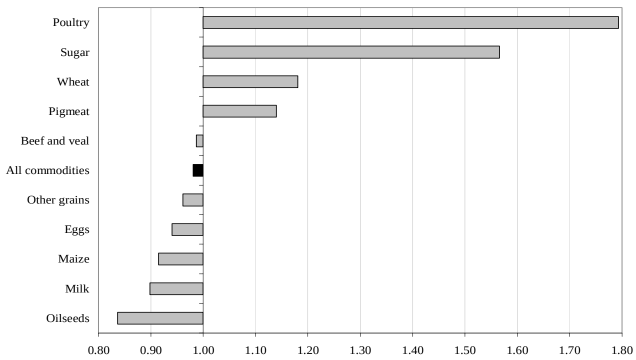


Figure 9.3. TSE composition over time

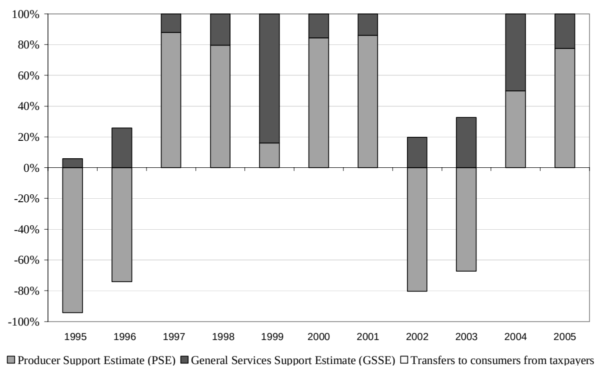


Table 9.1. Ukraine: Estimates of support to agriculture

(UAH million)

	1995-97	2003-05	2003	2004	2005
Total value of production (at farm gate)	**22 626**	**74 969**	**58 325**	**75 152**	**91 429**
of which share of MPS commodities (%)	*62*	*63*	*60*	*65*	*63*
Total value of consumption (at farm gate)	**22 064**	**71 561**	**60 522**	**67 686**	**86 474**
Producer Support Estimate (PSE)	**-1 746**	**3 253**	**-4 067**	**2 571**	**11 256**
Market Price Support (MPS)	-2 838	-2 225	-8 243	-3 380	4 949
of which MPS commodities	*-1 553*	*-1 340*	*-4 917*	*-2 206*	*3 105*
Payments based on output	16	1 425	549	1 549	2 176
Payments based on area planted/animal numbers	0	20	4	26	31
Payments based on historical entitlements	0	0	0	0	0
Payments based on input use	523	2 305	2 059	2 372	2 483
Payments based on input constraints	0	0	0	0	0
Payments based on overall farming income	525	1 569	1 400	1 900	1 407
Miscellaneous payments	28	159	164	103	210
Percentage PSE	**-10**	**3**	**-7**	**3**	**12**
Producer NPC	**0.89**	**0.98**	**0.90**	**0.97**	**1.08**
Producer NAC	**0.94**	**1.03**	**0.94**	**1.03**	**1.13**
General Services Support Estimate (GSSE)	**521**	**2 603**	**1 979**	**2 571**	**3 259**
Research and development	52	126	80	106	191
Agricultural schools	78	647	485	604	851
Inspection services	40	573	427	568	723
Infrastructure	329	724	494	707	971
Marketing and promotion	5	6	4	7	7
Public stockholding	0	440	439	450	431
Miscellaneous	17	88	50	130	85
GSSE as a share of TSE (%)	**-42.6**	**44.4**	**-94.8**	**50.0**	**22.5**
Consumer Support Estimate (CSE)	**3 138**	**69**	**4 714**	**1 790**	**-6 298**
Transfers to producers from consumers	3 384	1 595	6 683	2 876	-4 775
Other transfers from consumers	100	-1 484	-2 462	-670	-1 319
Transfers to consumers from taxpayers	0	0	0	0	0
Excess feed cost	-346	-42	493	-415	-204
Percentage CSE	**18**	**1**	**8**	**3**	**-7**
Consumer NPC	**0.88**	**0.99**	**0.93**	**0.97**	**1.08**
Consumer NAC	**0.89**	**0.99**	**0.93**	**0.97**	**1.08**
Total Support Estimate (TSE)	**-1 224**	**5 856**	**-2 088**	**5 142**	**14 514**
Transfers from consumers	-3 484	-111	-4 222	-2 206	6 094
Transfers from taxpayers	2 160	7 451	4 595	8 018	9 739
Budget revenues	100	-1 484	-2 462	-670	-1 319
Percentage TSE (expressed as share of GDP)	-3.08	1.39	-0.78	1.49	3.47
GDP deflator 1995-97 = 100	100	328	280	322	381

Notes : p: provisional. NPC: Nominal Protection Coefficient. NAC: Nominal Assistance Coefficient.
Market price support is net of producer levies and excess feed costs.
MPS commodities for Ukraine are: wheat, maize, other grains, oilseeds, sugar, milk, beef and veal, pigmeat, poultry and eggs. NPC: Nominal Protection Coefficient. NAC: Nominal Assistance Coefficient.
Source : OECD, PSE/CSE database, 2006.

2. Agriculture is an important sector of the Ukrainian economy, accounting for 11% of GDP and almost 20% of employment in 2005. Together with the food processing industry, its contribution to GDP and employment increases to 15% and 24%, respectively. Agro-food trade accounts for 13% of total exports and almost 8% of total imports. Food represents as much as 58% of households' expenditures, which indicates a low level of incomes in Ukraine.

Policy context

Macroeconomic situation

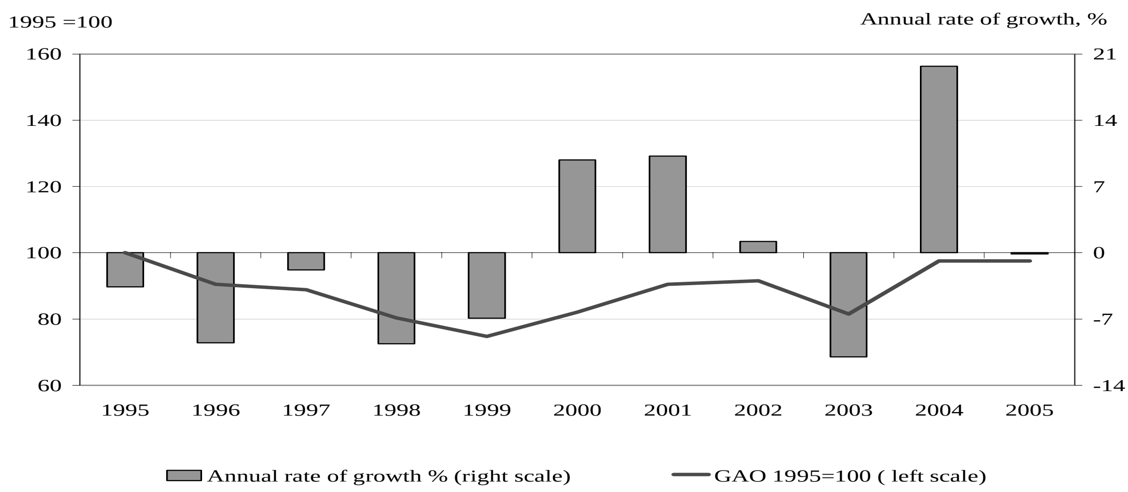
3. Real GDP growth slowed from 12.1% in 2004 to 2.4% in 2005, mostly due to adverse investment conditions and poor export performance. The growth rate accelerated to above 5% in the first half of 2006 helped by improved exports and strong domestic demand. Year-end inflation amounted to 10.3% in 2005, but fell to below 7% year on year in June, largely due to food price deflation and despite doubling of gas prices imported from Russia. The currency appreciated in 2005 by 4% in nominal terms against the US dollar exerting a competitive pressure on tradables, including agricultural commodities. Trade in goods returned to deficit in 2005, as rising incomes and high oil prices pushed up import expenditures. Real wages were up by almost one-fifth in 2005 and continued to grow at a high rate in the first half of 2006. However, Ukrainian wages remain low with the average monthly disposable income at UAH 1 080 (USD 214) as of August 2006, around half of what is earned in neighbouring Russia. The unemployment rate based on the International Labour Organisation methodology was 7.9% in the first quarter of 2006 (EIU, October 2006).

Agriculture and agri-food situation

Output

4. After a fall in Gross Agricultural Output (GAO) by about 50% in the 1990s, Ukrainian agriculture started to recover in 2000 and by 2004 it had increased by above 30% to roughly 70% of its pre-independence level. In 2005, GAO fell marginally by 0.1% due to a fall in crop output by 2.5% as livestock output increased by 4.4% (Figure 9.4).

Figure 9.4. Evolution and annual changes of agricultural output in Ukraine, 1995-2005



Source: OECD Secretariat.

5. Price signals for farmers were mixed in 2005 with wheat, rye and sunflower seed prices falling by 15-20% and sugar beet and most livestock prices increasing by above 30% compared to 2004. While the fall in prices for selected crops was due to large volumes produced in 2004 and 2005, not fully absorbed by domestic and international markets, the increase in livestock prices was driven primarily by an increase in domestic demand and high border protection on livestock imports. Overall, price trends for agricultural producers were unfavourable with output prices increasing by 9% compared to an increase in input prices of 15%.

Crops

6. Ukraine is a large producer and a significant net exporter of grains. Grains account for almost 60% of total area sown. A 2005 gross grain crop of 38 million tonnes was one of the highest over the last decade, but almost 4 million tonnes less than in 2004, partly due to worse weather conditions during the summer, resulting in lower yields. Good harvests in the two consecutive years combined with competitive prices allowed for a record grain export of 13.2 million tonnes in the marketing year of 2005/06.

7. The sunflower crop, another major export oriented commodity, proved even better with a record gross harvest of 4.7 million tonnes in 2005, about 50% above the preceding year. The rise was due to higher yields and high profitability of oilseed production inducing farmers to increase area sown. The sugar beet harvest, in contrast, was lower than in the preceding year, mostly due to lower area sown. A sharp increase in sugar prices in 2005 and in the first half of 2006, partly due to new barriers on raw cane sugar imports (see below), taxed consumers but may stimulate domestic production of sugar beet.

Livestock

8. Livestock production started to recover in 2001 and since then registered positive rates of growth every year with the exception of 2003. In 2004 and 2005, strong increase in real incomes stimulated demand for livestock products which in turn contributed to sharp increases in retail and farmgate prices for meat and milk products. Domestic livestock prices were further pushed up by stricter regulations on livestock imports, in particular for poultry, applied in 2005.

9. Milk production stabilised in 2005 as continued fall in the number of cows was counterbalanced by an increase in productivity per cow. Milk production is concentrated in tiny household plots providing 81% of milk produced and 67% of milk marketed in Ukraine. Poor sanitary conditions and low quality of milk supplied by households remains a major problem for milk processors. According to a report by the Ukrainian Dairy Union an average large dairy producer procures milk from as many as 20 000 suppliers (Tarassevych, 2005).

10. The Ukrainian livestock sector has been severely affected by a ban imposed by Russia on 20 January 2006 on all dairy, red meat and poultry products imported from Ukraine or transported through the Ukrainian territory. The Russian veterinary authority claimed the ban was introduced because Ukraine failed to implement veterinary controls over imported meat products, including those transhipped through its territory, and due to generally low quality of Ukrainian dairy products. The ban resulted in a collapse in the price of Ukrainian raw milk and accelerated the slaughter of dairy cattle for beef production. In July 2006, wholesale prices for pigmeat and beef were respectively 36% and 26% lower than in July 2005. The ban inspired Ukraine to introduce similar measures on livestock imports from selected neighbouring countries (see below).

Structures

11. There are three major categories of farms in Ukraine. In line with the Ukrainian definition, household plots are parcels of land that are owned by private individuals and do not exceed 2 ha.

Independent private farms are owned by private individuals and are larger than 2 ha. Agricultural enterprises (generally large farms) are legal entities such as production cooperatives, partnerships, collective agricultural enterprises, joint stock companies or owned by private individuals. Individual owners may choose to register their holdings as either agricultural enterprises or as private farms (WB/OECD, 2004).

12. Over 65% of arable land is owned by former state and collective farm members and rented out to large-scale operators. Around 30% of land is privately owned and individually operated in the form of household plots and independent private farms. Less than 5% of the country's arable land is owned by the state.

13. By the beginning of 2006, over 6.8 million citizens received land share certificates and 85% of them obtained state acts confirming their land property rights. The average size of land share is 4 ha. The process of physical delimitation of specific land plots has almost been completed. In most cases, the allocation of land plots was by drawing lots.

14. According to the Land Code adopted in October 2001, agricultural land sales are subject to moratorium, now extended up to the end of 2006. In addition, until the end of 2014, individuals and legal entities will not be allowed to purchase agricultural land if the total land owned would exceed 100 ha. According to the 2005 survey led by the FAO, almost half of the rural population is against and only about one-third in favour of agricultural land sales and purchases.

15. Household plots provide about 60% of gross value of agricultural production, in particular fruits, vegetables and livestock products. While the number of independent private farms stabilised at around 42 thousand and their average size increased to about 80 ha, they remain a rather small sector operating on about 15% of arable land (some data suggest that the share is even lower at between 5 and 8%).

16. Most of land is rented by land-holders to large scale farms of about 3 000 ha on average, operating on about 25 million hectares and dominating in cereal and oilseed production. More than half of them are registered as partnerships. Just 1% of land used by these enterprises is owned by their founders. Land rents are calculated at 1.5% of the normative price of land determined by a legal act and differentiated regionally depending on relative land productivity at the end of the 1980s.

17. Within the large-scale sector, there is a strong differentiation of performance with about 20% of farms relatively efficient, well managed and competitive. They are the major contributors to a rebound in Ukraine's agricultural production in the 2000s. Some of them develop into huge holdings through vertical integration with the upstream and downstream sectors or through investments by non-agricultural investors, such as coal mining in the Donieck area. The remaining 80% of farms are unprofitable and may survive only due to tax exemptions, debt rescheduling, and weak land market mechanisms, still not permitted to function. Many of them have not yet been restructured and they continue to cross-subsidise household plots through limited employment income (often in kind), low-priced inputs (mainly feeds), machinery services and basic infrastructure (von Cramon-Taudabel *et al.*, 2006).

Inputs

18. After a decade of disinvestment, capital investments in agriculture started to increase at the beginning of the 2000s. This trend strengthened in 2005 with the investment growth of 45%. However, this growth does not yet benefit the Ukrainian agricultural machinery industry, still under crisis, producing poor quality and high priced machines, lacking modern marketing strategies, delinked from markets and non-competitive with imports. As a result, the recovery in demand for agricultural machinery is satisfied to a large extent by imports, mostly from Russia and Germany.

19. An average use of fertilisers is low at 24 kg of active substance per hectare. There is a risk that the sharp rise in prices for imported gas will translate into high prices for fertilisers, as natural gas accounts for about 80% of total costs of fertiliser production. This may lead to smaller application rates of fertilisers and a fall in crop yields.

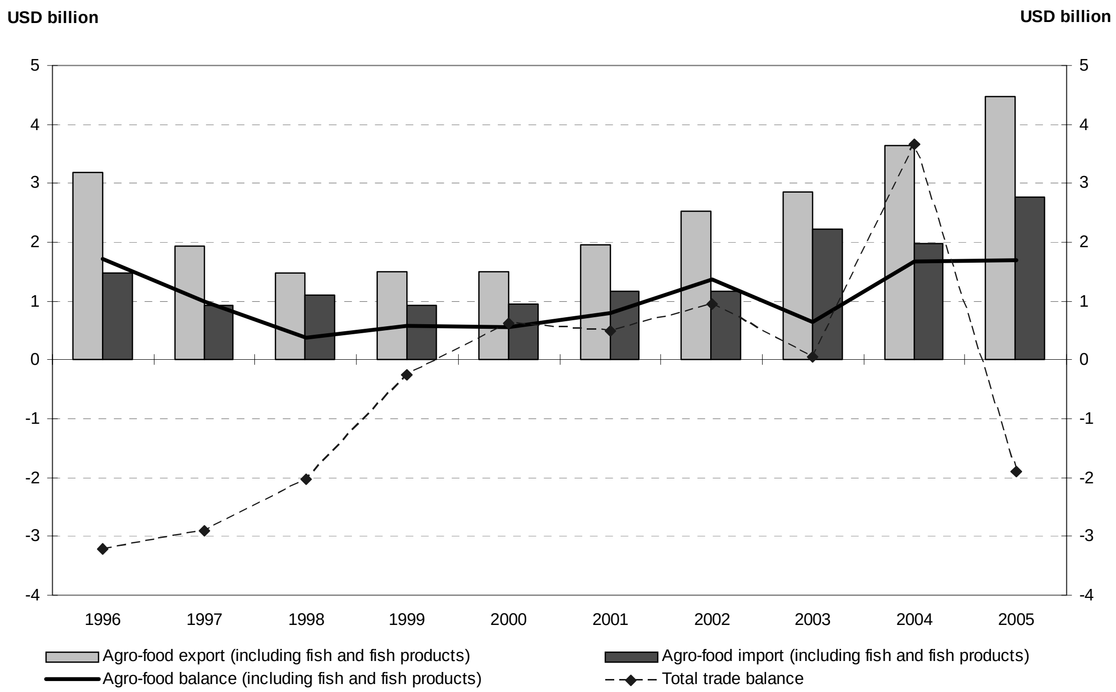
Food industry

20. In contrast to the upstream industry, food-processing, the second largest manufacturing sector, has developed rapidly in the past 5 years with an average growth over 15%. In 2005, the sector's output increased by 13.7% driven by a strong growth in demand. The highest rates of growth were registered in production of juices, canned vegetables, processed liquid milk, cheese, meat products and chocolate and cocoa products.

Agro-food trade flows

21. Ukraine is a consistent net exporter of agro-food products and since the lows at the end of the 1990s, exports have been rapidly increasing to the record level of USD 4.3 billion in 2005. Imports tended to increase as well but on average at lower rates. Net agro-food exports amounted to USD 1.7 billion in 2005 and were a major factor reducing an overall negative balance in 2005 (Figure 9.5).

Figure 9.5. Agro-food trade in Ukraine, 1996-2005



Source: Comtrade database.

22. Agro-food exports are quite strongly concentrated with the three major commodity groups (at HS 2-digit tariff lines) accounting for about 60% of the total agro-food exports in 2005. These are cereals which accounted for 32%, fats, animal and vegetable oils for 14% and dairy products for 13% of the total. Imports are more diversified with tobacco accounting for 13%, miscellaneous edible preparations

(including coffee extracts, essences, concentrates and preparations) for 11% and cocoa and cocoa preparations for 8% of total agro-food imports in 2005.

23. The largest export markets for Ukrainian agro-food products are CIS countries accounting for 44% of the total in 2005, followed by Asian countries (21%) and EU-25 (20%). Before the January 2006 import ban, Russia was the key market for milk and meat products. Asian countries absorb half of Ukrainian cereal exports, with Saudi Arabia being major importer of barley. The EU countries, in particular Spain, are important markets for wheat. Other products exported to the EU include vegetable oil and sunflower seeds. Export of livestock products to the EU market is negligible as only a few food processors comply with the EU food safety and packaging standards.

24. EU-25 is the main supplier of agro-food products to the Ukrainian market, accounting for 32% of the total in 2005, followed by the CIS countries (24%). Major products imported from the EU countries include miscellaneous edible preparations, tobacco, meat and meat by-products. From the CIS countries Ukraine imports meat, fish and dairy products, alcohol and non-alcohol drinks and confectionery. Asian countries prevail in supplies of fats, animal and vegetable oils, as well as fruits and vegetables while South American countries are important providers of meat and sugar. From the USA, Ukraine imports poultry, tobacco and fish products.

Domestic agricultural policies

Price and income support

25. The law On State Support to Ukrainian Agriculture voted in 2004 and implemented as from 2005 defines the principles of the state agricultural policy in the fields of budgetary support, credit, price, and insurance. State regulation of wholesale prices through setting of minimum and maximum prices, commodity and financial interventions, state pledge purchases, credit and insurance subsidies are to be applied to key crop products, in particular grains. The Agrarian Fund was designated to implement interventions on the market, to form State Food Reserve (intervention fund), to issue credit subsidies, and to carry out state pledge purchases of grain.

26. The Ministry of Agrarian Policy fixed minimum purchasing prices for grains and sunflower seeds for the marketing year 2005/06. The level of minimum prices was determined on the basis of market prices over the preceding five years and adjusted by the rate of inflation. The Agrarian Fund was charged to intervene to keep the level of prices between the minimum and the maximum levels and to make purchases for the State Food Reserve. Due to delays in the implementation process, the Agrarian Fund purchased at the minimum prices just 95 000 tonnes of grains instead of the 1 million tonnes instructed by the government for 2005. In mid-2006, minimum purchasing prices were approved for the 2006/07 marketing year to be implemented by the Agrarian Fund for purchases of 565 000 tonnes of wheat and rye for the State Food Reserve. The Ministry warned that sanctions could be imposed against anyone buying or selling grain at prices that are lower than the set prices.

27. The minimum purchasing prices were also applied for state pledge purchases in 2005. The budget loan per tonne was set at the level of 80% of the minimum price. The Agrarian Fund took 645 000 tonnes of grains as a pledge, which was almost completely redeemed by agricultural producers. A total of UAH 278 million (USD 54 million) was provided in budget loans. The interest rate was set at 8.95% per annum compared to the commercial rate of 17.9%.

28. During 2005 and again in June 2006, the government tried to establish minimum prices for milk to protect incomes of milk producers, but at the cost of processors and consumers. The level of prices was two-fold higher than the actual prices paid for milk supplied by households. This policy measure met

significant resistance from dairy processors and due to the lack of an effective enforcement mechanism the policy has been ignored by the industry (Tarassevych, 2006).

29. The programme called Financial Support to Animal Husbandry, first implemented in 2003 and 2004, was continued in 2005 and included payments for cattle, pig, broiler chicken, sheep, wool, honey, ecological milk, heifer and silkworm producers. Eligible producers receive direct payments on the presentation of receipts confirming sales to processing enterprises. In 2006, the list was extended, some implementation rules changed and the total allocation increased by 60% from UAH 594 million (USD 116 million) in 2005 to UAH 943 million (USD 187 million).

30. In 2006 a new programme of per-hectare payments was launched at a cost of UAH 1.1 billion (USD 208 million). The objective was to reverse the process of the reduction in area sown to crops, in particular to cereals. Payments were granted on the basis of area sown at the following rates per hectare: UAH 100 (USD 20) for winter crops (wheat, triticale, rye, barley and rapeseeds); UAH 65 (USD 13) for spring crops (wheat, barley, oats, pea, maize, soy, rape, buckwheat, millet and rice); and UAH 380 (USD 75) for long-fibred flax and hemp. An additional subsidy of UAH 53 (USD 10) per hectare was granted for crops grown on irrigated land.

Reduction of input costs

31. In 2004 there were two programmes applied to diminish variable input costs and both intended to stimulate production after very low grain harvests in 2003. A programme called Partial Reimbursement for Expenses Related to Spring and Winter Cereal Crop Sowing was to support agricultural enterprises in payments for wage arrears and in purchases of fuel and lubricants, spare parts, seeds, fertilisers and plant protection chemicals. Its budgetary cost was UAH 349 million (USD 66 million). Another programme was called Partial Reimbursement for Domestically Produced Fertilizers and the budgetary allocation for its implementation was UAH 113 million (USD 23 million), an equivalent of 13% of the total value of fertilisers purchased by agricultural enterprises in 2004. Both programmes were discontinued in 2005.

32. The Partial Reimbursement for Domestically Produced Complex Agricultural Machinery programme was implemented in 2002. Budgetary financing of this programme gradually increased to UAH 151 million (USD 29 million) in 2005 and then cut down to UAH 32 million (USD 6.3 million) in 2006. The partial reimbursement was set at 30% of the purchase price of the machinery and have in fact aimed at supporting Ukrainian agricultural machinery industry.

33. State support for plant, cattle and poultry breeding programmes has been increasing every year to reach UAH 158 million (USD 31 million) in 2005. The largest part of these funds is allocated to partial reimbursement for seeds and pedigree animals purchased by agricultural producers.

34. Budgetary allocation for interest rate subsidies on commercial loans to agricultural producers was small, but increased from UAH 142 million (USD 27 million) in 2004 to UAH 415 (USD 81 million) in 2005. A small budgetary allocation of UAH 27 million (USD 5.3 million) in 2005 was also provided for partial reimbursement for electric power used for irrigation of crops.

Tax concessions

35. Even if budgetary payments to support agriculture increased substantially in recent years, foregone budgetary revenues from agriculture remain key instruments in supporting the sector. These instruments include:

- Reduced taxes compared to other sectors of the economy through the so called “fixed agricultural tax”. Any enterprise receiving more than 75% of its gross receipts from sales of agricultural commodities is eligible for the fixed agricultural tax based on the estimated value of land. Eligible enterprises do not have to pay profit taxes and contributions to social funds. This system has been extended until the end of 2009.

- The repayment (“redirection”) of VAT paid by milk and meat processing plants back to meat and milk producers as per tonne subsidy.

- “Accumulation of VAT amounts”, which allows agricultural enterprises (except milk and meat producers) to retain VAT on agricultural goods and services of own production, including manufactured agro-food products for which own raw materials are used. These amounts are not channelled to the State budget, but to special accounts agricultural producers keep in commercial banks and can use for purchases of such inputs as fuel, seeds, fertilisers, pesticides, and agricultural equipment and machinery.

36. These preferences provide substantial benefits to agricultural producers. For example, according to official estimates, the annual benefits from the fixed agricultural tax amounted to UAH 1.4 billion (USD 275 million) between 1999 and 2003, UAH 1.9 billion (USD 357 million) in 2004 and UAH 1.34 billion (USD 262 million) in 2005, including compensation of UAH 1.21 billion (USD 237 million) paid by the State Budget to the Pension Fund.

37. Benefits from the two VAT-based instruments amounted to UAH 0.8 billion (USD 147 million) in 2000 and then increased each year to UAH 3.3 billion (USD 645 million) in 2005. While all categories of producers (small, large and household plots) are eligible for this type of support, in fact these are the largest producers which benefit most. This is partly linked with the fact that small-scale farms produce mostly for their own use or for local markets and do not have receipts which would allow them to benefit from subsidies. As a result, according to one survey, just 7% of livestock producers received 75% of all livestock subsidies in 2004, including VAT expenditures and limited direct budget transfers (Zorya, 2006).

General services

38. A new and positive feature of agricultural policies in Ukraine is a significant increase in support to general services from UAH 410 million (USD 75 million) in 2000 to UAH 3 259 million (USD 637 million) in 2005. The main beneficiaries of this increase are agricultural schools, inspection services, infrastructure (in particular irrigation and drainage systems) and public stockholding which accounted for above 90% of total public expenditures on general services in 2005. Since 2003 there is a yearly allocation of UAH 400 million (USD 75 million) for the State Committee of Ukraine for State Material Reserve aimed at the formation of the State reserve of food for security purposes.

Overall budgetary support

39. In total, budgetary support to agriculture, including budgetary payments to producers, tax benefits and general services increased from UAH 2.8 billion (USD 515 million) in 2000 to UAH 8.5 billion (USD 1.6 billion) in 2004 and to 9.6 billion (USD 1.9 billion) in 2005. There is a visible

change in the structure of support with the share of tax benefits declining from as much as 77% in 2000 to 49% in 2005, the share of payments to producers increasing from 8% to 17% and the share of general services increasing from 15% to 34% (OECD PSE/CSE databases).

Agro-food trade policies

Import policy

40. Ukraine has a complex system of border protection with the vast majority of agro-food imports charged with specific duty or with combined *ad valorem* and specific duty. The higher of the two is applied. The specific duties in *ad valorem* terms are very high and for frozen beef, fresh and frozen pork, poultry meat, potato, sunflower oil, and sugar are well above 100%. In addition to tariffs, Ukraine applies a number of non-tariff barriers, including quotas, licences and import bans, which often lack transparency and impose additional costs on importers (WB/OECD, 2004).

41. In recent years, an intensification of negotiations on Ukraine's accession to WTO (Box 9.1) led to a partial harmonisation of Ukraine's legislative framework with WTO rules and standards and to some lowering of border protection. However, any move in the direction of tariff reduction is strongly opposed by the agrarian lobby. By using domestic industry protection arguments they have managed to pressure the government to maintain tariffs at prohibitive levels. A law passed in mid-2005 (No. 2775) led to a reduction in average level of MFN *ad valorem* tariffs on agro-food imports from 19.8% in 2004 to 13.8% in 2005. However, for some tariff lines (such as 02-meat, 04-dairy products, 17-sugar), a combined *ad valorem* and specific duty was preserved, with the *ad valorem* rate decreased and the former specific rate kept unchanged. The specific tariff remains very high and varies from EUR 600-1 000 per tonne of beef, from EUR 500-1 000 per tonne of pork and from EUR 400-1 500 per tonne of poultry meat. On the date of Ukraine's accession to the WTO, Ukraine will not apply specific import duties for agricultural products and the average *ad valorem* rate for imported agricultural products (1-24 HS) will be set at a level not exceeding 10%. Phasing out of specific duties should lead to an important fall in border protection.

42. Some other changes in legislation led in effect to an increase in border protection. For example, in line with the government resolution passed in December 2005, licensing became obligatory for imports of frozen beef, pork (fresh, chilled or frozen) and for live cattle and pigs. Moreover, until spring 2005, imports could enter into Ukraine through Free Economic Zones (FEZs) and priority development areas free of import duties and other charges. With amendments to the law On State Budget of Ukraine for 2005 voted in March 2005, these privileges disappeared and all imports are now subject to the same taxes (including import duties) and charges. The elimination of FEZs through which most imports of poultry entered Ukraine and the prohibitively high import duties restricted imports of poultry products into Ukraine, in particular from the USA.

43. Another measure leading to an effective increase in border protection is suspension of the system of tariff quota for raw cane sugar imports. Such system was implemented between 1998 and 2004 with the exception of 2002. For example, in 2003 the quota allowed imports at preferential rates of 560 000 tonnes of raw sugar. In 2004, the quota was reduced to 125 000 tonnes with the in-quota tariff of EUR 30/tonne and the above quota 50% but not less than EUR 300 per tonne. In 2005 and 2006 no such quota was announced. Changes in the sugar quota regime contributed to a sharp fall in raw sugar imports from 1402 000 tonnes in 2003 to 176 000 tonnes in 2005 and were one of the factors leading to a drastic increase in domestic wholesale prices for sugar from USD 470 per tonne in March to USD 890 per tonne in July 2005, labelled by the Ukrainian press as the "sugar crisis".

44. Following Russia's import ban, in March 2006 Ukraine introduced similar import bans for meat from Poland, Belarus and Moldova. Later limited imports from Belarus were allowed. A separate ban was

imposed for live hog imports from Poland. Multiple meetings between Polish and Ukrainian officials have not resolved the problem as of mid-September 2006 (Tarassevych, 2006).

Export policy

45. Since 1996 Ukraine has applied export duties on live cattle, live sheep, as well as on cattle, sheep and pig hides and since 1999 on exports of sunflower seeds, flax seed and false flax seeds. The rate on sunflower seeds is currently at 17%. Expected WTO membership will lead to partial liberalisation of Ukraine's agro-food exports. For example, in line with the law voted in July 2005, export duties on sunflower and other oil crop seeds will be annually diminished by one percentage point starting from January 2007 (on condition of obtaining the WTO membership) until the rate falls to 10%. Another law drafted in September 2006 envisages gradual reduction of duties on exports of live cattle until it falls to 10% and on exports of hides down to the level of 20%.

46. In 2005, contradictory government resolutions were passed related to the role of state trading companies (in fact Joint Stock Company Bread of Ukraine) on grain markets. While the earlier resolution, passed in July, provided for privileged conditions for the state agents, the later, passed at the end of August 2005 and aimed at invigorating exports of grain, repealed all rules and measures that were intended to secure interests of state trading enterprises and stipulated that all entities operating on the grain market should have equal conditions. However, other measures suggest that the government still opts for keeping grain trade flows under its control. For example, in October 2006, it decided to introduce a new licencing system for grain exports and proposed grain export quotas for the last two months of the year as a precaution against possible grain shortages following lower than expected 2006 grain harvest (*AgraFood East Europe*, No. 289).

Box 9.1. Ukraine's trade agreements

Ukraine is at the final stage of negotiations on its **WTO accession**. The 16th official meeting of the Working Party on Ukraine's accession to the WTO was held on 15 June 2006. About 90% of the draft report of the Working Party has been agreed. 46 bilateral protocols on access to markets of goods and services have been signed (16 of them in 2005–06). Protocols with Chinese Taipei and Kyrgyzstan are still to be signed.

Ukraine accrued the status of a country with market economy from the European Union (December 2005) and the USA (February 2006), which strengthens the position of Ukrainian producers in antidumping investigations.

During the negotiations process Ukraine has already declared non-application of export subsidies for agricultural products in the future. The AMS level and base period for assuming commitments regarding reduction of domestic support to Ukrainian agriculture are still negotiated. As a base period, Ukraine proposes 1994-1996 with the resulting AMS at USD 1.14 billion but is demanded to change that period for more recent years.

Differentiated VAT rates to be applied for imported and domestically produced agricultural products also gave rise to comments on the part of WTO member countries. According to the law *On value added tax* voted in April 1997, Ukraine is to introduce as from January 2007 new VAT rates for domestically produced agricultural products at 9% and for fishery and forestry products at 6%. These rates are lower than the rate of 20% to be applied for imported agricultural products. The rate on imports is considered discriminatory compared with taxation of like products of national origin.

Regarding technical barriers to trade (TBT), Ukraine will not be able to bring its technical requirements and standards in full compliance with the WTO regulations by the presumed date of its WTO accession. Several related laws were voted in 2005 and 2006, but in line with the roadmap presented in Geneva in June 2005, full compliance will not be achieved before the end of 2011. In an effort to comply with international standards, Ukraine joined the *Codex Alimentarius* Commission and the International Plant Protection Convention, acceded to the European and Mediterranean Plant Protection Organization (EPPO) and became a member of the International Office of Epizootic.

Action Plan Ukraine-EU for 2005-07 was developed and signed in February 2005 within the framework of the European Neighbourhood Policy. This document includes such issues as food safety improvement for consumers and simplification of trade through reforming and modernisation of sanitary and phyto-sanitary rules and services. The Action Plan makes it incumbent upon Ukraine to ensure progress in conformity of Ukrainian SPS legislation and institutions to those of the European Union.

Ukraine's trade relations with the **CIS countries** are oriented towards the creation of bilateral free trade regimes without any exclusions and a formation of free trade zones. The Ukrainian government has agreements on the complete abolishment of exclusions from the free trade regime with Moldova (as from Ukraine's accession to the WTO), Belarus (from 2007) and Russia (from 2009).

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