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Government Spending in Agricultural Sector of Ukraine - Trends since 2007 and plans for 2015

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Budget support of agricultural sector has diminished both in absolute and relative terms since 2007 due to economic crisis and pressing need for budget consolidation. At the same time, total amount of indirect subsidies provided to agrisector through different types of special tax regimes increased considerably¹.

In 2015 budget support for agricultural sector is foreseen only at the level of UAH 3.7 bn, which equals to 0.7% of the total budget expenditures. The Government should address general policy challenges more actively, as this is the essential base for investments and economic prosperity also in the agriculture sector. This will lead to additional tax payments to the budget, which, in turn, will provide new opportunities to stimulate development of the agrisector.

Budget of Ukraine for 2015: highlights

Revenues of the state budget of Ukraine for 2015 are planned at UAH 502 bn², which is considered to be overoptimistic³ because it assumes unforeseen increase in revenues by more than 30% compared to 2014. Marginal deficit is approved at UAH 76.3 bn leading to marginal state debt at UAH 1 394 bn. Expenditures are planned at UAH 567 bn, 27% of which will be spent on social programmes and pensions, 16% on repayment of public debt liabilities, 15 % on education, science and culture, 14% on security and defence, 10% on healthcare, and the rest on various state support programmes and administration of government bodies.

About UAH 3.7 bn is envisioned in the budget to support the agricultural sector, which equals to 0.7% of the total outlays of the state budget. For comparison, in 2007, the share of agricultural outlays constituted 5.8% of the state budget.

¹ In nominal terms, total amount of indirect support (fixed agricultural tax and special VAT regime) increased from UAH 1.5 bn in 2001 to over UAH 18 bn in 2012. Source: http://www.apd-ukraine.de/images/APD_APR_07-2014_VAT_in_agriculture_eng.pdf

² <http://zakon4.rada.gov.ua/laws/show/80-19>

³ IER. 2015. Monthly Economic Monitor of Ukraine No.1 (171).

Notably, amendments of the Budget Law approved by the Parliament on 3rd of March, 2015, increased expenditures on several programmes and envisioned funds for support of the livestock sector and programme on reduction of interest rates for agricultural loans. Though it is questionable whether this will be implemented. Considering that budget deficit remains very large, there are high underfinancing risks of budget outlays as in the previous years.

Government spending on agricultural sector

Figure 1 illustrates that there is a clear trend of declining government spending on agricultural sector⁴ since 2008 explained by economic recession in 2009 and generally complex political and economic situation since the end of 2013 and until now. In particular, it decreased from UAH 10.7 bn in 2007 to UAH 6.9 bn in 2014. Unfortunately, comprehensive assessment of government programmes in agriculture is not available, except for critical comments of the Accounting Chamber of Ukraine on their low effectiveness⁵.

Following WTO approach⁶ on classification of subsidies by "boxes"⁷, government expenditures on agricultural sector of Ukraine are classified in two categories. The first one, "amber box" (or growth-hampering measures) refers to expenditures, which distort production and trade, e.g., price-support measures or direct subsidies related to production levels. Based on WTO rules application of the "amber box" measures is limited by 5% of agricultural production for developed countries and by 10% for developing ones. For Ukraine this indicator amounts to UAH 3 bn, but was not exceeded in the analysed period.

The second one, "green box" (or growth-enhancing measures) covers outlays, which do not distort or cause minimal distortion to trade. Thus, the use of such subsidies is not limited. These

⁴ This includes expenditures on forestry, specialized education and science.

⁵ For example, see <http://www.ac-rada.gov.ua/control/main/uk/publish/article/16720005>

⁶ https://www.wto.org/english/tratop_e/agric_e/negs_bkgnd13_boxes_e.htm

⁷ Similar to traffic lights, permitted support measures are indicated with green, and the ones, which should be reduced, with yellow.

measures do not target particular products but rather serve as income support for farmers, which is not linked to production levels or prices. Programmes supporting environmental protection and rural development also fall in this category.

It could be seen from the Figure 1 that the share of growth-hampering measures in cumulative government expenditures on agriculture has decreased from 46% in 2007 to 8% in 2014. Generally, this is a positive trend, however, effectiveness and efficiency of these measures should be also ensured.

Notably, the practice of considerable underfinancing of planned expenditures seems to improve. In 2014 allocated government support constituted about 85% of initially planned, which is much better than, for example, in 2011.

Figure 1. Government expenditures in agricultural sector

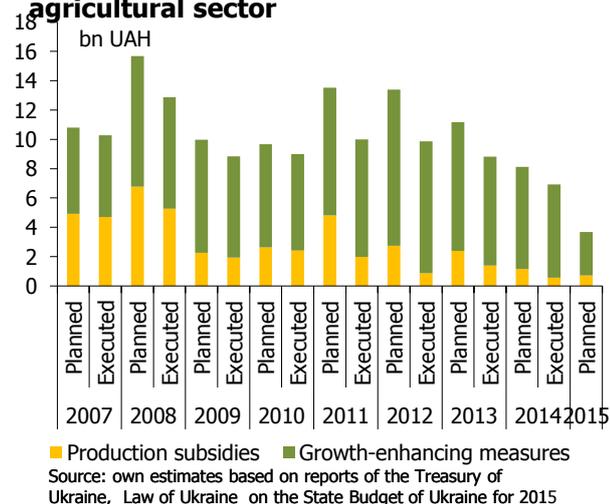
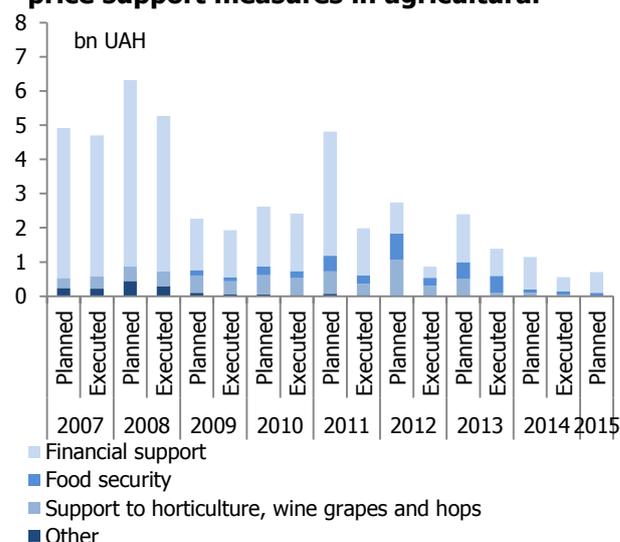


Figure 2 presents a breakdown of outlays under the umbrella of “amber box”, which covers a variety of financial support measures to animal and crop producers and price support measures provided through Intervention Fund (food security category). The majority of these programmes were either cancelled or reduced considerably since 2008 due to economic crisis and pressing need for budget consolidation. However, the amount of indirect subsidies obtained through preferential taxation regime (special VAT regime and fixed agricultural tax) increased from UAH 4 bn in 2007 up to UAH 19.6 bn in 2014⁸.

⁸<http://minagro.gov.ua/themes/garland/pdf/6.2.%20Basic%20material%20UKR.pdf>

Figure 2. Production subsidies and price support measures in agricultural



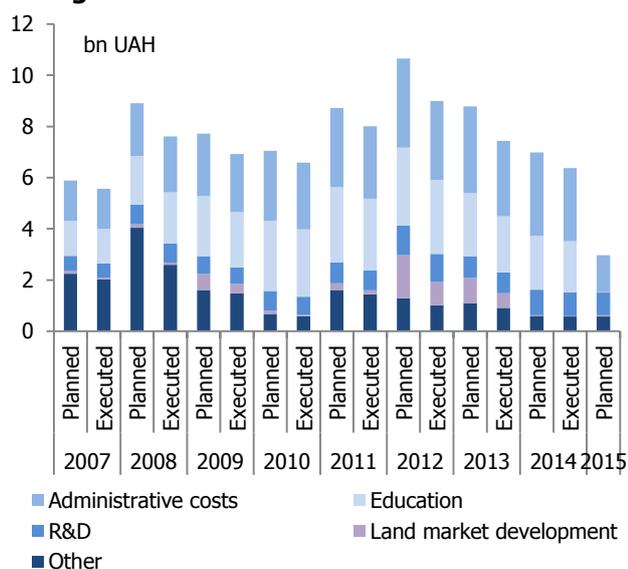
In 2014, direct budget transfers on production subsidies amounted to UAH 0.6 bn, which is about 8 times lower than in 2007. These included UAH 44 m to support horticulture, wine grapes and hops, UAH 371 m for livestock industry and about UAH 40 m were provided to state-owned JSC “Ukragroleasing” for purchase of new agrimachinery, which is then provided to producers on the terms of agrileasing.

In the state budget for 2015 about UAH 609 m of financial resources are envisioned to support livestock sector, agrimachinery leasing, program on reduction of interest rates for agricultural loans and UAH 100 m for activities of the Intervention Fund.

Figure 3 illustrates trends and structure of growth-enhancing support measures. Since 2012, the expenditures of “green box” decline.

Outlays on research and development increased more than twice from 2007 to 2012 (up to UAH 1.1 bn) and remained almost at the same level till 2014. At the same time, administrative costs increased both in absolute and relative terms. In particular, administrative expenditures have grown from UAH 1.6 bn (28% of total “green box” outlays) in 2007 to UAH 2.9 bn (45%) in 2014.

Figure 3. "Growth-enhancing" measures in agricultural sector



Source: own estimates based on reports of the Treasury of Ukraine, Law of Ukraine on the State Budget of Ukraine for 2015

In 2015, about UAH 1.4 bn will be spent on administration of agricultural institutions (49% of total "green box" outlays), UAH 0.8 bn – on research and development. It should be noted that expenditures on specialised institutions of higher education were transferred to the Ministry of Education and Science. That is why the share of outlays on education looks so marginal on the figure.

It is clear that the government had to cut spending on state support programmes in all sectors of the economy including agriculture due to exceptionally difficult budget situation. At the same time, the Government should focus on settling the existing general policy challenges and especially set the stability in the general frame conditions. This will lead also to increase investments in the agrisector and by that to additional tax payments to the budget. Finally this would provide new improved opportunities for more effective support to the agrisector.

Moreover, it is important to use the time of economic recession for reforms and introduce fundamentally new approaches to government spending when the economic situation will stabilise and more funds will be available to support agricultural sector.

Special attention should be given to political prioritisation of support, development of clearer eligibility criteria for agricultural producers and transparent allocation of funding; regular monitoring in order to prevent abuse and periodic evaluation of the effectiveness of measures⁹. In the context of Ukrainian legislation approximation with the EU acquis it seems reasonable to focus state support on sustainable development of the agrisector, taking particularly into account social and environmental functions of agriculture in rural areas.

⁹See AFPR.#5/2014 "Reforming government support in agricultural sector" for more detailed recommendations.