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Barriers to Investment in the Agriculture and Food Sector in Ukraine

Disclaimer:

This paper was prepared by the authors using publicly available information and data from various Ukrainian, EU and WTO sources as well as information obtained during interviews. All conclusions and recommendations included in this article in no circumstances should be taken as the reflection of policy and views of the German Federal Ministry of Food, Agriculture and Consumer Protection.

1 BACKGROUND

Efficiency and competitiveness are the key issues for any country that intends to become a real player on world markets. Investments from domestic and foreign investors in improved technologies and technical progress will increase efficiency and competitiveness of Ukrainian agriculture. There have been dozens of investment climate papers written over the last decade, including papers produced by the German Advisory Group (GAG) and the Institute for Economic Research and Policy Consulting (IER)[1] and there is little to add to that quite comprehensive analysis. Despite voluminous literature produces on this topic still investments in the sector have been too low during the last years.[2] Currently, investments are much lower than necessary for developing the agriculture and food sector. Foreign Direct Investment (FDI) plays a particularly important role. It adds to domestic capital accumulation (about 15 % of total investments), facilitates access to international markets and brings additional knowledge to the country. Ukraine lags behind most emerging economies. During the first years of economic recovery in Ukraine, consumer demand was the main domestic contributor to growth. Another key engine could be external demand on world food markets. These markets offer interesting opportunities with additional demand for bio energy raw materials and bio fuels.

Table 1: Growth of investments in Ukraine

2002	2003	2004	2005 (estimate)	2006 (forecast)
3.4 %	22.5 %	10.2 %	-3.1 %	4.3 %

Source: IER, inflation adjusted

Table 2: Growth of the agriculture sector in Ukraine

2002	2003	2004	2005 (estimate)	2006 (forecast)
2.0 %	-11.0 %	19.5 %	3.6 %	3.1 %

Source: IER, inflation adjusted

In our analysis we provide a sector level approach to the problem and mostly concentrate on import regulations (tariff, non-tariff), which in some cases constitute significant investment barriers for input supply. Ukrainian agriculture needs investors to bring in new machinery, equipment, seeds and the know how embodied in agricultural technology. Increased opportunities to invest in better inputs will help farmers and agribusinesses accelerating growth and income levels for capital accumulation and follow-up investments. Increased efficiency and competitiveness in turn will help to expand Ukrainian agriculture and food exports. In this view any obstacle that complicates the inflow of agricultural technology into Ukraine represents an investment barrier. Therefore, import regulations have to be very carefully analyzed whether they constitute in fact barriers to investment.

Although some work has been done in this direction,[3] however, not all aspects are available in one publication. In our approach we applied the following steps. First, we describe general import regulations, where basically summarize information available from different sources (see USDA FAS and Moody/Polivodskiy 2005). Additionally, we annex a detailed list of tariff regulations/barriers currently in force. Second, we offer a detailed analysis of non-tariff import barriers to agricultural inputs.

The Ukrainian Government welcomes and supports investments in the agriculture and food sector. However, support policies need transparency and harmonization with international trade standards in view of WTO accession and approximation of the legislation to EU standards. Currently, growth of investments is limited by unpredictable policy environment in general, and sometimes inconsistent and intransparent Government policies, excessive

[1] GAG (1997), Mollers, F. et al. (2001), Thiel, E. (2002), IER and GAG (2004), IER and GAG (2006)
[2] Cf. Monthly Economic Forecasts, Institute for Economic Research and Policy Consulting, Kyiv
[3] USDA FAS (2004) and (2005); EBRD (2006)

administrative regulations and high import tariffs for some key inputs. Therefore, the paper ends with future relevant WTO regulations for the agriculture and food sector.

2 OBJECTIVES

This paper summarizes general and specific barriers to investment with a focus on the agriculture and food sector inputs. It takes specific German supply and investment interests into consideration to support the policy dialogue between Germany and Ukraine. The paper outlines the state of affairs of import regulations for selected inputs . It further identifies the bottlenecks and non-tariff barriers to trade and the ways for improvement. WTO requirements (Agreement on Agriculture, Agreement on Sanitary and Phytosanitary Measures SPS, Agreement on Technical Barriers to Trade TBT, Agreement on Trade-Related Aspects of Intellectual Property Rights TRIPS), institutionalizing the world trade, and the needs for adaptation of these trade standards for the stimulation of investments, are explained.

The analysis has been conducted in two steps. First, the official import regulations have been documented and assessed. They are presented and discussed in the first part of the paper and the annex. It has to be noted that import regulations are not necessarily investment barriers. Import regulations are justified to reach certain Government legal, trade or food safety objectives. These are legitimate import regulations. However, regulations may become excessive trade barriers in some cases. To facilitate the identification of those specific cases we conducted a comprehensive analysis of relevant import regulations documented in the annex of the study.

In the second step interviews with selected agribusiness operators have been conducted to include their views and perception of barriers to investment in the analysis[4]. Additional expertise was available due to previous research and consultancy work.[5]

The following input sectors have been considered in our analysis:

a) agricultural machinery

b) agro-chemicals

c) seeds

d) livestock inputs

e) livestock equipment

These sectors have been chosen because we consider these inputs are key investments in Ukrainian agriculture where Foreign Direct Investment plays a significant role. Therefore, trade barriers for these inputs may be considered as investment barriers.

The paper ends with specific recommendations for investment promotion related to the above listed branches and with necessary Government actions to improve the legal and institutional framework conditions for a positive investment climate.

[4] See annexed list of organizations, companies and contact persons.
[5] See Moody and Polivodskyy (2006); Nivyevskiy and Strubenhoff (2006).

3 General import procedures for agricultural inputs and products

Import regulations in Ukraine are applied in the following way. Customs authorities upon clearance at the border collect all applicable duties and taxes, unless the cargo is forwarded to a bonded warehouse. Import duties might be in ad valorem terms (% based on the value of the goods), specific (absolute figures) or combined. For the combined duty the higher rate of the two is applied. The following steps must be taken when importing inputs or agri-food products into Ukraine:

- Register contract at commodity exchange;
- Pay import duty – defined in Custom Tariffs of Ukraine
- Pay Value Added Tax – 20%
- Pay other taxes (e.g. excise)
- Pay other customs duties

The import of agricultural produce including agricultural inputs is regulated in the law of Ukraine “On state regulation of import of agricultural produce” of July 17, 1997 (amended). Article 4 of this law states that agricultural produce, which is imported to the territory of Ukraine is subject to obligatory certification, sanitary-epidemiological, radiological and for certain types of produce – veterinary and phytosanitary control. Exporters from abroad have to confirm the exact import procedures for individual products prior to shipment with their importers. It is necessary to make sure that all required inspection services are performed at a given entry point.

The unified duty was introduced after approval of the Law of Ukraine «On the unified duty charged at the points of passing the state border of Ukraine» from 4 November 1999 N 1212-XIV. The unified duty is set for vehicles owned by domestic and foreign owners, which are crossing the state border of Ukraine and is paid at the entry points on the State border of Ukraine in accordance with Ukrainian legislation for conducting customs procedures during transit of commodities and vehicles, sanitary, veterinary, phytosanitary, radiological and environmental control of commodities and vehicles, for passage of vehicles along Ukrainian roads and for passage of vehicles with exceeding size, total mass, axle load and (or) external dimensions. The unified duty includes fares for along Ukrainian roads (per each kilometer) and fares for conducting control and is paid one-time depending on shipment type (import, transit) based on one single payment document depending on type, capacity or total mass of vehicles.

Any food product, food raw materials and agricultural products including agricultural inputs are prohibited entry into Ukraine without documented evidence of their quality and safety. The following documentation is required for customs clearance:

a. Certificate of conformity. This document confirms that agricultural products are properly identified and comply with the requirements of the obligatory quality and safety norms and standards in force in Ukraine. It is issued by the State Committee of Ukraine on Standardization, Metrology and Certification or an authority that is authorized (accredited) by the State Committee. There are more than 100 institutions authorized to conduct certification in the Ukrainian Certification System UkrSEPRO. Foreign certificates are taken into account only in cases when mutual recognition of such certificates is included in provisions of respective international agreements. So, imported produce must be confirmed by a certificate of conformity or a certificate of recognition of foreign certificate. There are two options to receive the certificate of conformity:

- The certificate is given for a period of two to three years in case all consignments shipped to one single recipient during the whole term of validity of the certificate. In this case commodities are produced serially
- The certificate is given for each specific consignment

b. State sanitary and epidemiological expertise certificate. The State Sanitary and Epidemiological Service of the Ministry of Health Care of Ukraine issues to the importer the certificate of state sanitary and hygiene testing conforming or not of the produce to the medical requirements of safety for human life and health.

c. Veterinary certificate. Every consignment imported into Ukraine is inspected and sampled regardless of the statements made in the accompanying veterinary health certificate. The importer/exporter will have to bear the costs associated with testing in the border laboratory or in the Central State Veterinary Laboratory in case of appeal. The testing costs vary between USD80 and USD500 depending on the number of tests required and the number of uniform lots in the shipment. The testing procedure takes up to 7 days making import of some highly perishable goods impossible.

d. Quarantine import permit/phytosanitary certificate. The phytosanitary certificate confirms that quarantine materials correspond to the requirements of safety standards. Ukrainian Phytosanitary inspectors conduct initial inspection of the cargo at the port of entry and take product samples for the laboratory test to verify that live quarantine pests are not present in the cargo. If the exporting country has no state bodies on quarantine and plant protection, import is allowed after a quarantine import permit is granted. The quarantine import permit is issued by Golovderzhkaranteen (Main State Inspection on Quarantine of Plants of Ukraine) and confirms that the product corresponds to the requirements of safety standards.

4 Major investment barriers perceived by the industry

General suggestions: Predictability, investment climate, law enforcement, human capital and land markets

Despite various barriers to investments described below the interviewed agribusiness operators perceive the unpredictable policy environment as the single most important obstacle. Businesses usually adapt to corrupt schemes by adding bribes to their costs and rolling it over to the client. They can even handle tedious and complicated registration and border clearing requirements. They can overcome everything as long as the environment remains stable. Businesses claim, "Let it be bad but stable!"

The very recent example of ad-hoc policy changes was the introduction of grain export licensing and export quotas in October 2006. After introduction of grain export licensing many traders in Ukraine stopped buying grain although ships have been ordered months ago leading to losses of several million $ for individual grain traders. This deteriorates the investment climate and will certainly negatively impacting investment decisions.

What does this mean? It shows the commitment of the Government to secure cheap flour for the state-owned bread producing company and to secure cheap feed grain for livestock producers. It further shows the interests of a few are of higher value than the welfare of the whole country. The introduction of grain quotas can be interpreted as a general mis-conception of the functioning of export-orientated market operations in an open economy. A few market operators benefit but the whole economy is losing welfare. The farmer at the end of the value chain will pay the price for this policy measure for he receives lower grain prices. This contradicts the political intentions. It adds to higher market transaction and infrastructure costs, one of the major bottlenecks to develop the sector.

Reducing market infrastructure costs would require further investments in improved marketing, handling and shipping facilities and equipment as well as more competition, e.g. to reduce the market power of individual providers of transport services. Private traders including foreign investors are by far the most important source of investment and know-how and, if permitted, they will develop a highly competitive, dynamic and efficient grain and oil seed marketing system for Ukraine.

Almost all agribusiness operators complained about the lack of qualified personnel in agriculture and agribusiness in Ukraine, beginning at the farm level (milkmaid and agronomist) and ending with agricultural economists with relevant skills to manage farms and agribusinesses and to develop the sector. There are only limited expectations in improvements during the next 3 to 5 years. Agribusinesses usually invest about 6 months in training before staff are able to perform at the required level.

Our first conclusion is that <u>the Government should put major emphasis on developing concepts and instruments for improving the investment climate and to enhance education in the sector</u>. Old and discredited models and habits have to be replaced by new ones. Investment in human capital for research, education, extension, management and policy analysis should become top priority in Ukrainian agricultural policy. No other measure can produce comparable returns on investment in the long run. The existing agricultural research and education establishment in Ukraine needs competition, new ideas and fresh blood.

A further important bottleneck mentioned by many agribusiness operators is the absence of a functioning agricultural land market. This is perceived as a precondition for increasing the efficiency and competitiveness of agriculture and an additional source of finance and investment for the sector. Land should have a real value and contribute to rural livelihoods, as well as the development of rural financial markets. In this view <u>the expected lifting of the moratorium on land sales in January 2008 will greatly contribute to investments in the sector</u>.

Another bottleneck reported by some agribusiness operators is <u>imperfect legal framework and weak law enforcement</u>. There is a lack of corporate governance rules that would ensure the transparency in shareholders' relationships, protection of companies from hostile takeovers (corporate raiders), minority shareholders' (property) rights protection etc. The current Law On Joint-Stock Companies and Regulation CMU on Joint-Stock Companies # 8326 does not solve disputable issues between shareholders as for the mandatory redemption of shares, quorum in JSC, pre-emptive rights etc. Weak judiciary system, with lack of independency and poor enforcement of court decisions constitute a major stumbling block for the development of a efficient legislation framework.

4.1 Agro-chemicals

According to the agro-chemical sector working group including the German companies Bayer Crop Science and BASF at the European Business Association EBA in Kyiv the industry sees major weaknesses in a) customs clearance procedures, b) registration procedures and c) trade with agro-chemical counterfeit and fake products.[7]

Customs clearance procedures: Customs authorities may delay customs clearance due to chemical analyses of active ingredients although such an analysis is a pre-condition for state registration at the Ministry of Environmental Protection and has already been done for registration purposes. The Customs authorities do not sufficiently take into consideration the documents available at the Ministry of Environment. This is possible due to inconsistencies in the Customs Code.

Registration procedures: Agro-chemical products may be registered for a validity period of ten years or for two years for experimental purposes. Many generic products are temporarily registered for two years only. As the documents required for long-term and short-term registration are different this puts the manufacturers of the original product – previously heavily investing in research and development of the original product - in an unequal position for it may delay the registration of the original product. Generic products come into the country with limited control and accelerated registration. This practice may lead to lower qualities of the available products on the market.

Recently, the Government has been requesting the industry to re-submit various documents to confirm the patents. The justification for this bureaucratic procedure is weak and the purpose unclear.

Counterfeit and fake products: The industry estimates that about 10 to 20 % of the market volume of about 180 mln USD in 2006 has been illegally produced, illegally repacked or is fake. The distribution of counterfeit products undermines the rights of producers, users and consumers. Due to recent awareness campaigns of the EBA and the EU in Ukraine in close collaboration with Ukrainian authorities the industry estimates that the market share of counterfeits has been slightly reduced. Also, legislation has been improved by the Ukrainian Parliament recently. However, the problem remains serious. State inspection and law enforcement are still too weak. This adversely affects the image of Ukrainian law enforcement bodies in view of WTO membership.[8]

4.2 Agricultural machinery

The agricultural machinery industry reports about phytosanitary certification of their imported new products to be added to the customs declaration. This measure can hardly be justified and should be regarded as an extreme example of legislation facilitating arbitrary actions of the involved Ukrainian authorities. This leads to higher costs of doing business and higher risks of corruption.

Ukrainian export-import operations require for various reasons, e.g. legal transfer of ownership rights, 100% up-front payment for the imported machinery, seriously limiting opportunities of domestic enterprises. At the same time it is possible to take a credit for the imported machinery with a foreign bank. However, this option is rarely used since it requires relevant communication skills and international experiences of Ukrainian banks' servants. Also, this option does not allow Ukrainian enterprises to receive interest rates compensation. A Government scheme to refund interest rates is available but the buyer

[7] See EBA: Barriers to Investment in Ukraine, Kyiv, May 2006
[8] See Moody and Polivodskyy (2006)

receives the money only after having bought and received the machinery. This puts additional uncertainty on the purchase and reduces liquidity of the investor.

International experience shows that leasing of agricultural machinery is a good option to reduce investment costs for the farmer (*"UkrAgroLeasing" supplies* according to CMU Regulation[9] machinery and equipment to farms at an annual interest rate of less than 10%). However, this option does not function well in Ukraine and does not play a practical role in financing agricultural machinery. In practice official depreciation rates do not correspond with the leasing cycle and the up-front payment of import duties plus VAT additional to the first leasing rate makes this financing scheme less attractive. Also, agricultural enterprises pay VAT two times. First, when the machinery is imported at the border. Secondly, when agricultural enterprises pay the leasing rates in the following years.

The certification process is a specific barrier that costs time and nerves of the importers. Additionally to the first registration of the product each supply has to be identified again. This procedure is hardly justifiable and leads to arbitrary actions of the concerned administration.

Some operators in the industry report about the difficulties to enforce contracts by the prosecutors office in case of insolvent or unwilling clients. The reputation and image of the prosecutors office in this respect is generally bad.

4.3 Seeds

According to the agricultural working group at the Eastern Council of the German Industries in Berlin including representatives of the German seed industry, the industry perceives the import tariffs on sugar beet seeds as prohibitively high. This was also the reaction of the Ukrainian sugar industry and sugar beet producers in a previous analysis of the sugar sector.[10]

The import tariff on sugar beet seeds has been fixed in April 2003 on 22 Euro per kg seed independent of the processing stage. Previously, the tariff has been fixed at 70 % of the value. This de-facto increase of the tariff lead to prices of imported seeds that are three times higher than seeds of domestic origin. The Ukrainian sugar beet producers are thus excluded from technical progress on world seed markets as well as the Ukrainian seed producers themselves. This weakens the competitiveness of the whole sugar value chain. Limited competition will have a desastreous long-term effect on the viability of the Ukrainian sugar beet seed industry itself.

Input traders report about grey imports of seeds (mainly sugar beets, but also rape seed and malt barley) from Poland to Ukraine that may account for up to 50 % in the sugar beet sector.

A further issue concerns genetically manipulated seeds. Officially, Ukraine is free of GMO seeds but in practice this may be threatened by the lack of consistent legislation to punish the producer. Technical thresholds are not defined.

4.4 Livestock

As a consequence of BSE cases in Germany a few years ago, the import of breed cattle from Germany has been banned by Ukrainian authorities. Due to adequate measures of the German authorities (strict animal identification and traceability schemes) according to EU legislation trade with breed cattle has been re-established with many countries including all new member states of the EU in Eastern Europe. Also, negotiations with important trade partners in Northern Africa and Russia have been successfully closed based on the principle of a fixed lowest date of birth for imported breed cattle (July 1, 2001).

The Ukrainian dairy industry is one of the most important food sectors in Ukraine and many agribusinesses are planning to expand production and trade of dairy products through investments in dairy processing. Their major concern is the availability and quality of raw material supply. Although the number of cows in Ukraine is quite significant most of them are producing milk in low-performing village herds with a peak of production in summer.

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[9] Regulation of CMU # 1904 as of 10 December 2003

[10] See IER policy paper on restructuring of the sugar sector

However, the demand for dairy products has its peak in winter. Therefore, the dairy industry will be forced to invest in high performance milk production units to ensure sufficient quantity and quality of raw milk for processing. High potential breeding animals are an important element to increase productivity in the value chain of the dairy sector. The sector needs less low performing village cows but more high performing quality breed. Breeding cows from the EU including Germany can play an important role to increase productivity of the dairy sector in Ukraine.

4.5 Livestock equipment

The current market volume for modern dairy equipment on farm level is estimated by the supply industry at 20 mln. US$ annually. This is an extremely low level compared to Central and Western Europe. With about 3.5 mln. cows in the country the current investment volume is about 6 US$ per cow and year. This is about 1 to 5% of the investment level in Western Europe. At the processing level some investments have taken place in dairy facilities but also at a very limited level. Compared to Russia where many international players invested in green-field dairy plants around the big cities after the 1998 Rouble devaluation investments in Ukraine are comparatively low. Assuming that the dairy sector represents interesting opportunities with comparative advantages the sector needs a lot of public attention to restructure the dairy value chain.

Perceived investment barriers by the industry are:

- import tariffs of 5 to 20 % for dairy equipment
- certification, food standards
- low quality of the raw milk
- slow VAT refunding
- non-functioning rural land and financial markets

A further specific customs clearance problem might occur since the Ukrainian buyer of the foreign equipment has only 90 days after prepayment to clear the whole operation. However, due to technical problems the delivery of agricultural or food equipment might take much longer (for example to build a food processing and packaging line in a dairy plant). To prolong the period an additional permission of the National Bank of Ukraine is needed. This procedure can hardly be justified.

4.6 Meat exports

To diversify food exports the EU market offers interesting perspectives. Ukrainian producers are able to produce beef at comparatively low costs and agribusinesses fromWestern Europe consider investments in feedlots and modern meat processing plants in Ukraine. First pilot investments show good technical and financial results.[11] However, the food safety and food traceability standards of meat exports to the EU have to be respected. At this moment, Ukraine is unfortunately not eligible to export meat because it lacks the so-called “Third Country Status”. To obtain this status the Ministry of Agricultural Policy has to follow a standard procedure of the EU. This includes (i) funds for a residue monitoring plan (available in 2004 and 2005, not available in 2006, to be provided in 2007), (ii) answering standard EU questionnaires on veterinary standards and procedures.

On company level the producer has to be certified according to EU food import rules. As pilot operators are large and experienced food businesses they would be able to facilitate market entry not only for themselves but also for following other domestic beef exporters. The potential pilot exporters should receive more attention by the Government.

[11] OSI International invested in a feedlot and meat processing plant in Hazatin, Vinnitsa Region. OSI Group needs about 170.000 t o beef annually a.o. for deliveries to the Mac Donalds Group in Europe. Ukraine is considered as a potential supply country for the group.

5 WTO requirements

The results of the GATT Uruguay Round of multilateral trade negotiations, adopted in April 1994, mark a milestone in the development of agribusiness international trade and investment. The “built-in” agreements cover important aspects of tariff trade barriers and also non-tariff barriers to trade. The relevant WTO agreements are to be found in the publication: “The results of the Uruguay Round of Multilateral Trade Negotiations” published in 1994. The final act of the Uruguay Round is the so-called WTO Agreement founding WTO itself. Annex 1A to the WTO Agreement comprises multilateral agreements on trade in goods, a.o. “Agreement on Agriculture”, “Agreement on the Application of Sanitary and Phytosanitary Measures – short SPS”, “Agreement on Technical Barriers to Trade – short TBT”, “Agreement on Trade-Related Investment Measures”. A further annex comprises the “Agreement on Trade-Related Aspects of Intellectual Property Rights – short TRIPS”.[12]

Why are these agreements relevant for investments?

1. All domestic support in favor of agricultural producers is subject to rules limiting and reducing the amount of support and defining those domestic support policies which are exempt from the reduction commitments, e.g. by defining the upper ceiling of Aggregate Measures of Support (Amber Box), Green and Blue Box Measures, De Minimis Ceilings etc. Future WTO Membership of Ukraine will influence and change support policies and is therefore relevant for investors.

2. Trade agreements providing discipline to national food safety and animal and plant health protection measures. According to established WTO principles of non-discrimination, harmonization and transparency the so-called SPS-Agreement has been worked out. This agreement defines international standards, guidelines and recommendations. It contains three parts: a) Codex Alimentarius (responsible organization: FAO, Rome), b) Animal health and zoonoses (responsible organization: Office Epizootiques, Paris), c) Plant health (responsible organization: International Plant Protection Convention, responsible organization FAO, Rome). The standards, guidelines and recommendations of these three international organizations, referred to as the “three sisters”, are the benchmark for meeting requirements of the SPS Agreement.[13]

3. The Agreement on TBT sets out the disciplines that will govern trading practices at the international level for all consumer type products. It sets out the rules and obligations of WTO Members when applying technical regulations and standards and conformity assessment procedures to traded goods. The agreement prevents member countries from establishing standards becoming obstacles to trade by insisting on products from any WTO Member receiving no less favorable treatment than that given to similar products of national origin or originating in any other country. Standards should be based on legitimate objectives, be drafted in terms of performance rather than design, and not create an obstacle to trade.

The WTO Agreements will most likely have a positive impact on trade and investment in agriculture and agribusiness after WTO accession of Ukraine. It will force the Government to harmonize sanitary and phytosanitary legislation and to reduce technical barriers to trade according to international standards. This will certainly reduce the scope of arbitrary actions of involved administrations, reduce the costs of doing business (trade, marketing and transaction costs) and eventually also contribute to fighting corruption. It will further have a positive impact on food safety and the protection of the rights of food consumers.

However, Ukraine also needs to consider the food safety and traceability rules of the EU. Whilst the WTO Agreements define international minimum standards, the EU – pushed by legitimate interests of the European consumers – sets in most cases higher standards, in particular in food processing and trade. The experience of the first wave of Eastern European EU Member States shows that the time and efforts needed to implement the requirements of the EU cannot be underestimated. The establishment of adequate general

[12] Cf. www.fao.org

[13] A specific website has been created by the Government of Ukraine supported by the European Commission: www.sps-info.org.ua

policy and legal framework conditions as well as the specific certification process at company level in line with WTO and EU requirements needs obviously more attention in future. Otherwise, theoretical gains from trade diversification wont be realized in practice.

CONCLUSIONS AND RECOMMENDATIONS

Currently, investments are much lower than necessary for developing the agriculture and food sector. Ukraine lags behind most emerging economies. During the first years of economic recovery in Ukraine, consumer demand was the main domestic contributor to growth. Another key growth engine could be external demand on world food markets. These markets offer interesting opportunities with additional demand for bio energy raw materials (e.g. EU market for biofuels).

Factors behind low investments:[14]

a) Unpredictable policy environment: ad-hoc policy measures have detrimental consequences for the investment climate in Ukraine.

b) Reprivatization: Rumours about intended Government actions of the Orange Coalition led by Yulia Tymoshenko caused postponement of investments.

c) Inconsistent tax policy: ad hoc change of tax policy related to special economic zones by the same Government led to fears of legal certainty amongst investors, also causing postponement of investments.

d) Taxation of investments: Non-zero import tariffs on inputs needed to boost productivity and competitiveness are clearly inconsistent with a commitment to more investment. Furthermore, the pension fund tax of 1.3 % on purchases of non-cash foreign currency acts as a detriment to imports of capital goods.

e) Poorly developed investment promotion institutions: The institutional mechanisms including the Investment Promotion Agency created in 2005 to create a better investment climate and to attract domestic and foreign investments are still weak. Investors are still missing a client-orientated “one-stop-shop” to address their questions.

f) Excessive regulation: In spite of attempts to simplify its regulatory mechanisms, Ukraine lags behind other countries. According to a recent World Bank study Ukraine ranked 110 out of 155 countries where the hurdles of launching a business have been assessed. The above specific branch examples confirm this.

g) Corruption: Related to excessive regulation is endemic corruption. All interviewed business operators confirm this. In spite of official anti-corruption Government programs, any improvements have not been reported.

h) Capital markets: Banks usually tend to prefer non-agricultural investments for various reasons. Farmers fear the high interest rates. Cumbersome regulations increase the cost of borrowing and risk assessment.

i) Ukraine’s agricultural research and education system is not yet able to produce the needed future agribusiness elite to become a major player on world food markets.

What the Government should avoid or do to promote investments:

a) Improve the legal protection of property of any size. Respect of property rights – even after biased privatization – is the basis of future investments.

b) Avoid ad-hoc policy measures and frequent changes of taxation of investments.

c) Reduce import tariffs for agricultural inputs to zero.

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[14] See: Institute for Economic Research and Policy Consulting and German Advisory Group: New Challenges for Economic Policy in Ukraine: Proposals for Immediate Action, Kyiv, July 2006

d) Investment privileges should be set in accordance with precise and transparent mechanisms. Instead of tax exemptions direct support of investments should be considered.

e) Develop a rural development strategy and program to finance rural infrastructure. Involve private operators in private-public partnerships.

f) Reduce the number of necessary steps in registration and certification procedures for trade and investment. Create co-ordinated information and advisory services - “one-stop-shop” - for domestic and foreign investors.

g) Simplify regulatory mechanisms. Introduce WTO-conform SPS, TBT and TRIPS standards.

h) Take the necessary steps to facilitate meat and dairy exports to the EU.

i) Launch adequate anti-corruption measures.

j) Streamline regulations for financing agriculture and agribusiness to facilitate leasing schemes.

k) Accelerate land market development.

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Kyiv, October 2006

ANNEX 1

LIST OF RELEVANT DOCUMENTS AND WEB SITES

European Business Association (EBA) (2006): Barriers to Investment in Ukraine. Kyiv. May 2006.

FAO: Multilateral Trade Negotiations on Agriculture – A Resource Manual, www.fao.org; www.sps-info.org.ua

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Annex 2

List of relevant contacted Organizations, Companies and Contact Persons

	Contact person	Company / Organization	Position
1.	**Brückner. Holger** **Zurupja Vadim**	Westfalia Surge Ukraine	Director General Director
2.	**Bulgakova Alla**	Lemken-Ukraine	Chief executive
3.	**Fedorenko Sergey**	Ukrros	President
4.	**Feofilov Sergey**	Ukragroconsult	Director General
5.	**Rehbein, Joerg**	Bayer Ukraine	Director General
6.	**Schimetschek Hartmut**	OSI International Foods GmbH	Director Business Dvt. Eastern Europe
7.	**Kube Harald**	BASF Ukraine	Country manager
8.	**Buchma Maryna**	European Business Association	Executive Director
9.	**Tschagarovskij Wadym**	Ukrainian Union of Diary Enterprises	Chairman of board of directors
10.	**Yakovenko Anton**	Rise - Agroservice	Financial director
11.	**Sauer Gerlinde**	Eastern Council of German Association of Industries	Managing Director of Agricultural Working Group
12.	**Lissitsa Alexej**	Ukrainian Agrarian Confederation	General Director
13.	**Lapa Volodymyr**	Ukrainian Agrarian Confederation	Analytical department head
14.	**Varodi Oksana**	IFC PEP in Ukraine	Projects Development Officer
15.	**Afanasiev Igor**	Agency for Investment and Development	Director
16.	**Starikov Olexander**	Apple Consulting	Head of Investment Projects Department
17.	**Kaliberda Alexander**	World Bank	Senior Projects Officer
18.	**Schroeper Dorian**	Alfred C. Toepfer International	Export Administrator
19.	**Artiushyn Olexander**	Ukrainian Grain Association	Deputy General Director
20.	**Usov Anton**	EBRD	Communication adviser
21.	**Kresse Stefan**	German Embassy	Counselor for Agriculture, Food, Consumer Protection and Environment

Annex 3

Specific import regimes for agricultural products

3.1 Crop seeds and other plant origin inputs to agriculture

3.1.1 Import tariffs

Table 6
Customs duties

Seeds/other plant origin inputs	Import duty
Soft, hard wheat; corn hybrids; pea; soybean; peanut packed; flax; rapeseed; sunflower seed; anise; coriander; cumin; caraway; alfalfa; clover; vetch; lupine; kohlrabi.	0%
Sorghum hybrids	2%
Rice; peanut other than packed; poppy; vine grafts	5%
Mushroom spawn, haricot; mustard;	10%
Perennial plants	15%
Potato; palm nuts; cotton; castor; sesame; safflower; hemp; oil cakes; Other than pea beans; by products from processing and feed for animals	20%
Rye; barley; oats;	€20/t
Buckwheat; millet;	€50/t
Molasses	€80/t
Onion; garlic;	€200/t
Sugar (cane/beet)	50 %, but not less €300/t
Other sugar, including lactose, maltose, glucose, fructose, honey	€300/t
Sugar beet seeds	€22000/t

Source: Custom Tariffs of Ukraine

3.1.2 Non-tariff import procedures:

Seeds may bee imported if the following requirements are met:

a. Registration. Prior to importing seeds for commercial release each plant variety has to be registered in Ukraine. It is done to protect the intellectual property of plant breeders and to assure farmers that the variety has all the features claimed by its developers. The State Service for Plant Varieties Rights Protection (Ministry of Agricultural Policy) is responsible for the registration process. After the plant variety is listed in the State Register of Plant Varieties, or in the process of registration or imported for the first time for trials, research or display purposes, variety owners of the above listed species may obtain a Ukrainian patent that will ensure their exclusive rights in the country or simply lists the variety in the Register. The second option provides a higher degree of intellectual property rights protection and is usually preferred by companies without their own distribution system. The entire plant registration process may take up to three years and costs about USD 750 if the variety is registered in another member country, and reach USD 10 000 otherwise. There are annual payments for maintaining a patent or maintaining a variety in the Register. The patent fee gradually increases from USD 90 for the second year to USD 600 for the tenth and every consecutive year. The fee for keeping a variety in the Register is USD 20 during the first five years per annum, after it gradually increases to USD 300 in the 16th year of registration.

b. Import permit. This document is granted by the Main State Phytosanitary Inspection Service of Ukraine of the MAP containing information on species allowed for entry, quantity, list of pests, product-specific treatment requirements, entry points into Ukraine and post-entry inspection procedures.

c. Certificate of conformity. See Section 3 for details

d. Phytosanitary certificate from the Plant Health Organization of the exporting country.

e. Quality certificate. The State Seed Inspection Service of the MAP tests imported and domestic seeds for complying with Ukrainian quality standards. The same standards are applied both for imported as well as for domestic seeds. Certification usually takes up to 30 days. On average each sample test costs USD 22.

Additionally to the above requirements, the State Sanitary and Epidemiological Service of Ukraine requires testing of seeds for pesticides. Also, each seed lot must be tested for compliance with radio-ecological standards.

Genetically modified plants. Currently, there is no legislation in place that clearly defines how products of biotechnology can be developed, traded or utilized within Ukraine. Furthermore, there is no official line of authority by agency for the regulation of biotechnology. There is a draft law (pending review by the Ukrainian parliament since November 2002) that divides responsibility for the development, testing, and registration of domestic and imported products of biotechnology among various government agencies. Adoption of this law will enable the regulatory process to commercialize plant biotechnology products in Ukraine. According to Government authorities, Ukraine is free of genetically modified organisms (GMO). However, business operators expressed doubts about this assumption because of the lack of adequate legislation and law enforcement bodies.

3.2 Animals and animal origin inputs

3.2.1 Tariffs

Table 7
Customs duties

Animals and animal origin inputs	Import duty
Cattle sperm; Cattle embryos; Pedigree animals (cattle, horses, sheep, goats, chicken)	0%
Liquid Milk	€0.1/liter
Milk powder, condensed milk, lubricator	€0.5/kg
Buttermilk	€0.2/kg
Butter	€1.5/kg
Cheese	€0.8/kg
Eggs	€1/kg
Beef; mutton; pork; goat meat	10 %, but not less €600/t
Poultry (uncarved)	10 %, but not less €400/t
Poultry (carved, parts) and its subproducts (liver, hart etc)	30 %, but not less €1500/t
Food animal byproducts (liver, tongue, heart, guts, for pharmacy industry etc); Lard	€500/t
Other meat	10%

Source: Custom Tariffs of Ukraine

3.2.2 Non-tariff import procedures

To import livestock produce into Ukraine an importer should have permits and certificates of the following authorities:

a. Hygienic conclusion of the State sanitary-hygienic examination.

b. Certificate of conformity.

c. Veterinary certificate.

The costs of the non-tariff import procedures cannot be identified precisely since the costs depend on the type of certification we mentioned in section 3, i.e. whether the certificate is based on the consignment or the production site. In case the production site is inspected the travel of a specialist to the importing country is necessary. The client should cover such costs. In some cases the total value of certification and documentation may exceed USD10 000.

3.3 Agricultural machinery

3.3.1 Tariffs

Table 8
Customs duties

Machinery	Import duty
Equipment for lifting, transferring, loading and unloading developed for agricultural tractors; seeding and planting machines; scattering fertilizers machines; mowing machines; hay collecting machines; straw and hay presses; grain combine harvesters; potato diggers and collectors; beet diggers; silage combines; grapes combines; machines for cleaning, sorting and screening eggs, fruits etc.	0%
Diesel engines for wheel agricultural tractors	5%
Plough; harrow; cultivators; scarifies; weeding machines; caterpillar tractors; wheel agricultural tractors	10%
Garden tractors	15%
Wheel tractors for semitrailer transferring:	
- New	5%
- Used	10%
Automobiles and trucks	25%
Dump-body trucks	20%

Source: Custom Tariff of Ukraine

3.3.2 Non-tariff procedures

Agricultural machinery requires some non-tariff import measures. To avoid repetition but keeping the structure consistent we refer the reader to section 4 for more detailed information on this issue.

3.4 Agricultural and food processing equipment

3.4.1 Tariffs

Table 9
Custom duties

Equipment	Import duty
For spreading liquid and powdery substances for agriculture and horticulture; for lifting, transferring, loading or unloading (on tractors) in agriculture; for feed preparing to animals; for aviculture; for cleaning, sorting and calibrating grain and beans, except those used on farms; for milking; for milk treating and processing. Drying apparatus for agricultural products. Scales for animals	0%
Confectionary equipment	1%
Brewery equipment	2%
Bakery and macaroni production equipment	3%
Refrigerators; machines for washing, drying, filling of bottles, bags, labeling; presses for production of vine, juices etc; beverages production equipment; fruit, nuts, and vegetable processing equipment	5%
Hand tools: spade, picks, saps, pitch-fork, rakes, axes etc; milk skimming machines	10%
Sugar production and meat processing equipment	12%

Source: Custom Tariffs of Ukraine

3.4.2 Non-tariff procedures

Agricultural equipment requires some non-tariff import measures. To avoid repetition but keeping the structure consistent we refer the reader to section 4 for more detailed information on this issue.

3.5 Agro-chemicals

3.5.1 Tariffs

Table 10
Custom duties

	Import duty
Fertilizers:	
Nitrogen based	5%
Phosphorus based	5%
Potassium based	
Natural potassium salts (carnallite, sylvinite, etc)	0%
Mixed element or other fertilizers	5%
Agro-chemicals	Up to 20 %

Source: Custom Tariffs of Ukraine

3.5.2 Non-tariff procedures

Agrochemicals and pesticides have several non-tariff measures that hamper imports to the country and investments in the sector. To avoid repetition but keeping the structure consistent we refer to section 4 for more detailed information on this issue.