

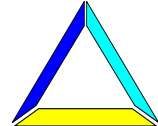


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Analysis of Economic Impacts of Ukraine's Accession to the WTO

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List of Abbreviations

AMS	Aggregate Measures of Support
bn	billion
c.i.f.	Cost, Insurance, Freight
CMU	Cabinet of Ministers of Ukraine
CPI	Consumer Price Index
EPT	Enterprise Profits Tax
EU	European Union
FAT	Fixed Agricultural TAX
f.o.b.	Free On Board
FPI	Food processing industries
GDP	Gross Domestic Product
HS	Harmonized System (of trade nomenclature)
IMF	International Monetary Fund
ISIC	International Standard Industrial Classification
KMT	Thousand Metric Tons
m	million
MAP	Ministry of Agricultural Policies
ME	Ministry of Economy
MF	Ministry of Finance
MFE	Ministry of Fuel and Energy
MFN	Most Favoured Nation
MPS	Market Price Support
MT	metric ton
NBU	National Bank of Ukraine
NMC	New Member Countries of the EU (see Annex)
PIT	Personal Income Tax
R&D	Research and Development
SCM	Agreement on Subsidies and Countervailing Measures
SEZ	Special Economic Zones
SNA	System of National Accounts
SPS	Agreement on Sanitary and Phyto-Sanitary Measures
TPD	Territory of Priority Development

TRQ	Tariff Rate Quota
UAH	Ukrainian Hryvnia
URAA	Uruguay Round Agreement on Agriculture
URIFFM	Ukrainian Research Institute of Forestry and Forest Melioration
VAT	Value Added Tax
VR	Verkhovna Rada of Ukraine
WB	World Bank
WTO	World Trade Organization

PART I

GENERAL OVERVIEW

Introduction: Ukraine's WTO accession

At the very moment Ukraine seems to be on the home stretch to become member of the World Trade Organisation. After Ukraine applied for membership in WTO in 1993 it took Ukrainian policy makers more than a decade to negotiate the terms of accession. The Government announced its strong intentions to finalize all negotiations before the Ministerial Conference in Hong-Kong in December 2005, in order to secure that during the Conference the decision concerning Ukraine's accession can be made.

The negotiations for the WTO membership had to be conducted in parallel at three levels: national (Ukrainian), bilateral, and multilateral.

When Ukraine applied for membership in the WTO the country found itself amidst of a long period of economic decline and macroeconomic instability, which culminated in a severe currency crisis and the default of the country. Under such circumstances no government will attach top priority to trade liberalisation. It was only after Ukraine returned to the path of real economic growth that the issue of WTO accession reappeared on the political agenda. However, vested interests and rent seeking with close political ties had developed by then, blocking for a long time the negotiation process. It was only after the Orange Revolution and the firm commitment of the new president and its government that the issue of WTO was decisively returned on the political agenda.

At the bilateral level, as of October 2005, Ukraine concluded negotiations concerning access to markets of goods and services with 38 countries, including protocols with Canada (2002), the EU (2003), Poland (2003), Japan (2005), and Norway (2005). Still, Ukraine has to complete negotiations with ten countries, including such important WTO members like the USA and Australia.

In July 2005 the Ukrainian Parliament (Verkhovna Rada) adopted a law, strongly advocated by the USA, making the production of pirated CDs in Ukraine a crime. The strengthened intellectual property rights protection should help Ukraine to conclude negotiations with the USA. The negotiations with Australia are more difficult due to Ukrainian desire of high protectionism in the agriculture. So far the Verkhovna Rada failed to pass laws reducing the level of protection in agriculture, what endangers and complicates the negotiations.

At the multilateral level, Ukraine has been conducting legal reforms harmonising national legislation with the WTO rules. One of important achievements is an adoption of new Customs Code compliant with the WTO agreements. Also, Ukraine has introduced laws tightening the enforcement of intellectual property rights, adopting a new approach to compliance with standards, and governing regulations in key service sectors. However, more needs to be agreed in the nearest future, or committed to be changed immediately upon country's accession. The unresolved areas include export tariffs, protection of the sugar market, and regulation in banking concerning foreign branches, and further harmonisation of technical trade barriers with the WTO rules.

Ukraine's foreign trade

The substantial increase in both exports and imports has been a major determinant for the recent recovery of Ukraine's economy. For many key industries, sales opportunities abroad have by far exceeded those on domestic markets. Key industries such as metallurgy or chemicals manufacturing currently export more than half of their total output. Accordingly, export earnings have contributed significantly to Ukraine's GDP. The share of exports in GDP has increased from 54.3% in 1999 to 61.3% in 2004.

Similarly, the recent increase in imports has also played an important role for the recovery of the Ukrainian economy. Increased availability of high-quality imports has improved the welfare of final consumers and the efficiency of domestic producers. The availability of new varieties – for example on food markets – has stimulated competition in the respective sectors and induced further product development. Opportunities to import machinery have contributed to renewing the domestic capital stock, and have thereby contributed to economic growth. Finally, many imports – once established on Ukrainian markets – have often been followed by direct investments of foreign firms, and have thereby enhanced economic growth even further.

The development of aggregate exports as well as imports during the past six years is shown in Table 1. Obviously, as Ukraine's economy has recovered, trade has become ever more important. This rising importance as such has been accompanied by a strong geographical diversification of trade flows. In recent years, exports to the EU including its new members and (to a lesser extent) to other markets such as Asia or the Middle East have grown one and a half times more than exports to Russia and other CIS countries. Similarly, imports from the EU increased faster than imports (of mainly energy) from Russia and other CIS countries. Still, trade with Western Europe and other non-CIS countries is severely constrained by various trade barriers, in particular, tariffs. In contrast, trade with CIS is conducted under Free Trade Agreements. Thus, it can be expected that despite the recent reorientation of Ukraine's trade flows away from the CIS and towards the EU, Asia and other countries, much more could be achieved if barriers to trade were lowered or removed.

Table 1
Ukraine's exports and imports of goods

	1998	2004	Change (in %)
Total Exports (USD m)	13699	33432	144
to Russia and other CIS countries	4202	9045	115
to EU-25*	3489	9779	180
to the rest of the world	6008	14608	143
Total Imports (USD m)	16283	29691	82
from Russia and other CIS countries	7897	14891	89
from EU-25*	4682	9441	102
from the rest of the world	3704	5359	45

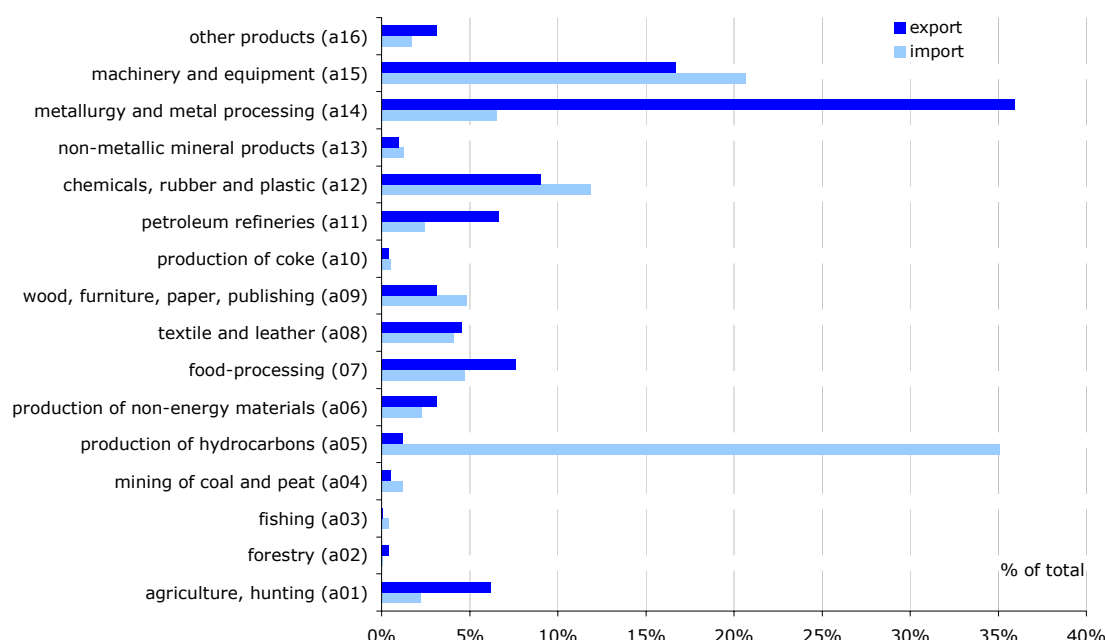
* EU-25 includes the current 25 members of the European Union

Source: National Bank of Ukraine

Despite a strong geographical diversification of trade flows, its commodity diversification has remained rather limited. Ukraine's exports flows are dominated by metals and metal-processing products, trade in which is extremely sensitive to economic trends and business cycles abroad. Moreover, such products are prone to protection measures, as according to the WTO statistics¹, from 1995 to 2004 out of all countervailing initiations 41% were launched against metal products.

The import side is dominated by energy imports, as Ukraine is one of the most energy-intensive economies in the world. In order to produce one US dollar of GDP in 2003, Ukraine needed 3,15 kg of crude oil, while the OECD average is with 0,19 kg or more then 16 times lower. The high levels of energy consumption indicate the lack of structural reforms in key sectors, hence hydrocarbons account for more than one third of all imports, followed by machinery and equipment, and chemicals.

Figure 1
Sectoral structure of commodity trade flows in 2002



Source: UN ComTrade database, IER estimates

Tariffs in Ukraine

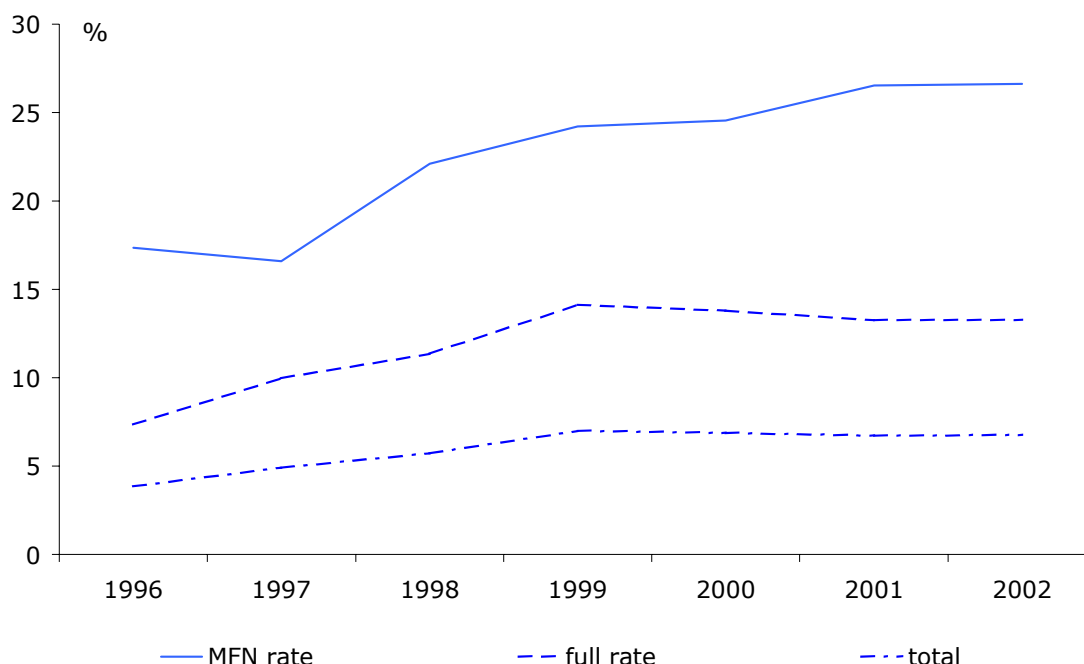
Despite the importance of trade for the economy, Ukrainian policy-makers have done so far little to support further improvements in this area. Trade flows in particular with non-CIS countries are restricted by high tariff levels. Tariff protection increased significantly between 1996 and 2002 and the simple average MFN tariff rate reached 13% in 2002 or almost twice as much as in 1996.

¹ www.wto.org.

The total simple average tariff rate is only one half of the MFN rate, since approximately half of imports arrive under free trade agreements with typically zero tariff rates. Trade under full tariff rates constitutes only a minor share of Ukraine's total imports, and affects on the total tariff rate only marginally. Thus, the reduction of the MFN rate is the key for further promotion of the market access in Ukraine.

Figure 2

Applied simple average tariff rates in Ukraine, 1996-2004



Source: Customs tariff, UN ComTrade database, IER estimates

The MFN treatment, binding of import duties, and tariff cuts are three cornerstones of tariff liberalisation under the WTO auspices. Upon becoming a WTO member, a country commits itself to cut and "bind" its customs duty rates on imports of goods, as well as provide non-discriminatory treatment for all trading partners who are members of the WTO.

Ukraine submitted in 1999 its first offer regarding tariffs and revised it since then several times². The offer includes a substantial liberalisation of tariff protection, including a relative change in simple average MFN tariffs by two third³, a conversion of specific tariffs to ad valorem duties, and jointing most of the sectoral initiatives (see below details in the section Sectoral Initiatives).

At present, the agro-food sector faces the highest level of tariff protection in Ukraine. The simple average MFN import duty in food industry reached 67.2% in

² Ukraine. Trade Policy Study. Volume II: Main Report. World Bank, 2004.

³ According to the IER estimates.

2002, followed by tariffs in agriculture (29.0%) and fishing (28.1%). For comparison, the highest simple average tariffs in non-agricultural sectors are levied on 'other products' at 12.8% and non-metallic mineral products at 11.5%. The lowest simple average MFN tariffs are in mining of coal and peat, and in production of hydrocarbons. These sectors face zero MFN tariffs.

We estimate, that the most drastic relative change in simple average tariffs due Ukraine's WTO accession will be in wood, furniture, paper, and publishing sector (A09) – by 93%. To the large extent it is explained by Ukraine's offer to join the sectoral initiative. The next most significant relative reductions in tariffs will be in fishing, food industry, and agriculture by 85%, 81%, and 74% respectively.

Table 2

Simple average applied tariffs in 2002 and the estimate of simple average tariff rates after Ukraine's WTO accession

SAM code	Industry	Simple average MFN tariff 2002	Estimate of simple average tariff after the WTO accession	Relative change, %
A01	Agriculture, hunting	29.0	7.5	74
A02	Forestry	3.1	1.3	59
A03	Fishing	28.1	4.3	85
A04	Mining of coal and peat	0.0	0.0	0
A05	Production of hydrocarbons	0.0	0.0	0
A06	Production of non-energy materials	4.9	3.9	20
A07	Food-processing	67.2	12.8	81
A08	Textile and leather	8.0	6.3	21
A09	Wood, furniture, paper, publishing	8.0	0.6	93
A10	Production of coke	7.1	4.7	33
A11	Petroleum refineries	2.5	1.7	32
A12	Chemicals, rubber and plastic	6.4	3.7	41
A13	Non-metallic mineral products	11.5	8.2	29
A14	Metallurgy and metal processing	5.6	2.3	59
A15	Machinery and equipment	6.9	3.8	45
A16	Other production	12.8	7.2	43

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

In terms of import-weighted tariffs the situation is quite similar. The highest tariffs are applied towards agro-food products, although import-weighted tariffs are somewhat lower due to reluctance of entrepreneurs to bring high-protected goods in the country. It is expected that the WTO membership will result in considerable drop in agro-food protection. Here the relative change in tariffs will be the second highest after wood and publishing sector, and the highest in absolute terms.

Table 3

Import-weighted applied tariffs in 2002 and the estimate of the import-weighted tariff rates after Ukraine's WTO accession

SAM code	Industry	Import-weighted MFN tariff 2002	Estimate of import-weighted tariff after the WTO accession	Relative change, %
A01	Agriculture, hunting	24.2	2.1	91
A02	Forestry	2.0	1.3	33
A03	Fishing	21.5	2.8	87
A04	Mining of coal and peat	0.0	0.0	0
A05	Production of hydrocarbons	0.0	0.0	0
A06	Production of non-energy materials	1.1	1.1	3
A07	Food-processing	54.7	12.0	78
A08	Textile and leather	6.2	5.1	17
A09	Wood, furniture, paper, publishing	9.6	0.3	97
A10	Production of coke	2.3	1.4	38
A11	Petroleum refineries	0.3	0.2	33
A12	Chemicals, rubber and plastic	5.9	3.0	49
A13	Non-metallic mineral products	11.4	8.1	29
A14	Metallurgy and metal processing	4.5	1.8	61
A15	Machinery and equipment	8.9	4.2	53
A16	Other production	3.6	1.2	68

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Subsidies in Ukraine

In line with WTO Agreement on Subsidies and Countervailing Measures (Agreement on SCM), for the purpose of this study a subsidy is defined as 'a financial contribution by a government or any public body, which confers a benefit'. Here, the following types of financial contributions are considered:

- direct or potential transfers of funds, including grants, loans, and loan guarantees;
- tax expenditures, i.e. 'government revenues which are otherwise due but are foregone or not collected';
- government purchases / provision of goods and services other than general infrastructure;
- quasi-fiscal activities, when 'a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the previously described functions';

- any other form of price or income support.

The SCM Agreements pre-dominantly concerns non-agricultural subsidies, while subsidies in agro-food sector are regulated by the Agreement on Agriculture (URAA).

The SCM Agreement defines two categories of subsidies: prohibited and actionable⁴. Prohibited are export subsidies, and subsidies directed upon the preferential use of domestic over imported goods, for instance, so-called 'local content requirement', i.e. subsidies that directly intervenes in international trade flows. All other subsidies are actionable. It means that the subsidy is permitted unless the complaining country shows that the subsidy has an adverse effect on country's interests. Thus, according to the SCM Agreement, the membership in the WTO does not mean an automatic end to subsidisation. However, SCM rules discipline policy makers, because in cases when the Dispute Settlement Body of the WTO decides that that a subsidy causes an adverse effect, the subsidy must be either withdrawn or its adverse effect must be removed in order to avoid countervailing measures.

The URAA prohibits export subsidies unless they are specified in a member's lists of commitments. As Ukraine has not employed export subsidies in the past it follows that Ukraine should not receive allowances for the use of export subsidies in the future. The WTO members agreed under the URAA provisions specifying subsidization or domestic support to reduce farm support and to switch to instruments that are less distorting production and trade. The Agreement distinguishes between support programmes directly linked to agricultural production and trade and those that are considered to have no direct effects on production and trade volumes. The first measures shall be reduced and decoupled from production, while the latter can be used freely (see Box 1 for details).

The elimination of subsidies in form of tax privileges could be requested under the WTO rules, if such a subsidy is considered to be discriminatory and thus contradictory the a national regime treatment.

The total amount of subsidization in Ukraine reached 6.1% of GDP in 2002 and decreased to 4.9% of GDP in 2004. In 2002 almost 70% of all subsidies were provided in the form of tax expenditures, including tax exemptions granted to enterprise in special economic zones and territories of priority development, state support programs for specific industry, various tax privileges, as well as tax arrears. Tax expenditures were reduced to 49% of total amount of subsidisation in 2004, and further decreased in early 2005 when the Parliament terminated most of Special Economic Zones and Territories of Priority Development, as well as most of state support programs.

⁴ Originally the SCM Agreement contained a third category: non-actionable subsidies, but this category existed only for five years, ending on 31 December 1999 (see www.wto.org).

Box 1

Domestic support in Agriculture: the amber, blue and green boxes

Amber box:

Domestic support measures that distort production and trade like price or production quantity support measures fall into amber box. The total amount of amber box measures is limited and subject to reduction commitments. The *de minimis* clause introduces limits for allowed support: less than 5% of the value of farm gate production in developed countries and less than 10% in developing countries.

Blue box:

It is the amber box with conditions designed to reduce distortion. Any support that otherwise placed the amber box, is considered as the blue box if the support envisages production-limiting programmes. So far no limits on blue box measures are established.

Green box:

These types of subsidies must not distort trade, or at most cause minimal distortions. Thus, these measures are not subject for reduction. The '**green box**' includes the following broad categories of measures:

- general services such as research, training, extension, inspection, pest and disease control, marketing and promotion services, and infrastructure services;
- direct income support payments decoupled from production, income insurance and social safety-net programmes, disaster relief, producer or resource retirement schemes, investment aids, environmental programmes, and regional assistance programmes;
- food security stocks; and
- domestic food aid.

Table 4

Subsidies in Ukraine in 2002-2004

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	1493	11	2231	13	3067	18
Tax expenditures	9493	69	9858	59	8373	49
State provision/purchase of goods or services	2214	16	3940	23	4589	27
Quasi-fiscal activities	0	0	0	0	138	1
Other income or price support	601	4	743	4	873	5
Total amount of subsidies	13801		16772		17038	
Total amount of subsidies, % of GDP	6.1		6.3		4.9	

Source: IER estimate

The next most common types of subsidies in Ukraine are state provision or purchases of goods and services and transfers of funds that increased and reached 27% and 18% of total amount of subsidy in 2004 respectively. With the exception of the agro-food sectors quasi-fiscal activities and other income or price support measures are rarely used.

Most of subsidisation in Ukraine is provided to agriculture, followed by mining of coal and peat, and manufacture of chemicals, rubber, and plastic goods.

Table 5
Subsidies by sectors, % of total

	2002	2003	2004
A01 Agriculture	38.0	36.3	33.3
A02 Forestry	0.2	0.2	0.2
A03 Fishing	0.3	0.3	0.5
A04 Mining of coal	14.3	18.7	28.1
A05 Production of hydrocarbons	2.0	1.3	1.3
A06 Extracting non-energy materials	0.7	0.9	1.7
A07 Food processing	5.9	5.9	5.5
A08 Textile and leather	0.2	0.2	0.3
A09 Wood working, pulp and paper industry, publishing	4.3	4.6	4.6
A10 Manufacture of coke production	0.1	0.0	0.0
A11 Petroleum refinement	0.5	0.2	0.0
A12 Manufacture of chemicals, rubber and plastic products	26.3	22.0	10.9
A13 Manufacture of other non-metallic mineral products	0.0	0.0	0.0
A14 Metallurgy and metal processing	2.1	0.9	0.9
A15 Manufacture of machinery and equipment	5.2	8.4	12.6
A16 Other production	0.0	0.0	0.0

Source: IER estimates

It is expected that Ukraine's WTO accession will at first lead to a reduction or removal of tax expenditures, since they could be classified as either prohibited under the SCM Agreement or violating national regime treatment. The most of other subsidies for non-agricultural goods are actionable, and their reduction or removal will depend on commitments of Ukraine as well as complains of the Member countries.

Also, Ukraine currently negotiates the Aggregate Measure of Support (AMS) for agriculture and food industry. The scale of the subsidies reduction will depend on

the agreed level of the AMS. Currently, several options are negotiated. Ukraine is proposing the AMS⁵ to be set at USD 1.14 bn, for the base period 1994-1996. However, some members of the working party are insisting instead on the base period 2000-2002, decreasing Ukrainian AMS to USD 1.1 bn or even USD 265 m if tax privileges are excluded from the AMS estimate.

Table 6

Level of subsidisation in agriculture (A01) and food industry (A07)

	2002		2003		2004	
	USD m	% of total	USD m	% of total	USD m	% of total
Agriculture (A01)						
Green box	204.3	20	453.9	38	332.2	30
Amber box	833.1	80	752.5	62	792.6	70
Total support	1037.4	100	1206.4	100	1124.8	100
Food industry (A07)						
Green box	0.0	0	0.1	0	0.1	0
Amber box	161.9	100	195.7	100	185.8	100
Total support	161.9	100	195.8	100	185.9	100
Agriculture and food industry (A01 + A07)						
Green box	204.3	17	454.0	32	332.3	25
Amber box	995.0	83	948.2	68	978.4	75
Total support	1199.3	100	1402.2	100	1310.7	100

Source: IER estimate

Current support measures in agriculture and food industry belonging to so-called amber box are estimated at the level slightly below USD 1 bn (Table 6). Thus, if the AMS to be agreed will be above USD 1 bn, no cuts of the current amber box measures will be required related to Ukraine's accession to the WTO. However, if the finally agreed AMS will be significantly below USD 1 bn a substantial reduction of amber box measures needs to be implemented. That might result in either a drop in overall domestic support or support measures need to be redirected into the green box.

Ukrainian Participation in Sectoral Initiatives

Ukraine made a commitment upon becoming member of the WTO to join several so-called sector initiatives. Most sector initiatives include an obligation to establish a binding tariff rate at a zero level, although some - namely textile and chemicals - envisage a non-zero binding level of tariff protection.

⁵ The member state are free to choose their 'amber' box measure as long as the resulting AMS does not exceeds the limits negotiated.

The sector initiatives mean a further liberalization of Ukraine's trade regime, in addition to all the other tariff-related commitments, which Ukraine will have to observe as a member of the WTO.

Ukraine committed to join sixteen out of nineteen sectoral initiatives, as stated in "Review of the Latest Achievements in Bilateral Negotiations on Market Access for Goods and Services and Enactment of Legislation"⁶. In particular are these the following sectoral initiatives⁷:

- Agricultural equipment
- Chemistry
- Civil aircraft
- Construction equipment
- Distilled spirits
- Furniture
- Information technologies
- Medical equipment
- Nonferrous metals
- Paper
- Pharmaceutical
- Scientific equipment
- Steel
- Textile and textile clothing
- Toys
- Wood

Ukraine will join the most of these initiatives immediately upon accession, with the exception of the 'Civil aircraft' initiative, that Ukraine will join in 2010. Concerning distilled spirits Ukraine offered to preserve the specific non-zero tariff rate for the next three years after the WTO accession. Afterwards Ukraine is committed to bind its duty rate on distilled spirits listed under initiative to zero.

In absolute terms, the most significant reduction in tariffs is foreseen for products that fall under 'Distilled spirits': from 167.1% ad valorem tariff equivalent in 2002 to zero in three years after Ukraine gains a WTO membership. The least significant binding duty rate will be applied to products that belong to the 'Chemistry' and 'Textile and textile clothing' sector initiatives. In the case of 'Chemistry', the envisaged binding rate is only 9.5% below the rate that was applied in 2002. In the

⁶ "Review of the Latest Achievements in Bilateral Negotiations on Market Access for Goods and Services and Enactment of Legislation", WTO, Working Party on the Accession of Ukraine, WT/ACC/UKR/109, 26 April 2002.

⁷ The exceptions are sectoral initiatives: "Oil Seeds", "Fish" and "Beer".

case of 'Textile and textile clothing' the reduction of the rate by 3.1% is rather small (see Table 7).

Table 7

Simple average tariff for goods that are subject to sectoral initiatives, %

	Name of initiative	2002 MFN tariff	Sector initiative tariff
1	Agricultural equipment	8.5	0.0
2	Chemistry	6.3	5.7
3	Civil aircraft	6.5	0.0 ^a
4	Construction equipment	6.3	0.0
5	Distilled spirits	167.1	0.0 ^b
6	Furniture	19.9	0.0
7	Information technologies	5.1	0.0
8	Medical equipment	1.7	0.0
9	Nonferrous metals	3.0	0.0
10	Paper	8.6	0.0
11	Pharmaceutical	2.5	0.0
12	Scientific equipment	3.5	0.0
13	Steel	6.2	0.0
14	Textile and textile clothing	6.4	6.2
15	Toy	13.3	0.0
16	Wood	2.0	0.0

Source: Customs Tariff, Ministry of Economy, IER estimate

Notes:

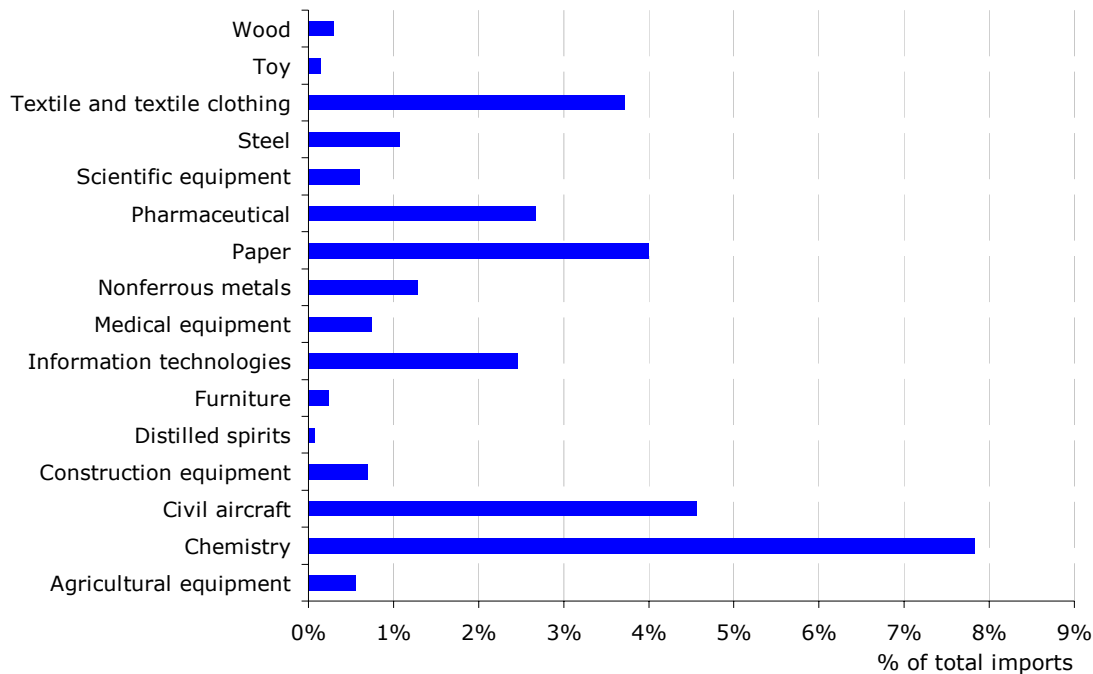
^a Ukraine offered to join 'Civil aircraft' sector initiative in 2010

^b Ukraine offered to bind duty rate to zero for 'Distilled spirits' sector initiative in three years after the country becomes a member of the WTO

In 2002 imports of products subject to sectoral initiatives accounted for approximately 31% of total imports. Imports of goods affected by the sectoral initiative 'Chemistry' constituted almost 8% of total imports. Imports of products covered by 'Civil aircraft' and 'Textile and textile clothing' sector initiatives represented almost 5% and 4% of total imports respectively.

Figure 3

Import of products subject to sector initiatives as share in Ukraine's total imports in 2002, %



Source: UN ComTrade database, Ministry of Economy of Ukraine, IER estimates

Sectoral initiatives will impact differently the sectors of economy and their distribution is uneven. Most of sector initiatives concern such sectors as wood, furniture, paper, and publishing (A09), chemicals, rubber and plastics (A12), and machinery and equipment (A15). Also, there are several sectoral initiatives that affect only one sector of the economy. These are 'Non-ferrous metals' and 'Steel' initiatives that refer only to metallurgy (A14), and 'Construction equipment' and 'Scientific equipment' for machinery and equipment (A15).

Table 8
Match of sectoral initiatives and sectors in the SAM

SAM code	Industry	Sector initiative
A01	Agriculture, hunting	Textile and textile clothing
A02	Forestry	Wood
A03	Fishery	
A04	Mining of coal and peat	
A05	Production of hydrocarbons	
A06	Production of non-energy materials	Chemistry
A07	Food industry	Chemistry, distilled spirits
A08	Textile and leather	Chemistry, paper, textile and textile clothing
A09	Wood, furniture, paper, publishing	Chemistry, civil aircraft, furniture, paper, textile and textile clothing, wood
A10	Production of coke	Chemistry
A11	Petroleum refineries	Chemistry
A12	Chemicals, rubber and plastic	Chemistry, civil aircraft, medical equipment, pharmaceutical, textile and textile clothing, toys, distilled spirits
A13	Non-metallic mineral products	Chemistry, civil aircraft, information technologies
A14	Metallurgy and metal processing	Chemistry, civil aircraft, furniture, nonferrous metals, steel
A15	Machinery and equipment	Agricultural equipment, chemistry, civil aircraft, construction equipment, information technologies, medical equipment, pharmaceutical, scientific equipment
A16	Other production	Chemistry, information technologies, paper, toy

Source: UN classifications, Ministry of Economy, IER estimates

The most significant reduction of import tariffs due to sectoral initiative commitments of Ukraine will be for wood, furniture, paper and publishing (A09), since most of sector imports (94.3% in 2002) are subject to various zero-rate sectoral initiatives.

Two other sectors, in which sectoral initiatives refer to 87.8% and 83.1% of imports respectively, are chemistry, rubber and plastics (A12) and textile and leather (A08). However, the reduction of tariffs in these two sectors due to sectoral initiatives will be far less significant, since most important initiatives for these sectors – ‘Chemistry’ for A12 and ‘Textile and textile clothing’ for A08 – imply non-zero binding tariff rates.

Table 9

Share of sector imports subject to sector initiative, %

SAM code	Industry	Share in imports, %
A01	Agriculture, hunting	0.0
A02	Forestry	29.3
A03	Fishery	0.0
A04	Mining of coal and peat	0.0
A05	Production of hydrocarbons	0.0
A06	Production of non-energy materials	0.3
A07	Food industry	1.7
A08	Textile and leather	83.1
A09	Wood, furniture, paper, publishing	94.3
A10	Production of coke	0.0
A11	Petroleum refineries	2.9
A12	Chemicals, rubber and plastic	87.8
A13	Non-metallic mineral products	8.0
A14	Metallurgy and metal processing	41.6
A15	Machinery and equipment	43.3
A16	Other production	10.1

Source: UN ComTrade database, Ministry of Economy, IER estimates

Structure of this Study

This sector study assesses subsidies and tariffs in Ukrainian agriculture and industry⁸ as well as the changes in tariffs and subsidies (explicit and implicit) due to WTO accession.

The study comprises twelve industrial and four agro-food sectors of Ukraine's economy, each are shortly described, including the particular sectors position in Ukraine's foreign trade. The overviews are followed by estimations of the import tariffs applied in each sector, in particular total tariffs, tariffs under Most Favored Nation⁹ (MFN) regime and Full Tariffs. Third, subsidies provided to the sectors under consideration are discussed. Fourth, we consider the expected changes in the trade regime of each sector related to Ukraine's accession to the WTO. Hereby we also assess the impacts of the sixteen sectoral initiatives Ukraine offered to join.

⁸ Selected key services sectors of particular importance to the accession negotiations of Ukraine, including telecommunications, banking, insurances and selected transport services, are covered in a separate study under this assignment.

⁹ "Privileged Tariff Rate" in Ukrainian legislation.

The codes attached to sectors (A01–A16) replicate codes in the CGE model allowing direct references within the project. The coding is based on the International Standard Industrial Classification (ISIC) that at the high level of aggregation matches with Ukraine's 'KVED' (CED - Classification of Economic Activities) and the codes in the input-output table.

The study divides the sectors of Ukraine's economy into two categories, agriculture (Part II) and industry (Part III). In doing so we follow the specific treatments of domestic support measures in agriculture and food industry under Uruguay Round Agreement on Agriculture. Hence, in part II of this study we investigate agriculture (A01), forestry (A02), fishery (A03), and food processing industry (A07). In part III follows the study on industry covering the sectors of manufacturing and extractive industries.

A summary of protectionism measures, a technical note on estimation of tariffs and subsidies, more detailed information on MFN tariffs and Special Economic Zones and Territories of Priority Development and Market Price Support Estimates are provide in part IV Summary and Appendix of the study.

PART II
SECTOR STUDY ON AGRICULTURE AND FOOD INDUSTRY

1 Agriculture and hunting (A01)

Table 1.1

Agriculture and hunting: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	58475	69690	70049	71151
	% total output	13.5	13.3	12.2	10.3
	% growth, real	9.8	10.2	1.2	-11.0
Value added	% GDP	14.7	14.8	13.0	11.0
Value added / output	%	42.7	43.3	42.0	41.4
Structure of value added:					
Compensation to employees	% sector VA	18.2	18.1	15.9	14.4
Profit, mixed income	% sector VA	75.4	76.7	80.6	81.9
Net taxes on production and imports	% sector VA	6.4	5.2	3.4	3.6
Employment	thousand people	2549	2206	1877	1537
	% total employed	18.6	17.1	15.3	13.1
Average wage	UAH	114	154	183	219
Exports	UAH m	4963	5758	7361	4052
	% total exports	4.7	5.1	5.9	2.6
	% sector output	8.5	8.3	10.5	5.7
Imports	UAH m	921	862	801	5024
	% total imports	0.9	0.8	0.7	3.4
	% sector output	1.6	1.2	1.1	7.1
Exports/imports	index	5.4	6.7	9.2	0.8

Source: State Statistic Committee, IER calculations

1.1 Overview

A large share of Ukraine's GDP is produced in the agricultural sector. This could enable Ukraine to play a significant role on the world's agricultural markets in the future. Ukraine possesses favourable natural endowments like soil, climate, and water, all making large-scale agriculture production suitable. About 80% of the total agricultural land (roughly 40 m ha) is arable, of which 50% consists of deep soils. A substantial share of Ukraine's population is employed in agriculture.

However, lack of market-oriented reforms in the sector hampers agricultural production in Ukraine. Only after a long and steep decline during the 1990s Ukrainian agriculture recovered somehow during the years 2000-2002. The share of agricultural production in GDP reached 15% in 2000 and fell to 11% in 2003 due to unfavourable climate conditions (see Table 1.1). The turnaround of agricultural production was achieved by reform measures of the government implemented at the end of 1999 and the following two years. In particular important were the

cancellation of the highly distorting and inefficient state credit program, first steps in agricultural land reform, and the beginning of enterprise restructuring.

The share of agriculture in total employment was 19% in the year 2000. By 2003 the employment share declined by around 1m employees to 13%, indicating the sector adjustment to new incentives. However, wages paid in agriculture remained at national lows, indicating a persistent surplus of labour in rural areas.

During the 1990 the importance of the agricultural sector as an earner of export revenues declined in parallel to the output decline in both absolute and relative terms.¹⁰

Table 1.2

Agriculture and hunting: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Export						
Free trade	76.0	23	63.7	10	77.1	7
<i>Including</i>						
Russia	27.1	8	20.2	3	15.3	1
other CIS	42.3	13	28.6	4	31.6	3
Baltic countries*	6.5	2	14.9	2	30.2	3
MFN trade	196.6	60	439.5	67	799.2	72
<i>Including</i>						
EU-15	106.4	33	228.5	35	429.0	39
NMC-5	15.2	5	21.9	3	48.9	4
Asia	53.7	17	105.6	16	120.3	11
America	4.3	1	7.2	1	30.2	3
"Full tariff" trade	52.4	16	151.7	23	236.6	21
Total	325.0	100	654.9	100	1112.9	100
Import						
Free trade	48.7	12	50.6	13	26.4	7
<i>Including</i>						
Russia	4.1	1	9.6	3	5.2	1
other CIS	44.3	11	39.1	10	20.5	5

¹⁰ OECD (Organization for Economic Co-operation and Development), (2004a): Achieving Ukraine's Agricultural Potential. Stimulating Agricultural Growth and Improving Rural Life, Paris <http://www.oecd.org/dataoecd/39/31/34031855.pdf>.

Table 1.2 (cont.)

Agriculture and hunting: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Baltic countries*	0.3	0	1.9	1	0.7	0
MFN trade	292.0	69	256.2	67	277.2	74
<i>Including</i>						
EU-15	69.2	16	63.5	17	70.5	19
NMC-5	42.4	10	13.1	3	16.6	4
Asia	115.1	27	100.7	26	108.5	29
America	40.0	10	55.2	14	69.4	19
"Full tariff" trade	79.5	19	75.8	20	70.4	19
Total	420.2	100	382.6	100	374.0	100

Source: UN ComTrade database, IER estimates

Note: * Selected agricultural products are exempted from free trade with Latvia and Lithuania

A comparison of Ukraine with other countries of similar agricultural capacities reveals the very low level of the share of agricultural exports in sector output. For instance, in the year 2000 the ratio of exports to agricultural sector output was about 8% for Ukraine, 25% in Poland and 53% for both, France and Germany. On the other hand, agricultural imports remain with a ratio of 1% almost insignificant, mainly due to high levels of border protection on imported goods (see Table 1.2). Only in the year 2003 and only due to a severe winterkill, resulting in grain shortages and substantial price increases, Ukraine imported a significant amount of food wheat for a certain period of time.

The Ukrainian agriculture and hunting sector is weakly integrated into the international trade system. The structure of trade in agricultural and hunting goods under different trade regimes changed considerably during the years 2000-2002. The bulk of imports originated from countries with MFN trade regimes with Ukraine. Here Asian countries played a major role, but also EU-15 and American countries constantly increased their exports to Ukraine. On the other hand trade with CIS countries under the free trade regime declined (Table 1.2).

The share of Ukraine's agricultural export to MFN countries constantly grew, and EU-15 countries were the major recipients. Free trade with CIS remained weak and Ukraine exported substantially more to countries under "Full tariff" regimes with Ukraine.

1.2 Tariffs

Table 1.3

Agriculture and hunting: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	10.5	20.1	25.4	29.7	26.0	30.4	32.2
<i>including</i>							
MFN tariff	9.4	21.1	22.6	26.4	23.4	27.6	29.0
Full tariff	17.5	23.2	43.5	50.5	43.4	49.9	53.8

Source: Customs tariff, UN ComTrade database, IER estimates

The import tariffs applied in agriculture are among the highest throughout the economy, and the level of protection increased. In particular, in 2002 simple average total tariff was equal to 32.2%, quite close to the level of the MFN tariff due to the fact that most of agricultural product imports come from the MFN countries.

Table 1.4

Agriculture and hunting: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	9.2	15.4	15.4	8.1	10.0	20.6	23.3
<i>including</i>							
MFN tariff	4.3	12.3	10.3	7.9	10.0	21.2	24.2
Full tariff	28.4	30.8	37.4	11.2	13.6	25.4	28.1

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

The import-weighted MFN tariff on agricultural products increased from 4.3% in 1996 to 24.2%, showing a persistent grow in border protectionism of agricultural products in Ukraine. The full tariff rate is quite close to the MFN rate and equals to 28.1%. The total import-weighted tariff more than doubled between 1996 and 2002, and reached 23.3% in 2002.

1.3 Subsidies

The following section describes the various types of subsidies existing in Ukraine's agriculture and hunting. Subsidies are classified according to the URAA provisions thereby falling into two broad categories: amber box and green box measures.

1.3.1 Transfer of funds

Most of subsidies in the 'transfer of funds' category belong to 'amber box' measures, thus a non-exempted from the reduction commitments in the WTO. For instance, in 2002 more than 90% of 'transfer of funds' fell into the category 'amber box' measures. The year 2003 was different, since an exceptionally low grain harvest due to a severe winterkill triggered huge transfers of payments for relief from natural disasters, accounting for a half of all transfer of funds that year.

Table 1.5

Agriculture and hunting: transfers of funds, UAH m

	2002	2003	2004
Amber Box:			
The partial interest rate compensation	119.6	94.6	141.5
Sowing winter and spring crops	0.0	0.0	247.9
Fertilizers	0.0	0.0	109.6
Partial cost compensation for machinery supply	15.7	18.3	36.2
Effective subsidy for funds on financial leasing for machinery supply*	144.3	31.1	0.0
Support of farms	4.5	13.4	0.0
Livestock and crop production	73.9	236.2	421.0
Planting of young gardens, vineyards, berry-fields, and hop-growing	118.1	5.0	109.1
Green Box:			
Selection in crop and livestock-breeding	25.6	238.2	152.7
Public stockholdings	19.2	30.3	50.0
Payments for relief from natural disasters and under regional assistance programs:	1.6	693.3	67.3
Total	522.5	1360.3	1335.2

* Funds envisages for financial leasing were UAH 656.1 m in 2002 and UAH 182.9 m in 2003, but effectively paid subsidy was far lower

Source: IER calculations based on State Treasury Report on the State Budget Execution 2002, 2003, 2004

Amber Box Measures

The partial interest rate compensation program: In the beginning of 2001, the government started a program of partial compensation of interest rates of commercial bank loans for agricultural producers. The Law¹¹ states that the compensation should be not less than 50% of the NBU refinance rate. Agricultural enterprises can receive a compensation of short-term credits obtained in national or

¹¹ Article 12, Law of Ukraine "On Stimulation of Agricultural Development for 2001-2004" as of 18 January 2001.

foreign currencies for financing production inputs and covering production costs (e.g. purchases of fuel, feed, spare parts, fertilizers, pests, insurance payments, etc.) as well as of long-term credits obtained in national or foreign currencies for financing costs on purchasing fixed capital.

Table1.6

Partial Interest Rate Compensation, %

	2002	2003	2004
Interest Rates Compensated by the Government			
Short-term credits:			
- In UAH	10-7	10-7	8
- In USD	7-5	7-5	6
Long-term credits:			
- In UAH	10-7	10-7	14-12
- In USD	5-4	7-5	9-8
Rates, eligible for compensation	Up to 21-18	Up to 21-18	Up to 19-18
NBU refinance rate	9.0	7.0	8.7
Interest rate of commercial banks	25	20.2	17.9

Source: The Laws on "State Budget of Ukraine" 2002-2005, Regulation of MAP and MF # 212/427 as of 02 July 2003, Regulation of CMU # 34 as of 15 January 2005, etc, Bulletin of NBU

Financial support of livestock and crop production: The program encompasses a broad range of measures, like payments per head of cattle, per hectare, partial compensation of production costs (e.g. flax and hemp production) and others. For example, producers selling young cattle of above-average weight were entitled to receive additional special payments per weight (kg). Similar procedures were applied to the sale of pigs and poultry¹².

Fertilizers: The government partially subsidized the price of domestically produced fertilizers to farmers. Agricultural producers received reimbursements from the state budget of around 40% of the fertilizer costs¹³. Additionally the government set the minimum prices on fertilizers for agriculture producers lower than market prices. Thus producers of fertilizers subsidized agriculture producers at the expense their own forgone revenues.

Financial support of farms: Farmers eligible for this program may get financial assistance from the state budget if they spend the provided funds exclusively for production or processing of self-produced agricultural goods. In general this constitutes a subsidization of input costs¹⁴.

¹² Regulation of the MAP and MF # 114/239 as of 31 March 2004.

¹³ Own calculations based on the Resolution # 1046 of the CMU as of 12/08/2004 and on the Order of the Ministry of Industrial Policy # 18 as of 20/01/2004.

¹⁴ Regulation of MAP and MF # 162/426/181 as of 17 June 2002.

The partial compensation of costs of agricultural enterprises for sowing of winter and spring grain crops: The partial cost compensation is done proportionally to the area of sowed land. The decision on the eligibility of compensation under this program and the total proportion of the sowing area to be considered is taken by a special commission¹⁵.

Government support of agricultural machinery supply - Financial leasing through the state joint-stock company "UkrAgroLeasing": According to a Regulation by the cabinet of Ministers¹⁶ the company "UkrAgroLeasing" supplied during the years 2002-2003 machinery and equipment to farms at an annual interest rate of less than 10%¹⁷ when the average commercial bank credit interest rate was above 20%. Thus, leasing of domestically produced agricultural machinery to farms through this scheme should be counted as a subsidy. By rough estimates - and assuming full payment by enterprises of the leasing rates - the government provided subsidies of UAH 144.33 m¹⁸ in 2002 and UAH 31.09 m¹⁹ in 2003.

Government support in agricultural machinery supply - partial compensation of purchases of domestically produced agricultural machinery: Under this scheme the government compensates 30% of the price of domestically produced equipment purchased by agricultural producers and enterprises of food and food processing industry²⁰. The MAP selects eligible national producers on a competitive basis.

Planting of young gardens, vineyards, berry-fields, and hop growing: The government provides eligible farms with funds for purchasing inputs, equipments etc. The MAP determines the list of eligible farms on a competitive basis²¹.

Green Box Measures

Selection in livestock crop production: Government funds are allocated for programs on special seed and semen selection in crop and livestock production. Farmers purchasing premium sorts of seed and semen are eligible for partial compensation of the additional cost²².

Public stockholdings: Budget funds are foreseen for purchasing and storing of some crop seeds (grain, peas, sunflower, sugar beet, corn etc) to satisfy the

¹⁵ Regulation of CMU # 96 as of 30 January 2004.

¹⁶ Regulation of CMU # 1904 as of 10 December 2003.

¹⁷ According to "Agro business 3(68)' 2005", p 32, currently it is 2.8% on average.

¹⁸ 656.065 m UAH x (25%-2.8%).

¹⁹ 182.92 m UAH x (20.2%-2.8%).

²⁰ Regulation of CMU # 959 as of 28 July 2004.

²¹ Regulation of MAP and MF #178/346 as of May 25 2004; Regulation of MAP # 238 as of June 30 2004.

²² Regulation of MAP # 123 as of 14 May 2001; Law of Ukraine "On the State program of selection livestock-breeding", #1517-15 as of February 19, 2004; Regulation of MAP and MF # 94/23/210 as of 22 March 2004.

demand of regions that do not produce these seeds or in a case when some seed sowings are damaged due to unfavourable climatic conditions²³.

Payments for relief from natural disasters and under regional assistance programs: This group of payments includes payments to producers in disadvantaged regions²⁴, to farms that suffered from unfavourable climatic condition in 2003²⁵, for relief from natural disasters²⁶ etc.

1.3.2 Tax expenditures²⁷

The Ukrainian government provides a substantial amount of subsidies through tax exemptions and payment arrears, both will be accounted as part of Amber Box measures.

Amber Box Measures

Fixed agricultural tax (FAT). In 1999 the Verkhovna Rada introduced the FAT, replacing a dozen of taxes previously paid by farms²⁸. This tax lowered the tax burden of farms and simplified tax calculation and collection. The FAT revenues are directed to the Pension Fund (68%), the Social Security Fund (2%), and the local budgets (30%). In 2003, amendments to the law obliged FAT payers to pay income tax on sales of non-agricultural products.

Farms of different organisational and legal forms are eligible to pay the FAT provided that they are involved in agricultural production and agricultural products account for over 75% (previously 50%) of their revenues. The base of the FAT is the value of a farm's agricultural land²⁹ as determined on July 1st, 1997. The tax rates are specified for two types of the agricultural land:

- (1) 0.5% of the value of arable land, haying, and pastures, and
- (2) 0.3% of the value of perennial plantations.

In several regions, where the land is considered much less productive³⁰, the tax rates are reduced for category (1) to 0.3% and category (2) to 0.1%

²³ Regulation of MAP and MF # 12/71 as of 23 January 2003.

²⁴ Regulation of MAP and MF # 60/138 as of 27 February 2002.

²⁵ Regulation of CMU # 410 as of 31 March 2003.

²⁶ Regulation of CMU # 923 as of 19 June 2003.

²⁷ This section partly follows the discussion in Demyanenko, S., Zorya, S. (2004): Taxation and Ukrainian Agriculture, in: von Cramon-Taubadel, S., Demyanenko, S., Kuhn, A. (eds.): Ukrainian Agriculture – Crisis and Recovery, Germany: Shaker Verlag, pp. 26-40.

²⁸ The most important of these were: land tax; profit tax; automobile tax; individual income tax; and payments to the Pension, Social Security and Unemployment Funds. See Law of Ukraine "On Fixed Agricultural Tax", December 17, 1998.

²⁹ Land value is determined according to quality and potential productivity and, therefore, can vary substantially from farm to farm. The average land value in Ukraine for FAT purposes is 8733 UAH/ha, ranging from a maximum of 11297 UAH/ha in Cherkasy to a minimum of UAH6244/ha in Zhytomyr (excluding Kiev city, Sevastopol and Crimea).

³⁰ For example, the Polissia zone or the Carpathian region.

correspondingly. FAT is paid monthly, but the payment rates vary so that 10% of the total payment is due in the first and second quarters, while 50 and 30% are due in the third and fourth quarters, respectively.

From 1999-2001 farms had to pay only 70% of the FAT, i.e. the sum of the Pension and Social Security Fund shares. Initially the FAT could be paid either in cash or in kind, but now only cash payment is allowed. In 2001, Ukrainian farms should have paid UAH 421.7 m the FAT (USD 79 m), but actual payments amounted to UAH 337.4 m (USD 63 m). While collection rates have improved somewhat, the total FAT burden is very low compared with what farms would pay if they were subject to the same taxation as other sectors. The value of this tax exemption is estimated to be **UAH 1400 m.** (see Table 1.7).

Value added tax (VAT): Agricultural enterprises in Ukraine benefit from special provisions concerning the accrual and payment of VAT. First, farms were exempted from paying the VAT to the national budget during the period 1999-2004. The accumulated VAT received from sales had to be deposited with a special bank account and used only to purchase the agricultural production inputs. In 2001 the VAT tax exemption equalled to **UAH 582 m.** However, farms continued paying VAT for non-agricultural products and services.

Second, producers of milk and meat are VAT exempted when selling their products. According to the MAP, this resulted in a benefit **of UAH 634 m** for milk and meat producers in 2001 (see Table 1.7).

Tax arrears: Tax arrears are an implicit subsidy and included in the amber box measures. Since agriculture producers do not pay some fraction of due payments to the budget, they get a zero rate loan from the budget for their day-to-day operational needs.

Payments from VAT returns: 70% of the VAT received by food processing enterprises upon selling milk and meat products is passed on to farms, while 30% of VAT receipts are accumulated in special accounts at the MAP to finance livestock breeding.

Table 1.7

Agriculture and hunting: tax expenditures, UAH m

	2002	2003	2004
Tax privileges:			
Amber Box:			
Fixed agricultural tax	1400.0	1400.0	1400.0
VAT	2128.0	1911.0	1239.6
Land tax	1.3	1.7	1.6
Tax arrears	247.5	440.6	158.8
Write-offs	140.0	n.a.	n.a.
Total tax expenditures	3731.2	3401.7	2669.6

Source: State Tax Administration of Ukraine, IER calculations

1.3.3 State provision/purchase of goods or services

All subsidies classified under 'state provision / purchase of goods and services' category belong to green box measures. The list includes such measures as financing of R&D programs, maintaining pest and disease control, providing training and advisory facilities, etc.

Green Box Measures³¹

General agricultural research and research programs related to particular products: Budget expenditures on research include expenditures on exploratory development and applied research, scientific works of state and inter-sectoral programs, general basic research by scientific institutions and research related to particular products.

Pest and disease control: Ukraine paid so far only minor attention to issues of pest and disease control. For example, almost every year the grain harvest in the Southern regions of Ukraine is damaged by locusts. However, nothing was done to reduce the locusts impact and until now only eradication measures were financed.

Extension and advisory services: Public spending on extension and advisory services includes expenditures on maintenance of research laboratories, crop protection stations that provide consulting services to farmers and disseminate information. Despite the importance of extension services, fiscal restraints have led to a financial crisis in agricultural extension in Ukraine. Indeed, expenditure on extension and advisory services accounted for only a tiny fraction of total agricultural support in the years 2002-2004 (see Table 1.8).

General inspection services and inspection services related to particular products for health, safety and standardization purposes: Government spending on inspection services includes expenditures on the maintenance of state veterinary institutions, state seed inspections, state selection stations and state bread inspections. The trend over the last few years is a gradual increase in expenditures on guaranteeing safety and quality of agricultural and food products.

Training facilities: Expenditures on training services in Ukraine include expenditures for the maintenance of higher schools of the 1st, 2nd, 3rd and 4th accreditation level, and graduate schools of the 2nd and 3rd accreditation levels (academies, institutes, re-training centres etc.).

Land reform: Expenditures on land reform include expenditures on implementing the new land law, implementation of land registration procedures, cadastral examinations, determination of soil quality and agrochemical land certification. The share of these expenditures in total agricultural support remains tiny (see Table 1.8).

³¹ The discussion in this section is partly based on the publication of Demyanenko, S., Galushko, V. (2004): Shifting Agricultural Policy towards Measures Envisaged by the Green Box, in: von Cramon-Taubadel, S., Demyanenko, S., Kuhn, A. (eds.): Ukrainian Agriculture – Crisis and Recovery, Aachen (Germany), Shaker Verlag, pp. 17-25.

Rural infrastructure: Expenditures on infrastructure include public investment in the construction of health-care institutions, water pipelines, sewage systems, gas supply networks, roads, seaports, etc. Despite the importance of rural infrastructure, public spending has remained at an extremely low level at 15,6 m UAH in 2004 or roughly % of total Green Box Measures.

Environmental protection: Spending on environment protection is precisely determined within the framework of the state programs. The share of public spending in total agricultural support is less than 1%.

Table 1.8

Agriculture and hunting: state provision/purchase of goods or services, UAH m

	2002	2003	2004
Green Box measures:			
Agricultural research	146.6	295.1	61.8
Pest and disease control	37.2	140.4	86.3
Extension and advisory services	1.3	4	7.9
Inspection services	397.8	375.4	606.9
Agricultural training and education	385.4	485.8	603.1
Land reform implementation	0.2	3.6	1.8
Rural infrastructure development	7.9	25.4	15.6
Environmental protection	8.9	0.7	24.4
Total	985.3	1330.4	1407.8

Source: IER calculations based on State Treasury Report on the State Budget Execution 2002, 2003, 2004

1.3.4 Quasi-fiscal activities

Amber Box Measures

Fuel supply for agricultural enterprises: Among the most favourite policies of successive Ukrainian governments is the privileged, while subsidized fuel supply to agricultural enterprises. The government forces fuel producers and suppliers (f.ex. Joint-stock company "Uktatnafta") to provide certain quantities of fuel to agriculture producers at lower than market prices for a certain period of time. Such quasi-fiscal activities are to be counted as subsidies to agriculture. In 2004 more than 250 KMT³² of Diesel fuel were distributed at discounted (hence subsidized) prices - UAH

³² In 2004 oil refineries agreed to supply diesel fuel for conducting spring field works and harvesting at the fixed price of UAH 1700/MT till August 1, 2004; 200 KMT of diesel fuel at UAH 1950/MT in June/July for harvesting the year 2004 crop; and 160 KMT at UAH 1970/MT for conducting autumn field works.

550 ,-/MT below the wholesale market prices for Diesel fuel of UAH 2500,-/MT³³ - what amounts to Diesel fuel subsidies of UAH 137.5 m in 2004.

Table 1.9

Agriculture and hunting: quasi-fiscal activities, UAH m

	2002	2003	2004
Fuel Supply	0.0	0.0	137.5
Total	0.0	0.0	137.5

Source: IER estimates

1.3.5 Other income or price support

The Market Price Support (MPS) is measured according to the URAA (Annex 3 of the Agreement) using the gap between fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price. In Ukraine, although some attempts to support prices were taken, but mostly on the grain market in 2004.

Amber box measures

Grain pledge purchase and intervention purchases: This mechanism copied some features of the US loan rate program for grains. It allows producers to receive a loan (based on the pledge price) upon delivery of grain to the state-authorized agencies. Producers can claim grain back within eight months on the condition of repaying the loan; otherwise they lose the title to the product³⁴. Additionally in June 2002, the Law "On Grain and Grain Market in Ukraine" stipulates new grain purchases for intervention purposes, which overlaps with the pledge purchases mechanism. Nevertheless, these mechanisms suffered from the lack of funds during 2002-2004. Also pledge prices were set significantly higher the world level³⁵. Table 1.10 reports an approximate estimate of MPS support.

Table 1.10

Agriculture and hunting: other income and price support, UAH m

	2002	2003	2004
Effective MPS	0.0	0.0	130.0
Total	0.0	0.0	130.0

Source: IER calculations based on State Treasury Report on the State Budget Execution 2002, 2003, 2004; The Law "On State Budget 2005"

³³ Business 35/30.08.04, p. 86.

³⁴ Resolution of the CMU # 1141 "On introduction of pledge grain purchase from agricultural producers" as of 21 July 2000.

³⁵ At UAH 800/MT (USD 151.2/MT) for wheat, at UAH 600/MT (USD 122.5/MT) for rye, and UAH 450/MT (USD 92.3/MT) for barley, while world prices were USD140/MT for wheat and USD90/MT for barley during the period of intervention.

1.3.6 Total subsidization of agricultural production

The total domestic agricultural support measures in Ukraine are substantial and equalled 2.37% of GDP³⁶ in 2002 and fluctuated in absolute terms over the period 2002-2004 (see Table 1.11). In various years between 60% and 80% of all support measures qualified as "amber box" measures and thus would be subject to reduction. The single most important support for agricultural producers in Ukraine is tax expenditures. However, during the period the importance of this support measure declined somewhat, while all other measures grew in importance. Especially high were increases of direct transfers of funds, most of which belong in the "amber box".

Table 1.11

Agriculture and hunting: total amount of subsidy, 2002-2004, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Direct transfer of funds	522.5	9.9	1360.3	22.3	1335.2	23.5
Tax expenditures	3731.2	71.2	3401.7	55.8	2669.6	47.0
State provision of goods and services	985.3	18.8	1330.4	21.8	1407.8	24.8
Quasi-fiscal activities	0.0	0.0	0.0	0.0	137.5	2.4
Other income support	0.0	0.0	0.0	0.0	130	2.3
Total subsidy	5238.9	100.0	6092.4	100.0	5680.1	100.00

Source: IER calculations

1.4 Expected changes in agricultural trade due to WTO accession

Ukraine is negotiating on WTO accession in agriculture goods under the URAA. Topics under discussion in the Working Party fall into four categories: market access; export subsidies, domestic support, and SPS.

Market Access: By this time the Working Party members accepted about 98% of consolidated tariff lines. The implementation period of tariff reductions is expected to start immediately after accession³⁷, with few exemptions for which the tariffs will stay until 2010. At the end of this period, the maximum binding rate³⁸ for agricultural products is expected to be 20% (see Table 1.12 for examples of tariff rate reductions). Also Ukraine offered to switch completely to the use of ad valorem import duties after the accession to the WTO, except for goods subject to excise tax.

³⁶ 2002 GDP was UAH 220932 m.

³⁷ Initially, according to the Ministry of Economy information, negotiations envisaged that implementation period would spread between 2001 and 2005 with few exemptions. Ukraine has agreed to cut the average tariff on agro-food products from 30% in the first year of implementation period (i.e. 2001), to the final level of 12.53% in 2005. However, protracted negotiations imply that Ukraine will, most likely, reduce tariffs immediately after accession.

³⁸ Binding rate means the ceiling rate: "no more than ...".

Table 1.12

Agriculture and hunting: expected change in selected MFN tariffs on agricultural goods due to WTO accession

	2001 MFN tariff, %	Expected binding tariff, %	Absolute difference
Wheat	44	20	22
Maize	30	20	10
Barley	20	20	0
Sunflower seeds	263	20	243
Beef	56	20	36
Pork	52	20	32
Poultry	137	20	117
Eggs	29	20	9

Source: Customs tariff, Ministry of Economy, IER calculations

Binding tariffs at 20% for agriculture goods, as well as the introduction of ad valorem tariffs mean a substantial fall in border protection compared to currently applied MFN tariffs in Ukraine. As estimated, the WTO accession will trigger a 78% reduction in simple average total tariff on agricultural goods. In absolute terms, it means more than 25 percentage points reduction in tariffs from 32.2% to 7.0% (Table 1.13).

Table 1.13

Agriculture and hunting: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	32.2	7.0	25.3	78
<i>including</i>				
MFN tariff	29.0	7.5	21.5	74
Full tariff ^a	53.8	7.5	46.3	86
Import-weighted tariffs	23.3	1.9	21.4	92
<i>including</i>				
MFN tariff	24.2	2.1	22.1	91
Full tariff ^a	28.1	2.1	26.0	93

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

In terms of import-weighted tariffs, the reduction is expected to be more substantial – from 24.2% MFN tariff to 2.1% MFN tariff rate, or by 91%. Larger

reductions of import-weighted tariff rates mean that lower tariffs will be applied to most popular imported goods.

However, despite high border protection domestic farm-gate prices remained low, reflecting the fact that Ukraine is a net exporter of most primary agriculture goods (OECD, 2004)³⁹. Moreover, the price differentials between domestic farm-gate price and external reference prices in percentage terms for most agricultural products except meat goods are lower than the expected binding tariffs.⁴⁰ This means that the impact of reduced MFN tariffs on domestic prices is expected to be negligible, with the exception of meat products.

Alongside with the committed binding of import duties and their reduction, Ukraine offered to joint to several sector initiatives (see also Part I for details). Agriculture (A01) appeared to be a subject to only one sector initiative, namely 'Textile and textile clothing'. However, since the actually applied MFN tariff for codes that fall under this sector initiative is already zero, no changes are expected.

Table 1.14

Agriculture and hunting: expected change in import tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Textile and textile clothing	0.0	0.0	0.0	0.0	No change

Source: Customs tariff, Ministry of Economy, IER calculations

Export Subsidies: The Ukrainian Government has committed itself not to use export subsidies for farm products, so no changes are expected.

Domestic Support: Ukraine offered the *de minimis* at 5%, for both product specific support and non-product specific support. Ukraine is negotiation the AMS⁴¹ to be set at USD 1.14 bn, for the base period 1994-1996. However, some members of the working party are insisting instead on the base period 2000-2002, decreasing Ukrainian AMS to USD 1.1 bn or even USD 265 m if tax privileges are excluded from the AMS estimate.

Ukrainian negotiators argue that USD 1.14 bn is already a very small amount if compared with the domestic support provided to agriculture in other countries – in particular the EU and the US. However, so far the base period and the resulting AMS level are still under negotiations.

³⁹ OECD (Organization for Economic Co-operation and Development), (2004a): Achieving Ukraine's Agricultural Potential. Stimulating Agricultural Growth and Improving Rural Life, Paris <http://www.oecd.org/dataoecd/39/31/34031855.pdf>.

⁴⁰ OECD (Organization for Economic Co-operation and Development), (2004a): Achieving Ukraine's Agricultural Potential. Stimulating Agricultural Growth and Improving Rural Life, Paris <http://www.oecd.org/dataoecd/39/31/34031855.pdf>.

⁴¹ The member state are free to choose their 'amber' box measure as long as the resulting AMS does not exceeds the limits negotiated.

SPS: These measures have to be based on scientific evidence. Ukraine needs to reconsider its epizootic rules, which are stricter than those applied by the WTO members, or give them scientific justification.

2 Forestry (A02)

Table 2.1

Forestry: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	1456	1134	1241	1410
	% total output	0.3	0.2	0.2	0.2
	% industrial output				
Value added	% GDP	0.7	0.4	0.4	0.3
Value added / output	%	76.3	69.8	67.4	57.7
Structure of value added:					
Compensation to employees	% sector VA	31.2	46.6	49.9	78.7
Profit, mixed income	% sector VA	62.6	50.4	44.7	18.8
Net taxes on production and imports	% sector VA	6.1	2.9	5.4	2.5
Employment ^e	thousand people	118	112	105	101
	% total employed	0.9	0.9	0.9	0.9
Average wage ^e	UAH	194	262	317	390
Exports	UAH m	424	305	351	502
	% total exports	0.4	0.3	0.3	0.3
	% sector output	29.1	26.9	28.3	35.6
Imports	UAH m	26	38	124	40
	% total imports	0.0	0.0	0.1	0.0
	% sector output	1.8	3.4	10.0	2.8
Exports/imports	index	16.3	8.0	2.8	12.6

Source: State Statistic Committee, IER estimates

Note: ^e estimate on the basis of year 2004 information

2.1 Overview

Ukraine's natural endowment with forests is rather sparse; the forest cover rate is only 15.6%. In comparison the rate in the East European Region is 43.2%. Ukraine's total area of forestland amounts to 10.8 m ha, of which 9.4 m ha are covered by forest vegetation. The forest coverage rate varies significantly across the regions, in the steppe zone it is lower than 5%, in forest steppe zone it constitutes 16%, in mixed forests it's roughly 30%, and in the Carpathians Mountains it reaches around 70%. Consequently nearly 20% of Ukraine's forests are concentrated in the Carpathian region. The wood flora of Ukraine is comprised by 42% of coniferous forests, by 43% of hardwood forests, and by 15% of softwood

broadleaves and shrubs. A significant feature of Ukrainian forests is the uneven age structure. Young stands constitute 31.5%, middle-aged stands 44.6%, premature 12.7%, and mature and over-mature 11.2% of the total forestry area.

The productivity of Ukrainian forests varies considerably. The average annual volume increment is 4 cubic meters per ha. Average growing stock is 185 cubic meters per ha overall and 236 cubic meters in mature and over-mature stands. The total growing stock was estimated to be 1,736 m cubic meters in 2002⁴². Since the mid 1990's wood harvesting recovered and amounted to 10-11 m cubic meters in 2001⁴³.

All forests in Ukraine are property of the state. The share of forestry constitutes about 0.2-0.3% of the total production volume of the economy or 0.3-0.6% of GDP over the period 2000-2003 (see Table 2.1).

Approximately 100 thousand individuals are employed in forestry, of which 20% are the management staff. Compensation to employers constituted significant share of the sector value added, which is different to, for example, agriculture and hunting sector.

The forestry sector of Ukraine is relatively strongly integrated into the world trade system, especially if compared to agriculture. The ratio of exports to sector output was 29% in 2000 and increased to 36% in 2003 (see Table 2.1). Ukraine is a net exporter of forest products. The composition of Ukrainian exports is as follows: 36,1% sawn wood export, 37,5% round-wood, 14,7% board wood, and 11,3% paper and cardboard. However, the share in European trade of Ukrainian forestry exports accounts only for 0.13% of the total European trade, while imports constitute 0.3%.

The structure of trade in forestry goods under different trade regimes fluctuated over the period considered. Most imports and increasingly so originated from MFN trade with Ukraine, especially from EU-15, although in the year 2000 the share of imports was almost equal to trade with countries under free trade agreements. In particular Russia lost shares on the Ukrainian market of forestry goods.

The situation concerning exports is similar to the import side. Again, countries with MFN trade regime with Ukraine were major export destinations for Ukraine, especially the NMC-5 countries.

⁴² State Committee of Forestry, (2004): Forests of Ukraine Overview, <http://www.dklg.kiev.ua>.

⁴³ A detailed breakdown of produce shows that in 2001 about 2.0 m cubic meters of sawn wood, 0.4 m cubic meters of particle board, 20.0 m square meters of fiber board, 68 thousand tons of wood-pulp, and 474 thousand tons of paper and cardboard were produced, as showed by State Committee of Forestry and Ukrainian Research Institute of Forestry and Forest Melioration, (2003): National Report to the Third Session of UN Forest Forum, http://www.un.org/esa/forests/pdf/national_reports/unff3/ukraine.pdf.

Table 2.2

Forestry: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	3.9	5	3.1	5	3.4	5
<i>Including</i>						
Russia	1.1	2	0.8	1	0.4	1
other CIS	1.0	1	0.8	1	2.1	3
Baltic countries	1.8	2	1.5	2	0.9	1
MFN trade	69.5	93	56.0	93	65.2	92
<i>Including</i>						
EU-15	12.0	16	11.5	19	11.5	16
NMC-5	33.4	45	31.8	53	35.5	50
Asia	22.4	30	11.3	19	16.6	24
America	0.4	1	0.0	0	0.0	0
"Full tariff" trade	1.1	1	1.0	2	2.0	3
Total	74.4	100	60.1	100	70.5	100
Imports						
Free trade	5.2	43	2.5	16	1.4	9
<i>Including</i>						
Russia	3.5	29	1.4	9	0.8	6
other CIS	1.2	9	0.6	4	0.3	2
Baltic countries	0.6	5	0.5	3	0.4	2
MFN trade	6.8	55	12.6	80	13.5	88
<i>Including</i>						
EU-15	5.0	41	10.4	66	11.5	75
NMC-5	0.7	5	0.8	5	0.9	6
Asia	0.7	6	0.7	5	0.7	4
America	0.2	2	0.3	2	0.1	1
"Full tariff" trade	0.3	2	0.5	3	0.3	2
Total	12.2	100	15.6	100	15.3	100

Source: UN ComTrade database, IER estimates

2.2 Tariffs

Table 2.3

Forestry: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	3.8	10.5	10.0	2.3	2.2	3.1	2.9
<i>including</i>							
MFN tariff	4.1	11.5	10.9	2.4	2.4	3.3	3.1
Full tariff	9.0	13.5	15.8	4.9	4.8	7.2	6.9

Source: Customs tariff, UN ComTrade database, IER estimates

Total simple average tariff on forestry products was reduced over the period of study (1996-2002) from 3.8% to 2.9%. The MFN tariffs, reached 3.1% in 2002, being quite close to the total tariff.

Table 2.4

Forestry: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	5.1	17.6	17.3	2.9	2.9	1.9	1.8
<i>including</i>							
MFN tariff	5.5	19.5	18.9	3.1	3.2	2.1	2.0
Full tariff	10.0	20.6	24.6	5.2	5.2	4.4	4.2

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

Both the MFN and full import-weighted tariffs have declined since 1996, and in 2002 they stayed at 2.0% and 4.2% respectively.

2.3 Subsidies

In the period 2002-2004 most subsidies to forestry were provided in form of state service provision and tax arrears, while other tax privileges remained rather insignificant. However subsidies in forestry are not regulated by URAA (see Annex 1 of Agreement for product coverage). Thus they are neither amber box nor green box measures, except some measures on environment protection (i.e. protective afforestation), which are green box measures.

2.3.1 Tax expenditures

In comparison to agriculture are tax subsidies to forestry rather insignificant. Tax expenditures are provided as land tax exemptions by local and national authorities (e.g. for national parks, special nature reserves etc). Research in forestry is VAT

exempt and financed from budget⁴⁴. However, tax arrears are in the state owned sector of greater concern.

Table 2.5

Forestry: tax expenditures in Forestry, UAH m

	2002	2003	2004
Tax privileges:			
EPT	na	na	0.09
VAT	na	na	0.11
Land tax	na	na	0.03
Tax arrears	3.28	3.10	1.24
Total tax expenditures	0.83	0.63	0.45

Source: IER estimates based on State Tax Administration

2.3.2 State provision/purchase of goods or services

General provision of services is budget the main source of subsidization in forestry. The State Committee of Forestry and the MAP increased significantly the funds allocated for the implementation of governmental programs, such as the "State Program of Forest Management and Forest Industry Complex Development till 2015" (1993), the "National Program of Ecological Network Development in Ukraine for 2000-2015" (2000), and the program "Forests of Ukraine" for 2002-2015 (2002)⁴⁵. As mentioned above, such measures as Protective afforestation and Nature-protective measures belong into the **green box**.

Table 2.6

Forestry: state provision/purchase of goods and services, UAH m

	2002	2003	2004
Protective afforestation	4.8	4.0	8.6
Nature-protective measures	5.1	10.3	12.1
Training Facilities	8.5	10.9	15.8
R&D	2.1	2.9	1.9
Total	20.55	28.0	38.2

Source: State Treasury Report on the State Budget Execution 2002, 2003, 2004, IER estimates

2.3.3 Total subsidization of forestry

In general, Forestry represented a sector with insignificant subsidies, a bulk amount of which is provided in form of General services. Table 2.7 summarizes the discussion above.

⁴⁴ See Laws of Ukraine "On VAT" as of June 27, 1997 and "On taxation of profits of enterprises" as of December 28, 1994.

⁴⁵ Regulation of the CMU # 581 "On the Ratification of the State Program "Forests of Ukraine" for 2002-2015", as of April 29, 2002.

Table 2.7

Forestry: total amount of subsidy, 2002-2004, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Direct transfer of funds	0.0	0	0.0	0	0.0	0
Tax expenditures	0.8	4	0.6	2	0.5	1
State provision of goods and services	20.6	96	28.0	98	38.2	99
Quasi-fiscal activities	0.0	0	0.0	0	0.0	0
Other income support	0.0	0	0.0	0	0.0	0
Total subsidy	21.4	100	28.6	100	38.7	100

Source: IER estimates (see text for discussion)

2.4 Expected changes in trade regime in forestry due to WTO accession

Market Access: The high share of free trade imports in Forestry (A02) explains a comparatively low reduction in simple average total tariff that is expected after Ukraine's accession to the WTO. As estimated, total tariff protection will be reduced by 60%, with the simple average MFN rate dropping by 59% and the full rate by 81% (Table 2.8). The reduction in the import-weighted MFN tariff is expected from 2.0% to 1.3%, or by one third.

Table 2.8

Forestry: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	2.9	1.2	1.7	60
<i>including</i>				
MFN tariff	3.1	1.3	1.8	59
Full tariff ^a	6.9	1.3	5.6	81
Import-weighted tariffs	1.8	1.2	0.6	35
<i>including</i>				
MFN tariff	2.0	1.3	0.7	33
Full tariff ^a	4.2	1.3	2.9	69

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

The expected reduction in tariff will include one sectoral initiative, namely 'Wood', that concerns forestry sector (A02). This initiative *per se* envisages a reduction of imports tariff on almost one third of sector imports from a current simple average tariff of 3.3% to a zero level.

Table 2.9

Forestry: expected change in tariffs due to sectoral initiatives

Initiative	2002 MFN tariff, %	Sectoral initiative tariff, %	Difference	Share of imports, %	Comment
Wood	3.3	0.0	3.3	29.3	Reduction

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic support: It is expected that the WTO accession will - if any - only minor reductions of subsidies in Forestry (A02). Most subsidies in the sector are provided in the form of General services, which cause only negligible trade distortion, and, thus, according to the Agreement on subsidies and countervailing measures are not subject to reduction.

3 Fishery (A03)

Table 3.1

Fishery: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	730	671	540	609
	% total output	0.2	0.1	0.1	0.1
	% industrial output				
Value added	% GDP	0.1	0.1	0.1	0.1
Value added / output	%	31.0	32.3	28.5	25.0
Structure of value added:					
Compensation to employees	% sector VA	34.5	45.2	58.4	52.6
Profit, mixed income	% sector VA	42.5	18.4	38.3	55.9
Net taxes on production and imports	% sector VA	23.0	36.4	3.2	-8.6
Employment	thousand people	31	28	26	23
	% total employed	0.2	0.2	0.2	0.2
Average wage	UAH	147	204	242	291
Exports	UAH m	124	71	57	52
	% total exports	0.1	0.1	0.0	0.0
	% sector output	17.0	10.6	10.6	8.5
Imports	UAH m	368	454	622	697
	% total imports	0.4	0.4	0.5	0.5
	% sector output	50.4	67.7	115.2	114.4
Exports/imports	index	0.3	0.2	0.1	0.1

Source: State Statistic Committee, IER estimates

3.1 Overview

Ukraine inherited from the Soviet era a sizeable fishery sector with a developed infrastructure providing the basis for the further development of fishery industry. Ukraine is fishing in the high seas, the Black and the Azov Seas and inland reservoirs. Fresh water fish farms (or aquaculture production), marine culture and processing of aquatic products are developed. Ukraine possess the largest European system of artificial reservoirs, consisting of fresh-water ponds with total area of more than 2,230 square km, of which currently only 20-25% of the potential are utilized.

Catch from the Black and Azov Seas, fresh fish farming and aquacultures as well as imports are mostly supplying the domestic market. Imports significantly increased from 2000-2003 and reached a domestic market share of roughly 65%. Almost all

imports (99%) are frozen fish. Ukrainian companies fishing in distant waters on the high seas sell the most part (up to 80%) of their catch in the respective fishing grounds⁴⁶.

In 2003, total Ukrainian catch in the World Ocean, the Black and the Azov Seas, inland reservoirs, and aquaculture production amounted to about 260,000 MT.

About 80-90% of the production of aquaculture and inland fishery is sold fresh; the rest is salted and smoked. Up to 70-80% of fish caught in the Azov-Black Sea basin (anchovy, sardelle, sprats) is sold salted and smoked, about 10% is processed to fish conserves, about 10% (anchovy, grey mullet, pike-perch) is sold fresh or frozen.

The share of fishery in the total output of Ukraine constituted around 0.1% and its contribution to GDP fluctuates around 0.1%, where expenditures on employees compensation contributed most.

More than 45,000 people were professionally employed in the sector over the considered period. However, the total number fishermen is estimated to be in the range of 500,000 – 1m. Fishery is especially important in the coastal regions economy.

Ukraine's Fishery sector is substantially integrated in the world trade system. The ratio of sectoral export to sectoral output constituted 17% in 2000 and declined to 9% in 2003 (see Table 3.1). However, the share of sectoral imports in the sectoral output is a multiple higher, 50% in 2000 up to 114% in 2003.

The structure of trade experienced same trends for imports and exports. On the import side full tariff trade countries dominated on the Ukrainian import market. Russia and other CIS countries under free trade lost significant market shares. The regional orientation of Ukrainian fishery exports was the same, with more than 50% of trade went to countries with full tariff trade.

Table 3.2
Fishery: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	1.1	5	5.3	23	4.8	35
<i>including</i>						
Russia	0.5	2	2.6	11	1.7	13
other CIS	0.2	1	0.2	1	0.3	2
Baltic countries*	0.4	2	2.5	11	2.7	20
MFN trade	8.8	37	3.9	17	2.9	22
<i>including</i>						

⁴⁶ Overview of Ukrainian Fishery Industry, (2004): Eurofish, <http://www.eurofish.dk/indexSub.php?id=1894>.

Table 3.2 (cont.)

Fishery: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
EU-15	6.7	28	1.9	8	0.6	4
NMC-5	1.3	5	1.1	5	1.4	10
Asia	0.5	2	0.4	2	0.3	2
America	0.2	1	0.4	2	0.6	4
"Full tariff" trade	13.9	58	13.7	60	5.7	43
Total	23.8	100	23.0	100	13.4	100
Imports						
Free trade	22.8	35	25.0	32	11.8	17
<i>including</i>						
Russia	15.1	23	13.2	17	3.2	5
other CIS	0.1	0	0.1	0	0.0	0
Baltic countries*	7.6	12	11.7	15	8.5	12
MFN trade	5.9	9	4.8	6	7.1	10
<i>including</i>						
EU-15	3.3	5	3.0	4	4.6	6
NMC-5	0.0	0	0.1	0	0.1	0
Asia	0.3	0	0.1	0	0.4	1
America	2.2	3	1.5	2	2.0	3
"Full tariff" trade	37.0	56	48.2	62	52.2	73
Total	65.7	100	77.9	100	71.1	100

Source: UN ComTrade database, IER estimates

Note: * Some fishery products are exempted from free trade with Lithuania

3.2 Tariffs

Table 3.3

Fishery: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	9.3	21.2	34.6	38.8	21.4	43.6	40.4
<i>including</i>							
MFN tariff	5.5	24.0	25.3	30.4	20.1	30.3	28.1
Full tariff	12.0	25.6	43.7	48.8	26.4	55.3	51.2

Source: Customs tariff, UN ComTrade database, IER estimates

Although Ukraine is net importer of fish, and domestic production is extremely limited, import tariffs on fish are high. In particular, the MFN tariff on fishery products was 28.1% in 2002, that is four times higher than in 1996. The increase in simple average full tariff was equally substantial from 12.0% in 1996 to 51.2% in 2002. Thus, total simple average tariff on fishery appeared to be high, reaching 40.4% in 2002.

Table 3.4

Fishery: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	7.9	29.0	35.8	65.4	16.0	27.9	30.3
<i>including</i>							
MFN tariff	5.0	34.8	25.4	46.8	18.7	20.0	21.5
Full tariff	10.1	34.8	45.3	82.8	19.2	35.4	38.4

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

Both MFN and full import-weighted tariffs have increased since 1996. In 2002 they reached 21.5% and 38.4%.

3.3 Subsidies

In the period 2002-2004 most subsidies to fishery were provided in form of General Services provision and tax arrears, while tax privileges remained rather insignificant. Also subsidies to fishery are not regulated by URAA (see Annex 1 of the Agreement for product coverage).

3.3.1 Tax expenditures

The fishery industry has been mostly privileged with VAT exemptions (see Table 3.5), like import of fish and fish goods from World Ocean with Ukrainian ships registered in State ship register etc. Some subsidization occurs also in form of tax arrears.

Table 3.5

Fishery: tax Expenditures, UAH m

	2002	2003	2004
Tax privileges:			
VAT	na	na	26.9
Tax arrears	5.9	5.0	2.0
Total tax expenditures	1.5	1.3	27.4

Source: IER calculations based on data provided by State Tax Administration

3.3.2 State provision/purchase of goods or services

Like in forestry most financing to fishery is provided from the State budget in the form of general services provision. The State Committee of Fishery under guidance of MAP expanded over the period the allocated funds for such measures (see Table 3.6).

Table 3.6

Fishery: state provision/purchase of goods or services, UAH m

	2002	2003	2004
R&D	0.9	2.8	1.6
Training and Schools	11.6	14.0	16.7
Protection	20.4	34.3	45.2
Selection	0.4	1.3	2.0
Total	33.1	52.4	65.5

Source: IER calculations based on State Treasury Report on the State Budget Execution 2002, 2003, 2004

3.3.3 Total subsidy

Ukrainian fishery is a sector with almost insignificant subsidization. Where subsidization occurs it is mostly in form of VAT reduction exempt and provision of general services (see Table 3.7).

Table 3.7

Fishery: total amount of subsidy, 2002-2004, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Direct transfer of funds	0	0	0	0	0	0
Tax expenditures	1.5	4	1.3	2	27.4	30
State provision of goods and services	33.1	96	52.4	98	65.5	71
Quasi-fiscal activities	0	0	0	0	0	0
Other income support	0	0	0	0	0	0
Total subsidy	34.6	100	53.7	100	92.9	100

Source: IER estimate

3.4 Expected changes in fishery trade regime due to WTO accession

Market Access: Ukraine's accession to the WTO is expected to result in a 91% reduction in simple average total tariff on fishery products from currently 40.4% to 3.6% (In absolute terms it means a 36.8 percentage points drop in tariff). The reduction on simple average MFN and full tariff rates will be equally substantial – by 85% and 92% respectively. The reduction is also large, if estimated in terms of

import-weighted tariffs. In particular, the MFN import-weighted tariff will be reduced by 87% from 21.5% to 2.8%.

Table 3.8

Fishery: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	40.4	3.6	36.8	91
<i>including</i>				
MFN tariff	28.1	4.3	23.8	85
Full tariff ^a	51.2	4.3	46.9	92
Import-weighted tariffs	30.3	2.3	28.0	92
<i>including</i>				
MFN tariff	21.5	2.8	18.7	87
Full tariff ^a	38.4	2.8	35.6	93

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

Domestic support: It is expected that WTO accession will not cause significant reduction of subsidization of fishery, as most subsidies are provided in the form of state provision of services, which cause only negligible trade distortion, and thus are not subject to reduction according to the Agreement on subsidies and countervailing measures.

4 Food processing industries (A07)

Table 4.1

Food processing industries: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	48892	64810	68973	84470
	% total output	11.3	12.4	12.0	12.3
	% industrial output	20.9	23.4	22.9	23.2
	% growth, real	23.0	18.0	8.0	20.0
Value added	% GDP	7.8	7.7	7.9	8.2
Value added / output	%	27.3	24.2	25.8	25.8
Structure of value added:					
Compensation to employees	% sector VA	30.9	26.3	24.7	25.5
Profit, mixed income	% sector VA	15.0	24.8	27.6	28.6
Net taxes on production and imports	% sector VA	54.1	48.9	47.6	45.9
Employment	thousand people	518	485	464	445
	% total employed	3.8	3.8	3.8	3.8
Average wage	UAH	281	364	423	496
Exports	UAH m	7775	7780	8961	12246
	% total exports	7.3	6.9	7.2	7.9
	% sector output	15.9	12.0	13.0	14.5
Imports	UAH m	3456	5005	4903	6701
	% total imports	3.5	4.6	4.3	4.5
	% sector output	7.1	7.7	7.1	7.9
Exports/imports	index	2.2	1.6	1.8	1.8

Source: State Statistic Committee, IER estimates

4.1 Overview

The food-processing industry (FPI) is an important sector in Ukraine's economy, accounting for about 12% of the whole Ukrainian output and for about 23% of the industrial output over the last years (see Table 4.1). More than 9,000 enterprises are active in the food industry, ca. 25% of which are large and medium-sized. Nearly 90% of the food output is produced by the food processing industry while

agricultural enterprises account for the remaining 10% share.⁴⁷ Stable growth of value added allowed keeping the share of food industry in GDP constant at 8%. Employment declined in the FPI, hence increasing gross value added per employee. Output and value added growth in the sector was significantly higher than for the economy as a whole. Having average output growth around 17% between 2000 and 2003, FPI is one of the fastest-growing sectors in the economy, with production of beverages taking the lead.

The largest contributors to the total food industry output are beverages with about 20% (in 2001), milk and milk products (16.6%), meat and meat products (10.4%). Tobacco products accounted for 8.4%, and the aggregate "bread and bakery products, sugar, confectionary, tea etc" accounts for 29.8% of FPI.

Total employment in the industry declined from 518,000 peoples in 2000 to 445,000 in 2003. Employment in capital-intensive sub-sectors, e.g. beverages, tobacco, and oil seed crushers is significantly below the sectors average. Average wage in food-processing industry is in the middle range of the whole economy.

Comparison of the relative size of the food industry in Ukraine with other countries in 2001, e.g. Estonia, Slovakia, Poland Czech Republic, has shown that their sizes are very similar, i.e. in terms of output, employment etc (OECD, 2004).

Table 4.2

Food processing industries: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	725.3	64	822.0	65	914.2	67
<i>Including</i>						
Russia	583.7	52	651.8	52	627.5	46
other CIS	104.0	9	118.0	9	224.0	16
Baltic countries*	37.6	3	52.2	4	62.7	5
MFN trade	371.3	33	394.6	31	401.5	29
<i>Including</i>						
EU-15	170.7	15	160.0	13	172.6	13
NMC-5	44.6	4	91.5	7	59.6	4
Asia	41.4	4	40.5	3	38.2	3

⁴⁷ OECD (Organization for Economic Co-operation and Development), (2004a): Achieving Ukraine's Agricultural Potential. Stimulating Agricultural Growth and Improving Rural Life, Paris <http://www.oecd.org/dataoecd/39/31/34031855.pdf>.

Table 4.2 (cont.)

Food processing industries: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
America	14.5	1	10.7	1	11.2	1
"Full tariff" trade	28.7	3	40.6	3	53.6	4
Total	1125.3	100	1257.2	100	1369.4	100
Imports						
Free trade	125.2	27	222.0	30	205.8	26
<i>Including</i>						
Russia	80.0	17	123.5	17	138.3	17
other CIS	31.2	7	75.8	10	42.7	5
Baltic countries*	14.0	3	22.6	3	24.9	3
MFN trade	306.1	66	453.9	62	545.2	68
<i>Including</i>						
EU-15	159.5	34	195.6	27	228.3	29
NMC-5	25.8	6	49.5	7	57.5	7
Asia	23.5	5	28.6	4	65.3	8
America	92.5	20	169.3	23	182.4	23
"Full tariff" trade	33.1	7	57.3	8	47.7	6
Total	464.3	100	733.2	100	798.7	100

Source: UN ComTrade database, IER estimates

Note: * Some food products are exempted from free trade with Latvia and Lithuania

Food sector belongs to the top sectors exporting its production abroad. As Table 4.1 report, on average it exported 12-16% of the total sector output, reaching 50% in some sub-sectors (e.g. oil-fat industry). Import also experienced a modest growth over the period considered. A comparison of the relative size of the food industry in Ukraine with other countries in 2001, e.g. Estonia, Slovakia, Poland Czech Republic, reveals similarities in terms of output, employment etc (OECD, 2004).

Ukraine's food sector is a significant exporter, exporting on average 12-16% of the total sector output, and reaching in some sub-sectors almost 50% (e.g. oil-fat industry). Imports were modestly growing over the period considered.

Most imports originated in countries with MFN trade regime with Ukraine, lead by EU-15 and America. Nevertheless countries trading under free trade agreements with Ukraine delivered with roughly one third amounts of imported food products. In the latter group Russia maintains a strong position.

On the export side, countries trading under free trade regime with Ukraine received more than 60% of total exported food products, roughly half of all exports were shipped to Russia. Countries covered by MFN agreements accounted for roughly 1/3

of the total of the sectors exports. The share of exports to “full tariff” partners remains small over the period.

4.2 Tariffs

Table 4.3

Food processing industries: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	18.7	27.5	37.7	43.4	48.0	53.1	53.4
<i>including</i>							
MFN tariff	22.7	36.7	46.5	54.7	60.1	66.8	67.2
Full tariff	48.2	41.1	91.4	95.3	108.9	116.8	117.1

Source: Customs tariff, UN ComTrade database, IER estimates

The food industry lobbied for the highest level of tariff protection in Ukraine. The MFN simple average tariff on food products was steadily increased between 1996 and 2002, and reached 67.2%. The full tariff rate was almost twice higher at 117.1% in 2002. Since more than one fourth of imports originates from countries with which Ukraine signed free trade agreements, total simple tariff on food products was somewhat lower at 53.4% in 2002.

Table 4.4

Food processing industries: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	22.8	34.2	35.3	39.3	35.3	37.3	41.9
<i>including</i>							
MFN tariff	27.6	45.1	43.3	51.1	46.0	48.7	54.7
Full tariff	59.7	56.1	87.7	70.7	62.8	66.7	73.8

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

The MFN import-weighted tariff on food products reached 54.7% in 2002, while the full import-weighted tariff rate was 73.8%.

4.3 Subsidies

In the period 2002-2004 subsidies to food industry were provided in the form of tax expenditures, state provision of services, and price support mechanisms.

4.3.1 Tax Expenditures

All subsidies to the food industry in the category "tax expenditures" were provided in the form of tax privileges. However, these granted privileges do not reach the same extent as in agriculture.

Amber Box Measures

Enterprise profit tax: Sales of self-produced food for child nutrition are exempted from EPT (see Table 4.5)⁴⁸.

Value Added Tax: Sales of domestically produced food for child nutrition to milk kitchens and specialized shops are exempted from VAT duty⁴⁹.

Excises: Export of alcohol beverages and tobacco products in exchange for foreign currency is exempted from excise duty (provided the receipts from export are accumulated on foreign currency accounts). Some operations with Cognac and ethyl alcohol are levied with zero excise duty or exempted from excise.

Table 4.5

Food processing industries: tax expenditures, UAH m

	2002	2003	2004
Tax privileges			
<u>Amber Box:</u>			
EPT	1.4	1.8	1.5
VAT: food for child nutrition	3.5	3.2	3.0
Excises	113.7	160.3	167.2
Tax arrears	388.4	317.7	93.8
Total tax expenditures	216.5	245.4	195.3

Source: IER calculations based State Tax Administration report

4.3.2 State provision/purchase of goods or services

Green Box Measures

General research and research programs related to particular products: Budget expenditures on FPI research include expenditures on exploratory development and applied research, scientific works of state and inter-sectoral programs, general basic research by scientific institutions and research related to particular products.

⁴⁸ See the Law of Ukraine "On taxation of profits of enterprises" as of December 28, 1994.

⁴⁹ See the Law of Ukraine "On VAT" as of June 27, 1997.

Table 4.6

Food processing industries: state provision/purchase of goods or services, UAH m

	2002	2003	2004
Green Box:			
R&D	0.2	0.3	0.3
Total	0.2	0.3	0.3

Source: IER calculations based on State Treasury Report on the State Budget Execution 2002, 2003, 2004

4.3.3 Other income or price support

Amber Box Measures

Sugar: The main exception as regards subsidisation in Ukraine's food processing industry being the sugar production, production of white sugar is heavily subsidized. In June 1999, the Law of Ukraine #758 "On State Regulation of Sugar Production and Marketing" stipulated the new price regime, thereby setting the marketing quota for sugar and within-quota minimum sugar beet and minimum sugar prices. The overall national quota is allocated to regions, and then to sugar plants and sugar beet growers. In fact, the volume of quota and fixed prices has not changed since 2002⁵⁰. As a consequence, consumers subsidize sugar industry through higher prices (see Table 4.7)⁵¹.

Table 4.7

Food processing industries: other income or price support, UAH m

	2002	2003	2004
Market Price Support (MPS)	601.0	743.0	Na
Total	601.0	743.0	Na

Source: OECD (2004b)⁵², IER calculations

4.3.4 Total subsidy

Except for sugar the food FPI industry did not receive significant subsidies from the government. Most subsidies are the transfers from consumers to sugar producers, receiving more than 80% of all industry subsidies. The level of subsidization remained quite stable over the period.

⁵⁰ Resolution of the CMU # 1977 "On State regulation of Sugar Production and Marketing", as of December 25, 2002 (with amendments).

⁵¹ For estimation of MPS for sugar see Annex C, Table 1.

⁵² OECD (Organization for Economic Co-operation and Development), (2004b): Producer and Consumer Support Estimates, OECD Database 1986-2003, <http://www.oecd.org/dataoecd/42/57/32429179.xls>.

Table 4.8

Food processing industries: total amount of subsidy, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Direct transfer of funds	0.0	0	0.0	0	0.0	0
Tax expenditures	216.5	27	245.4	25	195.3	21
State provision of goods and services	0.2	0	0.3	0	0.3	0
Quasi-fiscal activities	0.0	0	0.0	0	0.0	0
Other income support	601.0	74	743.0	75	743.0	79
Total subsidy	817.7	100	988.7	100	938.6	100

Source: IER calculations

4.4 Expected changes in trade regime for food industry due to WTO accession

Negotiation on WTO accession in food goods are proceeding under the URAA. General URAA encompasses food goods as well as agriculture goods. Therefore, as with agriculture goods, the Working Party discussions fall into four categories: market access; export subsidies, domestic support, and SPS.

Market Access: Ukraine offered to switch completely to the use of ad valorem import duties after the accession to the WTO, except for goods subject to excise tax. The implementation period of tariff reductions is expected to start immediately after accession⁵³ (for a few tariff lines until 2010). At the end of this period, the maximum binding rate for food products is expected to be 20%, except some sensitive positions for Ukraine, in particular they are sugar, sunflower oil etc (see Table 4.9).

Table 4.9

Expected change in selected MFN tariffs on food products due to WTO accession

	2003 MFN tariff, %	Expected binding tariff, %	Difference
Sugar	108	50	58
Sunflower Oil	263	30	233

Source: Customs tariff, Ministry of Economy, IER calculations

In general, the WTO membership is expected to result in 82% reduction of import tariffs on food products, if measured in terms of simple average tariff rate: import duty will drop from 53.4% to 9.5%. The MFN import-weighted tariff will reduce by 78%.

The reduction of tariff will partially occur due to sector initiatives. The food industry is subject to two sector initiatives: 'Distilled spirits' and 'Chemistry'. For 'Distilled

⁵³ Initially, negotiations envisaged that implementation period would spread between 2001 and 2005 with few exemptions. However, protracted negotiations imply that Ukraine will, most likely, reduce tariffs immediately after accession.

spirits' sector initiative the schedule of import duties binding is more complicated than for majority of other sector initiatives, since it includes two stages. At the first stage that starts immediately after the WTO accession, specific tariffs are preserved. At the second stage that starts in 3 years after accession, imports duties are bound at a zero level. While this reduction in tariffs is significant for distilled spirits industry, for the food industry as such the reduction will be less substantial due to low share of imports of these products (1.7% of sector imports).

Table 4.10

Food processing industries: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	53.4	9.5	43.9	82
<i>including</i>				
MFN tariff	67.2	12.8	54.4	81
Full tariff ^a	117.1	12.8	104.3	89
Import-weighted tariffs	41.9	8.9	33.0	79
<i>including</i>				
MFN tariff	54.7	12.0	42.7	78
Full tariff ^a	73.8	12.0	61.8	84

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

The second initiative – 'Chemistry' – has its own peculiarities, since it does not include a reduction of imports duties to a zero level. The binding tariff rate of the "Chemistry Initiative" is with 6.5% above actually in Ukraine applied MFN tariff on these tariff lines. Thus, at the moment this sector initiative is not binding for the Ukrainian food industry.

Table 4.11

Food processing industries: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %		Difference	Share of imports, %	Comment
		Immediately after accession	In 3 years after accession			
Distilled spirits	n.a.	n.a.	0.0	n.a.	1.7	Reduction
Chemistry	3.4	6.5	6.5	-3.1	0.0	Non-binding

Source: Customs tariff, Ministry of Economy, IER calculations

Export Subsidies: Ukraine is committed not to use export subsidies for food products.

Domestic Support: The URAA basically regulates trade in food industry products together with agriculture goods. So, all said above for Agriculture is applicable as well to domestic support in FPI. In 2002-2004 most of domestic support measures in food industry were provided either in the form of tax expenditures or the support measures for sugar industry (price regulation and TRQ). These measures belong into the amber box and hence will subject to WTO-related negotiations and reductions.

SPS: These measures have to be scientifically based. Ukraine needs to reconsider its epizootic rules, which are stricter than those applied by the WTO members, or give them scientific justification.

PART III
SECTOR STUDY ON INDUSTRY

5 Mining of coal and peat (A04)

Table 5.1

Mining of coal and peat: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	11555	12798	12654	13438
	% total output	2.7	2.4	2.2	1.9
	% industrial output	4.9	4.6	4.2	3.7
	% growth, real ^a	6.0	3.0	2.0	6.0
Value added	% GDP	1.5	1.7	1.8	1.6
Value added / output	%	22.6	27.1	32.1	32.0
Structure of value added:					
Compensation to employees	% sector VA	113.1	91.7	99.9	99.1
Profit, mixed income	% sector VA	7.7	28.9	18.5	15.2
Net taxes on production and imports	% sector VA	-20.7	-20.7	-18.4	-14.3
Employment ^e	thousand people	395	371	351	339
	% total employed	2.9	2.9	2.9	2.9
Average wage ^e	UAH	339	458	554	681
Exports	UAH m	391	645	523	503
	% total exports	0.4	0.6	0.4	0.3
	% sector output	3.4	5.0	4.1	3.7
Imports	UAH m	1502	1796	1104	2515
	% total imports	1.5	1.6	1.0	1.7
	% sector output	13.0	14.0	8.7	18.7
Exports/imports	index	0.3	0.4	0.5	0.2

Source: State Committee of Statistics, IER estimates

Notes: ^a real growth of extractive industry that includes mining of coal and peat (A04), production of hydrocarbons (A05), and production of non-energy materials (A06)

^e estimate on the basis of year 2004 information

5.1 Overview

Mining of coal and peat accounted during the years 2000-2003 for 2-3% in total output, 4-5% in industrial output and 2% of GDP. The share of value added for the sector averages at a level of about 30%. Most of the value added is distributed to employees as salaries, while profit roughly equals to the net subsidies from the government.

Coal extraction is still regarded as a strategic sector of Ukraine's economy. About 30% of electricity is generated from steam coal. Coking coal is an important input

in the enormously important steel industry, which accounts for about 18% of industrial output and roughly 30% of Ukrainian exports (see A14).

Restructuring of the coal-mining sector seems to pose a special challenge, like in so many other countries. Especially problematic are the labour force relations due to absence of proper management incentives. In the past wages and salaries were often neither in time nor fully paid. In turn trade unions lobbied for more state aid to the industry, getting the government even deeper involved but the problems remained unsolved. So far organized vested interests prevented successfully any opening of the sector to competition or foreign investment. Coal mining in Ukraine remains almost unreformed. Soviet era structures and state ownership with heavy administrative involvement of the Ministry of Fuel and Energy (MFE) in the sector are still the case. This is especially remarkable as domestic production fails to meet the growing demand from the domestic industry. Hence import of coal and coal products is growing. It remains to be seen whether Ukrainian coal can compete successfully without state aid with imports from Russia or Poland. However, the recent price increases on world markets for coal and coal products could prove positive for the prospects of Ukrainian coal production.

Most coal and peat imports arrive to Ukraine under free trade agreements. The share of such imports increased from 77% in 2000 to 87% in 2002 in the total volume of sector imports. In turn the importance of MFN trade regime mostly with NMC-5 countries declined and the share fell from 23% in 2000 to 13% in 2002. Russia is the single most important trading partner for coal and peat with a share of 87% in 2002.

Table 5.2

Mining of coal and peat: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	6.8	10	14.3	13	11.4	12
<i>including</i>						
Russia	0.1	0	0.0	0	0.1	0
other CIS	6.1	9	14.1	13	11.3	12
Baltic countries	0.6	1	0.2	0	0.0	0
MFN trade	59.0	89	96.4	87	86.1	88
<i>including</i>						
EU-15	2.7	4	10.4	9	6.7	7
NMC-5	17.5	27	23.3	21	14.9	15
Asia	0.3	0	6.8	6	12.5	13
America	0.0	0	1.4	1	0.1	0
"Full tariff" trade	0.2	0	0.1	0	0.2	0
Total	66.0	100	110.8	100	97.7	100
Imports						
Free trade	202.9	77	246.8	85	180.8	87

Table 5.2 (cont.)

Mining of coal and peat: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
<i>including</i>						
Russia	202.9	77	246.7	85	180.5	87
other CIS	0.0	0	0.1	0	0.3	0
Baltic countries	0.0	0	0.0	0	0.0	0
MFN trade	59.3	23	44.0	15	26.4	13
<i>including</i>						
EU-15	0.7	0	0.4	0	0.4	0
NMC-5	53.4	20	40.9	14	25.8	12
Asia	0.0	0	0.7	0	0.0	0
America	5.3	2	2.1	1	0.2	0
"Full tariff" trade	0.0	0	0.0	0	0.0	0
Total	262.3	100	290.9	100	207.2	100

Source: UN ComTrade database, IER estimates

MFN trade is important for Ukrainian exports of coal and peat products (see Table 5.2), its share accounted for roughly 88% during the years 2000-2002. Exports under free trade oscillate between 10% and 13% in the reviewed period. Buyers of Ukrainian coal and peat products are mostly from CIS-countries (except Russia), NMC-5 countries and Asia. However, Ukraine is a net importer of coal and peat.

5.2 Tariffs

Table 5.3

Mining of coal and peat: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>including</i>							
MFN tariff	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Full tariff	8.3	8.3	8.3	8.3	8.3	8.3	8.3

Source: Customs tariff, UN ComTrade database, IER estimates

Imports of coal and peat originate predominantly from free trade areas established among CIS countries and from the countries enjoying the MFN trade regime with Ukraine. Coal and peat imports from these countries were subject to a zero simple average rate from 1996 till 2003, resulting in a zero rate of total tariff. At the same

time, the simple average full tariff rate has been constant at 8.3% in 1996-2002. Import weighted tariffs in mining of coal and peat sector have been zero for free trade and MFN trade regimes since 1996, and 10.0% for full-rate trade regime.

Table 5.4

Mining of coal and peat: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>including</i>							
MFN tariff	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Full tariff	10.0	10.0	10.0	10.0	10.0	10.0	10.0

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

5.3 Subsidies

The coal mining industry is heavily supported by the state. The government wants to secure low prices for coal and to maintain a certain volume of output. State aid is provided through (1) direct transfers for the producers to cover the costs of production in case the costs are above the price of coal produced by the enterprise; (2) tax arrears and (3) capital expenditures and other types of service provision.

5.3.1 Transfer of funds

The governmental program "Ukrainian Coal" (2001)⁵⁴ provides the framework for direct state transfers to coal enterprises. The annual transfers are specified in the Law on State Budget. In 2004 the amounts of transfers from the state budget to coal mining enterprises increased sharply (see Table 5.5).

Table 5.5

Mining of coal and peat: transfer of funds, UAH m

	2002	2003	2004
State support for cost covering	930	831	1602
Total	930	831	1602

Source: State Treasury reports for the budget execution 2002, 2003, 2004

In 2002-2003⁵⁵ the funds assigned for providing state support to coal mining enterprises had been distributed according to the procedure developed by CMU.⁵⁶

⁵⁴ Resolution of CMU "On approving the program "Ukrainian Coal"" # 1205 from 19 September 2001.

⁵⁵ Before January 1, 2002 the provision of state support to coal-mining industry was governed by the Resolution of the Cabinet of Ministers of Ukraine No. 26 of 6 January 1999.

⁵⁶ Resolution of the CMU "On approval of procedure for identification and provision of the State support to the Coal Mining Enterprises" No. 1733 from 27 December 2001.

The procedure envisages that state support for capital investments is provided if the enterprise in question possesses substantial production reserves of quality coal, but experiences shortage of financial means in order to extend production (if the reconstruction of such enterprises is economically viable). This support is financed from the state budget. Such a procedure shall not be applied to profitable enterprises or to enterprises meant for liquidation. State support for compensation of costs of production of merchandise coal is provided on the basis of the planned sales revenue. State support shall be provided directly to enterprises to reimburse expenses related to the costs of coal production. For these purposes, the MFE shall identify the planned cost of production of the coal products and the scope of expenditures for the capital investment on the basis of the following information:

- the elements and directions for application of industry norms (approved production capacities, norms of the work load with respect to the preparation of mines, work load norms, material and power resources and so on)⁵⁷;
- need to undertake measures to improve work productivity and reduce production expenditures.

The planned cost of production of coal products, and the extent that expenses are covered by income shall be identified for each enterprise on the basis of targets for production of coal products introduced by the MFE and should ensure maximum economic efficiency.

The MFE approves on an annual basis the coal quality indicators for purposes of identification of production amounts. The Industry Commission established by MFE performs assessment of enterprises' performance (taking into account economic indicators; production potential; financial plans and results of business plans competition with regard to capital investments).

For the year 2004 state support in the area of partial cost coverage to the coal enterprises of all forms of ownership is distributed according to the guidelines approved by CMU⁵⁸ (2003).

Support for partial cost compensation is granted if the output of the enterprises is included into the demand-supply balance of the MFE and if the enterprise takes on the obligation to increase efficiency of coal extraction. Support is granted after the review of the economic indicators of the enterprise and taking into account the fact that forecasted prices of the enterprises do not fully cover costs of production. Costs and prices of the previous year are taken into account in evaluation of the volume of state aid to be disbursed.

⁵⁷ Provided by the State Holding Companies, Production Unions and enterprises.

⁵⁸ Resolution of CMU "On approval of Procedure for provision and identification of the volume of state support to the coal mining enterprises on cost compensations and on building and technical modernization of enterprises extracting coal, lignite, and peat" # 1311 from 21 September 2003.

5.3.2 Tax expenditures

Coal enterprises frequently functioned under soft budget constraints, and one form of state support was a possibility to postpone tax payments, i.e. accumulate tax arrears. The amount of tax arrears in coal industry is presented in the Table 5.6.⁵⁹

Table 5.6

Mining of coal and peat: tax expenditures, UAH m

	2002	2003	2004
Tax arrears	1524	1834	1962
Total tax expenditures	384	376	937

Source: State Tax Administration, IER estimates

5.3.3 State provision/purchase of goods or services

The State budget finances other types of support to the coal sector. In particular, all amounts to be spent on R&D, applied developments in the sector, and protection of labour are approved with the respective Budget Law. The capital related expenditures and funds directed for restructuring of coalmines are also foreseen in the State Budget.

Restructuring: Guidelines for distribution of restructuring funds are approved by the CMU (2002)⁶⁰. These guidelines define the directions of the funds utilisation, including:

- completion of work on coal reserves (compensating production costs);
- preparing the liquidation of enterprises (solving environmental problems, ensuring labour safety);
- cutting the number of employees according to the norms set by State Committee of construction and architecture (2002)⁶¹;
- preparing transfer or writing off of coal reserves;
- transfer of social infrastructure objects;
- inventarisation of land plots;
- performing environmental protection tasks.

The redistribution of funds is performed according to these guidelines by MFE under agreement of the Ministry of Economy and the Ministry of Finance.

⁵⁹ Yet other form of tax support is through the tax privileges under the SEZ and TPD regime. Unfortunately, no information is available on the amount of tax privileges so far.

⁶⁰ Resolution of CMU "On the guidelines for financing coalmines meant to be prepared for liquidation" #223 from 28 February.

⁶¹ Order of the State Committee of Ukraine on Construction and Architecture "On approving the norms on worth of creation of a working place in different industries of economy" #13 from 19 July 2002.

Capital expenditures: Capital investments for coalmines are distributed according to the guidelines set by the CMU (2003)⁶². The procedure for capital investments with participation of public funds (including coal mines liquidation) was outlined by the CMU in 2001⁶³. These guidelines are mandatory for all investment projects without distinction of the type of ownership of the enterprise - provided the investment is carried out fully or partially with the funds from the State budget. The state support in 2004 for restructuring and technical equipment of coal and peat enterprises was granted based on the guidelines defined by CMU (2003)⁶⁴ as described above for the transfer of funds. The capital expenditures for the years 2002 and 2003 were made taking into account the Resolution of the CMU (2001)⁶⁵ as described above.

Projects to be financed from the State budget are selected in accordance with the respective Resolutions of CMU⁶⁶. If capital investments are financed from the state budget, the following three-tier procedure for selecting investment projects is applied.

I. stage: enterprises that seek participation of public funds in their investment projects submit proposals to sectoral ministries. The MFE chooses the projects on the basis of priorities and economic appraisal.

II. stage, the sectoral ministry submits the winning proposals to the Ministry of Economy, which in turn determines which projects to finance from the state budget. Afterwards the Ministry of economy forwards the winning applications to the Ministry of Finance and asks to include these projects while drafting the state budget for the next year.

III. stage: 20 days after the State Budget Law of Ukraine is adopted, the Ministry of Economy conducts the final selection of the investment projects taking into account the amount of funds allocated to financing state capital investments. The enterprises that receive capital investments from the state budget are listed in respective decrees of the CMU.

⁶² Resolution of CMU "On approval of Procedure for provision and identification of the volume of state support to the coal mining enterprises on cost compensations and on building and technical modernization of enterprises extracting coal, lignite, and peat" # 1311 from 21 September 2003.

⁶³ Resolution of CMU #1764 "On adoption of the Guidelines of state financing of capital construction" from 27 December 2001.

⁶⁴ Resolution of CMU "On approval of Procedure for provision and identification of the volume of state support to the coal mining enterprises on cost compensations and on building and technical modernization of enterprises extracting coal, lignite, and peat" # 1311 from 21 September 2003.

⁶⁵ Resolution of the CMU "On approval of procedure for identification and provision of the State support to the Coal Mining Enterprises" No. 1733 from 27 December 2001.

⁶⁶ Resolution of CMU #2145 "On the guidelines of appraisal and tenders for the selection of investment projects foreseeing the participation of funds from the state budget" from 25 November 1999.

Table 5.7

Mining of coal and peat: state provision/purchase of goods or services, UAH m

	2002	2003	2004
Restructuring expenditures	508	622	676
Capital expenditures	25	1113	1341
Other including R&D, labor protection, and aid payments	126	199	236
Total	659	1934	2254

Source: State Treasury reports for the budget execution 2002, 2003, 2004

5.3.4 Total amount of subsidy

The government heavily supports coal industry. Support to the coal industry grew sharply through the period. The government covered differences between prices and costs to loss-making enterprise, financed capital expenditures and tolerated tax arrears. Expenses for capital expenditure grew the most from 2002 to 2004. Overall, subsidies in the sector grew from UAH 1,973 m (2002) to UAH 4,793 m (2004) (see Table 5.8).

Table 5.8

Mining of coal and peat: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	930	47	831	26	1602	33
Tax expenditures	384	19	376	12	937	20
State provision/purchase of goods or services	659	33	1934	62	2254	47
Quasi-fiscal activities	0.0	0.0	0.0	0.0	0.0	0.0
Other income or price support	0.0	0.0	0.0	0.0	0.0	0.0
Total subsidy	1973	100	3141	100	4793	100

Source: State Treasury reports for the budget execution, State Tax Administration, State Treasury reports for the budget execution 2002, 2003, 2004, IER estimates

5.4 Expected changes in trade regime in mining of coal and peat as a result of the WTO accession

Market Access: Because of the already zero tariff level no changes will occur due to WTO membership of Ukraine.

Domestic Support: In 2002-2004 between 40% and 60% of total domestic support was provided in the form of direct transfers of funds and tax expenditures. If such subsidies are considered as trade distorting, they are to be abolished under WTO rules.

Table 5.9

Mining of coal and peat: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	0.0	0.0	0.0	0
<i>including</i>				
MFN tariff	0.0	0.0	0.0	0
Full tariff ^a	8.3	0.0	8.3	100
Import-weighted tariffs	0.0	0.0	0.0	100
<i>including</i>				
MFN tariff	0.0	0.0	0.0	0
Full tariff ^a	10.0	0.0	10.0	100

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

6 Production of hydrocarbons (A05)

Table 6.1

Production of hydrocarbons: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	7594	7784	7555	8390
	% total output	1.8	1.5	1.3	1.2
	% industrial output	3.3	2.8	2.5	2.3
	% growth, real ^a	6.0	3.0	2.0	6.0
Value added	% GDP	2.3	2.4	2.1	1.6
Value added / output	%	51.5	63.7	61.6	51.8
Structure of value added:					
Compensation to employees	% sector VA	12.5	10.0	13.4	16.1
Profit, mixed income	% sector VA	59.9	59.3	59.8	58.8
Net taxes on production and imports	% sector VA	27.7	30.7	26.8	25.1
Employment ^e	thousand people	50	47	45	43
	% total employed	0.4	0.4	0.4	0.4
Average wage ^e	UAH	483	610	692	704
Exports	UAH m	1239	871	1335	4273
	% total exports	1.2	0.8	1.1	2.8
	% sector output	16.3	11.2	17.7	50.9
Imports	UAH m	24029	29311	31738	38863
	% total imports	24.6	26.7	27.7	26.3
	% sector output	316.4	376.6	420.1	463.2
Exports/imports	index	0.1	0.0	0.0	0.1

Source: State Committee of Statistics, IER estimates

Note: ^a real growth of extractive industry that includes mining of coal and peat (A04), production of hydrocarbons (A05), and production of non-energy materials (A06)

^e estimate on the basis of year 2004 information

6.1 Overview

Extraction of hydrocarbons is about 1% in total output, about 3% in industrial output and 2% of GDP. The share of value added in the sector varies from 52-62%. About 60% of the value added accounts for enterprise profits, 13% is paid to employees and taxes constitute the remaining 27%.

The sector produces oil and natural gas. However domestic demand exceeds domestic production, thus imports of hydrocarbons are important. The share of hydrocarbons in total Ukraine's imports reaches on average 26,5% for the years

2000-2003, being 3-4 times higher than a domestic production. Export of hydrocarbons could be a profitable business for domestic producers, as costs of natural gas extraction, are below the costs of the imported natural gas plus the transportation costs. However, Ukraine committed itself under the international treaties with Russia not to export more than a certain volume of natural gas. This restriction is enforced with a prohibitive export duty for the volumes above the threshold. In 2000-2002 the share of the sector in total exports was between 1-2%. In 2003 the export share grew to 3%, as the state owned company "Naftogaz of Ukraine" a major producer of hydrocarbons - started more actively to export for natural gas. Since Naftogaz was also re-selling natural gas, which it bought from Turkmenistan this was to a certain extent a "re-export activity". Despite the sector's growing exports it will remain mostly import oriented as Ukraine lack enough domestic resources for covering the demand for hydrocarbon.

Table 6.2

Production of hydrocarbons: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	9.6	5	5.0	4	7.7	4
including						
Russia	0.1	0	0.1	0	0.0	0
other CIS	9.6	5	4.9	4	7.7	4
Baltic countries	0.0	0	0.0	0	0.0	0
MFN trade	193.7	93	111.5	96	187.6	88
including						
EU-15	16.6	8	2.0	2	29.2	14
NMC-5	85.4	41	99.5	85	113.6	53
Asia	4.6	2	5.6	5	4.5	2
America	0.0	0	0.0	0	0.5	0
"Full tariff" trade	6.0	3	0.0	0	17.1	8
Total	209.3	100	116.5	100	212.4	100
Imports						
Free trade	4423.4	100	5394.2	100	5952.4	100
including						
Russia	2984.1	67	2975.0	55	3732.3	63
other CIS	1439.0	33	2419.2	45	2220.1	37
Baltic countries	0.4	0	0.0	0	0.0	0
MFN trade	0.1	0	0.0	0	0.0	0
including						
EU-15	0.1	0	0.0	0	0.0	0
NMC-5	0.0	0	0.0	0	0.0	0
Asia	0.0	0	0.0	0	0.0	0
America	0.0	0	0.0	0	0.0	0
"Full tariff" trade	0.0	0	0.1	0	0.0	0
Total	4423.5	100	5394.3	100	5952.4	100

Source: UN ComTrade database, IER estimates

Hydrocarbons are imported into Ukraine under free trade agreements, of which Russia accounts for 63% in 2002 and the rest originated from other CIS countries.

On the export side most delivery of hydrocarbons are directed under MFN trade with a share of about 90%. Here are the main trading partners the NMC-5 countries - Ukrainian hydrocarbon exports increased from 41% in 2000 to 53% in 2002.

6.2 Tariffs

Table 6.3

Production of hydrocarbons: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>including</i>							
MFN tariff	13.1	13.1	13.1	0.0	0.0	0.0	0.0
Full tariff	13.1	13.1	13.1	4.4	4.4	4.4	4.4

Source: Customs tariff, UN ComTrade database, IER estimates

As well as imports of coal and peat, imports of hydrocarbons originate from free trade areas established among CIS countries, mostly from Russia. It comes without tariff. Thus, 4.4% full tariff rate on imports in 2002 has no effect on zero total simple average tariff rate in this sector.

Import weighted tariff in hydrocarbon sector have been zero for MFN trade regime in 2002.

Table 6.4

Production of hydrocarbons: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>including</i>							
MFN tariff	8.9	8.9	8.9	0.0	0.0	0.0	0.0
Full tariff	8.9	8.9	8.9	3.0	3.0	3.0	3.0

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

6.3 Subsidies

Companies do not receive any direct transfers from the state budget. Subsidies are mostly provided as state aid for exploration of domestic resources and other activities, mostly R&D. Ukraine is a net importer of hydrocarbons and its imports depend heavily on Russia. Thus, there is a desire to increase domestic production of hydrocarbons, which mainly manifests itself in support of extraction of

hydrocarbons in depleted fields and extraction under difficult or tough geological conditions. Support is given to the exploration of new fields and other activities, which may be susceptible to market failures, such as R&D.

6.3.1 Tax expenditures

In 2003-2004 the budget lost tax revenues due to the special status of taxation of the profits received after the execution of the agreement on production sharing. There is a higher than usual rate of capital depreciation guaranteed for the contracts with production sharing provisions⁶⁷. This rule of quicker balance sheet depreciation also includes fields of natural resources, exploration costs, construction and development of these resources.

Tax privileges were granted to the enterprises of extraction industry in the realm of deductions of the EPT. Until 2003 enterprises were granted not very insignificant privileges, like accumulating funds earmarked for improvement of assets bought before 1993. These funds were included into overall enterprise costs. Such privileges were not of a serious magnitude. The costs of field exploration and setting up of oil fields (except for drilling for the purposes of extraction) are also counted as costs. Both of these privileges are contained in the Law "On Enterprise Profit Tax".

Firms operating oil and gas fields in difficult or tough geological conditions and with depleted resources are exempt for a period of 10 years from paying fees for geological exploration in case they have achieved additional quantities of gas and oil extracted⁶⁸.

The third form of tax privilege in the sector is tax arrears that have gradually decreased throughout 2002-2004.

Table 6.5

Production of hydrocarbons: tax expenditures, UAH m

	2002	2003	2004
Tax privileges	586	473	381
EPT deferment	24	68	63
Charge for geological survey works (exemption)	5	7	7
Tax arrears	558	398	311
Tax expenditures	150	99	73

Source: Explanatory note to the draft budget 2004, 2005, State Tax Administration, IER estimates

6.3.2 State provision/purchase of goods or services

The state budget contains a program on "Development of the mineral resource base, including further exploration of new Ukrainian copper ore fields". Somehow

⁶⁷ Law of Ukraine "On contracts on production sharing.

⁶⁸ Decree of the President "On measures attracting investments for the development of oil fields with complicated extraction conditions or with depleted resources".

hidden in the program are funds directed towards the hydrocarbon production sector, but in the realm of resource exploration and R&D. This program includes exploration of natural resources, exploration drilling and geological exploration.

Table 6.6

Production of hydrocarbons: state provision/purchase of goods or services, UAH m

	2002	2003	2004
R&D	10	10	10
Geological survey works	116	105	133
Other	6	6	0
Total	132	121	144

Source: Treasury reports on the execution of State budget 2002, 2003, 2004

6.3.3 Total amount of subsidy

The hydrocarbon production industry receives support in the forms of tax expenditures and direct state provisions and purchases of goods and services. Tax expenditures are meant to support the extraction of resources in depleted domestic fields. Other support directed to research and development as well as to the natural resource exploration. The total amount of subsidisation is rather small and decreased over the period reviewed (see Table 6.7).

Table 6.7

Production of hydrocarbons: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	0	0	0	0	0	0
Tax expenditures	150	53	99	45	73	34
State provision/purchase of goods or services	132	47	121	55	144	66
Quasi-fiscal activities	0	0	0	0	0	0
Other income or price support	0	0	0	0	0	0
Total subsidy	282	100	220	100	217	100

Source: Treasury reports on the execution of State budget 2002, 2003, 2004, Explanatory note to the draft budget 2004, 2005, State Tax Administration, IER estimates

6.4 Expected changes in trade regime in the sector as a result of the WTO accession

Market Access: There will be a reduction of tariff rate on imports of hydrocarbons from countries that are currently subject to the full tariff rate. Practically no changes will occur, since all imports of hydrocarbons originate from the CIS, and current applied rate is already zero.

Table 6.8

Production of hydrocarbons: expected changes in tariffs on hydrocarbons due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	0.0	0.0	0.0	0
<i>including</i>				
MFN tariff	0.0	0.0	0.0	0
Full tariff ^a	4.4	0.0	4.4	100
Import-weighted tariffs				
MFN tariff	0.0	0.0	0.0	0
Full tariff ^a	3.0	0.0	3.0	100

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

Domestic Support: Subsidies to the sector are provided in form of either tax expenditures (via tax arrears) or state provision of goods and services. It is assumed that Ukraine's accession to the WTO may result in reduction of tax expenditures decreasing subsidization of the sector by 30-50%.

7 Production of non-energy materials (A06)

Table 7.1

Production of non-energy materials: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	6892	7363	8976	10838
	% total output	1.6	1.4	1.6	1.6
	% industrial output	3.0	2.7	3.0	3.0
	% growth, real ^a	6.0	3.0	2.0	6.0
Value added	% GDP	1.4	0.9	1.2	1.3
Value added / output	%	35.6	24.2	30.1	32.6
Structure of value added:					
Compensation to employees	% sector VA	57.2	79.3	61.8	56.8
Profit, mixed income	% sector VA	29.3	10.8	33.4	38.3
Net taxes on production and imports	% sector VA	13.6	9.9	4.8	4.9
Employment ^e	thousand people	173	163	154	148
	% total employed	1.3	1.3	1.3	1.3
Average wage ^e	UAH	357	483	584	718
Exports	UAH m	4104	3137	3071	3852
	% total exports	3.9	2.8	2.5	2.5
	% sector output	59.5	42.6	34.2	35.5
Imports	UAH m	2937	2644	2004	3433
	% total imports	3.0	2.4	1.8	2.3
	% sector output	42.6	35.9	22.3	31.7
Exports/imports	index	1.4	1.2	1.5	1.1

Source: State Committee of Statistics, IER estimates

Note: ^a real growth of extractive industry that includes mining of coal and peat (A04), production of hydrocarbons (A05), and production of non-energy materials (A06)

^e estimate on the basis of year 2004 information

7.1 Overview

Production of non-energy materials is an important part of extractive industry that includes an extraction of iron ore and non-ferrous metals, mineral fertilizers, as well as quarrying of stones and clays. The share of the production of non-energy material in both total output and industrial output was remained at 2% and 3% respectively staying almost unchanged during the years 2000-2003. The sector accounts for a share of 1% in GDP. The ratio of value added to the output of production of non-energy materials declined somewhat from 36% in 2000 to 33%

in 2003, indicating a slight increase in spending on intermediate products in the sector, thus a minor deterioration of technological process.

Compensation to employees reached in 2003 again 57% in value added, indicating labour shedding in production of non-energy materials. Profits grew from 29% in 2000 to 38% in 2003, mainly due to a declining tax share. The share of net taxes on production and imports declined from 14% in 2000 to 5% in 2003.

The shares of the sector in the total exports and the export share in the sector output were almost halved during the period 2000 to 2003. Also, the share of imports in sector output declined between 2000 and 2003 from 43% to 32%. Thus, the sector became more closed to other markets. Partially it occurs due to increasing domestic demand on sector's products, especially iron ore that is a key input for growing production of metals. Nevertheless, the ratio of exports over imports remained higher, than the benchmark of 1, so we still can consider this sector as export-oriented.

Table 7.2

Production of non-energy materials: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	65.3	11	83.1	15	84.1	15
<i>including</i>						
Russia	47.9	8	64.0	12	63.0	11
other CIS	14.6	3	15.7	3	17.8	3
Baltic countries	2.8	0	3.4	1	3.4	1
MFN trade	501.0	88	452.1	83	470.1	84
<i>including</i>						
EU-15	102.0	18	109.0	20	120.1	21
NMC-5	317.5	56	259.4	48	251.5	45
Asia	10.0	2	7.3	1	10.8	2
America	15.2	3	17.3	3	14.3	3
"Full tariff" trade	4.2	1	7.6	1	5.1	1
Total	570.5	100	542.7	100	559.3	100
Imports						
Free trade	246.8	46	167.2	37	124.4	32
<i>including</i>						
Russia	237.8	45	155.1	34	113.6	29
other CIS	8.5	2	11.3	2	10.2	3
Baltic countries	0.5	0	0.8	0	0.7	0
MFN trade	133.9	25	114.6	25	114.8	30
<i>including</i>						
EU-15	16.7	3	10.8	2	9.1	2
NMC-5	33.4	6	35.3	8	27.5	7
Asia	49.3	9	53.0	12	55.1	14
America	25.5	5	3.2	1	16.0	4
"Full tariff" trade	152.1	29	174.5	38	147.0	38
Total	532.8	100	456.2	100	386.2	100

Source: UN ComTrade database, IER estimates

Exports went overwhelmingly to MFN countries (84%), especially the NMC-5 and EU, while exports under free trade accounted for 15% and most was sent to Russia (11% of total exports). At the same time, the sector structure of imports of non-energy materials reveals a rather low sensitivity to trade agreements. In 2002 roughly equal shares of imports arrived under free trade (32%), MFN (30%) and full tariff trade (38%). It could be explained by geographical location of non-energy materials imported by Ukraine.

7.2 Tariffs

The simple average tariff on imports of non-energy raw products was increased from 3.1% in 1996 to 4.5% in 2001-2002 due to increase in both the MFN and full tariffs. While keeping in mind the import pattern with continuous declining shares of free trade and especially Russian shares and with the almost equal shares for free trade, MFN and full tariff imports in 2002, the tariffs might indicate a competitive disadvantage of mostly Russian producers. The other interpretation would be that tariffs do not matter for this sector, since a demand for imports is determined by geographical location of natural resources.

Table 7.3

Production of non-energy materials: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	3.1	3.1	4.9	4.9	4.3	4.5	4.5
<i>including</i>							
MFN tariff	2.3	2.3	5.2	5.2	4.5	4.9	4.9
Full tariff	6.4	6.4	8.8	8.8	7.7	7.9	7.9

Source: Customs tariff, UN ComTrade database, IER estimates

Among the sub-sectors of non-energy materials production the highest tariffs are charged for products belonging to stone quarrying, clay and sand pits sub-sector. The tariffs were increases from 1.9 % in 1996 to 9.5% for MFN imports in 2001. Other increase in simple average MFN tariff covered mining and quarrying products.

At the same time, import tariffs on products belonging to chemicals, fertilizers and mineral mining were reduced from 5.9% in 1996-1998 to 2.3% in 2001-2002. Most other tariffs for products produced in sub-sectors like iron ore, non-ferrous metals iron ore, and salt remained unchanged in 1996-2002.

While the MFN import-weighted tariff has slightly reduced between 1996 and 2002 from 1.6% to 1.1%, the full tariff rate remained at around 5.0% level.

Table 7.4

Production of non-energy materials: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	2.4	2.4	2.4	2.4	2.4	2.3	2.3
<i>including</i>							
MFN tariff	1.6	1.6	1.6	1.6	1.6	1.1	1.1
Full tariff	5.0	5.0	5.1	5.1	5.1	5.1	5.1

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

7.3 Subsidies

Key forms of subsidies in the sector are tax expenditures, and state provision of goods and services.

7.3.1 Tax expenditures

Tax expenditures are the key form of subsidies provided to the enterprises producing non-energy materials. Although some enterprises of the non-energy material sector accumulated tax arrears. However in comparison to other sectors the amounts of tax arrears appear rather low. Most privileges were granted through so called Special Economic Zones (SEZ), like for example the SEZ Donetsk. The Government of Ukraine eliminated all SEZ in the beginning of 2005.

Table 7.5

Production of non-energy materials: tax expenditures, UAH m

	2002	2003	2004
Tax privileges	98	140	270
Tax arrears	25	26	22
SEZ	73	114	248
Total tax expenditures	79	119	252

Source: State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates

7.3.2 State provision/purchase of goods and services

During the period 2002-2004 state provisions to the non-energy materials producing sector were granted mainly for restructuring activities. Among the biggest recipients were enterprises of the formerly state owned holding "Ukrudprom", which combined approximately 70% of iron ore output in Ukraine. Other beneficiaries were the extracting ferrous metals enterprises in Kryvorizhskiy basin, brimstone, and polymineral extracting works in Western Ukraine.

Restructuring and liquidation of emergency consequences at the enterprises that extract ferrous metals:

The state budgets for the years 2002-2004 provided funds for restructuring of state owned ferrous metals enterprises. Funds were disbursed under specially adopted Resolutions of the CMU⁶⁹. Most restructuring resulted in closure of non-profitable mines and accompanying technical, environmental and socio-economic programs.

In the onset of the privatisation of "Ukrudprom" in the year 2004 the framework was changed⁷⁰. In particular, additional co-financing from the budget is foreseen for hydro-engineering protection in underground excavations and technical safety measures for mines and carriers, which are closed or subjected to closure.

Table 7.6

Production of non-energy materials: state provision/purchase of goods or services, UAH m

	2002	2003	2004
Restructuring	7	15	11
Liquidation of emergency consequences	12	23	23
Total	19	38	34

Source: State Treasury reports on State budget execution 2002, 2003, 2004

7.3.3 Total amount of subsidy

Subsidies provided to enterprises producing non-energy materials are listed in Table 7.7. Approximately 80% of subsidies in the period 2002-2004 are disbursed in the form of tax expenditures mostly through special economic zones.

Table 7.7

Production of non-energy materials: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	0	0	0	0	0	0
Tax expenditures	79	80	119	76	252	88
State provision/purchase of goods or services	19	20	38	24	34	12
Quasi-fiscal activities	0	0	0	0	0	0
Other income or price support	0	0	0	0	0	0
Total	98	100	157	100	286	100

Source: State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates, State Treasury reports on State budget execution 2002, 2003, 2004

⁶⁹ CMU Resolution "On financing expenditures for restructuring smelting and mines enterprises that extract ferrous metals" # 637 from 5.11.97; CMU Resolution "On further restructuring of enterprises that extract ferrous metals in Kryvorizhskiy basin" # 1847 from 23.11.98; CMU Resolution "On special regime of restructuring of mine and smelting enterprises of Kryvbas, Yavorivskogo and Rozdolskogo "Sirka", Stebnynskogo "Polimineral" that are located in Lvivska oblast" # 258 from 2.03.98.

⁷⁰ Law of Ukraine "On peculiarities of privatisation of Ukrudprom" # 1677-IV from 9.04.04.

7.4 Expected changes in trade regime in production of non-energy materials as a result of the WTO accession

Market Access: It is expected that Ukraine's accession to the WTO will cause approximately 41% reduction in simple average total tariff on imports of non-energy materials. Most important will be a reduction of full tariffs by 51%, since imports from countries with full tariff rates gained a key position in overall flows of non-energy materials. In terms of import-weighted tariffs, the 3% reduction in the MFN tariff is minor compared to 79% drop in full tariff rate.

Table 7.8

Production of non-energy materials: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	4.5	2.7	1.8	41
<i>including</i>				
MFN tariff	4.9	3.9	1.0	20
Full tariff ^a	7.9	3.9	4.0	51
Import-weighted tariffs	2.3	0.7	1.5	67
<i>including</i>				
MFN tariff	1.1	1.1	0.0	3
Full tariff ^a	5.1	1.1	4.0	79

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

There is only one sector initiative that concerns sector A06, namely 'Chemistry'. This initiative envisages a binding rate not at the zero level, but at 6.5%. So, it appeared to be insignificant for imports of non-energy product, for which the actually applied tariff is 3.7%. Also, sector initiative is applied to tiny share of sector imports (0.3%).

Table 7.9

Expected change in tariffs due to sector initiative applied to A06

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	3.7	6.5	-2.8	0.3	Non-binding

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic support: It is expected that the level of subsidization of the sector may drop by approximately 80% due to reduction of tax expenditures, first of all, the elimination of Special Economic Zones.

8 Textile and leather industry (A08)

Table 8.1

Textile and leather industry: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	8384	8941	9648	10806
	% total output	1.9	1.7	1.7	1.6
	% industrial output	3.6	3.2	3.2	3.0
	% growth, real	36.0	14.0	0.0	4.0
Value added	% GDP	1.1	1.1	1.1	1.0
Value added / output	%	22.4	25.2	26.3	24.7
Structure of value added:					
Compensation to employees	% sector VA	40.4	40.5	44.5	47.4
Profit, mixed income	% sector VA	24.3	31.2	39.6	39.5
Net taxes on production and imports	% sector VA	35.3	28.3	15.9	13.1
Employment	thousand people	262	230	186	156
	% total employed	1.9	1.8	1.5	1.3
Average wage	UAH	162	219	259	323
Exports	UAH m	3806	4425	4532	5070
	% total exports	3.6	3.9	3.6	3.3
	% sector output	45.4	49.5	47.0	46.9
Imports	UAH m	5376	6132	7260	5795
	% total imports	5.5	5.6	6.3	3.9
	% sector output	64.1	68.6	75.2	53.6
Exports/imports	index	0.7	0.7	0.6	0.9

Source: State Statistic Committee, IER estimates

8.1 Overview

Textile and leather sector includes a wide range of industries from knitting mills and manufacturing of carpets and rugs to manufacturing of wearing apparel and footwear. This industry in Ukraine's remains rather underdeveloped, and the contribution to economic development is only limited. Moreover, the relative importance diminished over time, as indicated by the decreasing share of light industry output in both total output and industrial output. Thus, if in 2000 light industry products constituted 1.9% of the total amount of goods and services produced and 3.6% of industrial production, in 2003 these figures declined to 1.6% and 3.0% respectively. This negative trend was counterweighted by positive restructuring within the sector and a stable share of value added generated in the

sector in total GDP. The value-added-to-output-ratio registered an upward trend. As far as the distribution of value added is concerned, compensation to employees accounts for the largest part in value added. It was followed by profits and mixed income category, whereas the part of the state appeared to be the smallest. The distribution of value added was gradually changing over time in favour of employees and, to lesser extent, entrepreneurs.

The number of people employed in the sector was relatively small constituting less than 2% of total labour force. Furthermore, the share of labour force working in light industry was falling steadily over time. Together with the growing value-added-to-output ratio, this indicates restructuring, improved technologies and/or reorientation to less labour intensive types of production. Nominal average wage, albeit growing, remained far below the economy-average level.

The role of the sector in foreign trade was rather limited, with the share of industry exports in total exports never exceeding 4% and on the import side - 7%. Exports developed relatively stable, the volume grew steadily in nominal terms, although shares in total exports and in industry output started to fall in 2001. The flow of imports changed more drastic. After three years of real economic growth, imports declined substantially in nominal terms. The same trends occurred in shares of industry imports in total imports and in sector output. Yet, intra-industry trade remained at quite high level, with about 47% of industry output exported and more than 53% imported in 2003. The abrupt change in imports development affected the relative orientation of the industry. While the sector was traditionally more import-oriented, reached the exports-to-imports ratio by 2003 almost parity.

The major part of light industry products was traded under the MFN regime with EU-15 being the most important trade partner for imports and, to larger extent, for exports. Notable share of imports originated from the free trade agreement countries, especially from Russia. However, exports to those countries remained smaller than imports.

Table 8.2

Textile and leather industry: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	62.2	9	68.0	9	64.6	8
<i>including</i>						
Russia	37.6	6	37.6	5	28.3	3
other CIS	10.9	2	14.2	2	15.8	2
Baltic countries	13.7	2	16.2	2	20.4	2
MFN trade	598.9	89	711.6	90	746.4	91
<i>including</i>						
EU-15	472.9	71	524.8	67	556.2	68
NMC-5	36.3	5	58.2	7	79.6	10
Asia	28.3	4	33.3	4	26.6	3

Table 8.2 (cont.)

Textile and leather industry: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
America	57.7	9	85.5	11	68.8	8
"Full tariff" trade	8.3	1	8.0	1	7.2	1
Total	669.5	100	787.6	100	818.1	100
Imports						
Free trade	77.2	14	90.7	14	90.4	13
<i>including</i>						
Russia	55.1	10	61.0	9	60.9	9
other CIS	14.2	3	19.1	3	19.1	3
Baltic countries	7.9	1	10.6	2	10.4	1
MFN trade	461.7	84	553.6	84	587.2	85
<i>including</i>						
EU-15	324.5	59	368.5	56	387.5	56
NMC-5	33.3	6	47.7	7	48.2	7
Asia	52.9	10	83.7	13	106.0	15
America	37.6	7	38.6	6	33.6	5
"Full tariff" trade	12.3	2	15.0	2	15.0	2
Total	551.2	100	659.3	100	692.7	100

Source: UN ComTrade database, IER estimates

8.2 Tariffs

Although the simple average tariff on products of textile and leather industry was at near 7.7% level for the period 2001-2002, tariff levels peaked during the years 1997-2000, reaching the highest with 16.4% in 1999. Tariff increases affected mostly the MFN tariff rate starting in 1997 and reached the highest level of 18.6% in 1999. During the years 2001-2002 MFN tariffs were again reduced to 8.0% accounting for most in the decrease in overall tariff rate.

Table 8.3

Textile and leather industry: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	10.1	11.6	12.9	16.4	15.1	7.7	7.7
<i>including</i>							
MFN tariff	11.0	13.1	14.6	18.6	17.0	8.0	8.0
Full tariff	21.3	18.7	19.4	23.8	24.0	23.7	23.7

Source: Customs tariff, UN ComTrade database, IER estimates

The small gap between the total and the MFN tariff indicates that the largest share of textile and leather products imports arrives from countries with which Ukraine upholds a MFN trade regime.

The highest simple average MFN tariffs with 45.3% during the years 2000-2002 were levied among textile and leather products on imports of footwear, except vulcanized or moulded rubber or plastic footwear. High tariffs of 22.3% are applied also to leather and leather substitutes. The lowest tariffs are applied to spinning (2.4% in 2001-2002), and to cordage, rope, and twine (3.6% in 2001-2002).

Ukraine reduced between 1996 and 2002 for most textile and leather products the simple average MFN tariffs, with the exemptions mentioned above (footwear, except vulcanized or moulded rubber or plastic footwear; leather and its substitutes, except footwear and wearing apparel; spinning and finishing textile; and products of tanneries and leather finishing).

Table 8.4

Textile and leather industry: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	6.9	9.5	10.8	14.2	12.8	6.1	6.1
<i>including</i>							
MFN tariff	7.3	10.6	12.1	16.1	14.4	6.2	6.2
Full tariff	18.4	16.5	17.1	20.8	20.9	20.9	20.9

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

Since the year 2001 the import weighted MFN tariff rate remained stable at 6.2%, or more then 10 percentage points lower then two years before however, the import weighted full tariff rate was kept since 1999 at high levels above 20%.

8.3 Subsidies

In period 2002-2004 the only type of subsidies in textile and leather industry were tax expenditures.

8.3.1 Tax expenditures

In the textile and leather sector were subsidies provided only in the form of tax expenditures. Tax privileges were granted mostly as enterprise tax arrears and tax privileges to enterprises working in SEZs and TPRs, like for example underwear production in Lvivska region, clothes in Zhytomirska region, footwear in Kharkivska region, and fabric in Donetska region.

Table 8.5

Textile and leather industry: tax privileges, UAH m

	2002	2003	2004
Tax privileges	61.2	66.8	59.8
<i>SEZ&TPR</i>	12.2	20.8	51.6
<i>Tax arrears</i>	49.0	46.0	8.2
Tax expenditures total	24.4	29.9	53.0

Source: State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates

8.3.2 Total amount of subsidization

The light industry received in comparison to other sectors only very little state support, and that in form of tax expenditures.

Table 8.6

Textile and leather industry: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	0.0	0	0.0	0	0.0	0
Tax expenditures	24.4	100	29.9	100	53.0	100
State provision/purchase of goods or services	0.0	0	0.0	0	0.0	0
Quasi-fiscal activities	0.0	0	0.0	0	0.0	0
Other income or price support	0.0	0	0.0	0	0.0	0
Total	24.4	100	29.9	100	53.0	100

Source: State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates

8.4 Expected changes in trade regime in textile and leather sector as a result of the WTO accession

Market Access: The WTO accession of Ukraine in combination with the impact of the sector initiatives will reduce the simple average tariff on textile by 29% from 7.7% to 5.5%. Most of reduction will occur due to reduction of tariff protection via full tariff rate. The reduction of the MFN simple average tariff is expected to be rather small at 9%.

Table 8.7

Textile and leather industry: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	7.7	5.5	2.2	29
<i>Including</i>				
MFN tariff	8.0	6.3	1.7	21
Full tariff ^a	23.7	6.3	17.4	73
Import-weighted tariffs	6.1	4.5	1.6	27
<i>Including</i>				
MFN tariff	6.2	5.1	1.0	17
Full tariff ^a	20.9	5.1	15.8	75

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

Textile and leather sector (A08) is subject to three sector initiatives: 'Chemistry', 'Paper', and 'Textile and textile clothing'. 'Chemistry' initiative concerns only 0.4% of total sector imports, and envisage a reduction of simple average MFN tariff rate on one percentage points: from currently applied 7.5% to 6.5%. 'Paper' sector initiative envisages much more significant reduction in import tariff – from current 5.0% to 0.0%. But currently there are very small imports of products that are subject to this sector initiative.

The most important for a sector is 'Textile and textile clothing' initiative that currently covers 82.8% of sector imports. However, since this initiative establishes a binding duty rate at the level of average 6.2%, the expected reduction in import tariffs will be only marginal – by 0.3 percentage points from current 6.4%.

Table 8.8

Textile and leather industry: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	7.5	6.5	1.0	0.4	Reduction
Paper	5.0	0.0	5.0	0.0	Reduction
Textile and textile clothing	6.4	6.2	0.3	82.8	Reduction

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic Support: Most of subsidies to the sector are likely to be abolished since domestic support to textile and leather sector was provided through Special Economic Zones and other forms of tax expenditures.

9 Woodworking, furniture, pulp and paper industry, publishing (A09)

Table 9.1

Woodworking, furniture, pulp and paper industry, and publishing: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	6823	8879	9482	13324
	% total output	1.6	1.7	1.7	1.9
	% industrial output	2.9	3.2	3.1	3.7
	% growth, real ^e	38	20	12	26
Value added	% GDP	1.1	1.2	1.2	1.2
Value added / output	%	26.6	28.1	28.5	24.1
Structure of value added:					
Compensation to employees	% sector VA	55.5	46.5	54.3	56.3
Profit, mixed income	% sector VA	26.6	37.4	33.6	28.5
Net taxes on production and imports	% sector VA	17.9	16.2	12.1	15.3
Employment	thousand people	100	97	92	90
	% total employed	0.7	0.8	0.8	0.8
Average wage	UAH	311	418	492	587
Exports	UAH m	2108	2558	2747	3650
	% total exports	2.0	2.3	2.2	2.4
	% sector output	30.9	28.8	29.0	27.4
Imports	UAH m	3630	4100	4069	5407
	% total imports	3.7	3.7	3.6	3.7
	% sector output	53.2	46.2	42.9	40.6
Exports/imports	index	0.6	0.6	0.7	0.7

Source: State Statistic Committee, IER estimates

Note: ^e estimate on the basis of growth rates in production of wood and wood products, and in pulp, paper and publishing industries

9.1 Overview

The wood, wood-working, paper and publishing sector (thereafter W&P) combines 2% in total output and 4% in industrial output. The share of value added generated to GDP added up to 1.2% and kept steadily growing, reflecting some positive developments in the sector. The distribution of value added between employees, entrepreneurs and the state fluctuated, with a trend of a declining tax share.

The number of people employed in W&P sector constitutes less than 1% of total labour force. Nominal average wages grew correspondingly to the general tendencies of the economy.

The sector plays a smaller role in foreign trade. Export of W&P goods was slightly higher than 2% of total exports. The share of sector imports in total imports was somewhat higher with 3.7%. Notably, the level of intra-industry trade was steadily abating indicated by declining shares of exports and imports in sector output. If the former fell down by 3.5 percentage points, the latter reduced by as much as 12.6 percentage points. The sector can be characterised as import-oriented with a slight tendency of reorientation towards export, as evidenced by the exports-to-imports ratio changes from 0.6 to 0.7.

Table 9.2

Woodworking, furniture, pulp and paper industry, and publishing: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	198.3	51	292.0	57	275.7	50
Including						
Russia	159.8	41	220.5	43	222.1	40
other CIS	21.9	6	26.8	5	38.5	7
Baltic countries	16.5	4	44.7	9	15.1	3
MFN trade	188.7	48	218.8	43	276.3	50
Including						
EU-15	80.3	21	94.5	18	124.0	22
NMC-5	63.8	16	73.8	14	110.3	20
Asia	29.0	7	33.4	7	23.0	4
America	2.1	1	2.4	0	2.8	1
"Full tariff" trade	4.2	1	2.5	0	3.3	1
Total	391.1	100	513.2	100	555.2	100
Imports						
Free trade	168.8	35	247.9	38	232.4	28
Including						
Russia	137.0	29	207.8	32	187.7	23
other CIS	18.1	4	17.2	3	19.3	2
Baltic countries	13.7	3	22.8	3	25.4	3
MFN trade	304.6	64	408.1	62	583.6	71
Including						
EU-15	160.1	34	208.5	32	310.4	38
NMC-5	99.5	21	149.3	23	199.5	24
Asia	6.2	1	6.2	1	14.2	2
America	13.0	3	18.3	3	28.6	3
"Full tariff" trade	2.9	1	1.4	0	3.1	0
Total	476.4	100	657.4	100	819.1	100

Source: UN ComTrade database, IER estimates

On the import side MFN trade is the most important one for W&P and more than 50% of all imports originated in the EU and NMC-5. Roughly one third is supplied by free trade partners with Russia taking the largest share. Full tariff trade is almost irrelevant for the sector for both, imports and exports. MFN and free trade account for almost equal export shares, so do EU-15 and the NMC-5 on the one side and Russia on the other.

9.2 Tariffs

Simple average total tariff on products of wood and paper industries, furniture and publishing were steadily increased since 1996 from 2.9 to 6.1% in 2001-2002.

Table 9.3

Woodworking, furniture, pulp and paper industry, and publishing: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	2.9	3.2	4.8	5.3	5.4	6.1	6.1
<i>including</i>							
MFN tariff	3.8	4.2	6.5	7.2	7.3	8.1	8.0
Full tariff	10.2	9.6	10.5	11.0	11.7	17.6	17.5

Source: Customs tariff, UN ComTrade database, IER estimates

In the period 2001-2002 the highest simple average MFN tariff at 18.6% level was levied on imports of furniture and fixtures, 16.0% were applied to products of the printing and publishing industry and 15.9% on products of manufacture of containers and boxes of paper and paperboard. The sectors lowest tariffs of 2.5% were set for manufacture of wooden and cane containers and small can ware and for sawmill and other wood mills products. Simple average MFN tariffs were raised for products of all W&P sub-sectors.

Table 9.4

Woodworking, furniture, pulp and paper industry, and publishing: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	2.4	2.7	4.5	4.4	4.2	7.2	7.2
<i>including</i>							
MFN tariff	3.0	3.4	6.0	6.0	5.6	9.6	9.6
Full tariff	10.7	10.4	11.1	11.4	11.4	20.0	20.0

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

MFN and full import weighted tariffs reached 9.6% and 20.0% respectively in 2002.

9.3 Subsidies

State support to W&P industry was primarily directed to publishing, explained with the importance of books, textbooks and other publishing materials for cultural and educational development and the social life of the young nation state.

9.3.1 Transfer of funds

In the state budget were according to the Law of Ukraine "On state support of mass media and social protection of journalists"⁷¹ some modest amounts of financial funds foreseen to support with subsidies and current transfers the press and editions of special value to society.

Table 9.5

Woodworking, furniture, pulp and paper industry, and publishing: transfer of funds, UAH m

	2002	2003	2004
Direct funds transfers	6.6	15.9	20.4
Transfer of funds total	6.6	15.9	20.4

Source: State Treasury reports on budget execution 2002, 2003, 2004

9.3.2 Tax expenditures

Privileges were granted to publishing industry during the years 2002 and 2003 under the Law on VAT⁷², according to which the delivery of nationally produced publishing materials (text books, writing books, study guides, and media) were exempted from VAT.

Revenue from sales of publishing products was deductible for EPT purposes⁷³ and paper, pasteboard and other materials used in publishing as well as specified publishing equipment were exempted from import duty and from VAT.

In 2004 the privileges were re-regulated by the Law of Ukraine "On state support of book-publishing activity in Ukraine"⁷⁴ with amendments⁷⁵. While VAT exemptions for sales of school notebooks, textbooks and study guides produced in Ukraine were immediately in place, other privileges were renewed only with amendments to the

⁷¹ Law of Ukraine "On state support of mass media and social protection of journalists" #540/97 as of September 23, 1997.

⁷² Law of Ukraine "On value added tax" # 168/97-VR as of April 03, 1997, article 5, clause 1, sub-clause 2.

⁷³ Law of Ukraine "On amendments to some laws of Ukraine that regulate taxation" # 2410-III as of May 17, 2001; The Law of Ukraine "On amendments to some laws of Ukraine that regulate taxation" # 440-IV as of January 16, 2003.

⁷⁴ Law of Ukraine "On state support of book-publishing activity in Ukraine" #601-IV as of March 6, 2003.

⁷⁵ Law of Ukraine "On amendments to some laws of Ukraine concerning state support of book-publishing in Ukraine" #1300-IV as of November 20, 2003.

State budget 2004⁷⁶. A specified list of imported goods used in publishing activity was exempted from import duty⁷⁷ and VAT⁷⁸. Production, publishing and distribution of books, book-related products (except advertisement and erotic materials), paper and pasteboard were exempted from VAT⁷⁹. Publishing houses, polygraphic enterprises and distributors of books and book related products (except for advertisement and erotic materials) are exempted from EPT, if re-directing funds for investment to renew equipment develop and introduce new publishing technologies and expand of book-publishing activities⁸⁰.

Enterprises of W&P industry accumulated some tax arrears. However, the comparatively low amounts declined significantly in 2004. Tax expenditures to enterprises operating in TPRs became a major channel of total tax expenditures in the industry in 2004, in particular wood-processing in SEZs and TPRs of Volynska, Lvivska and Kharkivska regions and paper production in TPRs of Volynska, Zhytomyrska, Chernigivska, and Sumska regions.

Table 9.6

Woodworking, furniture, pulp and paper industry, and publishing: tax expenditures, UAH m

	2002	2003	2004
Tax privileges	615.6	917.9	960.1
Import duty exemptions	N/a	N/a	N/a
EPT exemption	80.5	75.8	37.9
VAT exemption of sale of products	407.1	483.1	319.9
VAT exemption of imported inputs	-	163.3	223.3
Tax arrears	44.0	52.0	22.5
SEZ & TPR	83.9	143.7	356.4
Tax expenditures total	582.5	745.2	758.0

Source: explanatory note to the draft state budgets 2004 and 2005, State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates

9.3.3 State provision/purchase of goods or services

The State budget contains several support programs to publishing companies, particularly financing of information policy in mass-media (the highest share of funds), applied mass media research, standardization, and education of mass

⁷⁶ Law of Ukraine "On State Budget 2004" #1344-IV as of November 27, 2003, article 80, paragraphs 49 and 50.

⁷⁷ Law of Ukraine "On unified custom duty" #2097-XII as of February 05, 1992. article 19, paragraph "o".

⁷⁸ Law of Ukraine "On value added tax" # 168/97-VR as of April 03, 1997, article 11, clause 37.

⁷⁹ Law of Ukraine "On value added tax" # 168/97-VR as of April 03, 1997, article 11, clauses 38 and 40.

⁸⁰ Law of Ukraine "On enterprise profit tax" # 334/94-VR as of December 28, 1994, article 7, clause 13, sub-clause 7.

media employees. The total amount funds extended under these programs is comparably small.

Table 9.7

Woodworking, furniture, pulp and paper industry, and publishing: state provision / purchase of goods or services, UAH m

	2002	2003	2004
R&D	0.4	0.5	0.2
Training	0.5	0.6	0.6
Governance	1.9	2.6	5.8
Other	1.3	1.5	1.9
State provision/purchase of goods or services total	4.1	5.2	8.6

Source: State Treasury reports on budget execution 2002, 2003, 2004

9.3.4 Total amount of subsidy

In sum, almost all government support to W&P industry was directed towards mass media and publishing activities, whereas the wood-processing industry was receiving very little attention of the state. The major share of state support was granted in the form of tax expenditures, mainly VAT and other tax exemptions of mass-media and publishing enterprises. Other state support to the industry was rather negligible.

Table 9.8

Woodworking, furniture, pulp and paper industry, and publishing: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	6.6	1.1	15.9	2.1	20.4	2.6
Tax expenditures	582.5	98.2	745.2	97.2	758.0	96.3
State provision/purchase of goods or services	4.1	0.7	5.2	0.7	8.6	1.1
Quasi-fiscal activities	0.0	0.0	0.0	0.0	0.0	0.0
Other income or price support	0.0	0.0	0.0	0.0	0.0	0.0
Total	593.2	100	766.3	100	787.0	100

Source: State Treasury reports on budget execution 2002, 2003, 2004, explanatory note to the draft state budgets 2004 and 2005, State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates

9.4 Expected changes in trade regime in woodworking, furniture, paper and pulp industry, and publishing as a result of the WTO accession

Market Access: Ukraine's WTO accession will have a significant impact on tariff protection of woodworking, furniture, paper and pulp industry. An expected reduction of simple average tariff is 93% from 6.1% to 0.4%.

Table 9.9

Woodworking, furniture, pulp and paper industry, and publishing: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	6.1	0.4	5.7	93
<i>including</i>				
MFN tariff	8.0	0.6	7.5	93
Full tariff ^a	17.5	0.6	16.9	97
Import-weighted tariffs	7.2	0.2	7.0	97
<i>including</i>				
MFN tariff	9.6	0.3	9.2	97
Full tariff ^a	20.0	0.3	19.7	98

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

The W&P sector (A09) is one of the sectors, for which an expected reduction in tariffs due to WTO accession will be predominantly regulated by sector initiatives, and not a tariff proposal of Ukraine. It happens because of very high share of imports that are subject to sector initiative in this sector (94.3% of total sector imports).

There are six sector initiatives that will be applied to products of the W&P sector, including 'Chemistry', 'Civil aircraft', 'Furniture', 'Paper', 'Textile and textile clothing', and 'Wood'. Out of these initiatives, one will be non-binding: the binding duty rate in 'Chemistry' is above actually applied in Ukraine. Yet other initiative ('Textile and textile clothing') is expected to have no effect since the proposed binding duty rate is exactly the same as actually applied. Four other sector initiatives will imply smaller or larger reduction in import tariffs.

The most important will be a reduction of import tariffs under 'Paper' sector initiative, since it concerns 83.0% of sector imports. This initiative envisages a binding zero duty rate that will substitute current 8.8% tariff. The largest magnitude of tariff reduction is expected under 'Furniture' initiative: from average

18.9% to zero immediately after Ukraine's WTO accession. The reduction of tariffs under 'Wood initiative' will be less substantial – by 2.4 percentage points. Finally, it is expected that Ukraine will join 'Civil aircraft' initiative in 2010, and that will imply a 13.1 percentage points reduction in tariffs.

Table 9.10

Woodworking, furniture, pulp and paper industry, and publishing: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	5.0	6.5	-1.5	0.2	Non-binding
Civil aircraft	13.1	0.0 ^a	13.1	0.7	Reduction
Furniture	18.9	0.0	18.9	4.5	Reduction
Paper	8.8	0.0	8.8	83.0	Reduction
Textile and textile clothing	10.0	10.0	0.0	0.2	No change
Wood	2.4	0.0	2.4	5.7	Reduction

Note: Ukraine offered to join 'Civil aircraft' sector initiative in 2010

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic Support: During the years 2002-2004 nearly almost all (98%) subsidies to the sector were provided as tax expenditures, including VAT exemptions and tax privileges applied to enterprise in the Special Economic Zones and Territories of Priority Development. In the beginning of 2005 SEZ and TPD were cancelled. It is expected that all such subsidies will be terminated permanently.

10 Manufacture of coke products (A10)

Table 10.1.

Manufacturing of coke products: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	4212	5513	5772	7909
	% total output	1.0	1.1	1.0	1.1
	% industrial output	1.8	2.0	1.9	2.2
	% growth, real ^e	-8.0	54.0	25.0	9.0
Value added	% GDP	-0.2	0.1	0.2	0.2
Value added / output	%	-6.5	5.3	7.5	6.9
Structure of value added:					
Compensation to employees	% sector VA		84.5	73.1	73.6
Profit, mixed income	% sector VA		-2.4	12.6	9.9
Net taxes on production and imports	% sector VA		17.9	14.3	16.5
Employment ^e	Thousand people	54	55	57	58
	% total employed	0.4	0.4	0.5	0.5
Average wage ^e	UAH	490	634	824	951
Exports	UAH m	495	789	763	1271
	% total exports	0.5	0.7	0.6	0.8
	% sector output	11.8	14.3	13.2	16.1
Imports	UAH m	106	367	659	650
	% total imports	0.1	0.3	0.6	0.4
	% sector output	2.5	6.7	11.4	8.2
Exports/imports	index	4.7	2.1	1.2	2.0

Source: State Statistic Committee, IER estimates

Note: ^e refers both to manufacture of coke (A10) and to petroleum refinement (A11)

10.1 Overview

Production of coke accounts for about 1% in total output, 3% in industrial output and 2% in GDP. The share of value added for the sector lies in the range of 7%, of which employees receive 75%, taxes constituted 17% and 10% goes to entrepreneurs.

Coking coal is *per se* not an important commodity for foreign trade, but it is an very import production input for metallurgy. In the face of growing prices for coke on the world market domestic metallurgical companies lobbied to limit exports of domestically produced coal. However, coke plants increasingly export their products

using the favourable price situation on the world market. In general, domestic production could cover all domestic demand for coke, but price differentials on different markets lead to situations that coke is exported, while metallurgical plants import it at the same time.

Table 10.2

Manufacturing of coke products: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	9.1	16	13.5	16	8.0	11
<i>including</i>						
Russia	6.4	11	10.0	12	4.7	6
Other CIS	2.3	4	3.2	4	2.9	4
Baltic countries	0.4	1	0.2	0	0.4	1
MFN trade	48.2	83	71.7	84	64.0	89
<i>Including</i>						
EU-15	6.5	11	2.8	3	3.5	5
NMC-5	0.4	1	2.6	3	1.3	2
Asia	10.8	19	8.8	10	6.8	9
America	0.0	0	0.0	0	0.0	0
"Full tariff" trade	0.8	1	0.2	0	0.3	0
Total	58.0	100	85.3	100	72.3	100
Imports						
Free trade	13.7	59	34.9	78	87.2	92
<i>Including</i>						
Russia	4.4	19	26.8	60	82.5	87
Other CIS	4.2	18	4.0	9	0.2	0
Baltic countries	5.1	22	4.1	9	4.5	5
MFN trade	8.1	35	9.6	22	5.8	6
<i>Including</i>						
EU-15	3.0	13	3.0	7	2.0	2
NMC-5	1.4	6	1.3	3	1.8	2
Asia	3.3	14	4.1	9	1.6	2
America	0.3	1	1.2	3	0.1	0
"Full tariff" trade	1.5	6	0.0	0	1.6	2
Total	23.2	100	44.5	100	94.6	100

Source: UN ComTrade database, IER estimates

Coke imports from Russia under the free trade regime were with 87% in 2002 the most important one, while 89% of coke exports in 2002 were sent to MFN trading partners.

10.2 Tariffs

Table 10.3

Manufacturing of coke products: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	0.6	0.6	0.6	0.7	0.7	0.7	0.7
<i>including</i>							
MFN tariff	6.5	6.1	6.8	8.0	8.0	7.1	7.1
Full tariff	11.3	11.3	11.3	11.3	11.3	15.3	15.3

Source: Customs tariff, UN ComTrade database, IER estimates

The simple average tariff on products belonging to production of coke industry has remained at the level of below 1% throughout most of the time between 1996 and 2002, despite increases in both the MFN and full simple average tariff rates to from 6.5% to 7.1% and from 11.3% to 15.3% respectively, strengthening the dominant position of imports from countries under free trade regime.

Table 10.4

Manufacturing of coke products: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	0.2	0.2	0.3	0.3	0.3	0.3	0.3
<i>including</i>							
MFN tariff	1.8	1.8	2.3	2.3	2.3	2.3	2.3
Full tariff	6.7	6.7	6.7	6.7	6.7	8.9	8.9

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

The MFN import-weighted tariff rate remained unchanged at 2.3% from 1998-2002, while the full import weighted tariffs was increased to 8.9% in 2001.

10.3 Subsidies

Ukraine's coke production is mostly privatised and did not receive any significant direct subsidies or state support. The only line of support was in the form of tax expenditures. The state, controlling most of the coking coal production, interfered into the coking coal price-setting setting maximum prices below the market ones. It was frequent, however, that these benefits were received by the intermediaries buying cheap coking coal from state mines and selling it at the market rate to the coke producers.

10.3.1 Tax expenditures

Tax privileges were granted to coke production enterprises in form of EPT deductions for funds spent on improvement of assets, which were bought before 1993.

Table 10.5

Manufacturing of coke products: tax expenditures, UAH m

	2002	2003	2004
Tax privileges	41.13	0.93	0.10
EPT deferment	34.13	0.00	0.00
Tax arrears	7.00	0.93	0.10
Tax expenditures	10.24	0.18	0.02

Source: Explanatory note to the draft budget 2004, 2005, State Tax Administration, IER estimates

10.3.2 Total amount of subsidization

The figure of tax expenditure is representative of all the subsidies, given to the coke production industry, which you can see in the Table 10.6.

Table 10.6

Manufacturing of coke products: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	0	0	0	0	0	0
Tax expenditures	10.24	100	0.18	100	0.02	100
State provision/purchase of goods or services	0	0	0	0	0	0
Quasi-fiscal activities	0	0	0	0	0	0
Other income or price support	0	0	0	0	0	0
Total subsidy	10.24	100	0.18	100	0.02	100

Source: State Tax Administration, IER estimates, Explanatory note to the draft budget 2004, 2005

10.4 Expected changes in trade regime in manufacture of coke products as a result of the WTO accession

Market Access: Expected reduction of tariff protection (measured as simple average total tariff) will reach 47%, basically due to reduction of full tariff rate.

Table 10.7

Manufacturing of coke products: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	0.7	0.4	0.3	47
<i>including</i>				
MFN tariff	7.1	4.7	2.4	33
Full tariff ^a	15.3	4.7	10.6	69
Import-weighted tariffs	0.3	0.1	0.2	62
<i>including</i>				
MFN tariff	2.3	1.4	0.9	38
Full tariff ^a	8.9	1.4	7.4	84

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

Only one sector initiative – ‘Chemistry’ – is applied to coke products (A10). A binding tariff rate under this initiative is 6.5% that is almost twice higher than currently applied import tariff. Thus, for this sector Ukraine’s sector initiative commitments are non-binding.

Table 10.8

Manufacturing of coke products: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	3.7	6.5	-2.8	0.0	Non-binding

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic Support: The level of domestic support is expected to remain at zero for this sector.

11 Petroleum refinement (A11)

Table 11.1

Petroleum refinement: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	15076	21817	24442	26199
	% total output	3.5	4.2	4.3	3.8
	% industrial output	6.5	7.9	8.1	7.2
	% growth, real ^e	-8.0	54.0	25.0	9.0
Value added	% GDP	1.2	1.0	1.2	1.2
Value added / output	%	13.4	9.4	10.7	12.7
Structure of value added:					
Compensation to employees	% sector VA	9.1	15.2	18.7	17.0
Profit, mixed income	% sector VA	17.8	24.2	19.4	45.4
Net taxes on production and imports	% sector VA	73.0	60.6	61.9	37.5
Employment ^e	Thousand people	54	55	57	58
	% total employed	0.4	0.4	0.5	0.5
Average wage ^e	UAH	490	634	824	951
Exports	UAH m	2018	4003	6061	8044
	% total exports	1.9	3.5	4.9	5.2
	% sector output	13.4	18.3	24.8	30.7
Imports	UAH m	9871	3949	2921	2237
	% total imports	10.1	3.6	2.6	1.5
	% sector output	65.5	18.1	12.0	8.5
Exports/imports	index	0.2	1.0	2.1	3.6

Source: State Statistic Committee, IER estimates

Note: ^e refers both to manufacture of coke (A10) and to petroleum refinement (A11)

11.1 Overview

Oil refining is about 4% in total output, about 7% in industrial output and 1% of GDP. The share of value added for the sector hovers around 13%. In 2003 most of the value added went to entrepreneurs (45%), employees received about 17% and the taxes constituted about 38%. Through the years 2000-2003 the sector went through significant structural changes, after privatization of most oil refining capacities. Because of Ukraine's dependence on oil-imports, excess refinery capacities stayed idle. However, after privatization the sector covered domestic supply and began exporting oil products. The trend in the sector is clearly towards export-orientation, the export/import ratio changed from 0.2 to 3.6 during the

years 2000-2003. Major refinery owners did compete fiercely over prices to get control of petrol stations in the country. By now market consolidated and prices are slowly approaching world market levels. Still in 2002-2003 the refineries receive most of their profits from exports, while using the domestic market as the market of the last resort.

Table 11.2

Petroleum refinement: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	39.9	10	99.4	12	137.3	11
<i>Including</i>						
Russia	19.6	5	25.2	3	20.3	2
other CIS	14.9	4	55.8	7	60.2	5
Baltic countries	5.5	1	18.4	2	56.8	5
MFN trade	188.0	48	539.0	67	899.0	75
<i>Including</i>						
EU-15	125.4	32	332.9	41	613.3	51
NMC-5	22.5	6	43.5	5	47.9	4
Asia	2.9	1	5.2	1	11.6	1
America	2.3	1	77.9	10	89.0	7
"Full tariff" trade	160.0	41	165.1	21	158.1	13
Total	387.8	100	803.5	100	1194.4	100
Imports						
Free trade	1088.9	83	390.8	72	195.7	47
<i>including</i>						
Russia	516.4	39	155.0	28	66.3	16
other CIS	450.4	34	173.9	32	64.1	15
Baltic countries	122.1	9	62.0	11	65.2	16
MFN trade	202.5	15	77.0	14	61.6	15
<i>including</i>						
EU-15	108.1	8	54.8	10	43.5	10
NMC-5	15.8	1	6.3	1	4.4	1
Asia	1.9	0	0.6	0	1.1	0
America	38.6	3	11.3	2	10.5	3
"Full tariff" trade	17.7	1	78.6	14	160.5	38
Total	1309.0	100	546.3	100	417.8	100

Source: UN ComTrade database, IER estimates

Most oil refinement products are imported from countries with which Ukraine signed free trade agreements, but this import share dropped significantly from 83% in 2000 to 47% in 2002. The change reflects an increase in “full tariff” trade from 1% to 38% at the same time with a drastic contraction of imports of oil refinement products in absolute terms due to increased domestic production. This allowed for diversification of the mix of imports by origin-countries. Russian imports with a 39% share dominated the market in 2000. Only two years later Russia is with a market share of 16% on par with other CIS and Baltic countries, as well as MFN trading partners.

Since 2000 exports of oil refinement products grew significantly, with the EU-15 and a share of 51% being the major destination. Exports are made predominantly under MFN trade regime (75% in 2002).

11.2 Tariffs

Table 11.3

Petroleum refinement: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	3.2	3.2	3.2	3.2	3.5	3.3	3.3
<i>including</i>							
MFN tariff	2.1	2.0	2.0	2.2	2.9	2.5	2.5
Full tariff	7.5	7.5	7.5	7.4	7.9	7.5	7.5

Source: Customs tariff, UN ComTrade database, IER estimates

With slight increases in the MFN simple average tariff and a stable level of a full simple average tariff, total level of tariff remained almost unchanged at 3.2-3.3% level.

Table 11.4

Petroleum refinement: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	1.6	1.1	1.1	0.4	0.4	0.3	0.3
<i>including</i>							
MFN tariff	2.6	1.6	1.6	0.2	0.3	0.3	0.3
Full tariff	3.2	2.3	2.3	0.9	0.9	0.8	0.8

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

The MFN import weighted tariff has decreased from 2.6% to 0.3% between 1996 and 2002. The full import weighted tariff rate has also dropped.

11.3 Subsidies

Petroleum refineries in Ukraine were mostly privatized and did not receive any significant subsidies or state support.

11.3.1 Tax expenditures

Tax privileges were granted to the enterprises of petroleum refinement industry in the realm of EPT deferment according to the Law on EPT. In particular, until 2003, enterprises were allowed to accumulate funds for investments into fixed assets bought before 1993, showing these saved funds as costs on their balance sheets (up to a specified limit).

Table 11.5

Petroleum refinement: tax expenditures, UAH m

	2002	2003	2004
Tax privileges	287	169	24
EPT deferment	48	-	-
Tax arrears	239	169	24
Tax expenditures	71	33	4

Source: Explanatory note to the draft budget 2004, 2005, State Tax Administration, EIR estimates

11.3.2 Total amount of subsidization

Tax expenditures account for the total amount of subsidies to the petroleum refinement industry. The tax privileges gradually decreased over time.

Table 11.6

Petroleum refinement: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	-	-	-	-	-	-
Tax expenditures	71	100	33	100	4	100
State provision/purchase of goods or services						
Quasi-fiscal activities	-	-	-	-	-	-
Other income or price support	-	-	-	-	-	-
Total subsidy	71	100	33	100	4	100

Source Explanatory note to the draft budget 2004, 2005, State Tax Administration, EIR estimates

11.4 Expected changes in trade regime in petroleum refinement as a result of the WTO accession

Market Access: Simple average total tariff on petroleum refinement products is expected to drop by 72% due to Ukraine's accession to the WTO, basically due to reduction of tariff for full tariff rate regime countries.

Table 11.7

Petroleum refinement: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	3.3	0.9	2.3	72
<i>including</i>				
MFN tariff	2.5	1.7	0.8	32
Full tariff ^a	7.5	1.7	5.8	77
Import-weighted tariffs	0.3	0.1	0.3	74
<i>including</i>				
MFN tariff	0.3	0.2	0.1	33
Full tariff ^a	0.8	0.2	0.6	79

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

Petroleum refinement sector (A11) is subject to only one sector initiative, namely 'Chemistry'. Although this initiative envisages a binding duty rate at 6.5%, it is still below the actually applied import tariff that constitutes 9.2%. Thus, after Ukraine's WTO accession, it is expected that tariff on selected petroleum refinement products that fall under sector initiative (such products constitute nearly 3% of sector imports) will reduce by 2.7 percentage points.

Table 11.8

Petroleum refinement: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	9.2	6.5	2.7	2.9	Reduction

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic support: With the elimination of tax arrears domestic support to the sector will be zero.

12 Manufacture of chemicals, rubber and plastic products (A12)

Table 12.1

Manufacture of chemicals, rubber and plastic products: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	15353	17944	19322	25346
	% total output	3.6	3.4	3.4	3.7
	% industrial output	6.6	6.5	6.4	7.0
	% growth, real	9.0	11.0	6.0	17.0
Value added	% GDP	2.5	2.0	2.0	2.1
Value added / output	%	27.5	22.7	22.8	21.7
Structure of value added:					
Compensation to employees	% sector VA	38.7	45.4	42.8	42.3
Profit, mixed income	% sector VA	33.3	29.6	33.5	37.6
Net taxes on production and imports	% sector VA	28.1	25.0	23.7	20.2
Employment	thousand people	200	193	191	179
	% total employed	1.5	1.5	1.6	1.5
Average wage	UAH	305	405	459	568
Exports	UAH m	9619	9365	9862	13361
	% total exports	9.1	8.3	7.9	8.7
	% sector output	62.7	52.2	51.0	52.7
Imports	UAH m	9774	11766	11507	15498
	% total imports	10.0	10.7	10.0	10.5
	% sector output	63.7	65.6	59.6	61.1
Exports/imports	index	1.0	0.8	0.9	0.9

Source: State Statistic Committee, IER estimates

12.1 Overview

The chemical industry's share in total output and industrial output did not exceed 4% and 7% respectively despite a steady growth of the sector's real output. The share of value added generated by the industry in GDP declined from 2.5% in 2000 to 2.1% in 2003, what corresponds with the decline of the value-added-to-output ratio, indicating lack of restructuring in the sector (e.g. equipment outdated, lack of new technologies, etc). Compared with other sectors of the economy, the share of value added in industry output is in the middle range. Distribution of value added between employees, entrepreneurs and the state was almost even in 2000 and

changed gradually in favour of employees and entrepreneurs, whereas state's stake declined.

Changes in the employment levels of the sector occurred in line with the overall employment trends: against the background of increasing wages, the total number of people employed in the sector decreased, so that the share of chemical industry employees in total labour force practically remained unchanged at around 1.5%.

The chemical industry plays an important role in foreign trade. Imports remained on average at the level of around 10.5% of total imports and exports at roughly 8.5% in total exports. The level of intra-industry trade in chemistry was one of the highest among the considered sectors with more than half of sector output being exported and imported. The volumes of chemical products inflows and outflows were relatively balanced with slight overweight of imports.

The structure of trade in chemical products under different trade regimes reveals that most imports and with an increasing tendency originate from the countries with MFN status, especially from the EU-15. NMC-5 and Asia are also important sources of imports under the MFN trade regime. Significant imports are supplied also supplied under the free trade regime, mainly from Russia. However, the volumes of free trade in chemical did not increase in US-dollar terms during the years 2000-2002 and hence losing market share. The same reorientation towards MFN trading partners was recorded for exports, with Asian partners receiving the largest share of chemical exports from Ukraine. At the same time exports to Russia decreased significantly. Although this was partially compensated by an increase in exports to other CIS countries, exports under the free trade regime declined.

Table 12.2

Manufacture of chemicals, rubber and plastic products: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	808.0	47	699.1	42	571.7	35
<i>including</i>						
Russia	612.5	35	521.4	31	375.0	23
other CIS	181.7	10	155.2	9	172.9	11
Baltic countries	13.8	1	22.6	1	23.7	1
MFN trade	837.1	48	853.5	51	930.5	58
<i>including</i>						
EU-15	233.7	13	233.4	14	186.5	12
NMC-5	140.5	8	142.7	9	210.7	13
Asia	298.1	17	323.2	19	414.4	26
America	133.0	8	99.0	6	70.9	4
"Full tariff" trade	92.2	5	105.8	6	116.0	7
Total	1737.2	100	1658.5	100	1618.2	100
Imports						
Free trade	439.4	29	459.3	26	447.0	22

Table 12.2 (cont.)

Manufacture of chemicals, rubber and plastic products: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
<i>including</i>						
Russia	365.2	24	371.8	21	367.8	18
other CIS	53.5	4	65.8	4	59.7	3
Baltic countries	20.6	1	21.8	1	19.6	1
MFN trade	1069.8	70	1316.4	73	1548.1	77
<i>including</i>						
EU-15	557.8	37	736.4	41	871.6	43
NMC-5	191.9	13	236.0	13	279.0	14
Asia	199.5	13	181.9	10	221.2	11
America	56.6	4	80.0	4	81.1	4
"Full tariff" trade	11.4	1	20.0	1	22.2	1
Total	1520.7	100	1795.7	100	2017.4	100

Source: UN ComTrade database, IER estimates

12.2 Tariffs

Table 12.3

Manufacture of chemicals, rubber and plastic products: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	4.8	4.9	4.9	6.2	5.7	5.5	5.3
<i>including</i>							
MFN tariff	5.6	5.9	5.8	7.6	6.8	6.6	6.4
Full tariff	13.4	12.9	12.9	14.5	14.0	14.1	13.9

Source: Customs tariff, UN ComTrade database, IER estimates

The simple average tariff on imports of chemicals, rubber, and plastics was nearly 5.0% in 1996-2002. Both the MFN and full simple average tariffs rates have slightly increased between 1996 and 2002 and remained from the year 2000 onwards at 6.4% and 13.9% respectively. The gap between total and the MFN tariffs is explained by the significance of chemicals, rubber, and plastics imports from countries with which Ukraine signed free trade agreements.

The highest MFN simple average tariff at 15.2% is levied on imports of tyres and tube industries products, followed by 12.8% on products of manufacture of chemical products not elsewhere classified, and 11.3% on products of manufacture of soap and cleaning preparation products, perfumes, cosmetics and other toilet preparations. The lowest tariffs (3.0%) are applied towards imports of products

belonging to manufacture of synthetic rubber, plastic materials and man-made fibres except glass.

The MFN tariffs were increased for the most of sub-sectors. The only sub-sector at which tariffs remained fairly stable were products of manufacture of rubber products not elsewhere classified. Also, for one sub-sector (products of manufacture of basic industrial chemicals except fertilizers) tariff was reduced by one percentage point from 5.6% in 1996 to 5.5% in 2001-2002.

Table 12.4

Manufacture of chemicals, rubber and plastic products: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	3.2	5.5	6.8	6.4	6.5	4.9	4.9
<i>including</i>							
MFN tariff	3.8	6.6	8.3	7.8	7.9	5.9	5.9
Full tariff	10.0	13.8	13.9	14.0	14.2	13.0	13.0

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

Both the MFN and full import weighted tariffs were gradually increased between 1996 and 2003. The MFN reached 5.9% and the full tariff at 13.0%.

12.3 Subsidies

12.3.1 Transfer of funds

Direct state transfers to the chemical industry started in 2003 with the disbursement of funds from the state budget for reconstruction of mining production of the state enterprise "Kaliynny zavod" (Potash plant) and the Stebninsky state mining-chemical enterprise "Polimineral"⁸¹.

Direct state transfers sharply increased in 2004 after the CMU introduced a scheme to compensate drug-producing companies using ethyl alcohol for production⁸². Producers are compensated for the additional higher costs related increased excises in order to prevent price hikes for drugs. For sales of ethyl alcohol to drugs producers a privileged excise rate is used equalling UAH 2 per 1 litre of pure alcohol. The same privileged excise rate is used in the calculation of the drugs price. The amount of compensation equals to the difference between actual excise

⁸¹ It is stated in the State Budget that the funds were assigned according to the adoption of the Program of potash fertilizer production development. However, there is no official document supporting this statement.

⁸² Resolution of CMU "On compensation of additional costs to producers - subjects of entrepreneurship activity, which are associated with an increase from January 1, 2004 in excise rate on ethyl alcohol used for production of drugs" # 2077 as of December 30, 2003.

rate set in the Law on excise rates (2003)⁸³ and privileged rate of UAH 2. The drugs producer, which is going to buy ethyl alcohol, shall issue a tax bill (veksel) to the local tax administration on the amount of compensation. Ethyl alcohol can be received only on presentation of the copy of the discounted tax bill to a producer of ethyl alcohol. The tax bill is retired when the drugs producer pays the amount of compensation to the budget. Afterwards the compensation is returned to the drug producers on the basis of the retired tax bill, which is submitted to the local tax administration together with other tax reports on quarterly basis.

Table 12.5

Manufacture of chemicals, rubber and plastic products: transfer of funds, UAH m

	2002	2003	2004
Direct transfer of funds	-	10.0	59.0
Transfer of funds total	-	10.0	59.0

Source: State Treasury reports on budget execution 2002, 2003, 2004

12.3.2 Tax expenditures

Tax privileges in the chemical industry concern mainly production and distribution of medical products. In 2002 and 2003 deliveries of all drugs and medical products, registered in Ukraine, were exempted from the VAT according to the sub-clause 5.1.7 of the Law on VAT⁸⁴. In 2004 the amount of tax privileges was reduced substantially due to the introduction of a list of medical products subject to the exemption as stipulated by the Law on State Budget for 2004 (article 80, clause 49). The list of medical products is approved and extended by respective resolutions of CMU⁸⁵.

Another tax privileges were granted as tax arrears. Although, in 2002 and 2004 a part of the accumulated tax debt was written off and another part restructured, the stock of overdue tax obligations increased each year. In addition, tax privileges were granted to chemical enterprises operating in SEZs and TPRs in Zhytomirskya and Donetska regions and in the Autonomous Republic of Crimea. In addition, fertilizers production situated in SEZs of Odessa region were eligible for privileges as well as production of medicine in SEZs and TPRs of Zakarpatska and Donetska regions.

⁸³ Law of Ukraine "On excise rates and import duty on ethyl alcohol and hard drinks" #178/96-VR as of May 07, 1996.

⁸⁴ Law of Ukraine "On value added tax" # 168/97-VR as of April 03, 1997.

⁸⁵ Resolution of CMU "On the list of medicines and medical products, selling of which is exempted from the value added tax" #1949 from December 17, 2003; Resolution of CMU "On extension of the list of medicines, selling of which is exempted from the value added tax" # 1006 as of August 10, 2004.

Table 12.6

Manufacture of chemicals, rubber and plastic products: tax expenditures, UAH m

	2002	2003	2004
Tax privileges	3 325.7	3 367.3	1 408.9
VAT exemptions	3 112.5	3 065.0	747.0
Tax arrears	74.0	64.0	71.0
SEZ	139.2	238.3	590.9
Tax expenditures total	3 298.4	3 315.9	1 350.7

Source: explanatory notes to the draft state budgets 2004 and 2005, State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates

12.3.3 State provision/purchase of goods or services

The State Budget contains a number of support programs for the chemical industry. Several chemical enterprises received funds from the budget for conservation, reconstruction and renewal of capacities. Most of the state provision was again directed to pharmaceutical enterprises and related spheres, specifically to training and qualification improvement of medical and pharmaceutical personnel in higher education institutions.

Table 12.7

Manufacture of chemicals, rubber and plastic products: state provision / purchase of goods or services, UAH m

	2002	2003	2004
Restructuring	1.8	3.0	7.8
Governance	0.6	0.7	1.2
Training	321.6	360.9	431.1
Other	2.6	0.0	0.0
State provision total	326.6	364.6	440.1

Source: State Treasury reports on budget execution 2002, 2003, 2004

12.3.4 Total amount of subsidy

The overwhelmingly large share of state support to chemical industry was granted in a form of tax expenditures (mostly directed to pharmaceutical sub-industry). State provision of goods and services was much less, but still noticeable, as compared to transfer of funds. State support changed in the structure over time in the sense that the share of tax expenditures was gradually reduced while that of state provision, mostly directed to training programs, was going up. The latter can be considered as a positive trend.

Table 12.8

Manufacture of chemicals, rubber and plastic products: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds: direct or potential (grants, loans, equity infusion, loan guarantees, etc.)	0.0	0	10.0	0	59.0	3
Tax expenditures	3298.4	91	3315.9	90	1350.7	73
State provision/purchase of goods or services (including capital transfers, R&D, restructuring, etc.)	326.6	9	364.6	10	440.1	24
Quasi-fiscal activities (if government entrusts/directs private body to perform government functions)	0.0	0	0.0	0	0.0	0
Other income or price support	0.0	0	0.0	0	0.0	0
Total	3625.0	100	3690.5	100	1849.7	100

Source: explanatory notes to the draft state budgets 2004 and 2005, State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates, State Treasury reports on budget execution 2002, 2003, 2004

12.4 Expected changes in trade regime in manufacture of chemicals, rubber and plastic products as a result of the WTO accession

Market Access: It is expected that the simple average total tariff on chemical products, rubber and plastics will drop by 45% due to the WTO accession.

Manufacture of chemicals, rubber and plastic products (A12) is subject to seven sector initiatives: 'Chemistry', 'Civil aircraft', 'Distilled spirits', 'Medical equipment', 'Pharmaceutical', 'Textile and textile clothing', and 'Toy'. In terms of imports, the most important are two - 'Chemistry' and 'Pharmaceutical' that occupy 61.4% and 20.9% of sector imports. The reduction of import tariff under 'Chemistry' initiative, however, is not very significant - by only 0.5 percentage points from currently applied 6.3% to 5.8%. 'Pharmaceutical' initiative envisages binding zero duty rate the adoption of which will imply 2.3 percentage points reduction in tariffs.

'Textile and textile clothing' sector initiative is expected to be non-binding for sector A12, since the proposed binding duty rate is already above the actually applied tariff by 0.2 percentage points.

Introduction of 'Distilled spirits' initiative will have two stages. During the first three years after accession the binding duty rate will be 10%, and after three years it will be reduced to zero level. It is hard to estimate the potential effect from these changes since the current share of products that are subject to 'Distilled spirits' initiative in sector imports is very close to zero.

Table 12.9

Manufacture of chemicals, rubber and plastic products: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	5.3	2.9	2.4	45
<i>including</i>				
MFN tariff	6.4	3.7	2.6	41
Full tariff ^a	13.9	3.7	10.1	73
Import-weighted tariffs	4.9	2.3	2.6	52
<i>including</i>				
MFN tariff	5.9	3.0	2.9	49
Full tariff ^a	13.0	3.0	10.0	77

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

Yet other sector initiative the introduction of which will be postponed is 'Civil aircraft'. It is supposed to come into force in 2010, and will imply a 9.9 percentage points reduction in tariff.

Table 12.10

Manufacture of chemicals, rubber and plastic products: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %		Difference	Share of imports, %	Comment
		Immediately after accession	In 3 (10) years after accession			
Chemistry	6.3	5.8	5.8	0.5	61.4	Reduction
Civil aircraft	9.9	9.9	0.0 ^a	9.9	2.7	Reduction
Distilled spirits	n.a.	10.0	0.0 ^b	n.a.	0.0	Reduction
Medical equipment	2.0	0.0	0.0	2.0	0.1	Reduction
Pharmaceutical	2.3	0.0	0.0	2.3	20.9	Reduction
Textile and textile clothing	2.5	2.7	2.7	-0.2	2.6	Non-binding
Toy	10.0	0.0	0.0	10.0	0.0	Reduction

Notes:

a Ukraine offered to join 'Civil aircraft' sector initiative in 2010

b Ukraine offered to bind duty rate to zero for 'Distilled spirits' sector initiative in three years after the country becomes a member of the WTO

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic support: In 2002-2004 between 70% and 90% of all subsidies to the sector were provided in the form of tax expenditures, namely the VAT exemptions, tax arrears and tax privileges under the SEZ and TPD tax regimes⁸⁶. It is expected that these types of subsidization will not be applied after Ukraine joined the WTO.

⁸⁶ The SEZ and TPD were cancelled in early 2005.

13 Manufacture of other non-metallic mineral products (A13)

Table 13.1

Manufacture of other non-metallic mineral products: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	5621	7569	8238	10893
	% total output	1.3	1.4	1.4	1.6
	% industrial output	2.4	2.7	2.7	3.0
	% growth, real	8.0	11.0	5.0	18.0
Value added	% GDP	0.8	1.0	1.0	0.9
Value added / output	%	24.0	28.2	26.1	23.2
Structure of value added:					
Compensation to employees	% sector VA	75.6	60.3	65.5	71.9
Profit, mixed income	% sector VA	4.4	25.3	21.8	13.5
Net taxes on production and imports	% sector VA	20.0	14.5	12.6	14.6
Employment	thousand people	206	184	161	150
	% total employed	1.5	1.4	1.3	1.3
Average wage	UAH	232	314	384	490
Exports	UAH m	1032	1077	1134	1626
	% total exports	1.0	1.0	0.9	1.1
	% sector output	18.4	14.2	13.8	14.9
Imports	UAH m	885	1150	1202	1705
	% total imports	0.9	1.0	1.0	1.2
	% sector output	15.7	15.2	14.6	15.7
Exports/imports	Index	1.2	0.9	0.9	1.0

Source: State Statistic Committee, IER estimates

13.1 Overview

Manufacturing of other non-metallic mineral products takes account of production of glasses, pottery, as well as most of building materials like cement, lime, plaster, etc. It account to approximately 1.5% of total output in Ukraine, and nearly 3.0% of industrial production. Still, a low share of value added in output (between 23% and 28% in different years depending on costs of intermediate consumption) explains a low share of the sector in GDP. This share has remained at nearly 1.0% level during 2000-2003.

Workers are main recipients of the value added in the sector: compensation to employees varies between 60% and 75%. At the same time, a share of net taxes

on production and imports has declined from 20% in 2000 to 14% in 2003, being redistributed towards profit and mixed income. A steady reduction in employment – from 206 thousand people in 2000 to 161 thousand in 200 – could rationalize a drop in share of compensation to employees in the value added in 2000-2002, while a growth in wage in 2003 explains a subsequent rise in compensation.

This sector is not very intensive in foreign trade. Both shares of exports and imports in sector output remains at on average 14% level. A close balance between values of exports and imports don't allow classifying sector as either export- or import-oriented.

Sector exports is oriented mostly towards the CIS countries that account for nearly 57-66% of total exports. A lion share of exports is directed to Russia that could be explained by preservation of trade relationship established in the Soviet era. Exports of non-metallic mineral products to the EU-15 remained quite limited at 7-10% of total sector exports.

In imports the situation is different. Ukraine imports products of this sector both from Russia (22-30% of imports in different years) and from the EU-15 (31-33%). The diversification of the market, as well as growing share of trade with the MFN countries against the background of rather high tariff protection allows concluding that quality of the products play one of the key roles in imports.

Table 13.2

Manufacture of other non-metallic mineral products: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	96.0	70	110.0	70	114.0	66
<i>including</i>						
Russia	72.8	53	82.9	53	72.0	42
other CIS	18.0	13	21.2	13	25.8	15
Baltic countries	5.2	4	5.9	4	16.2	9
MFN trade	38.3	28	43.2	27	55.1	32
<i>including</i>						
EU-15	10.2	7	14.1	9	16.9	10
NMC-5	15.1	11	14.7	9	22.5	13
Asia	3.4	2	3.3	2	4.5	3
America	1.1	1	1.2	1	1.1	1
"Full tariff" trade	3.4	2	4.1	3	2.8	2
Total	137.7	100	157.3	100	171.9	100
Imports						
Free trade	62.4	40	73.7	37	73.3	34
<i>including</i>						
Russia	46.9	30	54.6	27	47.5	22

Table 13.2 (cont.)

Manufacture of other non-metallic mineral products: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
other CIS	13.6	9	14.3	7	20.3	9
Baltic countries	1.9	1	4.8	2	5.4	3
MFN trade	92.5	59	125.3	63	141.6	66
<i>including</i>						
EU-15	52.0	33	64.1	32	66.7	31
NMC-5	32.4	21	45.8	23	52.5	24
Asia	5.1	3	11.2	6	18.9	9
America	1.4	1	2.1	1	1.9	1
"Full tariff" trade	0.8	1	1.1	1	0.9	0
Total	155.7	100	200.1	100	215.9	100

Source: UN ComTrade database, IER estimates

13.2 Tariffs

Simple average tariff on non-metallic mineral products was steadily increased due to rise in both the MFN and full tariff rates, and remained since 1999 at the level of 7.8%. The significant tariff gap between total and the MFN tariffs indicates substantial imports from countries with which Ukraine signed free trade agreements.

Table 13.3

Manufacture of other non-metallic mineral products: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	4.6	4.5	6.8	7.8	7.8	7.8	7.8
<i>including</i>							
MFN tariff	6.8	6.7	10.2	11.8	11.7	11.5	11.5
Full tariff	12.7	12.7	14.7	15.3	15.4	22.8	22.8

Source: Customs tariff, UN ComTrade database, IER estimates

In 2001-2002 simple average MFN tariffs were the highest on imports of structural clay products (13.6%), cement, lime, and plaster (13.5%), and glass and products thereof (13.1%). The lowest rate (9.3%) was on imports of non-metallic mineral products not elsewhere classified. For most of sub-sectors simple average MFN tariffs were raised between 1996 and 2003, with only exception of cement, lime and plaster.

Table 13.4

Manufacture of other non-metallic mineral products: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	4.9	4.9	7.0	6.9	6.8	7.6	7.6
<i>including</i>							
MFN tariff	7.3	7.3	10.5	10.3	10.3	11.4	11.4
Full tariff	12.5	12.5	14.3	14.4	14.4	22.4	22.4

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

Both the MFN and full import weighted tariffs gradually grew between 1996 and 2003. Since 2001 the MFN tariff remained at 11.4%, and the full tariff at 22.4%.

13.3 Expected changes in trade regime in manufacturing of other non-metallic mineral products as a result of the WTO accession

Market Access: Ukraine's membership in the WTO is expected to result in 31% reduction of simple average total tariff on non-metallic mineral products.

Table 13.5

Manufacture of other non-metallic mineral products: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	7.8	5.4	2.4	31
<i>including</i>				
MFN tariff	11.5	8.2	3.4	29
Full tariff ^a	22.8	8.2	14.6	64
Import-weighted tariffs	7.6	5.3	2.3	30
<i>including</i>				
MFN tariff	11.4	8.1	3.3	29
Full tariff ^a	22.4	8.1	14.3	64

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

There are three sector initiatives that are applied to manufacturing of other non-metallic mineral products. These sector initiatives are 'Chemistry', 'Civil aircraft' and 'Information technologies'. 'Chemistry' is expected to be non-binding for imports of

respective products, since its envisaged binding duty rate is 1.5 percentage points above the actually applied duty.

The significant reduction is expected for products subject to 'Information technologies' initiative. Here it is envisaged a reduction of an import tariff from current 10.5% level to a zero. At present the imports of these goods is 0.5% of sector imports.

The introduction of 'Civil aircraft' initiative will be postponed till 2010. This initiative foresees a reduction of import duty by 11.9 percentage points to binding zero duty rate.

Table 13.6

Manufacture of other non-metallic mineral products: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	5.0	6.5	-1.5	4.9	Non-binding
Civil aircraft	11.9	0.0 ^a	11.9	2.6	Reduction
Information technologies	10.5	0.0	10.5	0.5	Reduction

Note: ^a Ukraine offered to join 'Civil aircraft' sector initiative in 2010

Source: Customs tariff, Ministry of Economy, IER calculations

14 Metallurgy and metal processing (A14)

Table 14.1

Metallurgy and metal processing: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	44365	46554	52845	66697
	% total output	10.3	8.9	9.2	9.7
	% industrial output	19.0	16.8	17.6	18.3
	% growth, real	21.0	5.0	4.0	14.0
Value added	% GDP	6.3	4.1	4.0	4.2
Value added / output	%	24.1	18.0	17.3	16.9
Structure of value added:					
Compensation to employees	% sector VA	34.5	53.3	56.2	62.9
Profit, mixed income	% sector VA	53.4	39.5	36.6	30.0
Net taxes on production and imports	% sector VA	12.2	7.3	7.2	7.0
Employment	thousand people	430	428	418	409
	% total employed	3.1	3.3	3.4	3.5
Average wage	UAH	421	540	619	781
Exports	UAH m	32320	34502	36456	46908
	% total exports	30.4	30.5	29.3	30.4
	% sector output	72.9	74.1	69.0	70.3
Imports	UAH m	5708	8306	8619	8754
	% total imports	5.8	7.6	7.5	5.9
	% sector output	12.9	17.8	16.3	13.1
Exports/imports	index	5.7	4.2	4.2	5.4

Source: State Statistic Committee, IER estimates

14.1 Overview

Metallurgy is the third largest sector in the economy with a share of 10% by total output, ranking only behind food industry (2003:12%) and agriculture and hunting (2003:10%). Its share in the industrial output remained rather constant with 18% respectively, backed by more than 10% average growth of real output between 2000 and 2003.

In 2001 the share of value added in metallurgy measured as the percentage of GDP diminished from 6% to 4% and remained stable in 2002-2003. Traditionally, the share of value added in the output for metallurgy lags far behind the other sectors of economy. Thus, the ratio of value added to the total output declined from 24% to 18% in 2001 and 17% in 2002-3. Such low share of value added in output

comparing to other sectors is explained by high level of intermediate consumption in metallurgy, which is partially grounded in out-of-date technologies.

The distribution of value added shifted towards payments to employees from 34% in 2000 to 63% in 2003, at the expense of profits. Specifically, the share of the sector value added spent on the profit, mixed income defrayals dropped from 53 to 30% for the period under review. The share of value added directed at the repayment of the net taxes on production and imports remained relatively constant since 2001 at 7%.

Metallurgy employs continuously 3% of the total working force. The average wage for the workers in the sector increased permanently and reached in 2003 UAH 781 per month, around 70% higher than the average wage level of the economy.

Ukraine is the seventh biggest steel producer in the world after China, Japan, United States, Russia, South Korea, and Germany (for 2003), and third biggest net steel exporter after Japan and Russia (for 2002).⁸⁷ Metallurgy and metal processing is the largest Ukrainian export sector with 30% share of the total volume of exports and 70% share of the sector output. Domestic consumption of metallurgical products remains around 30% of output.

The share of metallurgy imports in the total import structure was 6-8% and ranked fourth among all importing sectors. Metallurgy imports account for a 13% share in the total volume, after a rise up to 18% in 2001. The metallurgical sector is highly export oriented with the ratio of exports to imports of 5.4 in 2003.

Table 14.2

Metallurgy and metal processing: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	1413.9	23	1396.6	22	953.7	15
<i>including</i>						
Russia	1061.9	18	989.2	15	617.3	10
other CIS	259.2	4	239.1	4	235.1	4
Baltic countries	92.8	2	168.3	3	101.3	2
MFN trade	3721.5	61	3605.0	56	3943.7	61
<i>including</i>						
EU-15	649.8	11	736.6	11	779.8	12
NMC-5	240.0	4	295.5	5	296.9	5
Asia	1588.5	26	1739.7	27	1986.3	31
America	534.2	9	260.1	4	220.8	3
"Full tariff" trade	921.1	15	1437.0	22	1540.0	24
Total	6056.4	100	6438.6	100	6437.4	100

⁸⁷ International Iron and Steel Institute statistics www.worldsteel.org.

Table 14.2 (cont.)

Metallurgy and metal processing: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Imports						
Free trade	576.4	60	684.7	62	698.4	63
<i>including</i>						
Russia	510.4	53	599.0	54	629.3	57
other CIS	56.8	6	69.0	6	61.7	6
Baltic countries	9.2	1	16.7	1	7.4	1
MFN trade	373.7	39	418.6	38	390.7	35
<i>including</i>						
EU-15	239.5	25	223.6	20	213.0	19
NMC-5	78.2	8	117.1	11	112.2	10
Asia	24.5	3	28.2	3	30.2	3
America	16.6	2	25.8	2	21.9	2
"Full tariff" trade	6.3	1	9.9	1	17.3	2
Total	956.3	100	1113.2	100	1106.4	100

Source: UN ComTrade database, IER estimates

Most exports of metallurgical output (Table 14.2) are delivered under MFN trade shares of 61% in 2000 and 56% in 2002. Asian countries are increasingly primary destinations of the sector's output absorbing roughly one third of total sector exports in 2002. The 11,5% share of the EU-15 countries remained relatively stable. "Full tariff" trade has grown in importance to 24% of sectoral exports in 2002.

Metallurgical imports under free trade regimes dominate the import structure (see Table 14.2) with increasing shares from 60% in 2000 to 63% in 2002 in the total volume of sector imports. Russia is the most important trading partner with a 57% share in 2002. MFN trade is also important but decreased slightly by 4 percentage points to 35% in 2002. Although the EU-15 share has dropped by 6 percentage points during 3 years and amounted 19% in 2002, imports from these countries has remained of primary importance under MFN regime. NMC-5 trading partners accounted for 10% of total sector imports, thus, occupying the second in significance position among MFN trading partners. The share of "full tariff" trade remained with 1-2% insignificant.

14.2 Tariffs

Simple average tariff on products of metallurgy and metal processing was increased from 1.7% to 2.2% throughout the period 1996-2002. Higher simple average tariffs resulted from increases in both the MFN and full tariff trade although the large

difference between total and the MFN tariff shows that the most of goods belonging to metallurgy and metal processing sector are imported under free trade regime.

Table 14.3

Metallurgy and metal processing: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	1.7	1.9	2.0	2.1	2.2	2.2	2.2
<i>including</i>							
MFN tariff	4.2	5.0	5.0	5.4	5.6	5.6	5.6
Full tariff	9.6	9.8	9.9	10.3	10.7	11.9	11.9

Source: Customs tariff, UN ComTrade database, IER estimates

In 2001-2002 the highest simple average MFN tariff rate of 17.2% was levied on imports of furniture and fixtures primarily of metal, almost twice as high as the second largest tariff of 8.9% charged on cutlery, hand tools and general hardware. The lowest tariff in the sector (2.7%) was applied to imports of products of non-ferrous metal basic industries. Tariffs for all sub-sectors, except for iron and steel, were increased between the years 1996-2002, while tariffs on imports of iron and steel remained fairly stable at around 5.5%.

Table 14.4

Metallurgy and metal processing: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	1.4	1.5	1.5	1.7	1.8	1.8	1.8
<i>including</i>							
MFN tariff	3.4	3.7	3.7	4.2	4.6	4.6	4.5
Full tariff	10.3	10.2	10.2	10.6	11.4	11.3	11.2

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

Both the MFN and full import weighted tariffs gradually increased between 1996 and 2003, with the MFN tariff levelling at 4.5% and the full tariff at 11.2%.

14.3 Subsidies

14.3.1 Transfer of funds

Transfers of funds in the sector were provided in order to intensify construction and renovation activities, and to avoid bankruptcies of metallurgical enterprises.

Construction and renovation of production capacities: One of the main recipients of funds for construction and renovation was Kryvorizskiy ores mining

and enriching industrial complex receiving about UAH 11 m over 3 years. According to the Presidential Decree⁸⁸ the program was implemented to avoiding bankruptcy of the complex, and to reconstruction its capacities. However, most funds were spent for management and employees compensation.

Table 14.5

Metallurgy and metal processing: transfer of funds, UAH m

	2002	2003	2004
Direct transfer of funds	2	3	6
Total	2	3	6

Source: State Treasury reports on State budget execution 2002, 2003, 2004

14.3.2 Tax expenditures

Steel sector enjoyed a number of tax privileges in the course of the "Economic experiment in metallurgical sector" granted from 1st July 1999 until January 2002⁸⁹, with a further extension till January 2003⁹⁰. During the "experiment" metallurgical enterprises were granted the following privileges:

- **Writing-off the fines for untimely tax, duties, and other obligatory payments before 1 July 1999.** Under the economic experiment only half of the fines were paid, while foreign currency payments were not covered at all.
- **EPT.** The participating in the economic experiment enterprises was allowed reducing the amount of the profit tax from 30% to 9% in 2000. In 2001, the EPT for companies working under the economic experiment was increased to 15%. Such tax exemptions were directed at the investment in the working capital. Funds deposited at special accounts of the State Treasury were completely exempted from EPT.
- **Environmental pollution fee.** The generally charged fee for the environmental pollution was reduced by 70% and the saved amounts were supposed to be spent for environmental protection measures of the enterprise.
- **The road fund fee.** The economic experiment cancelled the road fund fee payments of participating enterprises.
- **The innovation fund fee.** The charges of the fee were reduced by 50%.

Also, tax expenditures include subsidies provided under the SEZ and TPD, as well as tax arrears.

⁸⁸ The President Decree "On the organization of the completion of the construction activities of "Kryvorizskiy ore mining and enriching combine" # 301/2001-RP from 8.11.01.

⁸⁹ Law of Ukraine "On the Conduct of the Economic Experiment at Enterprises of the Mining and Smelting Sector in Ukraine" # 934-XIV from 14.07.99.

⁹⁰ Law of Ukraine "On further development of mining and smelting complex of Ukraine" according to the CMU Resolution # 477 (477-2003-n) from 7.04.03 # 2975-III from 17.01.02.

Table 14.6

Metallurgy and metal processing: tax expenditures, UAH m

	2002	2003	2004
Tax privileges	466	239	181
EPT deferment	81	0	0
EPT abatement	102	0	-
SEZ	126	130	136
Tax arrears	157	109	45
Total tax expenditures	288	152	144

Source: explanatory note to the draft budget 2004, 2005, State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates

14.3.3 State provision/purchase of goods or services

The government provided funds for closure and restructuring of mining complex "Mykytivskyy Rtutnyy Kombinat"⁹¹. Quicksilver (Hg) mines were closed, liquidated or production changed.

Table 14.7

Metallurgy and metal processing: state provision/purchase of goods or services, UAH m

	2002	2003	2004
Capital transfers	1	1	1
Total	1	1	1

Source: State treasury reports on the State budget execution 2002, 2003, 2004

14.3.4 Total amount of subsidy

Table 14.8

Metallurgy and metal processing: total amount of subsidies, UAH m

	2002		2003		2004	
	UAH m	% total	UAH m	% total	UAH m	% total
Transfer of funds	2	1	3	2	6	4
Tax expenditures	288	99	152	97	144	95
State provision/purchase of goods or services	1	0	1	1	1	1
Quasi-fiscal activities	0	0	0	0	0	0
Other income or price support	0	0	0	0	0	0
Total	290	100	157	100	151	100

Source: explanatory notes to the draft state budgets 2004 and 2005, State Tax Administration, Ministry of Economy reports on major indicators of SEZ and TPR activity, IER estimates, State Treasury reports on budget execution 2002, 2003, 2004

Most of the subsidies in the metallurgy and metal processing sector is provided in form of tax expenditures (see Table 14.8). The reduction of sector subsidization between 2002 and 2003 is explained by the termination of 'tax experiment' in

⁹¹ The Resolution of CMU "On the special regime of restructuring of JSC "Mykytivskyy Rtutnyy Kombinat" # 1807 from 16.11.98.

metallurgical sector. Still, tax expenditures remain a key form of subsidies thanks to support via the SEZ.

14.4 Expected changes in trade regime in metallurgy and metal processing as a result of the WTO accession

Market Access: The expected reduction of the simple average total tariff on metal products will be by 62%, from 2.2% to 0.8%.

Table 14.9

Metallurgy and metal processing: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	2.2	0.8	1.4	62
<i>including</i>				
MFN tariff	5.6	2.3	3.3	59
Full tariff ^a	11.9	2.3	9.6	81
Import-weighted tariffs	1.8	0.7	1.2	64
<i>including</i>				
MFN tariff	4.5	1.8	2.8	61
Full tariff ^a	11.2	1.8	9.5	84

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

The metallurgy and metal processing sector (A14) is subject to five sector initiatives, including 'Chemistry', 'Civil aircraft', 'Furniture', 'Nonferrous metals' and 'Steel'. In terms of imports, the most important of them are 'Nonferrous metals' and 'Steel' initiatives that account for 19.8% and 16.5% of sector imports respectively. Both of these initiatives foresee a reduction in imports tariffs. Under 'Nonferrous metals' initiative, a tariff reduction will be 2.8 percentage points, and under 'Steel' initiative 5.8 percentage points. In both cases the binding duty rate will be established at a zero level.

In absolute terms, the most significant tariff reduction is expected under the 'Furniture' initiative. Here, the binding rate will be established at the zero level, while the currently applied import tariff is 18.3%. A substantial reduction in tariffs is also envisaged under 'Civil aircraft' initiative that will be introduced in 2010. Here, the reduction will be 8.3 percentage points.

Table 14.10

Metallurgy and metal processing: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	5.0	6.0	-1.0	0.0	Non-binding
Civil aircraft	8.3	0.0 ^a	8.3	4.9	Reduction
Furniture	18.3	0.0	18.3	0.4	Reduction
Nonferrous metals	2.8	0.0	2.8	19.8	Reduction
Steel	5.8	0.0	5.8	16.5	Reduction

Note:

a Ukraine offered to join 'Civil aircraft' sector initiative in 2010

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic support: Most of subsidies in the sector are provided as tax privileges. It is expected that Ukraine's membership in the WTO will end such practice.

15 Manufacture of machinery and equipment (A15)

Table 15.1

Manufacture of machinery and equipment: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	25192	30664	37526	47884
	% total output	5.8	5.9	6.6	6.9
	% industrial output	10.8	11.1	12.5	13.2
	% growth, real	15.0	19.0	11.0	36.0
Value added	% GDP	5.3	5.2	5.5	5.3
Value added / output	%	35.7	34.3	33.1	29.8
Structure of value added:					
Compensation to employees	% sector VA	48.7	52.2	52.6	62.0
Profit, mixed income	% sector VA	17.8	25.7	22.2	12.1
Net taxes on production and imports	% sector VA	33.5	22.1	25.2	25.9
Employment	thousand people	1060	958	867	810
	% total employed	7.7	7.4	7.1	6.9
Average wage	UAH	222	319	387	497
Exports	UAH m	10626	13977	15262	23319
	% total exports	10.0	12.3	12.3	15.1
	% sector output	42.2	45.6	40.7	48.7
Imports	UAH m	15641	19953	22062	33781
	% total imports	16.0	18.2	19.3	22.9
	% sector output	62.1	65.1	58.8	70.5
Exports/imports	index	0.7	0.7	0.7	0.7

Source: State Statistic Committee, IER estimates

15.1 Overview

The share of manufacturing of machinery and equipment in the total output has increased from 6% in 2000 to 7% in 2003 due to a more than 20% average growth of real output in the sector in 2000-2003. In 2003 sector produced 13% of the total industrial output, ranking third after food processing and metallurgy.

In terms of value added machinery and equipment manufacturing share accounts for nearly 5% in the total volume of GDP, taking since 2001 constantly the fifth place behind trade, agriculture, transport, and food processing. During the period 2000-2003 the share of value added in the output has decreased from 36 to 30%, indicating a growth of intermediate consumption in the sector and, thus, deterioration of productivity.

The structure of value added in the sector has changed towards increase of the compensation payments to the employees at the expense of value added shares in profit, mixed income and net taxes on production and imports. In particular, in 2003 the share of value added directed to the compensation payment to the employees consisted 62% compared to 49% in 2000. In 2000-2003 the share of value added assigned for the net taxes on production and imports declined by 8 percentage points and constituted 26% in 2003.

In 2003 the machinery sector employed 810 thousand people that is 250 thousand less than in 2000 and accounted for 7% from the total number of employed in Ukraine. During the period of investigation the nominal average wage in the sector increased to the level of UAH 497 in 2003, while constantly being above the nominal average wage across all sectors.

The machinery and equipment manufacturing sector exports about half of its output with constantly intensifying export orientation: while in 2000 producers exported 42% of the output, the share raised to 49% in 2003. In 2003 the share of machinery exports in the total volume of Ukrainian exports was 15%, second only to metallurgical exports. In general, the share of export increased during the years 2000-2003 from 10 to 15%. Machinery is an import intensive sector, second only to the production of hydrocarbons. The high volume of imports is related to growing investment activity in Ukraine's economy. In terms of the sector output, machinery imports increased by 9 percentage points from 62% in 2000 to 71% in 2003. With a rather stable 0.7 ratio of exports over imports manufacturing of machinery and equipment is clearly more import oriented.

Table 15.2

Manufacture of machinery and equipment: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	1144.8	62	1341.2	58	1565.6	52
<i>Including</i>						
Russia	821.4	45	1006.8	44	1094.9	37
other CIS	231.4	13	241.8	10	292.0	10
Baltic countries	92.0	5	92.5	4	178.6	6
MFN trade	510.1	28	882.6	38	1283.2	43
<i>Including</i>						
EU-15	151.8	8	403.8	17	383.6	13
NMC-5	66.8	4	184.3	8	146.6	5
Asia	142.9	8	162.6	7	599.7	20
America	91.2	5	68.2	3	83.9	3
"Full tariff" trade	189.0	10	88.9	4	146.4	5
Total	1843.9	100	2312.7	100	2995.2	100

Table 15.2 (cont.)

Manufacture of machinery and equipment: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Imports						
Free trade	739.2	31	902.3	29	814.2	23
<i>Including</i>						
Russia	642.6	27	767.9	25	674.0	19
other CIS	76.8	3	104.0	3	107.3	3
Baltic countries	19.7	1	30.3	1	32.9	1
MFN trade	1573.1	67	2155.7	69	2638.9	75
<i>Including</i>						
EU-15	986.0	42	1330.1	43	1663.7	47
NMC-5	176.0	7	257.5	8	316.7	9
Asia	197.9	8	318.9	10	394.0	11
America	135.9	6	168.1	5	172.9	5
"Full tariff" trade	53.0	2	46.4	1	61.3	2
Total	2365.3	100	3104.3	100	3514.4	100

Source: UN ComTrade database, IER estimates

Imports under MFN trade are the most important among the different trade regimes. The share of MFN import increased from 67 to 75% during the years 2000-2002. Since "full tariff" trade remains not very significant, the shares of MFN trade grew at the expense of free trade. The share of free trade in the total trade volume declined from almost one third to less than one fourth from the total sector imports. In 2002 Ukraine imported from EU-15 under MFN trade 47% of the total machinery imports, some 5 percentage points higher than in 2000. Thus, EU-15 is the most important trading partner for the sector. Second in importance but with declining shares is free trade with Russia.

The structure of machinery exports under different trade regimes is still dominated with 52% in 2002 by free trade, although with decreasing importance. In particular exports to Russia declined from 45% in 2000 to 37% in 2002, while MFN trade more than doubled in US-Dollar terms combining in 2002 a 43% share in the total exports. Especially shipments to Asian destinations increased from 8 to 20%, while "full tariff" trade halved its shares 5% in 2002.

15.2 Tariffs

Simple average tariffs on imports of machinery and equipment were gradually increased between 1996 and 2002, and reached 5.5% in 2002. The increase results from higher MFN tariff rates, while the full tariffs were slightly reduced during the same period. The gap between total and the MFN tariffs indicates that significant shares of machinery and equipment imports arrive under free trade regimes.

Table 15.3

Manufacture of machinery and equipment: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	2.7	3.0	3.0	5.4	5.3	5.5	5.5
<i>including</i>							
MFN tariff	3.1	3.4	3.5	6.7	6.6	6.8	6.9
Full tariff	14.8	14.4	14.5	15.6	15.7	14.4	14.4

Source: Customs tariff, UN ComTrade database, IER estimates

In 2001-2002 the highest MFN simple average tariff with 18.8% was levied on electrical appliances and house wares, followed by the 14.0% tariff on imports of watches and clocks. The lowest tariff of 0.6% was charged for imports of railroad equipment. Between 1996 and 2003 the MFN tariffs for all sub-sectors were raised.

Table 15.4

Manufacture of machinery and equipment: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	3.1	3.1	3.2	7.6	7.1	6.9	7.1
<i>including</i>							
MFN tariff	3.5	3.7	3.8	9.6	8.9	8.7	8.9
Full tariff	17.4	14.1	14.1	19.6	19.7	17.1	17.1

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

While the MFN import-weighted tariffs more than doubled from 3.5% to 8.9% between 1996 and 2003, the full import weighed tariff rates slightly decreased from 17.4% to 17.1%.

15.3 Subsidies

Machinery sector was granted different types of subsidies, which were provided mainly in the form of tax expenditures and less frequently in the form of transfer of funds. The privileges were aimed at improving efficiency of production capacities in different industries of the sector, promoting investment activity, intensifying exports, and strengthening research and development. Particularly, tax privileges granted to producers of cars, ships, and aircraft, as well as to the space and defence industries provided extra funds to investment and renovation activities. Producers were exempted from import duties, land tax, VAT, and excise tax. Government of Ukraine introduced the first privileges in the mid-1990s and extended some of the privileges until 2012. However, in the State Budget 2005 the

majority of tax expenditures were reconsidered and some privileges were cancelled⁹².

15.3.1 Transfer of funds

Funds were mainly transferred to producers of ship and aircraft, and to producers of other machinery.

Ship building enterprises: The State budget 2002 and 2004 provided financing for construction of ships by the enterprise "Sudnobudivnyy Zavod 61 Komunara" for export by the "Laskaridis Shipping Company".

Aircraft producing enterprise: The State budget 2004 set aside funds for financing the production of AN-70 military transportation aircraft and purchases by the Ministry of Defence⁹³. The Government purchasing program shall be executed during the period 2004-2022.

Other machinery: Agricultural machine building companies were recipients of funds earmarked for expanding production and market development⁹⁴. Funds were spent for provision of cheap credits from State budget to manufacturers of agricultural machines. Funds were also foreseen for the development and introduction of new production technologies. In February 2002 the Government defined a list of enterprises and the respective amount of financing provided. However, according to the Accounting Chamber of Ukraine there were no explicitly defined criteria for the selection of enterprises eligible for state support. Moreover, enterprises used the earmarked funds for other purposes.

Table 15.5

Manufacture of machinery and equipment: transfer of funds, UAH m

	2002	2003	2004
Ship building	17	0	18
Aircraft	0	0	17
Other machinery	15	11	8
Total	32	11	43

Source: State Treasure reports on the State budget execution 2002, 2003, 2004

⁹² Subsidies are considered as of December 2004 before adoption of State Budget 2005.

⁹³ Law of Ukraine "On the state program of production the military transport aircraft AN-70 and its state purchase over the state defence order" # 1462-IV from 5.02.04.

⁹⁴ Resolution of CMU # 42 from 08.02.02, #403 from 30.03.98, Decree of the President "On the measures related to development of national technique for agricultural complex and expansion of production" # 1039 from 03.11.01, Law of Ukraine "On stimulation of development of national machine building for agricultural complex" #3023 from 07.02.02.

15.3.2 Tax expenditures

Car industry

Ukrainian car producers are among the core recipients of subsidies. The program "On Stimulation of Production of Motor Cars in Ukraine" was launched in the mid-1990s and introduced various tax exemptions. Subsequently the law was changed and many of the privileges were either eliminated or abated⁹⁵. Initially these privileges were to be effective until 1st of January 2008. However, the State Budget 2005 eliminated most privileges, but kept the import duty. Tax expenditures are granted to enterprises producing motor cars, buses and components if enterprises register investments (including foreign) exclusively in monetary form and investment amounts to at least USD 150 m for production of passenger cars; at least USD 30 m for production of trucks and buses; and at least USD 10 m – for production of components necessary for motor cars and buses production.

EPT. EPT is reduced by the amount used for investment credit repayments⁹⁶. The amounts saved must be reinvested in the development of enterprise's production and manufacturing of materials and components for car construction. EPT is further reduced by the amount of accrued and paid dividends, which are reinvested for the same purposes.

Import Duty. Import duties are cancelled for enterprise imports products, which are not produced within the territory of Ukraine. In order to be eligible the importing enterprise must have in Ukraine registered investments (including foreign investments) of not less than USD 150 m. The CMU determines the procedures and volumes of such imports.

Land Tax. Companies in Ukraine with registered investments of USD 150 m and more are exempted from land taxes. One hectare of land shall be exempted for each USD 400.000 of investment, calculated according to the exchange rate, established by the National Bank of Ukraine on the day of the investment (including foreign).

VAT. VAT is not charged for forwarding into the customs territory of Ukraine products (including car assemblies) necessary for production activities of car producers, unless such products are produced within the territory of Ukraine. Further, sales of motor cars, buses and components produced by Ukrainian residents operating under the Law of Ukraine "On Stimulation of Production of Motor Cars in Ukraine" are charged with the zero VAT rate.

Excise Tax. Sales of passenger cars, buses, and motorcycles produced by Ukrainian enterprises of all types of ownerships are released from excise tax payments⁹⁷. The minimum volume of production (out of both imported and

⁹⁵ Law of Ukraine "On Stimulation of Production of Motor Cars in Ukraine" # 535/97-VR from 19.09.97 (with respective changes and amendments according to the Laws # 2681-III (2681-14) from 13.09.01; # 2779-III (2779-14) from 15.11.01; # 1624-IV (1624-15) from 18.03.04).

⁹⁶ The investment program is approved by the CMU.

⁹⁷ Law of Ukraine "On the excise tax rate and import duties on some travel facilities and tires for them" # 216/96-VR from 24.05.96 implemented by the resolution of Verkhovna Rada #217/96-VR

Ukrainian produced accessories) of an enterprise must be 1000 cars **and** 1000 motorcycles per year in accordance with the procedure prescribed by the CMU.

Table 15.6

Tax expenditures for car enterprises (UAH m)

	2002	2003	2004
Tax privileges	316	979	1,115
EPT abatement(relief)	0	80	0
Land tax exemption	3	3	3
VAT exemption of imported inputs	74	128	136
VAT zero-rate of the sale of products	127	445	507
Import duty exemption of inputs	20	89	207
Excise tax exemption	92	233	263
Tax expenditures	260	876	1,004

Source: Explanatory notes to the draft budget 2004 and draft budget 2005

Defence Industry

The Ukrainian defence industry concern "Bronetehnika Ukrainy" incorporates the production of armoured equipment, production of ammunition, elements, chemicals, etc. Tax expenditures to "Bronetehnika" are provided in several programs. The producers of armoured equipment receive tax privileges according to the Law of Ukraine "About the Acknowledgement the Priority of and the State Support to the Armoured Industry of Ukraine"⁹⁸. The law was supposed to be in place from 1st of January 2001 to 1st January of 2006, but was prematurely cancelled with the State Budget 2005 withdrawing all tax privileges except for the excise tax privileges. Research institutes, producers of ammunition, their elements, and chemicals were also granted EPT and land tax deductions⁹⁹.

EPT. Amounts of advance payments for the *armoured* industry obtained from the State and foreign clients ordering equipment of the concern "Bronetehnika Ukrainy" may be kept at separate accounts of such enterprises and shall not be subject to the withholding procedure without consent of the enterprise, and shall be used only for specific purposes stemming from the contract obligations of the enterprise. Such amounts shall be included into the gross revenues of the concern for profit

from 24.05.96 (with respective changes # 340/97 – VR from 12.06.97, # 1214-XIV (1214-14) from 4.11.99, # 2134-III (2134-14) from 7.12.00, # 2371-III (2371-14) from 5.04.01).

⁹⁸ Law of Ukraine "About the Acknowledgement the Priority of and the State Support to the Armoured Industry of Ukraine" # 2211-III from 1.11.01.

⁹⁹ Law of Ukraine "On the State Support of enterprises, research institutes and organizations, which develop and produce ammunition, their elements and special chemicals" 1991-III (1991-14), from 21.09.00 and 01.01.01 (the law is suspended for 2004); Law of Ukraine "On the corporate income tax" #334/94-VR (283/97-VR), from 22.05.97, article 7, pp. 7.18, 7.13.

calculation purposes and subject to taxation in accordance with the Law of Ukraine "On Corporate Income Tax"¹⁰⁰.

For enterprises that set the contract before 01.01.2004 funds reinvested for the development of production of *ammunition, its elements and chemicals*, should not be included into the total costs. The total amount of the privilege cannot exceed the profit that otherwise could have been obtained.

Tax arrears. Enterprises of the concern "Bronetehnika Ukrainy" enjoy the privilege to pay debt to the State Budget and State funds-in-trust accumulated before January 2001 by equal monthly instalment within 60 months starting from 1 January 2002.

Import duty. Exemption from customs duty are in place for imports of materials, equipment and assembling parts, used for purposes of armoured production of concern "Bronetehnika Ukrainy" if these goods are not excisable and not produced in Ukraine or if such domestically produced goods do not comply with the requirements of the clients and with the respective contract provisions. The CMU shall approve on an annual basis a list of such goods (except for excisable goods).

Land tax. Armoured producers are exempted from the land tax.

In 2002 the enterprises, research institutes, and organizations defined in the Law of Ukraine "On the State Support of enterprises, research institutes and organizations developing and producing ammunition, elements and special chemicals" were completely exempted from payments of the land tax. In 2003 and 2004 these enterprises were exempted by 50% from payments of the land tax¹⁰¹.

VAT. Enterprises of the concern "Bronetehnika" were exempt from VAT¹⁰². The exemption were applied to imports (shipment) into the Customs Territory of Ukraine of materials, equipment and assembling parts used for purposes of armoured industry (except for excisable goods), in case such goods are not produced by enterprises within the territory of Ukraine or in case such produced goods do not comply with requirements of the Clients and with the respective Contract provisions. The CMU shall approve on an annual basis the list of such goods (except for excisable goods). Furthermore all sales of Ukrainian produce by the concern "Bronetehnika" are VAT exempt.

¹⁰⁰ In order to calculate income subject to taxation the enterprise own expenditures in accordance with the target allocation are included in gross expenses. In the respective tax period gross revenues are increased by the amounts of such expenditures.

¹⁰¹ Law of Ukraine "On the State Budget 2003" #380-IV (380-15), from 26.12.02, article 55; Law of Ukraine "On the State Budget 2004" # 1344-IV (1344-15), from 27.11.03, article 75.

¹⁰² Law of Ukraine "About the Acknowledgement the Priority of and the State Support to the Armoured Industry of Ukraine".

Table 15.7

Tax expenditures for defence enterprises (UAH m)

	2002	2003	2004
Tax privileges	51.8	25.1	62.2
EPT exemption	0.0	0.1	0.1
EPT deferment	0.5	0.6	0.6
Land tax relief	46.6	12.5	56.3
VAT zero rate of the sale of products	3.2	9.6	1.5
VAT exemption of imported inputs and zero-rate of other inputs	1.5	2.3	3.7
Tax expenditures	50.34	22.78	57.97

Source: explanatory note to the draft budget 2004, 2005, IER estimates

Ship building industry

Tax privileges to the shipbuilding industry are provided according to the Law of Ukraine "On Measures of State Support for the Ship-Building Industry in Ukraine"¹⁰³.

The CMU¹⁰⁴ approves a list of privileged ship building enterprises, except enterprises registered in special economic zones. Enterprises of ship building industry defined by CMU¹⁰⁵ were eligible for tax privileges while paying EPT, VAT, and land tax until 2005. After the adoption of the State Budget 2005 enterprises are released only from the excise tax.

EPT. Amounts of advance payments for the ship building industry obtained from the clients ordering ships (and credits for ship building financing (from 1 January, 2005) may be kept at separate accounts of such enterprises and shall not be subject to the withholding procedure without consent of the enterprise. They shall be used only for specific purposes stemming from the contract obligations of the specified enterprises. Technically it is proceed in the same way as that for the defence industry.

Import duty. Exemption from payment of customs duty for imports of materials, equipment and assembling parts, used for purposes of ship building if these goods are not produced in Ukraine or if such domestically produced goods do not comply with the Certification requirements of the International classification partnerships or do not comply with the requirements of the Clients and with the respective Contract

¹⁰³ Law of Ukraine "On Measures of State Support for the Ship-Building Industry in Ukraine" # 1242-XIV from 18.11.99, (including changes and amendments introduced in accordance with the Law of Ukraine # 2892-III from 13.12.01; # 1766-IV from 15.06.04).

¹⁰⁴ The Resolution of CMU # 978 from 16.06.00, (including changes and amendments introduced by the CMU Orders # 1106 from 21.08.01, and # 696 from 27.05.02).

¹⁰⁵ Law of Ukraine "On value added tax" # 168/97-BP, from 03.04.97, article 11.26, Law of Ukraine "On State Budget for the year 2004", # 1344-IV, from 27.11.03, article 80, paragraph 49.

provisions. The CMU shall approve on an annual basis a list of such goods (except for excisable goods).

Land tax. In the year 2002, eligible ship building enterprises were exempt from land tax¹⁰⁶. In the years 2003 and 2004, eligible enterprises were granted 50% land tax relief¹⁰⁷.

VAT. VAT exemptions are applied to imports (shipment) of materials, equipment and assembling parts, used for purposes of ship building (except for excisable goods), in case such goods are not produced by enterprises within the territory of Ukraine or in case such produced goods do not comply with the Certification requirements of the International classification partnerships or do not comply with the requirements of the Clients and with the respective Contract provisions.

The state support envisaged VAT exemption of research and development works performed by national entities according to the contracts signed with enterprises of ship building industry.

VAT privileges are also applied to transactions of product sales by the specified ship building enterprises, at the expense of funds of the State Budget of Ukraine¹⁰⁸.

Table 15.8

Tax expenditures for ship building enterprises (UAH m)

	2002	2003	2004
Tax privileges	50	34	14
EPT deferment	13	14	3
Land tax exemption (relief)	28	9	7
VAT exemption of imported inputs	1	0	0
VAT zero-rate of the sale of products	0	1	0
VAT exemption of works	2	0	0
Import duty exemption of inputs	7	6	0
Excise tax exemption	0	4	3
Tax expenditures	40	23	11

Source: explanatory note to the draft budget 2004, 2005, IER estimates

In the year 2004, the list of enterprises eligible for VAT privileges was narrowed to those that had signed contracts before January 1st 2004. These enterprises were eligible for the privileges in case the amounts of advanced payments received

¹⁰⁶ Law of Ukraine "On state support of ship industry in Ukraine" # 1242-XIV from 18.11.99, article 1; The Law "On Land payment" # 1242-XIV from 18.11.99, article 1 paragraph 13. The privilege is effective since the year 2000.

¹⁰⁷ Law of Ukraine "On State Budget for the year 2003", # 380-IV, from 26.12.2002, article 55. Law of Ukraine "On State Budget for the year 2004", # 1344-IV, from 27.11.2003, article 75.

¹⁰⁸ Law of Ukraine "On value added tax" # 168/97-BP, from 03.04.97, article 11.26.

according to the contracts signed exceed 20% of the contract's worth¹⁰⁹. State Budget 2005 cancelled such VAT privileges.

The shipbuilding industry enterprises located in SEZ Mykolayiv were eligible for tax privileges in case the investment project exceeded USD 3 m.

Space industry

Tax privileges to the space enterprises are granted according to the Law of Ukraine "On State Support of Space Activity"¹¹⁰. Space industry is defined as a "priority component of the high technology sector of the economy". Initially the mentioned law covered the period until January 1st 2009. But the State Budget 2005 eliminated all tax expenditures except of the excise tax.

Table 15.9

Tax expenditures for space enterprises (UAH m)

	2002	2003	2004
Tax privileges	40	51	57
EPT deferment	1	0	0
Land tax exemption	28	33	33
VAT zero rate of the sale of products	6	15	10
VAT exemption of imported inputs and zero-rate of other inputs	1	1	1
Import duty exemption	4	2	12
Tax expenditures	39	50	56

Source: Explanatory notes to the draft budget 2005, 2004, Ministry of Economy, Policy in UCII (2004), Annex 4, IER estimates

Import duty. Import duties shall not be charged while importing goods, used for production of space machinery (including units, systems and their components for space complexes, space carrier rockets, space vehicles and land segments of space systems), unless such products are domestically produced in Ukraine. The list of these products, except for excisable products, as well as the procedure and volumes of their importing is determined by the CMU.

Land tax. The enterprises of the space industry included into the list compiled by CMU (updated each year) are exempt from land tax¹¹¹.

VAT. Sales of space complexes, space carrier rockets, space vehicles, land segments of space systems and their units, systems and components are exempted from the value-added tax. Imports of products, used for production of space

¹⁰⁹ Law of Ukraine "On value added tax" # 168/97-BP, from 03.04.97, article 11.26, Law of Ukraine "On State Budget for the year 2004", # 1344-IV, from 27.11.2003, article 80, paragraph 49.

¹¹⁰ Law of Ukraine "On State Support of Space Activity" # 1559-III from 16.03.00.

¹¹¹ Law of Ukraine "On state support of space activity" # 1559-III from 16.03.00; The Law "On Land payment" # 1242-XIV from 18.11.99, paragraph 12.14.

machinery (including vehicles, systems and their components for space complexes, space carrier rockets, space vehicles and land segments of space systems), are exempted from the value-added tax, unless such products are produced domestically in Ukraine¹¹².

Aircraft industry

Tax privileges for aircraft producers were introduced by the Law of Ukraine "On State Support of Aircraft Industry in Ukraine"¹¹³ in order to create favourable conditions for the efficient use of the production, scientific and research potential, the modernization of aircraft enterprises, attraction investments, etc.

Initially tax privileges were granted to Ukrainian aircraft industry for the period from 1st of January 2002 to 1st of January 2007, but were later eliminated by the State Budget 2005, except of the excises tax privilege.

EPT. Amounts of advance and preliminary payments under the contracts of aircraft industry enterprises shall be transferred to separate accounts of these enterprises, and may be used exclusively for the purposes to meet the contractual obligations of the enterprises. This money shall be included in gross revenues of enterprises with the purpose of profit calculation subject to taxation in accordance with the law of Ukraine "On Corporate Income Tax".

Import duty. Exempt from import duties are all imports of materials, component products and equipment used for development and production of aircraft machinery and provision of (unless such products are produced within the territory of Ukraine, or those produced do not meet international classification requirements or requirements of customers of products (services), stipulated by terms of contracts). The list and volumes of such products (except excisable ones) shall be annually approved by the CMU.

Land tax. In the year 2002, eligible **aircraft** enterprises were exempted from land tax¹¹⁴. In the years 2003 and 2004, eligible enterprises were granted 50% land tax relief¹¹⁵.

VAT. Imports (forwarding) of materials, components and parts, equipment (except for excisable products) used for the needs of development, production of aircraft machinery and providing relevant services are VAT exempt, unless such products are domestically produced by, or if those domestically produced do not meet international classification requirements or requirements of customers of products

¹¹² Decree of the President of Ukraine "On state support of space industry" # 1191/98 from 27.10.98; Law of Ukraine "On value added tax" # 168/97-BP from 03.04.97, article 11.27.

¹¹³ Law of Ukraine "On State Support of Aircraft Industry in Ukraine" # 2660-III from 12.07.01.

¹¹⁴ Law of Ukraine "On state support of aircraft industry in Ukraine" # 2660-III from 18.11.99, article 2 (2660-14); Law of Ukraine "On the State Budget for the year 2003", # 380-IV from 26.12.02, article 55.

¹¹⁵ Law of Ukraine "On state support of aircraft industry in Ukraine" # 2660-III from 18.11.99, article 2 (2660-14); Law of Ukraine "On State Budget for the year 2004", # 1344-IV from 27.11.03, article 75.

(services), stipulated by the terms of contracts. Sales by the specified aircraft producers are VAT exempt, at the expense of funds of the State Budget of Ukraine.

In the year 2004, the list of enterprises eligible for VAT privileges was narrowed to those that had signed contracts before 01.01.2004. These enterprises were eligible for the privileges in case the amounts of advanced payments received according to the contracts signed exceed 20% of the contract's worth¹¹⁶.

Table 15.10

Tax expenditures for aircraft enterprises (UAH m)

	2002	2003	2004
Tax privileges	61	49	38
EPT deferment	0	1	0
Land tax exemption (relief)	28	15	14
VAT exemption of imported inputs	24	24	24
VAT zero-rate of the sale of products	2	3	0
Import duty exemption	7	8	
Tax expenditures	43	29	18

Source: explanatory note to the draft budget 2004, 2005, Ministry of Economy reports on major indicators of SEZ and TPR activity, Policy in UCII (2004), Annex 4, IER estimates

Table 15.11

Manufacture of machinery and equipment: tax expenditures, UAH m

	2002	2003	2004
Tax privileges*	418.34	1,000.78	1,146.97
Car industry	260	876	1,004
Defence industry	50.34	22.78	57.97
Ship building industry	40	23	11
Space industry	39	50	56
Aircraft industry	43	29	18
Tax arrears	191	182	84
SEZ	175.6	300.7	745.7
Total	656	1339	1908

Source: explanatory note to the draft budget 2004, 2005, IER estimates, Ministry of Economy reports on major indicators of SEZ and TPR activity, State Tax Administration, IER estimates

The total amount of tax expenditures for manufacturers of machinery and equipment are summarized in Table 15.11. It includes tax privileges, tax arrears and SEZ expenditures.

15.3.3 State provision/purchase of goods or services

State support was provided only to space industry and manufacturers of other machinery.

¹¹⁶ Law of Ukraine "On value added tax" # 168/97-BP from 3.04.97, article 11.34; Law of Ukraine "On State Budget for the year 2004", # 1344-IV from 27.11.03, article 80, paragraph 49.

Space enterprises. The state budget of Ukraine envisages the support of the space industry in order to improve R&D works, develop international relationships, maintain the space infrastructure, etc.

In 2004 the Government implemented the programs "On managing and testing space objects", "National space programs", and "Development of rocket complexes". The National Space program aims at utilizing space technologies for the development of civil high-tech products for domestic and foreign markets.

Other machinery enterprises. The State supported separate individual enterprises in order to develop and modernize production capacities, improve research and development activities, etc.

During the years 2002-2004 the state support was provided for financing of their special needs for financing construction works at "Zorya" Mashproekt and the reconstruction and re-equipment of "Pivdenny Mashynobudivnyy Zavod imeni Makarova".

With the special state program on "Creation and implementation into production of modern types of civil production at the enterprises of machine building complex" the government financed credit arrears of scientific and technical programs including the following:

- development and modernization of gas and hydraulic turbines;
- development and production of communication measures;
- development and production implementation of computer systems;
- creation and certification of AN-70;
- development of the technical re-equipment of docks;
- development of autobuses;
- development and putting into production of filter presses, etc.

The funds of the "Program of conversion of former military objects for the period of reformation of Armoured Forces and other armoured objects"¹¹⁷ were foreseen for the creation of new working places for demobilized military servicemen, increased investment attractiveness of military production enterprises, and the preservation and development of R&D potential of military objects.

State R&D programs. "State R&D programs of scientific part of state targeted programs in the sphere of industrial policy" are financed according to the Resolution of CMU¹¹⁸ and should be executed for the period of 1998-2005.

Budget programs. According to the budget program "On implementation of the programs of development of enterprises of ship-building, plane-building, industrial complex "Bronetehnika Ukrainy" and enterprises that develop and produce

¹¹⁷ Resolution of CMU "On the adoption of the Program of conversion of former military objects for the period of reformation of Armoured Forces and other armoured objects" # 81, from 18.01.03.

¹¹⁸ President's Decree "On the organization of the completion of the construction activities of "Kryvorizhskiy ore mining and enriching combine" # 963/98 from 30.03.1998.

ammunition, its parts and products of special chemistry" the budget funds are directed to the enterprises for R&D works, technical preparation of production, expansion of production, increasing competitiveness of the production according to the industry development programs approved by Ministry of Industrial Policy and Ministry of Finance.

According to the Law "On the State Support of enterprises, research institutes and organizations, which develop and produce ammunition, their elements and special chemicals"¹¹⁹ the enterprises are granted the privileges for scientific development.

Table 15.12

Manufacture of machinery and equipment: state provision/purchase of goods or services, UAH m

	2002	2003	2004
<i>Space industry</i>	29	42	110
R&D	26	37	44
Training	2	5	3
Capital transfers	1	0	65
<i>Other machinery</i>	4	23	85
R&D	1	7	22
Conversion	3	16	60
Capital transfers	1	0	2
Total	33	65	195

Source: State Treasury reports on the budget execution for 2002, 2003, 2004

15.3.4 Total amount of subsidy

All subsidies to manufacturing of machinery and equipment described and calculated above are summarized in Table 15.13.

Table 15.13

Manufacture of machinery and equipment: total amount of subsidies, UAH m

	2002	2002 structure (%)	2003	2003 structure (%)	2004	2004 structure (%)
Transfer of funds	32	4	11	1	44	2
Tax expenditures	656	91	1339	95	1908	89
State provision/purchase of goods or services	33	5	65	5	195	9
Quasi-fiscal activities	0	0	0	0	0	0
Other income or price support	0	0	0	0	0	0
Total subsidy	721	100	1414	100	2146	100

Source: State Treasury reports on the budget execution for 2002, 2003, 2004, explanatory note to the draft budget 2004, 2005, IER estimates, Ministry of Economy reports on major indicators of SEZ and TPR activity, State Tax Administration, IER estimates

¹¹⁹ The Law of Ukraine "On the State Support of enterprises, research institutes and organizations, which develop and produce ammunition, their elements and special chemicals" # 1991-III from 21.09.2000.

In general, most subsidies were provided in form of tax expenditures. The figures presented include tax arrears and the influence of SEZ. The subsidization was also provided through State provision as well as transfer of funds.

15.4 Expected changes in trade regime in machinery and equipment as a result of the WTO accession

Market Access: Simple average tariff on machinery and equipment is estimated to drop by 47% due to the WTO accession.

Table 15.14

Manufacture of machinery and equipment: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	5.5	2.9	2.6	47
<i>including</i>				
MFN tariff	6.9	3.8	3.1	45
Full tariff ^a	14.4	3.8	10.6	74
Import-weighted tariffs	7.1	3.2	3.8	54
<i>including</i>				
MFN tariff	8.9	4.2	4.7	53
Full tariff ^a	17.1	4.2	12.9	75

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

Machinery and equipment sector is subject to the largest number of initiatives – either. These initiatives include 'Agricultural equipment', 'Chemistry', 'Civil aircraft', 'Construction equipment', 'Information technologies', 'Medical equipment', 'Pharmaceutical', and 'Scientific equipment'. Only one of these initiatives is non-binding – namely 'Chemistry' because the binding duty rate is 6.5%, while Ukraine currently applies a zero rate. The rest of sector initiatives foresee a reduction of tariff rates to binding zero level either immediately after accession (most of them), or in 2010 (Civil aircraft').

In absolute terms, the highest reduction in import tariffs will be for products that fall under 'Agricultural equipment' (by 7.0 percentage points), 'Construction equipment' (by 6.4 percentage points), and 'Information technologies' (by 5.9 percentage points). These three initiatives concern 17.8% of sector imports.

Table 15.15

Manufacture of machinery and equipment: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Agricultural equipment	7.0	0.0	7.0	2.7	Reduction
Chemistry	0.0	6.5	-6.5	0.0	Non-binding
Civil aircraft	5.5	0.0 ^a	5.5	18.6	Reduction
Construction equipment	6.4	0.0	6.4	3.3	Reduction
Information technologies	5.9	0.0	5.9	11.8	Reduction
Medical equipment	1.2	0.0	1.2	3.5	Reduction
Pharmaceutical	0.7	0.0	0.7	0.3	Reduction
Scientific equipment	4.5	0.0	4.5	2.9	Reduction

Note:

a Ukraine offered to join 'Civil aircraft' sector initiative in 2010

Source: Customs tariff, Ministry of Economy, IER calculations

Domestic support: Since the vast majority of subsidies in the sector is provided in the form of tax expenditures, it is expected that the WTO membership of Ukraine will result in cessation of such practice.

16 Other production sector (A16)

Table 16.1

Other production sector: selected economic indicators

		2000	2001	2002	2003
Output	UAH m	5581	7358	6108	6539
	% total output	1.3	1.4	1.1	0.9
	% industrial output	2.4	2.7	2.0	1.8
Value added	% GDP	0.9	0.5	0.4	0.5
Value added / output	%	26.7	13.9	13.0	18.6
Structure of value added:					
Compensation to employees	% sector VA	35.2	54.6	86.3	62.4
Profit, mixed income	% sector VA	38.6	16.5	-11.7	13.3
Net taxes on production and imports	% sector VA	26.2	28.9	25.4	24.3
Employment	thousand people	84	74	64	59
	% total employed	0.6	0.6	0.5	0.5
Average wage	UAH	204.5	289.8	353.2	443.1
Exports	UAH m	5396	3518	2390	1213
	% total exports	5.1	3.1	1.9	0.8
	% sector output	96.7	47.8	39.1	18.6
Imports	UAH m	2625	524	599	886
	% total imports	2.7	0.5	0.5	0.6
	% sector output	47.0	7.1	9.8	13.5
Exports/imports	index	2.1	6.7	4.0	1.4

Source: State Statistic Committee, IER estimates

16.1 Overview

'Other production' sector includes sporting and athletic products, musical instruments, jewellery, as well as other products not elsewhere classified. It accounts for nearly 1% of total output, and approximately 0.5% of GDP. The reduction of a ratio of value added to output between 2000 and 2003 indicates growing costs of intermediate consumption, as thus potential technological regress in the sector.

Despite a 30% drop in sector employment in 2000-2003, employees became the key recipients of the value added, first of all, at the expense of employers that get lower profits and mixed income.

Both exports and imports in the sector have sharply declined in recent years, possibly due to re-orientation on domestic market. In particular, a share of exports

in sector output dropped from 96.7% in 2000 to meagre 18.6% in 2003. Although a reduction in imports was less impressive, its share in sector output also decreased from 47.0% in 2000 to 13.5% in 2003. Thus, although this sector still have higher share of exports than imports, its reliance on foreign trade has vanished.

'Other products' are exported mostly to the MFN countries, first of all the EU-15 and Asia. The same situation is also with imports. Most of imports of 'other products' come from countries, with which Ukraine enjoys the MFN trade regime, first of all, the EU-15. The share of Russia and other CIS countries was meagre at 2-3%.

Table 16.2

Other production sector: merchandise trade flows

	2000		2001		2002	
	USD m	% total	USD m	% total	USD m	% total
Exports						
Free trade	43.3	5	44.5	7	40.1	7
<i>including</i>						
Russia	3.4	0	4.5	1	6.2	1
other CIS	27.0	3	36.5	5	28.9	5
Baltic countries	12.9	2	3.5	1	4.9	1
MFN trade	734.6	91	622.9	93	507.0	91
<i>including</i>						
EU-15	477.2	59	352.7	53	252.1	45
NMC-5	13.2	2	14.6	2	7.1	1
Asia	209.4	26	223.9	33	202.6	36
America	2.4	0	2.4	0	2.5	0
"Full tariff" trade	29.0	4	3.0	0	10.7	2
Total	806.9	100	670.4	100	557.8	100
Imports						
Free trade	9.6	2	12.5	4	10.1	3
<i>including</i>						
Russia	6.0	1	7.9	3	6.2	2
other CIS	2.4	1	2.7	1	3.1	1
Baltic countries	1.2	0	2.0	1	0.8	0
MFN trade	392.5	94	280.8	93	273.3	94
<i>including</i>						
EU-15	344.1	83	230.6	77	209.4	72
NMC-5	8.4	2	8.8	3	10.8	4
Asia	20.4	5	20.8	7	28.0	10
America	5.6	1	6.3	2	7.8	3
"Full tariff" trade	13.6	3	7.4	2	6.6	2
Total	415.7	100	300.7	100	290.0	100

Source: UN ComTrade database, IER estimates

16.2 Tariffs

Simple average tariffs on 'other products' increased between 1996 and 2002 by almost 3 percentage points, stabilising at 12.6% in 2001-2002. The MFN simple average tariff reached 12.8% in 2001-2002. The highest MFN tariffs are applied towards sporting and athletic goods (20.5%).

Table 16.3

Other production sector: simple average tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	10.0	10.2	10.4	12.3	11.9	12.6	12.6
<i>including</i>							
MFN tariff	10.1	10.3	10.5	12.5	12.1	12.8	12.8
Full tariff	20.1	17.3	17.5	18.8	18.8	23.5	23.5

Source: Customs tariff, UN ComTrade database, IER estimates

Import-weighted MFN tariff was 3.6% in 2001-2003 that is almost twice below full tariff rate.

Table 16.4

Other production sector: import weighted tariffs

	1996	1997	1998	1999	2000	2001	2002
Total tariff	3.0	3.2	3.2	3.6	3.5	3.6	3.6
<i>including</i>							
MFN tariff	3.1	3.2	3.3	3.6	3.6	3.6	3.6
Full tariff	5.2	5.5	5.5	5.8	5.8	7.2	7.2

Note: weighted on total imports without differentiation among trade regimes

Source: Customs tariff, UN ComTrade database, IER estimates

16.3 Expected changes in trade regime in 'other production' sector as a result of the WTO accession

Market Access: Reduction of simple average total tariff on 'other products' is expected at the 45%.

Table 16.5

Other production sector: expected changes in tariffs due to WTO accession

	2002 tariff	Expected tariff	Absolute reduction	Relative reduction, %
Simple average total tariff	12.6	7.0	5.7	45
<i>including</i>				
MFN tariff	12.8	7.2	5.5	43
Full tariff ^a	23.5	7.2	16.3	69
Import-weighted tariffs	3.6	1.1	2.5	69
<i>including</i>				
MFN tariff	0.0	0.0	0.0	0
Full tariff ^a	7.2	1.2	6.1	84

Source: Customs tariff, UN ComTrade database, draft laws #7354 and #7181; IER estimates

Note: ^a Here, the decrease in full tariff rates is applied towards countries - WTO members, with which Ukraine currently has no MFN agreement, and now thus trades under the full tariff rate regime. It is presumed that after the WTO accession trade with these countries will be conducted under the MFN regime

'Other products' sector (A16) is subject to four sector initiatives, namely 'Chemistry', 'Information technologies', 'Paper', and 'Toy'. All of them will mean a significant reduction of tariffs. The largest reduction (in absolute terms) will be applied to 'Toy' where import duty will drop by 14.4 percentage points to zero binding duty rate. Also products under 'Toy' initiative now constitute the largest share of sector imports (8.7%).

'Chemistry' initiative envisages 10.6 percentage points reduction in tariff from currently applied 17.1% to binding rate of 6.5%. Under 'Paper' initiative a reduction will be 10.0 percentage points, and under 'Information technologies' 9.7 percentage points. The latter two initiatives apply zero binding duty rate.

Table 16.6

Other production sector: expected change in tariffs due to sector initiative

Initiative	2002 MFN tariff, %	Sector initiative tariff, %	Difference	Share of imports, %	Comment
Chemistry	17.1	6.5	10.6	0.5	Reduction
Information technologies	9.7	0.0	9.7	0.8	Reduction
Paper	10.0	0.0	10.0	0.1	Reduction
Toy	14.4	0.0	14.4	8.7	Reduction

Source: Customs tariff, Ministry of Economy, IER calculations

PART IV
SUMMARY AND APPENDIX

Summary of trade protectionism measures in Ukraine

Table S01

Ukraine: Summary of protectionism measures in 2002, UAH m

	Transfer of funds	Tax expenditu res	State provision of goods & services	Other subsidies	Total subsidy	Tariff revenues ^a
a01 Agriculture	522.5	3731.2	985.3	0.0	5239.0	72.4
a02 Forestry	0.0	0.8	20.6	0.0	21.4	0.9
a03 Fishing	0.0	1.5	33.1	0.0	34.6	73.4
a04 Mining of coal	930.0	384.0	659.0	0.0	1973.0	0.0
a05 Production of hydrocarbons	0.0	150.0	132.0	0.0	282.0	0.0
a06 Extracting non-energy materials	0.0	79.0	19.0	0.0	98.0	17.6
a07 Food processing	0.0	216.5	0.2	601.0	817.7	796.5
a08 Textile and leather	0.0	24.4	0.0	0.0	24.4	160.4
a09 Wood working, pulp and paper industry, publishing	6.6	582.5	4.1	0.0	593.2	109.0
a10 Manufacture of coke production	0.0	10.0	0.0	0.0	10.0	0.8
a11 Petroleum refinement	0.0	71.0	0.0	0.0	71.0	3.9
a12 Manufacture of chemicals, rubber and plastic products	0.0	3298.4	326.6	0.0	3625.0	207.9
a13 Manufacture of other non-metallic mineral products	0.0	0.0	0.0	0.0	0.0	35.3
a14 Metallurgy and metal processing	2.0	288.0	1.0	0.0	291.0	59.7
a15 Manufacture of machinery and equipment	32.0	656.0	33.0	0.0	721.0	597.5
a16 Other production	0.0	0.0	0.0	0.0	0.0	8.4
Total	1493.1	9493.3	2213.9	601.0	13801.3	2143.7

Source: IER estimate

Note: ^a Tariff revenues are estimated on the basis of total amount of import tariff revenues as stated in Consolidated Budget and the structure of estimated potential revenues

Table S02

Ukraine: Summary of protectionism measures in 2003, UAH m

	Transfer of funds	Tax expenditu res	State provision of goods & services	Other subsidies	Total subsidy	Tariff revenues^a
a01 Agriculture	1360.3	3401.7	1330.4	0.0	6092.4	101.0
a02 Forestry	0.0	0.6	28.0	0.0	28.6	1.2
a03 Fishing	0.0	1.3	52.4	0.0	53.7	102.5
a04 Mining of coal	831.0	376.0	1934.0	0.0	3141.0	0.0
a05 Production of hydrocarbons	0.0	99.0	121.0	0.0	220.0	0.0
a06 Extracting non-energy materials	0.0	119.0	38.0	0.0	157.0	24.5
a07 Food processing	0.0	245.4	0.3	743.0	988.7	1111.8
a08 Textile and leather	0.0	29.9	0.0	0.0	29.9	223.9
a09 Wood working, pulp and paper industry, publishing	15.9	745.2	5.2	0.0	766.3	152.2
a10 Manufacture of coke production	0.0	0.0	0.0	0.0	0.0	1.1
a11 Petroleum refinement	0.0	33.0	0.0	0.0	33.0	5.5
a12 Manufacture of chemicals, rubber and plastic products	10.0	3315.9	364.6	0.0	3690.5	290.2
a13 Manufacture of other non-metallic mineral products	0.0	0.0	0.0	0.0	0.0	49.3
a14 Metallurgy and metal processing	3.0	152.0	1.0	0.0	156.0	83.4
a15 Manufacture of machinery and equipment	11.0	1339.0	65.0	0.0	1415.0	834.1
a16 Other production	0.0	0.0	0.0	0.0	0.0	11.7
Total	2231.2	9858.0	3939.9	743.0	16772.1	2992.4

Source: IER estimate

Note: ^a Tariff revenues are estimated on the basis of total amount of import tariff revenues as stated in Consolidated Budget and the structure of estimated potential revenues

Table S03

Ukraine: Summary of protectionism measures in 2004, UAH m

	Transfer of funds	Tax expenditu res	State provision of goods & services	Other subsidies	Total subsidy	Tariff revenues^a
a01 Agriculture	1335.2	2669.6	1407.8	267.5	5680.1	135.6
a02 Forestry	0.0	0.5	38.2	0.0	38.7	1.7
a03 Fishing	0.0	27.4	65.5	0.0	92.9	137.6
a04 Mining of coal	1602.0	937.0	2254.0	0.0	4793.0	0.0
a05 Production of hydrocarbons	0.0	73.0	144.0	0.0	217.0	0.0
a06 Extracting non-energy materials	0.0	252.0	34.0	0.0	286.0	32.9
a07 Food processing	0.0	195.3	0.3	743.0	938.6	1491.8
a08 Textile and leather	0.0	53.0	0.0	0.0	53.0	300.5
a09 Wood working, pulp and paper industry, publishing	20.4	758.0	8.6	0.0	787.0	204.2
a10 Manufacture of coke production	0.0	0.0	0.0	0.0	0.0	1.4
a11 Petroleum refinement	0.0	4.0	0.0	0.0	4.0	7.4
a12 Manufacture of chemicals, rubber and plastic products	59.0	1350.7	440.1	0.0	1849.8	389.3
a13 Manufacture of other non-metallic mineral products	0.0	0.0	0.0	0.0	0.0	66.1
a14 Metallurgy and metal processing	6.0	144.0	1.0	0.0	151.0	111.9
a15 Manufacture of machinery and equipment	44.0	1908.0	195.0	0.0	2147.0	1119.2
a16 Other production	0.0	0.0	0.0	0.0	0.0	15.7
Total	3066.6	8372.5	4588.5	1010.5	17038.1	4015.3

Source: IER estimate

Note: ^a Tariff revenues are estimated on the basis of total amount of import tariff revenues as stated in Consolidated Budget and the structure of estimated potential revenues

Technical note

Methodology of tariff estimation

Applied tariffs

Information on import tariffs was taken from Ukraine's legislation, namely the Unified Custom Tariff of Ukraine¹²⁰ for rates before 2001, and the Custom Tariff of Ukraine¹²¹ for 2001 onwards.

There are three types of tariff rates applied in Ukraine: ad valorem, specific and mixed. All three of them were used for the estimation of the applied level of tariff protection in Ukraine. While nominal ad valorem tariffs were used directly, we have also estimated ad valorem equivalents of specific and mixed rates, wherever possible.

The ad valorem equivalents are estimated for each required year on the basis of annual average import unit value at the 6-digit level of the HS¹²². Since Ukraine's Custom Tariff has higher level of tariff rates' disaggregation (up to 10 digits), tariff rates were taken as simple averages wherever necessary. Also, due to information constraints ad valorem equivalents were estimated only for specific and mixed rates expressed in kilograms or litres.

The formula used to calculate ad valorem equivalent for specific tariff is the following: $(\text{specific rate/unit value}) \times 100\%$. The mixed rates were estimated likewise; only exception is that maximum value between ad valorem and specific parts of mixed tariff is chosen. Thus, the formula is: $\max \{(\text{specific rate/unit value}) \times 100\%, \text{ad valorem tariff}\}$ ¹²³.

The resulted tariff rates dataset still contained missed rates appeared because of:

- Absence of imports under the code, thus no ad valorem equivalent was estimated.
- Specific or mixed rate was expressed in units other than kilograms or litres.
- Difference in trade nomenclature in Unified Custom Tariff applied before 2001, and the Custom Tariff adopted in 2001.

¹²⁰ Approved by the Decree of the Cabinet of Ministers "On Unified Custom Tariff of Ukraine", # 4 adopted on January 11, 1993 with subsequent amendments.

¹²¹ Approved by the Law "On Custom Tariff of Ukraine" # 2371 adopted on April 5, 2001 with subsequent amendments.

¹²² The annual average import unit value is estimated as the ratio of value of Ukraine's total imports for each 6-digit code of the HS and weight of these imports. Information about value and weight of Ukraine's imports for years 1996-2002 is taken from the UN Commodity Trade database.

¹²³ "Ukraine's Trade Regime: Quantitative and Institutional Aspects. Ukraine trade regime overview", Background paper for World Bank Trade Study, 2004.

To avoid estimation biases resulted from missed tariff rates the dataset was corrected. The rules for the corrections were the following:

- If the rate was not estimated due to absence of imports, ad valorem equivalent for other year or for the related code was used, or ad valorem equivalents were estimated on the basis of unit values for related code.
- If mixed rates were expressed in units other than kilograms or litres, the ad valorem part of the rate was put, or ad valorem tariff for other year or for the related code was put.
- If specific rates were expressed in units other than kilograms or litres, ad valorem tariffs for other year or for the related code were put.
- If tariffs were missed due to difference in nomenclature, tariff rates for the related codes were applied.
- In several cases tariff rates provided by the Ministry of Economy in the explanatory notes (see below) were applied.
- The specific assumption was used for HS code 9999AA that are part of A16 (Goods not elsewhere classified). It was assumed that these goods were subject to zero tariff rates.

The resulted dataset include 5230 tariff lines at the 6-digit level of the HS. No corrections were applied towards tariffs in such SAM categories as in 'forestry' (A02), 'production of non-energy materials' (A06), 'production of coke' (A10), and 'petroleum refineries' (A11).

Simple average tariffs were aggregated to the SAM codes applying the table of concordances between the HS and the ISIC Rev.2. The correspondence was established between 6-digit HS codes and 4-digit ISIC codes. Tariffs were estimated for two sets of rates: the MFN (privileged) rate and full rate. Total tariffs were estimated using Ukraine's import value in 2002 as weights.

Import-weighted tariffs were estimated for the constant year base to ensure that a change in aggregate tariff represents changes in the level of tariff protection only, and not the change in imports. The year 2002 was used as a base year. To avoid estimation biases due to non-uniformity of import distribution between trade regimes, the same weight based on total imports of Ukraine for each code was applied to both for the MFN and full tariffs.

Expected change in tariffs

Expected change in tariffs was estimated on the basis of information from the following sources:

- sectoral initiatives that Ukraine offered to join;
- explanatory note for the law "On changes in the Custom Tariff of Ukraine" # 2470 adopted on March 15, 2005;
- explanatory note for the draft law "On changes in the Custom Tariff of Ukraine" registered under #7354 in April 2005;

- explanatory note for the draft law “On changes in selected laws” registered under #7181 in April 2005.

The following sources allowed detailed estimation of expected tariff rates after Ukraine’s accession to the WTO. The estimation was conducted following the methodology used for the estimation of applied tariff rates.

Methodology of subsidy estimation

While calculating the sector privileges we have grouped the state support into the following major group:

- ***Direct or potential transfer from the budget.*** This group of subsidies contains the state budget expenditures in the form of current transfers to enterprises.
- ***Tax expenditures.*** This group of subsidies contains subsidies related to tax payments. It has been estimated using special procedure. In particular, we have divided tax privileges into two major groups. The first group includes the privileges that result into nominal reduction of enterprise tax liabilities, for instance, tax abatement (reduction of tax base), tax relief (reduction of tax rate), and tax exemption. The second group includes privileges that allow tax deferral, for instance, VAT exemptions of imported inputs, deferment of the tax liability, and tax arrears. To estimate a correct amount of subsidy in the second case, we multiplied tax privileges allowing tax deferral by average weighted interest rate. This product is a potential gain of enterprises thanks to tax deferral.
- The total amount of tax expenditures was calculated as a sum of first group privileges and the potential gain of enterprise due to tax deferral.
- ***State provision/purchase of goods or services.*** This group of subsidies includes state budget expenditures for R&D, training, and capital transfers from the state budget to enterprises.

Annex A: Simple average MFN tariffs for sub-sectors

Table A1

Simple average MFN tariffs for agriculture and hunting (A01)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	9.4	21.1	22.6	26.4	23.4	27.6	29.0
<i>Including</i>							
Agricultural and livestock production	9.1	21.9	23.3	27.5	24.3	28.7	30.2
Hunting, trapping and game propagation	14.6	5.4	6.7	4.3	4.0	4.3	4.3

Source: Customs tariff, UN ComTrade database, IER estimates

Table A2

Simple average MFN tariffs for forestry (A02)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	4.1	11.5	10.9	2.4	2.4	3.3	3.1
<i>Including</i>							
Forestry	5.5	17.7	16.7	2.9	2.9	3.3	3.0
Logging	1.7	1.7	1.7	1.7	1.7	3.4	3.4

Source: Customs tariff, UN ComTrade database, IER estimates

Table A3

Simple average MFN tariffs for fishery (A03)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	5.5	24.0	25.3	30.4	20.1	30.3	28.1
<i>Including</i>							
Fishing not elsewhere classified	5.0	5.0	30.0	30.0	30.0	30.0	122.7
Ocean and coastal fishing	5.5	24.2	25.2	30.4	20.0	30.3	27.0

Source: Customs tariff, UN ComTrade database, IER estimates

Table A4

Simple average MFN tariffs for production of non-energy materials (A06)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	2.3	2.3	5.2	5.2	4.5	4.9	4.9
<i>Including</i>							
Chemical and fertilizer mineral mining	5.9	5.9	5.9	6.0	2.1	2.3	2.3
Iron ore mining	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Mining and quarrying not elsewhere classified	1.5	1.5	3.5	3.7	3.1	3.6	3.6
Non-ferrous metal ore mining	1.6	1.6	1.6	1.6	1.6	1.5	1.5
Salt mining	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Stone quarrying, clay and sand pits	1.9	1.9	8.7	8.7	8.7	9.5	9.5

Source: Customs tariff, UN ComTrade database, IER estimates

Table A5

Simple average MFN tariffs for food industry (A07)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	22.7	36.7	46.5	54.7	60.1	66.8	67.2
<i>Including</i>							
Canning and preserving of fruits and vegetables	12.7	33.1	59.9	69.5	74.4	82.4	104.1
Canning, preserving and processing of fish, crustacean and similar foods	23.8	25.8	31.7	50.6	46.2	76.3	87.3
Distilling, rectifying and blending spirits	30.0	30.0	32.4	12.8	14.6	58.9	83.5
Grain mill products	9.3	20.7	32.5	33.4	39.9	38.8	43.1
Malt liquors and malt	16.7	13.3	33.2	43.8	61.8	120.1	142.3
Manufacture of bakery products	9.2	30.2	45.2	70.6	78.6	64.4	57.8
Manufacture of cocoa, chocolate and sugar confectionery	20.8	34.8	32.5	30.7	24.2	33.7	28.2
Manufacture of dairy products	18.5	37.9	35.8	44.5	43.4	46.4	47.1
Manufacture of food products not elsewhere classified	9.9	60.8	44.9	32.5	36.9	34.2	32.6
Manufacture of prepared animal feeds	5.6	17.5	37.7	8.2	8.0	8.7	8.1
Manufacture of vegetable and animal oils and fats	13.1	31.7	43.8	52.5	72.2	104.0	68.9
Slaughtering, preparing and preserving meat	17.1	33.5	38.1	41.5	56.8	44.1	46.4
Soft drinks and carbonated waters industries	225.9	119.1	121.9	157.9	151.1	197.2	187.8
Sugar factories and refineries	14.1	34.0	53.7	54.7	41.9	46.6	48.6
Tobacco manufactures	36.9	36.1	30.0	46.6	59.1	66.6	69.9
Wine industries	109.9	31.7	125.9	257.4	131.5	163.7	227.2

Source: Customs tariff, UN ComTrade database, IER estimates

Table A6

Simple average MFN tariffs for Textile and leather (A08)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	11.0	13.1	14.6	18.6	17.0	8.0	8.0
<i>Including</i>							
Cordage, rope and twine industries	5.0	5.0	16.7	23.3	15.8	3.6	3.6
Fur dressing and dyeing industries	20.0	20.0	20.0	20.0	20.0	15.0	15.0
Knitting mills	10.0	12.5	12.5	12.7	12.7	9.1	9.1
Manufacture of carpets and rugs	17.8	25.2	25.7	25.7	24.0	10.6	10.6
Manufacture of footwear, except vulcanized or moulded rubber or plastic footwear	15.0	30.0	30.0	50.0	45.3	45.3	45.3
Manufacture of made-up textile goods except weaving apparel	12.2	16.8	20.8	26.8	23.1	9.0	9.0
Manufacture of products of leather and leather substitutes, except footwear and wearing apparel	10.8	15.2	15.2	22.4	22.3	22.3	22.3
Manufacture of textiles not elsewhere classified	9.7	9.8	12.9	14.2	12.5	4.3	4.3
Manufacture of wearing apparel, except footwear	25.7	26.3	26.2	30.0	29.4	13.6	13.6
Spinning, weaving and finishing textiles	1.5	3.3	5.3	9.1	7.4	2.4	2.4
Tanneries and leather finishing	5.0	5.5	5.5	5.5	5.5	5.5	5.5

Source: Customs tariff, UN ComTrade database, IER estimates

Table A7

Simple average MFN tariffs for woodworking, pulp and paper industry, publishing (A09)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	3.8	4.2	6.5	7.2	7.3	8.1	8.0
<i>Including</i>							
Manufacture of containers and boxes of paper and paperboard	4.3	5.8	8.9	8.9	13.0	17.2	15.9
Manufacture of furniture and fixtures, except primarily of metal	17.6	16.9	18.7	21.5	18.2	18.6	18.6
Manufacture of pulp, paper and paperboard	1.6	2.4	4.8	4.5	4.5	5.4	5.4
Manufacture of pulp, paper and paperboard articles not elsewhere classified	5.0	5.0	13.3	13.2	13.6	14.1	14.1
Manufacture of wood and cork products not elsewhere classified	3.9	3.9	3.9	3.9	3.9	4.4	4.4
Manufacture of wooden and cane containers and small can ware	2.0	2.0	2.0	1.9	1.9	2.5	2.5
Printing, publishing and allied industries	5.7	5.3	10.1	15.0	16.7	16.0	16.0
Sawmill, planing and other wood mills	0.6	1.2	1.2	1.2	1.4	2.5	2.5

Source: Customs tariff, UN ComTrade database, IER estimates

Table A8

Simple average MFN tariffs for manufacturing of chemicals, rubber and plastic products (A12)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	5.6	5.9	5.8	7.6	6.8	6.6	6.4
<i>Including</i>							
Manufacture of basic industrial chemicals except fertilizer	6.5	5.8	5.5	8.3	6.6	6.6	6.2
Manufacture of chemical products not elsewhere classified	7.9	9.0	9.1	10.1	12.3	12.8	12.8
Manufacture of drugs and medicines	0.0	2.9	4.0	2.9	3.2	2.3	2.3
Manufacture of fertilizers and pesticides	3.5	3.5	3.5	4.1	4.1	4.0	4.0
Manufacture of paints, varnishes and lacquers	3.8	3.5	5.8	5.4	7.3	6.0	6.0
Manufacture of plastic products not elsewhere classified	7.2	7.1	7.0	8.1	9.1	9.5	9.5
Manufacture of rubber products not elsewhere classified	4.1	4.0	5.3	5.9	5.0	4.1	4.1
Manufacture of soap and cleaning preparations, perfumes, cosmetics and other toilet preparations	7.9	17.0	14.9	15.4	15.6	11.3	11.3
Manufacture of synthetic resins, plastic materials and man-made fibres except glass	2.7	2.6	3.2	3.6	3.7	3.1	3.0
Tyre and tube industries	13.8	13.8	13.3	16.7	12.8	15.2	15.2

Source: Customs tariff, UN ComTrade database, IER estimates

Table A9

Simple average MFN tariffs for production of other non-metallic mineral products (A13)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	6.8	6.7	10.2	11.8	11.7	11.5	11.5
<i>Including</i>							
Manufacture of cement, lime and plaster	16.0	16.0	16.0	16.0	13.5	13.5	13.5
Manufacture of glass and glass products	6.4	6.4	10.9	13.8	13.4	13.1	13.1
Manufacture of non-metallic mineral products not elsewhere classified	5.8	5.8	8.7	8.8	9.1	9.3	9.3
Manufacture of pottery, china and earthenware	7.7	7.5	8.5	9.6	11.1	9.6	9.6
Manufacture of structural clay products	6.4	6.4	11.5	13.9	13.2	13.6	13.6

Source: Customs tariff, UN ComTrade database, IER estimates

Table A10

Simple average MFN tariffs for metallurgy and metal processing (A14)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	4.2	5.0	5.0	5.4	5.6	5.6	5.6
<i>Including</i>							
Iron and steel basic industries	5.4	5.3	5.2	5.2	5.2	5.3	5.3
Manufacture of cutlery, hand tools and general hardware	5.0	8.7	8.6	9.0	9.0	8.9	8.9
Manufacture of fabricated metal products except machinery and equipment not elsewhere classified	4.6	6.0	6.2	6.7	6.6	6.7	6.7
Manufacture of furniture and fixtures primarily of metal	14.3	20.0	20.0	21.1	20.6	17.2	17.2
Manufacture of structural metal products	5.3	5.3	6.0	9.5	9.1	7.8	7.8
Non-ferrous metal basic industries	1.1	1.1	1.2	1.6	2.6	2.7	2.7

Source: Customs tariff, UN ComTrade database, IER estimates

Table A11

Simple average MFN tariffs for machinery (A15)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	3.1	3.4	3.5	6.7	6.6	6.8	6.9
<i>Including</i>							
Machinery and equipment except electrical not elsewhere classified	2.2	2.3	2.4	5.0	4.9	5.1	5.2
Manufacture of agricultural machinery and equipment	4.9	4.9	5.8	7.1	6.7	7.4	7.4
Manufacture of aircraft	3.1	3.1	3.1	3.4	3.4	3.9	3.9
Manufacture of electrical apparatus and supplies not elsewhere classified	2.4	3.3	3.3	5.7	5.7	7.2	7.2
Manufacture of electrical appliances and house wares	7.3	8.0	8.0	17.1	16.4	18.8	18.8
Manufacture of electrical industrial machinery and apparatus	0.8	0.9	1.9	5.1	5.4	5.4	5.4
Manufacture of engines and turbines	1.1	1.1	1.1	4.0	4.0	3.8	3.8
Manufacture of metal and wood working machinery	1.6	1.5	1.5	4.1	4.1	3.9	3.9
Manufacture of motor vehicles	6.0	7.1	6.8	11.9	11.0	11.0	11.0
Manufacture of motorcycles and bicycles	8.6	11.4	11.4	11.4	11.4	11.6	11.6
Manufacture of office, computing and accounting machinery	1.3	2.9	2.9	7.5	7.5	9.1	9.1
Manufacture of photographic and optical goods	6.9	6.9	7.1	7.6	7.5	8.6	8.6
Manufacture of professional and scientific, and measuring and controlling equipment not elsewhere cl	2.7	2.9	3.4	5.2	5.2	4.9	4.9
Manufacture of radio, television and communication equipment and apparatus	4.4	5.0	5.0	9.3	9.0	8.6	8.6
Manufacture of railroad equipment	0.2	0.2	0.2	1.4	1.4	0.6	0.6
Manufacture of special industrial machinery and equipment except metal and wood working machinery	1.5	1.5	1.4	3.4	3.8	3.8	3.9
Manufacture of transport equipment not elsewhere classified	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufacture of watches and clocks	5.0	5.0	5.0	15.4	14.0	14.0	14.0
Shipbuilding and repairing	3.8	3.7	3.7	9.9	9.9	9.9	9.9

Source: Customs tariff, UN ComTrade database, IER estimates

Table A12

Simple average MFN tariffs for 'other production' (A16)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	10.1	10.3	10.5	12.5	12.1	12.8	12.8
<i>Including</i>							
Goods not elsewhere classified	4.3	4.3	4.3	6.8	6.8	6.8	6.8
Manufacture of jewellery and related articles	17.5	17.5	17.5	18.9	16.9	19.7	19.7
Manufacture of musical instruments	5.0	5.0	5.0	6.8	6.8	7.1	7.1
Manufacture of sporting and athletic goods	19.1	19.1	19.1	20.9	20.5	20.5	20.5
Manufacturing industries not elsewhere classified	9.1	9.5	9.9	12.0	11.7	12.3	12.3

Source: Customs tariff, UN ComTrade database, IER estimates

Annex B: Import weighted average MFN tariffs for sub-sectors

Table B1

Import weighted average MFN tariffs for agriculture and hunting (A01)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	4.3	12.3	10.3	7.9	10.0	21.2	24.2
<i>Including</i>							
Agricultural and livestock production	4.2	12.3	10.3	8.0	10.0	21.3	24.3
Hunting, trapping and game propagation	14.2	5.7	7.6	4.0	3.6	4.1	4.1

Source: Customs tariff, UN ComTrade database, IER estimates

Table B2

Import weighted average MFN tariffs for forestry (A02)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	5.5	19.5	18.9	3.1	3.2	2.1	2.0
<i>Including</i>							
Forestry	7.1	26.8	26.0	3.8	3.8	2.0	1.9
Logging	1.7	1.7	1.7	1.7	1.7	2.2	2.2

Source: Customs tariff, UN ComTrade database, IER estimates

Table B3

Import weighted average MFN tariffs for fishery (A03)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	5.0	34.8	25.4	46.8	18.7	20.0	21.5
<i>Including</i>							
Fishing not elsewhere classified	5.0	5.0	30.0	30.0	30.0	30.0	122.7
Ocean and coastal fishing	5.0	34.8	25.4	46.8	18.7	20.0	21.5

Source: Customs tariff, UN ComTrade database, IER estimates

Table B4

Import weighted average MFN tariffs for production of non-energy materials (A06)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	1.6	1.6	1.6	1.6	1.6	1.1	1.1
<i>Including</i>							
Chemical and fertilizer mineral mining	0.7	0.7	0.7	0.7	0.7	1.7	1.7
Iron ore mining	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Mining and quarrying not elsewhere classified	1.1	1.1	2.0	2.0	1.8	1.9	1.9
Non-ferrous metal ore mining	2.0	2.0	1.9	1.9	1.9	0.7	0.7
Salt mining	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Stone quarrying, clay and sand pits	0.4	0.4	0.5	0.4	0.4	1.1	1.1

Source: Customs tariff, UN ComTrade database, IER estimates

Table B5

Import weighted average MFN tariffs for food industry (A07)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	27.6	45.1	43.3	51.1	46.0	48.7	54.7
<i>Including</i>							
Canning and preserving of fruits and vegetables	12.2	40.2	44.7	55.2	59.8	74.3	75.6
Canning, preserving and processing of fish, crustacean and similar foods	17.2	39.8	23.8	25.8	27.6	86.3	100.1
Distilling, rectifying and blending spirits	30.0	30.0	32.4	12.8	14.6	58.9	83.5
Grain mill products	10.0	15.4	18.7	17.5	17.1	47.6	52.6
Malt liquors and malt	17.3	16.0	35.8	49.0	68.5	171.2	201.5
Manufacture of bakery products	8.2	27.6	41.0	61.1	50.9	43.7	42.3
Manufacture of cocoa, chocolate and sugar confectionery	14.5	27.5	34.9	15.6	14.4	25.8	22.8
Manufacture of dairy products	12.6	74.7	55.9	53.3	53.6	53.4	60.2
Manufacture of food products not elsewhere classified	13.3	87.2	30.5	19.5	22.6	21.9	20.0
Manufacture of prepared animal feeds	5.5	17.2	39.9	8.3	8.1	8.6	8.1
Manufacture of vegetable and animal oils and fats	19.5	33.6	21.4	27.5	12.7	17.8	20.4
Slaughtering, preparing and preserving meat	32.9	26.5	49.3	64.1	87.2	37.2	38.6
Soft drinks and carbonated waters industries	329.8	164.5	158.2	186.2	156.3	161.9	177.7
Sugar factories and refineries	28.7	48.8	108.7	136.9	133.4	115.1	143.1
Tobacco manufactures	33.6	33.9	30.0	38.8	41.7	44.6	48.2
Wine industries	46.7	25.9	40.4	219.7	127.6	121.7	143.5

Source: Customs tariff, UN ComTrade database, IER estimates

Table B6

Import weighted average MFN tariffs for Textile and leather (A08)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	7.3	10.6	12.1	16.1	14.4	6.2	6.2
<i>Including</i>							
Cordage, rope and twine industries	5.0	5.0	16.7	23.3	13.0	3.5	3.5
Fur dressing and dyeing industries	20.0	20.0	20.0	20.0	20.0	15.0	15.0
Knitting mills	10.0	11.4	11.4	12.4	12.4	9.0	9.0
Manufacture of carpets and rugs	19.9	28.9	29.4	29.4	26.3	11.6	11.6
Manufacture of footwear, except vulcanized or moulded rubber or plastic footwear	15.0	30.0	30.0	30.0	25.0	25.0	25.0
Manufacture of made-up textile goods except weaving apparel	8.5	10.5	17.8	24.3	23.6	6.9	6.9
Manufacture of products of leather and leather substitutes, except footwear and wearing apparel	12.8	14.8	14.8	19.0	19.3	19.3	19.3
Manufacture of textiles not elsewhere classified	8.5	8.7	18.0	19.9	19.1	6.4	6.4
Manufacture of wearing apparel, except footwear	25.3	26.0	26.0	27.9	27.7	11.9	11.9
Spinning, weaving and finishing textiles	1.6	5.5	6.4	11.6	9.4	2.5	2.5
Tanneries and leather finishing	5.0	5.1	5.1	5.1	5.1	5.1	5.1

Source: Customs tariff, UN ComTrade database, IER estimates

Table B7

Import weighted average MFN tariffs for woodworking, pulp and paper industry, publishing (A09)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	3.0	3.4	6.0	6.0	5.6	9.6	9.6
<i>Including</i>							
Manufacture of containers and boxes of paper and paperboard	3.5	9.1	9.6	9.6	11.6	20.9	20.5
Manufacture of furniture and fixtures, except primarily of metal	19.3	19.7	24.2	26.3	19.8	20.1	20.1
Manufacture of pulp, paper and paperboard	1.5	1.6	4.2	3.2	2.5	7.9	7.9
Manufacture of pulp, paper and paperboard articles not elsewhere classified	5.0	5.0	14.9	14.4	14.5	15.8	15.8
Manufacture of wood and cork products not elsewhere classified	4.7	4.7	4.7	4.7	4.7	4.8	4.8
Manufacture of wooden and cane containers and small can ware	2.0	2.0	2.0	1.9	1.9	2.1	2.1
Printing, publishing and allied industries	7.3	5.8	8.5	15.4	15.3	14.5	14.5
Sawmill, planning and other wood mills	1.7	3.1	3.1	3.3	6.9	6.2	6.2

Source: Customs tariff, UN ComTrade database, IER estimates

Table B8

Import weighted average MFN tariffs for manufacturing of chemicals, rubber and plastic products (A12)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	3.8	6.6	8.3	7.8	7.9	5.9	5.9
<i>Including</i>							
Manufacture of basic industrial chemicals except fertilizer	4.5	4.7	4.6	5.0	4.8	4.7	4.7
Manufacture of chemical products not elsewhere classified	6.0	5.8	5.8	6.6	6.4	6.5	6.5
Manufacture of drugs and medicines	0.0	8.8	15.2	12.3	12.6	6.2	6.2
Manufacture of fertilizers and pesticides	1.4	1.4	1.4	1.6	1.6	1.6	1.6
Manufacture of paints, varnishes and lacquers	3.5	3.0	5.5	4.9	6.7	5.9	5.9
Manufacture of plastic products not elsewhere classified	5.7	5.6	5.5	6.9	8.3	8.5	8.5
Manufacture of rubber products not elsewhere classified	5.2	4.2	4.6	4.9	4.4	5.9	5.9
Manufacture of soap and cleaning preparations, perfumes, cosmetics and other toilet preparations	7.8	18.4	19.8	18.4	20.2	14.3	14.3
Manufacture of synthetic resins, plastic materials and man-made fibres except glass	3.2	2.9	3.4	3.5	3.6	3.0	2.8
Tyre and tube industries	20.5	20.5	17.6	20.8	10.4	12.3	12.3

Source: Customs tariff, UN ComTrade database, IER estimates

Table B9

Import weighted average MFN tariffs for production of other non-metallic mineral products (A13)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	7.3	7.3	10.5	10.3	10.3	11.4	11.4
<i>Including</i>							
Manufacture of cement, lime and plaster	23.3	23.3	23.3	23.3	19.5	19.5	19.5
Manufacture of glass and glass products	5.3	5.2	12.7	11.9	11.7	12.8	12.8
Manufacture of non-metallic mineral products not elsewhere classified	5.7	5.7	8.1	8.1	8.7	9.1	9.1
Manufacture of pottery, china and earthenware	11.2	11.2	15.2	16.3	16.4	16.3	16.3
Manufacture of structural clay products	8.3	8.3	9.0	9.0	9.0	10.6	10.6

Source: Customs tariff, UN ComTrade database, IER estimates

Table B10

Import weighted average MFN tariffs for metallurgy and metal processing (A14)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	3.4	3.7	3.7	4.2	4.6	4.6	4.5
<i>Including</i>							
Iron and steel basic industries	4.8	4.7	4.4	4.4	4.4	4.7	4.7
Manufacture of cutlery, hand tools and general hardware	4.9	7.7	6.7	7.8	7.8	7.2	7.2
Manufacture of fabricated metal products except machinery and equipment not elsewhere classified	6.0	7.2	7.6	9.5	8.9	8.6	8.5
Manufacture of furniture and fixtures primarily of metal	19.2	20.0	20.0	22.4	21.2	19.7	19.7
Manufacture of structural metal products	1.6	1.6	1.8	2.1	2.1	1.6	1.6
Non-ferrous metal basic industries	0.5	0.5	0.7	1.1	3.9	4.5	4.5

Source: Customs tariff, UN ComTrade database, IER estimates

Table B11

Import weighted average MFN tariffs for machinery (A15)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	3.5	3.7	3.8	9.6	8.9	8.7	8.9
<i>Including</i>							
Machinery and equipment except electrical not elsewhere classified	1.9	2.0	2.0	4.5	4.2	4.6	5.4
Manufacture of agricultural machinery and equipment	3.4	3.4	6.2	7.8	7.6	8.1	8.1
Manufacture of aircraft	3.7	3.7	3.7	4.2	4.2	4.2	4.2
Manufacture of electrical apparatus and supplies not elsewhere classified	1.5	3.0	3.0	5.2	5.4	9.7	9.7
Manufacture of electrical appliances and housewares	7.3	7.9	7.9	20.5	18.4	20.0	20.0
Manufacture of electrical industrial machinery and apparatus	0.6	0.7	0.8	4.4	5.0	5.0	5.0
Manufacture of engines and turbines	0.4	0.4	0.4	3.9	3.9	4.1	4.1
Manufacture of metal and wood working machinery	1.5	1.5	1.5	3.8	3.9	4.0	4.0
Manufacture of motor vehicles	5.1	3.6	3.6	19.5	16.9	16.8	16.8
Manufacture of motorcycles and bicycles	8.7	10.1	10.1	10.1	10.1	10.5	10.5
Manufacture of office, computing and accounting machinery	0.9	3.8	3.8	5.6	5.6	8.9	8.9
Manufacture of photographic and optical goods	4.9	4.9	5.0	5.8	5.7	6.2	6.2
Manufacture of professional and scientific, and measuring and controlling equipment not elsewhere cl	4.1	4.1	4.5	4.5	4.9	3.3	3.3
Manufacture of radio, television and communication equipment and apparatus	7.3	11.7	11.7	12.3	12.5	7.9	7.9
Manufacture of railroad equipment	0.0	0.0	0.0	3.6	3.3	1.5	1.5
Manufacture of special industrial machinery and equipment except metal and wood working machinery	2.0	2.0	1.9	4.0	4.3	4.7	4.8
Manufacture of transport equipment not elsewhere classified	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufacture of watches and clocks	5.0	5.0	5.0	20.2	17.8	17.8	17.8
Shipbuilding and repairing	4.0	3.9	3.9	6.1	6.1	6.1	6.1

Source: Customs tariff, UN ComTrade database, IER estimates

Table B12

Import weighted average MFN tariffs for 'other production' (A16)

	1996	1997	1998	1999	2000	2001	2002
Total MFN tariff	3.1	3.2	3.3	3.6	3.6	3.6	3.6
<i>Including</i>							
Goods not elsewhere classified	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Manufacture of jewellery and related articles	5.0	5.0	5.0	15.0	15.0	15.0	15.0
Manufacture of musical instruments	5.0	5.0	5.0	5.7	5.7	5.8	5.8
Manufacture of sporting and athletic goods	20.0	20.0	20.0	20.0	20.0	20.0	20.0
Manufacturing industries not elsewhere classified	11.5	12.1	12.3	13.6	13.4	13.6	13.6

Source: Customs tariff, UN ComTrade database, IER estimates

Annex C. Special economic zones and territories of priority development

Table C1

The list of major privileges, provided to the investors at special economic zones (SEZ)

Name of SEZ	Regimes of special custom zone	Exemption from EPT	Exemption from import duty and VAT	Exemption from obligatory sale of foreign currency	Land tax exemption	Exemption from extra-budgetary obligatory contributions
Azov	yes	Rate -20%	-	yes	yes (For the period of the land plot)	yes
Donetsk	yes		-	yes		yes
Zakarpatye	yes	yes (5 years), following –50%	-	yes	-	yes
Yavoriv	-		yes (5 years)	-	yes (3 years),	yes
Avtoport	yes		yes	-	following – 50%	yes
Krakovets						
Slavutich	-	yes (3years), from 4 till 6 year– 50% of statutory rate	yes(5 years)	yes	yes (3 years), from 4 till 6 – 50% of statutory rate	yes
Kurortopolis Truskavets	-		yes	yes	yes (period of implementation) next 10 years – 50 % of statutory rate	-
Porto Franko	yes	yes(3years), from 4 till the year 6– 50% of statutory rate, from the year 4 till 10 - reinvestment	-	yes	-	-
Reni	yes		-	yes	-	yes
Port Krym	yes		-	yes	yes(5 years)	yes
Interport Kovel	yes		-	yes	yes(5 years)	yes
Mykolayiv	yes(only for territories of ship building plants)		yes(5 years)	yes	yes(5 years)	-

Source: Ukrainian legislation

Table C2

The major privileges that are provided to the investors at the territories of priority development (TPD)

Name of TPD	EPT exemption	Exemption from import duty and VAT	Exemption from obligatory sale of foreign currency	Exemption from land payment	Exemption from extra-budgetary obligatory contributions
Donetska oblast		yes (for the period of implementation)	-	-	yes
Luhanska oblast			-	yes (5 years)	yes
Zakarpatska oblast			-	-	yes
Crimea			yes		yes
City Shostka, Sumska oblast	yes (3 years) from 4 till 6 year – 50% of statutory rate	yes (5 years)	-		-
Zhytomyrska oblast			-	yes (5 years)	-
City Kharkiv			-		-
Chernihivska oblast			-		-
Volynska oblast			-		yes

Source: Ukrainian legislation

Annex D: Market price support estimate

Table D1

Market price support estimate

	Units	2002	2003	2004
Level of production (refined equivalent)	KMT	1,557	1,588	
Producer price (at farm gate, refined equivalent)	UAH/MT	1,189	1,183	
Value of production (at farm gate, refined equivalent)	UAH m	1,851	1,879	
Reference price (at farm gate, refined equivalent)	UAH/MT	803	715	
Border reference price (f.o.b. or c.i.f.)	Euro /MT	242	191	
Official exchange rate	UAH / Euro	5.03	6.03	
Market price differential	UAH/MT	386	468	
Market Price Support (MPS)	UAH m	601	743	
TRQ	KMT	-	360-200	125
Import Duty: in-quota	Euro /MT	-	30	30
Over-quota	%	50	50	50
Total	UAH m	601	743	

Source: OECD (2004)¹²⁴

In 2000 the government of Ukraine introduced a tariff-rate quota (TRQ) on raw sugar imports at the level of 260.000 MT, with within quota and over quota duties. As a result, consumers subsidize through inflated prices domestic sugar producers by additional USD 65-125/MT or 16-38% of the c.i.f. price.

¹²⁴ OECD (Organization for Economic Co-operation and Development), (2004a): Achieving Ukraine's Agricultural Potential. Stimulating Agricultural Growth and Improving Rural Life, Paris <http://www.oecd.org/dataoecd/39/31/34031855.pdf>.

Annex E: Country List

Table E1

Aggregation of countries into trade regime and major trading partner

Trade regime	Region	Country	UN country code
1. Free trade	1. Russia	Russia	643
	2. CIS (excl. Russia)	Armenia	51
		Azerbaijan	31
		Belarus	112
		Georgia	268
		Kazakhstan	398
		Kyrgyzstan	417
		Moldova	498
		Tajikistan	762
		Turkmenistan	795
		Uzbekistan	860
	3. Baltic countries	Estonia	233
		Latvia	428
		Lithuania	440
2. MFN tariff rates	1. EU-15	Austria	40
		Belgium	56
		Denmark	208
		Finland	246
		France	251
		Germany	276
		Greece	300
		Ireland	372
		Italy	381
		Luxemburg	442
		Netherlands	528
		Portugal	620
		Spain	724
		Sweden	752
		UK	826
	2. NMC-5	Czech Republic	203
		Hungary	348
		Poland	616
		Slovakia	703
		Slovenia	705

Trade regime	Region	Country	UN country code
3. Full tariff rates	3. Other Europe	Bosnia and Herzegovina	70
		Bulgaria	100
		Croatia	191
		Macedonia ¹²⁵	807
		Romania	642
		Serbia and Montenegro	891
		Switzerland	757
	4. Asia	China	156
		Hong-Kong	344
		India	699
		Indonesia	360
		Iran	364
		Israel	376
		Japan	392
		Korea (North)	408
		Lebanon	422
		Macao	446
		Mongolia	496
		South Korea	410
		Sri Lanka	144
		Syria	760
		Turkey	792
		United Arab Emirates	784
	5. America	Argentina	32
		Brazil	76
		Canada	124
		USA	842
	6. Africa	Algeria	12
		Egypt	818
		Tunisia	788
	1. NMC-2	Cyprus	196
		Malta	470
	2. Rest of the World	All other countries	

¹²⁵ Formally, Ukraine and Macedonia signed a free trade agreement. However, this agreement has so many exemptions, that for the purpose of this study trade relations between Ukraine and Macedonia are treated as MFN.