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Directorate-General for Agriculture and Rural Development

Ukraine's Agriculture: Harvesting the potential ?

CONTENTS

Introduction

The latest MAP of 2009 focuses on Ukraine. It is the second largest country in Europe after Russia and is bigger than any of the EU-27 member states. Ukraine's key geographical position combined with its fertile soils, give it huge agricultural potential, though up to now that potential has not been fully realised.

Ukraine's agriculture has undergone major transformation since gaining independence. The ownership structure of farming has changed, with 55% of land now in the "family farm" category. In the decade following independence, agricultural output, especially livestock collapsed. Although production has partly recovered (at least in the crops sector) over the past 10 years, there is still room for productivity growth.

Ukraine has been badly affected by the current economic crisis. The economy is projected to shrink by nearly 16% in 2009 with only a weak recovery expected in 2010. Incomes remain low and food still accounts for over half of the household budget. This explains the focus of public policy on controlling food price inflation, sometimes at the expense of the country's exporters.

Agriculture currently makes a positive contribution to the country's overall trade balance. Thanks to WTO accession in 2008, Ukraine's trade policy is becoming more open. The most protected sectors, notably sugar and livestock have been exposed to greater import competition while export restrictions, especially for grains and oilseeds, have been eased which should help Ukraine to play a bigger role on the world market.

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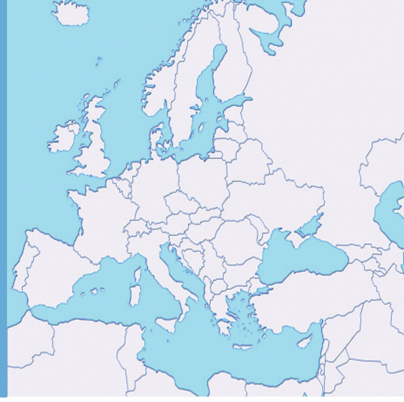


Economic environment

Ukraine is the second largest country in Europe after Russia, and is bigger than any of the EU-27 member states. It has huge agricultural potential thanks to its fertile soils and its key geographical position, with crucial access to the Black Sea and the key markets in the EU, CIS[1], the Middle East and North Africa. In 2008 65% of grain shipments were from the three Big Odessa ports, which remain ice-free all year round. Almost 80% of Russia's natural gas is transited to the EU through Ukraine.

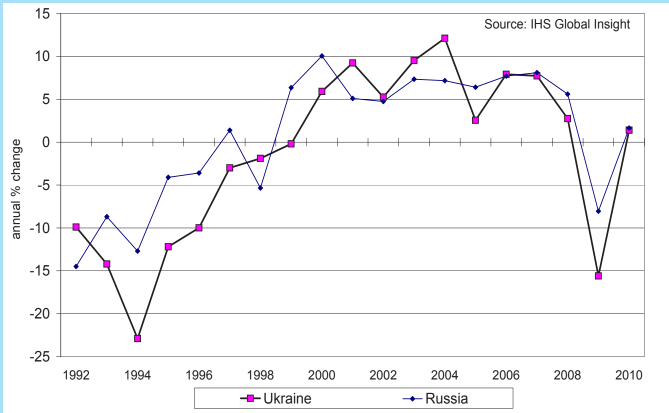
After Ukraine became independent in 1991, the country was plunged into severe economic recession, which lasted throughout the 1990's. Real GDP dropped from $81 billion in 1990 to $31 billion in 2000. This was the worst performance of any of the CIS countries. At the same time the country faced rampant inflation, exceeding 10,000% in 1993 and remaining at 3-digit levels until 1995.

Between 2000 and 2007, the economy grew by over 7% annually, fuelled by strong growth in domestic consumption and trade (graph 1). The value of overall trade in 2006 was equivalent to total GDP, largely due to high commodity prices, especially metal, which is Ukraine's top export contributing 40% to GDP.

Ukraine also benefited from subsidised Russian gas prices during this period. However prices have been increased many times over the past 5 years. By mid-2008 the economy was overheating and high food and energy prices added inflationary pressure. The current account balance went from a surplus of 10.6% GDP in 2004 to a deficit of 7.2% in 2008.

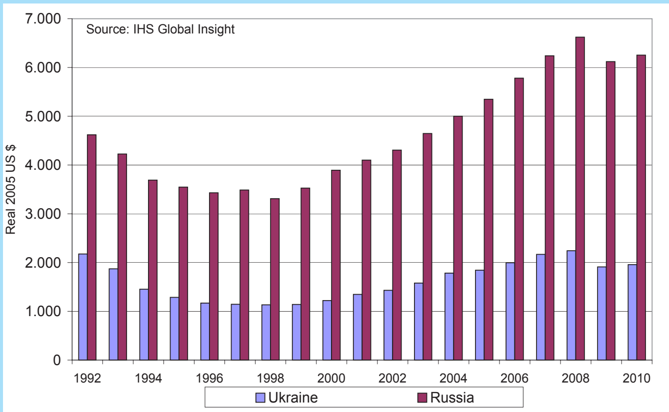
Furthermore Ukraine has been badly affected by the current economic crisis. Declining global demand led to a fall in industrial output and a sharp drop in steel prices. The economy is projected to shrink by nearly 16% in 2009, with a weak recovery in 2010. Ukraine's declining population remains a significant obstacle to its future economic growth. The World Bank is forecasting a decrease of 20% between 2000 and 2025, the largest decline in population within the CIS countries.

Graph 1: Real GDP Growth in Ukraine and Russia



During the transition period, real income per capita fell from just over $2,000 in 1992 to $1,100 in 1996 (graph 2). By 2007 it had only recovered to around 1992 levels but has since lost ground.

Graph 2: GDP per Capita in Ukraine and Russia



Per capita income remains at just one third of that of Russia. The cost of food is crucial since it still accounts

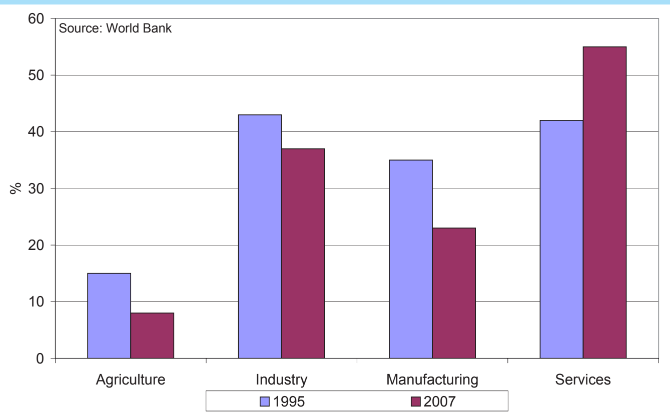
1 CIS: Commonwealth of Independent States, former Soviet Union

for a high share of household spending (57% in 2007 compared to 63% in 2000-2002).

Industry and services are the main drivers of the economy, together accounting for over 90% of GDP in 2007 (graph 3). The importance of agriculture has declined (as well as manufacturing), with its share falling from 23% in 1990-92 to 16% a decade later and just 8% in 2007 (World Bank).

If upstream industries are included, the contribution of the agri-food sector is around 20%. Agriculture is still a key employer with 17% of the workforce in 2007, down from almost one quarter in 2000-02.

Graph 3: Main Sectors Share of Ukraine's GDP



Agricultural structure

Over 70% of Ukraine's area is agricultural land (42 million hectares). More than half the agricultural land is highly fertile "black earth". Today's farm structure is part of the Soviet legacy. Privatisation of state–owned land began in 1988. Today there are some 11 million land owners, though some restrictions on ownership still exist.

Farms are split into individual and corporate holdings. The latter are large-scale agricultural enterprises, successors of the state-owned farms. According to OECD[2], there are almost 15,000 agricultural enterprises with an average size of 2,080 hectares. These account for a declining share of agricultural land, falling from 59% in 2004 to 46% in 2006 and contributing 39% of production.

Most production takes place on the smaller individual farms, which can be divided into family farms and household plots. Family farms are growing in number and size since independence. Between 1993 and 2005 the number of family farms increased from 14,700 to 46,400; their average size went from 20 to 90 hectares. These farms own 11% of all agricultural area.

However the bulk of production comes from non-commercial household plots. According to the World Bank[3] there were around 5.5 million plots of just 2.8 hectares on average, with 43% of the total agricultural area in 2006.

Agriculture policy

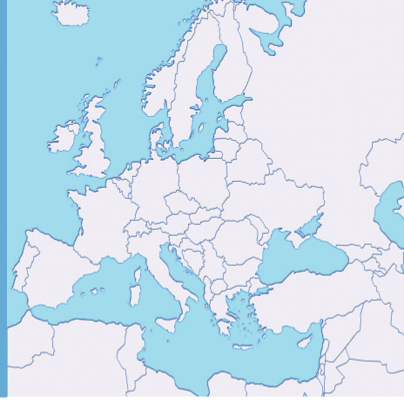
Since independence Ukraine's agricultural policy continues to face many challenges. Food security, international competitiveness and the development of rural areas are the key policy objectives.

The most protected sectors are poultry, beef, pigs and sugar. The main policy instruments are output payments and input subsidies. The focus is increasingly on direct area and headage payments, targeted mainly at the livestock sector.

Market price support instruments include a minimum purchase price for grains, oilseeds and livestock, direct state purchase and loans. Other policy instruments include purchased input subsidies, tax concessions and subsidised credit programmes. In 2007 over half of loans to agriculture were subsidised.

2 OECD Agricultural Policies in Emerging Economies (2009) and Economic Surveys (Sep 2007)

3 World Bank Report on Ukraine (2008) and Country Brief (2009)



The total value of agriculture support reached 2.5% of GDP in 2005-2007 (compared to support of -1.5% a decade earlier). According to OECD the overall level of producer support as measured by the Producer Support Estimate (PSE) in 2005-07 was 10%, (well below the OECD average of 26%), with commodity transfers contributing 45%.

The PSE dropped from 12% in 2005 to just 4% in 2007, due to a reduction in price support. Growing budgetary pressure means that government support is also likely to be cut back sharply in 2009.

Trade policy

In the lead up to accession to the WTO (2008), Ukraine's tariffs were significantly reduced, starting in 2005. Previously tariffs for some agricultural products were very high; e.g. applied tariffs for poultry were 250-300% ad valorem equivalent, sunflower seeds (around 200-250%) and sugar (around 150%).

Following WTO accession Ukraine's bound duties were set between 0% and 20% (except for sugar at 50% tariff and sunflower oil at 30%), phased in until 2010. The average bound agriculture tariff is 10.66% and 4.95% for industrial goods. Table 1 shows the variation in the level of protection across commodities from 2010, with the lowest tariffs in those sectors where Ukraine has a comparative advantage, i.e. oilseeds, grains and spirits.

For sugar Ukraine retained the right to apply an import Tariff Rate Quota for raw sugar. The quota for 2009 was set at 263,000 tonnes and for 2010 at 267,000 tonnes with an in-quota tariff rate of 2% and an out of quota tariff of 50%.

Ukraine agreed not to apply other duties and charges besides custom duties. It only applies ad valorem duties, except for goods that are subject to excise tax (e.g. wine and beer).

Licenses are required for both imports and exports with eligible goods determined by the government annually. Restrictions are applied to exports (quotas and duties) in an attempt to constrain food price inflation, which soared in 2007 and 2008. Export quotas were used between 2006 and 2008 for wheat, barley, maize and rye and in 2008 for oil crops. The result was a sharp decline in grain exports from 13.2 million tonnes (2005/06) to 9.6 million tonnes (2006/07) and 3.7 million tonnes (2007/2008). The country is now committed to lifting these quota restrictions on exports.

Table 1:
Ukraine's Tariff Structure for Selected Products from 2010

Product	Tariff
Meat products	10-15%
Dairy	9-10%
Wheat*	10%
Barley/Maize*/Rice	5%
Sugar	50%
Sunflower seeds*	10%
Other oilseeds	0-5%
Sunflower oil	30%
Other edible oils	0-20%
Oilcake	5-20%
Fresh fruits	0-20%
Fresh vegetables	10-20%
Spirits & liquers	0%
Beer	0.05 €/l
Wine	0.3-0.4€/l
Sparkling wine	1.5€/l
Tobacco	1%

**for sowing-0%* *Source: Market Access Database, DG TRADE*

Export duties are imposed on oilseeds, live animals, hides, and skins. Ukraine has retained the right to use such export duties, though they are to be cut over six years. Furthermore, obligatory export minimum prices are to be suspended.

Key sectors & outlook for production and trade

Table 2 shows the composition of Ukraine's production ranked by value for 2007. The top sector is milk followed by wheat and beef. Livestock accounts for 5 of the top 8 sectors. Ukraine is the world's second biggest producer of sunflower seed (the fifth highest value sector). It is ranked 6th in the world for potatoes, 7th for sugar beet and 8th for barley.

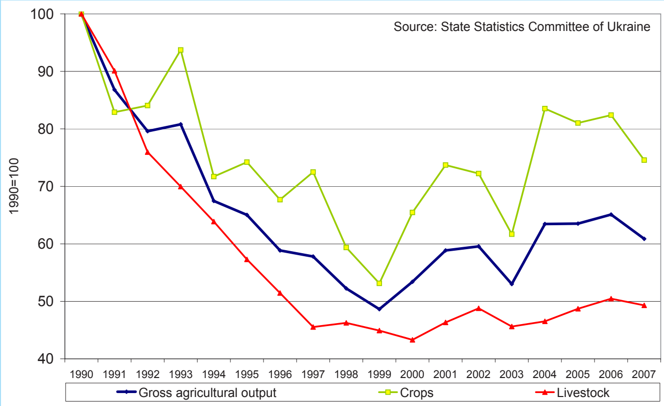
Table 2: Top Sectors of Ukraine & World Rank

Commodity	Rank	World Rank	Production (million $)	Production (1000 MT)
Milk	1	17	2.713	12.003
Wheat	2	13	1.293	13.938
Beef & veal	3	21	1.131	547
Potatoes	4	6	998	19.102
Sunflower seed	5	2	952	4.174
Chicken-meat	6	-	716	614
Eggs	7	11	663	807
Pigmeat	8	20	639	631
Sugar beet	9	7	478	16.978
Maize	10	11	451	7.421
Tomatoes	11	15	301	1.270
Apples	12	15	206	755
Barley	13	8	203	5.981
Rapeseed	14	11	178	1.047
Grapes	15	23	167	360

Source: FAOSTAT

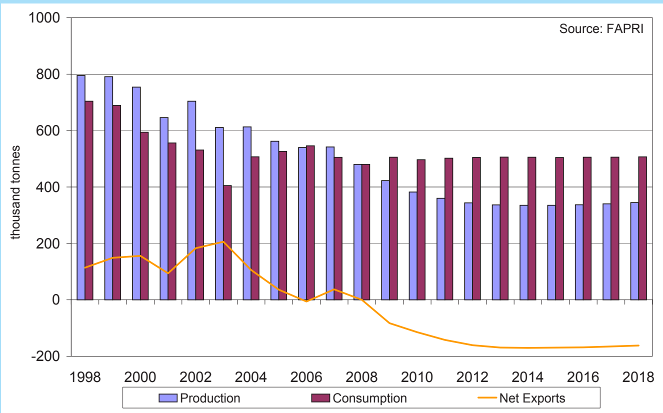
Total agricultural output collapsed by 40% from 1990 to 2007 (graph 4). Over the period there has been a reallocation of resources in line with comparative advantage. The share of grains in production has grown at the expense of livestock. While grain production fell by 25%, livestock output suffered a 50% collapse, as real per capita income and consumption declined. Foreign direct investment in Ukraine lagged behind other CIS countries, due to the regulatory framework. According to OECD, agriculture's share in investment fell from over 21% (under central planning) to 5% between 1990 and 2002.

Graph 4: Evolution of Agricultural Output in 1990-2007



The cattle herd in 2009 was almost 88% below the early 1990s. In 1998 beef was still the largest meat sector, with nearly 800,000 tonnes production (graph 5), compared to 670,000 tonnes of pigmeat and a tiny poultrymeat sector, at just 19,000 tonnes.

Graph 5: Beef and Veal Balance

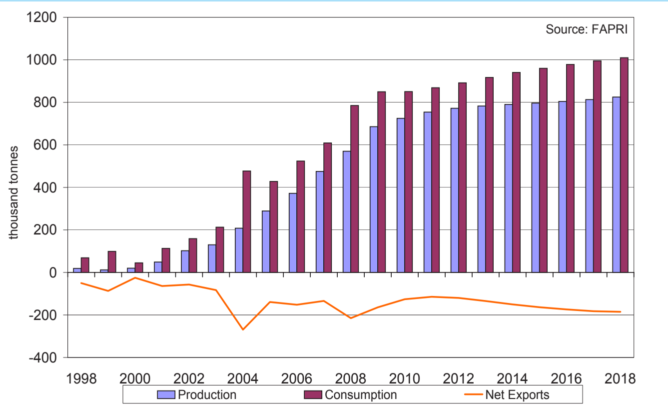


In the decade from 1998 to 2008 beef production collapsed by 47%. FAPRI[4] predicts that the sector will contract by a further 18% in the projection period from 2009 to 2018.

The pig herd also contracted by 60% compared to the early 90's. However increasing productivity in the sector means that production in 2009 (600,000 tonnes) was just 11% below 1998 levels, despite a 35% decline in the herd. Production is projected to increase by 8% over the coming decade.

Poultry numbers also fell sharply during the transition period. By 2001 the flock was 40% below the mid '90s. However output has since recovered given that it is the only profitable livestock sector. Broiler production has grown from almost nothing to become the most important meat sector in 2009 at 690,000 tonnes, with further growth of 20% projected to 2018 (graph 6).

Graph 6: Chicken Meat Balance



The contraction of meat production has had an impact on trade. At the beginning of the '90s beef and pigmeat were among Ukraine's top agricultural exports. The last time significant meat exports (beef) occurred was in 2006 and since then Ukraine has been a net importer of meat. Although consumption and imports have been affected by the current economic crisis, net imports are expected to grow over the projection period. FAPRI projects continued growth in meat consumption to reach 54 kg per capita by 2018, with poultry consumption overtaking beef and pigmeat by 2009.

Milk production also declined over the past decade, though "only" by 20% between 1998 and 2008, despite a fall of 60% in the herd. A further 10% contraction in output up to 2018 is forecast by FAPRI. Nevertheless Ukraine is currently the fourth largest cheese exporter in the world after New Zealand, the EU, and Australia. FAPRI believes that it still has good export potential, predicting that cheese exports will grow from 40,000 tonnes in 2006 to 90,000 tonnes in 2018.

Turning to crops, the total area has fallen (15%) since 1990, mainly reflecting the dramatic 75% decline in fodder crops area linked to the collapse of the livestock sector. The sugar beet area is also down by 75%. The area of vegetables and potatoes has remained steady while cereals and oilseeds have expanded.

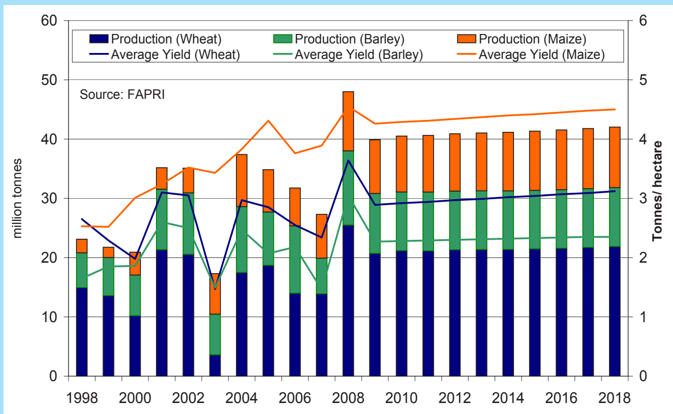
The grains area has increased by 10% (1.4 million ha), though the share of the different cereals has been relatively stable with approximately 50% wheat, 25% barley, and the remainder largely maize. A further shift into maize is projected over the coming decade. The sunflower area has grown by 150%, reaching a record 4 million hectares in 2008/09. The area of rapeseed also grew sharply from 54,000 ha in 2003 to 1.4 million hectares in 2008/09.

Between 1992 and 2000 cereal production decreased by a third. One reason was the collapse in input use. Fertilizer application in wheat fell from 50 kg/ha to 30 kg/ha, recovering only from 2000. The size of the harvest has fluctuated greatly from one year to another, due to both area and yield variation (graph 7). After the record 53 million tonnes grain crop in 2008/09, the 2009/10 crop is expected to be around 47 million tonnes.

4 FAPRI 2009 World Agricultural Outlook

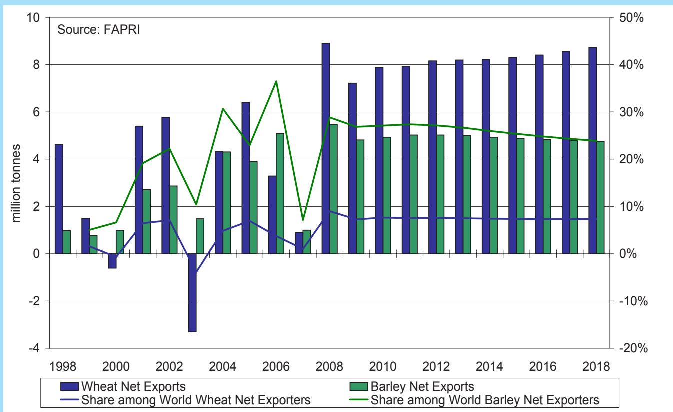
FAPRI predicts that grain production will stabilise over the projection period.

Graph 7: Production and Yield of Cereals



Ukraine has the potential to be one of the world's leading cereals exporters. However in recent years exports have varied greatly depending on the size of the crop and export quotas (graph 8).

Graph 8: Net Exports of cereals and share among top net exporters

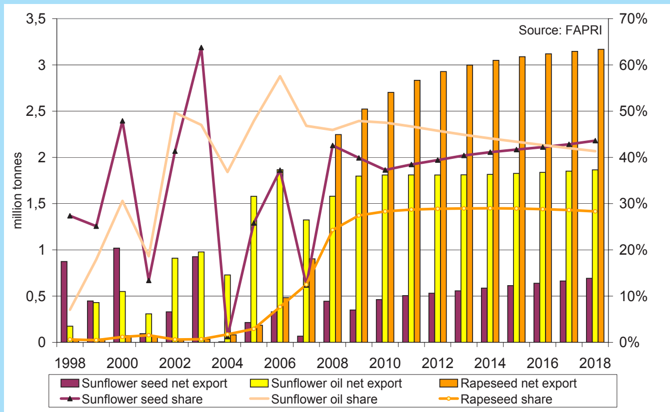


Wheat is the top export with annual average net exports of 4.5 million tonnes from 1998 to 2008 (in 2000 and 2003 wheat was imported). Net exports peaked in 2008/09 at 9 million tonnes. According to FAPRI, over the past decade Ukraine's share among the top world exporters was around 5% and is likely to grow to 7-8% up to 2018.

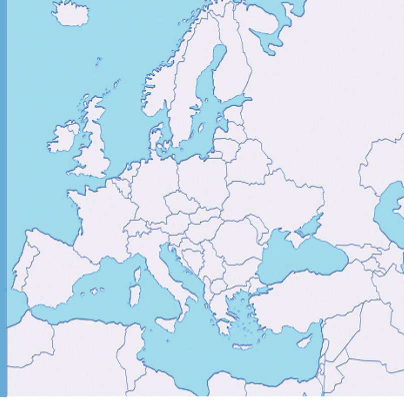
Ukraine became the world's top exporter of barley in 2006/07 with over 5 million tonnes of net exports. Following a decline in 2007/08, it is projected to be the biggest barley exporter once again in 2008/09. In the projection period FAPRI forecasts Ukraine's market share to be around 25-27% among the top exporters.

Meanwhile Ukraine's exports of oilseeds are linked to its policy to develop the domestic crushing industry and export (sunflower) oil to generate export revenue. To deter exports tariffs were introduced on exports of sunflower seeds in 1999, which led to wild fluctuations in trade (graph 9). In 2003 net exports reached 930,000 tonnes but the following year they were negligible. In 2008 net exports were 440,000 tonnes, equivalent to 43% share among the top exporters and FAPRI expects this to remain at around 40%.

Graph 9: Net Exports of Oilseeds and Share among Top Net Exporters



This policy has succeeded in increasing sunflower oil production from 1.5 to 2.2 million tonnes between 1998 and 2008. As domestic consumption has remained low, net exports of sunflower oil grew from 175,000 tonnes in 1998 to 1.5 million tonnes in 2008 (after a record harvest of over 6 million tonnes) and are expected to remain



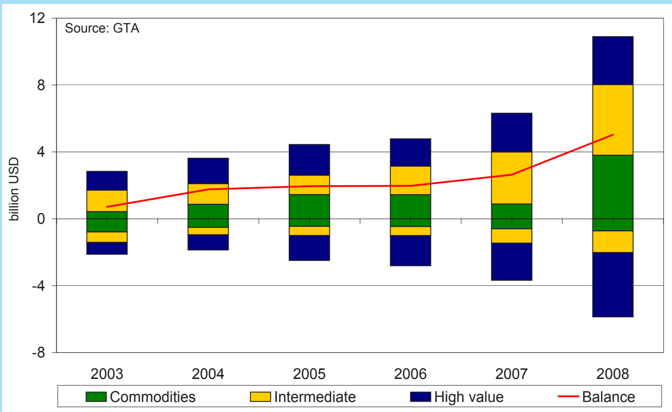
stable. Ukraine is the leading world exporter with over 40% share among the top exporters.

Ukraine is also a leading exporter of rapeseed. In 2006 net exports reached 483,000 tonnes. In 2009 they are expected to hit a record of 2.5 million tonnes (27% share of leading world net exporters). In the projection period Ukraine's exports are forecast to reach 3 million tonnes annually, so it remains the second largest exporter in the world after Canada.

Trade flows under the microscope

Ukraine's overall trade balance has deteriorated in recent years, with a deficit that has been growing since 2005. However it is a net exporter of agricultural products, with a trade surplus of $4.4 billion in 2008. The share of agriculture in total exports has been above 10% since 2003 and reached a historic record of 16% in 2008 (largely due to high commodity prices). Meanwhile the share of agriculture in overall imports has declined from over 9% to 7.5% over the period.

Graph 10: Structure of Agricultural Trade



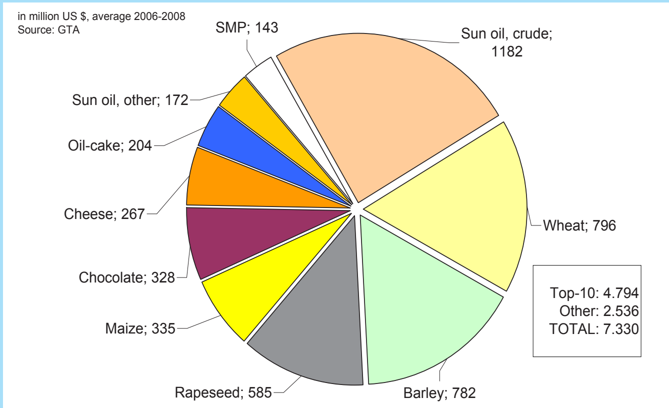
Trade has expanded greatly since 2003 (graph 10). Exports have almost quadrupled in value (reaching $11 billion in 2008) while imports nearly tripled ($6.5 billion).

In terms of the structure of trade, Ukraine exports commodities (34%) and intermediate products (39%) while it imports final products (65%). In 2008 the value of exports of commodities was more than four times the level of 2007 ($3.8 billion compared to $900 million).

Ukraine is a leading exporter

Graph 11 shows Ukraine's top 10 agricultural exports globally in 2006-2008. They account for 66% of its exports worldwide. The biggest export is sunflower oil (16% of total and valued at $1.2 billion), followed by wheat and barley (11%), rapeseed (8%), maize (5%), chocolate, cheese, oils, oilcake and SMP.

Graph 11: Ukraine's Top Agricultural Exports to the World

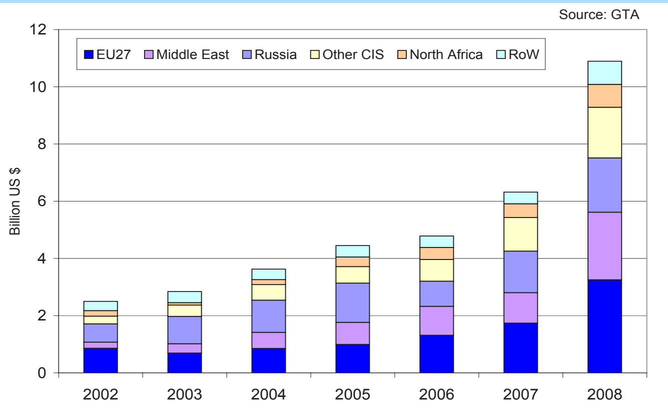


Ukraine is among the world's leading exporters, with nearly 30% of global exports of sunflower oil, 15% of barley, 9% of sunflower seed and 5% of rapeseed in volume terms in 2006-07.

The EU-27 became the main destination of Ukraine's agri-food exports from 2006 (graph 12). By 2008 its share had reached 30% and was valued at $3.3 billion (nearly double the 2007 level). Russia's share has waned somewhat in recent years, declining from 34% in 2003 to 17% in 2008 ($2.4 billion) with the introduction of embargos on meat and dairy products in 2006.

The share of the other CIS[5] countries has increased over the period, to reach 16% in 2008, above the 2002-2007 average. The most important destinations in this country group are neighbouring Belarus and Moldova. The share of exports to North African countries is stable at around 8%. Middle Eastern[6] countries, especially Turkey and Saudi Arabia, account for a significant share of exports, up from 9% in 2002 to 22% in 2008, with the value of exports more than doubling from 2007 and 2008.

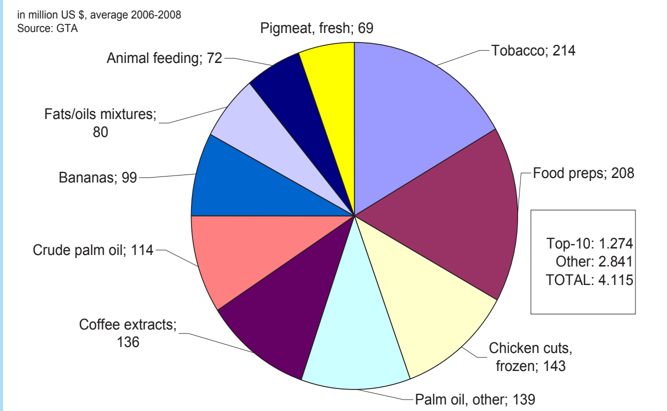
Graph 12: Ukraine's Exports by Destination



And Ukraine's imports….

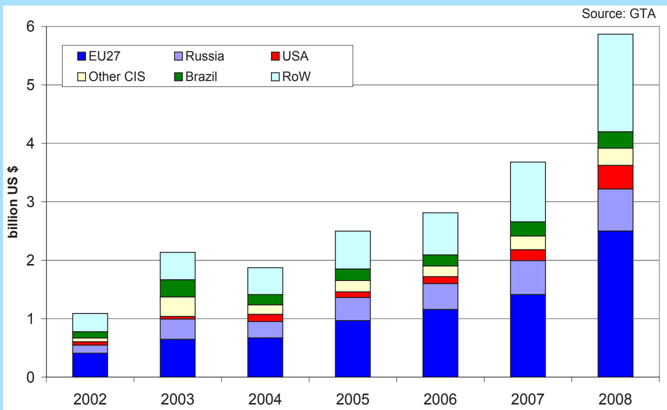
In 2006-2008 Ukraine's agricultural imports were valued at $4.4 billion. Final products account for the largest share, followed by intermediate products and commodities. Imports are more diversified than exports so that together the top 10 products represent less than 30% of total imports (graph 13). The biggest imports were raw tobacco and food preparations (both account for around 5% and are valued at over $200 million) and chicken (3.5%).

Graph 13: Ukraine's Top Agricultural Imports



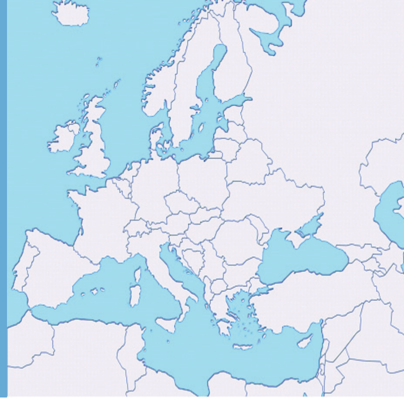
The EU and Russia are also Ukraine's top import partners (graph 14). The EU is by far the biggest supplier, increasing its share from around 37% in 2002 to 42% in 2008. Russia lags well behind with an average 14% share over the period. The US and Brazil lay in 3rd and 4th place respectively in 2008. The USA share has grown steadily from 4% in 2005 to 7% in 2008. The share of the CIS countries is stable at around 8%.

Graph 14: Ukraine's Agricultural Imports by Origin



5 Other CIS: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan.

6 Middle East: Saudi Arabia, Turkey, Iran, Syria, Israel, Jordan, UAE, Lebanon, Oman, Iraq

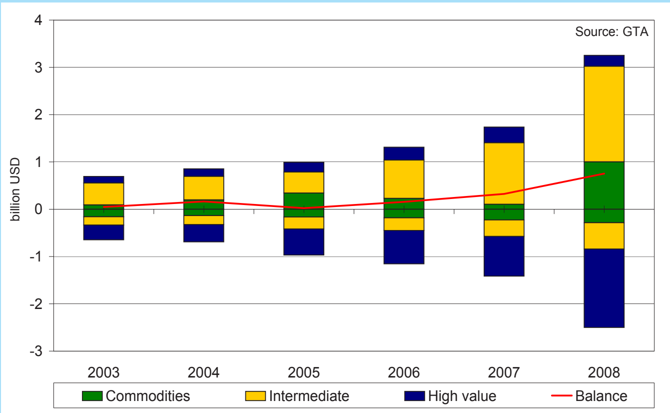


Ukraine's trade with EU27

The EU is Ukraine's biggest trade partner. This is set to continue with the launch of Free Trade Agreement (FTA) negotiations between Ukraine and the EU in February 2008.

The EU has had a small agricultural trade deficit with Ukraine since 2003, which has grown in recent years to reach nearly $750 million in 2008 (graph 15). The composition of agricultural trade flows between Ukraine and the EU is similar to its trade with the rest of the world, with Ukraine exporting mainly commodities and intermediate products while importing final products.

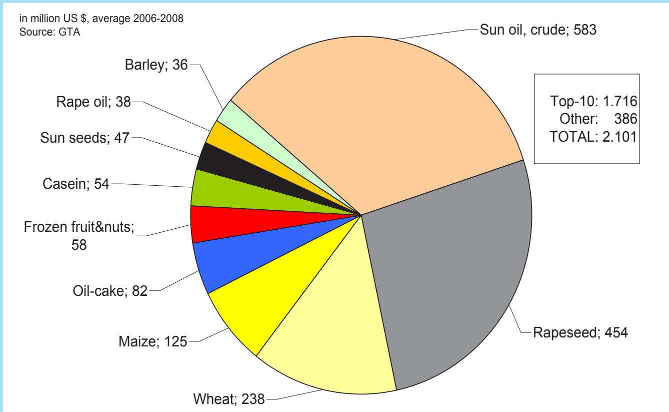
Graph 15: Ukraine's Structure of Agricultural Trade with EU27



Trade with the EU expanded greatly in 2008. Exports grew by $1.5 billion in 2008, in particular due to the dramatic increase in the value of commodity exports from just $100 million to $1 billion and the $700 million increase in intermediate products. Imports also grew sharply in 2008, by $1.1 billion, mainly final products.

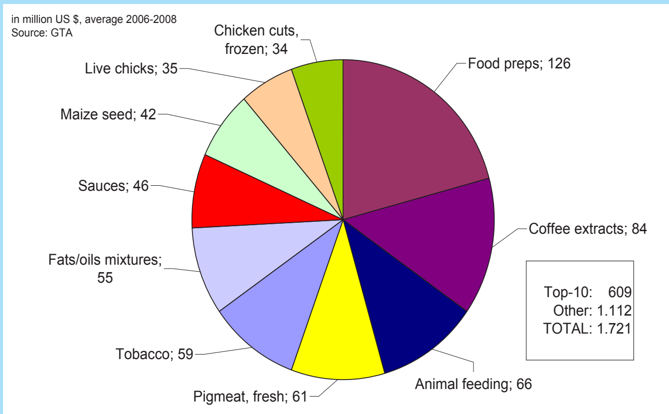
Considering Ukraine's exports to the EU, the top 10 product groups account for 82% of exports. These include sunflower and other oilseed products, cereals and frozen fruits & nuts (graph 16). The importance of the EU market for Ukraine is indicated by the very high EU market share for some products. The EU takes 77% of Ukraine's rape and colza seeds exports, crude sunflower seed and oil (49%), oil-cake (40%), maize (37%) and wheat (30%).

Graph 16: Ukraine's Top Agricultural Exports to the EU27



Turning to Ukraine's imports from the EU, the top 10 imports for 2006-2008 are shown in graph 17. The EU is an important supplier accounting for more than 60% of imports of both food preparations and coffee extracts, animal feed preparations (93%), pigmeat (33%), tobacco (28%), animal or vegetable fats (68%) and chicken (47%).

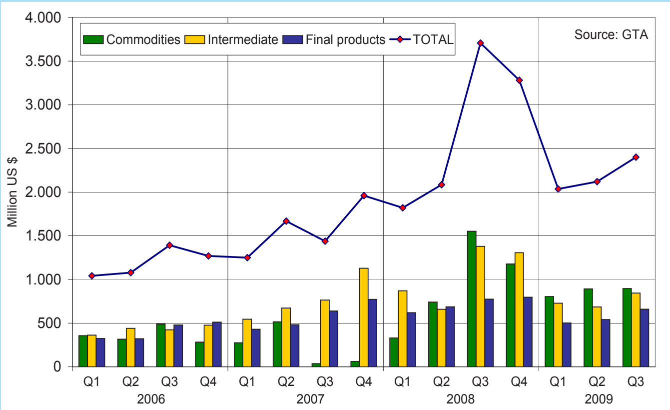
Graph 17: Ukraine's Top Agricultural Imports from the EU27



The economic crisis had an impact on Ukraine's trade…

Both imports and exports reached exceptionally high levels in the third quarter of 2008. Exports declined in the fourth quarter of 2008 and the trend continued in the first quarter of 2009, when they dropped sharply by over 50% compared to the fourth quarter of 2008 (graph 18).

Graph 18: Economic Crisis and Agricultural Exports

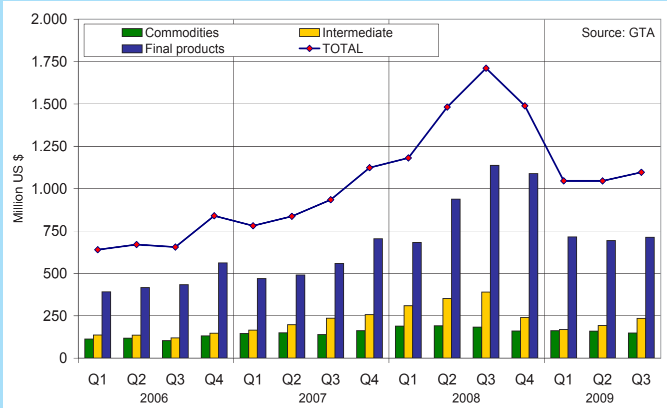


There was a small upturn in exports in the second quarter of 2009 which was sustained in the third quarter. The overall value of exports is down 15% for the first 9 months of 2009 compared to the same period in 2008, but is still 50% higher than the corresponding period of 2007.

The impact on imports has been more severe than on exports, though they show the same trend. Imports declined in the last quarter of 2008 and in the first quarter of 2009 (graph 19). Then they held steady in the second and third quarters. The overall value of imports is down 27% for the first 9 months of 2009 compared to the same period in 2008 but nevertheless is still 25% higher than the corresponding period of 2007.

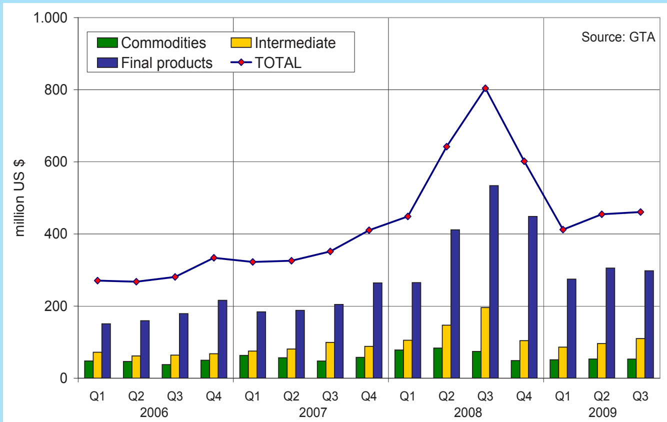
The trend in Ukraine's imports from the EU has followed the same pattern as overall imports (graph 20).

Graph 19: Economic Crisis and Agricultural Imports



Agricultural imports from the EU dropped by 25% in the fourth quarter, falling across all product categories. In the first quarter of 2009 final products were nearly 40% below the previous quarter. In the second and third quarter of 2009 all product groups recovered, suggesting that the recession may be bottoming out. Considering the first 9 months of 2009, imports from the EU are down 30% compared to the corresponding period in 2008 though they are still nearly one third higher than in 2007. Final products are up by over 50% on 2007 levels.

Graph 20: Imports from EU during the economic crisis



Conclusions

Today Ukraine is one of the potential rising stars of Eastern Europe. The sheer size of the country, its key geographical position, combined with its fertile soils, give it huge agricultural potential, which has yet to be fully realised. Ukraine's agriculture has undergone drastic changes in the decades since the Soviet era both in terms of farm ownership structure and the country's agricultural trade links with Russia. Agricultural output has still not recovered from its collapse after independence. The country has also been badly affected by the current economic crises.

Agriculture still remains an important sector in terms of its contribution to GDP and as an employer. The international competitiveness of agriculture, the development of rural areas and food security are the key declared objectives of public policy. However agriculture's capacity to contribute to Ukraine's economic development and to achieve its full export potential may actually have been hindered by public policy.

Real income is lower today than it was before independence (around one third of that of Russia) and food still accounts for nearly 60% of the household budget. Perhaps it is not so surprising therefore that the focus of policy has been to control food price inflation. However, the instruments used such as restrictions on exports have prevented Ukraine's producers from availing of export market opportunities.

WTO accession in 2008 is already pushing Ukraine in the direction of more open trade policy. The most protected sectors, especially sugar and livestock, are now exposed to more import competition, while export quotas and taxes, particularly for grains and oilseeds, have been eased. Already the country is a leading global barley and sunflower oil exporter and such measures should enable these competitive sectors to thrive. More vulnerable sectors like sugar and beef production are expected to contract further over the coming decade. However the prospects for intensive livestock, especially poultry look more optimistic, especially given the sector's access to cheap feed.

Agriculture currently makes a positive contribution to the country's overall trade balance, with a trade surplus that is growing annually. Economic recession has had an impact on trade, which dropped back at the end of 2008 and the start of 2009. However the decline seems to have bottomed out during the second quarter with even a small recovery in the third quarter of 2009. The EU has replaced Russia as Ukraine's top agricultural trading partner for both imports and exports. The EU imports mainly commodities and intermediate products from Ukraine and so it is in the EU's interest for Ukraine to become a more consistent exporter. Ukraine is also a growing market for the EU's exports, particularly final products. This looks set to continue with the launch of Free Trade Agreement (FTA) negotiations in 2008.

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