



Bundesministerium für
Ernährung, Landwirtschaft
und Verbraucherschutz

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

Policy Paper Series [AgPP No. 28]

Social Protection of the Population by Regulation of Food Prices and Trade Margins – Does the Law No. 1447-VI Achieve its Objectives?

Justyna Jaroszevska
Serhiy Kandul
Wolfram Rehbock
Dr. Heinz Strubenhoff

Kyiv, November 2009

About the Institute for Economic Research and Policy Consulting

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

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

Institute for Economic Research and Policy Consulting

Reytarska 8/5-A,
01034 Kyiv, Ukraine
Tel: +38 044 / 278 63 42
Fax: +38 044 / 278 63 36
institute@ier.kiev.ua
<http://www.ier.kiev.ua>

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

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

German-Ukrainian Policy Dialogue in Agriculture

Reytarska 8/5-A,
01034 Kyiv, Ukraine
Tel: +38 044 / 235 75 02
Fax: +38 044 / 278 63 36
agro@ier.kiev.ua
<http://www.ier.kiev.ua>

List of Recent Policy Papers

- Financial Crisis and Ukrainian Agriculture: Impact and Response, by Serhiy Kandul, Policy Paper AgP27, November 2009
- Options for Ukraine with regard to its National Policy towards GMOs: the EU or US Model?, by Justyna Jaroszewska, Policy Paper AgP25, June 2009
- Agroholdings in Ukraine: Good or Bad?, by Serhiy Demyanenko, Policy Paper AgP21, September 2008
- The EU Dairy Market – Real Opportunities for Ukraine?, by Sebastian Hess, Bernhard Voget and Mariya Ryzhkova, Policy Paper AgP19, September 2008
- The International Financial Crisis: Risks and Policy Implications for Ukraine, by Ricardo Giucci, Robert Kirchner and Veronica Movchan, Policy Paper W13, February 2008
- Ukraine and the UEFA EURO 2012 How to secure its economic potential, by Ferdinand Pavel, Natalia Sysenko, Policy Paper W12, December 2007
- Financing GHG Emission Reduction Projects in Agriculture in Ukraine – Use Options for Markets Related to the Kyoto Protocol, by Anna Lehmann, Tetyana Zhelyezna, Alexander Filonenko, Policy Paper AgP15, November 2007
- Housing Prices in Ukraine: Trends, analysis and policy implications, by Ricardo Giucci, Robert Kirchner, Inna Yuzefovych and Yaroslava Suchok, Policy Paper W4, August 2007
- Legal and Institutional Aspects of Agricultural Land Markets in Ukraine, by Max Fedorchenko and Alex Yanov, Policy Paper AgP13, May 2007
- The World Biofuel Boom and Ukraine – How to Reap the Benefits, by German-Ukrainian Policy Dialogue in Agriculture, Policy Paper AgP7, February 2007
- Restructuring of the Sugar Sector in Ukraine, by Oleg Nivievskiy and Heinz-Wilhelm Strubenhoff, Working Paper AgWP1, May 2006

All papers can be downloaded free of charge under http://www.ier.kiev.ua/English/papers/papers_eng.phtml. For more information on subscription to our regular email-distribution, please contact Ms Iryna Slavinska by email: slavinska@ier.kiev.ua.

Executive Summary

The Ukrainian Government and Parliament are trying to limit the negative consequences of the financial crisis on the Ukrainian population by various policies and legal initiatives. On June 4, 2009, the Ukrainian Parliament adopted the Law No. 1447-VI limiting trade margins, reducing payment terms of suppliers and reducing contractual arrangements between suppliers and wholesalers and retailers in the agriculture and food sector. The Law is limiting trade margins to 20 % over the whole value chain from the agricultural producer to the processor to the wholesale trader and finally to the shop. Law makers expect from this law to keep food prices at low levels, to fight inflation and to fight monopolies in the food distribution chain.

This policy paper is assessing the impact of this particular law on investments, producers, traders and consumers from a legal and an economic point of view. Does the law achieve its objectives? If not, would there be alternative approaches available? To provide insights and to develop recommendations the team is assessing in the first part of the paper the legal impact of the law. In the second part the economic impact will be assessed. The paper ends with an outline of policies providing more competition and thus cheaper food products for the population.

The Law is likely exceeding the constitutional authority of the Parliament. The Constitutional Court in its rulings of March 2, 1999 and February 10, 2000, delimited the jurisdiction of the Parliament and the Cabinet of Ministers with regard to state pricing policy: the Parliament determines the principles of domestic policy, including pricing policy (point 5 of Article 85 of the Constitution) while the Cabinet of Ministers is responsible for ensuring the implementation of pricing policy (point 3 of Article 116 of the Constitution). The latter involves the realization of the principles set by the Parliament and application of specific prices and tariffs, which logically includes also their concrete regulation - the Court ruled. Thus, according to the Court, the Parliament has interfered with the jurisdiction of the Cabinet of Ministers by direct regulation of prices, because it violates Articles 6, 19 and 116 of the Constitution. According to this ruling the Parliament should have left the introduction of the limit 20% trade mark-up to the Cabinet of Ministers. However, unless and until the provisions of the Law are found unconstitutional by the Constitutional Court of Ukraine, wholesale and retail sellers of the goods list of which is defined by the Law as well as their suppliers should follow all its provisions. Otherwise, they would risk fines established by the Law.

The law strongly intervenes in price formation on free markets. Investment climate, costs of doing business and competitiveness of Ukraine will be negatively affected; Ukraine's international ranking will further deteriorate and inflow of highly needed foreign capital will decline further. Moreover, domestic investors which currently pay the highest risk premiums in Europe may have to pay even more leading to less domestic investment and higher unemployment.

Large holdings and companies producing, processing and selling in a vertically integrated structure do have an advantage. Small producers, small traders and small shop keepers do have a disadvantage. In particular fresh produce (fruit and vegetables, meat and dairy products) is in high demand by wholesale and retail traders. This offers excellent opportunities for smaller producers able to organize themselves in producer groups to offer the required quantities and qualities to traders. The establishment of producer groups is one of the priority goals of the Ukrainian Government. The development of producer groups jointly grading, packaging or processing would be severely constrained by officially fixed price margins. Limitation of competition to large suppliers would inevitably lead to higher sales prices which would be rolled-over to the consumer. So, consumer prices may finally increase.

The mark-up of 20 % will not compensate all trading costs if the value chain covers many small producers, processors and traders and if production is spread all over the country. Their choice would be to either ignore the Law, increase trade margins and develop grey schemes, or to limit their product range and to increase transaction volumes. Big retail and

wholesale market chains will certainly limit their transactions and favor big agricultural holdings providing a full range of needed services around the end-product including logistics, promotional and advertising services, and quality control. Consequently supply to wholesale and retail traders will be reduced. Instead of enhancing competition supply would be monopolized by large suppliers.

The consequences of buyers' obligation to pay 7 days after the purchase seems highly questionable. Retail traders with a broad product range and various fresh and canned consumer goods may have practical problems to comply with the requirements of the Law. It may force retail traders to the introduction of new accounting systems: again favoring the biggest and financially strongest players in the market. Faster payment will follow if competition will be improved as on the grain market where quick payment is the rule.

Recommendation: The Law will most likely not achieve its objectives and should therefore be abolished!

Authors

Justyna Jaroszewska	Jaroszewska@ier.kiev.ua	+38044 278 6342
Serhiy Kandul	Kandul@ier.kiev.ua	+38044 278 6342
Wolfram Rehbock	Wolfram.Rehbock@arzinger.ua	+38044 390 5533
Dr. Heinz Strubenhoff	Strubenhoff@ier.kiev.ua	+38044 235 7502

Acknowledgement

This Policy Paper has been produced with support from Kyiv law firm Arzinger providing valuable analysis, comments and discussion

Table of Contents

1. BACKGROUND, SCOPE AND PURPOSE OF THE PAPER.....	7
2. OBJECTIVES AND CONTENTS OF THE LAW	7
3. RELATED LAWS	9
4. ASSESSMENT OF THE LAW	10
4.1 LEGAL ASSESSMENT	10
4.2 ECONOMIC ASSESSMENT	13
4.2.1 <i>Impact on Investments</i>	13
4.2.2 <i>Impact on Agricultural Producers and Wholesale and Retail Traders</i>	14
4.2.3 <i>Impact on Consumers</i>	15
5. CONCLUSIONS AND RECOMMENDATIONS	15
6. ANNEX - SELECTED RELATED LEGAL ACTS	17

Disclaimer:

This paper was prepared by the authors using publicly available information and data from various sources. All conclusions and recommendations included in this paper in no circumstances should be taken as the reflection of policy and views of the German Federal Ministry of Food, Agriculture and Consumer Protection.

© 2009 German-Ukrainian Policy Dialogue in Agriculture
© 2009 Institute for Economic Research and Policy Consulting

All rights reserved.

1. Background, Scope and Purpose of the Paper

On 4 June 2009, the Ukrainian Parliament adopted the law No. 1447-VI "On amendments to certain laws of Ukraine respecting improvement of state regulation of agricultural market". This law intends to (i) limit trade margins in the whole food value chain from producers to consumers to 20 %, (ii) reduce contractual arrangements between producers and wholesale and retail traders to pure purchase and sales contracts, (iii) limit payment terms to 7 days after sale of goods.

This specific law is an example of recent Government policies trying to reduce the negative consequences of the financial and economic crisis on the Ukrainian population, in particular on the poor. Policy and law makers state in various communications to the public that "market regulation" and "hand-steering" of economic activities would keep food prices at low levels, fight inflation, and increase competition in agriculture and food trade. In particular traders are regularly criticized by Government officials to exploit market opportunities in a non-competitive way. Therefore, they argue, prices and trade margins need to be regulated. Market participants, however, are questioning the effectiveness of these Government measures. They argue that the food markets would instead need less regulation and hand-steering to stimulate competition. This would then lead to steady and cheap supply of food. Economists argue that the agriculture and food sector would need additional structural reforms that have been postponed too long to attract new capital and investment to raise efficiency of the food chains to European levels. This would include adequate policy measures to enhancing transparency and competition, improving the investment climate, and accelerating deregulation and institutional reforms to fight corruption. These measures would greatly increase the visibility of the commitment of the Government to the rule of law and market economy and would send positive signals to potential domestic and international investors.

The purpose of this paper is to assess the effectiveness of this specific law in a broader sense. Does the law respect the Government commitment to the rule of law and market economy? Does the law lead to the intended objectives? If not, would there be alternative policy instruments and scenarios available?

To provide insights into the above questions a team consisting of legal experts and economists from the Institute for Economic Research and Policy Consulting and the Kyiv law firm Arzinger has been established. In a first step the team looks at the contents of the law and is assessing its legal impact. In a second step the economic impact of the law on producers, traders and consumers will be assessed. The paper ends with an outline of alternative approaches to reach the intended objectives of the law.

2. Objectives and Contents of the Law

What the Law is about

The law of Ukraine No. 1447-VI "On amendments to certain laws of Ukraine respecting improvement of state regulation of agricultural market" (referred to further as "the Law" or "the Law No. 1447") was adopted by the Verkhovna Rada on 4 June 2009. The Law has amended the law "On insurance"¹ and the law "On state support to agriculture of Ukraine"².

In particular, Chapter II (Articles 3 - 9) of the latter, which deals with state price regulation of specific types of agricultural products, has been amended. These particular amendments came into force on the day of the Law's publication, i.e. on 15 July 2009.

Objectives of the Law

Objectives of the Law are not formulated in the Law itself. However, we can deduce from related laws and current statements of policy and law makers that Ukrainian lawmakers have pursued the goal of social protection of the population, in particular the poor, by

¹ The law of Ukraine No. 85/96 "On insurance" of 7 March 1996.

² The law of Ukraine No. 1877 "On state support to agriculture of Ukraine" of 24 June 2004.

achieving price stability in the period of the economic and financial crisis, which should also help to combat inflation. We may also deduct that law makers aimed at strengthening competition in the food value chain and fight monopolies.

Main points of the Law

- 1) new version of the list of goods subject to state price regulation and new measures in the field of price regulation (see below for details);
- 2) amendments to the terms' definitions;
- 3) amendments to regulations on the operation of the Agricultural Fund, including the prohibition of purchase of imported goods for financial interventions;
- 4) creation of the state intervention fund for the objects of state price regulation, which shall be not less than 20% of the volume of their annual domestic consumption in the last marketing period;
- 5) amendments to regulations on the operation of the agricultural insurance market;
- 6) amendments to regulations on credit subsidies for agricultural enterprises;
- 7) new version of the list of the objects of budget subsidies, which now includes cattle, pigs, sheep, horses, poultry, rabbits, unprocessed unskimmed milk of extra class category, of higher, of first and second category, wool, cocoons of mulberry silkworm and natural honey;
- 8) new version of the list of the objects of special budget subsidies, which now includes dairy cattle, beef cattle, young cattle, horses, sheep, pigs, bee families, and sericulture produce;
- 9) new Article 17-2, which provides for other types of state support to agricultural producers (e.g. compensation of up to 50% of the value of construction/reconstruction of animal farms).

In this policy paper we limit the scope on those measures related to price regulation.

New measures in the field of price regulation³

- 1) The Law extends the list of the agricultural products – objects of state price regulation⁴. The list includes both primary products and processed products. Listed in sub-point 3.3.1 of Article 3 of the law “On state support to agriculture of Ukraine”, these are:
 - hard wheat,
 - soft wheat,
 - grain mixture of wheat and rye,
 - maize,
 - barley,
 - winter rye,
 - spring rye,
 - peas,
 - buckwheat,
 - millet,

³ Amendments to point 3.3 of Article 3 of the law “On state support to agriculture of Ukraine”.

⁴ The previous list, effective from 1 January 2005 until 15 July 2009, included wheat, grain mixture of wheat and rye, rye, barley, oat, maize, wheat flour or grain mixture of wheat and rye, soybeans not broken only, flax seeds not broken only, rapeseeds not broken only, sunflower seeds not broken only, hops cones fresh or dry, whether or not broken and sugar from sugar beets.

- oat,
 - soybean,
 - sunflower seed,
 - rapeseed,
 - flax,
 - hops cones,
 - sugar from beets (crystal),
 - wheat flour,
 - rye flour,
 - meat and sub-products of animals and poultry,
 - milk powder,
 - butter,
 - sunflower oil.
- 2) For the objects of state price regulation listed in sub-point 3.3.1 of the law "On state support to agriculture of Ukraine", a limit trade mark-up (surcharge) of maximum 20% of the producer's wholesale selling price (or customs value if the product is imported) to the end consumer over the whole value chain has been established.
 - 3) Further, the Law allows only contracts of purchase and sales of agricultural products to be signed between producers (suppliers) of the objects of state price regulation listed in sub-point 3.3.1 and wholesalers/retailers and their subordinated enterprises. Other financial obligations in the contracts are prohibited.
 - 4) Also, the Law obliges wholesalers and retailers to pay suppliers of the objects of state price regulation listed in sub-point 3.3.1 within 7 banking days from the day of receiving revenues from their sale i.e. from the day the commodities were sold.

Fines

For violation of its provisions related to price regulation, the Law envisages fines, which shall be paid upon a decision of the State Inspection on Price Controls to the local budget of the locality where the violator carries out his trade activity. The violator must pay the whole sum of the trade mark-up, received unlawfully, as well as a fine amounting to the double value of sales revenues.

3. Related Laws

Commercial Code of Ukraine No. 436-IV of 16 January 2003

Its Article 12 perceives regulation of prices and tariffs as one of the main mechanisms of the state's regulatory influence on enterprises' activities. Pursuant to Article 19 of the Code, the state is authorized to carry out control and surveillance over economic activities of enterprises as to their observance of state prices for products and services.

According to Article 191 of the Code, state regulated and fixed prices may be set for resources that have a dominant impact on the general level and dynamics of prices and for commodities and services of substantial social significance for the population. The list of such resources, products and services shall be determined by the Cabinet of Ministers.

Law of Ukraine No. 507-XII "On prices and pricing" of 3 December 1990⁵

⁵ The law No. 507-XII is supposed to be replaced by the draft law No. 5152 "On amendments to certain laws of Ukraine with regard to pricing" of 22 September 2009. Submitted by the Cabinet of Ministers, it includes a new text of the law "On prices and pricing". The objective of the state pricing policy shall be, inter alia, to secure social guarantees in case of price increases (Article 4). Regulated prices may be introduced for commodities that have a dominant impact on the general level and dynamics of prices as well as for commodities of substantial social significance (Article 10). The list of such commodities shall be approved by the Cabinet of Ministers. The draft law stipulates the following mechanisms of price regulation by the Cabinet of Ministers, other bodies of executive power and organs of local governments:

- 1) product intervention - sales of commodities in case prices on a certain product market are increasing, aimed at price stabilization;

For the sake of social protection primarily of low-paid and low-income citizens, this law foresees the possibility of setting fixed and regulated prices for resources that have a dominant impact on the general level and dynamics of prices, for commodities and services of critical social significance as well as for products, goods and services which are mainly produced by the enterprises that hold monopolistic (dominant) position on the market (Article 9).

Article 8 of this law lists the mechanisms of price regulation:

- 1) setting state fixed prices (tariffs);
- 2) setting limit levels of prices (tariffs) or limit deviations from state fixed prices (tariffs);
- 3) other (to be introduced by the Cabinet of Ministers).

It falls within the responsibilities of the Cabinet of Ministers to determine the list of products, commodities and services, for which fixed and regulated prices and tariffs shall be set by responsible bodies of state management. Also, it determines competencies of particular state bodies in the field of price-setting.

Resolution of the Cabinet of Ministers No. 33 "On approving the list of the objects of state price regulation with determining periods of such regulation in 2009 and 2010" of 21 January 2009

According to sub-point 3.3.2 of Article 3 of the law "On state support to agriculture in Ukraine", the Cabinet of Ministers may introduce state price regulation for separate objects listed in sub-point 3.3.1. Such "short list" for the period 2009/2010 was approved by the resolution No. 33 and includes hard wheat, soft wheat, grain mixture of wheat and rye, winter rye, spring rye, barley, wheat flour, rye flour, sugar from beets (crystal) and maize.

For these commodities minimum and maximum intervention prices have been set by the Ministry of Agricultural Policy (decree of the Ministry of Agricultural Policy No. 50 of 24 January 2009).

4. Assessment of the Law

4.1 Legal Assessment

Article 42 of the Constitution of Ukraine establishes the freedom of entrepreneurial activity: "everyone has the right to carry out business activity that is not prohibited by law". The Constitution establishes the general principle – the right, which may be realized in accordance with the law. The right to conduct business should not limit the freedoms and rights of other participants of business or consumers and may be limited in order to protect such freedoms and rights. Limitation of any right should be based on proper assessment. The highest legislative authority – the Parliament - is the primary body that may be considered as the proper assessor.

The limitation as to the trade mark-up for some agricultural products, envisaged by the Parliament in the Law No. 1447, is aimed at the protection of consumers by means of achieving stability of prices for the essential foodstuffs most required by them. As such, it does not violate the right to carry out business activity, anchored in the Constitution, but

-
- 2) financial intervention - purchase of commodities in case prices on a certain product market are decreasing, aimed at price stabilization;
 - 3) introduction of: licensing of the certain type of economic activity; quotas; measures related to customs tariff; subsidies; crediting; declaring price changes;
 - 4) setting of: fixed prices; limit (maximum or minimum) prices; limit (maximum) levels of trade mark-ups (surcharge), supply-sale mark-ups (suppliers' remuneration); limit rates of return (correlation between income and primary costs of a commodity); the value of suppliers' remuneration; the value of additional charges, discounts (discount coefficients); price parity;
 - 5) moratorium (temporary ban on changing current prices);
 - 6) other measures of price regulation (to be introduced by the Cabinet of Ministers).

only establishes additional rules for it. This applies also to other limitations introduced by the Law No. 1447 (as to the purchase-sales contracts and the payment period).

Moreover, lawfulness of establishing state price regulation for certain goods and services is also proven by the following provisions of Ukrainian legislation:

- According to Article 12 of the Commercial Code of Ukraine, the state executes regulation of enterprises' activities by applying different methods and mechanisms, one of which is the regulation of prices and tariffs.
- According to point 1 of Article 191 of the Commercial Code of Ukraine, state fixed and regulated prices are established for "resources which have dominant impact on the general level and dynamics of prices and for products and services of substantial social significance for the population". According to point 5 of this article, state regulation of prices is executed through "the establishment of fixed state and municipal prices, threshold prices, *threshold trade mark-ups* and suppliers' fees, threshold rates of profitability or through obligatory declaring of price changes". Pursuant to Article 8 of the law "On prices and pricing", the Cabinet of Ministers of Ukraine may introduce other mechanisms of state price regulation.
- According to Article 9 of the law "On prices and pricing", "state fixed and regulated prices are set by state bodies of Ukraine".

With respect to the above, the Law No. 1447 does not violate any of Ukrainian higher laws which create a legislative basis for setting minimum/maximum prices and trade mark-ups and provide for state control over prices.

However, considering the jurisdiction of the particular state bodies of Ukraine in the field of price regulation, the Law No. 1447 needs to be checked on exceeding the constitutional authority by the Parliament.

According to the provisions of point 5 and 6 of Article 85 of the Constitution – the article from the section "Verkhovna Rada of Ukraine" which defines the competence of the Parliament - in addition to making laws, "the authority of the Verkhovna Rada of Ukraine comprises determining the principles of domestic and foreign policy" and "approving national programs of economic, scientific and technical, social, national and cultural development, and environmental protection". It makes no doubt that these authorities include price regulation and other rules for conducting business in Ukraine.

On the other hand, according to Article 116 - which belongs to Section VI of the Constitution "The Cabinet of Ministers of Ukraine. Other bodies of executive authority" – and defines the authorities of the Cabinet of Ministers, it "ensures the implementation of financial, *pricing*, investment and taxation policy, the policy in the spheres of labor and employment of the population, social security (...)".

Accordingly, both articles define competences of the same rank of state bodies, which have to be demarcated from each other in order to avoid overlapping of competences. Current description of the responsibilities is rather broad so it is often difficult to define which body is authorized to directly regulate prices, including the introduction of limit trade mark-ups.

First, for this purpose it shall be determined what falls within the scope of "establishing of the policy principles" and "policy implementation" and where direct price regulation qualifies. Some previous decisions of the Constitutional Court of Ukraine can be a kind of help here as it is the only body authorized to decide whether a law may be found unconstitutional on the grounds that the body adopting it has exceeded its constitutional authorities (articles 13 and 15 of the law "On the Constitutional Court of Ukraine"⁶).

In 1999 and 2000 the Constitutional Court found unconstitutional one law and certain articles of the law "On prices and pricing" on the grounds that by direct regulation of prices

⁶ The law of Ukraine No. 422/96 of 16 October 1996.

the Parliament has exceeded its constitutional authority. In its rulings of 2 March 1999⁷ and 10 February 2000⁸, the Constitutional Court delimited the jurisdiction of the Parliament and the Cabinet of Ministers with regard to state pricing policy: the Parliament determines the principles of domestic policy, including pricing policy (point 5 of Article 85 of the Constitution) while the Cabinet of Ministers is responsible for ensuring the implementation of pricing policy (point 3 of Article 116 of the Constitution). The latter involves the realization of the principles set by the Parliament and application prices and tariffs, which logically includes also their concrete regulation - the Court ruled. Thus, according to the Court, by direct regulation of prices the Parliament has interfered with the jurisdiction of the Cabinet of Ministers, which violates Articles 6⁹, 19¹⁰ and 116 of the Constitution. Therefore, given these two decisions of the Constitutional Court, the Verkhovna Rada should have left the introduction of the limit 20% trade mark-up to the Cabinet of Ministers.

Moreover, according to the Commercial Code of Ukraine, it is the Cabinet of Ministers that approves the list of products for which state fixed and regulated prices shall be established (point 1 of Article 191). In the case of the Law No. 1447, the products subject to limitations on the trade mark-up have been determined directly by the Parliament.

Pursuant to Article 40 of the law "On the Constitutional Court of Ukraine", constitutionality of laws may be challenged only upon the petition of the President of Ukraine, not less than 45 deputies of Ukraine, the Supreme Court of Ukraine, Parliamentary Commissioner for human rights (Ombudsman) or the Parliament of Crimea. And considering the current political situation and pre-election period in Ukraine, it is doubtful that any of the mentioned bodies would initiate such unpopular challenging of the Law No. 1447.

As for the Supreme Court, according to Article 47 of the law "On the judicial system of Ukraine"¹¹, the Supreme Court of Ukraine addresses the Constitutional Court of Ukraine when courts of general jurisdiction, during execution of justice, have doubts regarding constitutionality of laws and other legal acts and also regarding official interpretation of the Constitution and laws of Ukraine. It means that constitutionality of the provision introducing the 20% trade mark-up may be reviewed by the Constitutional Court if a court of general jurisdiction, hearing the related case (e.g. on fines charged on a company for non-compliance with the limitations provided by the Law No. 1447) decides to request the Supreme Court to issue the constitutional petition to the Constitutional Court. It may also decide to suspend the fines until the respective decision of the Constitutional Court is available. And as pursuant to Article 18 of the law "On the judicial system of Ukraine", courts of general jurisdiction comprise also local courts of first instance, the related case does not necessarily have to go through all three instances (court of first instance, court of appeal and high specialized court) until it can finally be brought to the Supreme Court and the issue of unconstitutionality forwarded to the Constitutional Court.

However, unless and until the provisions of the Law No. 1447 are found unconstitutional by the Constitutional Court of Ukraine, wholesale and retail sellers of the goods list of which is defined by the Law as well as their suppliers should follow all its provisions. Otherwise, they would risk fines established by the Law.

⁷ Decision of the Constitutional Court of Ukraine in the case upon the constitutional petition of the President of Ukraine concerning conformity with the Constitution of Ukraine (constitutionality) of the law of Ukraine "On the temporary ban on increasing prices and tariffs for communal services and public transport services (the matter on communal services) of 2 March 1999.

⁸ Decision of the Constitutional Court of Ukraine in the case upon the constitutional petition of the President of Ukraine concerning conformity with the Constitution of Ukraine (constitutionality) of the provisions of part 2 of Article 5, part 3 of Article 9 of the law of Ukraine "On prices and pricing" and Chapter II "Final provisions" of the law of Ukraine "On amendments to the law of Ukraine 'On prices and pricing'" (the matter on prices and tariffs for communal and other services) of 10 February 2000.

⁹ State power in Ukraine is exercised on the principles of its division into legislative, executive and judicial power. Bodies of legislative, executive and judicial power exercise their authority within the limits established by this Constitution and in accordance with the laws of Ukraine.

¹⁰ The legal order in Ukraine is based on the principles according to which no one shall be forced to do what is not envisaged by legislation. Bodies of state power and bodies of local self-government and their officials are obliged to act only on the grounds, within the limits of authority and in the manner envisaged by the Constitution and the laws of Ukraine.

¹¹ The law of Ukraine No. 3018 of 7 February 2002.

As to the products to which the amendments introduced by the Law apply, direct regulation of prices through the introduction of the limit 20% mark-up is envisaged for all objects of state price regulation, listed in sub-point 3.3.1 of Article 3 of the law “On state support to agriculture in Ukraine”, regardless of the “short list” foreseen in sub-point 3.3.2. So even if the price for a certain product from the “long list” is not subject to state regulation under sub-point 3.3.2, suppliers and sellers of this product are still obliged to follow the rule of the limit 20% mark-up, to enter only into purchase-sales contracts and to pay fines in case of non-compliance.

In view of the amendments introduced by the Law, there is a practical question of how retailers should set prices of the products that are not purchased directly from producers. There is no traceability system in place in Ukraine to track agricultural and food products from the producer via suppliers to the retailer, where the additional information on price could be incorporated. And the Law No. 1447 does not oblige suppliers to make the information on prices they paid public. Moreover, according to Article 30 of the law of Ukraine “On information”¹², natural and legal persons that own information of professional, business, production, banking, commercial or other character which is subject of their commercial interest determine the access to it independently. Thus, recipients of products, including retailers, cannot be provided with the information that would enable them to set the trade mark-up in compliance with the Law.

Apart from that, the term “final consumer” has not been defined in the Law so it is not clear what is meant here – a natural person purchasing food products for own needs or a food processor too in case he produces new foodstuffs from the objects of state price regulation? Are clients of a restaurant final consumers for the purpose of the Law? Further, it remains unclear whether the restriction on the limit mark-up applies to processed products (e.g. maize or peas sold canned). If yes, what is the minimum level of processing that allows for a trade mark-up that is higher than 20%? Also, the issue as to how the mark-up should be calculated in the case of food which consists of several products listed in sub-point 3.3.1 of the amended law “On state support to agriculture of Ukraine” needs further clarification. The Law leaves these matters to discretion of the inspecting bodies, which may lead to abuses. The lack of transparency may also greatly impede the enforcement of the Law.

4.2 Economic Assessment

4.2.1 Impact on Investments

The financial crisis hit Ukraine particularly hard with a sudden stop of foreign capital inflows and lower export revenues because of low world raw materials market prices. High prices on international commodity markets and high capital inflows that lead to economic growth before the crisis came suddenly to an end in autumn 2008. The countries downturn is particularly severe because of lacking institutional and structural economic reforms that would have made the country more competitive. Investors currently pay a high risk premium on interest rates. Ukraine continues to perform poorly in international comparisons of country risks, investment climate, costs of doing business and competitiveness.

Overview: Business and Investment Climate Ranking of Ukraine – Various Performance Indicators in 2009

Index of Economic Freedom: No. 152 of 183 countries (Heritage Foundation and Wall Street Journal)

Global Competitive Index: No. 82 of 133 countries (World Economic Forum)

Ease of Doing Business: No. 142 of 183 countries (International Finance Corporation/World Bank)

¹² The law of Ukraine No. 2657 of 2 October 1992.

This overall picture combined with a high degree of political uncertainty and low predictability of framework conditions for investors is deterring international investors from activities in Ukraine so that the per capita level of foreign direct investment is among the lowest in Eastern Europe.

Table: Accumulated foreign direct investment in Ukraine and other Eastern European countries

Country	Accumulated stock of FDI, USD billion	Population, million	Accumulated FDI per capita, USD
Ukraine	35.7	46.3	771
Poland	196.1	38.1	5 147
Czech Republic	107.6	10.5	10 248
Hungary	152.4	10	15 240
Romania	72.8	21.5	3 386
Russia	491.2	141.9	3 462
Kazakhstan	47.7	15.8	3 019
Moldova	1.8	3.6	500
Bulgaria	45.1	7.6	5 934

Source: Astrum Investment Management, 2009

The above Law will certainly not lead to better rankings and accelerated inflows of foreign capital. One may argue that this is the price to pay for getting advantages for domestic investors. However, the negative impact for domestic investors is probably even higher. Because of the above rankings Ukraine is among the countries with the highest country risk and therefore the highest risk premium that has to be paid for getting loans for investments. The difference between interest rates in Ukraine and Germany is for instance about 7 to 9 % for hard currency loans. This means that Ukrainian companies have to pay considerably higher interest rates than their international competitors. A clear disadvantage for Ukrainian investors.

4.2.2 Impact on Agricultural Producers and Wholesale and Retail Traders

The Law No. 1447 is limiting trade margins to 20 % over the whole value chain from the agricultural producer to the processor to the wholesale trader and finally to the shop. So, big holdings and companies producing, processing and selling in a vertically integrated structure do have an advantage. Small producers, small traders and small shop keepers do have a disadvantage.

1. The mark-up of 20 % will not compensate all trading costs if the value chain covers many small producers, processors and traders. Their choice would be to either ignore the Law, increase trade margins and developing grey schemes, or to limit their product range and to increase transaction volumes.
2. Big retail and wholesale market chains will certainly limit their transactions and favor big agricultural holdings providing a full range of needed services around the end-product including logistics, promotional and advertising services, and quality control. In this way supply to wholesale and retail traders will be reduced. Instead of enhanced competition supply would be monopolized by large suppliers.
3. At first glance the obligation to pay 7 days after sales seems to be sympathetic. The question is whether this has to be regulated by the Government or by healthy competition. In agricultural sub-sectors with high competition payment to suppliers is actually very quick, e.g. grain traders pay usually in 24 hours. Their advantage is that grain is a homogeneous product with only a few quality classes. However, retail traders with a broad product range and various fresh and canned consumer goods may have practical problems to comply with the requirements of the Law. It may force retail traders to the introduction of new accounting systems. Again favoring the biggest and financially strongest players in the market.

4.2.3 Impact on Consumers

In particular fresh produce (fruit and vegetables, meat and dairy products) is in high demand by wholesale and retail traders. This offers excellent opportunities for smaller producers able to organize themselves in producer groups to offer the required quantities to traders. The establishment of producer groups is one of the priority goals of the Ukrainian Government. With limited price margins the development of producer groups jointly grading, packaging or processing would be severely constrained. Limitation of competition to large suppliers would inevitably lead to higher sales prices which would be rolled-over to the consumer. So, consumer prices may finally increase.

5. Conclusions and Recommendations

Ukraine's performance lags far behind its potential. The fundamental reason is the still vague direction of economic policies, where competitive forces capable of improving market performance are restricted by various regulations and direct market interference of public authorities. In this view economic performance is still restricted by a lack of competition. A well-defined strategy of competition-enhancing measures is required.

What are the benefits of competition?

Competition ensures the supply of consumer products at the lowest, but still cost-covering price. An economic structure built upon this principle is characterized by sufficient products in the shops available for consumers, income opportunities for many small and medium sized businesses, strong domestic companies, increasing investments and employment. Such an environment also stimulates entrepreneurship. It provides opportunities for many instead of limiting opportunities to a "happy few".

Competition raises also efficiency in the value chain. Traders with unreasonable profits will be forced to cut prices to the level of their competitors. Consumer prices thus reflect the true costs of production, processing and trade.

These benefits are strongly supported by international experience and many research results. The higher the degree of competition in a given country or sector the higher is the economic welfare of the people. One may conclude that competition makes the country richer; limited competition makes the country poorer.

The economic impact of price and trade margin regulations is clearly negative. It leads to less competition, lower investments, lower welfare of the Ukrainian people and lower future growth perspectives.

What could be done instead?

Within the agricultural value chain the highest degree of competition is usually in the farm sector. Many farms are producing homogeneous products and sell it to processors or traders. With limited individual market power farmers tend to unite in strong farmers associations and lobby groups. However, in Ukraine evolved during the last years a strongly growing sector of vertically integrated agricultural holdings. In an imperfect market with limited competition the advantage of agricultural holdings is better access to financial markets, input and output markets and knowledge. Individual private or corporate farms are disadvantaged. In Ukraine the situation is aggravated by the low representation of farmers interest groups in policy and law making. The interests of agricultural holdings, however, are far better represented within the Government for obvious reasons.

First conclusion: In view of creating an equal level playing field for all sizes and organizational forms of farms the law favors large structures. Government measures should instead have an equal impact on all producers.

In the food industry competition increased significantly after WTO accession. Import tariffs for various food products have been decreased and international competition forced the domestic industry to become more efficient after years of high protection. This is a challenging but healthy development. The food industry in Ukraine shows even in the financial crisis a convincing performance. The leading players in the edible oil seed industry, the poultry and pork meat industry, the fruit juice industry and the tomato processing industry demonstrate remarkably robust growth. Some sub-sectors and regions however are lagging behind including the dairy and the sugar sector. It is interesting to note that sectors with the highest protection rates, e.g. the sugar sector, show even with high sugar prices a remarkably low performance. Sectors with a high degree of foreign investment and competition, e.g. fruit juice and tomato processing, show satisfactory results even in times of crisis.

Second conclusion: Sub-sectors in the food industry with high levels of competition perform better than those with high protection rates. A clear indicator that competition works.

Food wholesale and retailing had very high growth rates during the last years in Ukraine. Growing consumer demand lead to high investments from domestic and international wholesale and retail chains. European experience shows that competition leads to ever shrinking trade margins favoring very large structures. Comparing the sales volumes of producers, processors and traders it is evident that this development is also under way in Ukraine. Some producers argue that this development is bad for it limits competition in favor of big wholesale and retail traders buying products in large quantities. However, this favors affordable prices for consumers. As the consumer demands at the same time cheap products as well as safe products for consumption the wholesale and retail sector is also very keen on having certified food products according to accepted industry quality standards. Although this development lags far behind other European countries with Ukraine having the lowest rate of certified suppliers of food products according to international food standards, e.g. Global Gap, HACCP, BRC or others, big wholesale and retail chains do have a specific long-term impact on their suppliers. This favors the development and introduction of food standards in the food value chain. It is therefore evident that the buyer introduces in contracts specific additional requirements for the supplier beyond the pure desire of buying a certain product. This may also concern the terms of payment as well as promotional and advertisement services in food distribution reflecting the market power of market agents and the degree of competition. One may argue that market power is in favor of big wholesaler and retail chains delaying payment for suppliers. However, even the biggest players face tough competition, and the higher the competition the better the terms for the supplier.

Third conclusion: Food wholesale and retailers buy big quantities and stimulate the introduction of quality standards in the food value chain. This may require and include contractual requirements beyond the purchase of products.

Recommendation: The Law will most likely not achieve its objectives and should therefore be abolished!

6. Annex - Selected related Legal Acts

Resolution of the Cabinet of Ministers No. 1548 "On determining competencies of bodies of executive power and executive organs of city councils with regard to price regulation" of 25 December 1996

According to the resolution, regional state administrations, cities of Kyiv and Sevastopol and the Council of Ministers of the Autonomous Republic of Crimea may establish:

- limit levels of profitability and trade mark-ups for baby food;
- limit trade (supply-sale) mark-ups of maximum 15%¹³ on producers' wholesale prices (customs value) for the following food products: flour, bread, macaroni products, grouts, sugar, beef, pork and poultry meat, boiled sausages products, milk, cheese, sour cream, butter, sunflower seed oil and hens eggs;
- limit levels of profitability for the production of some sorts of flour and bread;
- wholesale (selling) prices for some food products by means of declaring price changes (see below).

Resolution of the Cabinet of Ministers No. 1222 "On approving the procedure of declaring wholesale (selling) prices of food products" of 17 October 2007

Producers and sellers are obliged to seek consent with regional state administrations when changing prices of some food products in case the price increase is more than 1% within a month. This procedure applies to the following food products: wheat flour of higher, first and second category, rye flour peeled, beef, pork, poultry meat, boiled sausages products except for higher category, cows milk with up to 2.5% fat, sour-milk cheese with up to 9% fat, sour cream with up to 20% fat, butter with up to 72.5% fat, hens eggs, sugar (crystal) and sunflower seed oil.

Resolution of the Cabinet of Ministers No. 957 "On establishing minimum wholesale (selling) and retail prices of separate types of alcoholic beverages of domestic production" of 30 October 2008

It sets minimum wholesale and retail prices for some alcoholic beverages, produced in Ukraine, including vodka and cognac.

Article 8 of the law of Ukraine No. 1877 "On state support to agriculture of Ukraine" of 24 June 2004

Article 8 provides for temporary administrative price regulation, which is conducted by the Cabinet of Ministers. Its aim is to prevent or stop speculative or agreed establishing of prices by sellers and/or buyers of the objects of state price regulation on the organized agricultural market, which cannot be corrected by standard procedures of state interventions. This regime extends over legal relations which arise in respect of the particular commodity on both the organized and non-organized agricultural market. It may be applied by the Cabinet of Ministers upon submission of the Agricultural Fund only when certain conditions related to current prices on the market are fulfilled and for not longer than 6 months.

Article 8 identifies the following mechanisms of administrative price regulation:

- 1) limiting the level of trade mark-ups (discounts) on the wholesale or retail market of the given object of state price regulation;
- 2) setting limit levels of profitability to the expenditures of:
 - processors of the commodity in case that an object of state price regulation has been produced as a result of processing;
 - persons that provide storage services for the objects of state price regulation;

¹³ Without expenses on inter-city transportation.

- 3) setting limit sales prices of the objects of state price regulation at the level of the maximum intervention price and limit purchase prices at the level of the minimum intervention price.