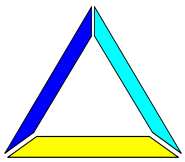
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S25

The Implications of WTO-Accession for Ukrainian Agricultural Policy

1. Introduction

The current focus of attention regarding the WTO in Ukraine is understandably on Ukraine's stated intention to join the WTO, the ongoing negotiations with the Working Party, and the resulting conditions under which Ukraine could be accepted as a member. While we will deal with the agricultural dimension of these questions in this paper, it is important to recognise that the on-going Doha Round of WTO negotiations could also have important implications for agriculture in Ukraine. Ukraine is currently negotiating with the WTO on the basis of agricultural provisions established under the Uruguay Round Agreement on Agriculture (URAA) in 1993. It may be that the result of the Doha Round shifts some of the URAA parameters, creating the need for further adjustment in Ukraine beyond that which would be the result of a successful completion of Ukraine's membership negotiations. Both processes – Ukraine's membership negotiations and the Doha Round – are uncertain as regards both outcome and timing. Hence, at the moment, it is only possible to engage in more or less informed speculation.

Before proceeding, it is useful to reiterate that Ukraine would gain a great deal from WTO membership, in agriculture as in other sectors. The discussion of membership implications in the body of this paper will centre largely on the disciplines and restrictions that will likely result for agriculture and agricultural policy makers in Ukraine. These disciplines and restrictions will undeniably reduce the freedom or leeway enjoyed by Ukrainian agricultural policy makers. This might lead some to question the wisdom of WTO membership in the first place, and for this reason it is important not to lose sight of the benefits that Ukraine will receive in return. These include the following:

- WTO membership would add impetus and urgency to Ukraine's agricultural policy reform agenda, and would also commit Ukraine to a more stable and transparent agricultural policy than has been implemented so far. This would have positive effects on both domestic and foreign investment, something which is of particular importance for a sector that is as capital and know-how intensive as agriculture. As a result, Ukraine, as a WTO member, could tap its agricultural potential faster, to the benefit of the entire economy.

- WTO membership would also give Ukraine a voice in future debates on the international rules governing agricultural trade and policy making. With its comparative advantage in agriculture and its status as a 'small' country exporter of major temperate agricultural products such as grains and oilseeds (and potentially livestock products), Ukraine appears predestined to become a member of the Cairns group. Like the Cairns group members, Ukraine desperately needs a level playing field in international agricultural trade. It was the Cairns group's insistence in the Uruguay Round that led to the first substantive agricultural agreement in the history of the (GATT-) WTO, and many are pinning their hopes on similar advocacy by the Cairns group in the Doha Round.[1]

- Finally, as a WTO member, Ukraine would enjoy access to the WTO's dispute settlement mechanism and protection from arbitrary treatment by its trading partners. That this can be of great importance has been demonstrated recently in connection with the EU's decision to introduce grain import quotas. While the EU had to consult with other WTO members – such as Canada and the United States – on this matter, it did not have to consult with Ukraine.[2]

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[1] This voice could become especially important if the so-called 'Peace Clause' agreed to under the WTO and due to expire on January 1, 2004 is not renewed. The Peace Clause protects important aspects of current agricultural policies – especially in the EU and the US – from challenge. Should it expire, some experts feel that other WTO members could mount a serious challenge against the world's major agricultural subsidisers (AGRA EUROPE, 2002, p. EP/12).

[2] It should be noted in passing that the EU's decision to impose grain import quotas is unfortunate and not in the spirit of a progressive liberalisation of world agricultural trade. Indeed, it borders on hypocritical when firms in the EU lobby for the opening of Ukraine's markets for agricultural machinery and other farm inputs, while the EU simultaneously resticts its own markets for the grains that these inputs are used to produce.

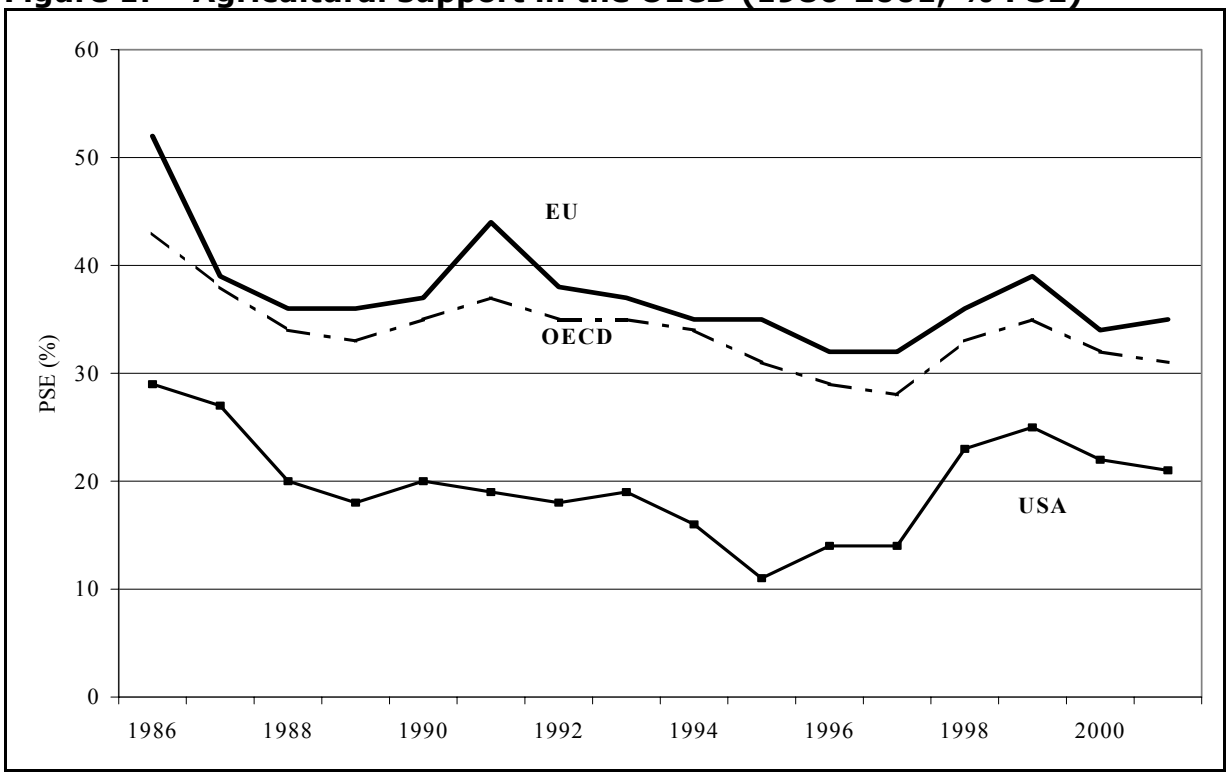
In the following we begin by briefly outlining the relationship between agriculture and the WTO (section 2), before proceeding to consider the likely impact of WTO membership on agriculture and agricultural policy making in Ukraine (section 3). We close in section 4 with conclusions and a brief look forward.

2. The WTO and agriculture

Agriculture has a special place within the WTO largely because it is spent most of the history of this organisation – and its predecessor, the GATT – without. As mentioned above, the Uruguay Round marked a turning point in that, largely as result of the insistence of the Cairns group, agriculture was for the first time subjected to meaningful disciplines. While the subjection of agriculture to international rules governing trade without doubt represented a major breakthrough, in retrospect the concrete impact of the URAA on domestic agricultural policies in the member countries has been rather disappointing. As illustrated in figure 1, for example, there has been some reduction in overall agricultural support in the OECD since the mid-1980s.[3] Since the mid-1990s, however, no clear trend is apparent. As a matter of fact, in the United States agricultural support is on the rise.

[3] Agricultural support is measured in figure 1 using the Producer Subsidy Equivalent (PSE) concept developed by the OECD. The PSE measures support to farmers, from consumers through higher commodity prices and from taxpayers through budgetary transfers. The PSE is defined as the annual value of the total monetary transfers from consumers and taxpayers to agricultural producers as a percentage of gross farm receipts (OECD, 2000).

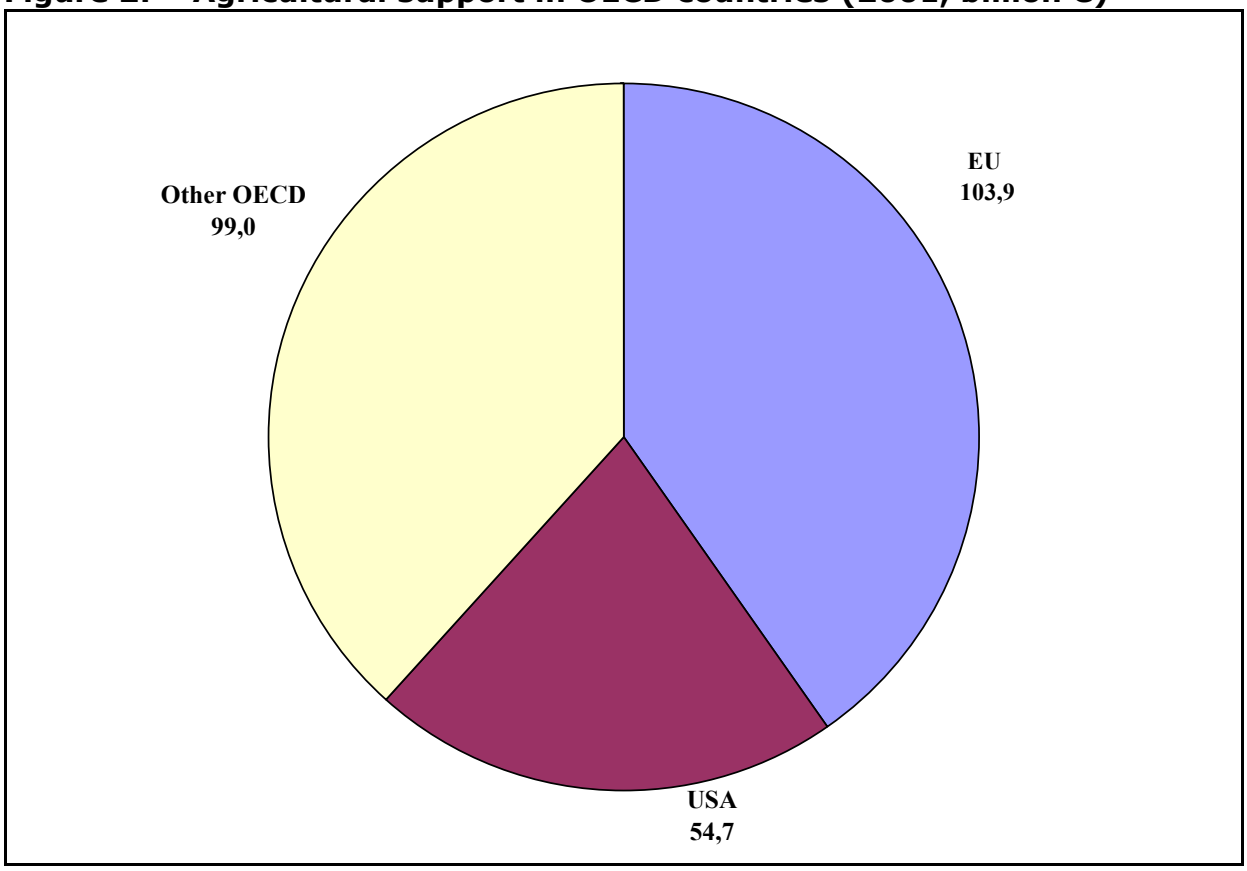
Figure 1: Agricultural support in the OECD (1986-2001, % PSE)



Source: TANGERMANN (2002).

With high insight it is clear that the URAA contained too many loopholes, for example in the form of base period definitions that were designed to leave as much leeway as possible, or commitments to reduce support or import protection that could be applied on average, leaving considerable discretion to maintain 'peaks'. As a result, agricultural support in the OECD as a whole in 2001 amounted to a staggering 258 billion euros or roughly 1% of total OECD GDP. As is apparent in figure 2, the EU and the USA are responsible for the lion's share of this support.

Figure 2: Agricultural support in OECD countries (2001, billion €)



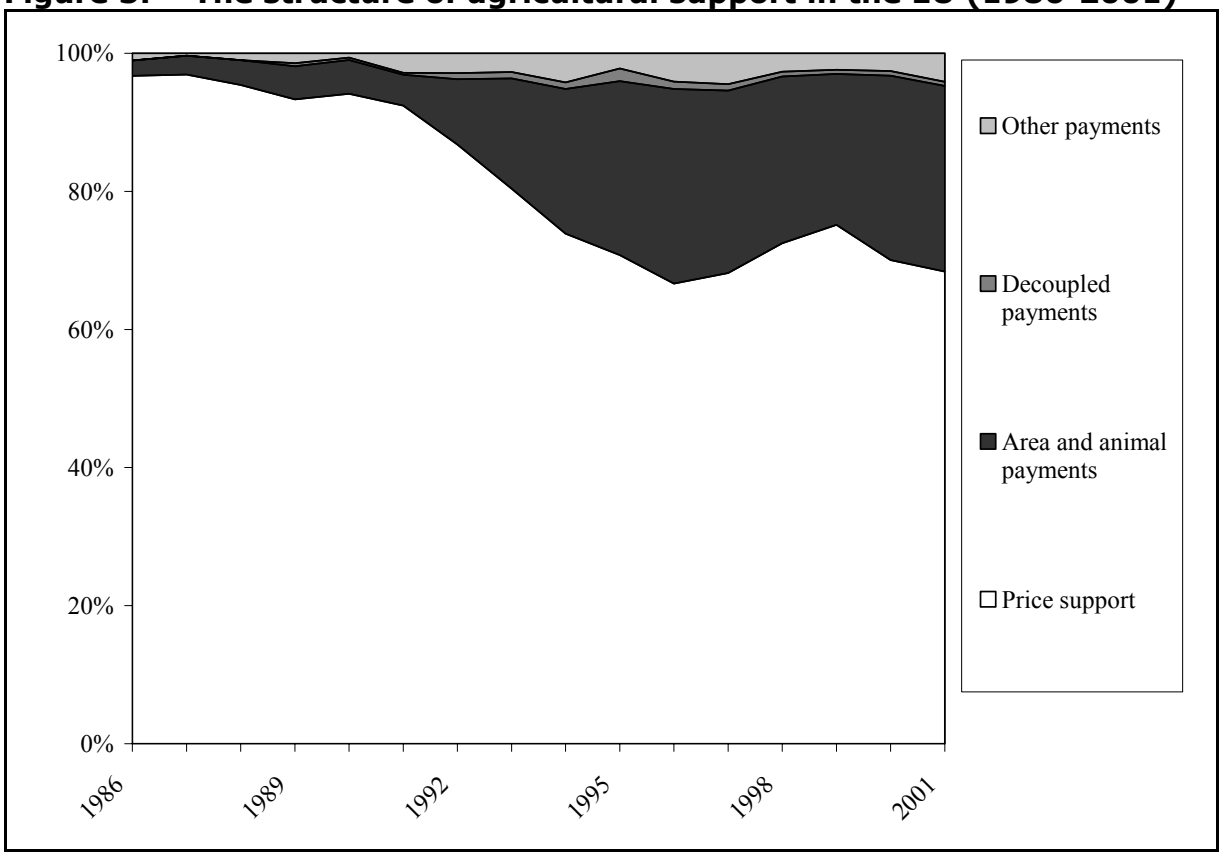
Source: TANGERMANN (2002).

In view of these agricultural policies elsewhere, it is easy to empathise with the position of Ukraine's negotiators with the WTO, who must at times feel as if they are being subjected to a double standard: "Don't do as we do; do as we say". Nevertheless, it is important not to draw the wrong conclusions from a Ukrainian perspective regarding the desirability of agricultural protection and support. First, as the numbers in figure 2 illustrate, agricultural support is very expensive. While it might benefit farmers, it places a significant burden on taxpayers and/or consumers. When support takes the form of protection (for example price support or production quota systems) it leads to economic waste, reducing economic growth and destroying jobs. It is moot whether 'rich' countries such as the EU can actually afford these costs; it is abundantly clear that Ukraine cannot.

Second, note that while agricultural support in the OECD countries has not fallen much on average since the end of the Uruguay Round, the structure of agricultural support has been changing. As illustrated in figure 3, the importance of price support has fallen progressively in the EU since the early 1990s, while the importance of various forms of direct payment has increased. This is important because, again, different types of agricultural support are associated

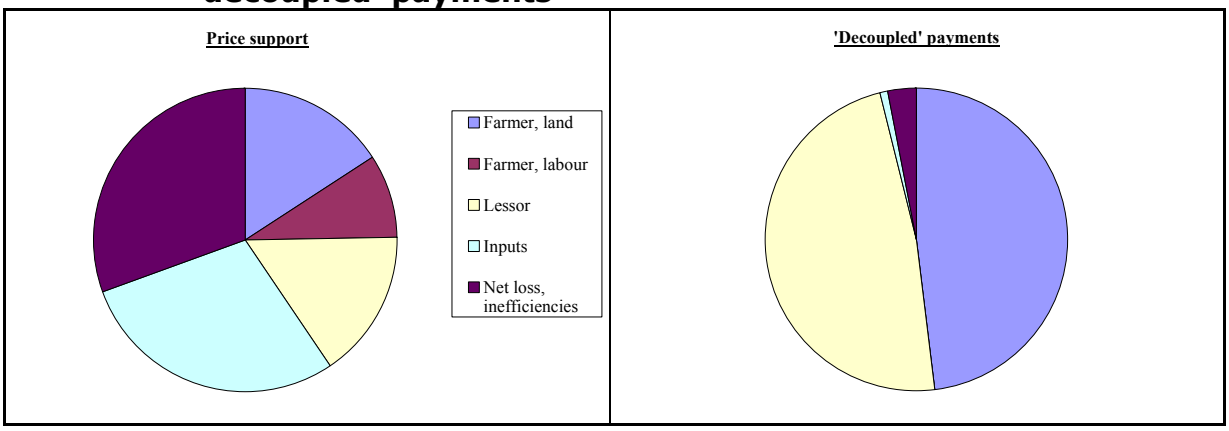
with different degrees of efficiency. As illustrated in figure 4, only roughly 40% of price support payments end up in farmers' or land owners' pockets – the remaining 60% end up either wasted or in the hands of input suppliers. Decoupled payments are considerably more efficient as roughly 90% end up benefiting farmers. Hence, while agricultural support remains prevalent, there is a clear trend to more efficient forms of support. The recent so-called Mid-Term Review (MTR) reform proposals tabled by EU agricultural Commissioner Fischler – with their emphasis on further reduction in price support and a move to decoupled income transfers – are symptomatic of this trend. Ukraine would be well advised to anticipate the results of this trend and design an agricultural policy that is forward looking and does not force Ukraine to repeat the costly mistakes that have created so much domestic and international friction elsewhere.

Figure 3: The structure of agricultural support in the EU (1986-2001)



Source: TANGERMANN (2002).

Figure 4: Who benefits from agricultural policy? Price support versus 'decoupled' payments



Source: TANGERMANN (2002).

Third, the results of the ongoing Doha Round of WTO negotiations can be expected to continue and perhaps accelerate the trend toward continued liberalisation of agricultural policies and the implementation of less distortive policy tools world-wide. The outcome of the Doha Round is uncertain at the moment[4], and some analysts are sceptical that it will lead to major a breakthrough in agriculture because two major players – the EU and the US – both appear to be considerably less than fervent in their desire for reform. The agricultural proposals that are currently on the table in the Doha Round and the prospects for a successful outcome of this round are discussed elsewhere in this book in great detail and clarity and need not be repeated here. Certainly, experience with the implementation of the URAA has made it clear where the loopholes are and how they might be plugged. Whatever the exact outcome of the Doha Round, a return to the policies of the 1960s-1980s, with their emphasis on price support, is out of the question. So, again, Ukrainian policy makers should look forward and not back in their search for '*Leitbilder*'. Any progress in the area of agriculture as a result of the Doha Round would benefit Ukraine. In particular, a reduction in the use of export subsidies – which both the Cairns group and the US have made a central element of their negotiation proposals – would make it easier for Ukraine to compete on world markets.

[4] The first draft of an outline agreement on agricultural subsidies was tabled by the Chairman of the WTO agricultural negotiations on December 18, 2002. According to schedule, the WTO members should agree on the so-called 'modalities' (a framework that specifies the percentage and other support and protection reductions that will emerge from the Doha Round) by March 31, 2003. After the 'modalities' have been established, member countries will make corresponding detailed offers on how they propose to reduced their domestic support and protection measures (AGRA EUROPE, 2002, p. EP/8).

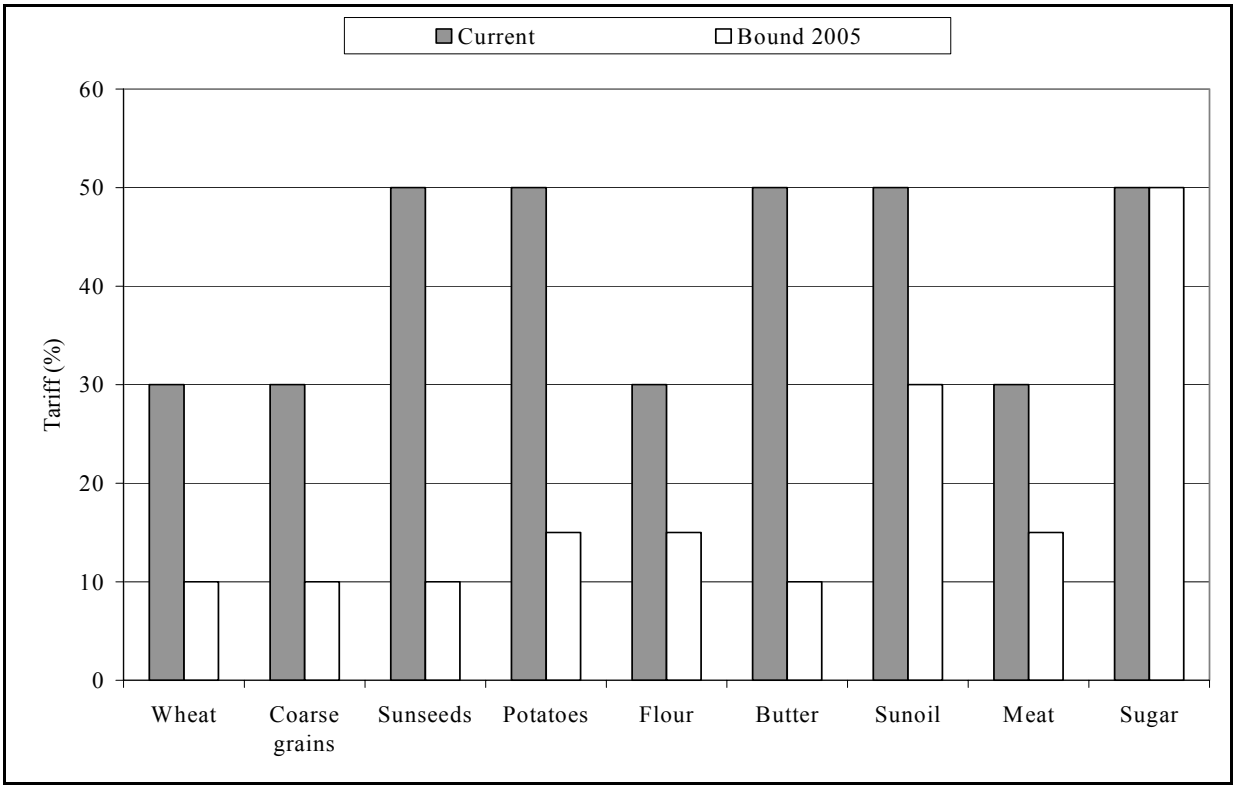
3. The implications of WTO membership for Ukrainian agriculture

The URAA contained provisions in four major areas related to agriculture. These are: market access; domestic support; export subsidies; and sanitary and phytosanitary measures. These categories are also framing the current Doha Round negotiations on agriculture, so it makes sense to structure the following discussion along these lines as well.

3.1 Market access

As the outcome of the negotiations between Ukraine and the member countries of Ukraine's WTO working party are ongoing, it is not yet clear exactly what concessions Ukraine will have to make in the area of market access. Ukraine has offered to reduce its tariffs on major agricultural products from the current levels illustrated in figure 5 to the bound levels also presented in this figure. This would reduce Ukrainian agricultural tariffs roughly from 22% to 13% on average, and there are indications that the members of the working party are more or less in agreement with this proposal.

Figure 5: Current and committed bound agricultural import tariffs in Ukraine



Source: Own presentation based on Government Decree on Unified Customs Tariff in Ukraine from 1993, Presidential Decree on Transformation of Unified Import Tariff in Accordance with the GATT/WTO from 1996 and law of Ukraine on State Regulation of Agricultural Imports to Ukraine from 1997 (see on www.rada.kiev.ua).

Membership in the WTO would also entail that the not infrequent use of specific agricultural tariffs in Ukraine would have to be curtailed in favour of *ad valorem* tariffs. Furthermore, it appears that Ukraine would not be permitted to make use of special safeguard provisions. Special safeguard provisions were introduced at the end of the Uruguay Round as a means of providing countries such as the EU – that were required to transform variable import levies and other non-tariff barriers to trade into bound tariffs – with a means of dealing with the import surges that might result. Since Ukraine makes no use of such non-tariff import barriers, it will not be required to subject them to 'tariffication' as a result of WTO membership and will therefore be in no greater danger of import surges after the fact than it was before.

A contentious area with regard to market access is sugar. As can be seen in figure 5, sugar is the one important agricultural product for which Ukraine has offered no tariff concessions. Ukraine is a net importer of sugar, so controlling imports is, together with the domestic production quotas that have been

implemented, a means of controlling domestic prices.[5] The size of Ukraine's tariff rate quota for imports of raw sugar has been an issue of some contention with different members of the working party; amounts of 200 000 tons and 260 000 tons have been discussed. As the Ukrainian authorities have discovered, and as was predicted several years ago by the German Advisory Group (VON CRAMON-TAUBADEL, 1999), Ukraine's sugar policy has generated considerable incentives for smuggling, so that the size of the tariff rate quota may be at least partly academic. Unfortunately, sugar would appear to be one area of agricultural policy in which Ukraine is insisting on repeating the costly errors committed elsewhere.

The net effect of all of these market access previsions on agriculture in Ukraine is difficult to predict. To date, there is no modelling tool available that provides the detailed depiction of cross-product linkages (i.e. between the livestock sector and the grain sector, or between different varieties of grain) that would be required to provide a detailed set of simulations. The *German Advisory Group* and the affiliated *Institute for Economic Reform* have begun to develop such a modelling tool and hope to be in a position to provide first results by mid-2003. However, the required data basis, especially as regards supply side responses, remains fragmentary and the prevalence of the shadow economy and activities such as smuggling will continue to challenge modellers for years to come.

3.2 Domestic support

The area of domestic support is perhaps one of the most controversial areas in the negotiations between Ukraine and the members of its WTO working party. Ukraine has proposed that a 1994 to 1996 base period be employed to define Ukraine's bound level of domestic support. The use of this base period leads to an aggregate measure of support (AMS) of 1.38 billion US$. Some members of the working party are, however, insisting on the use of a 1997 to 1999 base period that would leave Ukraine with an AMS of 0.64 billion US$. Ukrainian officials argue that 1.38 billion US$ is already a very small amount compared with the support that other countries – in particular the EU and the US – provide to their agricultural sectors (recall figure 2 above). They also argue that the use

[5] As a result of production quotas and import barriers, domestic prices for white sugar in Ukraine have ranged between 2 000 and 2 200 Hryvnia/t in recent months, the equivalent of 375 to 410 US$/t or roughly twice the world market price.

of 1997 to 1999 – the depth of Ukraine's agricultural crisis – is not at all representative and would limit Ukraine to a level of support that is not in keeping with the agricultural policy needs of such a large and important sector of the Ukrainian economy. Some working party members are insisting, however, that any amount of agricultural support is simply too much, and that Ukrainian agriculture should not be permitted to become addicted to subsidies in the first place. These countries – for example Australia[6] – are concerned that without strict WTO disciplines Ukraine would end up joining the ranks of those competitors that use subsidies to compete unfairly on world agricultural markets.

Ukrainian negotiators might be forgiven for feeling that the strict demands on Ukraine's AMS level that some members of the working party are making are at least partly the result of frustration born from their inability to apply meaningful pressure to the much larger and much more trade distorting domestic support provided by the US and the EU. On the other hand, note that Ukraine provides the majority of its domestic support (roughly 80%) in the form of tax exemptions that are not included in AMS calculations.[7] Hence, the debate over 1.38 *versus* 0.64 billion US$ of domestic support is to some extent artificial in that regardless of the amount that is finally bound, tax exemptions will continue to provide a means of delivering more support. Note as well that 1.38 billion US$ or the equivalent amount of Hryvnia (roughly 7.4 billion) is far in excess of any amount that could realistically be incorporated into Ukraine's state budget in the foreseeable future. For these reasons Ukraine would be ill advised to allow the success of its WTO negotiations to hinge on the domestic support issue. Indeed, from an economic perspective, Ukraine would be well advised to ensure that whatever agricultural policy tools it implements are largely green box measures – such as support for education and research in agriculture and the development of agricultural marketing infrastructure – that would not be subject to domestic support disciplines in the first place.

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[6] Note that Australia's agricultural policy is very liberal in comparison with other OECD members. Its PSE currently amounts to 4% or 1 billion US$ (TANGERMANN, 2002).

[7] See VON CRAMON-TAUBADEL and ZORYA (2001).

3.3 Export subsidisation

As Ukraine has not employed export subsidies in the past it follows – and would appear to have been accepted by all parties to the negotiations – that Ukraine should receive no allowance for the use of export subsidies in the future. Since it is not unlikely that the Doha Round will lead to a major curtailment and perhaps even the elimination of the use of export subsidies in agriculture, it would probably not make much sense for Ukraine to insist – as Russia currently is – on receiving an export subsidisation allowance; the 'bargaining chips' that would be required to gain concessions in this area are better employed elsewhere.

An important implication of the fact that Ukraine would not be permitted to use export subsidies as a future WTO member is that as a net exporter of most important agricultural products, Ukraine would not be able to employ domestic price support measures. This is because domestic price support in an export situation necessarily leads to the accumulation of surpluses that can only be exported with the use of some form of export subsidy, either implicit or explicit. This means, for example, that the intervention system for grain that Ukraine introduced in the summer of 2002 is fundamentally incompatible with the likely conditions of Ukraine's WTO membership. WTO membership would therefore result in a considerable reduction in the range of policy tools available to agricultural policy makers in Ukraine. From an economic efficiency perspective this would be a positive development as it would preclude the use of inefficient and distortive price support policies (recall the discussion surrounding figure 4 above). By joining the WTO, agricultural policy makers in Ukraine would in effect be committing themselves to resist the temptation to use these tools in the future.

3.4 Sanitary and phytosanitary measures

The agreement on sanitary and phytosanitary (SPS) measures reached at the end of the Uruguay Round aims to reduce trade tensions by limiting the use of health and safety measures that are disguised protection. The SPS agreement, which is described in greater detail by SCHULER elsewhere in this volume, aims to harmonise the SPS measures applied by WTO member countries and ensure that they are both transparent and science-based.

As the procedures used to test for contamination become increasingly sophisticated and sensitive, and as consumers in industrialised countries become increasingly sensitised to food quality issues, there has been some concern that SPS measures could lead to a 'race to the top' whereby industrialised countries set very exacting standards that are prohibitively expensive to control and monitor in 'small' countries that cannot afford to invest in the required capacities (for example, personnel and laboratories). The result could be non-tariff barriers in the guise of consumer protection.[8]

For this reason, 'small' countries such as Ukraine have a strong interest in an SPS agreement that ensures transparency and fairness. At the same time, Ukraine should take every possible step to ensure that problems with the quality of its own food exports do not fuel a demand for excessive SPS standards in other countries. As recent alleged findings of various types of contamination in shipments of Ukrainian grain to Brazil, France and Canada attest, the issue of product quality and the SPS measures employed to control this quality is already of vital importance to Ukraine.[9] While the costs of developing the required SPS infrastructure in Ukraine are high, they are actually fairly small in comparison to the potential economic value of agricultural trade to the Ukrainian economy. Furthermore, investments in developing this capacity would fall into the green box category of agricultural support measures; they would represent vital support for the development of Ukrainian agriculture that is not subject to WTO disciplines. Moreover, there is considerable multilateral and bilateral international aid available to countries such as Ukraine for the development of SPS capacity.

4. Conclusions

Experience in many countries has shown that agricultural policy making is fraught with difficulties. Agricultural interests – farmers, landowners and input suppliers – tend to be well organised and 'capture' the policy making process. As

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[8] See JOSLING (2002) for a discussion of some of these issues. JOSLING reports that so far the evidence on the use of the SPS dispute settlement mechanism by smaller economies is not encouraging. He reports on 69 cases that have been raised so far by small economies. Of these, roughly two thirds were raised against OECD countries. In only roughly 20% of these 69 cases did the small economy reach its objectives. He suggests that small economies should make use of joint representation to pool scarce resources, and that funds be made available to small economies to help them both adopt SPS measures and, when necessary, initiate SPS disputes.

[9] See VON CRAMON-TAUBADEL, S. (2002).

a result, agricultural policy tends to be both very wasteful and very resistant to reform. Experience, for example in the EU or New Zealand, has also shown that when agricultural policy reform does occur, it is not because agricultural policy makers have suddenly 'seen the light'. Instead, agricultural policy reform is almost always imposed from without, for example by strapped budgets or by the need to meet international commitments. The WTO is one source of such international commitments. While the results of the Uruguay Round breakthrough on agriculture have been somewhat disappointing in retrospect, this breakthrough did at least bring agriculture to the table and initiate a discernable trend towards less distorting forms of agricultural support worldwide.

An agreement on Ukrainian membership in the WTO is within reach. The likely agricultural conditions of WTO membership for Ukraine would not appear to be very onerous. Some liberalisation and market opening would result, but Ukrainian agriculture is only beginning to emerge from the transition crisis of the 1990s and agricultural policy in Ukraine is only beginning to take on clear contours. Hence, much is in flux and could be adapted with relative ease. It is much more difficult to change agricultural policy once it, and those who benefit from it, become firmly entrenched. If only for this reason, Ukraine should welcome WTO membership and make every effort to secure it quickly. The requirement that Ukraine would have to abstain from employing export subsidies as a WTO member would have especially far-reaching consequences in this regard; it would preclude the use of price support policies for agricultural products that Ukraine exports. This is just one of the ways in which WTO membership could help Ukraine avoid the agricultural policy mistakes that have proven so costly and difficult to repair elsewhere.

S.v.C.-T., S.Z., February 2003

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