

Ukraine

Agricultural Policy Review

Overview

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A Vision for the Future of Ukrainian Agriculture

The vision for Ukrainian agriculture is one in which the country rapidly secures an increasing share of the growing global food market by raising farm yields to their potential, demonstrated by Ukraine's best farms, and by building capacity to rapidly respond to export markets. This would be driven by more capital intensive agriculture, financed by unleashing potential domestic and foreign direct investment in Ukrainian agriculture. Unleashing this potential will require the government to remove the policy uncertainties faced by investors and to adopt a more consistent policy approach characterized by unbiased treatment of sub-sectors and enterprises, a reduced regulatory burden on businesses and a public spending program clearly focused on removing the key risks to private investors and stimulating technical innovation. The vision should also be one in which all land owners share the resulting prosperity. Achieving this could result in agriculture making a much greater contribution to Ukraine's economy and to the well-being of its citizens.

1. **Ukraine is exceptionally positioned to benefit from expected growth in global food demand due to expected increase of world population by 2.3 billion by 2050** with a shift to western style high protein diets, and increased demand for biofuels. Agricultural output will need to increase by 60% globally to match growth in global food demand by 2050. Growth in demand is primarily in cereals, oilseeds and vegetable oils – all products for which Ukraine has growing shares in growing world export markets. Ukraine could also exploit growing regional markets for fruit and vegetables.

2. **Ukraine could take advantage of growing global agri-food markets through increasing the level and reducing variability of agricultural productivity.** Given Ukraine's exceptional soil and supportive climate, closing the yield gap between average yields (2.2 t/ ha wheat) and the top 30 percent performing farms (5-7 t/ha wheat) is achievable and would generate an additional US\$1.9 bn. of revenue per year for farmers on average.

3. **Closing the agricultural productivity gap could result in agriculture making a much greater contribution to the country's economy and to the well-being of its citizens.** The share of agri-food industry is sizable in the national economy. Primary agriculture's contribution to GDP is over 8% and it accounts for 5.5% of employment in Ukraine. If upstream and downstream agribusinesses (input supply and food processing) are considered, these figures increase to approximately 22% and 10% respectively.

4. **Moreover, almost one-third of the Ukrainian population lives in rural areas.** A 30% productivity increase in agriculture could increase Ukraine's GDP by 4.4% in the medium term (5 years) and 12.5% in the long term (10 years). This growth would be especially beneficial for the poor, as unskilled wages and incomes of rural poor households could increase by 11.2% in the medium term and 27% in the long term¹.

5. **Agricultural exports make a crucial contribution to the country's trade balance** and current account. The share of agricultural exports in total exports has steadily increased from 12% in 2005 to 26% in 2012. Without agri-food products, the country's current account deficit in 2010 would have been 5.2% of GDP instead of the 2.2% of GDP officially recorded.

6. **Achieving potential farm productivity and export volumes will require more capital intensive agriculture. This can be financed by unleashing potential domestic and foreign investment.** Returns on capital in agriculture were 2.5 and 6.4 times that in industry and service

¹ Byerlee, D. (2010). Globalization: Opportunities and Challenges for Agriculture. Doing agribusiness in Ukraine: prospects for 2011.

sectors respectively and averaged 25% between 2002 and 2007. Yet, despite the apparent profitability of agriculture, Ukraine has not captured its potential share of global growth in foreign direct investment (FDI) in agriculture, which grew from US\$1bn. to US\$60bn. between 1990 and 2007, suggesting a lack of long-term certainty for investors. Overall, the share of agriculture in total FDI and total capital investments in Ukraine is low in comparison to other sectors considering its contribution to GDP.

7. Constraints to investment and growth in agriculture comprise three interrelated dimensions:

- (i) *Policy and Business Environment Constraints:* ad hoc policy making and resulting uncertainties for investors; lack of transparency in the implementation of policy; and privileged treatment of favored enterprises and sub-sectors, resulting in uneven playing field for enterprises.
- (ii) *Private Sector Markets for Land, Finance, Inputs and Services:* constrained access to land, finance, private agricultural services and technology, especially for small and medium sized enterprises.
- (iii) *Public Infrastructure and Services:* inefficiencies and gaps in public infrastructure, logistics, technical knowledge and managerial skills; significant gaps in public institutions and efficiency of public services and regulatory agencies, resulting in high costs of doing business.

8. Unleashing investments and ensuring sustainable agricultural growth in Ukraine requires a comprehensive approach to dealing with these interdependent constraints across the policy framework. Below we describe key reform priorities to address these constraints under six key aspects of the policy framework with some guiding principles for reform. Detailed recommendations are provided in Table 1:

- (i) **Trade Facilitating Framework:** Since Ukraine is a net exporter of agri-food products, closing the productivity gap would mean more exports and even more revenues to farmers as world prices are expected to remain on an upward trend. Export-conducive trade policy creates incentives for investors to undertake capacity-enhancing investments in production, marketing infrastructure and related services, thus reducing excess supplies which would otherwise have a dampening effect on domestic prices and on farmers' incomes. Two key reform priorities are:
 - *Export restrictions: Abandon official and unofficial export restrictions to create greater certainty for investors and avoid substantial revenue losses which exceeded US\$ 1.9 bn. in 2010/2011. The 2013 Memorandum of Understanding considerably strengthens coordination on export policy between government and private grain traders but only a long term commitment to the removal of export restrictions will fully eliminate the risks that such restrictions create for traders.*
 - *Marketing regulations: Comprehensively review and revise marketing regulations to decrease marketing costs and remove regulations which restrict the movement of agri-food products. The recent removal of the requirement to register grain exports is a very positive development in this respect.*
- (ii) **Business Facilitating Framework:** A stable and consistent policy environment which provides fair opportunities for all investors is needed to attract investments and encourage innovation. Consistency, transparency, and neutrality between enterprises and sub sectors

are guiding principles. Two key reform priorities are:

- *Policy consistency: Adopt a more consistent long-term policy approach to reduce decision making risks for investors and further embrace public private consultation in policy making. The development of the Ministry of Agriculture’s “Strategy for Development of the Agrarian Sector of the Economy” provides an opportunity to establish an improved long-term policy framework for agriculture.*
- *Sub-sector and enterprise bias: Establish an even playing field across the sector rather than focusing on individual strategic sub-sectors or favored enterprises. This would help to ensure that the allocation of private investments is unbiased and directed towards their most economically efficient purpose.*
- *Price regulation: Abandon the practice of (administrative) state price regulations and any other measure affecting market price formation, which creates further bias between sub-sectors and further uncertainty for investors.*

(iii) **Functional Agricultural Land and Finance Markets:** A free land market would allow the transfer of land from less efficient to more efficient farmers, thus increasing overall productivity. It would also allow land to serve as collateral, thus increasing investment in agriculture. The establishment of the Land Bank poses serious risks to the development of the land market and the financial sector. The concept of the Land Bank should be rethought. There is a clear risk that the Land Bank’s acquisition powers can be misused to collect land cheaply and then re-sell it to new investors at a premium. Creating the capital of the Land Bank from the value of land plots creates fiduciary risks and opportunities for corruption. Fostering competition and transparency is a guiding and fundamental principle. Three key reform priorities are:

- *The moratorium on land sales should not be lifted before an efficient and unified registry system and cadastre system has been put in place.*
- *New land legislation should be transparent and needs to be preceded by an information campaign to land owners about their rights. Information about the productive value of land in each region, auction sales prices, and names of land owners should be made public.*
- *Re-think the Land Bank concept and leave agricultural finance to financial institutions which have a more clearly defined capital base and which are subject to regulatory supervision and competition.*

(iv) **Supportive Tax and Agricultural Support Framework:** The current agricultural taxation system and farm support programs in Ukraine leaves farmers virtually untaxed, distort farm production decisions and have a highly questionable effect on overall sector competitiveness. The Government of Ukraine should consider comprehensive reform of the agricultural taxation system with the purpose of minimizing interference with economic decisions. Two key reform priorities are:

- *Undertake a quantitative assessment of the financial impact on farmers and fiscal implications for government of alternative reform options, including for reform of the Fixed Agricultural Tax (FAT) and the special VAT regime.*

- *Building on positive developments to date, continue to shift public support for agriculture to payments which are not linked to the type or level of farm production (decoupled payments). Further conversion of any remaining production-based support payments into decoupled area-based or farm-based payments would be beneficial for overall sector growth.*
- (v) **Enabling Regulatory Framework for Technologies and Innovations Transfer:** Access to modern and largely imported inputs (seeds varieties, machinery and equipment, agri-chemicals) is constrained by cumbersome state licensing, testing, and registration systems that ultimately increase producers' costs. The Government of Ukraine should consider reforming the currently expensive regulatory procedures for the import of agricultural inputs. Two key reform priorities are:
- *Comprehensively review regulatory procedures for imports/production and marketing of agricultural inputs and harmonize them with best international practices to reduce transaction costs and the time required to bring new technology to the market.*
 - *Revisit and make more efficient (i.e., less time consuming and less costly) the testing and registration procedures for imported genetic material.*
- (vi) **Modern Food Safety and Quality System:** Ukraine's largely Soviet-type food safety and quality system does not ensure effective food safety control but rather undermines agriculture's export potential and competitiveness through high compliance costs. The Government of Ukraine should consider leading a joint public-private reform effort to streamline food safety regulations and compliance requirements. This would significantly reduce compliance costs for businesses and improve the effectiveness of the system.
- *Fundamentally reform the food safety system through a public-private reform initiative, accelerating harmonization with the EU. Ongoing multi-agency efforts, in cooperation with IFC, to reform food safety legislation are a positive development in this respect.*
9. *Comprehensively move to a control system which targets critical areas of food safety risk (e.g. Hazard Analysis and Critical Control Point system (HACCP)) and establish a central registry for food safety inspections.*
10. Table 1 lists detailed policy reform and public investment priorities for the short-term, medium-term and long-term, under each of the six policy areas discussed above. In combination, these reforms will help to unlock the full potential of Ukraine's agriculture.

Table 1: Key reform areas to unlock potential investment in Ukraine’s agriculture

<i>Policy area</i>	<i>Guiding principle</i>	<i>Sub-area</i>	<i>Recommended policy reform and public investment measures</i>	<i>Priority and responsible agency</i>	<i>Period of Implementation</i>
Trade Facilitating Framework	Avoid trade distortions; min marketing costs	Exports and related regulations	Abandon the practice of unannounced official and unofficial export restrictions.	GoU/MoA/MoE	ST
			Introduce a set of indicators to monitor country’s food security as a basis for releasing strategic stocks/export measures	GoU/MoA	ST
			Among export restricting measures choose those that create the least distortions (tax better than quotas) and/or manage them with maximum transparency and equity (equal access)	GoU/MoA	ST
			Comprehensive review and revision of marketing regulations to decrease marketing costs (e.g. quality, quarantine and veterinary certificates). Remove unjustified certificates and other authorizations for the movement of agri-food products.	GoU/MoA	ST/MT
		Imports and related regulations	Drop tariff-rate quota for sugar imports Pursue import substitution through measures to improve the competitiveness of domestic producers rather than through trade measures on imports	GoU/MoA	
Business Facilitating Framework	Minimize transaction costs for doing business; equal opportunities for all sub-sectors and enterprise; minimize market distortions	General policy framework	Increase consistency of policy decisions and instruments with stated strategic objectives.	GoU/MoA	ST
			Increase predictability of the policy framework and the reliability of state support.		
			Increase consultation with business and civil society institutions in policy making to increase predictability of the policy framework and its consistency with policy objectives.		
		Minimize intervention in market decisions	Abandon the practice of focusing the development programs on individual strategic sub-sectors, which biases the allocation of private investments in the sector away from their most efficient use.	MoA	ST
			Comprehensive review of the Law of Ukraine On State Support of Agriculture to abandon practice of administrative state price regulations and any other measure affecting market price formation (including the obligation to provide notification of price increases and maximum trade margins). Replace these regulations by more effective social protection schemes (see below)	GoU/MoA	ST/MT
	Avoid state inference in production decisions, e.g. abandon mandatory crop rotation	MoA	ST		

schemes for farmers.

Functional Agricultural Land and Finance Market	Foster competition and information transparency; equal access	Free agricultural land market	The moratorium on land sales should not be lifted before an efficient and unified registry system and cadastre system has been put in place.	MoA/State Agency for Land Resources	ST
			The Law On Agricultural Land Circulation should not contain norms on preferred buyers, preemptive buyers, limitations to sellers/buyers, and specific powers granted to the state and Council of Ministers (through resolutions).	MoA	ST
			The introduction of new legislation for land markets needs to be preceded by an information campaign to land plot owners about their rights. In addition information about the productive value of land in each region, auction sales prices, and names of land owners should be made public.	MoA/Antimonopoly committee	ST
			Re-think the Land Bank concept and leave agricultural finance to financial institutions which have a more clearly defined capital base and which are subject to regulatory supervision and competition. Ensure that the concept follows best international practices and does not breach competition on land market.		
		Agricultural financial services	Continue development of legislation on innovative input and crop finance schemes (i.e. warehouse and crop receipts) to facilitate access to finance for agricultural producers, especially for small and medium sized farmers.	GoU/MoA	ST/MT
Supportive Tax and Agricultural Support Framework	Minimize interference with economic decision making; equity;	Agricultural taxation	Consider undertaking a quantitative assessment of the financial impact for farmers and fiscal implications of alternative reform options including reform of the FAT and of the special VAT regime	GoU/MoA/MoF /MoRL/MoE	MT
			VAT: ensure effective and transparent VAT refunds.	GoU/MoA/MoF /MoRL/MoE	MT
			Make more fiscal resources available to local authorities for important communal services and infrastructure.	GoU/MoA/MoF /MoRL/MoE	MT
		Public Expenditures	Continue to shift public support to agriculture to decoupled payments. Convert any remaining production-based support payments into (de-coupled) area-based or farm-based payments;	GoU/MoA/MoF	MT
			Improve equity and transparency of the state support system for agriculture (smaller number of programs, less conditions for applicants). Establish a platform for informing the public of the use of public expenditure in agriculture.	MoA/MoF	ST

			Improve governance in the implementation of state support programs. Ensure equal access of all producers to support programs. Remove opportunities for individual discretion (e.g. quota allocation).	MoA	ST
Enabling Regulatory Framework for Technologies and Innovations Transfer	Minimize transaction costs for doing business	Regulatory measures	Comprehensive review of regulatory procedures for imports/production and marketing of agricultural inputs and harmonize them with best international practices to reduce transaction costs and time required to bring new technology to the market Revisit and make more efficient (i.e., less time consuming and less costly) the testing and registration procedures for imported genetic material.	MoA/	ST
Modern Food Safety and Quality System	More effective food safety and quality control at less cost for the business	Food safety and quality system	Improve, fundamentally, the entire food safety system through a public-private reform initiative, accelerating harmonization with the EU: Remove fragmentation and inconsistencies in legislation. Revise / remove unnecessary standards with a strategic view towards expanding / new markets and their requirements. Remove redundancy in institutional mandates and services. Move comprehensively to a risk-based control system (e.g., based on HACCP) and establish a central registry for food safety inspections. Increase the number of food safety related laboratories that are accredited by an internationally recognized accreditation body. Improve traceability and other food safety requirements of target markets.	GoU/MoA/MoH	ST/MT
Other Areas		Food Security Policy	Design and introduce a Food Security Policy that would target support of vulnerable households against food inflation including: 1) a set of measurable food security indicators and adequate monitoring instruments; 2) social safety nets for vulnerable households against food inflation;	MoA/GoU/MoE	
		Knowledge and innovation system	Undertake comprehensive reform of the agricultural research and education system in line with existing reviews and recommendations.	MoEd/MoA/GoU	MT/LT
		Irrigation and Drainage	Formulate a national irrigation and drainage strategy based on: -A review of long-term water availability and irrigation requirements. -A review of institutional options for off-farm and on-farm irrigation and drainage system management, including options to improve cost recovery. -A review of the status of irrigation infrastructure building on the ongoing inventory -A review of the financial and economic viability of irrigation and drainage rehabilitation.		

Advisory services	<p>Increase public funding for agricultural advisory services.</p> <p>Reform education of extension officers.</p> <p>Simplify registration and certification process for extension service providers.</p> <p>Improve substantially the quality and accessibility of critical data (such as yields, gross margins, prices, farm profits, and weather information) (also see information systems below).</p>	MoA/GoU	MT/LT
Risk management	<p>Examine the feasibility of establishing a futures market in Ukraine according to Marche a Terme International de France (MATIF) or Chicago Board of trade (CBOT) models.</p> <p>Ensure the rule of law in contract enforcement.</p> <p>Ensure an effective legal framework for agri-insurance.</p>		
Information systems	<p>Consider comprehensive overhaul of agricultural information systems: market and technical information; weather information; farm information; subsidies information, possibly based on existing models such as Farm Accountancy Data Network (FADN) and other systems currently applied in the EU.</p>		

Abbreviations. ST/MT/LT: short, medium, and long term. MoA – Ministry for Agricultural Policy and Food; MoE – Ministry of Economic Development and Trade; MoEd – Ministry of Education; MoH – Ministry of Health; GoU – Government of Ukraine;
