GERMAN ADVISORY GROUP FOR ECONOMIC REFORMS WITH THE UKRAINIAN GOVERNMENT

Prof. Dr. Lutz Hoffmann		Dr. Lorenz Schomerus, Former State Secretary
German Institute for Economic Research, Berlin		Federal Ministry of Economics and Technology, Berlin
Group members in Kyiv	Prof. Dr. Stephan v.Cramon-T.	Department of Agricultural Economics, Göttingen
	Ricardo Giucci	German Institute for Economic Research, Berlin
	Dr. Christian v. Hirschhausen	German Institute for Economic Research, Berlin
	Felicitas Möllers	Deutsche Bank Research, Frankfurt
	Dr. Petra Opitz	German Institute for Economic Research, Berlin
	Ludwig Striewe	Department of Agricultural Economics, Göttingen
	Dr. Ulrich Thießen	German Institute for Economic Research, Berlin
	Dr. Volkhart Vincentz	Institute for Eastern European Studies, Munich

Office: Khreshchatyk Str. 30, 01 001 Kyiv,
Tel. 0038 044 228 63 42, 0038 044 228 63 60, Fax 0038 044 228 63 36, Email: germanad@public.ua.net

O11

After Decree No. 832: Grain Market Policy in Ukraine

Introduction

On July 29, 2000, President Kuchma signed Decree No. 832 „On immediate measures to stimulate grain production and to develop the grain market" in Ukraine. Since then, debate over this Decree in particular and grain market policy in general has dominated the agricultural policy scene in Ukraine.

Grain traders and many bi- and multilateral donors have been among the Decree's most vocal critics. These critics are concerned that elements of Decree 832 are evidence that agricultural policy makers in Ukraine are backtracking on their commitment to market oriented reform of Ukrainian grain markets. On July 17, the Senior IMF Representative in Ukraine together with the Chief of the World Bank Office in Ukraine and the Ambassador of the United States of America in Ukraine, in a letter to the Deputy Head of the Presidential Administration Haidutskiy, stated that Decree 832 presents a "serious threat" to the process of economic reform in Ukraine, and urged that this Decree be re-examined. In this letter, and in other statements, the future of bi- and multilateral aid to Ukraine was linked to a resolution of the concerns raised by Decree 832.

Representatives of the Government of Ukraine (GOU) and the Presidential Administration (PA) have been equally adamant in arguing that Decree 832 is nothing more than a legitimate attempt to monitor and stabilise grain markets at a time when production is very low and food security may be at risk. It is argued that the „grain market in Ukraine is currently completely out of balance" and that the „majority of countries all over the world have their state programs for the stimulation of grain production and the improvement of grain markets...".[1]

[1] See the document: *Item-by-item substantiation of the Decree of the President of Ukraine, Dated 29.06.00, No.832, „On immediate measures to stimulate production and to develop the grain market"*, released by the GOU in July, 2000.

Clearly, Decree 832 has proven costly both to Ukraine and to Ukraine's partners. It has bound analytical and political resources and it has added yet another hurdle to already complex negotiations with donors. It fostered mistrust and misunderstanding at a time when Ukraine had been making significant progress in the area of agricultural policy reform.

In the following we argue that some valuable lessons can be drawn from this experience. Learning from the experience with Decree 832 could improve both the agricultural policy process and agricultural policy outcomes in Ukraine. We begin by addressing issues of form, i.e. how was Decree 832 prepared and launched. We then continue by considering some issues of substance concerning the current situation on Ukraine's grain market and prospects for its future development.

Form: The timing and transparency of Decree 832

Decree 832 came as a complete surprise to most, if not all, actors on Ukraine's grain markets. It caught farms, input suppliers and grain traders off guard, and it appears to have caught most, if not all, of the GOU off guard as well. It completely by-passed institutions such as the *Commission for Agrarian Policy of the President of Ukraine* that were created with the express purpose of creating a forum for dialog and increased policy co-ordination and transparency.

Decree 832 was signed on June 29, 2000 as the grain harvest in Ukraine was entering full swing. It includes, *inter alia*, a provision for export certification that immediately caused concern on the part of grain traders.[2] Representatives of the GOU and the PA argue that this provision is not meant to control the grain trade. Instead, it is intended to help monitor the grain trade by forcing traders to quote "actual rather than reduced prices" and by reducing the volume of barter transactions.[3] Furthermore, Ukrainian policy makers point out that the actual implementation of this provision has been, in fact, rather innocuous: export certification only costs some 30-40 US¢/t, and while certification must be obtained *from* an accredited exchange, it can be obtained for contracts that were not concluded *on* one of these exchanges.

These arguments miss an crucial point, however. When Decree 832 was released traders had no way of knowing exactly how the export certification provision would be implemented in practice. Recall that in four consecutive years prior to 2000, grain traders in Ukraine were regularly confronted with export restrictions. These generally took the form of bans on the movement of grain across Oblast and country borders. It is well documented that the GOU's reaction to these bans was an ambiguous mixture of official reprimands and thinly veiled encouragement for the local authorities in question.

In view of this history, it is perfectly understandable that many observers concluded that Decree 832 is simply a pretence for renewed state interference on Ukrainian grain markets. In early 2000, the GOU had announced that it would not supply farms with inputs. Furthermore, in March Law No. 1565 'On the depreciation of taxes and other dues' cancelled all farm debts to the state. Together these steps implied that the GOU would not interfere with the grain harvest in 2000, since without having supplied farm inputs and without having

[2] The Cabinet of Ministers is called upon "to implement a procedure under which the export of grain is done only through export contracts concluded and registered at commodity exchanges that are accredited...".
[3] See footnote 1.

to collect old farm debts it would have no legitimate claim on farm output. For those who had experienced four years of regional bans on grain movement, these steps were welcome evidence of a new commitment to substantive agricultural reform. Indeed, for some observers these steps were almost too good to be true. In the course of 2000 many sceptics were actually expecting that agricultural policy makers in Ukraine would, somehow, find an excuse for interfering in grain markets. The timing and the vague wording of Decree 832 were ideally suited to confirming these fears.

Furthermore, while Decree 832 gave the Cabinet of Ministers two weeks from June 29 to implement export certification procedures, actual implementation took considerably longer. As late as September, traders still reported that customs officials were holding up export consignments because they had not received clear instructions on what constitutes appropriate certification. Moreover, while Decree 832 does explicitly forbid "restrictions on the interregional purchase of grain", such restrictions have been commonplace nonetheless.[4]

In other words, Decree 832 clearly did lead to much uncertainty and some disruption of the grain trade in Ukraine just as the harvest was coming in and farms, input suppliers and traders were hoping to conclude transactions. For a country that is trying to convince the world that it is seriously committed to substantial agricultural reform - and this in an atmosphere of mistrust fostered by four years of state sponsored market disruption - the timing of Decree 832 was ill-advised. The manner in which Decree 832 was adopted unnecessarily damaged Ukraine's credibility in the area of agricultural policy reform.

What conclusions can be drawn for the future? Even if we accept the argument that export certification is required to help monitor and stabilise grain markets, there is no escaping the conclusion that Decree 832 should have been proposed and subjected to debate at least several month prior to June 29, 2000. In this way, and by involving bodies such as the *Association of Agrarian Entrepreneurs* and the *Commission for Agrarian Policy of the President of Ukraine*, Ukrainian policy makers could made possible an open dialog on the pros and cons of certification (and of the other provisions of the Decree that are discussed below). Open dialog and debate involving all interested parties is a vital element of the democratic process in market economies; it does not guarantee that everyone is pleased with policy outcomes, but it does ensure that the policy process is seen as participatory and not as an arbitrary source of added risk for citizens and enterprises.

Tabling the Decree earlier in the year would also have made it possible to agree on the details of the implementation of export certification *before* rather than *after* its signing. Rather than plunging grain markets into turmoil at a critical moment, and rather than providing those who are cynical about Ukraine's commitment to agricultural reform with ammunition, policy makers could have demonstrated that Ukraine's policy process is open and transparent.

One might argue that Decree 832 could not have been introduced earlier because it represents a reaction to the unexpectedly low grain harvest in 2000. This argument is not convincing. First, it has been clear at least since the spring of 2000 that the grain harvest this year would be no higher than in 1999, and probably lower.[5] Second, Ukrainian policy makers defend

[4] Detailed lists of examples of interference in the movement of grain have been compiled by the *Commission for Agrarian Policy of the President of Ukraine*. It is widely reported, however, that the extent of interference has been less in 2000 than in earlier years.

[5] See for example the German Advisory Group's paper No. N26: *The Y2K harvest in Ukraine: Taking credit and laying blame*. In this paper, released at the end of March, we suggest that the GOU should release more realistic

Decree 832 and in particular the introduction of export certification by pointing to the need to avoid a repetition of events in 1999, when large quantities of grain were exported immediately after the harvest, leading to import demand in subsequent months. Regardless of whether export certification is an appropriate response to this phenomenon or not (see below); since this phenomenon had been well documented by the end of 1999, steps to avoid its repetition in 2000 could have been introduced much earlier than June 29.

Substance: The content of Decree 832

The discussion of form above has focussed on the export certification provision of Decree 832, because this provision generated the most immediate concern. However, the Decree also includes provisions for the introduction of a system of so-called "crop pledges" to stabilise grain prices in Ukraine, and for enhancing the role of *Khlib Ukrainy* as a state agent on Ukrainian grain markets. Beside the question of form discussed above, and along with the issue of export certification, these topics have also been the focus of much debate.

Export certification. As stated above, some agricultural policy makers in Ukraine argue that Decree 832 was necessary to avoid a repetition of events in 1999, when much grain was exported at low prices immediately following the harvest, and then imported later in the year at much higher prices. There is no denying that this phenomenon was observed in 1999, and many Ukrainian analysts conclude that it runs counter to Ukraine's national interests. At first glance this seems logical; why should a country export so much now that it is obliged to import later?

What is often overlooked is that the phenomenon of export followed by import is a perfectly rational response to excessive storage costs in Ukraine. It is true that traders could store rather than export grain in the fall, thus eliminating the need to import grain in the following spring and summer. But it is well known that grain storage in Ukraine is very costly. Storage costs include the physical costs of handling grain in elevators but also the opportunity cost of the capital that is tied up in grain stocks and the costs of quality and quantity losses in storage. Storage costs also include a risk premium that measures a trader's uncertainty regarding whether or not he will have free access to 'his' grain when he needs it.

Each of these costs is much higher in Ukraine than in most other countries of the world. Ukraine's grain handling infrastructure is old and inefficient, and storage losses are high. It is well known that elevators in Ukraine often exercise their local monopoly power by charging very high prices for storage. Since interest rates in Ukraine are high, the opportunity cost of the capital tied up in grain stocks is also high by international comparison.[6] Finally, storing grain in Ukraine is risky; stories abound of traders being denied access to their grain, of traders being given grain of a different quality and quantity than they had originally put in storage, etc.

In this environment, exporting today and importing tomorrow can make a lot of sense. In essence, when traders behave like this they are signalling that it is cheaper to 'store' Ukrainian grain abroad - by first exporting and then later importing - than it is to store

harvest forecasts, and we expressly warn that a low grain harvest in 2000 should not be used as an excuse for renewed interference.

[6] For example, a trader who stores 100.000 t of grain for 6 months in Ukraine has, at current market prices of 800 UAH/t, effectively tied up 80 million UAH for half a year.

Ukrainian grain in Ukraine.[7] It is easy to accuse traders of being rapacious and irresponsible when this happens, but the real problem is that Ukraine's grain storage system, like its entire grain marketing system, remains monopolistic and inefficient.

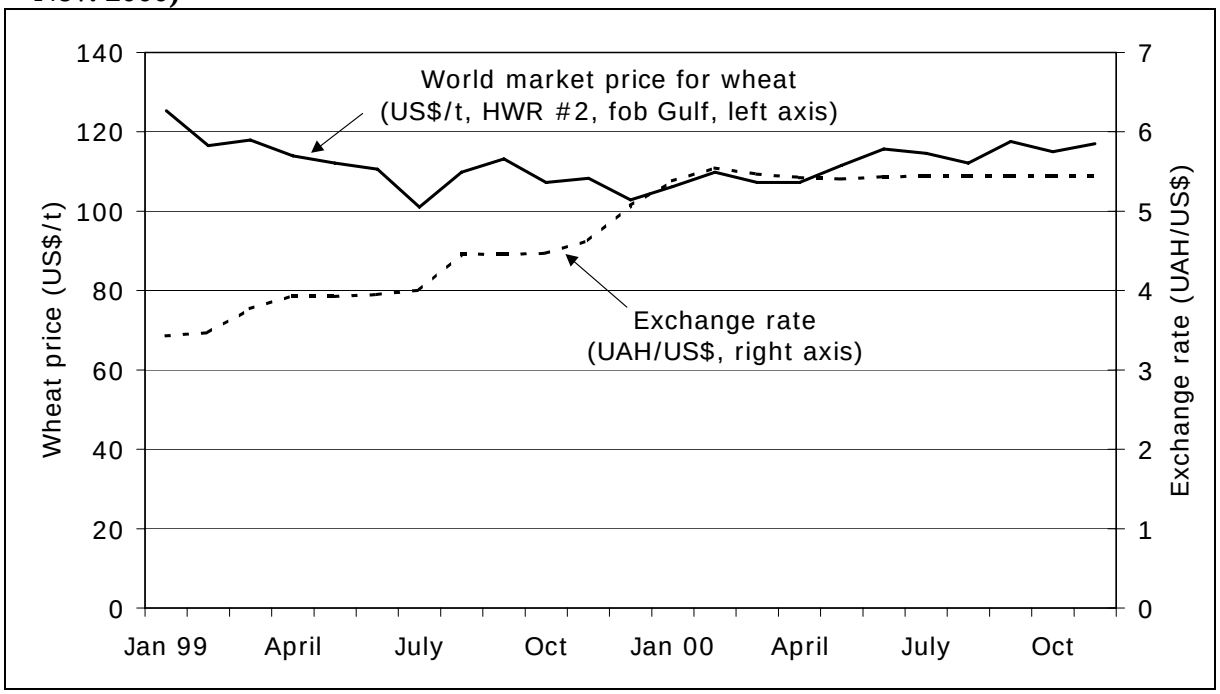
Note also that it is not uncommon that a country both export and import the same commodity. This can be due to quality differences (the EU is a net exporter of feed barley but nevertheless imports malting barley, for example from Ukraine) but also geography and transport costs. Hence, China often imports and exports grain simultaneously because it is easier to supply large coastal cities such as Shanghai by sea than from the Chinese hinterland, even if exports are leaving the country elsewhere.

Especially the latter argument might apply in the case of Ukraine: Given the high costs and general unreliability of grain transportation in Ukraine, it could be that supplying some parts of Western Ukraine with imported grain from Hungary, for example, and simultaneously exporting corresponding amounts of grain from South and Central Ukraine to third countries via Black Sea ports, is less expensive than shipping grain across Ukraine from South and Central regions to the West. This might remain true even if grain transportation in Ukraine were to become less expensive and unreliable. Transactions of this sort, referred to as 'intra-industry trade' are not uncommon in international trade in agricultural commodities today.

Ukrainian policy makers also defend export certification by pointing out that Ukrainian grain prices are highly volatile and arguing that this is due to uncontrolled speculative behaviour by traders. It is true that grain prices in Ukraine have fluctuated considerably in recent months. But here too, many analysts tend to overlook key facts. What are the true causes of grain price volatility in Ukraine? One important cause is the weakness of the Hryvnia. Although the grain market in Ukraine is far from being truly liberalised, world market prices for grain do have an important impact on grain prices in Ukraine. Figure 1 shows that between the beginning of 1999 and today, the world market price for wheat has remained quite stable (and low), varying between 100 and 120 US$/t. Over the first half of this period, however, the UAH/US$ exchange rate devalued by almost 60% from roughly 3,4 to a current value of roughly 5,4.

[7] Of course, the grain that is imported later is not the same grain that was exported months earlier. Ukrainian grain is only being 'stored' abroad in a figurative sense.

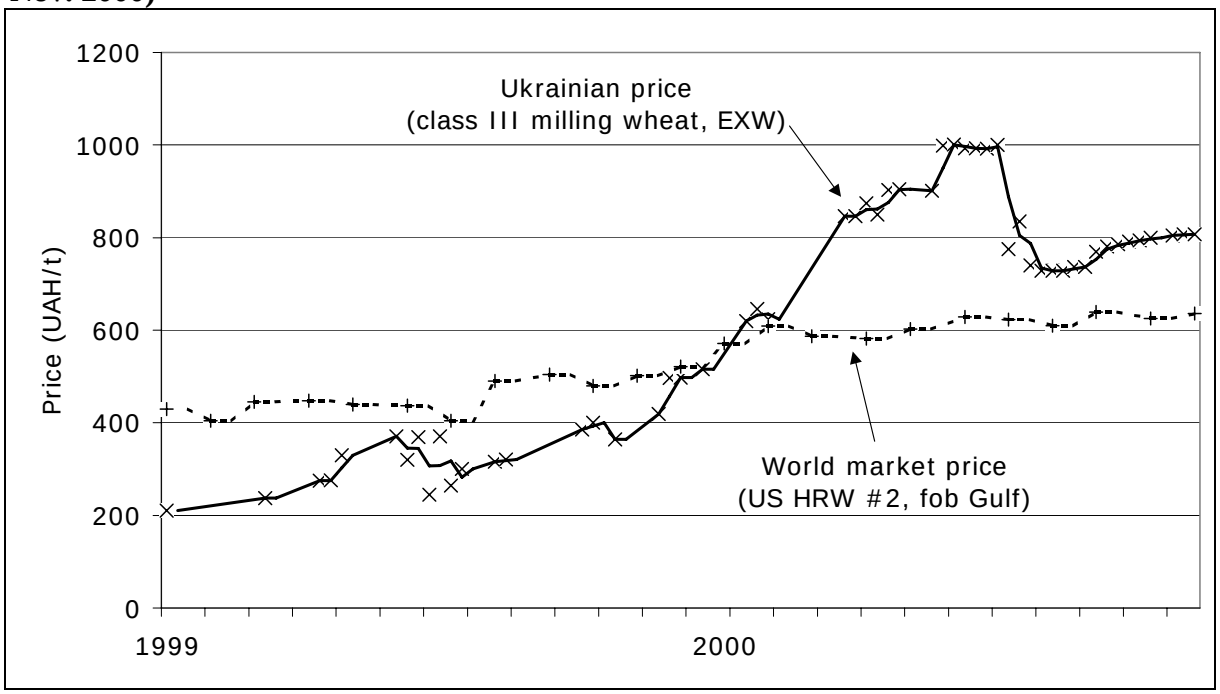
Figure 1: The world market price for wheat and the UAH/US$ exchange rate (Jan. 1999 – Nov. 2000)



Source: UkrAgroKonsult, United States Department of Agriculture and own calculations.

If we combine these two series of data we see that the world market price for wheat (fob Gulf) expressed in UAH increased from roughly 400 UAH/t in early 1999 to almost 640 UAH/t today (see figure 2). In the course of 1999 alone, the world market price increased by almost 150 UAH/t due entirely to exchange rate effects that overrode a slight decrease in US$ terms (in figure 1 we see that the world market price expressed in US$ actually fell over the same period). Therefore, a large share of the grain price instability on Ukrainian markets is due to exchange rate changes that have nothing to do with the behaviour of traders.

Figure 2: Wheat price developments on the Ukrainian and world markets (Jan. 1999 – Nov. 2000)



Source: UkrAgroKonsult, United States Department of Agriculture and own calculations.

A second important cause of grain price instability on Ukrainian markets are the inflated marketing costs that were mentioned above in conjunction with storage. The German Advisory Group first demonstrated over 5 years ago that grain marketing costs in Ukraine are very high by international standards and that this reduces the farm gate prices that Ukrainian producers receive for grain.[8] In late 1998 the German Advisory Group updated its analysis and provided evidence that while farmers in Germany receive a price that is equivalent to roughly 70% of the fob export price for German grain, farmers in Ukraine receive only roughly 40% of the corresponding Ukrainian fob price.[9] At the time, we argued that the difference between 70 and 40% represents a tax on agricultural producers in Ukraine that largely accrues to inefficient monopolists who provide storage, handling and transportation services.

At the time, however, Ukraine was an exporter of grain. Inflated marketing costs lowered grain prices in Ukraine because exporters had to subtract these costs from the world market price when calculating the price that they were prepared to pay Ukrainian producers. This situation changed when Ukraine began to import grain in early 2000. In an import situation, traders buy grain on the world market and move it to consumers in Ukraine. In so doing, they are obliged to use the same inefficient marketing system that they do when they export, but in the opposite direction. Clearly, if an importer is going to make any profit at all, he will have to charge consumers in Ukraine a price that is at least equal to the sum of the world market price plus the cost of moving grain from the harbour to consumption centres.

[8] See German Advisory Group paper G2, *Das Exportpotential der ukrainischen Landwirtschaft und Nahrungsmittelindustrie*, Kiev, 1996.
[9] See German Advisory Group paper K12, *Die Marketing Infrastruktur für Getreide und Ölsaaten in der Ukraine - Ineffizienzen in Lagerung, Transport und Handel behindern die Entwicklung des Agrarsektors*, Kiev, 1998.

Hence, inflated marketing costs are subtracted from world market prices in an export situation, but they are added to world market prices in an import situation. When Ukraine shifted from an export to an import situation in early 2000, domestic grain prices rapidly increased by an amount that is equal to roughly twice the cost of moving grain from farms to world markets, or vice versa. Since this cost is exceedingly high in Ukraine, the jump in domestic prices was high as well. This is illustrated in figure 2. Prior to early 2000, domestic prices in Ukraine were considerably lower that world market prices due to the marketing cost 'tax' on Ukrainian producers. Since early 2000 domestic prices have been considerably higher than world market prices due to the corresponding marketing cost 'tax' on Ukrainian consumers.

While domestic prices were, on average, some 150 UAH/t below the world market level in the export situation prior to early 2000, they have been considerably more than 150 UAH/t above the world market level for most of the period since. This can be explained by the import duty of 40 Euro/t on grain imports. This represents a further cost, in addition to the cost of the grain itself and the cost of moving it to consumers in Ukraine, that traders must charge consumers when they sell imported grain.[10]

What are the implications for Ukraine's grain market policy in general and Decree 832 in particular? First, price fluctuations on domestic grain markets in Ukraine since the beginning of 1999 have been partly caused by the devaluation of the Hryvnia, partly by inflated marketing costs, and partly by import duties for grain. The latter two factors are the direct result of inaction and action, respectively, on the part of agricultural policy makers. None of these factors is due to irresponsible behaviour on the part of traders.

Second, in the years since Independence, far more could have been done to increase competition and curtail the abuse of monopoly power in the grain marketing chain in Ukraine. Failure to take the appropriate steps, together with other missing or half-hearted reforms, has led to a dramatic decline in Ukrainian grain production since 1991 and, inevitably, to the net import situation in 2000. Together with the shift to a net import situation, inflated marketing costs have proven particularly destabilising, contributing to a rapid increase in grain prices and fuelling fears of food insecurity. If the marketing margin in Ukraine was one-half of its current size, which would bring it in line with international standards, wheat prices in Ukraine would have been some 100 UAH/t higher than they were prior to early 2000, and some 100 UAH/t lower after. This would have stabilised prices considerably. Export certification is no substitute for reforms that have been avoided for years.

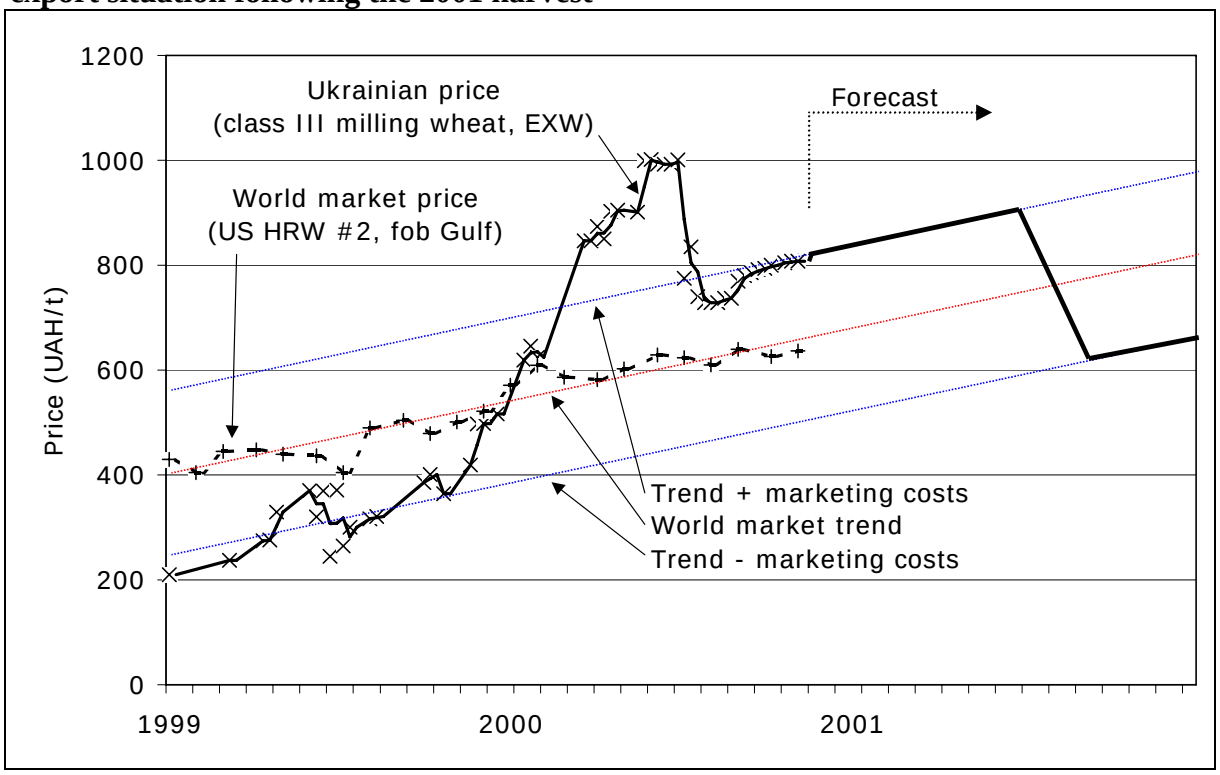
For the future, as soon as Ukraine returns to a net export situation, grain prices can be expected to plunge by an amount that is equal to twice the marketing margin plus. Figure 3 is a schematic depiction of what might be expected to happen, based on the assumptions i) that Ukraine returns to a net export position, ii) that the world market price denominated in UAH continues to follow the trend of the last 2 years[11], and iii) that there is no reduction in

[10] The impact of this import duty on domestic prices is not uniform, however, because not all importers are required to pay it. For example, it was recently reported that wheat from Kazakhstan imported by *W.J. Export-Import* is exempt from the import duty. It is not clear to outsiders why some traders must pay the duty and others not.

[11] This could happen due to a strengthening of the world market price in US$, due to a continued devaluation of the Hryvnia vis a vis the US$, or due to a combination of both. This would appear to be an optimistic assumption; if the UAH/US$ exchange rate remains stable as it has been in recent months, world market prices denominated in UAH are unlikely to increase as rapidly as projected in figure 3.

excessive marketing costs within Ukraine. We see that prices could drop by some 300 UAH/t as the next harvest is brought in. If prices were to fall more in percentage terms than the harvest increases, producers could very well end up with less revenue in 2001 than 2000, despite an improved harvest! This sort of instability has nothing to do with the behaviour of traders; it is entirely the result of a lack of effective reforms in the Ukrainian grain marketing system.

Figure 3: The possible development of wheat prices in Ukraine given a return to a net export situation following the 2001 harvest



Source: UkrAgroKonsult, United States Department of Agriculture and own calculations.

Pledge pricing. Decree 832 also includes provisions for the implementation of a so-called 'pledge price' system. This has obviously been modelled on the US loan rate system for grains. In its defence of the Decree the GOU points out that many countries have similar "state programs for the stimulation of grain production"[12].

There are several reasons why the GOU should be wary of implementing a pledge price system. First, while it is true that other countries have employed similar measures, there is a clear trend away from agricultural price support world-wide. The EU, for example, reduced its support prices for grain by 30% over the mid-1990s and will reduce them a further 15% by 2002. At the moment, EU grain prices do not differ significantly from world market prices – i.e. there is effectively no price support for grain in the EU at the moment.[13] The main reason for this trend away from price support are WTO commitments that were agreed to at the end of the Uruguay Round in 1993.[14] Ukraine would like to become a WTO member, and

[12] See footnote 1.

[13] This does not mean that grain producers in the EU receive no support whatsoever; since the mid-1990s they receive fixed payments per hectare of cropland. In principle, this form of producer support creates less economic distortions than price support.

[14] See German Advisory Group paper N31, *Agricultural Aspects of Ukrainian Membership in the WTO*, Kiev, 2000.

introducing a price support system now would only burden negotiations that are moving very slowly as it is.

Second, Ukraine cannot afford the expense of a truly effective price support system for grain, especially given that this expense is impossible to predict and could increase very rapidly. As discussed above, grain prices in Ukraine are volatile and can be expected to remain so (recall figure 3). Given this volatility, what is a 'reasonable' pledge price for grain in 2001? Looking at price developments in recent months, one might be tempted to choose a level of perhaps 700 UAH/t for 3rd class wheat. As they have become accustomed to higher prices in recent months, farmers might be expected to lobby for a pledge price that is at least this high. If the next harvest returns Ukraine to a net export position, however, prices would probably drop below this level. If the GOU were forced to purchase only 2 million tonnes of grain at a price that is just 50 UAH/t higher than the price at which this grain can be resold, costs of 100 million UAH would result.[15]

Note that the true costs would likely be much higher. If Ukraine remains a net exporter, then the only way to dispose of any grain that is accumulated as a result of pledge purchases would be to export it. Hence, the GOU would have to cover not only the difference between pledge price and the domestic market price but also the marketing margin between domestic prices and fob export prices. In other words, the GOU would essentially be forced to subsidise the monopolistic grain marketing structures that it has not succeeded in reforming so far! Any government that operates a pledge price system is essentially engaging in speculation regarding future harvests, exchange rate developments and world market price changes. With so many possible 'safe' investments to choose from (for example in education, research, and infrastructure development) why should the GOU risk its scarce budgetary resources on speculation?

Of course, it might be argued that the pledge price will never be set as high as 700 UAH/t. Instead, it could be set at a 'safe' level that is unlikely to result in any significant purchases. Since the GOU is committed to a balanced budget, the amount of budgetary funding that could be directed towards a pledge price system is limited. In this case, however, the honest policy would be to do away with the illusion of a pledge price system in the first case. The best way to stabilise and support grain prices in Ukraine would be to increase competition in the grain marketing chain, thus reducing monopolistic marketing costs.

Khlib Ukrainy. According to Decree 832, Khlib Ukrainy will be the "state agent to ensure the state pledge purchase of grain". This is justified by Khlib Ukrainy's "existing material basis, infrastructure [and] experience on the grain market".[16] The choice of Khlib Ukrainy raises several questions and concerns:

- First, in past negotiations with international donors, the GOU has made unequivocal commitments to privatise Khlib Ukrainy. Providing Khlib Ukrainy with additional powers and responsibilities would appear to contradict these commitments.

- Second, the fact that other countries - such as Canada and Australia – have state grain trading agencies (the so called 'Wheat Boards') is not germane to the debate over Khlib Ukrainy. The Wheat Boards in Canada and Australia do not implement pledge

[15] Note that according to one high-ranking advocate of Decree 832, purchases of 5 million tonnes of grain would be sufficient to stabilise the grain market in Ukraine.
[16] See footnote 1.

purchase systems (there are no such systems in Canada and Australia); the powers and responsibilities of the Wheat Boards in Canada and Australia have been significantly reduced in the last decade; and state trading agencies such as the Wheat Boards are going to be subject to very careful scrutiny in the coming round of WTO negotiations (i.e. it is likely that their powers will be reduced even more). Like price support, state trading agencies are policy tools of decades past. Why should Ukraine insist on travelling the same 'dead-end' agricultural policy roads that have proven so costly elsewhere?

- Finally, the choice of Khlib Ukrainy is puzzling. While it is true that Khlib Ukrainy does have significant "experience on the grain market", this experience has been mixed, to say the least. In the years since it began operation, Khlib Ukraine has amassed huge debts. In February 2000, the Court of Auditors of Ukraine reported that as of October 1, 1999 Khlib Ukrainy owed the state budget almost 1,26 bUAH.[17] Khlib Ukrainy also owes money to Bank Ukraina (Khlib Ukrainy is this bank's largest debtor). Bankruptcy proceedings were filed against Khlib Ukrainy in the summer of 1998; these proceedings are essentially suspended, however, because Khlib Ukrainy is – formally at least – in the process of privatisation. Finally, in 1998 Khlib Ukrainy was fined by the Anti-Monopoly for abusing monopoly power "in the regional services market in grain procurement, processing and storage in Dnipropetrovsk, Luhansk, Lviv, Mykolaiv, Kharkiv, Kherson and Cherkassy Oblasts".[18] All in all, this is not a record that inspires confidence.

Policy recommendations

Creating a transparent, participatory policy process. Future decrees should be tabled in draft form early enough to permit interested parties to inform themselves and develop and present their opinions.

Creating a stable policy environment for grain producers and traders. Regulations that affect grain markets in a given year should be finalised at least prior to the corresponding spring fieldwork, and preferably prior to the corresponding fall fieldwork, so that farmers, input suppliers and traders know the 'rules of the game' in advance.

Identifying the causes of the decline in grain production and grain market instability. Traders did not cause the low harvest in 2000, nor are they responsible for grain price fluctuations in recent years. Declining production is a result of years of government interference in input supply and grain marketing prior to 2000. Recent grain price fluctuations have been caused primarily by exchange rate movements amplified by the shift from a net export to a net import position in Ukraine. This amplification would be much less strong if the GOU had taken steps to improve the efficiency of the grain marketing chain in the past, and if it did not impose import duties for grain.

Avoiding costly policy 'traps'. Based on an accurate diagnosis (see above) the GOU should concentrate on policy measures that are effective and feasible. Export certification does not address the true causes of declining production and instability. And Ukraine cannot afford a costly pledge price system and the speculation that it implies. If we assume that Ukraine will

[17] See: Rechnungshof der Ukraine - *Über den Stand der Rückzahlungen von Haushaltsanleihen, erhalten von Unternehmen der Landwirtschaft von 1994 bis 1999*. February 2000, Issue 3, Kiev.
[18] Unian (1998).

return to a net export situation for grain in 2001, then domestic grain prices can be expected to fall considerably following the next harvest. The best way to limit this fall is to improve the efficiency of the grain marketing chain.

Improving the performance of Ukraine's grain marketing chain. The only way to improve the performance of the grain marketing chain is to open it to competition. Private investors, domestic and foreign, must be permitted to gain controlling interest of existing grain elevators (including the 81 owned by Khlib Ukrainy), terminals and harbours and/or to build new facilities wherever they see fit. The list of facilities that are exempt from privatisation must be drastically shortened. Barriers to the free movement of grain within Ukraine, for example at Oblast borders, must be eliminated.

SvCT, Lektor LS and SZ,
December 2000