UNDP Blue Ribbon Analytical and Advisory Centre

ECONOMIC IMPACTS OF WTO ACCESSION BY UKRAINE: ASSESSMENT OF PRICE COMPETITIVENESS

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Economic Impacts of WTO Accession by Ukraine: Assessment of Price Competitiveness

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This report presents results of a study of key economic impacts of WTO accession by Ukraine, based on an assessment of price competitiveness among Ukraine's primary products. The study was conducted by the UNDP Blue Ribbon Analytical and Advisory Centre, in cooperation with international and Ukrainian experts, at the request of the Parliamentary Committee on European Integration of Ukraine. The authors intend for the material presented to be comprehensible to professionals as well as those concerned with this important and complex issue.

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EXECUTIVE SUMMARY

Analysis of foreign trade trends, current and expected bound tariff rates in the framework of World Trade Organization (WTO) membership, and internal and global prices between 2001–2006 shows that after WTO accession, most economically crucial agricultural and industrial products shall remain unaffected.

A sampling of analyzed agricultural products (representing 70% of Ukraine's gross agricultural products) suggests that WTO accession shall have no negative impact on the agricultural sector as a whole. Relatively low bound tariff rates for agricultural products after WTO accession shall not produce additional pressures on producers, as Ukraine's primary agricultural products are more price competitive than their imported analogs. This reflects the fact that Ukraine is a net-exporter of most agricultural and food products.

Ukraine's WTO membership will result in transformational changes in state policies regarding the support of agriculture and the regulation of food markets. These changes will help create conditions for securing and strengthening the competitive advantages of agricultural products and domestic production both in internal as well as external markets. Liberalization of import regulations shall further enhance agricultural production efficiency and the competitiveness of domestic products.

Most industrial sectors in Ukraine already operate in compliance with WTO membership requirements. Unlike tariffs in the agricultural and food industries, most of the effective tariff rates for industrial products, currently, are almost equal with (e.g., iron ore, coke, clothing, and flat rolled metal) or are even lower than (e.g., rolling stock (tank-cars), ammonia, and urea) import tariff bindings that shall become effective after WTO accession.

For the industrial products analyzed price margins are negative, meaning that prices of domestic products are lower than those of foreign products. Even in years when the price margins for particular products were not negative, export volumes of Ukrainian products exceeded import volumes, indicating that Ukraine is a net-exporter of most industrial products – particularly mining, metallurgical, and chemical products. By introducing energy-saving production techniques Ukraine can remain competitive, yet this requires the development and implementation of relevant national policies.

Study results suggest that most key Ukrainian agricultural and industrial products shall retain competitiveness in global markets after accession to the WTO. Competitiveness shall even increase if Ukraine continues economic and institutional reforms and Ukrainian enterprises implement reforms and adopt modern business practices: develop new products and services, improve quality and reduce operational costs.

1. INTRODUCTION

Ukraine's WTO accession is a major challenge that policymakers and the business community consider with great care. It raises many important questions regarding the place of Ukraine in the global economy, the potential costs and benefits of WTO membership or non-membership, and the macroeconomic and sector impacts in both scenarios.

Ukraine has already introduced a considerable number of new laws that move the country closer to compliance with WTO norms. However, to complete accession negotiations, Ukraine will need to concentrate on completing the remaining legal reforms. Mobilizing political constituencies behind these legal reforms and providing stronger internal support are the key ingredients to completing accession negotiations.

The objective of this report is to provide an assessment of the implications of WTO membership for the following agricultural and industrial products:

Agricultural products	**Industrial products**
Wheat	Iron Ore and and ferrous concentrates
Corn	Coke
Barley	Cast Iron
Sunflower seeds	Clothing
Sugar	Rolling stock (tank cars)
Milk and Dairy Products	Ammonia
Beef	Carbamide (urea)
Pork	Flat section (flat rolled metal)
Poultry Products	

These products were chosen based on the results of broad and extensive consultations with experts and members of the business community. A more detailed description of approaches to product selection is provided further in this report.

For a variety of reasons, the process of WTO accession has been, and is likely to continue to be, lengthy, complex and challenging for all countries. Applicants often need to implement substantive reforms to align their domestic institutions and policies with WTO disciplines.

As illustrated by the experiences of many countries (China and Cambodia are two recent examples), WTO accession can be an effective lever to promote a market economy, substantive regulatory, institutional and economic reforms, economic growth, and employment.

There is a widespread perception, however, that the process is too cumbersome and onerous for acceding countries. This process has given rise to the following perceptions:

- The WTO accession process is costly and complex;
- The WTO accession process is taking longer and longer to complete;
- The price of joining the WTO now includes commitments that go beyond the GATT/WTO agreements;
- The price of joining the WTO is steadily rising; and
- The WTO accession process takes little account of the specific circumstances of applicant countries or their needs for special and differential treatment.

The critical question, however, is not whether the price of WTO accession is rising, but whether the price is worth paying in terms of its developmental impact. WTO membership does indeed involve some financial and economic adjustment costs. However, the experience of previously acceding countries shows that the benefits may be several times higher than the costs. The long-term economic benefits of WTO membership in terms of employment, growth, and prosperity can be significant.

The issue of membership should be considered within the ongoing international and regional integration process. Ukraine cannot prosper in isolation. What is happening currently, as well as what will be happening in Ukraine's immediate environment (European Union (EU) and Russia), and globally (especially in Asia and the Americas), will have obvious implications on the desirability of any of the choices available.

It is clear that WTO accession will bring competitive pressure to some sectors in Ukraine. Foreign institutions can bring in direct investment and advanced management skills and business practices. However, if Ukraine's institutions can reform, adopt advanced business practices, develop new products and services, improve quality, and cut down operating costs, they should be able to compete with their foreign counterparts. Therefore, pressure from WTO accession would be beneficial to the development of Ukraine's companies, encouraging them to provide more efficient and convenient goods and services to customers and benefiting Ukraine's overall economic growth.

There are four main benefits from WTO membership:

1. strengthening domestic policies and institutions for international trade in both goods and services, a requirement before accession into the WTO can be achieved;
2. improving the ease and security of access to major export markets;
3. accessing a dispute settlement mechanism for trade issues; and
4. providing Ukraine with "a seat at the table" as WTO members establish the rules that govern much of global trade.

Policies and Institutions

While there are significant differences in the institutional and policy environment of the various countries applying to accede, many countries face very similar challenges in establishing the institutions needed to implement WTO commitments. Perhaps the most important of these challenges is the need to introduce the laws and institutions for the operation of private enterprises and markets free from government controls, other than those explicitly provided under WTO regulations. Some examples include: standards, sanitary and phyto-sanitary measures, intellectual property rights, and state trading practices.

Equally important to a country's economy is the introduction of greater stability in commercial policy, which is a by-product of adherence to WTO rules and legally binding agreements. Stability is important both to domestic producers and to exporters from other countries wishing to access new markets. Adherence to the WTO provisions (e.g. bound tariff rates, as well as specific conditions for establishing foreign direct investment (FDI) in the WTO Agreement on Trade in Services, would improve the efficiency and productivity of acceding countries.

WTO membership also offers the opportunity for new members to lock-in present, relatively liberal trade regimes. While trade regimes in acceding economies vary considerably, many have established regimes with relatively low tariffs and no significant formal non-tariff barriers. For these countries, membership provides the opportunity to lock-in these regimes by assuming legally binding obligations regarding tariff levels. This not only permits them to enjoy the benefits of liberal trade but also gives them a first line of defense against domestic protectionist pressures that are present in all market economies.

Market Access

There are two main dimensions of market access that are of importance to acceding economies: first, is the extension of permanent and unconditional Most Favored Nation (MFN) status that comes with WTO membership. At present, economies that are not members of the WTO have been granted MFN treatment voluntarily by major trading partners. But there is nothing that guarantees that they will continue to be awarded such treatment. Second, there is substantial evidence that suggests that the incidence of anti-dumping actions is much higher against non-WTO members than against members.

Dispute Settlement

Access to an impartial and binding dispute settlement mechanism whose decisions have a significant chance of being enforced is a very important potential benefit for acceding economies, many of which are small and heavily dependent on international trade. The dispute settlement mechanism under the WTO has proven successful in providing opportunities for members to reach resolution on grievances stemming from the practices of other members that cause trade injury.

2. AGRICULTURAL PRODUCTS

2.1. Introduction

Agriculture has always been a very complex and difficult issue in WTO negotiations. For Ukraine, agricultural and food industries are also of great importance as they account for 20% of GDP.

Prior to the Uruguay Round of multilateral trade negotiations, regulations in international agricultural trade were much milder compared to the standard regulations of the *1947 General Agreement on Tariffs and Trade* (GATT). The Uruguay Round resulted in the signing of a multilateral trade agreement on agriculture, which became a reform program aimed at liberalizing trade in agricultural products in compliance with GATT regulations and principles.

At the Uruguay Round, participating countries, with the purpose of forming a fair and market-oriented system in agricultural trade, agreed to: reduce import tariffs, reduce internal support of agricultural producers that negatively affected trade, reduce expenditures on export subsidies, and reduce the number of agricultural products that received these subsidies. (See Table 1).

Table 1. Reduction of agricultural subsidies and levels of domestic market protection as a result of WTO Uruguay Round negotiations.

	Developed countries 6 years: 1995–2000	Developing countries 10 years: 1995–2004
Import tariffs: Average reduction for all agricultural products	-36%	-24%
Domestic support: Reduction of the total support in the sector ("yellow box" programs)	-20%	-13%
Export subsidies:		
a) Budget expenditures	-36%	-24%
b) Amount of export products that received subsidies	-21%	-14%

After Ukraine obtains WTO membership and complies with the consolidated tariff proposal, the average import tariffs for agricultural and food products will be reduced from 13,84% to 11,16%.[1]

The highest import tariff rate for agricultural and food products (group 1-24 UKT ZED) will be for sugar (at a rate of 50%) and sunflower oil (at 30%). After Ukraine obtains WTO membership, only ad valorem custom duty rates will be used, instead of the combined and specific ones in effect today.

After WTO accession, Ukraine will no longer be able to provide export subsidies. Abandoning export subsidies is an important element of WTO principles on trade liberalization of agricultural products. Internationally, agricultural products are, for the most part, under-priced because developed countries use export subsidies. For this reason, the potential for

[1] Information of WTO accession by Ukraine. The Ministry of Economy of Ukraine, 2006 – 19 pages.

Ukraine to increase exports of its agricultural products is limited. Nevertheless, ending global export subsidies will encourage the growth of international prices and expand the possibilities that Ukraine can use competitive advantages in agricultural product exports.

With WTO membership, Ukraine must also reduce the maximum level of agriculture support through "yellow box" programs, while the right for unlimited support under "green box" programs will remain.

The reduction of domestic support and the abandonment of export subsidies will have no direct effect on Ukraine's agricultural sector because the allowable support limit is much higher than the actual support provided; export subsidies have not been granted before nor are they being granted presently.

Reduced import tariff rates is the key factor that can have an impact on the agricultural sector after Ukraine's WTO accession.

This report analyzes the impacts of import tariff reduction on price competitiveness for 9 primary agricultural products: wheat, corn, barley, sunflower seeds, sugar, beef, pork, milk and dairy products, and poultry products (poultry and eggs). These products account for nearly 70% of Ukraine's gross agricultural output, with almost 4 million people employed in their production – more than half of the able-bodied population in rural areas. More than $US 600 million was directly invested into the production or processing of these products over the past 10 years (45% of the total foreign investments in agricultural and food industries), with about UAH 4 billion in domestic investments into capital assets.

2.2. Methodology and data used

The impacts of tariffs on the price competitiveness of Ukraine's agricultural products was analyzed between the years of 1996–2006. This timeframe makes the analysis more objective, taking into account the substantial annual deviations in the domestic and international agricultural product markets. The following three parameters are compared:

1. The current import tariffs (in percentages) on imports from countries to which Ukraine granted most favored nation (MFN) status in each of the years analyzed (1996–2006);
2. The differences (in percentages) of domestic and international prices in each of the years analyzed (1996–2006);
3. The expected bound[2] tariff rates (in percentages), which is the maximum protection level for each commodity after Ukraine joins the WTO.

For comparison purposes, the rates of import tariffs were converted into their ad valorem equivalents. We used statistical data produced by the State Customs Service of Ukraine on the value of a single unit of an imported/exported commodity and also monitored the legislative changes in the regulation of import tariffs with respect to the imports of similar commodities into Ukraine.

The price difference is the percentage correlation between the difference of the external price (price at the Ukrainian border) and the producer's sales price, and the relevant external price (price at the border)[3].

[2] Bound tariff: the rate bound within Ukraine's WTO negotiation process for a given product in the final year of the implementation period of tariff reductions. Assessment of binding import tariff rates, which may occur after joining WTO, was performed based on the information from the media, conferences, and seminars as well as presented by officials at Parliament proceedings.

[3] Some data were taken from the database of Producer Support Equivalent/Consumer Support Equivalent (PSE/CSE), prepared by the experts of the UNDP Project "The Agricultural Policy for Human Development" for the Secretariat of Organization for Economic Co-operation and Development in 2004 (see „Achieving Ukraine's

Calculation formulas (1) and (2) are provided below:

$$\Delta P = \frac{P_d - P_w}{P_w} \times 100\% \text{, where (1)}$$

ΔP — *market price difference*
P_d — *internal sales prices of agricultural producers*
P_w — *external reference prices*

$$P_w = P_b \times R_{exc} \times C_q - T \text{, where (2)}$$

P_b — *FOB or CIF prices at the Ukrainian border*
R_{exc} — *official NBU exchange rate*
C_q — *quality adjustment coefficient*
T — *transportation, storage and processing costs of one unit of produce*

If the price difference is negative, reflected on the following charts as a mark below the zero level, it means that a domestic product is more competitively priced than a similar imported product.

If the price difference is positive, reflected on the charts as a mark above the zero level, it means that the imported commodity is cheaper than a similar domestic commodity.

If the positive value of the price difference exceeds the bound tariff rate, it means that even after the import duty is paid, the imported product still has a more competitive price than a similar domestic product; and when the positive value of the price difference is below the bound tariff rate, domestic commodities are more price competitive compared to imported commodities after the import duty is paid.

2.3. Results for specific products

Wheat

Analysis of the current tariffs reveals that customs tariffs of 40-50% (calculated as an ad valorem rate) did not affect the price set by domestic wheat producers or their incomes from its sales. Wheat prices during the period under analysis remained low, sometimes even lower than abroad (for 6 of the 11 years analyzed). This suggests that Ukrainian wheat has a high competitive potential as an export-oriented commodity. In high yield years wheat crops increased steadily. In the 2005/06 marketing year, 13 million tons of grain were exported (25% more than in the 2004/05 MY), which included 6,4 million tons of wheat.

Agricultural Potential: Stimulating Agricultural growth and Improving Rural Life" Joint Publication by the OECD and the World Bank, 2004).

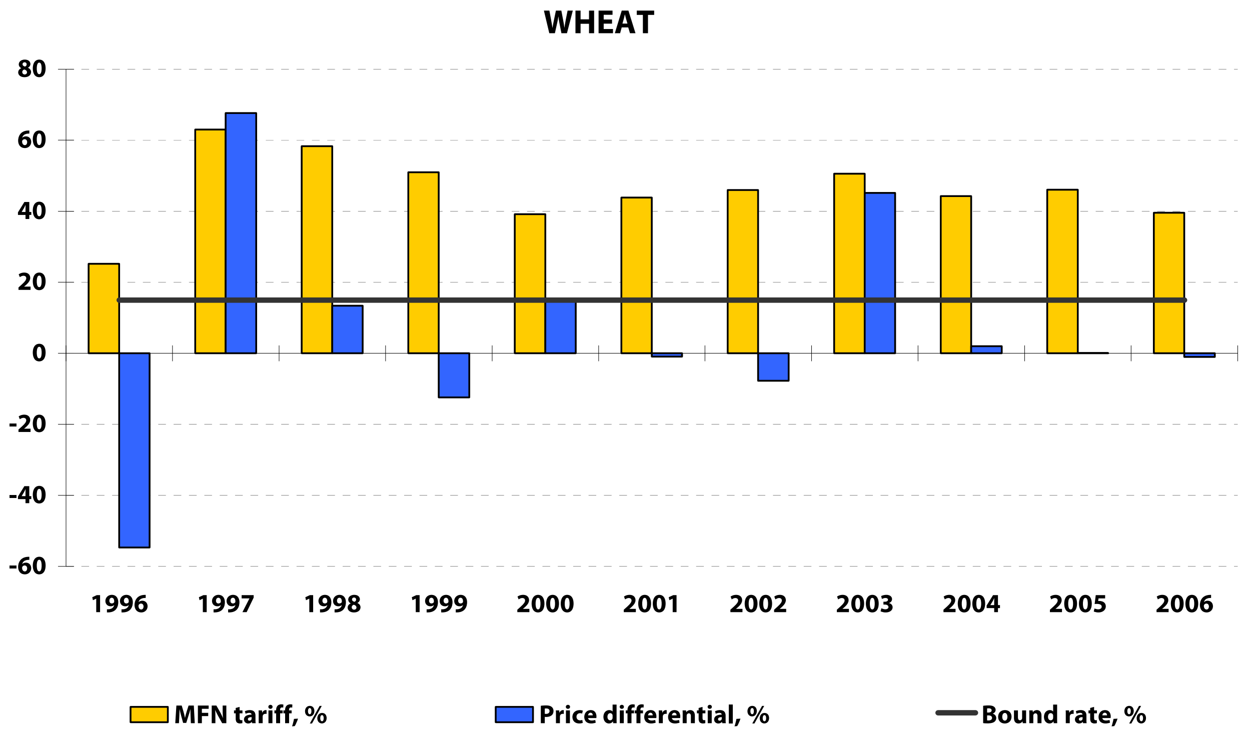


Figure 1. Wheat[4]. Comparison of prices and tariffs, 1996–2006

Thus, after entering the WTO, Ukrainian wheat will remain competitive, while the import tariff reduction will neither affect the price nor wheat producers' incomes from its sales.

Corn

For corn, the binding import tariff after entering the WTO will be set lower than that of the current tariff.

[4] Soft wheat (not for seeding)

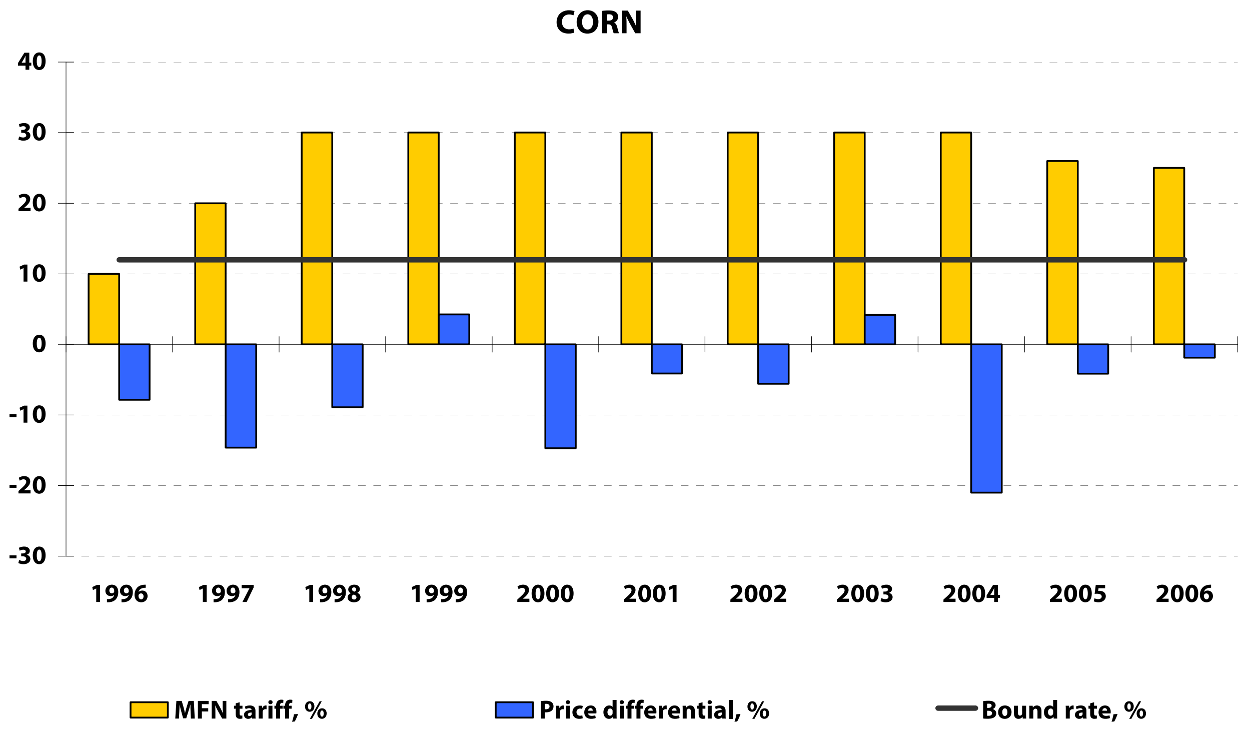


Figure 2. Corn. Comparison of prices and tariffs, 1996–2006

Meanwhile the percentage difference between domestic and international prices of corn was negative in most years, meaning domestic prices were lower than international ones; this suggests the high competitive potential for corn. Annually, Ukraine exports 1 to 2 million tons of corn. The low domestic demand for corn fodder has to do with the specific features of the cattle-farming industry in Ukraine. For this reason, more expensive corn fodder imports into Ukraine is unlikely.

Barley

The situation is similar with barley fodder. The price difference in most years was negative, which again suggests the high competitive potential of barley. Ukraine's annual export is 4 to 5 million tons.

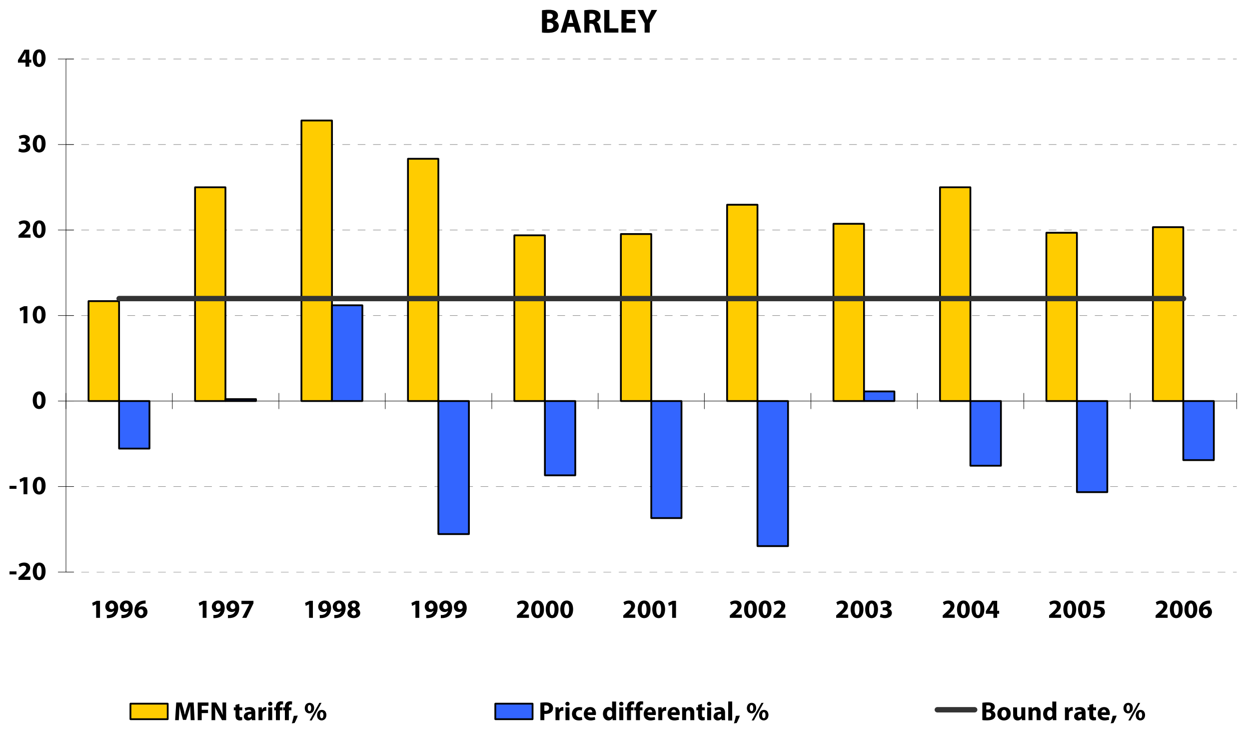


Figure 3. Barley Fodder. Comparison of prices and tariffs, 1996–2006

Sunflower seeds

During the last 10 years, the difference between domestic and international prices for sunflower seeds was negative, meaning domestic prices were lower than international prices. This trend suggests the high competitive potential of locally produced sunflower seeds. Sunflower seeds production is sufficient to satisfy the growing demand of the food industry as well as export demands. Both commodities – sunflower seeds and sunflower oil – are exportable. The export volumes of domestically produced sunflower oil have reached 1,6 million tons, while annual sunflower seed exports have reached 230,000 tons, even with an export duty of 17% (data for 2006).

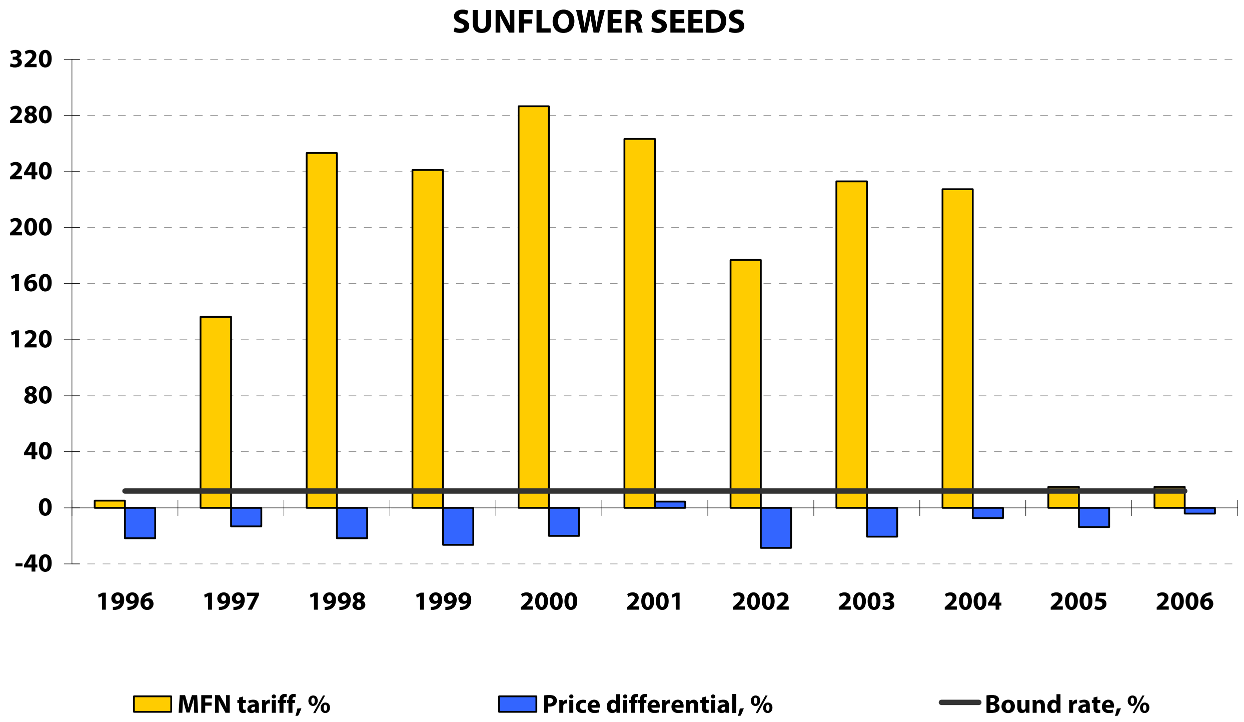


Figure 4. Sunflower seeds [5]. Comparison of prices and tariffs, 1996–2006

The import tariff in place between 1997-2004 was set at an unreasonably high level of €500 per 1 ton, which calculated as ad valorem, equaled 250% in 2000 and 227 % in 2004 (Fig. 4).

Price difference analysis reveals that the import tariff rate for sunflower seeds, after WTO accession by Ukraine, is enough to make the domestically produced raw commodity competitive compared to the imported product. For sunflower oil producing factories, the price of domestic sunflower seeds will remain more attractive than the price of imported sunflower seeds. Since July 2005, the import tariff for sunflower seeds has been reduced to 15%; however, annual volumes of sunflower seeds imported after the tariff reduction constituted only 4,000 tons, which is less compared to previous years. This suggests that reducing the import tariff for sunflower seeds, even several times, should not result in the decrease of production amounts nor affect the agricultural producers' income from sunflower seed sales.

Sugar

The analysis reveals that the domestic price of sugar is higher than the international price, but the 50% import tariff makes imported sugar almost equal to the price of sugar produced from domestic raw materials.

[5] Sunflower seeds not for seeding

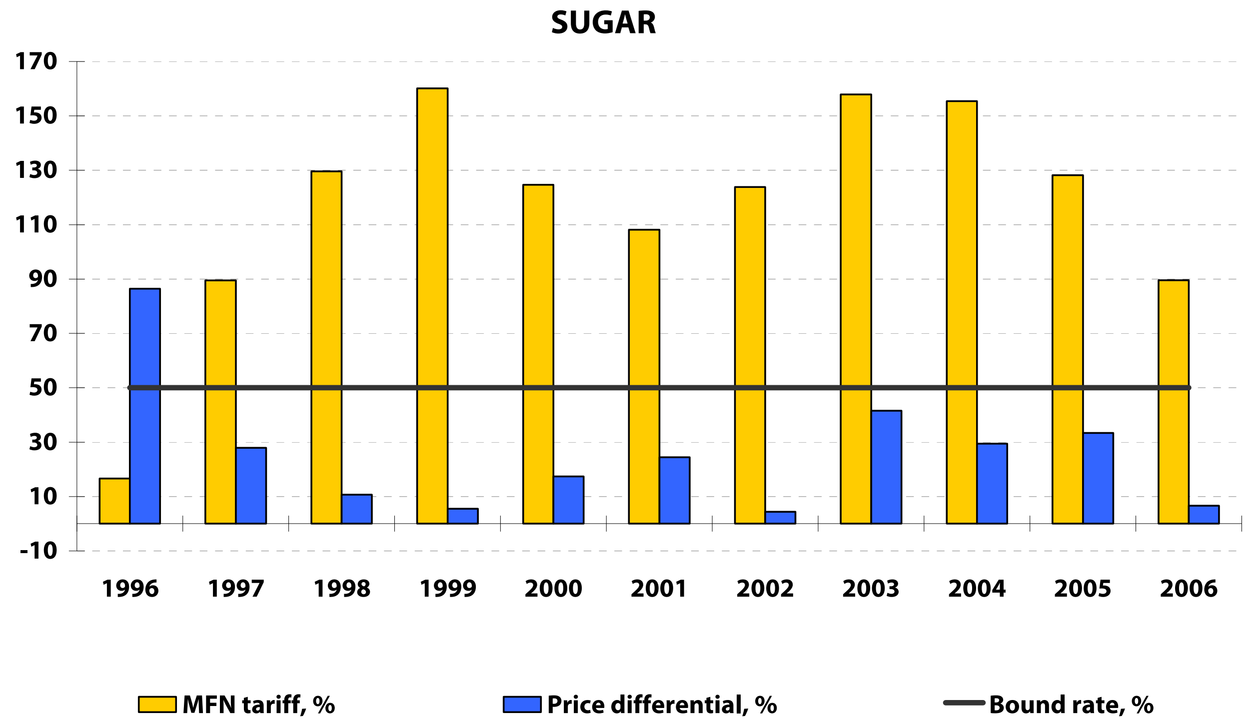


Figure 5. Sugar[6]. Comparison of prices and tariffs, 1996–2006

Additionally, after joining the WTO, the domestic sugar market will be protected by a tariff quota of 260,000 tons with the duty not exceeding 15%. The amounts in excess of the tariff quota will be charged with a high 50% tariff. There is a somewhat distorted perception of the tariff quota for crude sugar. The tariff quota is not a measure for enhancing market openness, but is instead, a measure of market protection because imports are limited by a quota and higher import tariffs apply to amounts in excess of the quota.

Milk and dairy products

The analysis of domestic and international prices for basic dairy products revealed that the prices of domestic products are more competitive than similar imported goods. Raw milk is also cheaper in Ukraine than in most European countries.

For example, if the import tariff is 12%, butter from Poland will be 40% more expensive than a similar domestic product (Table 2).

[6] White sugar

Table 2. Calculations of price differences for butter produced in Poland and Ukraine (code TH 0405101900)

#	Indicators	Per 1 ton
1	Price at the Polish border (FOB), USD/t [7]	3310
2	Delivery to the Ukrainian border, USD/t	125
3	Price at the Ukrainian border, USD/t	3435
4	Import tariff calculated as ad valorem rate, %	53%
5	Possible import tariff after WTO accession, %	12%
6	After-tax value of import, USD/t	3847
7	After-tax value of import, UAH/t (1 USD = 5,05 UAH)	19427
8	Price of imported commodities with VAT included, UAH/t	23312
9	Delivery to wholesalers or retailers, UAH/t	541
10	Retail margin (5%), UAH/t	1255
11	Retail value of import, UAH/t	25108
12	Retail price of domestic commodities, UAH/t	17500
13	Price difference, UAH/t	+7608

One of the expected results of the import tariff reduction after entering the WTO is a greater selection of imported dairy products entering the market. Initially, the number of imported commodities may increase due to consumers' demands to try new products, but eventually lower prices and higher quality will determine consumer interest. The challenge to Ukraine's dairy product competitiveness has more to do with quality control and consumer safety issues, rather than price.

In 2004–2005 the volume of Ukraine's dairy product exports (cheeses, yogurts, and dry and condensed milk, in particular) greatly increased, almost doubling in 2004 compared to 2003; this resulted from increased demand on behalf of traditional importers, primarily, Russia. At the beginning of 2006, however, Russia introduced an import ban on animal products from Ukraine, which was further compounded by permit restrictions for particular enterprises. As a result, the share of Ukrainian cheese products imported to Russia fell to 19% (compared to 50% in 2005); butter fell to 7% (compared to 27% in 2005); and dry milk fell to 10% (compared to 29% in 2005). Furthermore, European markets are presently closed to Ukrainian dairy imports due to problems of poor quality raw milk, 75% of which is produced in private part-time farms. These markets are closed to Ukrainian producers in spite of the fact that milk is in compliance with the EC Decision 2007/115/EC and on the list of animal products permitted for importing to EU countries from Ukraine. In the future, increases of milk and dairy product exports can be expected as Ukraine improves product quality and meets the sanitation requirements of importing countries.

[7] Calculations are based on data from the Polish State Statistics Committee as to the value and amounts of butter exported from Poland to Germany

Beef

Domestically produced beef, which accounts for 40% of the total meat in Ukraine, is competitive compared to imported beef. The sales price of beef sold by agricultural enterprises remained low in most of the years analyzed, often even lower than abroad; therefore, the potential bound tariff rate in Ukraine after WTO accession will be sufficient to guarantee the competitiveness of the domestic product price compared to imports. Beef is the leading meat export from Ukraine (80%).

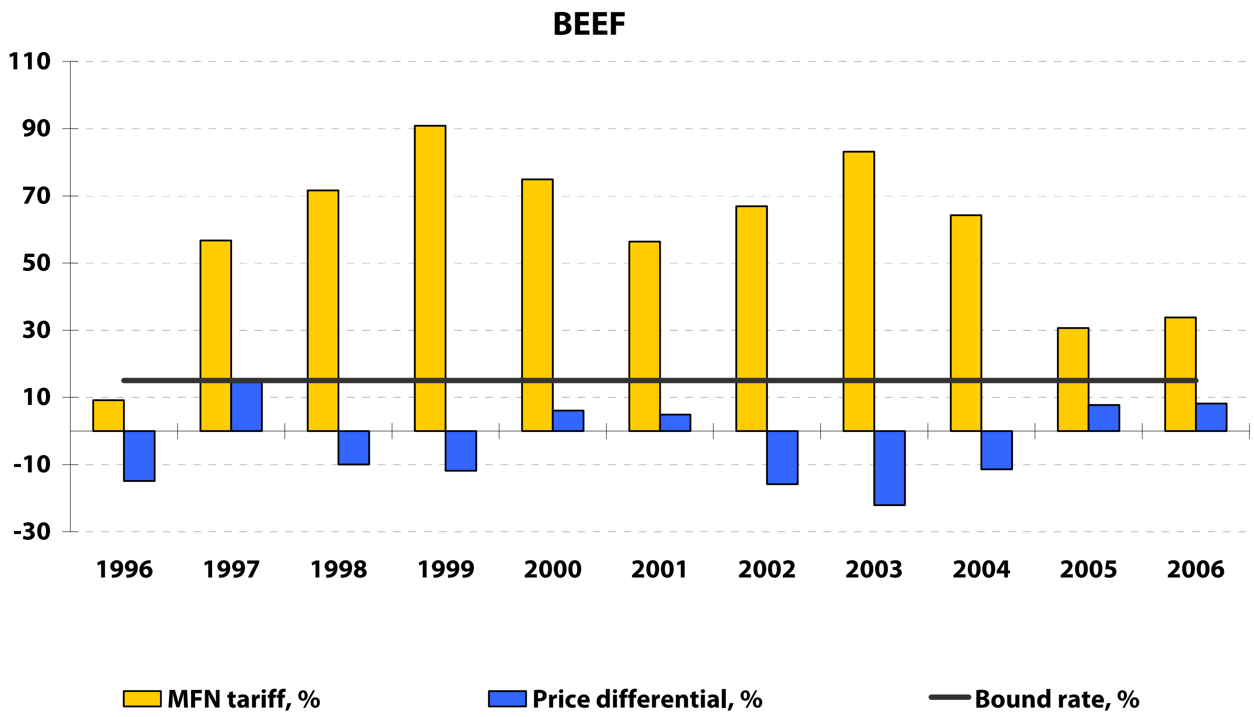


Figure 6. Beef. Comparison of prices and tariffs, 1996–2006

Pork

The domestic pork market is the most unstable compared to other meat products (Fig. 7). The domestic price of pork in some years was higher than international prices (prices at the border) and in other years, lower than prices abroad.

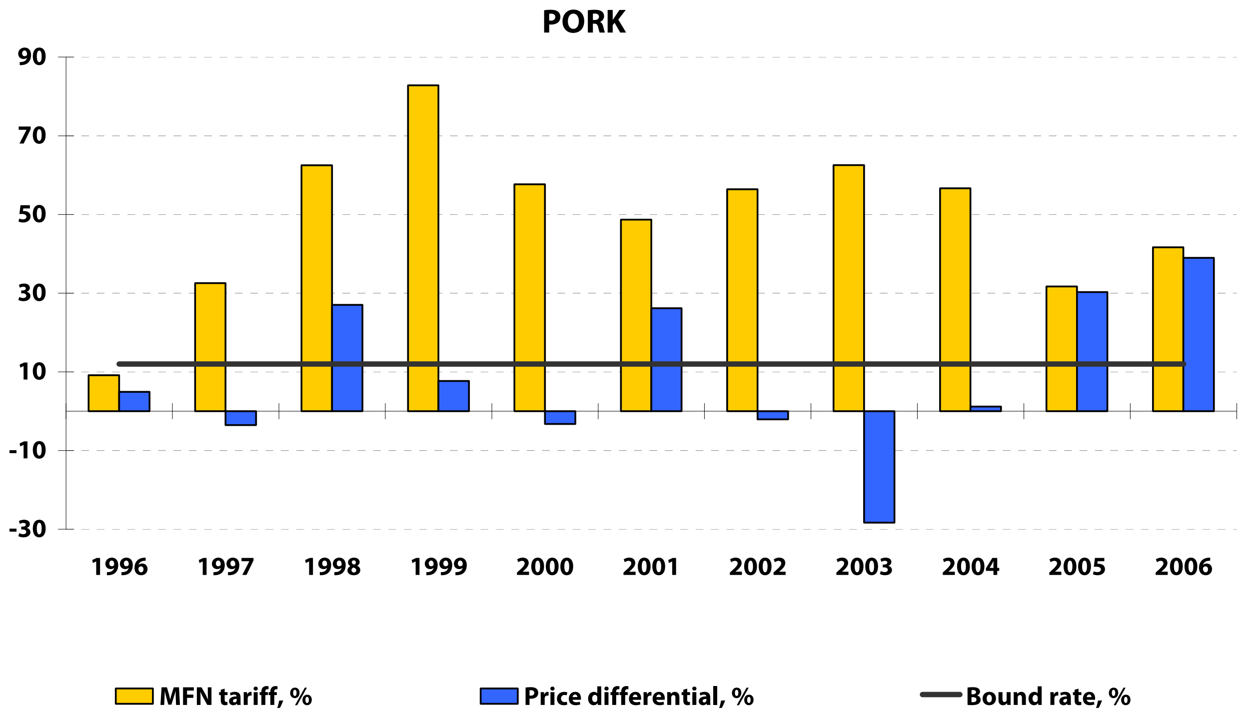


Figure 7. Pork. Comparison of prices and tariffs, 1996–2006

The marginal competitiveness of domestically produced pork is do to the fact that most pigs (65%) are raised in private part-time farms, which are characterized by high expenditures on fodder and labor and poor animal productivity as compared to large specialized pig-farming complexes.

However, the import tariff reduction will have no substantial effect on the level of producers' income or prices due to the market segmentation of imported and domestically produced pork in Ukraine. For example, imported refrigerated pork may be used for processing, while pork produced in private part-time farms will be sold as fresh meat and for home-made products at rural and urban market places and will be largely consumed by the producers themselves.

Poultry Products

In 2004, the import tariff calculated as ad valorem duty was 300%, but in reality the import duty was 0% because in previous years meat and poultry were imported via Free Economic Zones or Territories of Priority Development without incurring any taxes at all. In essence, the poultry industry has been working for several years under a more liberalized import system than exists within the WTO. Poultry accounted for 82% of meat imports in 2003-2004 and for 40% in 2005-2006.

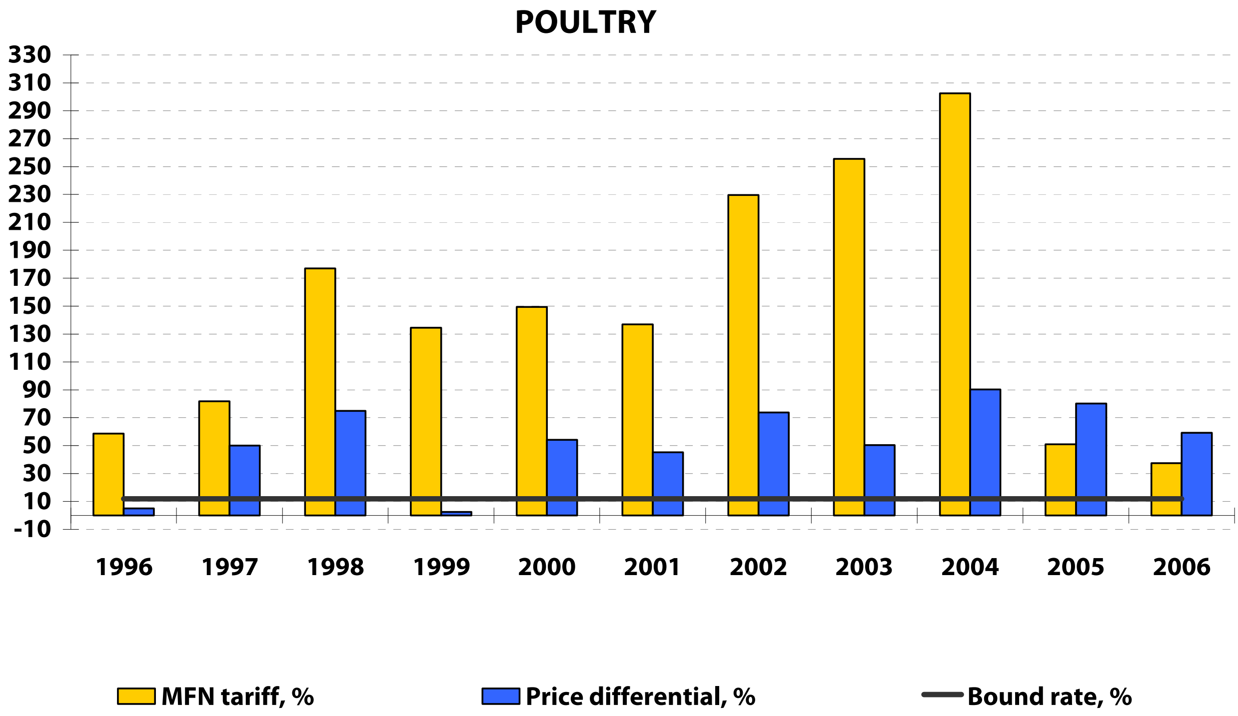


Figure 8. Poultry. Comparison of prices and tariffs, 1996–2006

Analysis of price differences and tariffs reveal that domestic prices of poultry, particularly in recent years, were higher than international prices (Fig. 8). Therefore, a tariff reduction will have a positive impact on the consumption of poultry given the reduced price of poultry for consumers. Poultry is the primary food of the Ukrainian diet.

With regard to poultry producers' incomes, the government can initiate a budget program that lowers the price of mixed fodders for poultry farming. This approach is in line with the WTO Agreement on Agriculture, and Ukraine's commitments on the amount of subsidies in "yellow box" programs. In addition, the poultry industry can maintain income levels by increasing production of other poultry products such as eggs.

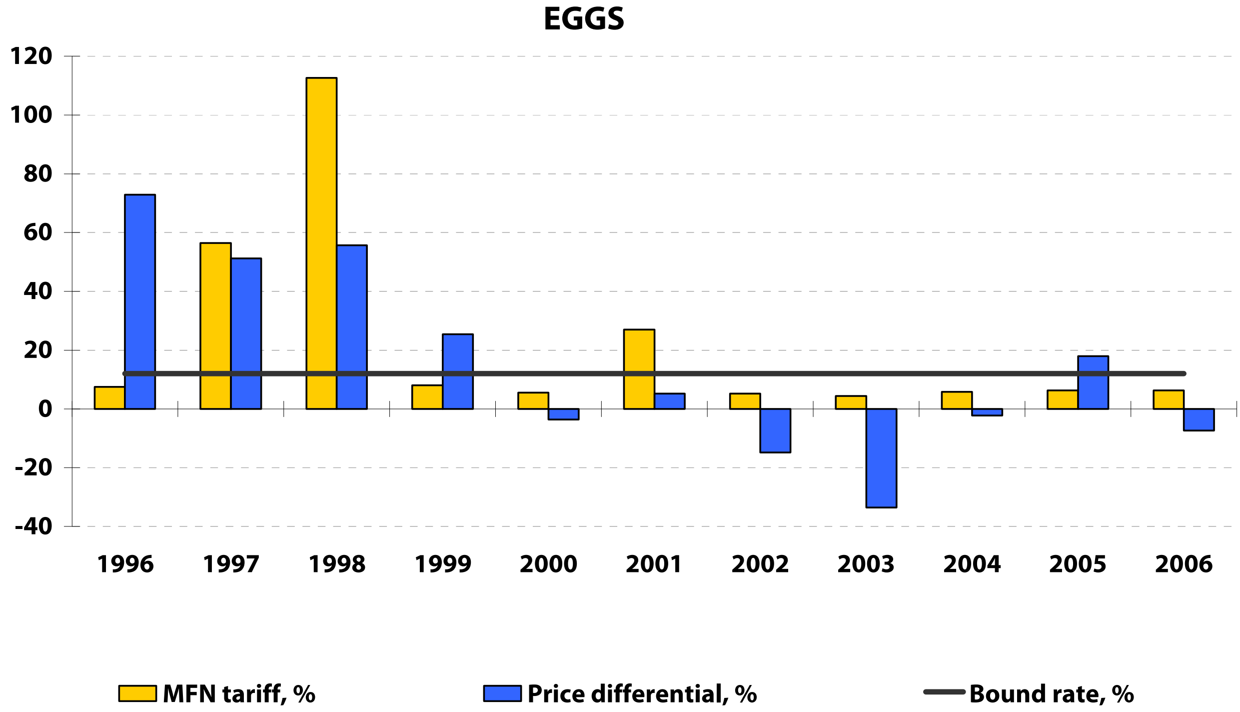


Figure 9. Eggs. Comparison of prices and tariffs, 1996–2006

The analysis revealed that the price difference for eggs is negative, which suggests the high competitive potential of the domestic product (Fig. 9). Besides, the bound tariff rate under WTO membership will be higher than the current tariff as an ad valorem rate.

2.4. Conclusions for the agricultural products

After analyzing the differences between domestic and international prices and the current and bound tariff rates applied after Ukraine's WTO accession, we conclude that higher customs tariffs will not affect the prices for domestic agricultural producers, which will remain low, sometimes even lower than international prices. This reflects the fact that, in most cases, Ukraine is a net-exporter of primary agricultural and food products.

Moreover, with the exception of poultry and pork, the differences between foreign and domestic prices, measured as a percentage, is much lower than the bound tariff rates that will come into effect with WTO membership, making the influence of reduced tariffs on domestic prices insubstantial. The low level of bound tariff rates after WTO accession will not result in additional pressure on producers, and the level of domestic market protection will be sufficient because Ukraine's primary agricultural products will, due to their prices, be more competitive compared to the imported commodities.

These conclusions are confirmed by long-term forecasts of global prices which appear quite favorable for Ukrainian commodities. Nominal price increases are expected for most of the commodities with currently competitive prices. According to forecasts by the Organisation for Economic Co-operation and Development (OECD) and the Food and Agriculture Organization of the United Nations (FAO), by 2014, global prices will increase 3% for wheat, 10% for grain fodder, 15% for sunflower seeds, 18% for vegetable oil, and up to 30% for beef and pork (in Argentina and Brazil)[8].

As a result of export subsidies by developed countries, global prices for most agricultural products are undercut. Agreements among WTO member countries at the Hong Kong Ministerial Conference (December 2005) for the total abandonment of export subsidies by 2013, shall foster increases in global prices and extend the potential for competitive advantages for Ukraine's agricultural exports.

WTO membership will open additional market opportunities for Ukraine, which is of particular importance for a country that is an agricultural exporter. Member countries only use tariff quotas for WTO members, therefore Ukraine, as a non-WTO member, has no or very limited access to other countries' markets.

The internal resources needed to increase agricultural competitiveness are as follows:

— Grain and sunflower seed producers need to reduce their marketing expenditures and solve the problem of value added tax (VAT) compensation for exporters.

— The sugar industry needs an immediate reform program and conversion of non-promising factories.

— The dairy sector needs to be ready for liberalization and stronger competition; it is urgent to drastically increase the technical and economic efficiency of the processing industry and restructure the sector as a more concentrated industry. The dairy sector also needs to adapt to the requirements of EU legislation with regards to hygiene and quality control.

— The Meat sector (pork and poultry production, in particular) needs to invest in new technologies to increase labor efficiency and animal productivity, as well as implement higher veterinary and sanitation requirements at each stage of the production and sales chain.

Price support for commodities for which Ukraine is a net-exporter should be low. Otherwise, the system of minimum prices and intervention purchases will lead to a situation where domestic prices will exceed international prices, undermining Ukraine's competitiveness in foreign markets. Price support for products where prices are already higher than those for similar imported commodities should be eliminated. State support is possible by making the input resources cheaper and paying direct subsidies per ton of production or per animal. At the same time, the removal of price support policies means that there will be no need to implement export subsidies for agricultural products in the future.

Nevertheless, Ukraine has extensive opportunities for supporting the agricultural sector after joining the WTO, as the level of sector support via "yellow box" programs, according to WTO norms, is much higher than the current support of Ukrainian agriculture. Budget financing of "green box" programs may be increased by Ukraine, as it is not limited by the WTO.

As a result of Ukraine's WTO accession, there shall be transformational changes in state supported agricultural policies, as well as the creation of market regulations aimed at increasing the competitiveness of domestic agricultural products in both internal and external markets.

The sampling of agricultural products analyzed in this report (representing 70% of Ukraine's gross agricultural products) leads to the conclusion that membership in the WTO will not have a negative effect on Ukraine's agricultural and food industries, on the whole. Liberalizing the import regime will become an incentive to further increase agricultural production efficiencies and domestic product competitiveness.

At the same time, reduced tariffs will have a positive impact on Ukrainian consumers. They will pay less for a wider range of products.

[8] OECD-FAO Agricultural Outlook: 2005-2014

3. INDUSTRIAL PRODUCTS

3.1. Introduction

After Ukraine joins the WTO, it must reduce import duties for a number of industrial products to levels prescribed by the bilateral agreements among Working Party member countries.

The impact of this requirement will differ among industries as some industries can be primarily characterized as export-oriented, while others are almost fully engaged in satisfying the demand of the domestic market.

Additionally, products manufactured by certain industries, consumer goods in particular, have large price elasticity and these industries are capable of quickly and effectively reacting to changes in market access – the import duty rate being one of the most important factors. At the same time, industrial market products will be less influenced by custom tariff changes as their prices are largely formed on the basis of other factors.

There are a number of sector agreements and initiatives under the WTO which regulate commodity trade in certain industrial sectors. One such example is identifying a single maximum import tariff for all member countries of a particular sector agreement. Negotiating its way to the WTO membership, Ukraine promised to join the following Industrial Sector Agreements by 2010: "Chemical Harmonization", "Steel", "Toys", "Wood", "Textile and Clothing", "Non-ferrous Metals", "Pharmaceutical Drugs", "Paper", "Agricultural Equipment", "Furniture", "Information Technologies", "Scientific Equipment", "Construction Machinery", "Medical Equipment", and "Civil Aviation".

The agreements and initiatives mentioned above introduce an import rate of 0% in the end of the transition period with the exception of the "Chemical Harmonization" sector where rates are 5.5% and 6.5% and the "Textile and Clothing" sector where the maximum rate for some types of products is as high as 17.5%.

After Ukraine becomes a WTO member, the average import duty tariff for industrial commodities will be 4.85%; the current average is 8,32 %.

WTO membership will substantially reduce Ukraine's ability to provide government support to industries and set limits (tariff and non-tariff) on certain types of exports. In fact, Ukraine will no longer be able to provide export support to industrial enterprises, whatsoever.

However, considering the existing low level of governmental support for industrial sectors in Ukraine and the lack of direct export support currently, this limitation will not affect the industry sector, substantially, after Ukraine is admitted into the WTO.

At the same time, it should be understood that Ukraine, as a WTO member, would have wide opportunities to support industrial enterprises in sectors not prohibited by WTO norms or regulations — provided criteria for the initiation of such programs are met.

Therefore, the primary concern of the industrial community is as follows: what are the possible consequences of import regime liberalization, resulting from import duty rate reductions, for local industrial producers?

Research was conducted on the industries listed in Table 3; these industries were selected based on the total number of workers employed, their share of total industrial product sales, and their share of total exports.

Table 3: Weight of industrial sectors in the economy[9]

[9]Based on the data of State Statistics Committee of Ukraine for 2005-2006.

Industry	Share in the total industrial product sales, %	Share in exports, %	Number of workers employed, thousand persons
Mining	8,7 %	6,7 %	518
Chemical industry	6,7 %	8,8 %	182
Metallurgy and metal processing	24,4 %	42,8 %	425
Light industry	1 %	2,4 %	147
Machine-building	12,9 %	14,1 %	773
Total	53,7%	75%	2045

The research in this report analyzed the impact of import tariff reductions on price competitiveness for 8 industrial commodities: iron ore, coke, ammonia, urea (carbamide), outer woolen garments, cast iron, flat section (flat rolled metal), and rolling stock (tank cars).

3.2. Methodology and data used

In this report, we analyze the impacts of tariffs on price competitiveness of industrial products between the period of 2001-2006. This timeframe makes the analysis more objective given the substantial drop in industrial production between 1993-1999.

The following three parameters are compared:

1. The current import tariffs (in percentages) on imports from countries to which Ukraine granted most favored nation (MFN) status in each of the years analyzed (2001-2006);
2. The differences (in percentages) of domestic and international prices in each of the years analyzed (2001–2006); and
3. The expected bound tariff rates (in percentages), which is the maximum protection limit for each commodity after Ukraine joins the WTO.

For comparison purposes, the rates of specific import tariffs were converted into their ad valorem equivalents, and for calculations of price competitiveness data from the State Statistics Committee and the State Customs Service of Ukraine.

In certain industries, metallurgy in particular, neither prices at the Ukrainian border nor prices used by producers can be regarded as representative for the purpose of comparison due to the existence of trading companies related to producers that sell products directly to end-consumers.

The price difference is the percentage correlation between the difference of the external price (price at the Ukrainian border) and the producer's sales price, and the relevant external price (price at the border).

If the price difference is negative, reflected on the following charts as a mark below the zero level, it means that a domestic product is more competitively priced than a similar imported product.

If the price difference is positive, reflected on the charts as a mark above the zero level, it means that the imported commodity is cheaper than a similar domestic commodity.

If the positive value of the price difference exceeds the bound tariff rate, it means that even after the import duty is paid, the imported product still has a more competitive price than a similar domestic product; and when the positive value of the price difference is below the bound tariff rate, domestic commodities are more competitive compared to imported commodities after the import duty is paid.

3.3. Results for specific products

Iron ore

Between 2001-2006, the import tariff for concentrated iron ore was 2%, which will remain the same after Ukraine becomes a WTO member.

Analysis of the differences between domestic and international prices reveals substantial oscillations, ranging from -12,2% in 2006 to 20,2% in 2003 (Fig.10).

Changes in import volumes between 2001–2006 reflect price changes in these commodity markets. For example, in 2003 the amount of concentrated iron ore imported into Ukraine grew by 51% compared to 2002, and decreased by 2,6 times in 2004 compared to 2003; in 2006 import volumes decreased by 23% compared to the previous year.

In addition, the primary imports of iron ore come to Ukraine from Russia under the free trade agreement, meaning that even the current duty of 2% for this commodity is not charged.

It is also worth mentioning that irrespective of the large amounts of iron ore imports into Ukraine, the average exports of this commodity between 2001-2006 were almost 6 times larger than imports, and in 2006 — 10 times larger. In the future, iron ore imports may increase due to internal haggling between ore producers and metallurgical enterprises (the potential importers of concentrated iron ore) that lack their own mining-and-processing plants.

As a result, iron ore is a commodity which is very sensitive to price differences in both domestic and foreign markets.

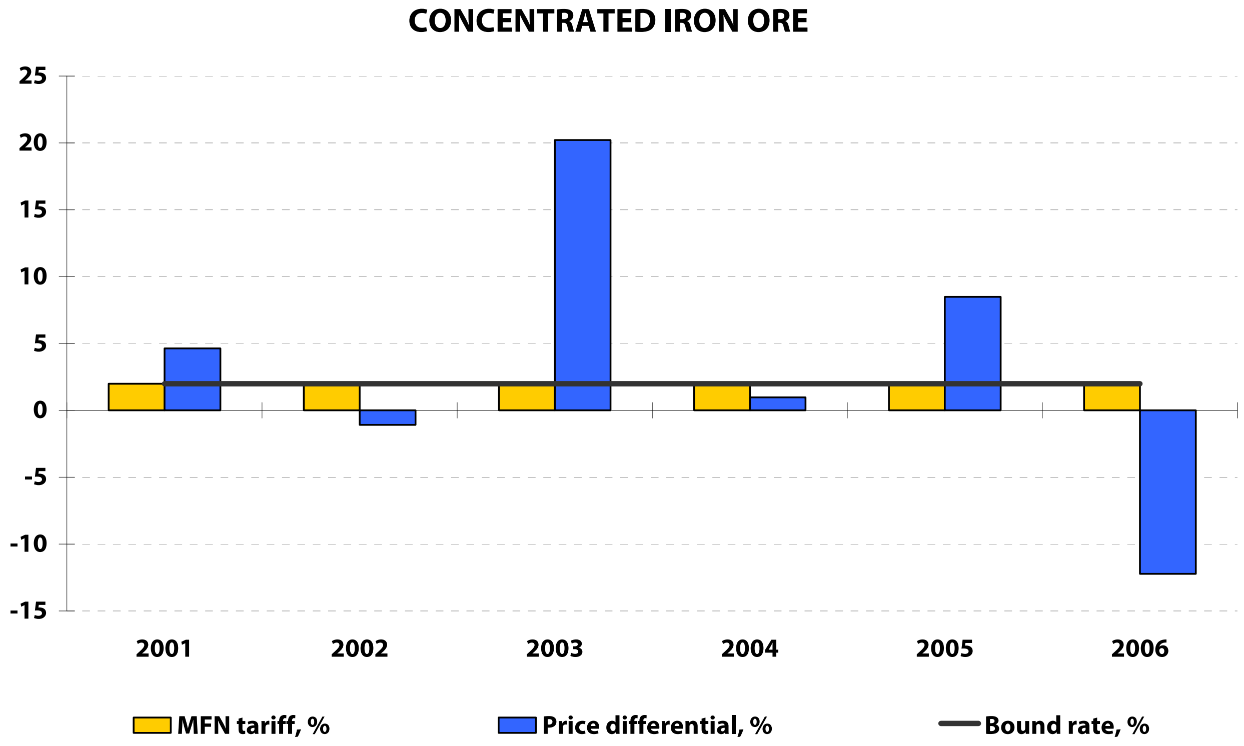


Figure 10. Concentrated iron ore. Comparison of prices and tariffs, 2001–2006

However, WTO membership will have no serious impact on trade in this commodity since the bound tariff rate that Ukraine will be bound to use as a WTO member is equal to the current import duty rate for this commodity.

Coke

The import duty rate for coke will not change after Ukraine becomes a member of the WTO. Between 2001-2006, the coke import tariff rate was 0%, and this same rate is expected after WTO accession by Ukraine.

Analysis of the domestic and foreign prices of coke shows that the price of the domestically produced commodity is more competitive than that of the imported one. For instance, between 2001–2006 the difference between domestic and the foreign prices increased from +1,9 % in 2001, to -15,5 % in 2004, and -11,3% in 2006 (Fig.11).

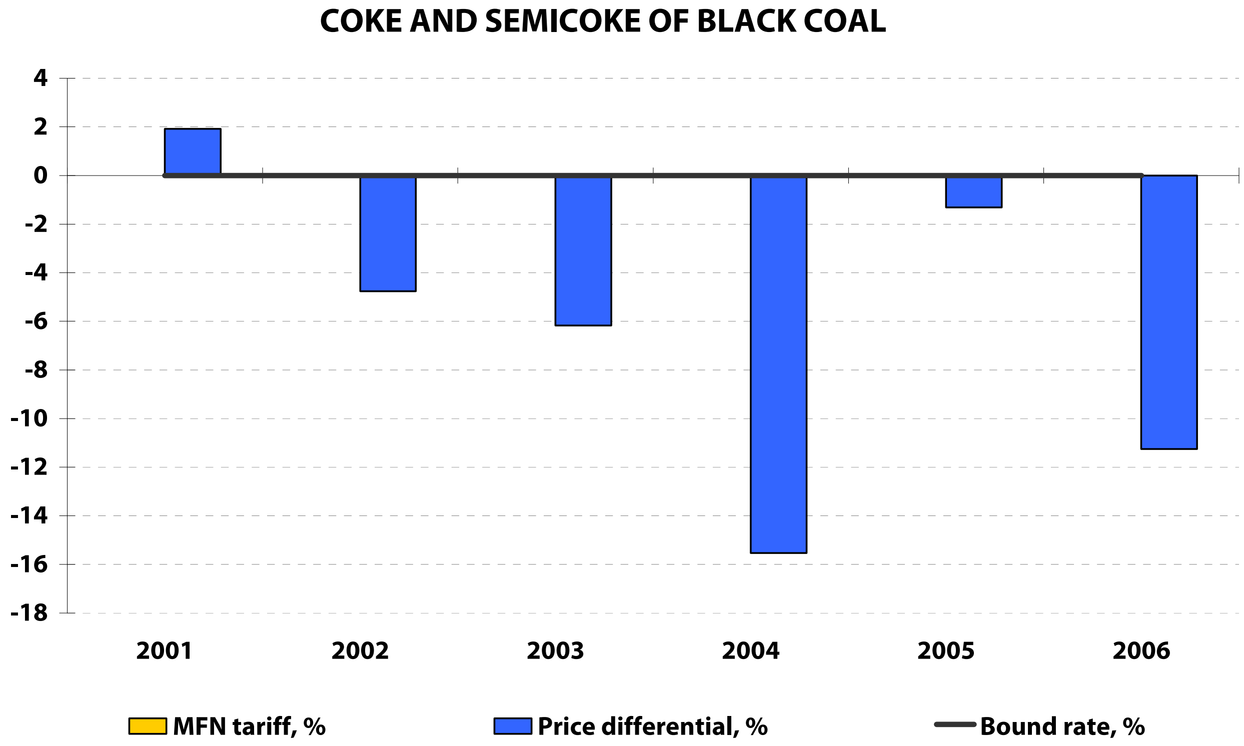


Figure 11. Coke and semicoke of black coal. Comparison of prices and tariffs, 2001–2006

Competitive advantages of Ukrainian coke as well as a favorable global market environment were used to the full extent by domestic producers who increased exports in 2004 by almost three times compared to 2002.

However, in 2005–2006 there was a downswing in export volumes – only 63% compared to the previous year. The particularity of the situation in 2006 reveals that within the seven previous years coke imports exceeded coke exports. Producers faced two crucial issues: a decrease in external and internal demand due to high production costs and a coking coal shortage.

The forecasted increase in coke consumption, which may lead to a shortage of coke and coking coal in Ukraine, is among the factors that can have an impact on the domestic market in the long-term. This shortage may result from the growth in cast iron production, and demand will mostly be met by imports from Russian. However, there are barriers preventing a substantial increase of coke and coking coal imports from Russian into Ukraine. As a result of the growing production of cast iron by Russian metallurgy enterprises, there is increasing consumption of this commodity in Russia as well.

WTO membership will have no direct impact on the coke trade nor will it change the competitiveness of the domestic commodity; however, it does highlight long-standing industry issues that are not related to WTO membership.

Cast iron

After Ukraine becomes a WTO member, the cast iron import duty rate will not change. During 2001–2006 the import duty rate for cast iron was 5%.

A comparison of domestic and international prices reveals insubstantial oscillations in price differences. In 2001-2002, the price difference for cast iron was positive, meaning that Ukrainian cast iron was less competitive when compared to cast iron produced in other countries. From 2003–2006, however, the price difference became negative, meaning domestically produced cast iron was more competitive when compared to products manufactured in other countries (Fig.12).

It should be emphasized, however, that even in 2001-2002, when the difference between domestic and international prices was positive, the existing import duty rate exceeded the difference, suggesting it could have an effective economic influence on the regulation of cast iron exports from countries with MFN status.

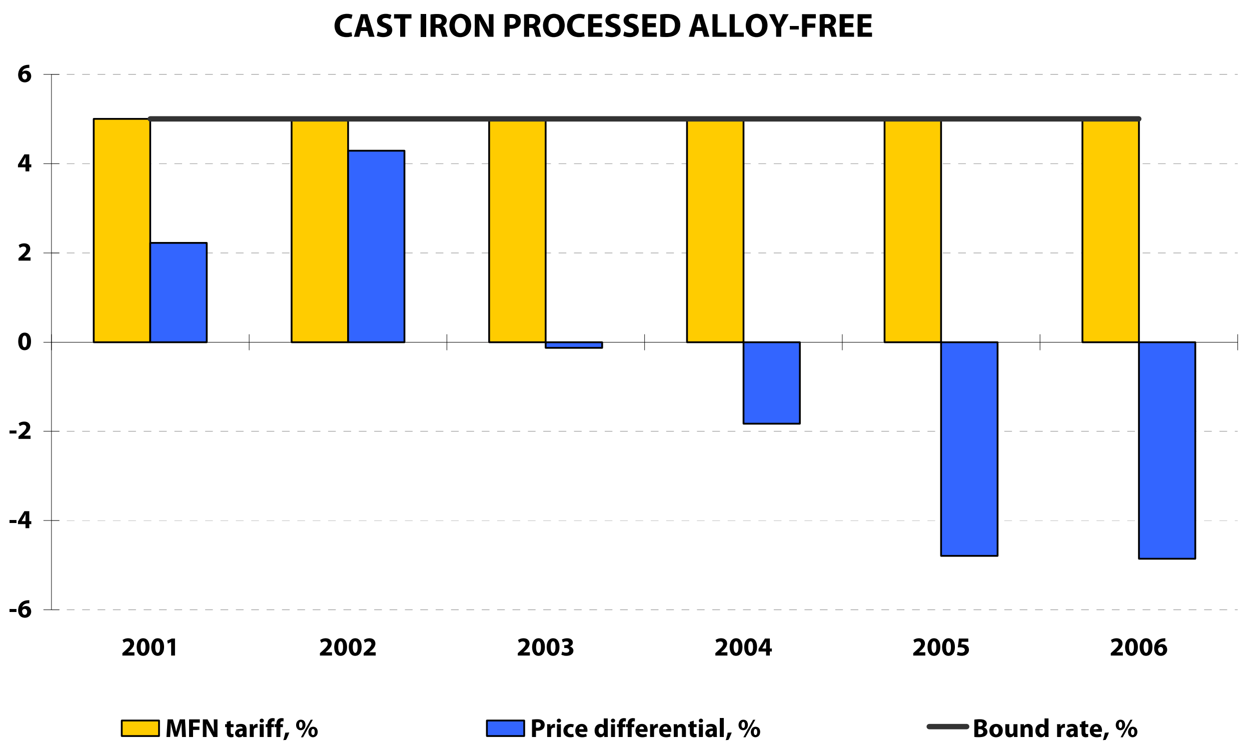


Figure 12. Cast iron processed alloy-free. Comparison of prices and tariffs, 2001–2006

WTO membership will produce no noticeable changes in the conditions of the cast iron trade that could substantially affect the trade itself or the production of this commodity. An analysis of the changes in the difference between foreign and domestic prices and bound tariff rates leads us to conclude that a bound tariff rate for cast iron of 5% is sufficient to correct potential price imbalances.

Generally, medium-term market forecasts indicate a steady growth of cast iron consumption in the world, creating increases in both production and prices, both of which are favorable conditions for competitive domestic cast iron.

Clothing

Since 2000, Ukrainian import tariffs on apparel have been determined by an agreement between Ukraine and the EU on trade in textile products. In compliance with this agreement, all non-tariff limits on textile imports from Ukraine to the EU were fully liberalized, and Ukraine reduced import tariffs in accordance to the timetable in the agreement.

The timetable for import duty rate transformation, prescribed by the agreement, was completely based on the sector initiative "Textile and Clothing". This means that in 2004, when Ukraine completed tariff transformations, the tariffs were in line with Ukraine's obligations for obtaining WTO membership.

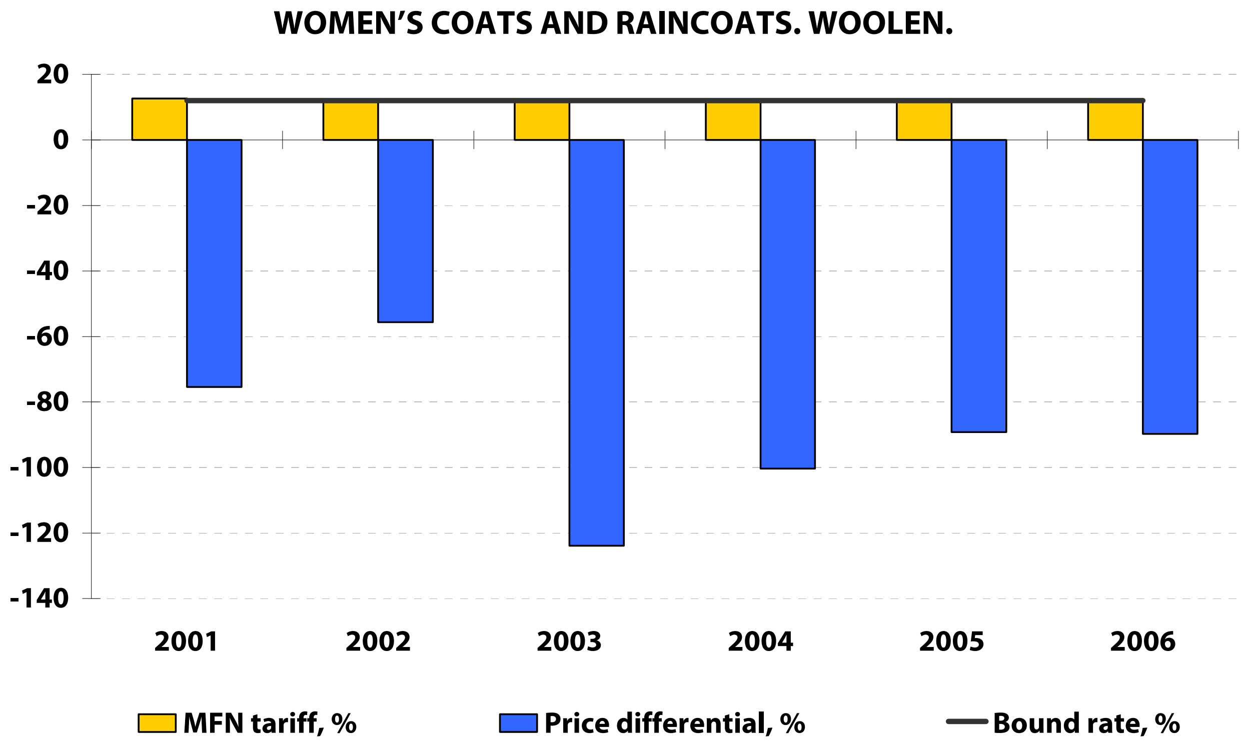


Figure 13. Women's coats and raincoats. Woolen. Comparison of prices and tariffs, 2001–2006

Analysis of the price differences during the period of 2001–2006 between the domestic and foreign markets for women's woolen coats and raincoats (this commodity has the largest share in Ukraine's foreign trade in textiles), proved that domestic goods were much more competitive. The price differences during the period reviewed were negative (Fig.13). This means that membership in the WTO will neither have a significant negative impact on Ukrainian textile producers nor will it result in large price oscillations in this commodity market. On the contrary, WTO membership shall: provide clothing manufacturers with new opportunities to access external markets where quality and low-cost Ukrainian light industry products are demanded, make foreign import commodities more transparent, and increase foreign investments in production, which will allow for upgrading production technologies and equipment.

In fact, since 2004, the import tariff rate set by Ukraine in the textile sector is in compliance with Ukraine's obligations to achieve WTO membership.

This review does not analyze potential share of imports and exports of textile products through non-commercial channels (carried through borders by individuals and reported as products for private use), which do not involve customs procedures (declaration of quantity and value) used for commercial transactions.

Rolling stock

Machine building is one of Ukraine's leading industries; its sales accounted for almost 13% of total industrial product sales in 2006. It should be noted that industrial machine building is one of the fields that will be minimally affected by the tariff mechanisms of foreign trade. This is due to the fact that very specific mechanisms (in particular, tender procedures, comparatively complicated procedures of national certification, etc.) prevail in this market, as well as professional well-defined consumers' requirements with respect to the products not directly related to price factors.

In order to evaluate the impact of WTO membership in the Ukrainian machine building sector, we chose rolling stock as a representative of this sector. This commodity, in addition to being used in the domestic market, accounts for a large share of Ukrainian foreign sales.

After Ukraine becomes a WTO member, the import duty rate for rolling stock (tank cars), agreed to at bilateral negotiations with Working Party member countries, will be 10%; this greatly exceeds the current import duty level of 0 %.

Review of domestic and international prices reveals that between 2001–2006 the price differences remained negative, meaning that domestic prices for this product were more competitive when compared to international prices. In general, the negative price differences were rather stable, in the range of -52% and -85% (Fig.14).

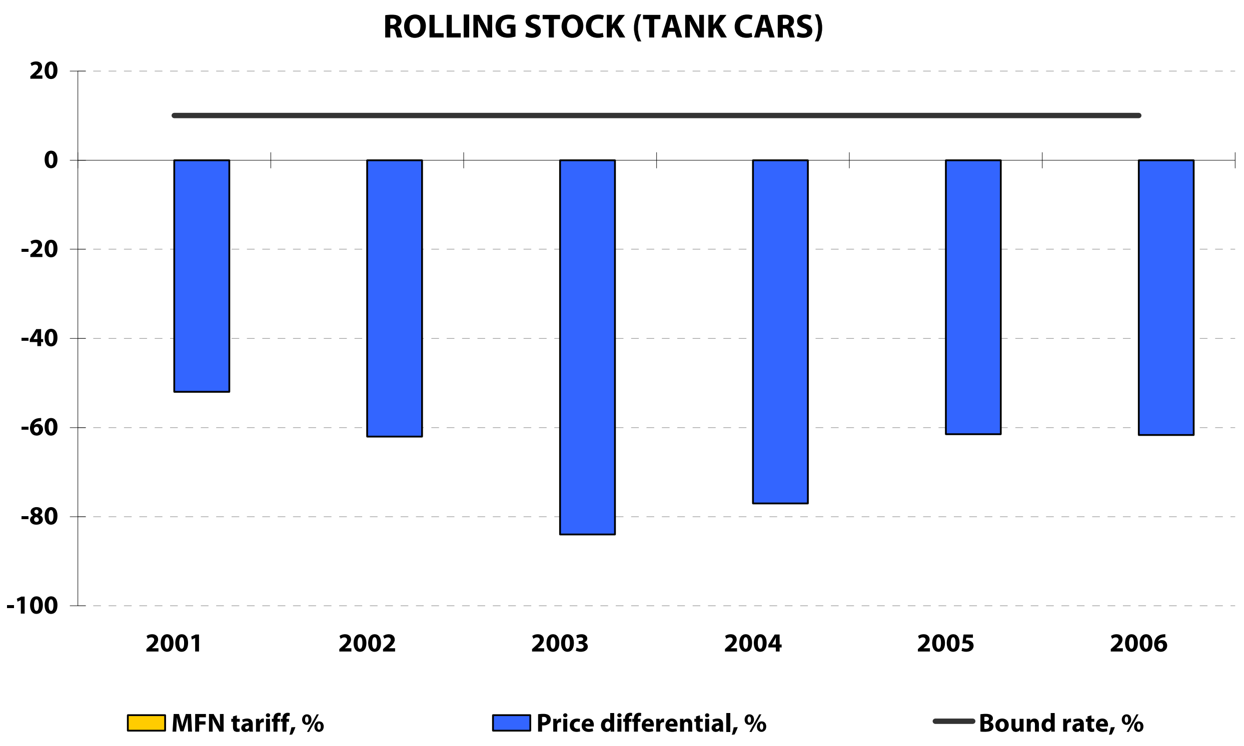


Figure 14. Rolling stock (tank cars). Comparison of prices and tariffs, 2001–2006

In 2006, rolling stock exports increased by 3 times when compared to 2001.

The relevant customs duty of 10% largely exceeds the current tariff rate of 0%, and the differences between domestic and global prices remain negative illustrating that the price competitiveness of domestic producers is much higher than that of foreign producers. This suggests that tariff changes stemming from WTO membership will have no substantial impact on the production or sales of this product.

Ammonia

Anhydrous ammonia accounts for a large share of Ukrainian chemical production and is one of the primary export commodities. Ammonia exports represented 13% of total chemical product exports in 2006. Exports of ammonia from Ukraine between 2001–2006 were rather stable; their average fluctuations did not exceed 10%. The absolute values of imports are dozens of times smaller than export amounts, meaning that Ukraine is basically a net-exporter of this commodity.

Ukraine's main competitive advantages in the production of ammonia between 2001–2004 were: the relatively low-cost of natural gas, which is the fuel as well as the raw material for ammonia, and low transport costs due to the proximity to Black Sea ports. However, in 2005, and especially in 2006, ammonia producers faced considerable increases in natural gas prices, diluting chemical plant earnings. Increases in natural gas prices shall continue. To retain competitiveness, producers need to upgrade equipment, apply gas-saving technologies, and optimize gas supply to plants.

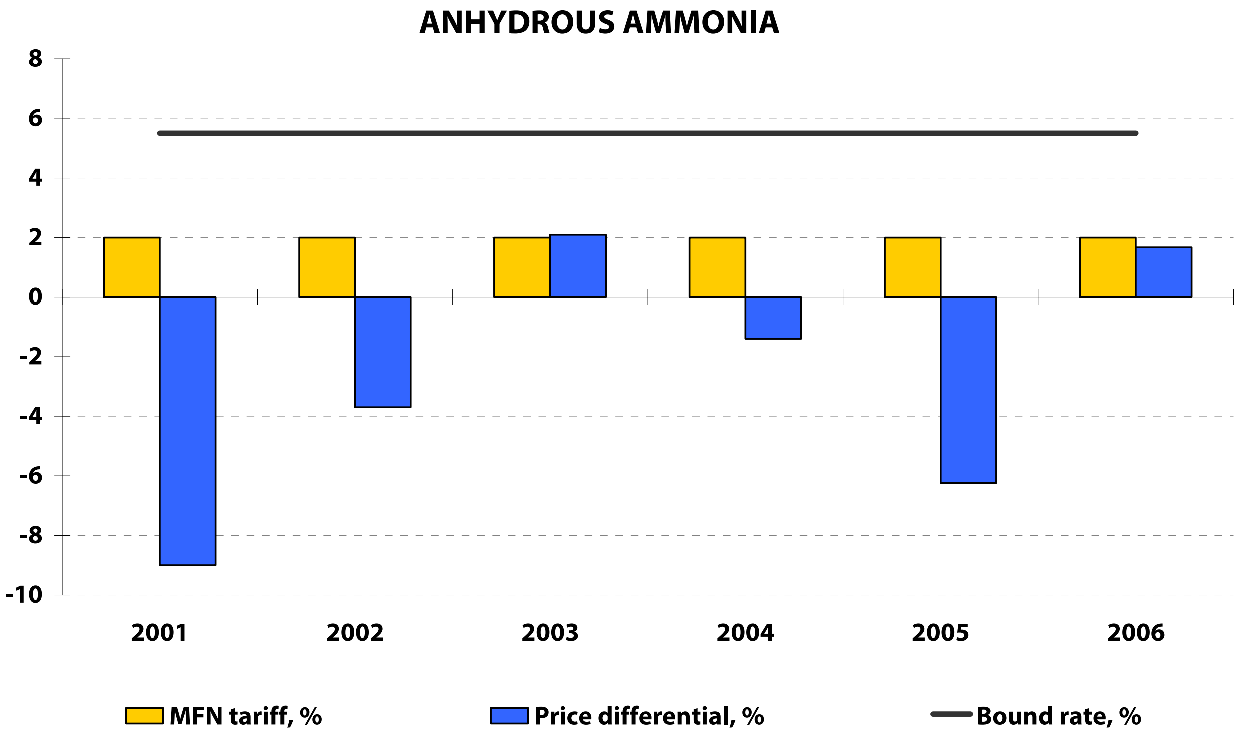


Figure 15. Anhydrous ammonia. Comparison of prices and tariffs, 2001–2006

Trade in anhydrous ammonia is regulated by general norms and agreements within the WTO and the sector initiative, "Chemical Harmonization", that Ukraine promised to join.

There are two import tariffs set by the sector initiative, “Chemical Harmonization”: 5.5% and 6.5%. The customs duty rate in the sector initiative for anhydrous ammonia is 5.5%.

The expected bound tariff rate to be introduced after Ukraine becomes a WTO member is 2.75 times higher than the current tariff rate. Therefore, this tariff rate protects against unfavorable trends emerging in this commodity market due to significant price fluctuations and will not impact Ukrainian producers in this sector after Ukraine joins the WTO. Analysis of the price dynamics for anhydrous ammonia between 2001-2006 reveals that the differences between domestic and international prices were generally negative (Fig. 15).

Fertilizers. Carbamide (urea)

Exports of urea from Ukraine increased during the period of 2001–2006, and imports did not have a serious impact on the domestic market. Ukraine imports less than it exports; therefore, Ukraine is basically a net-exporter of this commodity.

Trade in carbamide (urea) is regulated by general norms and agreements within the WTO and the sector initiative, “Chemical Harmonization”.

There are two tariffs set by the sector initiative: 5.5% and 6.5%. The customs duty rate in the sector initiative for urea is 6.5%.

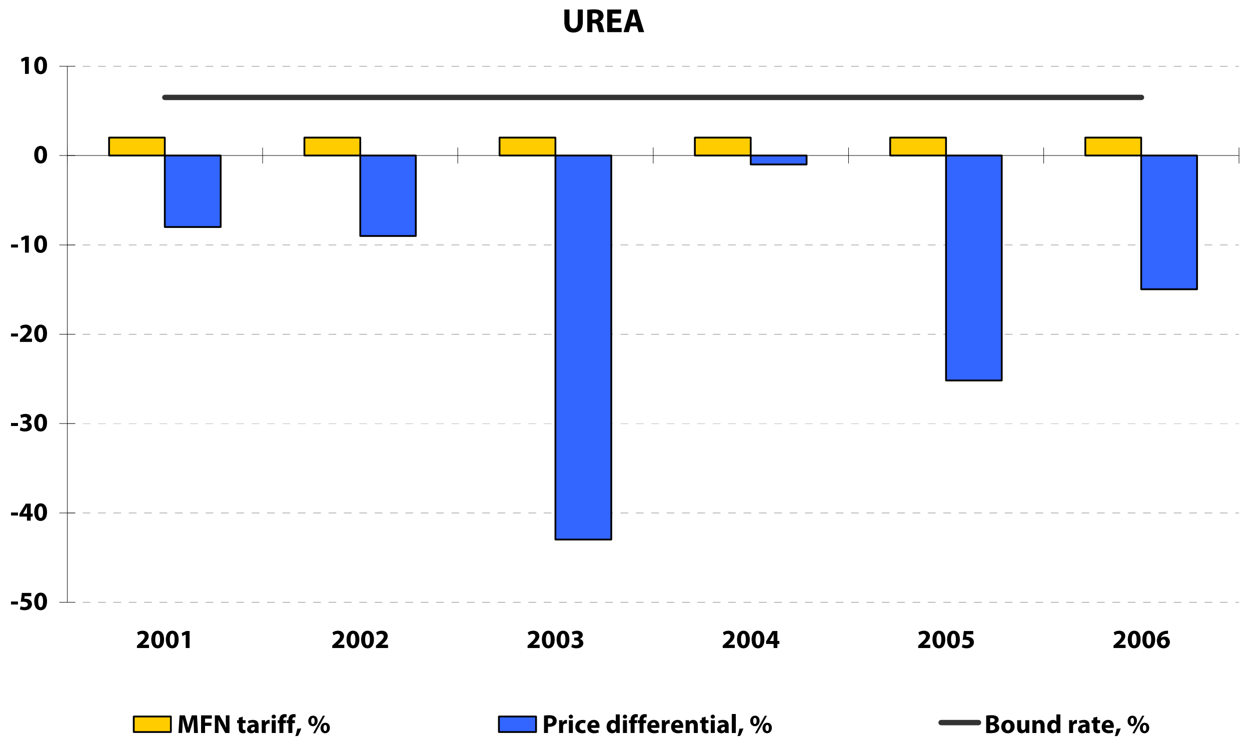


Figure 16. Urea. Comparison of prices and tariffs, 2001–2006

Analysis of the price dynamics for carbamide (urea) reveals that the differences between domestic and international prices during the period of 2001-2006 were negative (Fig.16). This means that domestic products were more competitive when compared to similar imported products.

Taking into account that the WTO tariff rate is 3.25 times higher than the current Ukrainian rate, WTO membership will have no negative influence on Ukrainian producers in this sector.

Flat section (flat rolled metal)

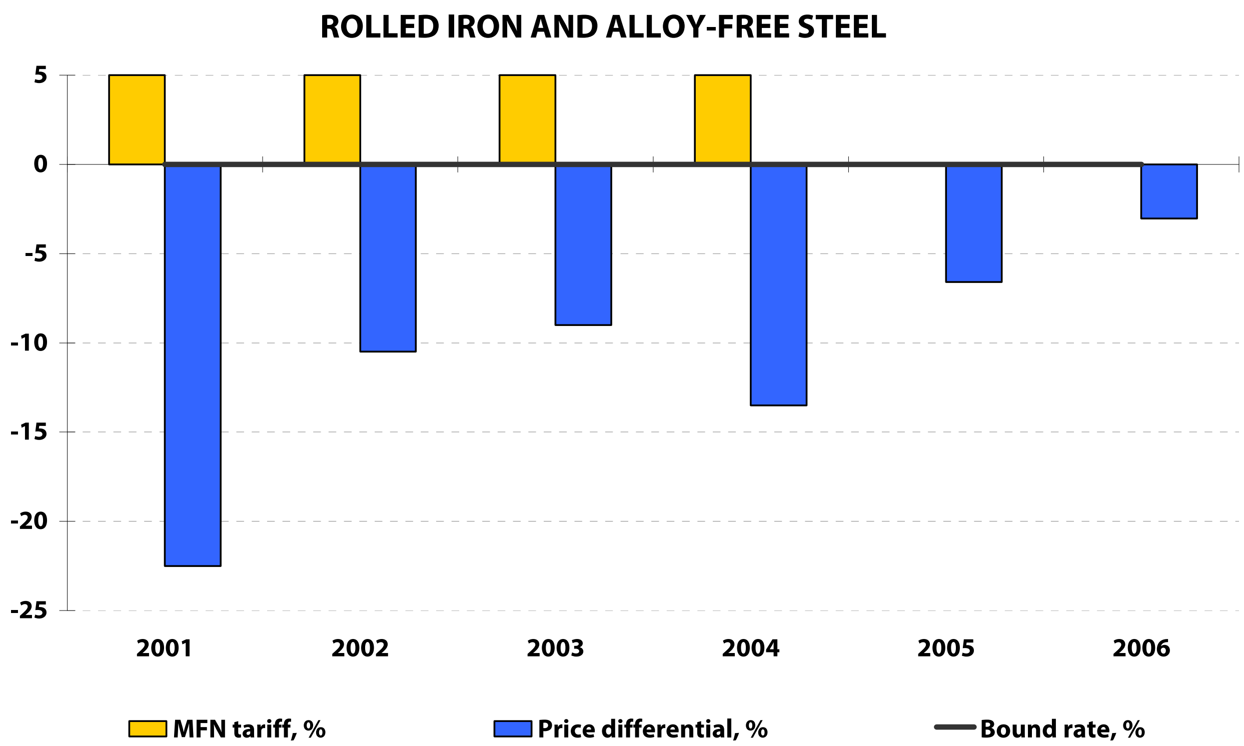
Ukrainian metallurgy is a strongly competitive industry due to Ukraine's raw material resources, qualified and low-cost workers, and proximity to neighboring seaports and Russia. However, there are crucial disadvantages: underdeveloped domestic consumption, creating industry dependence on global market prices, high levels of energy and natural gas consumption, and outdated equipment. In fact, the industry is facing crucial internal issues unrelated to WTO accession. Nevertheless, WTO membership shall facilitate the expansion of sales markets and more effective utilization of protective mechanisms from antidumping investigations as well as commercial disputes.

Rolled iron and alloy-free steel are commodities that account for large shares both in the total output of Ukrainian metallurgy and in Ukraine's exports of metallurgy products.

Ukraine is a net-exporter of rolled iron and alloy-free steel. During the period of 2001–2004 there was a steady growth in exports, but since 2005 there has been a downswing. For instance, in 2006 the decrease in exports of these products constituted approximately 11% (in terms of quantity) when compared to the previous year. Notwithstanding the export downswing, Ukraine is an absolute net-exporter of these products; in 2006, export volumes exceeded import volumes by 38 times.

Trade in this commodity is regulated by the general norms and agreements within the WTO and the sector initiative, "Steel", that Ukraine promised to join.

The import tariffs set by the sector initiative, "Steel", will be 0% at the end of the



transition period. This means that Ukraine will also apply a tariff rate of 0% after joining the WTO.

Figure 17. Rolled iron and alloy-free steel. Comparison of prices and tariffs, 2001–2006

Analysis of the price dynamics for rolled iron and alloy-free steel reveals that during the period of 2001–2006 the differences between domestic and international prices was negative.

The import duty for these products was 5% between 2001-2004. It was reduced to 0% in June 2005. This means that the bound tariff rate of 0% for rolled iron and alloy-free steel imports, which will be used after Ukraine becomes a WTO member, is already the current tariff used in Ukraine. This implies that the WTO membership will have no negative impact on Ukrainian producers of rolled iron and alloy-free steel.

3.4. Conclusions for the industrial products

Comparing domestic and international price differences with current and bound tariffs, we conclude that for most of the industrial products analyzed in this report, the price differences were negative. This means that domestic commodities were more competitive than foreign commodities.

Even during periods when the price differences for some products were positive and exceeded the current duty level, the volume Ukraine exported of these commodities was higher than the volume imported. This proves that Ukraine is a net-exporter of the majority of industrial commodities, in particular, those of the mining, metallurgy, and chemical industries.

The production capacities of Ukrainian companies in mining, metallurgy, and chemical industries are oriented mostly towards international markets, as these markets are much larger than the domestic markets for these commodities. Over recent years, the agricultural industry has reduced fertilizer consumption, while machine-building has reduced consumption of ore. This means that the export pattern of metallurgical and chemical industries low-processing products prevail, requiring further refinement for obtaining products easier to manufacture.

Currently, unlike agricultural and food industries, most current import duty rates for industrial products are consistent with the bound import tariff levels (e.g, iron ore, coke, clothing, and rolled metal) or are even lower than bound export tariff levels to be introduced after WTO accession (e.g., railway tank-cars, ammonia, and urea).

Therefore, for the overwhelming majority of industries and industrial commodities, changes to import duties, after Ukraine becomes a WTO member, will have no negative impact.

In **metallurgy**, positive trends in global demand and prices, stemming largely from huge increases in the demand by China, will have a much larger impact in the medium-term than Ukraine's membership in the WTO.

Additionally, the situation in the **metallurgy** and **chemical** industries will very much depend on the development of similar markets in Russia where the production is, to a certain extent, similar to that of Ukraine but where Russian consumption levels for these commodities are much higher than in Ukraine. Considering the free trade arrangement between Russia and Ukraine (0% export duty), the changes in tariffs related to WTO membership will have no impact on bilateral trade between Ukraine and Russia.

One of the factors making the position of Russian producers much more favorable in energy-intensive sectors is the increase in energy prices for Ukrainian industries, especially for those that use natural gas from Russia.

In this context, the competitiveness of Ukrainian commodities requires introducing energy-saving production technologies, and given a limited timeframe, calls for urgent development and implementation of relevant government policies.

It should be noted that as a member of WTO, Ukraine will receive additional protections from unfair antidumping and special protective investigations, from which Ukrainian metallurgy and chemical industries have suffered.

For domestic metallurgy and chemical industries the prognoses for global prices is promising. Global prices for metals in 2007 shall grow by 5-10%, and in 2008 shall remain the same, while prices for chemical products shall grow by 8-10% in 2007, and by 3-5% in 2008.

The competitiveness of Ukrainian **textile** products does not depend directly on WTO membership. Currently, Ukrainian textile producers operate in an environment that is consistent with Ukraine's obligations for WTO membership.

In **machine building** industries the bound tariff rate seems to be high enough to level out the potential negative consequences from severe price fluctuations.

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