Bundesministerium für
Ernährung, Landwirtschaft
und Verbraucherschutz

German–Ukrainian Policy Dialogue in Agriculture
Institute for Economic Research and Policy Consulting

Policy Paper Series [AgPP No. 35]

State monopoly in agricultural exports: the game is not worth a candle

Oleh Nivievskyi
Sergiy Kandul
Heinz Strubenhoff

Kyiv, February 2011

About the Institute for Economic Research and Policy Consulting

The Institute for Economic Research and Policy Consulting (IER) is the leading Ukrainian analytical think tank focusing on economic research and policy advice. The IER was founded in October 1999 by top-ranking Ukrainian politicians and the German Advisory Group on Economic Reforms.

The mission of IER is to present an alternative point of view on key problems of social and economic development of Ukraine. In frame of the mission IER aims at providing top quality expertise in the field of economy and economic policy-making; acting as real leader of public opinion through organisation of open public dialog; contributing to the development of economic and political sciences as well as promoting development of Ukrainian research community.

Institute for Economic Research and Policy Consulting
Reytarska 8/5-A,
01034 Kyiv, Ukraine
Tel: +38 044 / 278 63 42
Fax: +38 044 / 278 63 36
institute@ier.kiev.ua
http://www.ier.kiev.ua

About the Project "German-Ukrainian Policy Dialogue in Agriculture"

The German-Ukrainian Policy Dialogue in Agriculture is advising Ukrainian state authorities and business associations on reforming agricultural policy and legislation, taking into account international experience of Germany and other countries as well as international practice (EU, WTO), in accordance with principles of market economy. The project is funded by the German Federal Ministry of Food, Agriculture and Consumer Protection under its Cooperation Program and by the German Centre for International Migration.

German-Ukrainian Policy Dialogue in Agriculture
Reytarska 8/5-A,
01034 Kyiv, Ukraine
Tel: +38 044 / 235 75 02
Fax: +38 044 / 278 63 36
agro@ier.kiev.ua
http://www.ier.com.ua

List of Recent Policy Papers

- The issue of price volatility: what is behind? By Anna Kuznetsova, Oleh Nivievskyi and Heinz Strubenhoff (forthcoming)
- Raw sugar toll refining – a sensible policy? By Oleh Nivievkyi, Anna Kuznetsova, Serhiy Kandul and Heinz Strubenhoff, Policy Paper AgPP33 (forthcoming)
- Why agricultural producers lose huge market opportunities with state monopolies – International experience and Ukrainian evidence. Policy note by Oleg Nivievskyi, Serhiy Kandul and Heinz Strubenhoff (forthcoming)
- Straw use in Ukraine – opportunities and options by Anna Kuznetsova, Policy Paper AgPP31, September 2010
- Sustainability requirements for biofuels in the EU: implications for Ukrainian producers of feedstocks, by Serhiy Kandul, Policy Paper AgPP29, April 2010
- The Agriculture Knowledge and Information System in Ukraine – Call for Reforms by Ulrich Koester, Christopher Schumann, and Alex Lissitsa, Policy Paper AgPP30, February 2010
- Biogas and "green tariffs" in Ukraine – A profitable investment?, by Anna Kuznetsova and Kateryna Kutsenko, Policy Paper AgPP26, January 2010
- Social Protection of the Population by Regulation of Food Prices and Trade Margins – Does the Law No. 1447-VI achieve its intended objectives?, by Justyna Jaroszewska, Serhiy Kandul, Wolfram Rehbock and Heinz Strubenhoff, Policy Paper AgPP28, November 2009
- Financial Crisis and Ukrainian Agriculture: Impact and Response, by Serhiy Kandul, Policy Paper AgPP27, November 2009
- Options for Ukraine with regard to its National Policy towards GMOs: the EU or US Model?, by Justyna Jaroszewska, Policy Paper AgPP25, June 2009
- Agriculture, Bioenergy and Food Policy in Ukraine – Analyses, Conclusions and Recommendations. Editors: Heinz Strubenhoff, Igor Burakovsky and Veronika Movchan, Book, March 2009

All papers and the book can be downloaded free of charge under http://www.ier.com.ua/ua/arhives_papers.php. For more information on subscription to our regular email-distribution, please contact Ms Oksana Kukhar by email: kukhar@ier.kiev.ua

A Draft Law #8053 as of February 2, 2010 “On amendments to the Law of Ukraine “On State Support to Agriculture” (as to the peculiarities of exports of products subject to state price regulation)” effectively aims at granting to the State a monopoly of the export of various agricultural products. Economic theory and worldwide experience, however, warn about possible devastating consequences for the sector’s growth.

The Draft Law concerns the exports of agricultural products subject to the state price regulation (social agproducts in the following). The list of such products is quite comprehensive and includes all major primary agriculture products and certain food products[1]. According to the Draft Law, the export of the social agproducts can be exercised only by agricultural producers (export volumes should not exceed their production volumes) and by the so-called State Agent for export. The State Agent shall be tendered, and either a state-owned company or a private entity with Government shares in the statutory capital will be eligible for the tender by the Cabinet of Ministers. So either existing companies would have to introduce changes to their statutory capital (by selling a share to the state) or to cease exports of the social agproducts.

Historically, the Draft Law well embeds as a final accord in the sequence of events in agricultural markets in Ukraine over the last year. Establishment of the State Grain Corporation, introduction of the export quotas for major grains, and allocation of the largest share of the quota to a state-owned structure during the second phase[2], requirement to register export contracts at the state agrarian commodity exchange[3] seems to pinpoint at increasing the administrative control and reducing competition in the grain market. Market participants, already troubled with export quotas and obligatory registration of contracts with the state agrarian commodity exchange, said they were strictly against the initiative which could be hardly justified not only by economic but also legal reasoning[4] and expect further actions to monopolize the market by the state.

The government’s concern about food security is understandable, especially in the current environment of rising world and domestic food prices. Its response, however, might dampen the problem in the short run, but exacerbate it in the long run. State monopoly in economic terms is a form of a non-tariff barrier that restricts/controls the trade, for a State Agent makes the decisions on how much of each agproducts is to be exported each year and its timing of delivery. Additionally State Agents are not as experienced and quick in trade as private traders that increases transaction costs in the sector and might, for example, exacerbate a downward seasonal trend in producer prices.

The net economic effect of this policy step is evident and it is opposite to the food security aspirations. There is an international consensus that export restrictions discourage production of that product by downward pressure on the farm gate prices and thus providing disincentives for investment into the sector. Contrary to, perhaps widely spread opinion, private traders perform not only trade but make international capital available to

---

[1] The exact list of products under state price regulation for a particular year shall be defined by the Cabinet of Ministers from the following: wheat (soft and hard), mixture of wheat and rye, corn, barley, rye (spring and winter), pea, buckwheat, sorghum, oats, soybeans, sunflower seeds, rape seeds, linseeds, hops, sugar (from sugar beet), flour (wheat and rye), meat and by-products (inc. poultry), dry milk, butter, and sunflower oil. (Article 3.3 of the Law on Ukraine “On the state support to agriculture” No. 1877-IV as of June 24, 2004).

[2] According to the Ministry of Economic Development and Trade, LTD “Khlib Investbud” received 221.3 thd tons of wheat to export after second quota allocation in January 2011 out of total of 500 thd tons allowed (more than 40%).

[3] CMU Resolution #1254 "Certain Issues of Creation and Registration of Contracts"_from December 13th, 2010.

[4] Chapter X of the Law No37-IV “On grain and grain markets” as of July 4, 2002 envisaged similar State Agents for export and import within international state agreements only. Otherwise, state monopolization of trade is seen as infringing the major principle of equal rights in external economic activity fortified in particular in the Article 8 of the Law No.959-XII ”On external economic activity”.

help farms with liquidity constraints during harvesting and seeding campaigns. Decades of applied research on this issue demonstrate that most of the long-run supply elasticities are close to 1. This suggests that production will rise or fall approximately in proportion to price changes[5]. Applying this result to Ukraine, a conservative estimate, for example, of the domestic price drop after introduction of the export grain quota in the fall 2010 is about 16%[6]. Other things being equal, it will reduce the future grain crops in Ukraine approximately in the same proportion. This in turn will have markedly negative effects on the sector's finance, investment and growth prospects in the long run thus exacerbating shortages and price hikes in the future. The burden of this measure is especially felt in the export oriented sectors (which is definitely the case for Ukraine). Moreover, the state monopoly might also create additional inflation pressure in the entire Ukrainian economy, thus raising even more concerns about food security in the country. The mechanism is as follows. As agriculture and food processing sectors together make up a significant share of the total Ukrainian exports (e.g. about 14% in 2008), the state monopoly will likely influence the current account balance through less export earnings, other things being equal. This, in turn, will increase the demand for foreign exchange and weaken the Hryvnia. As a result, all imports will tend to be more expensive in Hryvnia, thus creating additional inflation pressure in the entire economy.

In summary, due to its deleterious effects, the trend worldwide is to eliminate State monopolies on trade in agricultural and food products. Instead, there are other more welfare friendly policy measures to ensure food security in the country..

[5] Norton R. (2004) Agricultural Development Concepts: concepts and experiences. FAO, (p 81)
[6] Getreideexportquoten: Zum Umgang mit Chancen und Verantwortung. Ausgabe 28, Dezember 2010. Newsletter, Deutsche Beratergruppe