



MEMU Supplement No.11-2006

What are the economic costs of recent grain export restrictions?

On September 28 the Ukrainian government introduced licensing¹ of grain exports. Officially, the restrictions are aimed to secure supply of domestic markets. In practice, this measure led to a complete stop of grain exports. The Ukrainian Grain Association claimed that no single license for exports has been issued as of October 10. Wheat has not been shipped for export, with ships standing idle in Ukraine's Black Sea ports, accumulating charges at a rate of about USD 30,000 per vessel a day.

The background of this measure relates to rising world market prices for grain and the Government desire to buy grain for reserves at discounted price. The wheat world market prices increased from about USD 130 to 200 during last months. The Government asked grain-trading companies to sell 300,000 tons of wheat to the strategic reserve at a discount of about USD 15 to the prevailing price. The grain traders, including international investors such as Cargill, ADM-Toepfer and Bunge, refused².

Following these discussions on October 11 the Government introduced export quotas for wheat, barley, corn and rye until December 31³. According to the Government resolution, the quota on wheat exports will be 400,000 tons, barley 600,000 tons, corn 600,000 tons, and rye 3,000 tons. These quota levels are clearly far less than actual potential export volumes. For example, in September 0.86 m tons of wheat and 1.2 m tons of barley were exported.

The economic costs of this policy for Ukraine could be high. In all probability, the ultimate impact of this measure will be to reduce farm gate prices and farm income. In the short run export licensing and later on quotation has greatly increased uncertainty on grain markets in Ukraine and caused huge losses to traders. Higher uncertainty and losses increase the risk premium that traders must include in their margin calculations when negotiating with farms to purchase grain. In other words, traders roll over their revenue losses to farmers. So the farmers will pay the price at the end.

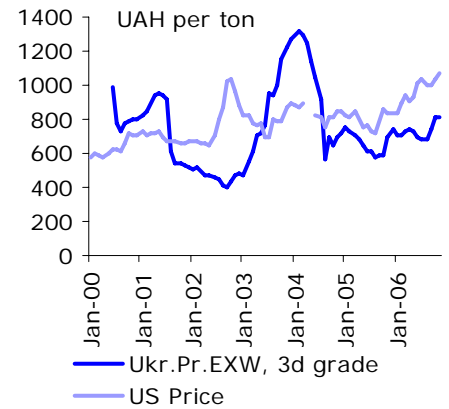
On the other hand, grain processors, compound feed producers and the livestock sector (pig and poultry branches) might benefit from lower farm-gate prices and more available grain in the short run. However, this benefit won't be sustainable, since it is hardly likely that domestic flour or fodder producers would produce more economic value than domestic or international grain traders. Grain processors and fodder producers reap the benefits of export restrictions at the expense of farmers and traders. Additionally, market transaction costs are increasing. There is empirical evidence that Ukraine pays by forgone welfare for this. This means that every ton of grain that is not exported by efficient traders, but instead goes at discount to domestic markets, makes the country overall poorer.

The most important consequence is that in the long run these measures send a clear message to the rest of the world that Ukraine's commitment to market-oriented reform of its grain markets is wavering. The policy measure is not in line with the intention to become WTO member.

It also sends a clear message to investors and grain importing countries that the policy change risk in Ukraine is increasing again. Those domestic and international investors who heavily invested in improved grain market infrastructure during the last years are taxed now. The result will be reduced investments, less efficient marketing systems than would otherwise be the case and, hence, lower grain prices for farmers.

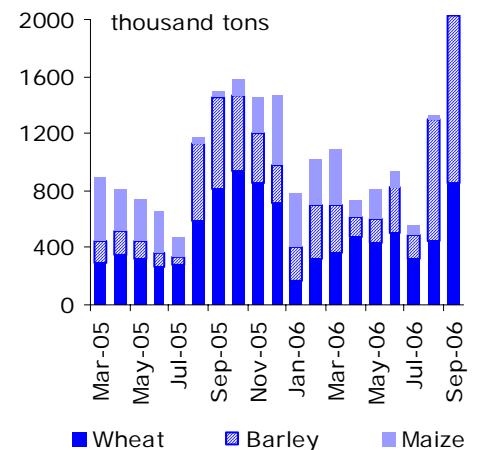
Ukrainian officials should take into account that grain production will be lower by millions of tons next year and in the years to come because of cancelled and delayed investments in Ukrainian agriculture caused by this conflict over 300,000 tons of grain.

Wheat prices on the world and domestic markets



Source: APK-inform

Ukraine's export of barley, maize and wheat



Source: Ukragroconsult

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¹ Cabinet of Ministers Resolution No.1364

² Financial Times, London, UK, Wednesday, Oct 11, 2006

³ Cabinet of Ministers Resolution No.1418



Quarterly trends

National accounts **		Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06
GDP	UAH bn	64.7	79.0	100.5	100.6	84.3	97.5	119.4	123.6	102.0	122.8	...
GDP (real)	% yoy	12.7	13.7	14.0	8.5	4.9	3.4	1.4	1.7	3.2	7.3	...
Households consumption (real)	% yoy	14.6	16.8	13.1	16.2	14.3	17.7	17.0	17.1	19.7	19.9	...
State consumption (real)	% yoy	3.3	1.0	5.0	10.1	6.1	0.0	1.0	4.0	2.0	7.3	...
Gross fixed capital formation (real)	% yoy	18.4	6.5	4.6	12.9	-2.3	-0.5	0.2	0.3	8.2	10.4	...
Exports of goods and services (real)	% yoy	18.1	19.9	10.5	8.6	-0.6	-14.0	-12.7	-15.5	-19.9	-11.2	...
Imports of goods and services (real)	% yoy	13.8	7.3	6.7	7.8	2.8	3.2	3.9	-0.9	5.6	1.0	...
Agriculture, hunting, forestry (real)*	% yoy	-4.4	0.9	35.7	9.9	5.8	8.3	2.6	-7.4	4.1	2.9	...
Manufacturing industry (real)*	% yoy	23.9	16.3	12.5	9.4	7.0	1.8	-1.1	2.0	-2.9	5.4	...
Construction (real)*	% yoy	29.9	30.6	16.4	3.9	-8.4	-11.3	-8.5	-7.5	2.6	5.7	...
Trade, repair services (real)*	% yoy	23.6	35.0	2.7	13.7	-2.1	-10.7	-11.7	-11.9	4.1	14.7	...
Transport (real)*	% yoy	10.1	8.0	12.3	10.5	6.6	5.7	2.8	7.8	3.4	9.7	...
Balance of payments												
Current account balance	USD bn	1.4	2.3	2.1	1.1	1.6	0.6	0.4	-0.1	-0.7	-0.4	...
Current account balance	% of GDP	11.1	15.7	10.9	5.7	10.1	3.2	1.7	-0.4	-4.0	-0.2	...
Trade balance in goods	USD m	933	1552	774	482	1020	-236	-1131	-788	-1288	-876	...
Trade balance in services	USD m	133	198	749	157	188	392	1035	191	176	401	...
Current transfers	USD m	475	758	720	623	626	694	745	780	616	782	...
Direct investment (FDI)	USD m	333	614	420	344	247	365	477	6474	662	1410	...
Portfolio investments	USD m	449	149	1313	156	397	923	90	1347	0	-264	...
Gross international reserves	USD bn	7.9	9.6	12.1	9.5	12.0	13.1	14.3	19.4	17.3	17.6	19.1
Fiscal indicators												
Consolidated fiscal revenues	% of GDP	27.2	26.9	26.3	25.9	32.1	35.1	31.5	31.0	35.3	34.7	38.1
Personal income tax	% of GDP	4.4	4.1	3.8	3.8	4.3	4.4	3.9	4.2	4.9	5.0	4.8
Enterprise profits tax	% of GDP	3.9	4.0	4.1	6.1	4.8	5.9	5.3	6.3	3.8	5.0	5.1
Value-added tax	% of GDP	6.2	5.7	5.1	4.1	8.6	9.2	7.9	7.3	10.4	10.1	11.6
Excise tax	% of GDP	2.1	2.1	2.0	1.8	2.0	2.0	2.0	1.7	2.0	1.8	1.8
Consolidated fiscal	% of GDP	25.3	26.5	26.8	35.2	28.3	36.4	28.1	41.7	35.0	36.1	35.2
Current expenditures	% of GDP	22.4	22.7	21.7	27.2	26.5	33.6	24.0	34.2	32.8	32.6	29.8
Capital expenditures	% of GDP	2.9	3.8	5.1	8.0	1.8	2.7	4.1	7.5	2.2	3.5	5.4
Consolidated fiscal balance	% of GDP	1.9	0.4	-0.5	-9.3	3.7	1.0	-5.0	6.2	-0.4	-1.2	2.1
Privatisation receipts	% of GDP	1.5	3.7	3.5	1.0	0.2	0.6	0.6	16.0	0.1	0.1	0.1
Labour market												
Average wage (real)	% yoy	19.9	18.6	14.7	15.4	15.0	19.0	19.6	26.4	23.8	22.6	18.8
Household income (real)	% yoy	11.7	16.3	11.3	16.6	24.0	28.0	19.4	18.9	22.1	18.6	20.3
Unemployment rate (ILO methodology)	%	9.3	8.3	8.1	8.7	8.7	7.1	5.2	7.8	7.9	6.9	...
Banking system												
Monetary aggregate M0	% yoy cum	29.1	25.6	37.1	27.9	28.2	39.1	31.1	42.2	36.2	25.3	23.7
Monetary aggregate M2	% yoy cum	45.4	44.8	51.5	32.3	38.9	37.4	31.3	53.9	39.2	36.6	36.7
Household deposits in national currency	% yoy cum	69.4	67.3	67.9	26.2	28.3	31.6	30.4	90.8	54.6	41.1	39.7
Household deposits in foreign currency	% yoy cum	67.0	61.7	55.2	54.3	51.8	45.4	46.4	59.1	54.5	66.2	64.3
Com. bank credits in national currency	% yoy cum	56.8	52.1	44.3	29.4	28.3	32.6	43.4	58.7	59.8	53.7	49
Com. bank credits in foreign currency	% yoy cum	63.6	56.2	43.5	32.2	33.1	36.8	47.1	66.3	72.0	82.1	90.4
Long-term com. bank credits	% yoy cum	141.7	102.7	82.7	57.1	49.5	53.0	70.1	84.6	87.6	86.7	76.6
Long-term com. bank credits	% of total	47.4	49.3	50.9	54.2	54.4	56.1	59.7	61.8	63.1	63.4	63.5
Average lending rate on national cur. credits	% p.a.	17.2	16.6	17.0	17.6	17.0	15.4	15.4	16.4	15.8	15.5	14.6
Average lending rate on foreign cur. credits	% p.a.	12.2	12.1	12.6	12.2	12.1	11.0	11.3	11.7	11.5	11.3	11.3

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

* change in value added

** preliminary

Notes:

yoy year on year change

p.a. per annum