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Legal and Economic Assessment of the Impact of the Draft Law on Domestic Trade – Does limiting Food Trade help the Poor?

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Executive Summary

The draft law "on domestic trade" has been developed by the Ministry of Economic Development and Trade aiming at regulating domestic trade and trade-related activities in Ukraine. It is based on the Decree of the Cabinet of Ministers #632 from June 24, 2009 outlining a State Program on Domestic Trade Development until 2012. The draft law passed several public hearings until July 2011 and is expected to be delivered to the Ukrainian Parliament by the Cabinet of Ministers in the second half of 2011.

Various interest groups voiced their concerns about the draft law including small and medium sized traders as well as large wholesale and retail chains. Their major concern is the limitation of the free choice of the area and size of the market outlets and the restriction of economic activities, limitation of trade contracts and direct price controls of socially sensitive goods. There are concerns that the draft law may force wholesale and retail traders to limit their product range because of excessive state control leading to less cheap and available food for the poor than before.

The general implicit strategy of the law is to broaden the regulatory scope of the Government and administration in domestic trade. It will thus limit the entrepreneurial activities and choices guaranteed by the Ukrainian constitution and other relevant laws. The draft law proposes to regulate trade relations which are already covered by the Civil Code of Ukraine and the Commercial Code of Ukraine. If the draft law would be approved, a number of contradictions due to different concepts of the draft law and the Civil Code and the Commercial Code will be inevitable.

Major conclusions:

1. The draft law contradicts basic principles of a free market economy and shows fundamental misconceptions about the role of the public sector in trade.

It is legitimate that the national and local administrations are master-planning the spatial distribution of wholesale and retail markets and may wish to reserve special commercial areas for trading activities in cities and villages. However, the final choice and decision of the location and size of a trading outlet must remain with the investor who is mobilizing financial resources and is taking the investment risks. The concept of introducing new permissions, price controls, limitations of trade contracts, licenses and bureaucratic requirements creates conditions for more corruption and higher costs of doing business. As a result the Ukrainian market may lose foreign and domestic investors. It may also lose ranks in international benchmarking surveys measuring investment climate and ease of doing business.

2. A second fundamental misconception concerns the social objectives of the draft law. It is evident that a law on domestic trade cannot be the best solution to reach social objectives.

Mixing trade regulatory and social policy instruments will neither lead to enhanced domestic trade nor to improving the food availability for poor people. Price regulations concern the whole population including rich and poor people. It would be better to target social policies to those in need. Such a focused policy would be more cost-effective and deliver better results.

3. Some of the regulations put a specific burden on small and medium enterprises.

The draft law requires everyone to be equipped with storehouses and offices. Today, with growing internet trade and services around trade, this seems not reasonable. The draft also requires obligatory terms of payment for socially important goods and special education for employees in trade. Trade activities are important for employment creation in a transformation society.

4. Government interventions in the food supply chain will limit consumers' choices. The dynamic development of the wholesale and retail sector in Ukraine confirms global trends, i.e. the increasing role of supermarket chains and cash & carry markets in linking agri-food suppliers with consumers. Food standards become increasingly important and are driving vertical coordination in agri-food supply chains. Leading retail chains are shifting toward higher quality and increasingly safe products through private standards imposed on suppliers and/or private-label products. This creates important opportunities for enhancing agricultural productivity, increasing rural incomes and thus reducing poverty. Higher private standards for product quality and food safety stimulate food suppliers to invest in upgrading technologies to comply with wholesalers and retailers' requirements.

In view of this positive impact on the development of food value chains from the farm to the consumers' table it is important to refrain from direct intervention by using price and mark-up controls. Direct government intervention in the food supply chains will lead to additional costs and less available food for consumers. Increasing regulation will decrease financing mechanisms and will increase transactions costs in the supply chain. This, in turn, will be born by the consumers paying higher consumer prices.

Recommendation: The Law would most likely not achieve its objectives and should therefore not be implemented. Instead of restricting domestic trade by excessive regulation of prices, mark-ups and investments, competition is the key to better performing markets. Poor people should be supported by targeted social programs.

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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.

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1. Background and Objectives of the Draft Law

The draft law "on domestic trade" has been developed by the Ministry of Economic Development and Trade aiming at regulating domestic trade and trade-related activities in Ukraine. It is based on the Decree of the Cabinet of Ministers #632 from June 24, 2009 outlining a State Program on Domestic Trade Development until 2012. The draft law passed several public hearings until July 2011 and is expected to be delivered to the Ukrainian Parliament by the Cabinet of Ministers in the second half of 2011. In the following we refer to the draft law version dated July 4, 2011.

According to the Explanatory Note to the Draft Law the main objectives are to increase competition, enhance traceability, and to support the organization of wholesale markets and retail trade to provide high-quality products and services to consumers with particular emphasis on socially sensitive goods, and to shape state policy and regulations regarding domestic trade.

In their communications, Ukrainian authorities also claim this law would have positive effects on poor people providing sufficient supply of food at affordable prices. This would be achieved a.o. through (i) price and trade margin controls, (ii) public purchases to the state food reserve, and (iii) regulation of the choice of retail investment areas. Additionally, the authors of the draft law argue that domestic trade during the 2012 European Football championship has to be regulated allowing local authorities to restrict trade during this event.

The list of socially sensitive goods may include:¹

- Bread
- Flour
- Ham (Salo)
- Pasta
- Buckwheat
- Salt
- Potatoes
- Rice
- Sugar
- Meat (pork)
- Meat (beef)
- Meat (poultry)
- Boiled Sausage
- Sunflower oil
- Milk (2.5% fat)
- Cottage cheese
- Sour cream
- Butter
- Chicken Eggs

The draft law is structured into five chapters:

- Chapter 1: general definitions, scope and general principles
- Chapter 2: definitions of wholesale and retail trade as well as catering
- Chapter 3: rules for trade organization, specific requirements and provisions
- Chapter 4: regulations and mechanisms
- Chapter 5: changes to related legal acts

¹ The draft law does not explicitly define the list of goods. It states that such list shall be approved by the Cabinet of Ministers. Therefore we assume that the list may contain those goods as currently defined by the decision of the Cabinet of Ministers No. 803 dated June 13, 2002

Various interest groups voiced their concerns about the draft law including small and medium sized traders as well as large wholesale and retail chains. Their major concern is the limitation of the free choice of the area and size of the market outlets and the restriction of economic activities, limitation of trade contracts and direct price controls of socially sensitive goods. There are concerns that the draft law may force wholesale and retail traders to limit their product range because of excessive state control leading to less cheap and available food for the poor than before. The study team has taken good note of various statements of trade associations. In particular, communications of the Reform Club and the American Chamber of Commerce have been very helpful in the analysis.

The study team includes legal and economic experts from Ukraine and abroad.

2. Assessment of the Law

2.1 Legal Assessment

The general implicit strategy of the law is to broaden the regulatory scope of the Government and administration in domestic trade. It will limit the entrepreneurial activities and choices guaranteed by the Ukrainian constitution and other relevant laws.

The draft law proposes to regulate trade relations which are already covered by the Civil Code of Ukraine and the Commercial Code of Ukraine. The Civil Code of Ukraine deals with property relations and contracts and the Commercial Code of Ukraine concerns business activities, including domestic trade. If the draft law would be approved, a number of contradictions due to different concepts of the draft law and the Civil Code and the Commercial Code will be inevitable.

The justification of the draft law is weak. It lacks a basic analysis of the potential impact on various actors and target groups.

In the following we are presenting three fundamental conceptual comments and various detailed comments on specific articles of the draft law.

1. **The draft law contradicts principles of a free market economy and shows fundamental misconceptions about the role of the public sector in trade.** It is legitimate that the national and local administration are master-planning the spatial distribution of wholesale and retail markets and may wish to reserve special commercial areas for trading activities in cities and villages. However, the final choice and decision of the location and size of a trading outlet must remain with the investor who is mobilizing financial resources and is taking the investment risks. The legal principle of freedom of economic activity is violated.

2. **It is evident that a law on domestic trade cannot be the best solution to reach social objectives.** Mixing regulatory and social policy instruments will neither lead to enhanced domestic trade nor to improving the food availability for poor people. Price regulations concern the whole population including rich and poor people. The draft law contains no provision for targeted (poor) groups.

3. **Some of the regulations put a specific burden on small and medium enterprises.** We are considering some of the articles as not reasonable. The draft law requires everyone to have storehouses and offices. In modern times with growing internet trade and services around trade this seems not reasonable. The draft also requires obligatory terms of payment for socially important goods and special education for employees in trade. Trade activities are important for employment creation in a transformation society. It allows participation of many people in economic activities.

A table describing specific articles and their shortcomings is presented below.

Summary of the major shortcomings of the Draft Law on Domestic Trade²

| Section of the Law | Comments |
|---|--|
| Preface | <ul style="list-style-type: none"> The Draft Law says it is to regulate both trade and production, but effectively contains no norms of production regulation. "Production" should be excluded. |
| Definitions | <ul style="list-style-type: none"> "Consignment" definition is not consistent with existing prescriptions in other legal acts (Art. 21 of Law on Consumer Protection). Proposed definition requires original documents from suppliers; however, small entrepreneurs are excluded from this obligation. |
| Scope of the Law | <ul style="list-style-type: none"> Art. 2 of the Law does not cover trade with special goods (medicals, securities). Following this arguments, trade of alcohol beverages and tobacco products should be excluded (already regulated by the Law #481 "On State Regulation of Production and marketing, of alcohol.." as of December 19, 1995) |
| Chapter III. Organization of trade and production | <ul style="list-style-type: none"> Restriction of trade in large areas (above 200 sqm) to legal entities only, e.g. no individual entrepreneur, contradicts to Art. 25 of the Commercial Code that forbids any actions by authorities creating unequal conditions for business entities; Restriction of trade of certain products (frozen poultry, fish) to stationary outlets does not necessarily imply quality control but unjustifiably excludes other forms of trade which fulfill all sanitary norms; Requirement of separate sections for selling of goods with minimum age restriction (alcohol, tobacco) creates additional burden for market operators (selling to customers under minimum age is prohibited by existing legal acts); Restriction of sales and working hours during public events is too broad (no strict definition or list of public events) and duplicates existing norms in the Law of State regulation #481. Rules for trading of certain goods, catering and special forms of domestic trade shall be established by central governmental body. However, the Law does not define the list of products neither forms of trade leaving space for speculations and excessive administrative control. |
| - General provisions. Art. 7, Part 3, 4, 8, 11 and 15 | |
| | |
| - Regulation of special forms of trade. Art. 9, 10, 11 | <ul style="list-style-type: none"> Requirements for trading agents and corresponding contracts are not in line with Art. 297 of the Commercial Code; Obligation requiring own storage capacities is too restrictive for many business entities (small entrepreneurs); All information that sellers shall provide to consumers is already regulated by the Law on Consumer Protection; Classification of open markets (Art. 11, part 6) contradicts its definition as stationary outlet. |
| Accounting and reporting for selling outlets. Art. 13-15 | <ul style="list-style-type: none"> Normative selling areas by Cabinet of Ministers is unjustifiable administrative intervention; Additional reporting requirement for business and responsibility for statistical reports. |
| Contracts regarding trade with foods. Art. 16 | <ul style="list-style-type: none"> Requirements of written contracts are already defined in Civil Code and the Commercial Code; Additional specific requirements set forth by the draft law for the contracts regarding trade with foods, e.g. equal amount of penalties for the supplier and purchaser, contradict to the |

² The analysis has been made by a joint working group organized by American Chamber of Commerce. We share the conclusions of the working group.

| | |
|--|--|
| | <p>general principle of freedom of contract set forth by Art. 3 of the Civil Code and Art. 44 of the Commercial Code</p> |
| <p>Chapter IV. State regulation of domestic trade</p> | <ul style="list-style-type: none"> • Prohibition of charges for marketing and advertisement service while trading with foods contradicts freedom of contracts established by Art. 44 of the Commercial Code; • The Draft Law does not define the cases (special forms of trade and reasoning) subject to regulation by Central governmental body; • State support <i>to social important goods</i> by allocation of local and regional food reserves (Draft Law) substitutes support <i>to providers of socially important goods</i> predefined in the Concept of the Law on Domestic Trade approved by Decision of Cabinet of Ministers № 1200 as of October 7, 2009 • State regulation of the prices for certain kinds of socially important goods |
| <p>Art.19-24</p> | <ul style="list-style-type: none"> • Exhaustive collection of data on each selling outlet (including prices) entails increasing costs of trading activity, • Central governmental body shall define the rule regarding special forms (certain goods) of trade. the Draft law does not contain the list of such forms and provides too much space for speculations; • No rights for NGO and traders associations to represent their interests; • Local authorities are empowered to check whether local legal acts regarding domestic trade comply with the Constitution. According to Art. 147 of the Constitution the only body with this power is the Constitutional Court of Ukraine. |
| <p>Chapter V. Final and transitional provisions</p> | <ul style="list-style-type: none"> • Restriction of sales of tobacco products in public catering does not comply with Art 15-2 of the Law # 481 "on State Regulation of Production and Marketing of Alcohol..." as of December 19, 1995 that allows selling tobacco products at 50% of trading areas in such places. • Restriction of trading area (100 sqm) for tobacco products contradicts to Art. 7 of this draft that stipulates that tobacco products shall be sold only in separated areas. |

The analysis of impact of the Law (the required official procedure) is not done properly according to the Law of Ukraine № 1160-IV "On principles of state regulatory policy regarding business activities" from September 11, 2003. In particular, paragraph II of Chapter II of the Analysis admits the possibility to regulate the underlying issue by amending existing legal acts but refuses to do so due to time and resource constraints. This argument is not valid as long as similar Draft Laws on Domestic Trade have been submitted several times over the last 3 years implying significant realized expenditures on their development.

The Analysis does not provide mechanisms to monitor the effectiveness of the Law. There is no sufficient evidence that the problems raised in the Draft Law could not be resolved with lowest possible public expenditures as required by the above mentioned Law № 1160-IV and the Methodology of analysis of impact of a legal act approved by Cabinet of Ministers Decree №308 as of March 11, 2004.

2.2 Economic Assessment

The draft law is introducing important changes that may have serious economic consequences. The economic impact of the draft law should have been assessed by the authors as required by Ukrainian law. It would have proved useful to involve market participants into the draft process. Some consultations took place, but the suggestions from the stakeholders were not fully incorporated. In the following we are summarizing our view on the economic impact on trade, poor target groups and the Ukrainian economy.

IMPACT ON FOOD SECURITY AND THE POOR

The list of socially important goods is determined by the Decree of the Cabinet of Ministers of Ukraine #803 as of June 13, 2002 with amendments is quite comprehensive, including wheat flour, bread (from wheat and rye flour), pasta, buckwheat, rice, beef, pork, lard, poultry, boiled sausage, milk, sour cream, mild cheese, butter, eggs, sugar, sunflower oil, potato, and salt. In prescribing the methods for the state regulation of prices for socially important goods, the draft law refers to corresponding legislation (see p. 2 of the Article 19), which is the Law of Ukraine # 507-XII 'On prices and pricing' as of December 3, 1990 with amendments. In this law the state can regulate the prices via a) fixed prices, b) minimum or maximum prices and marginal deviations from fixed prices.

Although it is not explicitly stated in the draft law the set of the above mentioned measures is aiming to ensuring food security in the country and protecting the poor. Market interventions and price regulations are mainly used by governments to avoid price spikes or to limit price fluctuations. The exact details on price levels, however, when intervention is allowed, are not mentioned in the current draft and in the law it refers to. This can be defined by local governments. Moreover, point 1 of the Article 19 suggests introducing national and local reserves for retail sales interventions to support trade of socially important goods.

Concerns of the government about food security are understandable and legitimate, especially in the light of the fact that on average half of the income of the Ukrainians are spent on food. According to the composition of the consumer basket in Ukraine for 2010 (provided by the State Service of Statistics of Ukraine), socially important agricultural and food products make up 25.2%. The high share of food in consumers' expenditures basically has driven the headline inflation in the country. This was particularly visible in 2008/09 and in 2010/11, when domestic food prices reacted on world agricultural and food market spikes. As one may see from the figure, socially important products (like meat and meat products, bread and bread products, milk etc) have been significantly contributing to the overall inflation.

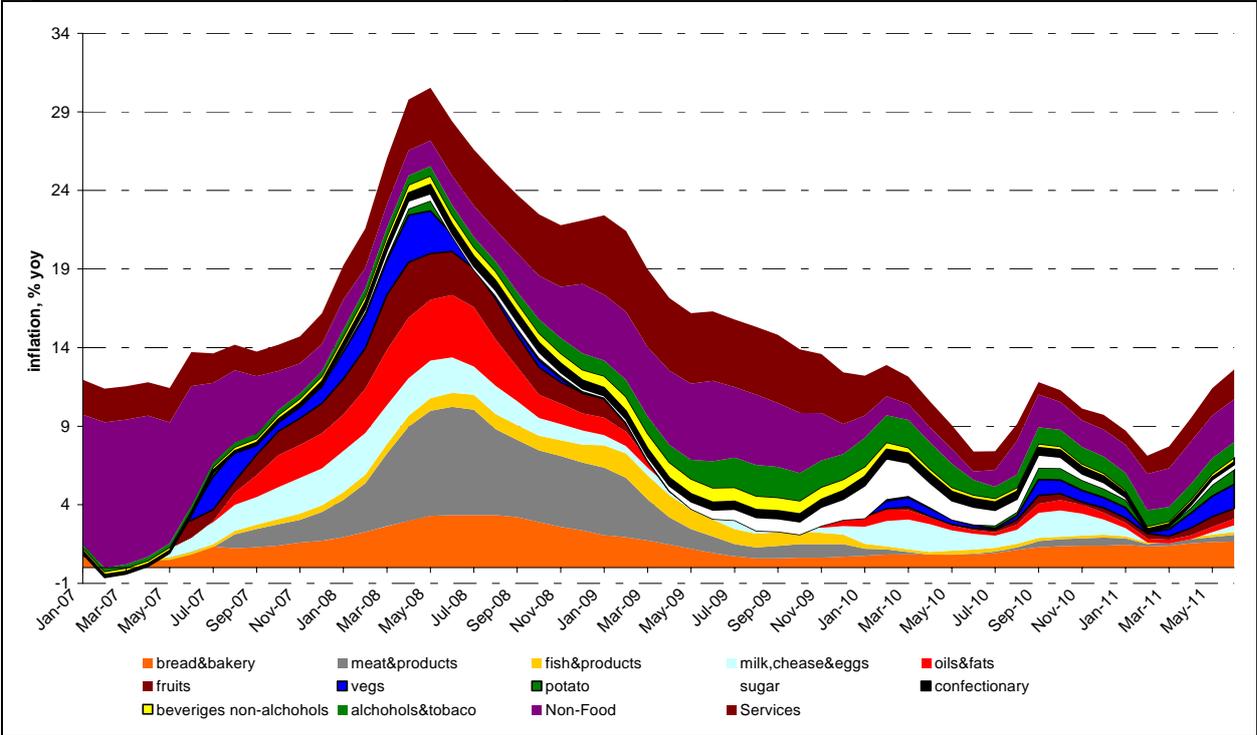
The policy, however, of administering wholesale and retail prices has been proven to be extremely inefficient in reaching and helping the poor and to ensure food security in the country (Galushko et al, 2004)³. The main reason is that these policies are poorly targeted. Restricting prices within certain limits is benefiting the poor and higher-income groups of the society at the same time. Higher-income groups essentially do not need this support at all or at least in the same proportion as the poor. Moreover, if we are talking about meat and dairy products, their consumption increases with rising income. So higher-income groups of the society benefit relatively more from administering prices than the poor, simply because they consume more of high-value food products.

Restricting prices and mark-ups in rural stores can be especially harmful for the rural poor. Poor rural roads often inflict significant transportation costs, so delivering of the products to

³ Galushko V., A. Kuhn, and O. Nivievskiy (2004). The 2003 Wheat Crisis and Food Security. In: von Cramon-Taubadel, S., Demyanenko, S., Kuhn, A. (eds.) (2004): Ukrainian Agriculture – Crisis and Recovery, Germany: Shaker Verlag, pp. 167-180.

remote rural areas might be rather expensive. This is reflected in high retail mark-ups. Limiting prices and mark-ups, however, might lead to a situation when transporting the food from supply centers to distant rural areas might not be economically viable, so it will cut rural inhabitants off from certain food products. Instead, they will be forced to spend additional sources to commute to neighboring areas.

Figure 1 Contribution of CPI sub-components to headline inflation



Source: Own calculations based on State Service of Statistics

Price and markup controls will cause a product to fall its supply below equilibrium level. Suppliers might reduce the quality of the product to regain some of the profits they lost due to the price controls and might switch to other goods that offer more profits. As Milton Friedman, a Nobel Prize winner, described it *"...we economists don't know much, but we do know how to create a shortage. If you want to create a shortage of tomatoes, for example, just pass a law that retailers can't sell tomatoes for more than two cents per pound. Instantly you'll have a tomato shortage..."*⁴

IMPACT ON DOMESTIC TRADE

The retail food sector has been quickly growing over the last decade offering market outlets to Ukrainian farmers. The annual retail turnover of food products is estimated at about \$500 per capita, or about \$23 billion. Super- and hypermarkets' share in the sales of agriculture and food products has been expanding and is estimated at about 40-50% at the moment. The average floor space of a Ukrainian supermarket grew from 822 square meters in 2005 to 1200 square meters in 2009. Only approximately 20% of food products in Ukraine were sold through open markets and about 90% of the meat in 2009. Also, open-markets are leading sellers of vegetables, fruits, meat, honey and dried fruits. At the same time, sales of dairy products, sunflower oil, and alcoholic drinks are gradually moving from open markets to outlets of other types. Soviet-style stores (with behind-the-counter sales) are still quite common in Ukraine. Some are operating successfully in distant small districts of large cities and small provincial towns and villages, where the construction of supermarkets or modern chain stores is not viable. These stores are likely to be quickly replaced by chain grocery stores (300 - 500 square meters), which are gaining more and more weight. The overwhelming majority of these stores (except small ones with 150-200 square meter floor

⁴ "Controls blamed for U.S. energy woes", Los Angeles Times, February 13, 1977, Milton Friedman press conference in Los Angeles

space) procure products through wholesale companies. Smaller ones buy products in cash & carry stores or from large wholesale open-air markets. Kiosks (usually 8-25 square meters) survived at road intersections, bus stops, underground stations, near open-air markets, in bedroom communities, and in rural areas. They are now becoming more specialized; for example, producers of meat and bakery products have opened kiosks to sell their own products near public transportation stops. Another rapidly growing market segment is sales at gas stations.

This dynamic development of the wholesale and retail sector confirms global trends, i.e. increasing role of supermarkets chains and cash & carry markets in linking agri-food suppliers with consumers. Food standards become increasingly important and are driving vertical coordination in agri-food supply chains. Leading retail chains are shifting toward higher quality and increasingly safe products through private standards imposed on suppliers and/or private-label products. This creates important opportunities for enhancing agricultural productivity and for increasing rural incomes and for reducing poverty (Swinnen and Maertens, 2007)⁵. Higher private standards for product quality and food safety put additional pressure on food suppliers to invest in upgrading technologies to comply with wholesalers and retailers' requirements.

In view of this positive impact on the development of food value chains from the farm to the consumers' table it is important to refrain from direct intervention by using price and mark-up controls. Direct government intervention in the food supply chains will lead to additional costs and less available food for the poor. Increasing regulation will decrease financing mechanisms and will increase transactions costs in the supply chain. This, in turn, will be borne by the consumers paying higher consumer prices. In this view the draft law is exacerbating the problem of food security for the poor.

Control the prices and mark-ups have to be constantly and extensively monitored. This implies increasing government bureaucracy and thus increasing budget expenditures to finance this government activity. It also increases the administrative costs of traders.

IMPACT ON INTERNATIONAL TRADE

The draft Ukrainian Law on domestic trade contains specific rules for trade in 'socially important goods'. According to article 16, paragraph 10 specific payment terms have to be met.

Although the draft Law on domestic trade only seems to target trade within the Ukrainian borders as it aims to regulate trading and trade-production activities in Ukraine (according to its preamble). It is however not clearly stated that foreign trade is excluded. The list of socially important goods for example only speaks about food products in general. The products are not clearly defined. This raises the question what will be the situation if for example an importer wants to import, Italian cottage cheese. It is therefore important to clarify that the law is indeed not applicable to goods that are imported.

For international traders it would also mean that for products that are meant to be sent to Ukraine they need different contracts than for the products to be sent elsewhere.

Article 18 mentions state regulation of the prices for certain kinds of socially important goods as a means to regulate the domestic trade. There are specific provisions in Article III GATT 1947 relating to price controls needing to avoid prejudicial effects to the interests of countries supplying imported products (Article III.9). The applicable provisions of Article III also caution that any measures should not be applied to imported products so as to afford protection to domestic production (Article III.1). Another requirement is that imported products cannot be treated less favorably than domestic like products in respect to all rules

⁵ J.F.M. Swinnen and M. Maertens (2007). Global supply chains, standards and the poor: some conclusions and implications for government policy and international organizations. In: J.F.M Swinnen (ed) (2007): Global supply chains: Standards and the poor. How the Globalization of Food Systems and Standards Affects Rural Development and Poverty, CAB International

relating to internal sale, transportation, distribution or use. These rules need to be accommodated.

Since February 2008 Ukraine is negotiating a **Deep and Comprehensive Free Trade Agreement** with the EU. The next round of negotiations takes place in September 2011 in Brussels. It is obvious that a Ukrainian law which impedes international trade between the EU and Ukraine goes against the idea of a free trade agreement.

3. Conclusions and Recommendations⁶

The above draft law will not improve Ukraine's economic performance that is lagging far behind its potential. It will also not improve Ukraine's international rankings of ease of doing business and investment climate surveys. 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. However, the draft law is introducing new elements of a planning economy and thus reducing 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.

Direct interference in the planning of wholesale and retail outlets will worsen the availability of food for the poor. It is the investor who takes the risks of investing his own money who should make the choice of the location of his outlets. A step back to planning economy will not lead to the expected results. It will increase bureaucracy and corruption instead.

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 after 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.

Food wholesale and retailing had very high growth rates during the last years in Ukraine. Growing consumer demand leads 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, IFS or others, big wholesale and retail chains do

⁶ This section draws on previous policy papers of IER

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.

Recommendation: The Law will most likely not achieve its objectives and should therefore be abolished! Instead of restricting domestic trade by excessive regulation of prices, mark-ups and investments, competition is the key to better performing markets. Poor people should be supported by targeted social programs.