

POSITION PAPER of Ukrainian business (Federation of Employers of Ukraine, Ukrainian part of Civil Society Platform under Association Agreement) on trade and trade related issues in connection with entering into force of DC FTA between Ukraine and EU

Preamble:

When signing the AA, Ukraine made an irrevocable political choice to become part of the European integration process. A general weakness is the fact that the AA was negotiated and concluded already in 2011 under very different conditions than those prevailing in Ukraine today. Many assumptions, in particular economic expectations, are now overly optimistic. Under the given circumstances the whole project appears to be too ambitious in terms of timing and funding.

However, the situation in Europe has fundamentally changed since the AA was initiated at the beginning of 2012. The EU has still not yet overcome its multifaceted crisis. Ukraine was severely hit by the global financial and economic crisis of 2008 and its economic and social situation was further aggravated from 2013 on. Instead of the assumed FDI inflows needed to finance the EU approximation process, the country has experienced massive outflows of FDI. The conflict in Ukraine since 2014 and the very tense relations with Russia have added another heavy burden.

Ukraine's foreign trade is still largely influenced by the structures and economic ties developed inside the Soviet Union. CIS countries were the most important export market for goods for Ukraine up to 2013. In fact, between 2003 and 2013 the export performance of Ukraine on CIS markets was stronger than on the EU market, while the EU gained ground as the most prominent source of imports during this period. As a result, Ukraine has had large trade deficits with the EU since 2004.

Due to the economic crisis, Ukraine's general volume of trade (in goods) started declining in 2013 by 8% for exports and 9.9% for imports. This negative development continued in 2014, with a 13.5% decline in exports and a sharp contraction of 28.2% in imports. Trade contracted even more sharply in the first semester 2015, cutting exports and imports down by more than one-third compared to the same period 2014. Regarding the trade relations with the EU, it is worth noting that the exports of Ukraine to the EU in 2014 declined by only 0.9%, while imports from the EU fell by 28.3%. During the first semester 2015 Ukrainian exports displayed a high volatility, falling to 63.7% of what they had been in the first 5 months in 2014, while strongly picking up in June. Compared to the first semester 2014 the exports to the EU declined by only 17.2%, while the overall exports fell to 65% of their previous level. Imports from the EU decreased by one quarter¹.

EU exports to Ukraine amounted to EUR 17 billion and Ukraine exports to the EU equaled EUR 13,7 billion (data for 2014). Main EU exports to Ukraine consist of machinery and appliances (€ 3.9 bn in 2014), products of the chemical or allied industries (€ 2.9 bn), mineral products (€ 1.9 bn), plastics, rubber and articles thereof (€ 1.3 bn), transport equipment (€ 1.1 bn). Ukraine's main exports to the EU are base metals (€ 3.3bn in 2014), vegetable products (€ 2.5bn), mineral products (€ 2.4bn), machinery and appliances (€ 1.3bn), wood, charcoal and cork and articles thereof (€ 0.7bn). Among the Eastern partner countries, Ukraine (€17.1 bn or 52% of total EU exports to the Eastern Partners) was the leading destination for EU exports in 2014. The leading source of EU imports from the Eastern Partners was also Ukraine (€13.8 bn or 42% of total EU imports from the Eastern Partners). The largest EU surpluses with the Eastern Partners in 2014 were recorded with Belarus (+€4.0 bn) and Ukraine (+€3.4 bn). While for Ukraine negative balance amounted to - €3.3 bn.

All recent trade figures need to be explained with caution, because Ukraine is in the middle of a deep economic and financial crisis. Nonetheless, it seems evident that the benefits of the deep and comprehensive free trade arrangement between the EU and Ukraine will only slowly materialize.

The current trade structure between the EU and Ukraine reflects the relatively low level of economic activities in Ukraine, which predominantly imports high quality industrial goods from the EU. In contrast primary products (agriculture, raw materials) dominate Ukraine's current exports to the EU. Machinery and transport equipment account for only 10% of its exports to the EU. There are temptations in the EU to associate the

¹ See European Commission EU - Ukraine Trade Statistics

http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113459.pdf as well as State Statistics Service of Ukraine, Ukraine's Foreign Trade in Goods, multiple years, including January–June 2015 and own calculations

future strength of Ukraine largely with its agricultural potential and raw materials. However, the AA entails some precautionary measures against such a narrow-minded division of labour.

Trade in agricultural goods is not yet fully liberalized. Moreover the AA does not foresee the inclusion of Ukraine into the common agricultural market. Both sides are allowed to protect the agriculture against export pressures, with the aim to ultimately eliminate the restrictions within ten years. In particular, both sides maintain import quotas for certain agricultural goods that are considered sensitive.

Here the EU list is much more comprehensive than the Ukrainian one. The latter indicates only four market sensitive products. This quota system effectively limits the opportunity of duty-free trade for Ukrainian agricultural exporters and prevents them from short-term gains. Available research on the functioning of these trade provisions after one year indicates that the quota regime may have a potentially limiting effect on exports of some products (tomatoes, wheat, poultry) from Ukraine. For a number of other products the quota was only partially utilized. The reasons for that ranged from health concerns over non-compliance with SPS standards to low demand or no trading partners in the EU².

WHEREAS:

Reaffirming the paramount importance of the establishment and entering into force of a deep and comprehensive Free Trade Zone in the framework of the Agreement on Association between Ukraine and the EU as of 1 January 2016, the Ukrainian side has demonstrated its willingness to take unprecedented steps to liberalize its markets to the highest extend. In midterm perspective, such steps would hold dire implications and consequences for the Ukrainian industry, agriculture and the economy in general.

Stressing the importance of joint obligations fulfilment under Agreement Ukrainian business firmly adheres to the principles of transparency, free trade and fair competition.

Recalling the obligations of both Parties under Article 29 “Elimination of customs duties on imports” point 4 of Association Agreement, Federation of Employers of Ukraine and its member organizations stressed the following:

- 1. The EU imports to Ukraine mainly high-tech product groups with high added value. Excluding the re-export of gas. High-tech imports from the EU to Ukraine amounts to more than 70%. While Ukraine exports mainly raw materials to the EU. The share of raw materials in Ukraine's exports to the EU - 75%.**
 - a. Ukraine received zero custom duties for raw goods when exporting to the EU (except agricultural products safeguarded by quotas regime), while duties for hi-tech products from EU remain high and quotas for agricultural products low, which lead to today's uncompetitive conditions for business. Imports of high-tech products will continue to grow, export of Ukrainian industrial products and agriculture will remain at the same level due to tariff and non-tariff measures. Accordingly, the negative trade balance of trade between both Parties will increase.
- 2. Tariff measures applied in the tariff Schedule of EU to Ukraine originated goods are the subject of deep concern by certain Ukrainian sectors.**
 - a. Certain quotas applicable to Ukraine originated agricultural goods are fully used in 2014 (under unilateral preferences regime) and 2015. These quotas are too small to allow Ukrainian producers to use the possibility to enlarge their export to EU market, and far lower vs. Ukrainian producers' full capacities. This in its turn triggers artificial barriers for certain industries at the EU market. Industries and goods specifically concerned are chicken meat, eggs, tomatoes, apple and grape juices, honey, corn and corn flour, wheat and wheat flour as well as barley and barley flour. Quotas for these commodities are low, while import duties for over exceeding quotas are high³ (150% for poultry meat, 230% for eggs, 80% for cheese, 270% for butter) (see *Annex I*);

² See http://www.beratergruppe-ukraine.de/wordpress/wp-content/uploads/2014/06/PB_06_2015_en.pdf

³ The ad valorem duties are calculated based on specific import duties for one item.

As of February 1 2016 the quotas used for export of poultry meat to EU are 100%, sugar export amounted to 20 k tones which constitutes 66% of the total quotas, pork meat amounted to 278 tones, or 2.8% of quota.

- b. At the same time the list of 0% rates includes 25 percent of commodity positions subject to 0% duty which have never existed in Ukraine. E. g. primates, lichen, papaya, tea green/black, ginger, bamboo, cocoa beans, Armagnacs, pineapples, coconuts;
- c. While quotas remain low for poultry meat and semi-finished poultry meat - in case of excess of supply from Ukraine in the amount of 16 tons per year or plucked "65-70% chickens" 36 tons per year, a special rate of duty applicable - 18,7-276,5 euros per 100 kg of net weight (25% ad valorem equivalent - 340%). This quota amount covers only 5% of Ukrainian export potential and 16% of EU annual demand.
- d. For eggs - in case of excess of supply from Ukraine in the amount of 1 500 tons per year, a special rate of duty applicable- 16,7-30,4 euros per 100 kg of net weight (the ad valorem equivalent of 30% -230%).
- e. And processed tomatoes with the quota of 10 000 tones, while Ukrainian industry potential production is around 1183000 tones and export potential exceeds 35 000 tones capacity, i.e. 3.5 times higher vs. existing quota;
- f. Certain import duties fully jeopardize cost preference of potential export to EU of industrial goods. Automotive sector is among them, applicable rate of 8,7% with 7 years liberalization term is a case of approach that can be treated as of suspended liberalization, given the fact of GSP current rate is at the level of 6.5% (see *Annex II*).

3. Certain non-tariff measures retain Ukrainian producers from smooth entering EU markets.

- a. High sanitary and phytosanitary measures, long procedures for certification, and existing practice Ukrainian impose export restrictions in form of limitation of licenses number.
- b. Certain difficulties arising from acceptance and recognition of Certificates issued by Ukraine and EU by Customs authorities of both sides due mainly to certain errors and mistranslation in Ukrainian and European versions of the Protocol on the Rules of Origin.

THREFORE:

The Federation of employers of Ukraine:

1. Confirms its dedication to the integration of European norms and standards, continues facilitation of the process of harmonization of the said norms and standards, and provides EU side of Platform with the list of existing problems arising from DCFTA implementation, in trade relations and market access issues.
2. Encourages Ukrainian authorities and institutions concerned under Association agreement to proceed with a plea of Ukrainian business and civil society (NGOs) in line with all necessary official procedures.

The Federation of employers of Ukraine strives to have support of the The European Union side in:

1. Assisting Ukraine with the implementation of higher European standards and supporting Ukrainian business attempt on the review of certain tariff schedules and quotas by means of informing all parties concerned under Association agreement re Ukrainian side intentions.
2. Encouraging European Institutions (the European Commission and Parliament) through various instruments to assist the Ukrainian industry in the Tariff Schedules review procedures by means of architecting communication of Ukrainian and European industries on the point of working out joint positions for particular goods under concern.

Annex I

Information regarding the use of tax tariff quotas for imports by Ukraine to the European Union during 2014-2015

Product	Volume of quotas, tons	Use of quotas, 2014	Manufacturing tons, 2014	Share of quotas, 2014	Use of quotas, 2015	Manufacturing, tons, 2015	Share of quotas, 2014
Poultry meat and poultry meat preparations	16 000 + 20 000	12 360	694 000	5%	16 000 + 4504,5	707 200	5%
Eggs and albumins	1 500	0	36555	4%	75	16780 mio	
Honey	5 000	5 000			5 000		
Garlic	500	36			44		
Sugar	20070	522	2105000	1%	19 851	1466000	1%
Another sugar (glucose, fructose)	10 000	350			612,4		
Common wheat, flours, and pellets	950 000	950 000	24101900	4%	950 000	26490600	4%
Barley groats and meal	250 000	22 721	9043400	3%	194 237,5	8281100	3%
Oat	4 000	65			4 000	487200	1%
Corn, corn meal and granules	400 000	400 000	28452200	1%	400 000	23216900	2%
Starch	10 000	725	12971	77%	960,6		
Bran, shaps and residues	16 000	1 841	764540	2%	3 628,6		
Processed tomatoes	10 000	10 000	1183000	1%	10 000		
Grape and apple juice	10 000	10 000	172678100	0%	10 000		
Sweet corn	1 500	0	7865	19%	6,1		
Sugar processed products	2 000	211			319,8		

Annex II

Automotive sector

Regime	Validity date	Duty rate	Transition period to 0%	Rules of origin requirements (local content)
GSP	Within the end of 2016	6.5%	-	
EU-Ukraine FTA	From 15/05/2014 (EU side) and since 01/01/2016 (Ukrainian side)	10% 8.7%	7	Not less than 60%