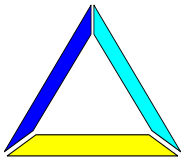
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Wheat market stabilisation: Options for Ukraine

Executive Summary

Ukraine has harvested roughly 4,2 million tonnes of wheat in 2003, its worst wheat crop in decades. Policy makers in Ukraine have responded to this situation with a series of measures in recent months, many of which have actually limited the ability of markets to respond and relieve the current situation. Instead, they have sharpened shortages of wheat on Ukrainian markets and driven prices higher than necessary, as they have created insecurity on the part of importers and thus delayed necessary wheat imports while world market prices were continuously rising.

Even though it is hoped that the increasing productivity of Ukraine's wheat production will make such a situation less and less likely in the future, the Ukrainian government can take measures today which can dramatically alleviate future grain shortages. Our recommendations related to this policy area are:

- Lengthy parliamentary decision processes are not suited to deal with a grain shortage. **Trade policies should be generally prepared for such a shortage** in order to allow necessary imports in time.
- The **import tariff on wheat is completely useless and should be abolished**, as it is either dysfunctional (in a normal export situation) or politically unbearable in case of a need for imports when it drives bread prices further up.
- The chance to **benefit from special export facilitation programmes** of the USA or the EU should not be missed, but only if they do not restrict the freedom of Ukraine to export grain after the next harvesting season. Furthermore, negotiations leading to such deals should not be allowed to increase uncertainty and further delay necessary commercial imports.
- The **temporary exemption from VAT** is predominantly attractive to traders with claims on VAT refunds from earlier export deals. Moreover, it reintroduces an element of mutual debt-setoff with budget entities, the latter which has been largely criticised and recently been ruled out by law.
- Agricultural policy should make the **reduction of transport, handling, and various other trade costs** within Ukraine a top priority.

1 Introduction

Ukraine has harvested roughly 4,2 million tonnes of wheat in 2003, its worst wheat crop in decades. Since April/May of this year at the latest, when the impact on winter crops of severe frosts followed by weeks of drought became apparent, it has been clear that Ukraine will have to import food wheat to meet domestic demand. As a result of the shift from a net export to a net import position, grain prices in Ukraine have increased significantly; prices for food grade wheat are currently well over twice as high as the highest levels observed in 2002. This has led to concerns that food price inflation is threatening overall price stability and significantly lowering standards of living among the low-income strata of Ukrainian society.

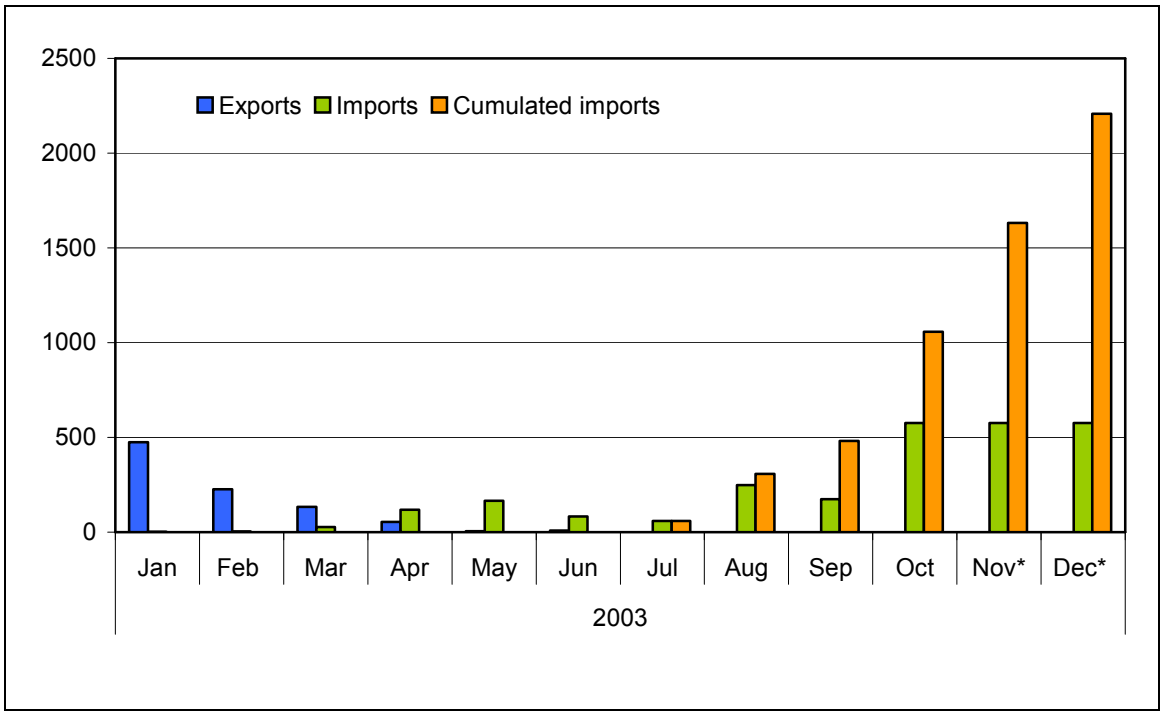
Policy makers in Ukraine have responded to this situation with a series of measures in recent months. Most of these measures have been in the spirit of intervention, with policy makers actively attempting to determine market outcomes (prices and quantities), rather than attempting to enhance and 'lubricate' market mechanisms. We are concerned that many of these measures have actually limited the ability of markets to respond and relieve the current situation as quickly and completely as possible. As a result, they have sharpened shortages of wheat on Ukrainian markets and driven prices higher than necessary. As we demonstrate in Section 3 below, the resulting costs are far from negligible.

We do not discuss these costs as an exercise in rehashing past mistakes, but rather to guide and motivate future grain market policy. As we discuss in Section 4, the current pursuit of grain under the US PL 480 program is reminiscent of attempts to stabilise grain markets earlier this year, and could create more problems than it solves. In Section 5 we discuss the impact on grain and food markets of freeing food grain from import VAT and suggest other means of stabilising food grain markets in Ukraine.

2 Background

Since mid-2003, Ukraine has imported roughly 1,5 – 1,6 million tonnes of wheat (see Figure 1). Estimates of total import requirement for the 2003/04 crop year range from 3,5 (UkrAgroConsult, citing government expectations) to 4,2 million tonnes (Reuters, quoting traders). There is no way anyone can know exactly what the final import requirement will be: This is not a question of planning by so-called experts according to norms because, unlike livestock, humans are not fed fixed rations. Instead, humans choose between bundles of commodities, and the composition of these bundles varies with relative prices and substitution possibilities. The development of the ratio of rye to wheat prices in Ukraine and on world markets, for example, could have a significant impact on final wheat demand and imports in the current crop year. Nevertheless, it does appear that an additional 2 to 3 million tonnes of imports will be required in the coming roughly 6 months.

Figure 1: Ukrainian wheat exports and imports in 2003 (thousand tonnes)

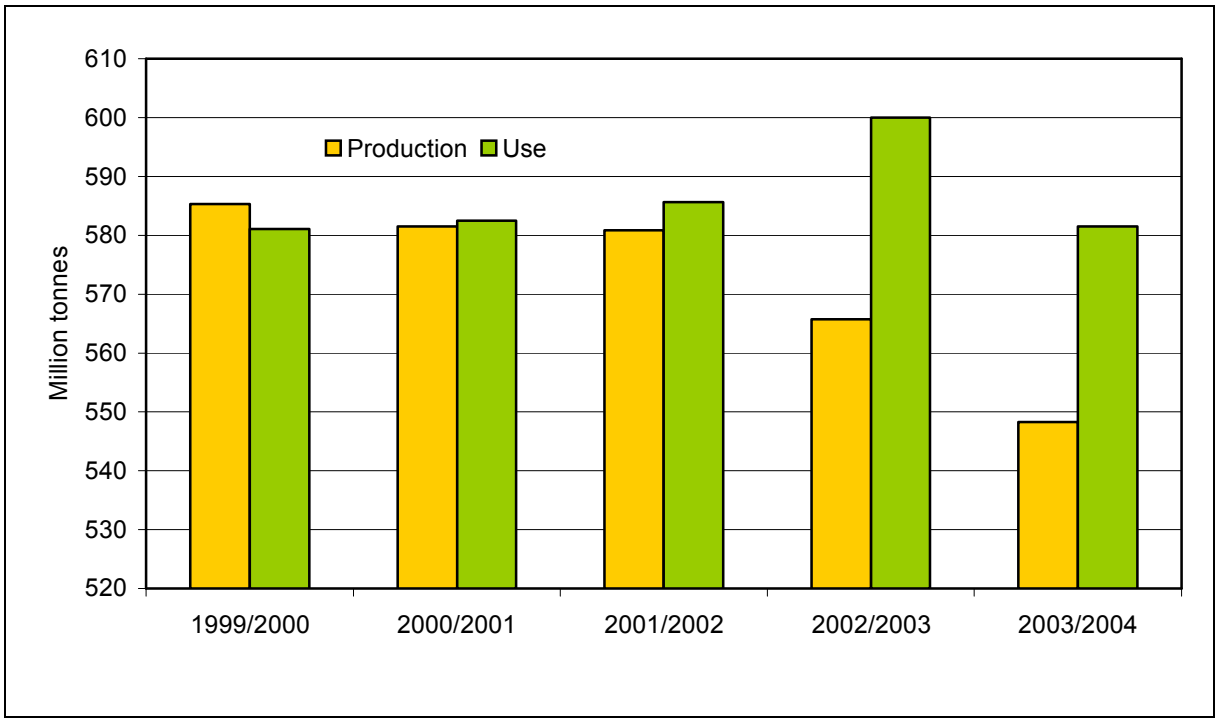


* Imports in November and December are assumed to equal the record level of 575 thousand tonnes attained in October.

Source: UkrAgroConsult; Derzkomstat; Reuters.

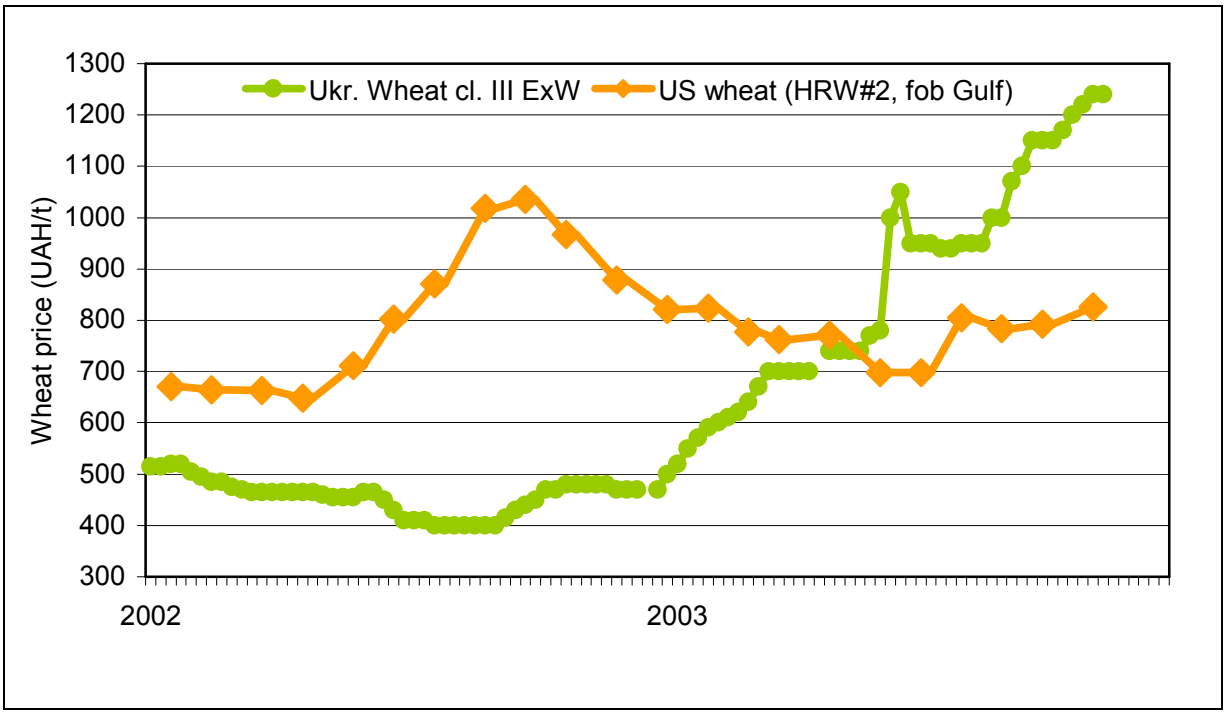
As (bad) luck would have it, the price that Ukraine has to pay for food wheat imports has been increasing rapidly in recent months. Two factors have contributed to this increase. First, world market prices for wheat have been climbing. For the second year in a row, production has fallen considerably below consumption world-wide (see Figure 2). Poor harvests in Eastern Europe have contributed to this imbalance. As a result, world-wide stocks are low and falling: the international ratio of stocks to use is expected to fall to roughly 22% in the current crop year, from over 30-35% throughout the second half of the 1990s. This is the lowest level since 1972/73, and it has caused world market prices, which had been falling from high levels in 2002, to rise again since mid-2003 (Figure 3).

Figure 2: Production and use of wheat world-wide (1999/00 – 2003/04, million tonnes)



Source: USDA.

Figure 3: Ukrainian and world market wheat prices (2002-2003, UAH/t)



Source: UkrAgroConsult, USDA.

Second, ocean freight rates have climbed to unusual highs, increasing the costs of transporting wheat and other commodities from export to import harbours. This has been caused by unexpected increases in the demand for shipping services (for example, Japan's coal imports have increased substantially due to a

move to reduce dependence on atomic energy, and economic growth in China has lead to increasing imports of bulk commodities) that cannot be matched by equally rapid increases in supply (it takes time to build ships). As a result, the cost of transporting grain from the US-Gulf to Odessa has increased from roughly 13 US$/t in August 2002 to 36 US$/t at the end of 2003.

3 The cost of delayed imports

Import demand coupled with increasing world market prices have significantly increased the costs of a series of policy measures taken in Ukraine in the course of 2003. These measures have been commented upon elsewhere[1] and include:

- The 'personalisation' of grain market policy in mid-2003, with numerous officials being dismissed and in some cases subject to criminal investigations;
- Accusations levelled at grain traders, leading to searches, threats and in some cases direct interference in movements of grain; and
- Open advocacy by some government officials of a partial or complete nationalisation of the grain trade, as exemplified, for example, by calls for the establishment of a 'large Ukrainian grain trader'.

Taken together, these developments have given rise to doubts about the Ukrainian Government's commitment to continued market-oriented agricultural reform. Especially foreign investors – some of whom have invested notable sums in the modernisation of Ukraine's grain marketing infrastructure in recent years – were unsettled by what appeared to be an instinctive return to old recipes and ways of thinking. The concern, echoed in many forums where potential agricultural investors gather,[2] is that after taking many courageous steps forward at the turn of the century, agricultural reform in Ukraine appears to be taking several steps back.

The consequence is that the perceived risk associated with investments in Ukrainian agriculture has increased, and with it the price that Ukraine must pay to attract capital and investors. The costs in terms of delayed investments – and higher costs of financing those investments that do take place – can only be guessed at, but could easily run into the tens and hundreds of millions.

Other policy responses to the emerging grain shortage have included:

- A lengthy series of debates and decisions leading to the reduction of duties on grain imports and the freeing of food grain imports from VAT; and
- The announcement of agreements that the Governments of Kazakhstan and the Russian Federation will provide Ukraine with 2,2 tonnes of grain at a price of 550 UAH/t.

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[1] See '*The Situation on Ukraine's Grain Markets: Crisis! What Crisis?*', Policy Paper T9 by the German Advisory Group on Economic Reform with the Government of Ukraine, September 2003.

[2] For example, the symposium on the *Competitiveness of Ukrainian Grain and Oilseeds Production* held on November 12th 2003 during the *Agri-Technica* Trade Fair in Hanover.

The decision to eliminate duties on food grain imports took several months. In early July, three different draft laws, some calling for elimination of import duties, others for the elimination of VAT and duties on imports, for different periods of time and different quantities of grain, were being considered by Parliament. On the 9th of July, a law setting a zero rate duty on wheat imports until November 1st, 2003 was passed. In early September, the government proposed extending the duty free status of wheat imports until June 2004 and cancelling VAT payments on imports until August 2004. Not until the 23rd of October, however, was corresponding legislation passed. In other words, it took almost 4 months from the beginning of July to provide food grain markets with a clear, dependable import regime for the 2003/04 crop year. In the interim, many traders delayed import transactions that could have been initiated earlier. After all, why import now and risk having to compete with other traders who waited and were able to import duty free?

There is no convincing need for duties on wheat imports in Ukraine in the first place; they have no meaningful impact in a net export situation[3] and they exacerbate price increases in a net import situation. In both recent episodes of grain shortage in Ukraine (2000 and 2003), import duties have eventually been eliminated, but in both cases this has cost valuable time as parliament and the government have wrangled over the associated legislative steps in the midst of the summer lull.

This situation was aggravated by the announcement at the end of July that Presidents of Kazakhstan and Russia had agreed to supply Ukraine with low-priced wheat. This announcement was a classic example of old-style policy, with high-ranking policy makers casting themselves as crisis managers decisively taking control of the situation (while lower-ranking officials, who allegedly have failed, are dismissed). The only problem is that this decisive action did at least as much damage as good. Kazakhstan may have the promised grain, but it increasingly appears that Russia does not. And whatever grain these countries do have is certainly not available for roughly 100 US$/t, when world market prices are easily 50% higher.

The resulting damage has been twofold. First, policy makers' credibility took a blow as market participants saw once again that words are not backed by action. Second, the announcement of low-priced imports from Kazakhstan and Russia reinforced traders' inclination to wait and see before importing grain. After all, why import grain at world market prices when Russian and Kazakh grain might soon become available at a considerable discount?

The long run costs of credibility loss and the resignation and cynicism that it engenders are impossible to quantify. But it is possible to estimate the magnitude of the losses that have been caused by the combined impact of

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[3] Even when Ukraine is a net exporter, it imports small quantities of grain for special purposes and in the course of normal cross-border trade with neighbours such as Moldova. In the 2001/2002 crop year, for example, Ukraine exported 9,2 million tonnes of grain, but also imported 49,2 thousand tonnes. Duties on such imports do generate a certain amount of customs revenue in net export years, but this revenue is hardly worth the damage caused by duties in net import years when keeping prices low is the top priority.

import duties and the Kazakhstan/Russia grain deal announcement on the timing of food grain imports. We provide such estimates in the Appendix at the end of this paper. First we assume that world market prices and freight rates will remain constant at their current (November 2003) levels of roughly 155 and 36 US$/t for the remainder of the 2003/04 crop year. We also assume that Ukraine's remaining imports up to a total of 4 million tonnes by the end of the crop year (roughly 2,4 million tonnes) will be distributed evenly over the months December 2003 through June 2004. Under these conditions (referred to as the 'Baseline' in the Appendix), Ukraine's wheat import bill in the 2003/04 crop year will add up to roughly 755 million US$.

What if imports had not been delayed by the policy measures? We will, of course, never know what might have been, but the Appendix contains calculations based on several alternative scenarios. In 'Scenario 1' we assume that the 4 million tonnes of total imports hypothesised above could have been distributed evenly over all 12 months of the crop year. In 'Scenario 2' we assume that traders could have locked in 2 million tonnes of imports at the average world market prices prevailing in June and July, with the remaining 2 million tonnes distributed evenly over the remainder of the crop year. We also repeat these scenarios under the assumption that world market prices do not remain constant but rather increase gradually to 170 US$/t between now and June 2004 ('modified' Scenarios 1 and 2 in the Appendix). In this case, cif prices rise to 206 US$/t, which is not unrealistic given that there are reports already now, at the end of November, of purchases of US wheat for roughly 200 US$/t, cif Odessa.

The results of these calculations suggest that policy measures that delayed the necessary import response to Ukraine's disappointing wheat harvest could lead to an increase in Ukraine's 2003/04 wheat import bill of somewhere between 10 and 60 million US$. To put these estimates into perspective, note that actual government expenditure on agricultural research in Ukraine in 2003 amounted to roughly 33 million US$.

The implications for future policy are clear:

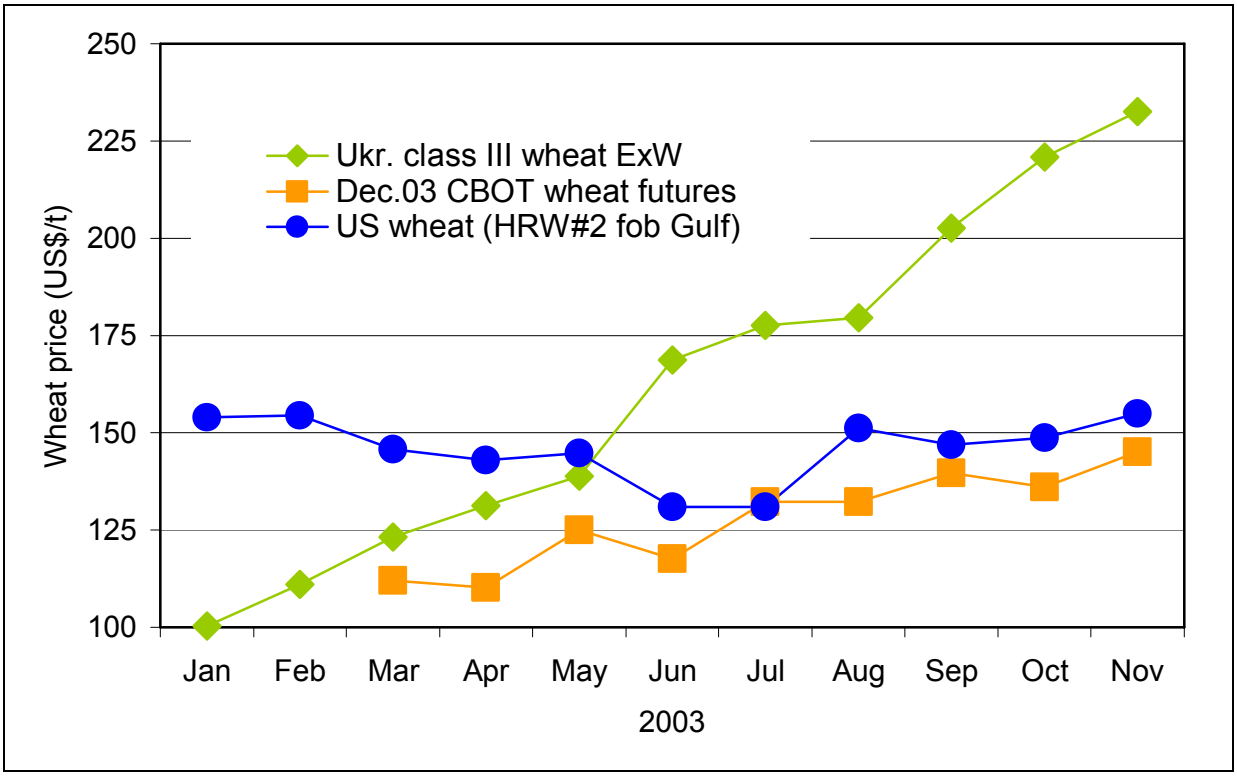
- First, **import duties for food grain should be completely and permanently eliminated** in the future, or at least implemented in a manner that allows them to be suspended on short notice in a blanket, non-discriminatory manner. In other words, there should be no need for time-consuming haggling by Parliamentarians over temporary increases in tariff rate quotas or partial reductions in duties whenever Ukraine becomes a temporary net importer of wheat.[4]
- Second, policy makers should **resist the temptation to micro-manage grain markets**. Grain traders know far better than high-ranking policy makers where, when and for what price wheat and other grains can dependably be purchased (or sold) on world markets. They will always be at

[4] We have argued in the past that negotiations of this type are largely an exercise in rent seeking ('Who Gains and Loses – Import Tariffs and Tariff Rate Quotas for Sugar and Grain in Ukraine', In: von Cramon-Taubadel, Zorya and Striewe (eds.), Policies and Agricultural Development in Ukraine. Shaker Verlag, 2001, pp. 134-143.

least one step ahead of policy makers when it comes to recognising important changes and trends on these markets. Instead of trying to negotiate deals themselves, policy makers should **invite traders to tender for the right to import a fixed quantity and quality of wheat**[5] spread out over the remainder of the crop year, with the contract going to the trader who provides the best combination of quality, price, financing conditions and timing. Competition between traders would guarantee that Ukraine imports at the best possible conditions given the means and mechanisms at their disposal, including up-to-date information collected world-wide and experience with risk management tools.

As an example of these risk management tools, consider futures markets. Figure 4 illustrates that back in May and June of 2003 – when indications were mounting that Ukraine's wheat crop would be very low and domestic prices were jumping to over 160 US$/t – December 2003 wheat was trading for 120-125 US$/t in Chicago. Of course, hindsight is always perfect, but a hedge against rising import prices brokered by one (or more) of the major grain traders could have been part of a reasonable risk management strategy at this time.

Figure 4: Wheat price developments in 2003 on world, futures and Ukrainian markets



Source: UkrAgroConsult, USDA, Chicago Board of Trade

[5] Back in mid-2003, tendering for perhaps 2 million tonnes would have been appropriate means of stabilising markets by demonstrating that a sizeable share of the expected shortage will be imported at a transparent price.

4 PL 480: A magic bullet?

In view of the events of the last half year discussed above, what is to be made of the recent announcement that Ukraine has officially requested that the US Government grant Ukraine credit for the purchase of one million tonnes of grain (as quoted by Reuters on November 20)? This grant would presumably take place under what is known as Public Law 480 (PL 480), the so-called Food for Peace Program. PL 480 foresees three types of food aid. The type that Ukraine might be eligible for is referred to as Title I, which provides for sales of agricultural products to developing countries under long-term credit arrangements.[6] A developing country is considered eligible for PL 480 assistance under Title I "…if it has a shortage of foreign exchange earnings and has difficulty meeting all of its food needs through commercial channels".[7]

Besides the question of whether these conditions really apply to Ukraine (for example, can it really be argued that Ukraine has a shortage of foreign exchange earnings, when leading policy makers are advocating that Ukraine repay xx billion US$ of IMF loans ahead of schedule?), a number of points can be made:

- First, any arrangement that is made with the US will take time to negotiate and ratify. The Ukrainian Parliament would, for example, have to grant sovereign credit guarantees, something that could take months under the best of conditions. PL 480 regulations require that all purchases be made via a tendering procedure in the US that would also take some time. All in all, it would appear that PL 480 wheat could arrive in Ukraine in perhaps 3 months at the earliest. Some analysts are arguing that it could not arrive until close to or after the 2004 harvest! If this were the case, the PL 480 wheat might actually arrive after Ukraine has (we all hope) returned to a net export situation, i.e. when prices are falling and the last thing Ukraine needs is more wheat.
- Second, agreements under PL 480 Title I "…prohibit the resale or transhipment of Title I commodities ('export restrictions') and may prohibit or limit the export of similar commodities ('export limitations')…" (see footnote 7). This might imply that Ukraine would not be permitted to export (food) wheat from the 2004 harvest, at least for a number of months. Should Ukraine return to a net export situation with the 2004 harvest, such a restriction could lead to a severe price collapse on the domestic grain market, with disastrous consequences for agricultural producers.[8]
- The possibility that as much as one million tonnes of wheat might be imported under special conditions in the current crop year will likely have the same impact on imports as the announcement of special deals with Kazakhstan and

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[6] The other two types of PL 480 assistance (Titles II and III) provide for donations of agricultural products to meet humanitarian needs and to support long-term development in the least developed countries, respectively.

[7] See http://www.fas.usda.gov/excredits/pl480/pl480brief.html.

[8] Wheat prices would fall not only from world market levels plus marketing costs to world market levels minus marketing costs (see below), but also by an additional amount equal to the costs of storing wheat from the harvest until such a time as it could be exported again.

Russia back in late July. Traders will adopt a wait and see approach; import transactions may be delayed or deferred. In the same vein, the possibility of export restrictions after the 2004 harvest could reduce the willingness of traders and input suppliers to provide producers with credit. In other words, it is very conceivable that PL 480 could destabilise rather than stabilise Ukrainian grain markets.

For these reasons, grants from the US under PL 480 should be pursued with considerable caution. **If a PL 480 agreement cannot be reached very quickly, ensuring that wheat will arrive well before the 2004 harvest, there would appear to be little sense in pursuing it.[9] By no means should such an agreement limit Ukraine's freedom to export wheat or other grains from the 2004 harvest**, as this could create serious problems for Ukrainian grain producers. If an agreement is reached, it must be reached and made completely transparent as soon as possible. One million tonnes of US grain will not suffice to make up the remaining shortfall in Ukraine prior to the 2004 harvest. Hence, additional imports will be required, and any uncertainty that delays these imports could add to the unnecessary costs that have already resulted from well-meaning but ill-advised attempts to out-guess markets.

5 The impact of VAT exemptions for imported food grain

Two things about the current VAT exemption for imported food grain in Ukraine deserve mention. **First**, a VAT exemption that applies exclusively to imports does not reduce prices for consumers. Table 1 illustrates this effect by schematically comparing situations a) with and b) without import VAT. Note that neither the tax authorities nor intermediate or final consumers notice any difference between situation a) and b): net VAT revenues and the final price to consumers are identical. The reason is that a VAT is passed along the marketing chain to – and finally paid by – the final consumer. Hence, a reduction in VAT will only benefit consumers if it is extended to the entire marketing chain. So the VAT exemption for imports does not address the most important concern stemming from the current shortage of food grain in Ukraine, which is high bread prices for consumers.

Second, the VAT 'exemption' for food grain imports in Ukraine as it is being implemented does not really represent an exemption. According to traders, the following procedure is in effect: At the border an importer is given a VAT bill to be met within 180 days. Hence, the importer is not exempt but simply does not have to pay VAT immediately at the border. The trader then sells the imported grain on the domestic market (for example to a mill) and collects VAT. The 'exemption' lies in the fact that instead of surrendering this VAT to the authorities, the trader can cancel his obligation against export VAT arrears that

[9] Unless, of course, there are very clear signs that the 2004 harvest will not suffice to move Ukraine back into a net export situation. Such signs could first appear in the early months of 2004 (for example if, heaven forbid, the coming winter was as severe as last year's) and would necessitate a complete rethinking of Ukraine's medium-term grain market strategy.

are owed him the authorities. For example, if a trader owes the tax authority 1 million UAH in import VAT, and the tax authority owes this trader 2 million UAH of export VAT refunds from previous years, the amounts are netted out; the trader's import VAT obligations are eliminated and the tax authority's export VAT liabilities are reduced to 1 million UAH. The principle is illustrated in part c) of Table 1. Of course, this 'swap' only works if the trader in question is owed export VAT. However, it is safe to assume that this will be the case for many, if not most of the traders currently importing food grain into Ukraine.

Table 1: The impact of an import VAT exemption

a) 20% VAT, no exemptions				
	Importer	Stage 2: Milling	Stage 3: Baking	Total
VAT rate	0,2	0,2	0,2	
'Production' costs	1	1	1	
Sales price net of VAT	1	2	3	
Sales price including VAT	1,2	2,4	3,6	
VAT paid to tax authority	0,2	0,4	0,6	1,2
VAT refund from tax authority	0	0,2	0,4	0,6
Authority's net VAT revenue	0,2	0,2	0,2	0,6
b) 20% VAT, import transaction exempt				
	Stage 1: Import	Stage 2: Milling	Stage 3: Baking	Total
VAT rate	0	0,2	0,2	
'Production' costs	1	1	1	
Sales price net of VAT	1	2	3	
Sales price including VAT	1	2,4	3,6	
VAT paid to tax authority	0	0,4	0,6	1
VAT refund from tax authority	0	0	0,4	0,4
Authority's net VAT revenue	0	0,4	0,2	0,6
c) 20% VAT, 'exemption' as applied in Ukraine				
	Stage 1: Import	Stage 2: Milling	Stage 3: Baking	Total
VAT rate	0	0,2	0,2	
'Production' costs	1	1	1	
Sales price net of VAT	1	2	3	
Sales price including VAT	1,2	2,4	3,6	
VAT paid to tax authority	0	0,4	0,6	1
VAT refund from tax authority	0	0,2	0,4	0,6
Authority's net VAT revenue	0	0,2	0,2	0,4

Source: Own schematic depiction.

Who gains and who loses from this 'exemption' procedure? While consumer prices do not fall (see Table 1, c), it may be that some traders step up their imports in order to take advantage of the opportunity to secure export VAT refunds. Depending on the magnitude of this incentive effect, increased imports could relieve pressure on the domestic food grain market in Ukraine. The tax authority would appear to lose import VAT revenue, but elsewhere in its accounts export VAT liabilities are simultaneously reduced by the same amount. The

trader gains an amount equal to the import VAT that he/she does not have to surrender to the tax authority, but at the same time his/her export VAT receivables are reduced by the same amount. Since there may be no other way for traders to receive the export VAT that they are owed by the tax authority, they may consider this a gain. Alternatively, it is reported that export VAT refunds can be obtained in return for a bribe equal to roughly 40% of the amount in question. If this is considered the reference situation, the current import VAT 'exemption' scheme provides a trader with a net benefit of these 40%, i.e. the bribe that he/she would otherwise have had to pay to receive the refund.

In summary, therefore, the only contribution to relieving the current situation on Ukraine's domestic food grain market that is provided by the import VAT 'exemption' results from its possible effect of increasing the volume of food grain imports. The magnitude of this effect is difficult to estimate because we will never know how much would have been imported otherwise, but it certainly is a positive effect. At the same time however, the mechanism used to generate this effect is questionable, to say the least. Traders who have exported grain in the past are legally entitled to receive their export VAT refunds; they should not have to bribe or import grain or do anything else to receive them. So while the import VAT 'exemption' (actually a swap) may have some positive impact, it is not going to contribute to Ukraine's reputation as a place to do business subject to the rule of law.

Provisions for the future of export VAT refunds in the draft budget for 2004 will create problems as well. First, existing VAT refund arrears are to be converted into 5 year government bonds that yield 20% above the NBU refinance rate. This represents a loss to the firms in question, both in terms of liquidity (they will be forced to grant the Ukrainian State a 5 year credit) and in terms of profit (as the yield of these bonds is not sufficient to cover the costs of the corresponding credits). Second, according to the draft Budget (Article 83), agricultural exports will no longer be eligible for VAT refunds as of January 1, 2004. This will hurt firms who have already made deals to be consummated after January 1, 2004 on the assumption that VAT will be refunded on export. These firms have calculated prices on the basis of this assumption, and may now be forced to take a corresponding loss.

Furthermore, all future transactions will be based on a new calculation that does not assume that VAT will be refunded on export. In the end farmers will feel the impact of this decision, as traders will simply pass on what is essentially a cost increase when they purchase Ukrainian grain for export. It is already easy to predict what will happen next year when Ukraine (we hope) returns to a next export situation (see below): prices will fall dramatically from current levels and policy makers will scramble to devise methods of supporting farmers (pledge prices, intervention, etc.). Why not simply maintain VAT refunds for traders (and actually pay these refunds on time)? This would be the simplest way of providing farmers with tangible support.

What else could be done to relieve the current situation on food grain markets in Ukraine? The main objective stated by many policy makers is to stabilise markets and keep prices for wheat as low as possible. The domestic price of wheat in Ukraine has two main components: the world market price at the border, and the

cost of importing and moving this wheat from the border to inland positions where it is milled. Let us consider some typical current data on these components. At the moment, the border price for imported class II wheat is roughly 170 US$/t, or about 905 UAH/t. By the time it reaches Bila Tserkov, this wheat costs roughly 1230 UAH/t, in other words 325 UAH/t or 36% more than at the border. What cost components make up these 325 UAH? Table 2 gives an indication of the various components[10].

Table 2: Typical costs of marketing import wheat

Nr.	Marketing cost component	Cost (UAH/t)
1	VAT	182,00
2	Interest rate on credit	22,00
3	Custom duty (0.2% of the value of the wheat)	1,82
4	Unified custom tariff (based on 2 €/carriage)	0,20
5	Payments to custom workers (for their service - $20/hour)	1,60
6	Certification procedures	8,00
7	Custom clearing	11,00
8	Forwarder's service	5,00
9	Extra costs (storage at the railway station, detention of the carriage)	38,00
10	Railway tariff	20,00
11	Revision at the station	5,60
12	Quarantine tax	0,50
13	Unloading on the elevator	8,00
14	Weighing	0,50
15	Storage (based on 5 UAH/ton/month)	5,00
16	Currency operations (imports must be paid for in US$)	14,00
	Sum	323,22

Reducing some of these costs components is a policy priority that would not only reduce wheat price in the current import situation, but also reduce the size of the price reduction that can be expected when Ukraine returns to a net export situation after the 2004 harvest. After all, in a net export situation domestic prices can be expected to fall to world market levels minus marketing costs; all other things being equal they would fall from 1230 UAH/T (= 905 + 325) to 580 UAH/t (= 905 – 325) or by more than 50%.

6 Summary

Initial policy reactions to the emerging grain crisis, especially the announcement of import deals with Russia and Kazakhstan and the delays in removing import barriers, exacerbated the problem by delaying imports and thus destabilising markets. The recent announcement that Ukraine is seeking grants from the US under PL 480 could have a similar effect. The so-called VAT exemption for food grain imports does not reduce consumer prices in Ukraine, and is essentially

[10] The data were provided by the Ukrainian Grain Association

implemented as a swap with traders against outstanding VAT export refunds. This will encourage imports to a certain degree, although traders are entitled to these refunds and should not have to import food grains to secure them. A key problem that destabilises grain markets in Ukraine, pushing prices higher (lower) than necessary in import (export) situations is that of excessive marketing costs. Reducing these costs remains a key policy priority. Proposed changes to the system of VAT refunds on agricultural exports will reduce farm gate prices when Ukraine returns to a net export position, presumably following the next harvest. This tax on farmers contradicts the stated policy goal of supporting grain production in Ukraine.

SvCT, Lector AK

December 2003

Appendix 1: Ukrainian wheat import bills in the 2003/04 crop year under various scenarios

Month	Baseline imports ('000 t)	Baseline price (US$/t)	Freight costs (Gulf-Odessa, US$/t)	Price cif Odessa (US$/t)	Baseline import bill (mill. US$)	Scenario 1 imports ('000 t)	Scenario 1 import bill (mill. US$)	Scenario 2 imports ('000 t)	Scenario 2 import bill (mill. US$)
Jul	59,6	133,8	27,6	161,4	9,6	333,3	53,8	666,6	107,0
Aug	248,4	155,2	28,9	184,1	45,7	333,3	61,4	666,6	107,0
Sep	174,0	150,0	29,8	179,8	31,3	333,3	59,9	666,6	107,0
Oct	565,2	149,0	36,0	185,0	104,6	333,3	61,7	222,2	41,1
Nov	565,2	155,0	36,0	191,0	108,0	333,3	63,7	222,2	42,4
Dec	341,1	155,0	36,0	191,0	107,9	333,3	63,7	222,2	42,4
Jan	341,1	155,0	36,0	191,0	58,0	333,3	63,7	222,2	42,4
Feb	341,1	155,0	36,0	191,0	58,0	333,3	63,7	222,2	42,4
Mar	341,1	155,0	36,0	191,0	58,0	333,3	63,7	222,2	42,4
Apr	341,1	155,0	36,0	191,0	58,0	333,3	63,7	222,2	42,4
May	341,1	155,0	36,0	191,0	58,0	333,3	63,7	222,2	42,4
Jun	341,1	155,0	36,0	191,0	58,0	333,3	63,7	222,6	42,5
Total	4000				**755**	4000	**746**	4000	**702**
Month	Baseline imports ('000 t)	ModifiedBaseline price (US$/t)	Freight costs (Gulf-Odessa, US$/t)	ModifiedPrice cif Odessa (US$/t)	ModifiedBaseline import bill (mill. US$)	ModifiedScenario 1 imports ('000 t)	ModifiedScenario 1 import bill (mill. US$)	ModifiedScenario 2 imports ('000 t)	ModifiedScenario 2 import bill (mill. US$)
Jul	59,6	133,8	27,6	161,4	9,6	333,3	53,8	666,6	107,0
Aug	248,4	155,2	28,9	184,1	45,7	333,3	61,4	666,6	107,0
Sep	174,0	150,0	29,8	179,8	31,3	333,3	59,9	666,6	107,0
Oct	565,2	149,0	36,0	185,0	104,6	333,3	61,7	222,2	41,1
Nov	565,2	155,0	36,0	191,0	108,0	333,3	63,7	222,2	42,4
Dec	341,1	157,1	36,0	193,1	109,1	333,3	64,4	222,2	42,9
Jan	341,1	159,3	36,0	195,3	59,3	333,3	65,1	222,2	43,4
Feb	341,1	161,4	36,0	197,4	60,0	333,3	65,8	222,2	43,9
Mar	341,1	163,6	36,0	199,6	60,6	333,3	66,5	222,2	44,3
Apr	341,1	165,7	36,0	201,7	61,3	333,3	67,2	222,2	44,8
May	341,1	167,9	36,0	203,9	61,9	333,3	68,0	222,2	45,3
Jun	341,1	170,0	36,0	206,0	62,6	333,3	68,7	222,6	45,9
Total	4000				**774**	4000	**766**	4000	**715**

Source: Own calculations based on actual data up to October-November 2003 and various projections/assumptions through to June 2004 (see text).