

EU-Ukraine Free Trade Agreement Negotiations Stakeholder Briefing Note 1

Trade in Goods

The most fundamental component of any free trade agreement (FTA) is the liberalisation of “substantially all” tariffs and duties of equivalent effect between the two parties. This is defined within World Trade Organization (WTO) rules under article XXIV of the General Agreement on Tariffs and Trade (GATT94). However, there is a degree of flexibility in both the coverage of trade (the actual percentage of trade which is covered by each party) and the sequencing/timing of liberalisation.

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CURRENT SITUATION FOR UKRAINE

National

Ukraine currently applies its normal MFN tariff rates on imports from the EU. Tariffs range from 0 to 24 per cent for non-agricultural imports¹ with an average applied rate of 6.8 per cent² across all sectors. Removal of these tariffs, under a free trade agreement, will result in a fall in government revenue (from duties collected on EU imports) and increased competition for Ukrainian producers from lower priced imports (as a result of the removal of the tariff) from the EU. On the other hand, other producers will benefit from lower priced imports to their production making them more competitive in Ukraine and foreign markets, and consumers will also benefit from lower priced consumer goods and food from these producers as well as EU suppliers.

EU-Ukraine Agreements

The EU applies its General System of Preferences (GSP) to exports from Ukraine. This system provides some of Ukraine's exports with lower tariffs on exports to the EU market and of these, some tariffs are eliminated. As a result of a free trade agreement, EU duties (either full MFN or reduced GSP levels) on those exports from Ukraine will be eliminated and there will be a rise in exports from Ukraine to the EU of both existing and new exports. According to Eurostat data³, less than 5 per cent of 2006 exports from Ukraine were entitled to enter the EU duty free, although under the GSP scheme, the EU allowed a further 40 per cent duty free. The remaining 55 per cent of 2006 exports paid a duty of just over 12 per cent at the full MFN rate and of 42 per cent at a reduced (non-zero) rate.

WTO Commitments

Following Accession to the WTO (May 2008), Ukraine's tariffs will be bound at rates up to 50 per cent, involving reductions from current rates to the bound rates over the next five years (up to 2013). The highest rates and the phase-in period are for sugar (50 per cent), sunflower seed oil (30 per cent) and radio-broadcast receivers, catgut, and certain conveyor/transmission belts (25 per cent). Over the phase in period, tariffs will be eliminated on a range of products including civil aircraft, construction equipment, distilled spirits, certain types of fish, pharmaceuticals, certain chemicals and petroleum oils, medical equipment, wood, pulp & paper, certain yarn and fabric, certain base metals, steel, information technology products, furniture, and toys.

Ukraine has also committed to introduce a tariff quota on raw cane sugar within 3 years of accession.

Other Agreements

Ukraine has concluded free trade agreements covering 100 per cent of imports/exports with the Commonwealth of Independent States (CIS): Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, Tajikistan, Turkmenistan, the Republic of Uzbekistan and; with Macedonia.

¹ Based on WTO Tariff Profile of Ukraine (2006): Agricultural MFN applied tariffs exceed range from 0 to over 100%; but less than 20% of imports have applied tariffs of over 24% and less than 4% over 100%.

² Based on WTO Tariff Profile of Ukraine (2006): average MFN applied rate of 4.4% for non-agricultural imports to Ukraine and 22.3% from agricultural imports.

³ Calculated from Eurostat External Trade Database (2008)

ECONOMIC IMPACT (COST-BENEFIT)

Broadly, the economic impact of a free trade agreement from the elimination of tariffs between the EU and Ukraine will be:

- a fall in government revenue;
- an increase in Ukrainian imports from the EU as a result of elimination of Ukrainian duties on EU imports (this will result in some products in Ukraine facing greater competition and result in falls in production, employment etc);
- a rise in Ukrainian exports to EU as a result of the elimination of EU duties on Ukrainian imports (this would result in some Ukrainian products raising production).

The extent of the gains and falls in production will vary by sector according to the coverage and timing of the FTA.

In recent years, a number of studies have attempted to estimate the costs and benefits of the EU-Ukraine FTA using various assumptions on the scope and coverage of a future agreement.

In terms of government revenue loss, a study by ICPS⁴ (2007) estimated that the impact of eliminating 100 per cent of import duties on EU imports would result in a loss of US\$600 million in government revenue in Ukraine.

None of the studies have identified specific products which would see a rise or fall in export. They have modelled the impact at a sector level which has shown that across every sector there would be a rise in Ukrainian imports from the EU and a rise in exports from Ukraine to the EU (with some products gaining and some losing in each sector).

SUMMARY OF SHORT-TERM IMPACT ON UKRAINE

	ECORYS Study ⁵		CEPS Study	
	Trade Balance With EU (X-M)	Ukrainian Production	Trade Balance With EU (X-M)	Ukrainian Production
Agriculture:				
- Agriculture, fisheries, forestry	-43.0%	+1.1%		
- Cereals/oil seeds	-6.0%	+1.1%		
- Meat	-8.0%	+2.2%	+20.4%	-2.34%
- Sugar/sugar confectionary	-259%	-4.7%		
- Animal/Vegetable Fats	-58%	+5.5%		
- Fruits and nuts	-12%	+3.8%		
Minerals	-	-	-27.2%	-2.17%
Food Processing				
- Beverages and vinegar	-3%	-0.2%	+13.07%	+24.6%
Light Manufacturing	-	-	+2.7%	+6.23%

⁴ CEPS, IFW & ICPS (2006): The Prospects of deep free trade between the European Union and Ukraine

⁵ ECORYS (2008): Trade Sustainability Impact Assessment for the FTA between the EU and Ukraine within the Enhanced Agreement

	ECORYS Study ⁵		CEPS Study	
	Trade Balance With EU (X-M)	Ukrainian Production	Trade Balance With EU (X-M)	Ukrainian Production
Heavy Manufacturing			+5.9%	+2.58%
- Machinery and Electronics	+30%	+7.4%		
- Motor vehicles/parts	-9.0%	+4.7%		
- Transport equipment	-2.0%	+3.3%		
Metal			+3.6%	+6.81%
- Ferrous Metals	+8.0%	+2.6%		
- Metal Products	+14%	+5.8%		

Note: ECORYS Study assumes 100 per cent coverage of non-agricultural products and 95 per cent coverage of agricultural products
 CEPS study assumes 100 per cent coverage of both agricultural and non-agricultural products

EU APPROACH IN OTHER AGREEMENTS

A comparison of the approach of the EU in other agreements is not relevant in terms of coverage as it is understood that Ukraine and the European Commission are aiming to eliminate 95 per cent of all tariffs and duties on both non-agriculture and agricultural products. However, as far as the asymmetric phasing is concerned, it would be useful to compare the level and timing of the elimination of tariffs in other agreements.

EU FTA AGREEMENTS: ANALYSIS OF COVERAGE AND PHASING BY TARIFF LINES

Agreement	Total Coverage	% Trade Eliminated Immediately	Group 1	Group 2	Group 3	Group 4
EU-Mexico FTA (2000)						
Agriculture	75%	n/a				
Non-Agriculture	100%	46%	+11% by Year 5	+43% by Year 7		
EU-Chile FTA (2003)						
Agriculture	93%	82%	+5% by Year 5	+6% by Year 10	2% Subject to Tariff Quotas	
Non-Agriculture	100%	94%	+3% by Year 5	+3% by Year 7		

ISSUES FOR UKRAINE

What does this mean for stakeholders and negotiators in Ukraine:–

Implications: Assuming that 95 per cent of tariffs on actual trade should be eliminated under the EU-Ukraine FTA., this means that 5 per cent of current imports to Ukraine from the EU can continue to enjoy tariff protection:

- *Which products (specific tariffs lines) should negotiators propose?*
- *What criteria should be set for selection? Protection of local industries or protecting tariff revenues?*
- *How to assess a product's need for protection on a permanent basis, to be included in the negative list?*

Next Steps: Stakeholders need to engage with government negotiators in a positive way to agree the content of the negative list:

- *Representatives of sectors who believe their products should be permanently protected should articulate their position to Ukrainian negotiators, providing fully justified positions based on facts and figures;*
- *Ukrainian negotiators should determine the criteria for selection of "sensitive" sectors, for example based on job security, strategic industries, food security or others;*
- *A provisional negative list (by tariff line) should be prepared based upon submissions by stakeholders and Ukrainian negotiators. This then has to be analysed to determine whether or not this exceeds the allowable 5 per cent of EU imports (average over 3 years) and 5 per cent of tariff lines.*

Implications: Phasing in of tariff liberalisation is expected and it is likely that this will be front-loaded. Under the EU-Chile FTA⁶, only 6 per cent of non-agricultural, and 11 per cent of agricultural products were liberalised gradually over 7 and 10 years respectively. The EU has indicated it expects a more ambitious approach in Ukraine so less products will be likely to be phased-in, although phasing of up to 10 years could be foreseen:

- *Which products (specific tariffs lines) should negotiators propose for phasing?*
- *What periods of phasing are required?*

⁶ The most recent and purportedly most liberal of the EU FTAs to date (excluding the interim SAA and EPAs which are only interim agreements).

Next Steps: In order to have these products phased in, concrete justification of the need will be required by Ukrainian negotiators. Stakeholders will need to engage with government negotiators in a positive way to agree which products need phasing in and the required periods:

- Representatives of producers who believe their products' tariffs should be phased in should articulate their position to Ukrainian negotiators, providing fully justified positions based on facts and figures;*
- Ukrainian negotiators should determine the criteria for selection of phased products and determine a maximum coverage for these groups;*
- A list of products and phasing periods needs to be prepared as an opening negotiating position – however, clear and transparent reasons, based on evidence needs to be presented.*

Implications: It is likely that limited use of tariff quotas will be allowed. Chile included tariff quotas on 2 per cent of its agricultural products (including fisheries under HS Chapter 3):

- Which products (specific tariffs lines) should negotiators propose for tariff quotas (if any)?*
- What levels of quota would be appropriate?*

Next Steps: If Ukrainian negotiators are to propose any tariff quotas, they will need to be fully justified in their aims, objectives and need. Stakeholders will need to engage with government negotiators in a positive way to agree the which products should be covered and to what extent:

- Representatives of producers who believe their products' should benefit from tariff quotas should articulate their position to Ukrainian negotiators, providing fully justified positions based on facts and figures;*
- Ukrainian negotiators should determine whether or not to propose tariff quotas (given their administrative cost) and if so set clear objectives and purpose for such measures;*
- If it is agreed that tariff quotas should be proposed during the negotiations, a list of products and quota levels (and formula for increasing the quota) should be presented, fully justified.*