

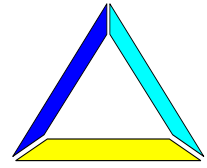


Bundesministerium für
Ernährung, Landwirtschaft
und Verbraucherschutz

**Institute for Economic Research
and Policy Consulting**

**German–Ukrainian Policy Dialogue
in Agriculture**

Reytarska 8/5-A, 01034 Kyiv
Tel. (+38044) 278-6342, 278-6360, Fax 278-6336
E-Mail: agro@ier.kiev.ua, <http://www.ier.kiev.ua>



AgPP 4

Policy Paper No. 4

**Comments on the Draft Presidential Decree: „On the main
principles of reforming state support to agriculture and rural
areas“**

LIST OF ABBREVIATIONS

AMS	AGGREGATE MEASURE OF SUPPORT
BN	BILLION
CMU	CABINET OF MINISTERS OF UKRAINE
CPI	CONSUMER PRICE INDEX
EPT	ENTERPRISE PROFITS TAX
FAT	FIXED AGRICULTURAL TAX
GDP	GROSS DOMESTIC PRODUCT
IMF	INTERNATIONAL MONETARY FUND
KMT	THOUSAND METRIC TONS
M	MILLION
MAP	MINISTRY OF AGRICULTURAL POLICIES
ME	MINISTRY OF ECONOMY
MF	MINISTRY OF FINANCE
MT	METRIC TON
NBU	NATIONAL BANK OF UKRAINE
PIT	PERSONAL INCOME TAX
SEZ	SPECIAL ECONOMIC ZONES
TPD	TERRITORY OF PRIORITY DEVELOPMENT
TAFS	TOTAL AGRICULTURAL FISCAL SUPPORT
TABE	TOTAL AGRICULTURAL BUDGET EXPENDITURES
UAH	UKRAINIAN HRYVNIA
URAA	URUGUAY ROUND AGREEMENT ON AGRICULTURE
VAT	VALUE ADDED TAX
WB	WORLD BANK
WTO	WORLD TRADE ORGANIZATION
IER	INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING
SME	SMALL AND MEDIUM SIZED ENTERPRISES

BACKGROUND

Based on the request of the Advisor to the President, Pavlo Haidutsky, at the Office of the President of Ukraine in February 2006 this paper presents an independent assessment of the draft decree „**On the main principles of reforming state support to agriculture and rural areas**“. The assessment starts with a brief overview on the fiscal support to agriculture from 2000 to 2006¹, continues with the presentation of the major elements of the foreseen reform to be implemented from 2007 to 2015 and ends with a preliminary brief assessment of the expected impact of the reform.

PREVIOUS FISCAL SUPPORT

Since 2002, Ukrainian agriculture has enjoyed significantly increasing fiscal support² from the state in the form of budget and tax expenditures³. Table 1 shows the total fiscal support to agriculture and rural areas. It grew almost threefold over the last four years, fluctuating around 2% of Ukraine's GDP. Although in absolute values Ukraine spends a tiny fraction of that, for example, EU or USA does, however, in terms of GDP fraction it already spends a lot, e.g. in EU this ratio equalled 0.65%, in USA 0.73% (see Zorya⁴ (2005)). Moreover, we argue that Total fiscal support to agriculture (TAFS) documented in table 1 represent only the lower bound estimate since benefits (mainly tax benefits) from Free Economic Zones and Territories of Priority Development were not included in these estimates (due to the lack of relevant data).

Table 1

Total Fiscal Support to Agriculture in Ukraine, UAH m

	2002	2003	2004	2005*	2006**
Budget expenditures	1,473.1	2,827.8	3,250.5	4,379.1	6,678.5
Tax expenditures	3,349.7	3,424.6	3,563.7	3,493.7	5,769.9
Other Fiscal Support	13.1	318.0	184.8	214.5	Na
Total fiscal support to agriculture (TAFS)	4,835.9	6,570.3	6,999.0	8,087.3	12,448.4
Share of TAFS in GDP	2.1%	2.5%	2.0%	1.9%	2.4%
Ratio of tax proceeds from agriculture to TAFS	34.6%	19.6%	23.6%	Na	Na
Ratio of tax proceeds from agro-food sector to TAFS	120.5%	87.6%	87.9%	Na	Na

Source: IER databank and estimates; Notes: * - proj.; ** - planned; Na – not available

¹ For a detailed analysis of budget and tax expenditures as well as budget execution in agriculture in Ukraine see Oleg Nivyevskiy: Fiscal support to agriculture in Ukraine, German-Ukrainian Policy Dialogue in Agriculture, Policy Paper No.2, January 2006

² However, the total support to agriculture (fiscal plus non-fiscal support) has been much higher in Ukraine, since significant non-fiscal measures benefit domestic agricultural producers as well. For example, high import tariffs protect domestic producers from foreign competitors, forcing consumers to pay more for food products such as sugar and thus indirectly supporting agriculture. Also, there are other than tariffs measures being often nontransparent and distortive for production and trade. For example, sugar quota and privileged inputs supply to agricultural producers might serve as an illustration of such measures.

³ Tax Expenditures include tax privileges, tax arrears, and tax write-offs

⁴ Zorya, S. (2005): Reforming Agricultural Support. In: Meyers, W., et al (eds): Refocusing Agricultural and Rural Development Policies in Ukraine: action Plan for the Road Ahead. Washington, DC: USAID. p. 18 <www.dec.org/pdf_docs/PNADD.pdf>

BUDGET EXPENDITURES ON AGRICULTURE AND RURAL DEVELOPMENT

In this section we consider State Budget spending⁵ on agriculture and rural development. Table 2 lists the whole set of budget spendings grouped into MAP expenditures and Other Ministries' expenditures, since a bulk share of expenditures is delegated to MAP. We have grouped MAP expenditures into several subgroups as it is documented in the Law of Ukraine "On the State Budget of Ukraine" (e.g. "Financial support of livestock and crop production") or according to some relevant criteria (e.g. "Education and training"). Then these subgroups have been grouped according to their effect on production and trade, i.e. distortional or non-distortional. Such a division generally mimics WTO classification of state domestic support measures thereby falling into two broad categories: "amber box" and "green box" measures. "Production subsidies" group in this report corresponds to the "amber box" measures, while the other two groups (i.e. "Growth enhancing" and "Other measures") correspond (with some exceptions) to the "green box" measures. Other Ministries' measures are classified as Growth-Enhancing, thus falling into the green box according to WTO classification.

Table 2 shows the total agricultural budget expenditures (TABE) growing from UAH 1.47 bn in 2002 to the planned UAH 6.68 bn for 2006. At the same time the share of TABE in total budget expenditures has been growing (although not steadily) from 3.3% to 4.9% over 2002-2006. If we compare the dynamics of both types of expenditures to 2002 then total budget expenditures grew by 3.1 times in 2006, whereas TABE grew by 4.5 times over the same period. The ratio of tax proceeds from agriculture to TABE shows that the agriculture sector in Ukraine received almost two times more from the budget than it contributed, which together with significant tax expenditures creates an imbalanced tax burden on Ukrainian economy, thus potentially decreasing the competitiveness of the whole economy.

We observe that MAP expenditures have been prevailing in total budget expenditures, accounting for more than 90%. It is worth mentioning that although this figure is a bit lower for 2005 and 2006, however, these are planned figures, whereas table 2 reports executed figures for 2002-2004. Such a low fraction of Other Ministries' expenditures in TABE reflects probably an implicit assumption of the Government that MAP must be responsible for, in addition to agricultural policy, the whole range of rural development issues, such as social policy in rural areas, rural infrastructure, health, education, etc. However, this should primarily be the task of other line ministries.

⁵ Allocated via different ministries, e.g. Ministry of Agricultural Policy (MAP), Ministry of Finance, State Committee for Land Resources etc.

Table 2

Public Expenditures on Agriculture, UAH m

	2002	2003	2004*	2005	2006**
MAP programs (in % of TAFE):	95.7%	91.4%	91.1%	90.4%	78.3%
Production subsidies (in % of TAFE):	22.1%	21.4%	32.8%	34.89%	38.40%
Financial support of livestock and crop production:	73.9	236.2	421.0	689.5	1,992.5
<i>Slaughter premiums per kg with minimum weight threshold</i>	Na	174.0	338.0	553.5	745.0
Support to horticulture, viticulture, and hops	111.2	151.3	109.1	175.0	227.7
Partial compensation of interest rates for credits	119.6	74.8	141.5	350.0	260.0
Financing of sowing winter and spring grain crops	Abs	Abs	247.9	Abs	Abs
Financial support of rural farms	4.5	13.4	1.1	27.3	28.0
Fertilizer subsidies	Abs	40.0	109.6	Abs	0.0
Partial compensation of costs of agricultural machinery	15.7	18.3	36.2	270.0	32.0
Milk processing	Abs	Abs	Abs	10.0	4.0
Growth-Enhancing measures⁶ (in % of TAFE):	65.0%	47.0%	51.6%	54.5%	53.3%
Rural Development	8.7	42.4	24.3	23.1	24.4
Research and Development	161.5	66.5	77.9	143.1	154.5
Education and training	382.9	490.8	619.8	913.5	1,041.7
Public stockholdings	19.2	13.5	50.0	25.9	10.0
Pest and disease control	4.9	7.0	9.9	20.0	30.0
Food safety and quality control	297.5	370.0	471.0	585.0	704.0
Extension and Advisory Services	1.8	6.3	8.6	8.1	10.0
Insurance costs compensation	0.0	0.0	0.0	54.0	10.0
Land Resources	0.2	5.6	10.4	15.0	5.0
Selection programs:					
<i>Livestock</i>	13.9	76.6	112.8	124.0	110.0
<i>Crops</i>	11.7	41.7	42.8	103.3	104.7
<i>Fish</i>	0.3	1.3	2.0	6.5	6.8
Other measures:					0.0
Natural disaster relief	2.3	695.3	67.3	20.0	25.0
Environment Protection	29.2	44.6	61.1	81.8	109.6
Others:	150.4	189.2	336.6	315.6	340.1
<i>Administrative costs</i>	7.9	50.8	59.2	80.3	101.2
Other Ministries' programs (in % of TAFE):	4.3%	8.6%	8.9%	9.6%	21.7%
Rural Development	2.4	86.5	104.3	170.3	1,075.3
Education and training	47.7	71.6	102.9	121.0	103.7
Selection programs	1.3	13.0	11.5	12.3	13.9
Land Reform	3.5	35.7	28.2	62.7	154.7
Total agricultural budget expenditures (TAFE)	1,473.1	2,827.8	3,250.5	4,379.1	6,678.5
Share of TAFE in total public expenditures	3.3%	5.0%	4.1%	3.7%	4.9%
Share of public expenditures on agriculture in total GDP	0.7%	1.1%	0.9%	1.0%	1.3%
Ratio of tax proceeds from agriculture to TAFE	113.5%	45.5%	50.8%	Na	Na
Ratio of tax proceeds from agro-food sector to TAFE	395.6%	203.5%	189.2%	Na	Na

Source: IER estimates based on State Treasury Report on the State Budget Execution 2000, 2001, 2002, 2003, 2004 and Laws of Ukraine "On State Budget" (2005 and 2006 years); Notes: * - numbers for 2000-2004 period are actual budget expenditures; ** - numbers for 2005 and 2006 are planned budget expenditures; Abs - program is absent; Na - data not available;

⁶ Estimates of the Growth-Enhancing measures as % of TAFE include Other Ministries' Programs as well.

Table 3

Execution level of selected budget programs for agriculture and rural development, %

	2000	2001	2002	2003	2004
Production subsidies:					
	87.86	45.86	62.90	99.03	98.03
Financial support of livestock and crop production					
Support to horticulture, viticulture, and hops	131.52	91.85	79.89	97.30	77.92
Partial compensation of interest rates for credits	28.53	46.40	79.63	99.71	74.39
Financial support of rural farms	100.00	50.17	37.61	99.49	8.70
Growth-Enhancing measures:					
Rural Development	-	-	21.56	99.92	97.32
Research and Development	-	-	74.11	87.12	85.08
Education and training	-	-	88.49	93.03	93.37
Public stockholdings	-	100.00	46.79	45.13	71.43
Pest and disease control	89.27	40.61	60.38	99.99	98.77
Food safety and quality control	100.47	75.44	86.00	93.91	93.00
Extension and Advisory Services	-	-	67.54	85.44	93.40
Land Resources	95.17	79.25	3.33	99.29	86.35
Selection programs:					
<i>Livestock</i>	64.68	67.04	23.71	99.72	91.00
<i>Crops</i>	51.55	65.67	39.52	99.71	80.80
<i>Fish</i>	95.34	47.63	26.15	100.00	70.29
Other measures:					
Natural disaster relief	99.98	76.51	34.09	97.42	96.14
Environment Protection	-	-	65.51	99.24	92.39

Source: IER estimates based on State Treasury Report on the State Budget Execution 2000, 2001, 2002, 2003, 2004 and Laws of Ukraine "On State Budget" (2000-2004 years)

PROPOSED REFORM OF MEDIUM TERM BUDGET EXPENDITURE PLANNING AND REORIENTATION OF THE SUPPORT TO AGRICULTURE

Table 4 to 7 show the intended medium term reorientation of the support system for agricultural producers proposed by the Presidential Office. The cornerstones of the reform are:

1. Production subsidies would be replaced by direct payments to comply with WTO obligations and to follow the reforms of the EU;
2. The calculation of direct payments would be based on cultivated land and number of livestock units;
3. Growth enhancing "green box" measures would be considerably increased;
4. Tax privileges for agricultural producers would be considerably decreased;
5. Support for rural and social infrastructure as well as environmental protection would be increased.

Justification of the reform:

There are various driving forces behind the reform. From a domestic perspective the main reasons are the following:

First, it is becoming increasingly clear that the current system of production subsidies as well as inconsistent price regulations and market interventions does not achieve its goals of making the agriculture and food sector more competitive and providing food at affordable prices to consumers. These goals could not be achieved by the present inefficient support system. Second, the production subsidies are unevenly distributed, e.g. in livestock production 7 % of producers receive 74 % of production subsidies. Particular interest groups with preferential access to decision makers have benefited most, a large part of farmers has only partially or not at all benefitted from production subsidies. Third, the mechanisms of the current support system encourages arbitrary actions of involved Government bodies leading to high risk of corruption.

Table 4: The profile of subsidies distribution in livestock-breeding of Ukraine

Subsidies and premiums, thd UAH	Livestock-breeding		Raw milk			Poultry		
	Weight of group, %	Weight of subsidies, %	Weight of group, %	Weight of subsidies, %	Animal heads	Weight of group, %	Weight of subsidies, %	Animal heads
0	25.8	0	29.6	0.0	92	95.2	0.00	42209
0 ÷ 5	13.8	0.3	15.8	0.9	61	0.2	0.01	1407
5.1 ÷ 25	22.1	2.6	24.4	7.8	111	0.4	0.09	319340
25.1 ÷ 50	11.2	3.4	11.2	9.6	184	0.2	0.17	9046
50.1 ÷ 100	10.6	6.5	8.8	15.1	256	0.4	0.44	188270
100.1 ÷ 250	9.3	12.6	6.7	24.4	346	1.0	2.85	67548
250	7.2	74.6	3.6	42.3	676	2.6	96.44	459460

Source: IER estimates and database

Furthermore, the current policy measures have not been able to avoid severe deterioration of rural communal and social infrastructure although this was – and should be - an important goal for policy makers. Also, environmental concerns are rising.

From an international perspective – assuming approximation of the policy and legal framework of Ukraine towards international agreements – it becomes obvious that the WTO requirements positively leverage necessary policy decisions and the willingness to reform. In this view the perspectives of a deep free trade agreement with the EU leading to an eventual full membership of Ukraine in the EU at a later stage further reinforce necessary reforms in the agriculture and food sector.

Main principles of the reform:

1. Differentiation of state support to a) agricultural producers and b) rural areas
2. Providing state support not only to particular interest groups but to the majority of agricultural producers and rural areas
3. Creating an equal level playing field and equal access for all organizational forms of farming
4. Making the support more transparent and fair by clear definitions of the eligibility criteria
5. Avoiding administrative interference and monopolistic structures, create transparent markets
6. Providing support for regions with adverse weather conditions
7. Gradual approximation of the system of agricultural support to the requirements of WTO and EU

Main policy objectives:

The reformed state support to agriculture is targeted at:

1. Moving from production subsidies to direct payments
2. Increasing the competitiveness of producers on world markets
3. Ensuring food security for consumers
4. Improving rural communal and social infrastructure by decoupling it from agricultural production and increased public finance
5. Environmental protection

Main mechanisms and instruments:

1. Direct composite income payments for agricultural producers based on the area of arable and perennial crops above a defined ceiling (0.25 ha) considering the fertility of the land
2. Direct composite income payments for livestock producers based on the number livestock units above a defined ceiling (3 unit heads)
3. Reduction of the composite payments by the sum of tax arrears
4. Specifying the level of support to effectively increase competitiveness and subsequent gradual reduction
5. Compensation for land taken out of production at a level of at least 30 % of the level of support for cultivated land
6. State budget financing of the agrarian fund for market regulations and providing minimum state reserve for sugar and grain at 10 % of total state needs

7. State budget support for education, research, plant protection, veterinary, extension and advisory services, food quality control and safety, risk and insurance, support of unfavourable regions and public stocks at not less than 5 % of total agricultural production value
8. Financing of rural communal and social infrastructure at minimum 0.5 % of GDP
9. Financing of environmental protection measures at minimum of 0.05 % of GDP

Implementation timetable:

First period from 2005 – 2006: necessary change of legislation and institutional arrangements, specifying budgets for 2007

Second period from 2007 – 2010: introduction of new support mechanisms, end of tax privileges by 2010, formulation of programmes for sub-sectors and rural areas, introduction of programmes for environmental protection

Third period from 2011 – 2015: Increase of direct support to the level of 10 % of agricultural output, increase of rural areas support to the level of 1 % of GDP of Ukraine, increase of support for environmental protection to the level of 0.1 % of GDP of Ukraine

The further tables specify the measures.

Table 5
Transformation of the state support system for agricultural producers
(measures of "amber box"), mln. UAH⁷.

Support measure:	2002-2005 average	2005	2007	2011	2015
1. Partial compensation for interest rates for credits	173,6	350,0	-	-	-
2. Fertilizer subsidies	109,4	-	-	-	-
3. Partial compensation of costs for agr. machinery	75,0	270,0			
4. Financial support of crop and livestock production	296,5	689,5	-	-	-
5. Support to horticulture, viticulture and hops	101,8	175,0	-	-	-
6. Financial support of rural farms	19,1	27,3	-	-	-
7. Pledge purchasing	67,5	200,0	-	-	-
8. Agrarian fund financing	10,5	42,0	300	400	400
9. Producer's direct income support			12700	10500	10000
Total support	853,4	1753,8	13000	10900	10400
10. Total direct income support for agricultural land under cultivation	-	-	7971	6747	6510
11. Area of agricultural ⁸ land, mln. ha	-	-	30	30	30
12. Direct income support for 1 ha of agricultural land, UAH	-	-	266	225	217
13. Total direct income support for animal producers	-	-	4292	3633	3505
14. Total livestock, mln. head	-	-	10	10	10
15. Direct income support for 1 livestock head, UAH	-	-	429	363	351

Source: Presidential Office

⁷ 2007-2015 orientation figures

⁸ Agricultural land is arable and perennial land under cultivation above 0.25 ha.

Table 6

Transformation of the state support system for agricultural producers (measures of "green box"), mln. UAH ⁹.

Measures of financing	2002-2005 average	2005	2007	2011	2015
1. Maintenance of budget institutions	158,2	191,2			
2. Education and research	154,1	113,0			
3. Pest and disease control programs	98,8	131,4			
4. Selection programs in crop and livestock breeding	160,1	224,0			
5. Extension and advisory services	7,4	16,3			
6. Quality control and food safety	534,8	532,9			
7. Training and further education	582,2	881,5			
8. Land reform	2,7	5,0			
9. Agrarian insurance	13,5	54,0			
10. Creation of food reserves (public stock holdings)	31,4	25,9			
11. Natural disaster relief	195,6	20,0			
12. Other expenditures	163,8	151,5			
Total support	2102,6	2346,7	3204,7	7306,8	10355,2
13. Total agricultural production	63407	70000	75000	80000	90000
14. Support level in % of total production	3,3	3,4	4,3	9,1	11,5

Source: Presidential Office

⁹ 2007-2015 - orientation figures

Table 7**Transformation of the tax privilege system for agriculture, mln. UAH.¹⁰**

Tax privilege	2003-2004 average	2006	2007	2008	2009	2010
1. By fixed agricultural tax	1395	200	200	200	200	-
2. Total VAT, including:	2555	2600	-	-	-	-
VAT accumulation	1350	1400	-	-	-	-
VAT return to processors for milk and meat	835	850	-	-	-	-
Zero VAT rate for milk and meat sales	370	350	-	-	-	-
3. Pension fund transfers	-	1200	960	700	400	-
Total	3950	4000	1160	900	600	-
Source: Presidential Office						

¹ 2006-2010 - orientation figures

Table 8**Transformation of the state support system for rural areas, mln. UAH¹¹**

Financing	2002-2005 average	2005	2007	2011	2015
1. Rural infrastructure	16,5	400	200	600	1000
2. Rural social sphere	-	321,9	700	2100	3500
Total	16,5	721,9	900	2700	4500
3. Environmental protection	15,1	26,5	100	300	500
Total	31,6	748,4	1000	3000	5000
Source: Presidential Office					

WHAT CAN BE EXPECTED FROM THE PROPOSED REFORM MEASURES?

The proposed reform contains many elements that would greatly improve the efficiency of agricultural policy in Ukraine. In many respects it represents a move away from old and discredited models of agricultural policy towards goals and instruments that are cutting-edge world wide. What the agriculture and food sector needs and economists re-iterate for years is now in sight. The reform would lead to more competitiveness, transparency and increased investments. If implemented in a proper way this reform would likely contribute to developing the agriculture and food sector in the expected direction.

The separation of state support to a) producers and b) rural areas would have a significant impact on the medium-term planning of regional and communal public authorities and producers. The producers could fully concentrate on production, increase of productivity and farm income as well as increased investments. The medium-term public expenditure planning would facilitate investment decisions by lowering risks of ad-hoc policy changes. Investors – including foreign ones - would benefit from more stable framework conditions. The farmers, regional authorities and communes would know what they could expect from the central state authorities. Farms would no longer be burdened by too high expectations of villagers to maintain communal and social infrastructure.

The replacement of direct production subsidies currently delivered through intransparent tender procedures often to particular lobby groups by a transparent direct income transfer to farmers would have a positive impact in different ways. First, it would limit arbitrary decisions of agricultural administration because every farmer knows exactly what he should get from the system. Secondly, income transfers from the state to producers would be more evenly spread

¹¹ 2006-2010 - orientation figures

over the country leading to a fairer distribution of support to all forms of farms. Thirdly, it would limit the distortions in agricultural markets through less Government interference.

The re-direction of state support to rural and social infrastructure is urgently needed. Investment decisions in the sector, in particular in food processing, depend a.o. on the availability of reliable infrastructure, i.e. roads, energy supply, electricity, water etc. However, the means of support have to be further developed. Would the support be delivered by regional or structural support mechanisms similar to EU funds for these purposes?

The cut of VAT tax privileges will have a significant impact on agricultural producers. However, these cuts are understandable and will reduce distortions in the agri-food sector and the whole economy. As explained above the agricultural sector currently receives almost two times more from the budget than it contributes to it creating distortions on the whole Ukrainian economy. However, the agri-food sector as a whole is a positive net tax payer. Including the food industry the tax ratio becomes positive. The cut of tax privileges of agricultural raw material suppliers will have an impact on the food value chain. It will strengthen the competitiveness of holding structures with vertically integrated structures.

Although the overall impact of the proposed reform will be positive there are a few question marks and further clarification needs:

1. In the process of creating a growth enhancing policy framework for the agriculture and food sector to make the sector more competitive and productive the farms will have to release workers. Therefore, rural employment and development of rural SMEs will become an important issue. Most of the released workers have to find working places in rural handicraft and small and medium sized enterprises in future. This problem has to be addressed in rural development programmes in an adequate way.
2. The proposed reform will replace policy measures from producer subsidies to direct support. This means the support from the state to producers will be rationalized and will most likely become more effective. However, the welfare transfers from consumers to producers by inefficient price and market interventions, e.g. by minimum prices or quotas, e.g. in the sugar sector, have not been mentioned. Also, these issues have to be addressed in view of increasing competitiveness, reducing policies for particular interest groups and WTO membership.
3. The implementation of the reform needs administrative streamlining of involved line ministries and Government institutions to achieve the expected goals. Institutional responsibilities for agriculture, rural development, social and communal infrastructure and environmental protection have to be clearly defined jointly with a consistent legal framework to facilitate long-term commitment of all public and private stakeholders in the reform process.
4. The order of magnitude of some envisaged measures has not been explained in the draft decree. One would expect a thorough justification based on economic reasoning or policy considerations. In particular the minimum percentage figures for state security funds for grain and sugar need further explanations and justifications.
5. The importance of education, research and extension services for innovation and technical progress is reflected in the proposed reform. However, the current system in Ukraine is not able to produce high quality human resources for the future. The system needs transformation and new leaders who have the necessary skills and expertise according to international standards that are required to train a new generation of agricultural managers and agricultural policy analysts. Ukraine is aiming to be a major player on world agricultural markets and deserves a world class Agricultural Knowledge and Information System with excellent agricultural economists for education, research and extension. Unless steps are taken to radically shake up and renew the system, in the long run know-

how is going to be by far the most limiting factor for agricultural growth and competitiveness in Ukraine. Farm management experts and the food industry tell us that it already is the most limiting factor, and little has been done to improve the situation in recent years.

6. The goal of supporting regions with adverse climatic conditions needs further clarification. If conditions are constantly adverse, then does it make sense to support? In the extreme, we could support greenhouse banana production in Germany according to this criterion, as climatic conditions in Germany are adverse to banana production. International competitiveness can only be attained in harmony with existing natural conditions and not against them; if Ukraine wants to become competitive, then the bottom line is not to support production that is not suited to natural conditions but rather to ensure that existing natural conditions at a certain location are combined with the best possible biological, management and marketing technology and know how. If the goal of this measure is to help farmers deal with unstable climatic conditions (i.e. periodic drought years), then the appropriate measure would be to develop risk management tools (insurance, futures markets and income averaging options for tax purposes).
7. In future agricultural and energy sectors will be more closely interrelated not only through agricultural input markets but even more important by agricultural and energy output markets¹². It is highly likely that the future energy prices will set price floors for major agricultural commodities providing new opportunities for increased agricultural output by producing renewable energy in Ukraine. The Ukrainian Government should carefully monitor these developments on world markets and should intensify its efforts to make the sector more competitive.
8. The decree does not mention the problem of duplication of different state agencies responsibilities for the state reserve creation. So far Ukraine has four state agencies (including Agrarian Fund, State Reserve, JSC "Khlib Ukrayiny", and Oblast administrations) responsible for creation of state reserves, which makes activities of government institutions inefficient, nontransparent, and complex. To avoid duplication and to enhance efficiency the institutional setup should be streamlined.
9. Direct payments proposed in the decree are still not decoupled, since they are supposed to be paid according to clearly defined criteria of agricultural production (cultivated land, animal heads). This issue might become important for Ukraine's WTO membership negotiations because the question may arise whether direct payments fall into the green or the blue box. In the latter case they would count towards Ukraine's AMS commitments. This issue would almost certainly have further important implications for Ukraine following accession to the WTO because if direct payments do fall into the blue box, then it is likely that Ukraine would have to either reduce them or decouple them in the medium to long term, since recent developments of the Doha round negotiations showed a clear tendency towards further tightening and eventual elimination of the amber and blue boxes.

Authors: Heinz Strubenhoff, Oleg Nivyevskiy

Lector: Stephan von Cramon-Traubadel

Kyiv, March 2006

¹² For more details please refer to IER policy paper : Renewable Energy Policy in Ukraine by Stephan von Cramon-Traubadel