Impact assessment of a possible change in Russia's trade regime vis-a-vis Ukraine

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Summary

- Russia might change its trade regime vis-a-vis Ukraine from the current free trade regime to Most-Favoured-Nation (MFN) status
- In such a case, Russian average import tariffs for Ukrainian goods would increase from 0% to 10.6%
- As a result, based on data from 2010-2012, Ukrainian exports to Russia would decrease by 17% or USD 3.0 bn per year
- The decrease in exports to Russia would have a negative short-term impact on Ukraine, amounting to 1.7% of annual GDP
- The most affected product groups would be:
  - Minerals
  - Based metals
  - Transport equipment
  - Machinery
  - Finished foods
- <u>Thus</u>: The impact on the Ukrainian economy would be significant

Contents

I. Introduction

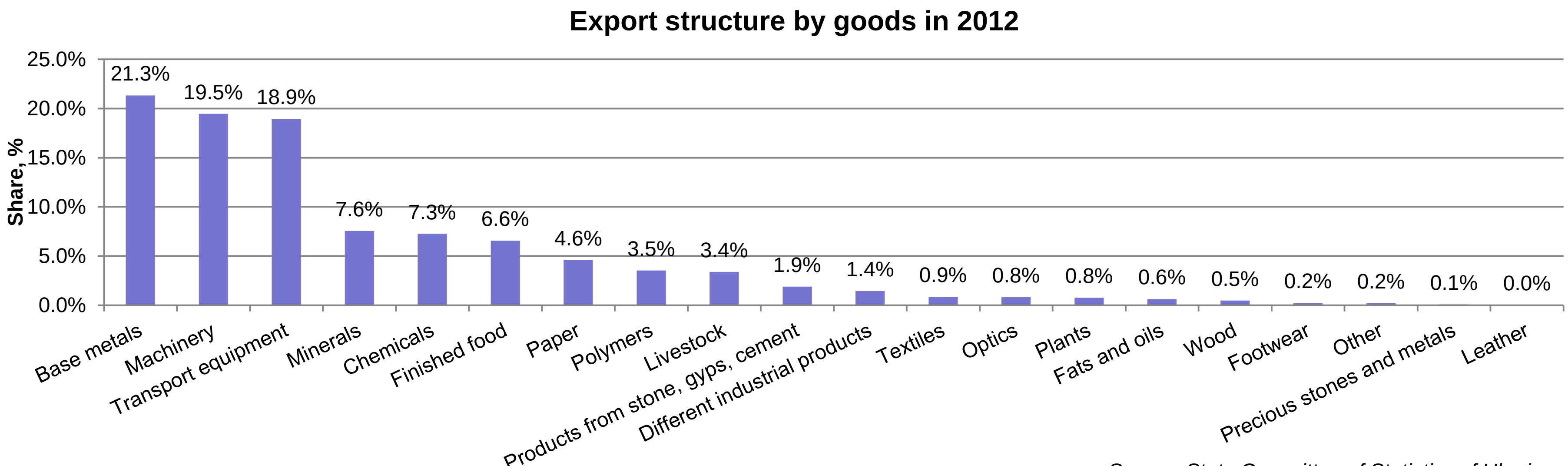
- The Russian Federation might unilaterally change its trade regime with Ukraine from the current free trade regime to Most-Favoured-Nation ("MFN") status

- The likelihood for such a change might increase in case Ukraine signs an Association Agreement/DCFTA with the EU at the end of November 2013 in Vilnius

- In this policy brief we present the results from our estimation of the economic impact (i.e. the short-term effect) of such a change on the Ukrainian economy

II. Structure of Ukraine's exports to Russia (goods)

- Exports to Russia amount currently to roughly 25% of total exports of goods
- Main products: base metals, machinery, transport equipment, minerals, chemicals and finished food



Source: State Committee of Statistics of Ukraine

III.a. Current trade regime: Bilateral FTA (1993)

- In 1993, Russia and Ukraine concluded a bilateral Free Trade Agreement (“FTA”)
- The focus of the FTA lies on trade in goods; it does not cover trade in services and other trade-related questions
- Aimed at the establishment of duty-free trade in goods
- Products removed from FTA are subject to MFN regime
- There are two types of exemptions:
  - Reciprocal exceptions are applied as an answer to export duties, quotas and licenses by a trading partner
  - Explicit exemptions stipulated in separate protocols
- Trade defence measures are allowed

Current trade regime: Regional CIS FTA (2011)

- In 2011, the Commonwealth of Independent States concluded a regional Free Trade Agreement (“CIS FTA”)
- The CIS FTA focuses on trade in goods; it doesn’t cover trade in services and pays limited attention to other trade-related questions
- The CIS FTA has retained most of the bilateral trade exemptions related to import and export duties from the bilateral FTA of 1993
- Specific features of CIS FTA:
  - Does not support reciprocity principle in exemptions
  - Contains explicit list of import and export duties and commitment not to increase them; moreover, any reduction in export duties provided to the third party is to be applied to all signatory parties of the CIS FTA, unless this advantage is provided in the framework of other regional trade agreement
  - Postulates that trade in goods within the CIS will be governed by WTO rules and practices
  - Provides a mechanism for solving trade disputes, including timeline for trade dispute resolution

Regional CIS FTA (2011): Annex 6

- According to Annex 6 of CIS FTA, the Customs Union between Russia, Belarus and Kazakhstan (“CU RBK”) can apply MFN tariffs to Ukraine if:
  - Ukraine participates in another FTA, e.g. in the forthcoming DCFTA with the EU or the already enacted FTA with EFTA
  - Participation in these FTAs lead to an increase in Ukraine’s exports to the CU RBK, and
  - The additional exports damage or threaten to damage the industry of the CU RBK
- Only the CU RBK can apply this norm
- Introduction of the MFN rates doesn’t require an investigation of causality and can be implemented after consultations

Trade defence measures

Trade defence instruments applied by Russia on Ukraine's exports

	Trade defence measures	Trade defence investigations
Antidumping	3	-
Safeguard	3	2
Total	***6***	***2***

Trade defence investigations

Goods	Investigation period
SAFEGUARD MEASURES	
Porcelain table- and kitchenware	10.2011-11.2014
Fabrics of chemical fibers and yarns	10.2011-03.2014

Trade defense measures

Goods	Applied measures	Application date
ANTIDUMPING MEASURES		
Pipes (of small and medium diameter)	Ad valorem duty of 18.9-37.8%	10.2011-11.2015
Nylon industrial thread	Ad valorem duty of 11.6%	10.2011-09.2013
Steel forged mill rolls	Ad valorem duty of 26%	02.2012-05.2016
SAFEGUARD MEASURES		
Stainless steel pipes	Quota of 5784 tonnes	10.2011-11.2014
Machine-building fasteners	Specific duty of USD 282.4/tonne	10.2011-03.2014
Caramelized products	Specific duty of USD 294.1/tonne	01.2012-06.2014

Trade defence measures:

- Anti-dumping measures
- Safeguard measures

- As of November 2013, Russia applies 6 trade defence measures (3 antidumping and 3 safeguard) against Ukraine’s goods and conducts 2 safeguard investigations

Current Trade Regime: Customs Union RBK

- The formation of the Customs Union between Russia, Belarus and Kazakhstan ("CU RBK") started on January 1, 2010 with the implementation of common tariff scheme
- On July 6, 2010 the Customs Code of CU RBK came into force and in mid-2011 a common border control in the CU RBK was established
- Bilateral FTAs concluded by Russia, Belarus and Kazakhstan with the third parties remain in force until they are renegotiated by the CU Commission

Current Trade Regime: WTO framework

In 2012, Russia joined the WTO; all WTO agreements and commitments should be expanded to the whole CU RBK

Specific Russia's commitments are:

- Improved market access (MFN rate 20% lower now)
- Improved market access for services
- Ceiling on export duties
- Cap on trade distorting agricultural subsidies
- Energy pricing based on normal commercial considerations
- Alignment of development and application SPS measures with the WTO SPS Agreement and other international norms
- Alignment of technical regulation system with WTO TBT Agreement
- Improved protection of trade-related intellectual property rights
- Increased transparency

III.b. Potential change to the trade regime

- CU RBK intends to strengthen its domestic market protection in the near future

- ***Legal basis:*** Draft of Eurasian Economic Commission Board Decision "On the application of response measures against systemic violations of tariff preferences conditions by third countries"

- ***Motivation:*** Risk of tariff-free shipments of European goods through Ukraine to the CU RBK market due to Ukraine's intention to sign a DCFTA with the EU

- In "third countries" (e.g. Ukraine) certificates of origin are issued by non-governmental organizations, which do not have the authority to conduct on-site audits, which creates room for duty-free imports of non-eligible goods to CU RBK market

Possible measures

- Consultations with exporting countries
- Closer monitoring of shipments from these countries resulting in shipment delays
- Conduction of on-site audit in exporting countries subject to their consent, resulting in additional expenditures for exporters
- ***Measure of last resort:*** Temporary suspension of the acceptance of certificates of origin, which implies a blocking of duty-free imports and the introduction of MFN tariffs (scenario depicted in this policy briefing)

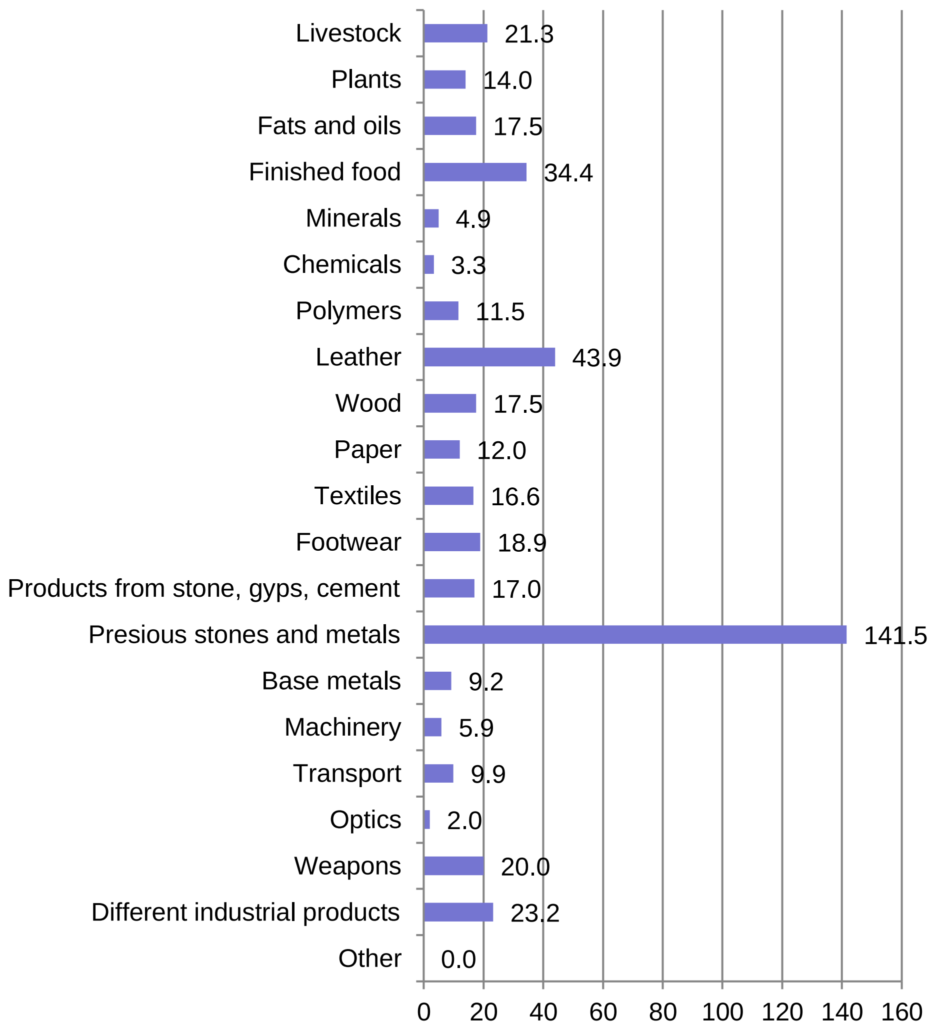
IV.a. Assessment: Methodology and data

- ***Modeled scenario***:
  - Russia rises its import tariffs vis-à-vis Ukraine from zero (assuming that all goods are imported duty-free) to MFN level
  - Only tariff measures are considered; a possible increase in non-tariffs barriers is not depicted in this scenario
  - *Note*: In the modeled scenario only Russia, not the CU RBK, increases tariffs vis-à-vis Ukraine. Strictly speaking, only the CU RBK should be able increase tariffs against Ukraine.
- ***Methodology:***
  - For assessment of changes in exports: SMART partial equilibrium modeling tool
  - For assessment of changes in GDP: IER forecasting tool
- ***Data***:
  - Current Russian MFN tariff schedule (TRAINS)
  - Statistics on Russian imports of Ukrainian goods over 2010-2012 aggregated at 6-digits of HS 2007 classification (UN Comtrade)
  - Russian import demand elasticities (TRAINS)
- ***Note***:
  - Mirror statistics effects are not taken into account in the calculations

Weighted MFN tariffs

- Using actual Russia's MFN tariff schedule and data on Russia's imports from Ukraine in 2010-2012, we obtained the following weighted tariffs for HS 2-digit tariff lines

- Thus, precious stones and metals, leather and finished food will be subject to the highest import tariffs



IV.b. Assessment of the general impact

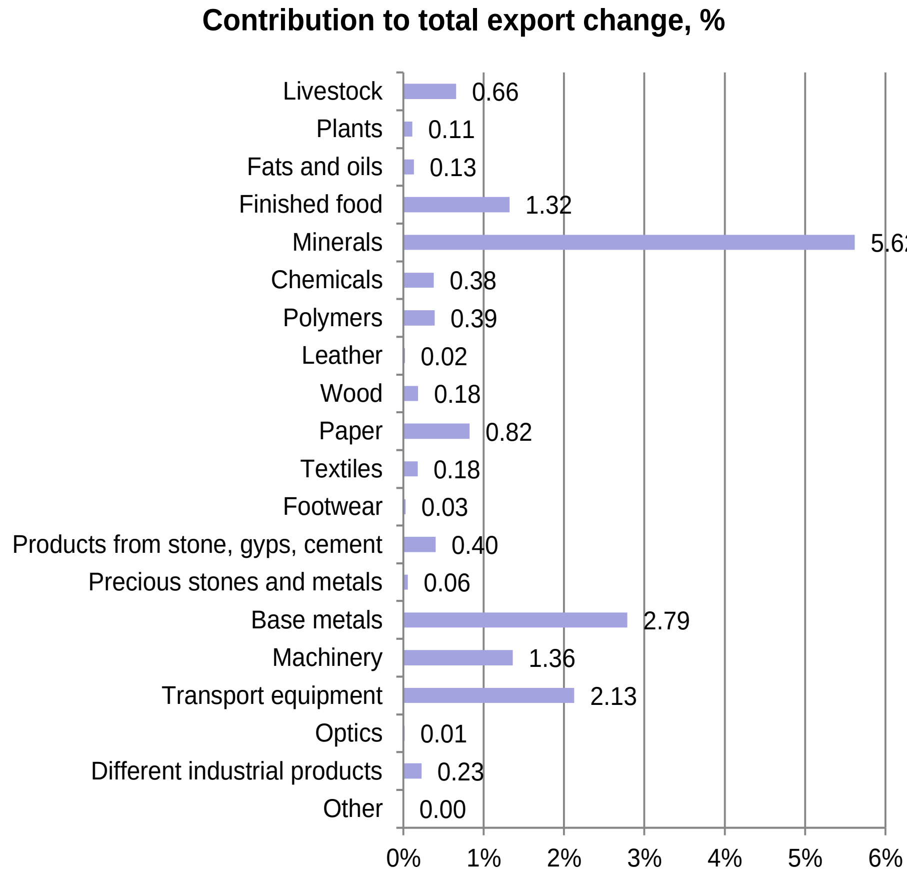
Impact on total exports to the Russian Federation

Trade structure	Change, USD bn	Change, %	Average tariff, %	Weighted tariff, %	Number of 6-digit tariff lines, where trade stops
2010	-2.4	-17.3	10.95	11.05	130
2011	-4.0	-20.2	10.55	10.16	128
2012	-2.4	-14.3	10.17	10.80	127
Average	**-3.0**	**-17.4**	**10.53**	**10.62**	**128**

<u>Results based on average for the period 2010-2012</u>

- Average tariff increase from 0% to 10.5%
- Weighted tariff increases from 0% to 10.6%
- Exports to Russia decrease by 17% or USD 3.0 bn
- Negative (short-term) impact on Ukraine's GDP amounts to 1.7%

Assessment of results by products



The most affected product groups are minerals, base metals, transport equipment, machinery and finished food.

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