



Association  
Ukrainian Agribusiness Club

# Doing Agribusiness in Ukraine



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**Dear readers,**

I am pleased to present another issue of our publication "Doing Agribusiness in Ukraine" for 2010. This bulletin highlights the key aspects of the agricultural business, including macroeconomics, government support for farmers, and taxation.

The Ukrainian agricultural sector was the most stable sector of the economy during the crisis in 2009. Agricultural production remained at the record level of 2008, whereas the positive balance of foreign trade with agricultural and food products was in excess of 4.5 billion U.S. dollars.

However, behind this success, there are rapid processes at the micro level. Here, the least successful businesses have to wind-up and, thus, assets are concentrated in the hands of the more successful companies. In fact, the crisis is the Rubicon that will be crossed only by the best. Under the conditions of modest state support, the contrast in the operational results of agricultural companies is becoming even more evident. Therefore, the processes of concentration and verticalization that have occurred during pre-crisis times take the bit also today, when the first shock of the crisis is over.

Another distinctive feature is a desire to invest in infrastructure, be these on-farm investments in drying machines, grain elevators and potato stores, or off-farm investments in port terminals. A lack of finance is often an obstacle but this cannot stop the process because infrastructural costs are unreasonably high.

Furthermore, the investment attractiveness of the sector is gradually recovering. The key factors such as rich land resources and well-educated labor will continue to contribute to the growth, whereas the increased value of assets draws attention to the industry right now.

Association "Ukrainian Agribusiness Club" unites and represents the interests of the leading agricultural and food companies in Ukraine. The team of "Ukrainian Agribusiness Club" involves highly skilled experts in key sectors of agriculture. The Club carries out a number of projects such as comparative efficiency analysis, and market research in the agri-food sector and, thereby, brings about tangible benefits to our members.

The publication of "Doing Agribusiness in Ukraine" is one of the projects that have proved to be successful. The number of publication copies of the brochure is growing year by year.

I hope that this issue of "Doing Agribusiness in Ukraine" will be both interesting and beneficial. We are open to dialogue and ready to consider your questions and comments.

Dr. Alex Lissitsa  
President "Ukrainian Agribusiness Club"

A handwritten signature in blue ink, appearing to read "Alex Lissitsa". The signature is fluid and cursive, written over a light blue background.



**Dear readers,**

The business guide "Doing Agribusiness in Ukraine 2010" is a source which provides important and useful information related to the processes that currently occur in our country. The publication is dedicated to one of the most important branches of the Ukrainian economy – agriculture.

The role of agriculture in the country's economic growth cannot be overemphasized. After all, the agricultural sector can become a source of growth of our national economy. GDP growth as a result of upturn in the agricultural sector is more effective in reducing poverty than GDP growth as a result of improvements in other industries. Thus, we must be aware of the social mission of the agricultural business.

The development of the Ukrainian agrarian sector can be described as a certain dilemma today. On the one hand, it is possible to create a competitive industry which, for a number of priority areas, will be successful in world markets. On the other hand, this perspective can be missed and the possibility to join the developed countries will be lost for Ukraine. Therefore, the transition to effective policy that would enable further investment opportunities and innovative development of the agricultural sector is one of the primary tasks of the state.

In order to become attractive for investments, the agricultural sector of Ukraine must become a successful business. To bring agricultural production to a new level, the main strategic branches must be reformed through a stepwise technological and technical re-equipment.

We must also create a model for the simultaneous development of both, vertically integrated structures and small-scale production.

It is time to unite the efforts of business, government, and science!

The state is rarely an effective owner. It should be rather recognized as an arbiter. In today's agricultural business, we do not have enough elementary rules of the game. In this respect, the state should create a mode of maximum assistance to domestic producers, especially those who determine the development strategy of the major branches and areas.

The most important point is that investments should be made not only in production, but also in technology, science, and the development of the social sphere.

I hope that "Doing Agribusiness in Ukraine 2010" will be useful for you and the information contained will prove that Ukraine is a powerful and strong agrarian country with great potential and possibilities. May I take this opportunity to wish you all interesting business ideas, successful solutions, and profitable results.

Mykola Pryszyzhnyuk  
Minister of Agrarian Policy of Ukraine

A handwritten signature in blue ink, which appears to be "Mykola Pryszyzhnyuk". The signature is fluid and cursive, written in a professional style.



# 1. Ukraine: main characteristics of the country

## 1.1. Introduction

Ukraine is located in the centre of Eastern Europe. In the east and north-east it borders on Russia, in the north - Belarus, in the west - Poland, Slovakia and Hungary, and in the south-west - Romania and Moldova. In the south, the country is washed by the Black Sea and the Sea of Azov. Ukraine occupies 603,700 square kilometers of territory, which makes it the second largest country in Europe after Russia. The city of Kiev is the capital and the largest city in Ukraine.

Ukraine is a unitary state, consisting of 24 regions, the Autonomous Republic of Crimea, and two cities with special status, Kiev and Sevastopol. Ukraine is a republic with a parliamentary-presidential form of government, which uses the principle of separation of powers between the legislative, executive and judicial branches.

The population of the country is 45.9 million (as of March 1, 2010); 77.8% of them are ethnic Ukrainians, and the major ethnic groups are Russians, Belarusians and Romanians. The only official language is Ukrainian, but the Russian language is also widely used. The dominant religion in the country is Orthodox Christianity.

## 1.2. Structure of the state and political situation

At the present time, the President of Ukraine is Viktor Yanukovich who took his oath on February 25th, 2010. Legislative power is exercised by unicameral Parliament, Verkhovna Rada, which consists of 450 Members of Parliament, and is elected every five years. The last parliamen-

tary elections were held in 2007. The Cabinet of Ministers of Ukraine is the sovereign executive authority. Currently, it is chaired by the Prime Minister, Mykola Azarov.

Noteworthy, after the election of Victor Yanukovich as the President of Ukraine, the actual distribution of powers between the authorities has drastically changed. In the Parliament, a majority support in favor of the President was created and, consequently, a more loyal government was formed. Therefore, despite the fact that Ukraine de jure remains a parliamentary-presidential republic according to the Constitution, it has de facto become a presidential-parliamentary once again after the arrival of Viktor Yanukovich to power. Thus, many important government decisions (in particular, concerning personnel) will only be accepted after obtaining agreement from the Administration of the President.

The consolidation of power opens up new opportunities in terms of economic policy but it also brings additional risks. One important opportunity includes pro-active adoption of necessary legislative support for further economic reforms. However, the factor of future election campaigns (elections to local authorities and Parliamentary elections will take place on October 31, 2010, and in 2012, respectively) hampers the implementation of necessary, often unpopular, reforms. Nevertheless, Mr. Yanukovich, the President of Ukraine, and Mrs. Akimova, the Coordinator of the Committee for economic reforms in the Administration of the President, clearly favor the creation of civilized agricultural land market and maintain that adequate preparatory work must be carried out.






Potential risks reside in adoption of documents that have not passed through necessary public discussions. For example, the adopted Law of Ukraine "On State Budget of



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Ukraine for 2010" contained the norm which dramatically changed the conditions of tax support to milk and meat producers. As a result, the Parliament was forced to adjust it shortly after the vote on the budget.

Nevertheless, the consolidation of power and the arrangements for reducing the cost of gas imported from Russia have led to higher credit ratings of Ukraine. This has particularly enabled the government to obtain financing at lower rates to cover the budget deficit. A certain "cooling" of the market of credit resources makes financial volumes for the real sector of the economy accessible. However, real interest rates in UAH at the level of 25% and even higher make it still hard to get access to credits for many economic entities.

### 1.3. Legal system<sup>1</sup>

#### Government

According to Article 1 of the Constitution of 1996, Ukraine is a sovereign, independent, democratic, social, and legal state.

Ukraine has a state form of government that combines the principles of a presidential and parliamentary republic. The main characteristics of such a parliamentary-presidential form of government are as follows: the President of Ukraine is elected by the people through a general election; the President of Ukraine nominates the Prime Minister and the Parliament approves the nomination; the government is responsible to the President of Ukraine and is controlled by and accountable to the Parliament.

#### Judicial system

The current judicial system of Ukraine consists of the Constitutional Court of Ukraine and courts of general jurisdiction. The main task of the Constitutional Court of Ukraine is the commission of constitutional justice which guarantees the rule of the Constitution of Ukraine as the Supreme Law.

The system of courts of general jurisdiction includes local courts, appeal courts, supreme specialized courts, and the Supreme Court of Ukraine. Within the court system there are general and specialized courts. The latter include economic and administrative courts which operate under their procedural rules (based on Economic Procedural and Administrative Procedural Codes, respectively). Higher specialized courts are the Supreme Economic Court of Ukraine and the Supreme Administrative Court of Ukraine.

The possibility of changing the judicial system and the introduction of additional special courts are currently being discussed.

#### Land legislation

Legal relations arising from the use of lands are governed by the Constitution of Ukraine, Land Code of

Ukraine (2001), Civil and Economic Codes of Ukraine (both adopted in 2003), the Acts of Ukraine "On Land Management," "On Land Lease," "On estimation of land," "On the state expertise of surveying documentation," "On land melioration," "On state control over land use and protection," "On the separation of state and communal land ownership," "On protection of citizens' constitutional rights on land," "On the order of land allocation (on district) to land owners of land plots (shares)," and by other laws and regulations.

Land Law provides the right for private ownership of land (including legal persons' ownership) and defines the rights of the state and municipal property. At the same time, the right of communal property is implemented by local councils, and applies to land that is not privatized within the boundaries of a locality. The right of state property is implemented by district state administrations whose authority, according to a general rule, covers all lands outside the locality.

Ownership of agricultural land is guaranteed. However, today, the moratorium on agricultural land transactions such as buying and selling is in action. The introduction of agricultural land market in Ukraine is a highly politicized topic and has been discussed in the society for the last 20 years. The current Ukrainian Government supports the introduction of a full-fledged agricultural land market which is going to be expected in 2012.

#### Agrarian legislation

In addition to general provisions of civil, commercial and land laws, the agricultural legislation of Ukraine involves a number of other laws. They particularly include the laws "On a private farm", "On the priority of social development of villages and agricultural complex in national economy of Ukraine", "On state support of agriculture in Ukraine", "On agricultural cooperation", "On Grain and Grain Market in Ukraine", "On state regulation of production and marketing of sugar", "On Pesticides and Agrochemicals", "On a personal agriculture of a countryman", "On seeds", "On livestock breeding", "On plant quarantine", "On the quality and safety of food and raw food", and others. These laws were adopted during the transition period from 1991 till 2002. Since 2003, the farm structure has completely changed, mainly due to the creation of new business entities out of the former CAE (collective agricultural enterprises). In most cases, these new business entities use land or land shares leased from former CAE members.

Today, the farm structure in Ukraine is mostly represented by legal persons (most of them are companies with limited liability or joint stock companies), private farms and private households (or subsidiary farms of rural people). There are very few production or service cooperatives.

<sup>1</sup>—Prepared by "Sofia" law company





## 2. Ukraine: economy

### 2.1. Macroeconomic characteristics

Ukraine is an industrial and agricultural country. The most developed industries are metallurgy, energy, the chemical industry and mining.

After the breakdown of Soviet Union in 1991, the economic ties with countries of the former Soviet Union have been mostly disentangled. This has led to a deterioration of the economic situation in Ukraine. In the early 90s, a process of profound economic transformation from the planned to the market economy began; the aim was to modernize the administratively planned economy into the modern market economy with high social standards.

Economic reforms have led to the following results:

- Reduction of state control over prices and commodity markets.
- Introduction of the national currency, Ukrainian hryvnia, in September 1996.
- Privatization process (although the share of state and municipal property is still significant in sectors such as utility services, fuel extraction and transport).
- Creation of a relatively liberal regulatory framework for small and medium businesses.

After more than a decade of reforms in the Ukrainian economy, the transition period can be considered as completed today. Ukraine received the status of a country with

market economy from the European Union and the United States, and became a member of WTO in 2008.

The GDP fall in the 90's was followed by annual growth of more than 7% from 2000 to 2008. In 2009, this growth was interrupted because of the global financial crisis. Due to the difficult political situation and insufficient governmental economic policy, the reduction of GDP accounted for 15% in 2009. However, the agri-food sector of Ukraine was not severely affected by the crisis and produced the gross output at the level almost equal to 2008.

Summary of main economic indicators of Ukraine is presented in Table 2.1.

The positive moments at the end of 2009/beginning of 2010 can be regarded as a slowdown of the economy decline, emergence of a positive trend, stabilization of the national currency as compared to dollar and euro, reduction of inflation rate, increase of foreign reserves and decrease of a discount rate of the National Bank. Further improvements included a slight decrease in interest rates on loans from commercial banks, growth of the Ukrainian stock market, and stabilization of the political situation after the presidential elections in February 2010.

At the same time, there are several negative factors caused by financial crisis which can influence massively the further development of the country. These factors are as follows:

Table 2.1. Main macroeconomic indicators in Ukraine.

| Indicators  | 2001    | 2007   | 2008   | 2009   |
|---|---------|--------|--------|--------|
| Gross domestic product*, Mio. UAH   | 204190  | 720731 | 949864 | 914720 |
| in comparative prices, % to previous year   | 109,2   | 107,9  | 102,1  | 84,9   |
| Gross agricultural production*, Mio. UAH  | 65218   | 113149 | 154445 | 157185 |
| in comparative prices, % to previous year   | 110,2   | 93,5   | 117,1  | 98,2   |
| Investments in capital assets*, Mio. UAH  | 32573   | 188486 | 233081 | 151777 |
| in comparative prices, % to previous year   | 120,8   | 129,8  | 97,4   | 58,5   |
| Retail turnover*, Mio. UAH  | 34417   | 178233 | 246903 | 229855 |
| in comparative prices, % to previous year   | 113,7   | 129,5  | 117,3  | 79,4   |
| Financial results of enterprises before tax, Mio. UAH                               | 18741   | 135898 | 8954   | -31590 |
| in current prices, % to previous year   | 134,5   | 178,2  | 6,6    | -352,8 |
| Share of unprofitable enterprises, %  | 38,2    | 32,5   | 37,2   | 41,3   |
| Average monthly nominal wage, UAH   | 311,08  | 1351   | 1806   | 1906   |
| in % to previous period   | 135,2   | 129,7  | 133,7  | 105,5  |
| Index of real wages, in % to December of previous year                              | 120,4   | 110,3  | 97,0   | 99,1   |
| Household income*, Mio. UAH   | 1093912 | 623289 | 856633 | 897669 |
| Growth rate, in % to previous year  | 125,9   | 132    | 137,4  | 106,2  |
| Household expenditure and savings*, Mio. UAH  | 1028353 | 623289 | 856633 | 897669 |
| Growth rate, in % to previous year  | 122,7   | 132    | 137,4  | 106,2  |
| Consumer price index, in % to December of previous year                             | 106,1   | 116,6  | 122,3  | 112,3  |
| Producer price index, in % to December of previous year                             | 100,9   | 123,3  | 123,0  | 114,3  |
| Recorded unemployment (at end of period),%  | 3,68    | 2,4    | 2,1    | 2,5    |
| Exports of goods and services*, Mio. USD  | 16264   | 49248  | 66954  | 39703  |
| Growth rate, in % to previous year  | 109,5   | 128,4  | 135,8  | 59,3   |
| Imports of goods and services *, Mio. USD   | 15775   | 60670  | 85535  | 45456  |
| Growth rate, in % to previous year  | 114,1   | 134,7  | 141,1  | 53,1   |
| External debt service ratio, %  | 14,6    | 18     | 18,9   | 44,7   |
| Gross gold and currency reserves, in months of future imports of goods and services | 1,7     | 3,9    | 6,4    | 4,9    |

Source: State Statistics Committee of Ukraine, National Bank of Ukraine.

\* – in actual prices.

- negative foreign trade balance (-5.7 billion US dollars in 2009);
- increasing amount of external debt (89% of GDP by the end of 2009);
- limited availability of credit resources;
- low production and economic efficiency as well as low productivity;
- high level of urbanization and migration abroad of highly skilled labor;
- a low level of national education and science, especially in agriculture; and
- a relatively small domestic market with low purchasing power.

## 2. 2. The impact of financial crisis on agriculture

The effects for agriculture imposed by financial crisis are miscellaneous. Farmers faced a significant increase in costs of external financing and decreased availability of loans. Together with rising interest rates, prices for inputs increased (fertilizers, diesel). Prices for outputs (crops) went down and further exhausted the resources to finance the next seeding campaign. This entailed certain changes in the production of crops: shift towards less intensive commodities and decreased level of fertilizer and plant protection use. At the same time, total area seeded shrank by less than 1%.

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**Changes in interest rates and the availability of credit**

Due to the problems with liquidity, banks have become less willing to issue new loans increased the requirements for borrowers interested in securing loans.

The amount of outstanding debt decreased by the end of 2009 and increased slightly in the first quarter of 2010.

According to the Ministry of Agrarian Policy, in January-April 2010, agricultural companies raised loans about 1.9 billion UAH, which is 33% more than in the same period of 2009.

Despite the increase in loans issued, lending rates remain high. Since the second half of 2008, rates on loans to agricultural companies have ranged from 18% to 35% and remained at the same level in 2010. This means that the problem of credit tightening will be further experienced in various markets in 2010/2011. This will limit the ability of securing external finance, especially for small farms.

The global economic slowdown led to the decline of input prices and to the reduction of the demand for agricultural commodities.

In Ukraine, the agricultural commodity prices (cereals, oilseeds, etc.) decreased more rapidly than input prices (fertilizers, fuel, etc.). The autumn of 2008 demonstrated a significant deterioration of trade conditions for farmers. At the same time, a substantial devaluation of Ukrainian hryvnia caused by the negative trade balance and ill-advised policy of the National Bank of Ukraine helped to keep the prices that rapidly decreased in both domestic and international markets. The gap between calculated prices (subject to maintaining the rate of hryvnia to US

dollar at the level of September 2008) and actual prices reached as high as 50% in midwinter. As a result, Ukraine could export about 45% of grain produced in 2008/09, i.e. at the level of pre-crisis period.

**Structural and Production Changes**

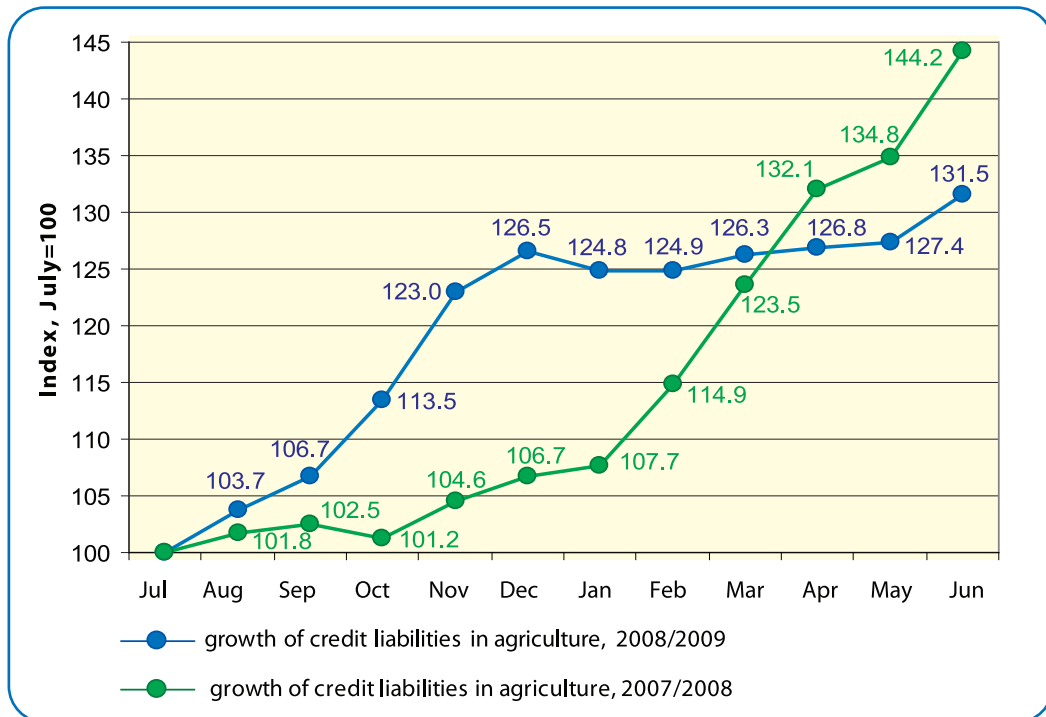
More unstable and costly external financing has led to the situation when manufacturers have been forced to apply a cost-saving strategy, which included less intensive production as well as changes in its structure.

Large companies that used long-term credit agreements, proved to be more flexible to external financial shocks, trying to make full use of synergies within sub-structures and concentrating on core activities. This process was facilitated by flexible labor markets.

However, input suppliers have documented the decline in sales: sales of domestic manufacturers of fertilizers fell by more than 25% in January-June 2009 (import volumes have not changed). Accordingly, agricultural companies have reduced the use of fertilizers and the intensity of production which caused the change in volumes and quality of crop production in 2009/10.

**Anti-crisis policy of the Government**

The Government reduced the amount of direct budget support compared with previous years but the taxes remained low. Ukrainian agricultural producers are exempt from the 25% income tax, and pay only the Fixed Agricultural Tax (FAT). FAT is calculated as a percentage of the deemed value of all land plots leased and equals approximately to 60 thousand US dollars per year per



Source: National Bank of Ukraine

Graph 2.1. Growth of credit liabilities in agriculture, hunting and forestry, end of the period, July=100

Notes: \* Including hunting and forestry

100,000 hectares held by a company. Producers are also entitled to retain the difference between Value Added Tax (VAT) paid on inputs purchased and VAT received from the sale of crops.

There were attempts to solve the problems of payment inability by companies through the mechanism of credit prolongation and price stabilization for fertilizers.

The reduction of subsidies from the budget led to a decrease in support in spring, just before the beginning of field work, and that was only partially offset by additional funds from the Stabilization Fund.

Common Law extended the durability of fixed agricultural tax, which was to be abolished at the end of 2009, and retained the ability to accumulate the amounts of VAT. The Act on the Financial Crisis in Agriculture preserved the existing order of VAT subsidization for milk and meat producers and required banks that apply for re-financing to the National Bank to extend loans granted to agricultural enterprises for no less than a year. This prolongation reduced the problem of solvency in the industry. In 2009-2010, about 75% of loans were prolonged (according to the Ministry of Agrarian Policy) but mostly under less favorable conditions for farmers.

### 2.3. Investment climate (FDI and investment in assets)

The main factors that attract investors to Ukraine are comparatively low production costs and strong economic growth in the pre-crisis period. The official unemployment rate in 2009 accounted for 2.5%. Noteworthy, the

real level of unemployment, especially in 2009, is considerably higher than official figures due to the fact that economic relations are gradually becoming more liberal and public.

The Ukrainian parliament ratified the protocol on WTO accession on May 16, 2008. Currently, Ukraine is actively negotiating for a free trade zone with the European Union. However, the negotiations with the EU prove to be more difficult than expected. The European Union follows clearly the protectionism strategy that might not be supported by the Ukrainian agribusiness.

At the same time, imperfect regulatory procedures, corruption (including corruption in legal system), and the penetrable culture of law enforcement agencies are among the main barriers for facilitating the investment activities in Ukraine. Additional obstacles to investments in agriculture include incomplete land reform and low predictability of state support and tax programs.

As a result and despite the fact that the dynamics of foreign direct investments (FDI) remain positive, the volume, of FDI per person is significantly lower than in neighboring countries of Eastern Europe.

In 2009, Ukraine received the largest volumes of direct investments from Cyprus (8.59 billion US dollars), Germany (6.61 billion US dollars), the Netherlands (4 billion US dollars), Russian Federation (2.67 billion US dollars), Austria (2,6 billion US dollars), Great Britain (2.38 billion US dollars), and France (1.64 billion US dollars).

In the context of the global financial crisis, FDI decreased by several times in early 2009, but the situation has slightly improved by the end of the year. Thus, in total,

#### POINT OF VIEW

Sergiy Fedorenko, President of Group of companies "UkrRos"

Conditions for conducting business over the past two years have changed dramatically. The rapid changes in the financial and stock markets, the unstable situation in world commodity markets including rapid increases and decreases of the price of grain, oilseeds and sugar is the reality of today. Figuratively speaking, many "bubbles" have burst, not only in financial and stock markets, but also in our conscience.

There is also another side of a coin - we observed a sharp devaluation of hryvnia in Ukraine, significant reduction of state support of agriculture in 2009, reduction of consumer demand and, as a consequence, a decline of output in the food industry.

Accordingly, agricultural companies had to quickly adjust to drastically changed conditions. Optimization took place in almost all directions, from ownership structures to labor, marketing and other costs.

Certain expectations are associated with rationalization of the governmental policy. I would like to believe that the new government will ensure predictability of tax and direct budget support, in particular, support through Stabilization Fund of the State budget.

However, I agree with the view that the crisis has also had a positive impact on agricultural enterprises. Companies who can survive the crisis with a post-crisis development mindset will restructure and reorganize themselves and, thereby, obtain an additional resource to gain competitive advantage and a potential to become a player on a global scale.



Table 2.2. FDI growth in Ukrainian economy

| Year | FDI, Mio. USD | % to previous year |
|------|---------------|--------------------|
| 1995 | 413,4         | 85,5               |
| 1996 | 541,3         | 130,9              |
| 1997 | 625,4         | 115,5              |
| 1998 | 747,0         | 119,4              |
| 1999 | 471,1         | 63,1               |
| 2000 | 593,2         | 125,9              |
| 2001 | 680,3         | 114,7              |
| 2002 | 916,6         | 134,7              |
| 2003 | 1322,6        | 144,3              |
| 2004 | 2252,6        | 170,3              |
| 2005 | 7843,1        | 348,2              |
| 2006 | 4717,3        | 60,1               |
| 2007 | 7935,4        | 168,2              |
| 2008 | 6180,7        | 77,9               |
| 2009 | 4410,4        | 71,4               |

Ukraine received 4.41 billion US dollars of FDI in 2009 (71,4 % of FDI in 2008). The FDI growth rate was 40 billion US dollars on January 1, 2010 which is 12% more than in the last year.

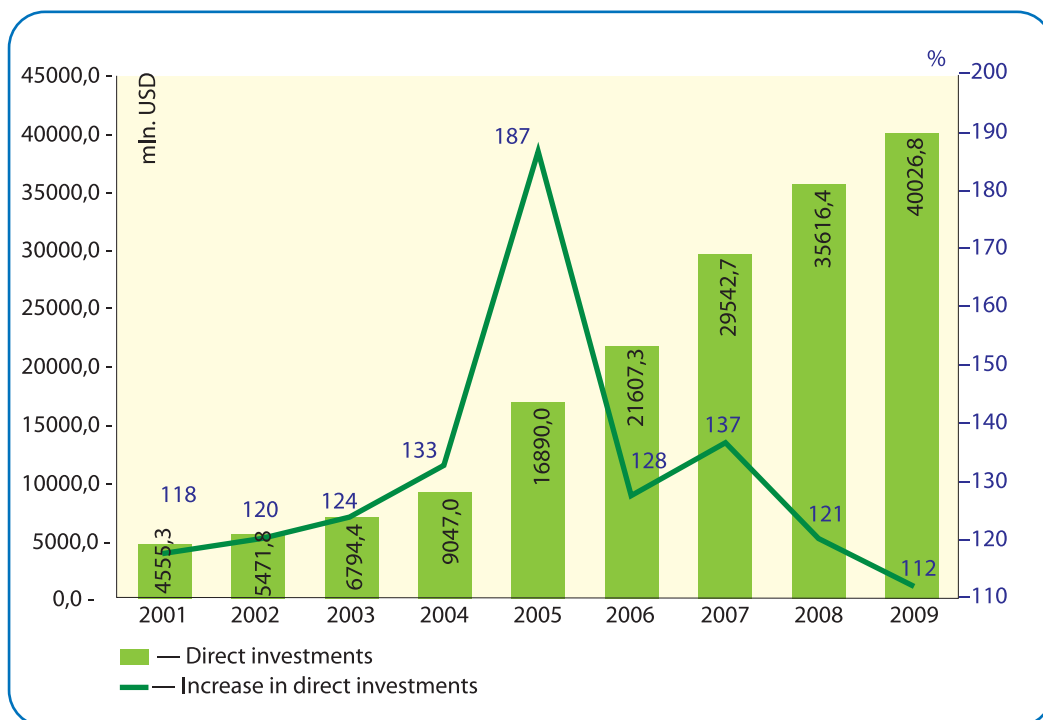
Table 2.3. FDI per capita

| Year | FDI, USD per capita |
|------|---------------------|
| 2000 | 78,7                |
| 2001 | 94,1                |
| 2002 | 114,0               |
| 2003 | 142,6               |
| 2004 | 191,4               |
| 2005 | 359,9               |
| 2006 | 463,6               |
| 2007 | 637,7               |
| 2008 | 775,3               |
| 2009 | 870,9               |

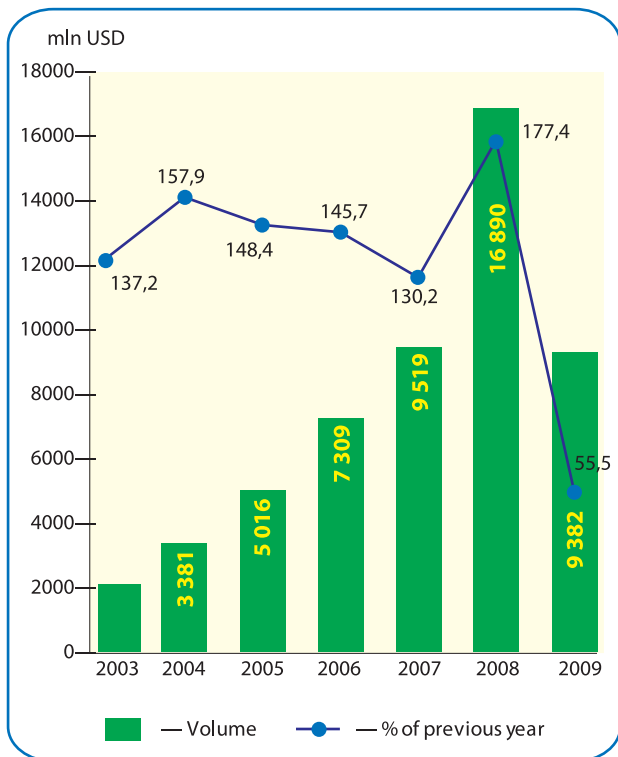
Agriculture remains one of the most investment-attractive sectors. In 2009, FDI in agriculture increased by 7.1% and accounted for 871.4 million US dollars. This amount does not include investments attracted via initial public offerings (IPO) by some of the largest Ukrainian agricultural holdings (according to Association “Ukrainian Agribusiness Club”, big agricultural companies attracted about 600 million US dollars by selling stocks and bonds in the first quarter of 2010).

More detailed information on the amount of investments is shown in Figures 2.3 and 2.4.

Regarding investments in fixed assets in agriculture, they accounted for only 9.38 billion UAH in 2009 (55% of



Graph 2.2. Dynamics of FDI in economy of Ukraine.



Graph 2.3. Investment volumes in fixed assets in agriculture, hunting and forestry.

2008 volumes). Such a significant drop is due to the crisis in the economy and due to reduced availability of long-term credit for agricultural enterprises.

A slight improvement in the investment climate in agriculture is forecasted for 2010. The stabilization of the political situation, possible introduction of land market in 2012 and orientation towards global markets stimulate investments in the agricultural sector although conditions for attracting investments are not as promising as in the pre-crisis period.

## 2.4. Income

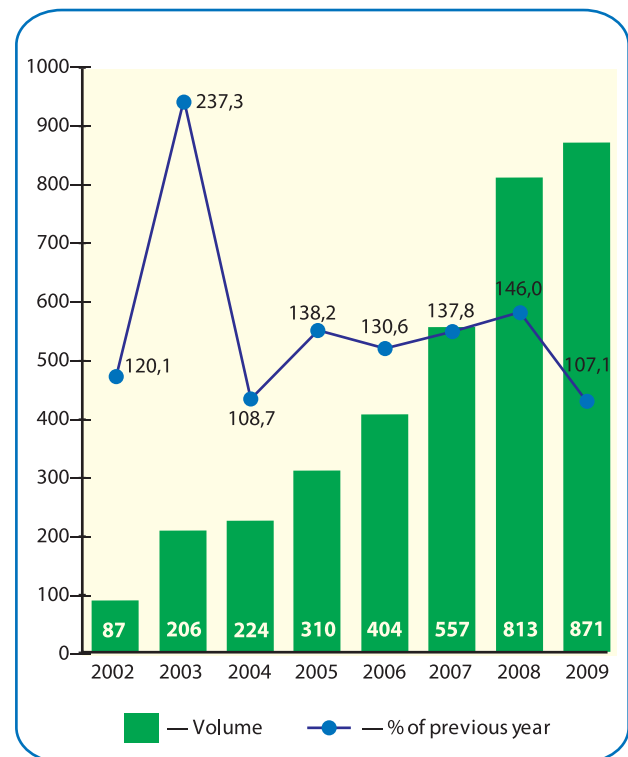
While nominal income continued to grow in 2008/2009, real incomes decreased. This accentuated a decrease in real wages by 9.2% in 2009.

According to the State Statistics Committee of Ukraine, the real income per capita decreased by 8.1% in 2009. At the same time, the average monthly nominal wage increased by 5.5% to 1,906 UAH.

In general, it should be noted that the growth rate of nominal wages significantly reduced in 2009 because of the lack of opportunities to increase payroll and due to strong competition in the labor market fostered by an increased unemployment.

Information on personal income and nominal wages is shown in Figures 2.5 and 2.6.

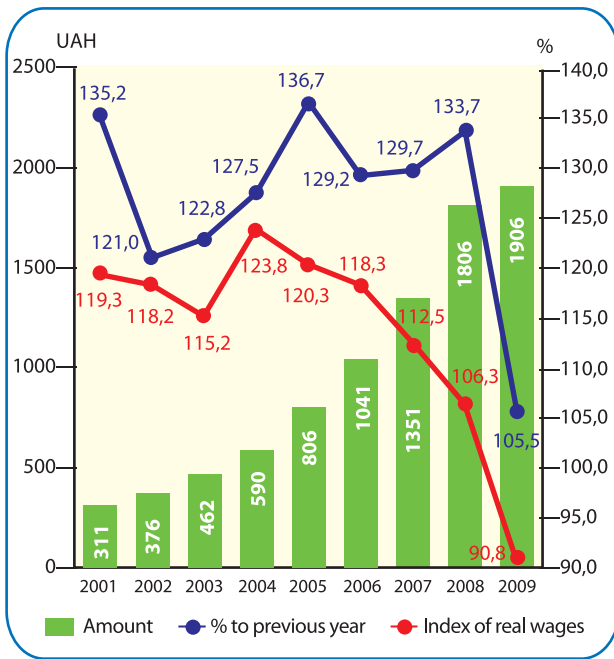
The drop in revenue was partially caused by a decrease of informal wages. At the same time, the cooling in the labor market led to a shift of consumer demand to middle and low quality goods.



Graph 2.4. Foreign direct investments in agriculture.

Table 2.4. Index of real wage growth per capita

| year | % to previous year | % to 1991 |
|------|--------------------|-----------|
| 1992 | 75,3               | 75,3      |
| 1993 | 56,2               | 42,3      |
| 1994 | 78,4               | 33,2      |
| 1995 | 108,3              | 35,9      |
| 1996 | 87,8               | 31,5      |
| 1997 | 102,7              | 32,4      |
| 1998 | 102,4              | 33,2      |
| 1999 | 99,3               | 32,9      |
| 2000 | 104,1              | 34,3      |
| 2001 | 110,7              | 38,0      |
| 2002 | 118                | 44,8      |
| 2003 | 109,1              | 48,9      |
| 2004 | 119,6              | 58,5      |
| 2005 | 123,9              | 72,4      |
| 2006 | 111,8              | 81,0      |
| 2007 | 114,8              | 93,0      |
| 2008 | 110,3              | 102,5     |
| 2009 | 91,9               | 94,2      |

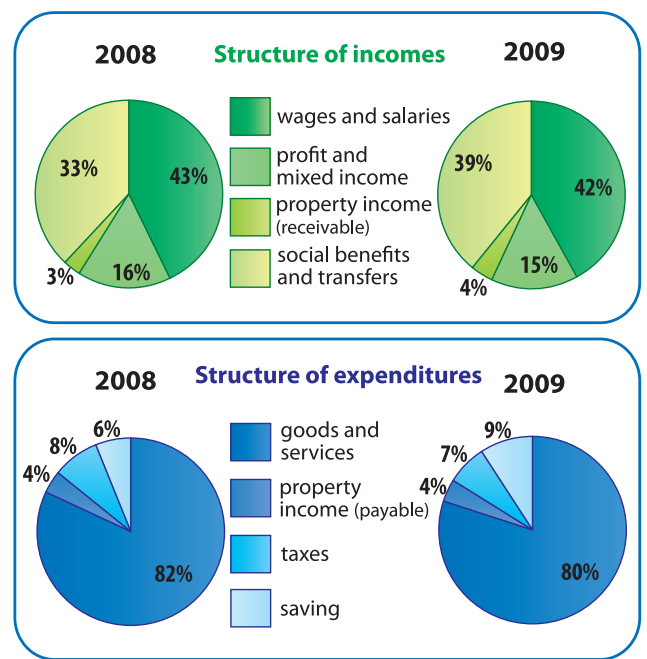


Graph 2.5. Dynamics of average monthly wage.

In 2009, the share of savings increased from 6% to 9% in the structure of expenditure at the expense of consumption of goods and services. This can be explained by increased uncertainty during the financial crisis and by the desire to improve personal financial stability given possible risks.

### 2.5. Import and export

Thanks to the advantageous geographical position between Europe and Asia and access to maritime trade



Graph 2.6. Dynamics and structural change of personal income and expenditures in Ukraine.

routes, Ukraine exports agricultural products to many countries around the world. In foreign trade activities, the main partners of Ukraine are the European Union and Russian Federation. Ukraine also uses free trade agreements with all former Soviet Union countries (except Baltic countries), and is an associate member of the quadripartite agreement on creating a common economic space, which was signed with Russia, Belarus and Kazakhstan.

Table 2.5. Exports of goods in 2009/2010\* (by main exporters, thousand tons)

| Grains             |        | Barley             |        | Rapeseeds   |        |
|--------------------|--------|--------------------|--------|-------------|--------|
| Country            | Volume | Country            | Volume | Country     | Volume |
| USA                | 80598  | Ukraine            | 6000   | Canada      | 6700   |
| EU-27              | 22645  | Australia          | 3400   | Ukraine     | 1790   |
| Canada             | 21425  | Russian Federation | 2100   | Australia   | 1200   |
| Ukraine            | 20215  | Canada             | 1400   | EU-27       | 200    |
| Russian Federation | 19965  | EU-27              | 1000   | USA         | 182    |
| Sunflower seeds    |        | Sunflower oil      |        | Cheese      |        |
| Country            | Volume | Country            | Volume | Country     | Volume |
| EC-27              | 700    | Ukraine            | 2300   | EU-27       | 470    |
| Ukraine            | 400    | Argentina          | 850    | New Zealand | 275    |
| USA                | 184    | Russian Federation | 500    | Australia   | 145    |
| China              | 150    | EU-27              | 140    | USA         | 104    |
| Canada             | 85     | Bolivia            | 134    | Ukraine     | 77     |

\* - in actual prices.

Source: FAS USDA.



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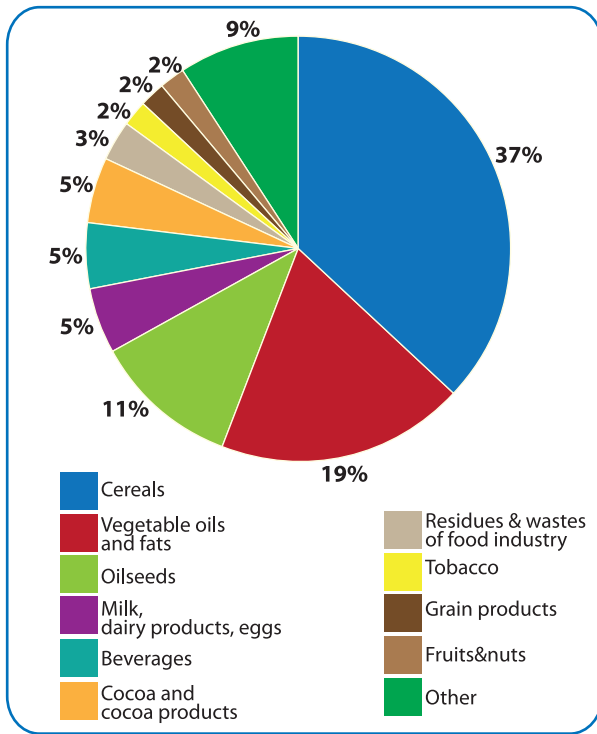


Figure 2.7. Exports structure by agricultural and food commodities in 2009, %

Ukraine is an important global exporter of many agricultural products: it is No. 1 in export of sunflower oil and barley, No. 2 in export of crops, and No. 5 in exports of cheese worldwide. Detailed information on exports of agricultural products by major players in the world market is presented in table 2.5.

The structure of international trade with agricultural products in Ukraine is presented in Figures 2.7 and 2.8. The volume of agricultural exports was 9515 million US dollars and imports 4936 million US dollars in 2009.

Compared to 2008, the volume of agricultural exports was slightly lower, while the total exports of the country fell by 40%. However, in 2009, supply of Ukrainian vegetables abroad almost doubled, supply of livestock increased by 46%, and meat and meat products by 6%. At the same time, exports of milk, fish and other foods reduced by 30%, and oilseeds by 27% on average. In many

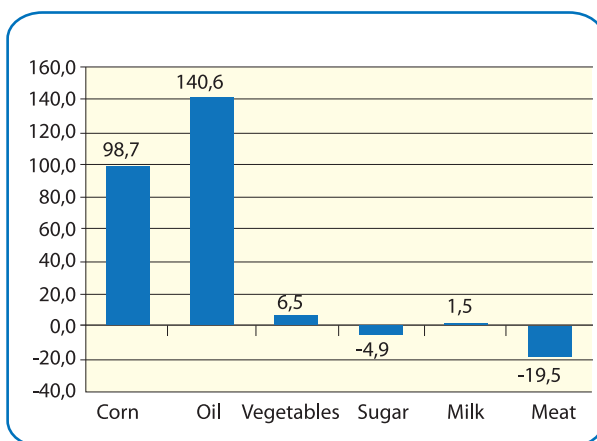


Figure 2.9. Share of net trade in domestic consumption, %

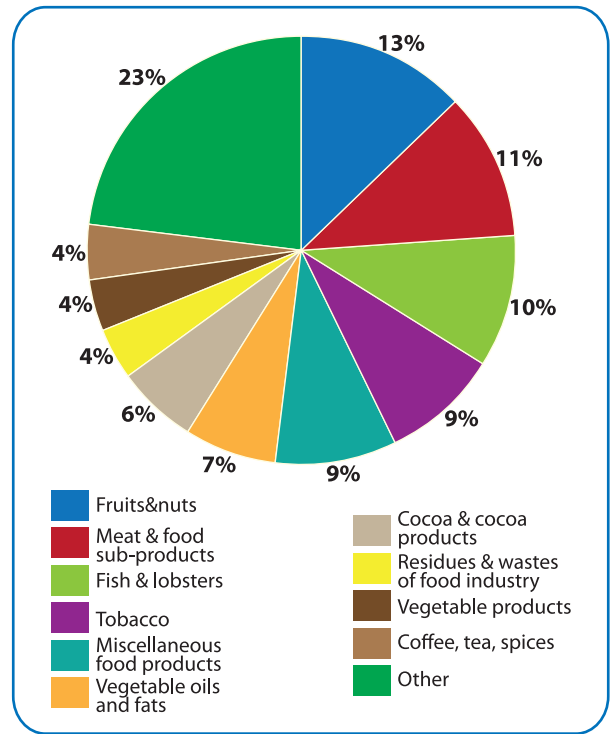


Figure 2.8. Imports structure by agricultural and food commodities in 2009, %

other items, some decline was also observed, but it did not have any significant effect on the overall result.

The situation in the Ukrainian domestic market strongly depends on the international trade as shown in Figure 2.9. As one can see, the market of cereals and oilseeds depends on demand from the world market, while the meat market depends, for now, on import volumes. Demand on such products as milk, sugar, and vegetables is satisfied mainly by domestic producers, focusing generally on the domestic market.

## 2.6. Influence of WTO and free trade areas

We thoroughly covered the conditions of Ukraine's accession to WTO in the previous edition of "Doing Agribusiness in Ukraine 2009." Thus, in this edition, we dwell only on certain aspects that, we believe, will have a long term impact on the agribusiness of the country.

### Customs duty

It is widely known that Ukraine has lowered import duties to 10-15% and even below on most agricultural commodity items, while rejecting a specific component of import duties, using only the ad valorem. As a consequence, the import volume of food products in Ukraine increased dramatically in 2007-2008. This holds particularly for those product groups that prior to entry into the WTO had a strong tariff protection, such as meat and meat products.

We did not observe a continuation of this trend in 2009. The influence of the economic and financial crisis led to 60 per cent devaluation of hryvnia, which has made

imported goods more expensive and has freed space for the price of manure for Ukrainian producers.

It is obvious that we are dealing with a temporary effect. Since the beginning of 2010 and especially after the reduction of political tension, the balance of currency supply on the interbank market of Ukraine has become positive, and the National Bank holds the national currency from the revaluation that could disrupt the monetary balance and competitiveness of the national economy, which is still significantly export-oriented.

Thus, the devaluation effect has been exhausted in both export and import markets. For example, there is a decrease in prices in the pork market caused not only by competition of domestic producers with imports, but also by increasing competition among domestic producers themselves. Likewise, a perilous situation in the world market of grain is being quickly transferred to the Ukrainian market because exporters do not enjoy any devaluation compensators.

Turning back to customs protection of the domestic market, it should be mentioned that the minimum rates of import duty weaken the position of Ukraine in reaching agreement on the establishment of free trade zones.

Attention should also be paid to the possible use of export subsidies in the export of grain by Russia in the current year, which apparently gives Russia a right to retain this opportunity when joining the WTO. Thus, Ukraine will have two powerful economic organizations, the EU and Russia, as neighbours which have a right to use export subsidies, at least until the logical conclusion of WTO Doha Round negotiations.

Ukraine responded to the new economic realities by a significant strengthening of non-tariff barriers for imports. First of all, we are talking about the tightening of customs and veterinary control during importation. The former primarily aims to improve customs value of goods. This is extremely important for the government willing to cover, at least partially, the budget deficit through payments of customs duties and VAT on imports. The latter formally aims to «ban imports of low quality products» although importers often complain that problems arise even with a registration of cargo, which is not supposed to have any claims. Thus, the unprecedented liberality of Ukraine, regarding the level of customs duties is, to some extent, offset by the strict administration of import flows.

### **State support**

As known, Ukraine has undertaken a commitment to the WTO to limit the level of state support of farmers to 3043 million UAH. This amount was recorded precisely in UAH equivalent, because at that time, many people thought that the hryvnia was an undervalued currency and Ukrainian officials were afraid of losing the resource support for its revaluation.

However, whereas at the time of entry into the WTO, the possibilities of support within the “yellow box” of WTO slightly exceeded 600 million US dollars, this resource was reduced to approximately 380 million US dollars in 2010, due to hryvnia devaluation.

Given structural weaknesses of the economy, explicit and implicit fiscal deficits of recent years, and the fact that, in the medium term perspective, hryvnia is unlikely to become a stable currency, we can conclude that support to Ukraine within the yellow box of WTO will be extremely low over time.

Another problem here is the low readiness of the authorities to improve public support at the legislative and regulatory levels such that the WTO requirements are met. Despite the large number of discussions on this topic, the actual process ground to a halt. As a result, many support programs which, in accordance with the classification of WTO, might refer to “green box” are actually spelled out so that they are treated as “yellow box” ones.

It should be noted, however, that this problem is solved in a different way now - by reducing the opportunities of state support during the crisis. But, its relevance will obviously come to the forefront in the medium term perspective.

### **Quality and safety systems**

The systems of quality and safety are, admittedly, one of the weaknesses of Ukrainian agriculture. At the origin of the problem, there is a lack of a clear strategy and a competent authority (or coordination of interactions among authorities) in this area. Some visible problems are the consequences of this situation.

For example, medical and biological requirements that define safety characteristics of a product and are approved by the Ministry of Health have not been updated for many years and do not correspond to modern needs. As a result, the Ministry of Agrarian Policy attempts to assert requirements toward safety in a vertical standard for food products but this process faces resistance from the Ministry of Health which does not approve such draft documents. This is just one of many examples, which also indicates the absence of a clear vision of the role of vertical standards and horizontal normative regulations.

Another public authority - State Committee of Ukraine for Technical Regulation and Consumer Policy – steadily emphasizes the importance of compliance with standards for domestic producers and, at the same time, regularly demonstrates the statistics on the amount of products that do not correspond to standards.

The State Committee of Veterinary Medicine relies on this quality system, in particular, for the promotion of Ukrainian animal products in foreign markets. However, a number of external factors, such as a possible supply of goods to overseas markets, stimulate certain progress.

Additionally, due to pressure from major trading partners and commitments in terms of WTO, Ukraine had to cancel the compulsory certification of imported products.

Furthermore, a decision taken by the State Committee of Veterinary Medicine on mandatory inspection of foreign companies supplying products of animal origin to Ukraine was not implemented in 2009. It was assumed that such a procedure will come into operation from January 1, 2010, but Ukraine canceled it under pressure from trade partners.

### Free trade agreements

After the collapse of the Soviet Union, Ukraine concluded free trade agreements with all of the CIS countries in order to maintain economic ties with these already independent states.

The provisions of these treaties contain a number of exceptions for one or more trade positions. For example, Russia reserves the right to levy export duty on oil, sugar and a number of products excluded from free trade with Ukraine. Non-tariff barriers are used partly. For example,

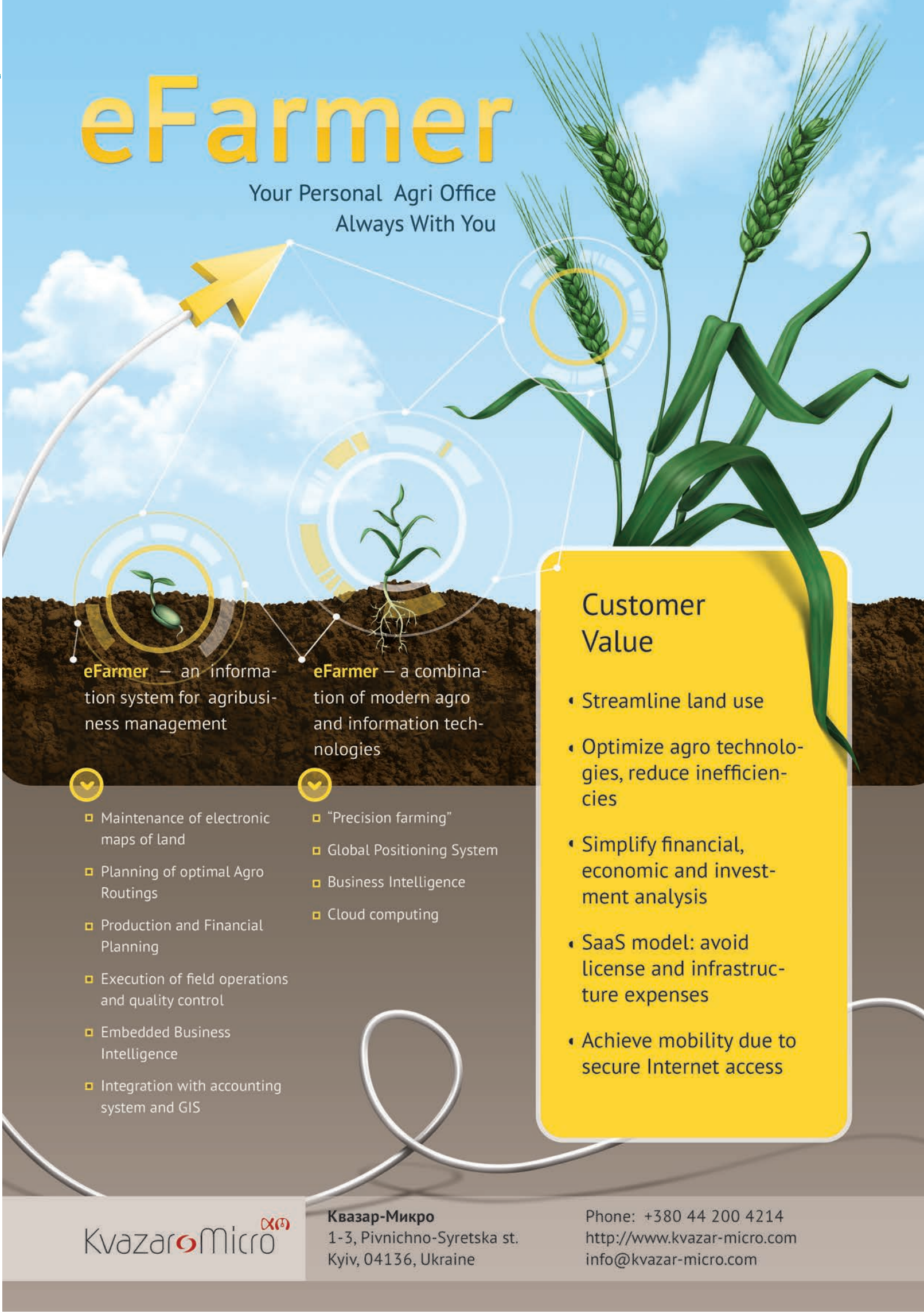
Table 2.6. The main commodity items of exports and imports to EU and from EU in 2009.

| Exports  | thousand USD | Imports  | thousand USD |
|--|--------------|--|--------------|
| Turnip and rapeseeds                             | 555 567      | Extractions, essences and concentrates of coffee and tea                 | 110 655      |
| Raw sunflower oil, safflower or cottony          | 412 350      | Cheese spreads, alcoholic products, sugar syrups and other food products | 87 390       |
| Wheat and meslin                                 | 302 083      | Fresh apples   | 86 767       |
| Sunflower cake and meal                          | 164 127      | Fresh or cooled pork carcasses and semi-carcasses                        | 82 750       |
| Maize  | 115 771      | Animal feedstuffs (except for cats and dogs)                             | 78 699       |
| Sunflower seeds                                  | 96 751       | Liquid margarine   | 64 901       |
| Soybeans   | 56 329       | Frozen parts of carcasses and sub-products                               | 49 891       |
| Blackberry and other fruit and nuts              | 36 222       | Chickens of domestic hens  | 49 097       |
| Barley   | 29 492       | Feeding stuff for dogs or cats   | 49 011       |
| Other sunflower oil, safflower or cottony        | 27 559       | Stripped tobacco   | 48 460       |
| Soy oil  | 23 601       | Cocoa beans  | 46 060       |
| Chocolate and cocoa products                     | 19 069       | Bacon, pork fat and poultry fat  | 45 505       |
| Mustard seeds                                    | 14 587       | Sauces, flavors and dressings  | 41 085       |
| Vegetable seeds                                  | 14 152       | Fried coffee with caffeine   | 37 894       |
| Nuts without shell                               | 13 912       | Seed maize   | 26 842       |
| Ethanol non-denaturated (not less than 80 vol.%) | 13 583       | Frozen pork  | 25 259       |
| Peas   | 12 678       | Soybean cake and meal  | 24 205       |
| Apple juice (with Brix number higher than 20)    | 11 977       | Cocoa butter, cocoa fat  | 23 763       |
| Honey  | 11 697       | Peaches  | 22 461       |
| Vodka  | 11 598       | Mandarins  | 22 099       |

Source: UCAB calculations based on official data.

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there is a requirement to inspect meat and dairy enterprises before supplying products to Russia.

After the accession to WTO, the Ukrainian government of that time focused on Euro-Atlantic integration and was actively promoting the idea of closer integration into the EU. Because none of the parties were ready for direct membership of Ukraine in the EU (Ukraine was not ready because of inconsistency with many basic EU requirements, and the European Union - because of entry of other new members), the choice was made to conclude an Association Agreement. One of the main components of this agreement should be a Free Trade Agreement.

The newly elected President of Ukraine and the new government do not conduct such a rigid foreign policy, trying to maintain a balance in relations with all so-called "strategic partners." Nevertheless, the issue of the Association Agreement with the EU is still relevant. Ukraine strives to gain access to big labor markets, capital and goods of the EU, to simplify the visa system as well as to move away from the unilateral policy of developing relations with Russia.

Thus, although the negotiation process to establish a free trade area (FTA) is not going so smoothly, both Ukrainian and European parties are quite active in this regard. The agreement on free trade will involve several logical blocks that include several points related to agriculture. They are as follows:

- tariff protection of markets;
- sanitary and phytosanitary controls;
- state support;
- protection of geographical names;
- access to public procurement; and
- bilateral safeguard measures.

The situation on the main directions of the negotiation process is briefly described below.

#### Tariff protection of markets

As mentioned above, Ukraine has lowered import duties when joining WTO by rejecting a specific part of the duty. The EU, in contrast, has one of the largest levels of protection of domestic market which specifically includes:

- ad valorem rates of customs duties;

- specific duty rates;
- combined duties;
- tariff quotas on import; and
- the so-called "input prices" (entry prices, analogous with indicative import prices, which affect the rate of duty).

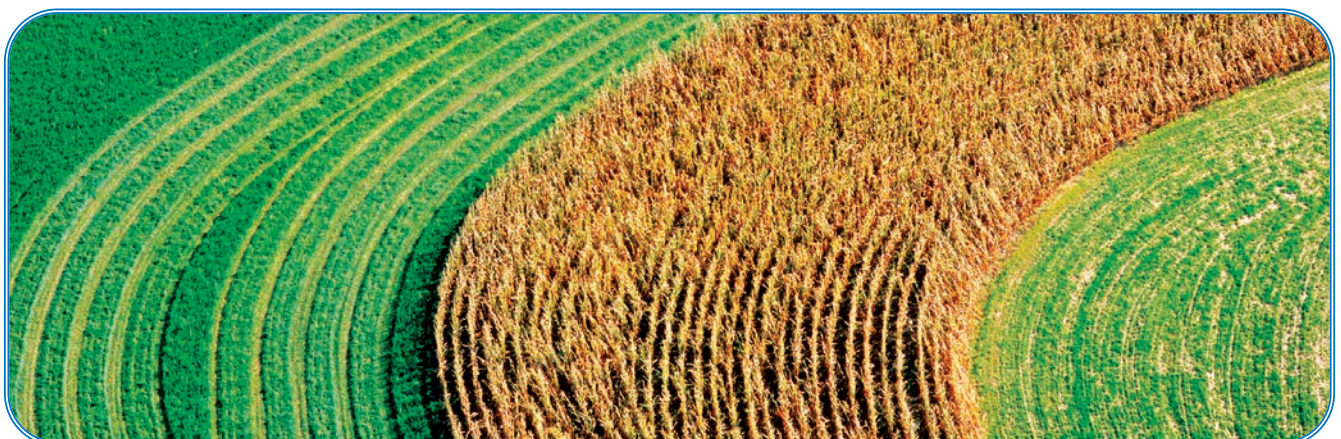
It is evident that the parties find it difficult to agree when considering the possibilities of establishing a zero rate of import duties on a large number of positions of commodity nomenclature. Therefore, the most likely option might be that Ukraine sets zero rates of custom duty for most commodity items at once or with a certain transition period, in exchange for the establishment of a special customs procedure in the EU, which for various commodity items may take the following forms:

- zero rate of import duty (as an option - with the establishment of input price);
- zero rate of duty within quota;
- a reduced rate of duty (ad valorem reduction and / or a specific component);
- a reduced rate of duty within quota; and
- a reduced level of input price.

The problem of the negotiation process is that the positions of parties concerning the long-term level of protection of domestic market and access to markets differ significantly. Primarily, this relates to the volume of quotas which, according to the parties, should be allocated by the EU for imports of products from Ukraine in BCT (VST) mode. It is possible that the tariff issues will be resolved at the final stage of negotiations together with concessions in other areas of the negotiation process.

#### Sanitary and phytosanitary control

At the initial stage of negotiations, the parties were considering various options for cooperation, including even complete approximation of Ukrainian legislation to the EU norms. However, this particular option was brought to the background. Ukraine is unlikely to make such a huge move in the foreseeable future given the specifics of legislative changes in Ukraine as well as the state-of-the-art in many branches of agriculture and food industry that are not ready to work by the European standards.



Thus, probably, this section will not contain a sort of revolutionary standards but it will become more focused on facilitating the procedural aspects of interaction between competent supervisory authorities during access to markets of trading partners.

#### State support

It is assumed that the parties will record a reference of the possibility of using the instruments of state support in accordance with the obligations of each party to the WTO. In this case, the danger for Ukraine is a possibility of usage of export subsidies by the EU although, perhaps, some restrictions on their use will be spelled out directly in the text of the agreement.

#### Protection of geographical names

Since there are almost no registered geographical names in Ukraine, the parties negotiate primarily the protection of geographical names that are registered in the EU but are produced in Ukraine.

Possible options with regard to this issue include:

1. a transition period for Ukrainian producers to ensure that they are able to adapt by changing their geographical names, and / or
2. an indication of a separate list of items produced in Ukraine for which protection will not be applied.

It concerns, first of all, manufacturers of alcoholic beverages such as champagne, cognac, etc.

#### Access to public procurement

According to the agreement on FTA, it is a matter of opportunity for companies of the country-partner to gain access to public procurement procedures on a par with local companies. This regime is more favorable to European companies, many of which have offices in Ukraine.

#### Bilateral safeguard measures

While joining WTO, Ukraine has undertaken a commitment not to use special protective measures in foreign trade, under Article 5 of the Agreement on Agriculture of the WTO. In an FTA with the EU, the use of bilateral safeguard measures will be provided (for example, additio-

nal tariff protection of markets at a sharp increase of imports in free trade).

In general, it is expected that the negotiation process to establish an FTA with the EU can be completed by the end of 2010. Key sector risks for Ukraine in this context include, primarily, further liberalization of imports of livestock products as well as possible abolition of the export tax on oilseeds. The hypothetical benefits for Ukraine are expansion of opportunities for marketing grain, recycled products, vegetable oils, vegetables, and sugar. However, based on the trade position of the EU, we can see that they are not ready for serious liberalization.

It should be noted that in parallel with the negotiating process on FTA, negotiations on FTA with the European Free Trade Association (EFTA) are held. EFTA involves Iceland, Lichtenstein, Norway, and Switzerland. Moreover, the formal negotiation process with EFTA is almost completed and, perhaps, an agreement will be signed during 2010. A key problem that remains partially unresolved is parity of tariff concessions of the parties.

Finally, the negotiation process on establishing an FTA with Turkey and Canada is in the initialization phase. Thus, the term "economization of foreign policy" is becoming very definite in practice though, according to some experts, the establishment of free trade areas often becomes an end in itself, without a proper defense of interests of Ukrainian economy.

## 2.7. Banking and insurance sectors

As in many developed countries, the banking system in Ukraine belongs to a market type and has a two-tier structure which consists of a central bank on one side and commercial banks and nonbank financial lending institutions on the other.

The National Bank of Ukraine (NBU) provides a unified state policy in the sphere of money circulation, regulation of the local currency rate to foreign currency, issue

Table 2.7. Assets of the biggest Ukrainian banks on January 1, 2010, billion UAH.

| #  | Title                 | Assets | Equity capital | Liabilities |
|----|-----------------------|--------|----------------|-------------|
| 1  | PRIVATBANK            | 86,1   | 10,3           | 75,8        |
| 2  | OSHCHADBANK           | 59,9   | 16,4           | 43,5        |
| 3  | UKREXIMBANK           | 57,2   | 10,9           | 46,3        |
| 4  | RAIFFEISSEN BANK AVAL | 54     | 5,3            | 48,7        |
| 5  | UKRSIBBANK            | 46,3   | 4,9            | 41,4        |
| 6  | UKRSOTSBANK           | 43,6   | 6              | 37,6        |
| 7  | PROMINVESTBANK        | 30,4   | 5,6            | 24,8        |
| 8  | OTP BANK              | 29,4   | 2,8            | 26,6        |
| 9  | VTB BANK              | 28,8   | 3,3            | 25,5        |
| 10 | ALFA-BANK             | 28,7   | 2,9            | 25,8        |

Table 2.8. Interest rates on loans and deposits of the commercial banks (except for NBU).

| Period      | On credits, including overdraft credits |                     | On deposits          |                     |
|-------------|---|---------------------|----------------------|---------------------|
|             | in national currency                    | in foreign currency | in national currency | in foreign currency |
| 2000        | 40,3                                    | 17,0                | 13,5                 | 5,8                 |
| 2001        | 31,9                                    | 13,1                | 11,2                 | 5,6                 |
| 2002        | 24,8                                    | 11,9                | 7,8                  | 6,0                 |
| 2003        | 20,2                                    | 11,6                | 7,1                  | 6,0                 |
| 2004        | 17,9                                    | 12,3                | 7,8                  | 6,2                 |
| 2005        | 16,4                                    | 11,6                | 8,5                  | 6,8                 |
| 2006        | 15,4                                    | 11,3                | 7,6                  | 5,8                 |
| 2007        | 14,4                                    | 11,3                | 8,2                  | 5,8                 |
| 2008        | 17,8                                    | 11,6                | 9,9                  | 5,4                 |
| 2009        | 20,9                                    | 10,0                | 14,0                 | 9,2                 |
| January'10  | 18,3                                    | 10,7                | 13,0                 | 9,8                 |
| February'10 | 18,6                                    | 10,7                | 13,2                 | 9,8                 |
| March'10    | 17,5                                    | 11,2                | 13,9                 | 9,2                 |

of banknotes, and coordination of the banking sector as a whole. It also performs several other functions in financial and credit spheres within its competence.

At the beginning of 2010, there were 182 commercial banks that operate in Ukraine and provide services to residents, businesses and organizations. Their net assets amounted to 880.3 billion UAH, and liabilities to 765.1 billion UAH.

Due to the financial crisis, some Ukrainian banks faced serious financial problems. In 2009, they had to introduce a temporary administration by the National Bank. Currently, the interim administration is still in effect in the following banks: Rodovid, Nadra, CB Vladimirskiy, Stolitsa Bank, Inprombank, DialogBank, ZEMBANK. In addition, the National Bank initiated a liquidation procedure on a number of banks, including Ukrprombank among others.

Foreign banks in Ukraine that basically represent the major European financial groups and that came within recent years, overcame the financial crisis more easily, primarily due to access to foreign currency infusions from parent companies.

Currently, the banking system has some drawbacks associated with difficulties in documentation procedures for foreign economic transactions. In particular, it concerns small transactions where organizational costs are relatively high.

Since the beginning of 2010, there has been a slight decrease in the lending rates of commercial banks in UAH, with simultaneous growth rates in foreign currency, due to the recent straightening of the national currency to the US dollar and euro. But, despite this positive trend, credit resources for the majority of companies are still inaccessible because of their deficits as well

as of more stringent requirements of banks to borrowers. The resumption of the pre-crisis growth rates is hampered thereby.

Noteworthy, in early 2010, credits for the real sector were issued under the rates ranging from 17-18% to 27-30% per annum. Thus, the data of the National Bank listed in Table 2.8 should be considered rather as a description of trends in the market.

Regarding monetary policy, it is worth noting that the main pressure on hryvnia has passed and the National Bank redeemed more hryvnia excess supply in the inter-bank market in 2010. This is also due to a positive trade balance in this period. It is important to understand that, despite recent strengthening of hryvnia in May (up to 7,9 UAH per 1 USD and 9.9 UAH per 1 EUR), the situation in the currency market remains potentially volatile.

The Ukrainian aggroinsurance market is still in its fledgling stage. A number of existing obstacles are primarily caused by conservatism of farmers and amorphous state policy.

The active growth of the aggroinsurance market started in 2005, after adoption of the Law of Ukraine "On State Support of Agriculture of Ukraine" dated June 24, 2004 № 1877-IV. It provided insurance subsidies for producers of agricultural products but, in 2009, the growth was interrupted due to lack of budget finance in the Fund of Agricultural insurance subsidies.

On the one hand, this provoked a significant fall in levels of insurance. On the other, qualitative changes in the structure of transactions occurred (in 2009, the share of formal or so-called "scheme-theoretic" insurance, was insignificant, whereas in previous years it was around 50%).



Table 2.9. Subsidized insurance of crop areas in Ukrainian agriculture in 2005-2009.

|                              | 2005     | 2006     | 2007      | 2008      | 2009     |
|------------------------------|----------|----------|-----------|-----------|----------|
| Insured lands (thousand ha)  | 390,6    | 668,2    | 2358,2    | 1171,6    | 510,1    |
| Number of contracts          | 910      | 1330     | 4397      | 1637      | 1980     |
| Premium volume, thousand UAH | 12 800,0 | 28 518,4 | 117 120,1 | 155 382,0 | 42 003,0 |
| Subsidies, thousand UAH      | 5 800,0  | 12 490,6 | 47 767,8  | 72 800,0  | 0,0      |
| Insurance companies          | 28       | 37       | 62        | 59        | 16       |

Table 2.10. Consolidated data on agroinsurance in 2009.

| Indicator                      | Crop production | Animal production | Total     |
|--------------------------------|-----------------|-------------------|-----------|
| Number of contracts            | 1 980           | 5 330             | 7 310     |
| Insured value (thousand UAH)   | 1 300 000       | 128 000           | 1 428 000 |
| Premium volume (thousand UAH)  | 42 003          | 2 100             | 44 103    |
| Insured                        | 510 115 (ha)    | 77 500 (entities) | x         |
| Internal tariff                | 3,24%           | 1,63%             | x         |
| Number of payments             | 140             | 54                | 194       |
| Sum of payments (thousand UAH) | 13 423          | 219,7             | 13 642,7  |
| Level of payments              | 36,48%          | 10,46%            | 30,93%    |

In 2009, insurance companies concluded 1980 contracts for crops and 5330 contracts for animal production with a total amount of 44 million US dollars.

Importantly, the number of insurance companies that generously offered their services to agricultural sector in 2009 considerably reduced. As previously, the leaders were Oranta Insurance Company, Ukrainian Agrarian Insurance Company, and TAS, whose composite share in the

number of contracts as well as in the volume of premiums earned accounted for more than 70%.

A significant increase of agroinsurance is not projected for 2010, due to the fact that the adopted state budget does not provide subsidies for insurance tariffs that were a key factor of growth in the previous years. Furthermore, the financial situation of many agricultural enterprises does not allow them to spend resources on insurance.





## 3. Ukrainian agriculture

### 3.1. Land resources and land relations

Ukraine has a high proportion of arable lands in agriculture. Most of the national lands are suitable for cultivation, and more than a half of the 60 million hectares is occupied by arable land.

The territory of Ukraine is divided into three climatic zones: steppe, forest steppe and woodlands. Each zone has its specific characteristics for agricultural production.

In the course of the reforms in the 1990's, the land that was cultivated by collective farms came into possession of rural residents - employees of collective farms. Today, these lands are divided into shares. The distribution of agricultural land in regions of Ukraine and the average size of land shares are presented in Figure 3.1

Despite the fact that, as a result of land reform, many rural residents became owners of agricultural land, most of them were neither ready to handle it by themselves, nor

Table 3.1. Distribution of land by type on January 1, 2010 (thousand ha)

| All lands, total area              | 60354,8 |
|------------------------------------|---------|
| All agricultural lands, total area | 42813,7 |
| Including farmlands, total area    | 41569,4 |
| Of them:                           |         |
| Arable lands                       | 32478,4 |
| Fallow lands                       | 320,8   |
| Perennial plantings                | 897,7   |
| Hayfields                          | 2409,8  |
| Pastures                           | 5489,7  |

Source: State Committee for Land Resources

to unite into larger business structures. Therefore, the cultivation of these lands is made by tenants, who are typically a company based on the basis of former collective farms. The structure of land use is presented in Table 3.2.

At the beginning of 2010, an average lease rate on agricultural land was 260.2 UAH per ha. Regulatory monetary evaluation is the only official method of measuring the value of agricultural land. The last assessment was conducted in 1995 but, due to high inflation, indexation is made almost annually. In early 2010, the average regulatory monetary value of agricultural land amounted to 11 187 UAH per ha, whereas regulatory monetary value of arable land amounted to 11 783 UAH ha.

According to the calculations of the "Ukrainian Agribusiness Club" the normative monetary evaluation does not reflect the real value of agricultural land in case of creation and full operation of land market in Ukraine. An in-depth analysis of prospects of agricultural land market and its possible value in 2012 along with other equally important issues is presented in the study "Superlarge farms in Ukraine: efficiency and competitiveness" which is expected to be published in July of this year.

Table 3.2. Agricultural land use on January 1, 2009 (thousand ha)

|  | Agricultural land | Arable land |
|--|-------------------|-------------|
| Ukraine in total                         | 42844,8           | 32473,4     |
| Including:                               |                   |             |
| Rural population (individual households) | 15604,0           | 11374,6     |
| Agricultural enterprises                 | 17252,2           | 15695,4     |
| Farmers                                  | 4031,9            | 3817,0      |

Source: State Statistics Committee of Ukraine

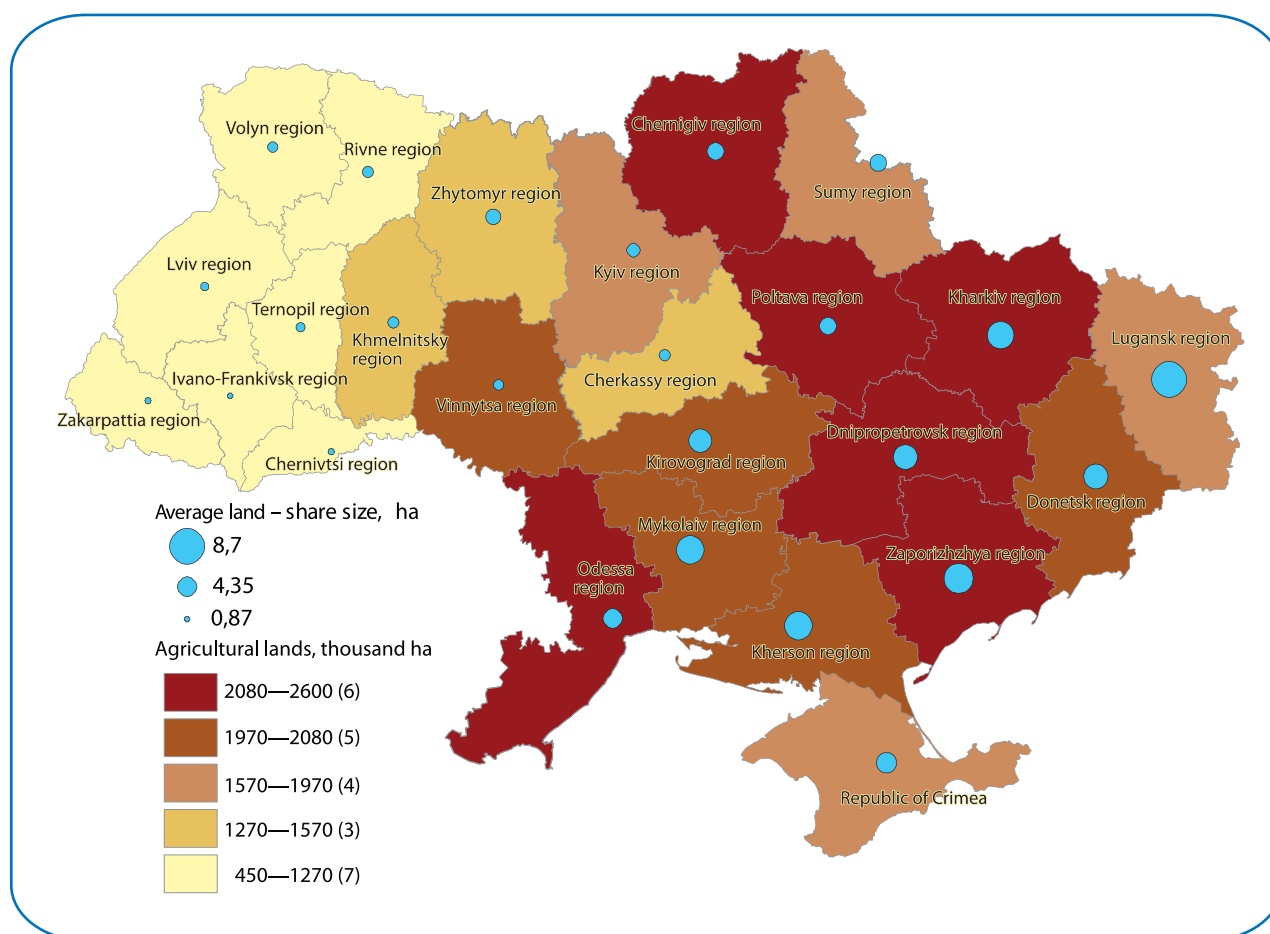


Figure 3.1. Agricultural land distribution and average land share by regions of Ukraine.

The average rental rate was 2.32% of the normative monetary value of the land in 2009. Presidential Decree № 92 dated February 2nd, 2002 provides that land rate should be set at a level no lower than 1.5% of the normative value of money. In fact, the average land rate exceeded the established minimum rate only in early 2008.

Many lawyers doubt the legality of the presidential decree on the establishment of minimum rental rate. They insist that it must be done by amending the legislation.

However, on August 19, 2008 the President signed the decree No. 725 which stipulates that the minimum rental rate should be set at a level no lower than 3% of the normative monetary value of the land. Bodies of the State Committee require an increase in rental rates to a specified level during the registration of leases or their prolongation.

Today's relatively low average lease rates are partly explained by signing long-term leases in previous years when the yield from cultivation of agricultural products was minimal even in productive farms. In 2009, the most typical lease rates for land were about 2.5-3% of their normative monetary value. In some cases, rental rates exceeded this level.

The time frame for forming a full operation land market is constantly being postponed. In addition to political instability, the powers of public authorities in the land registration and cadastre are repetitively being

debated as well as a number of conceptual parameters of a possible land market act an obstacle to the formation of a full operation market. It is also necessary to pass the laws "On Land Market" and "On State Land Cadastre."

However, due to a number of statements made by political officials, the probability of formation of a land market within the next year or two has become higher. The Minister of Agrarian Policy of Ukraine Mykola Prysazhnyuk and the first deputy head of Presidential administration Iryna Akimova advocate the formation of land market and the removal of the moratorium on sale of agricultural land until 2012.

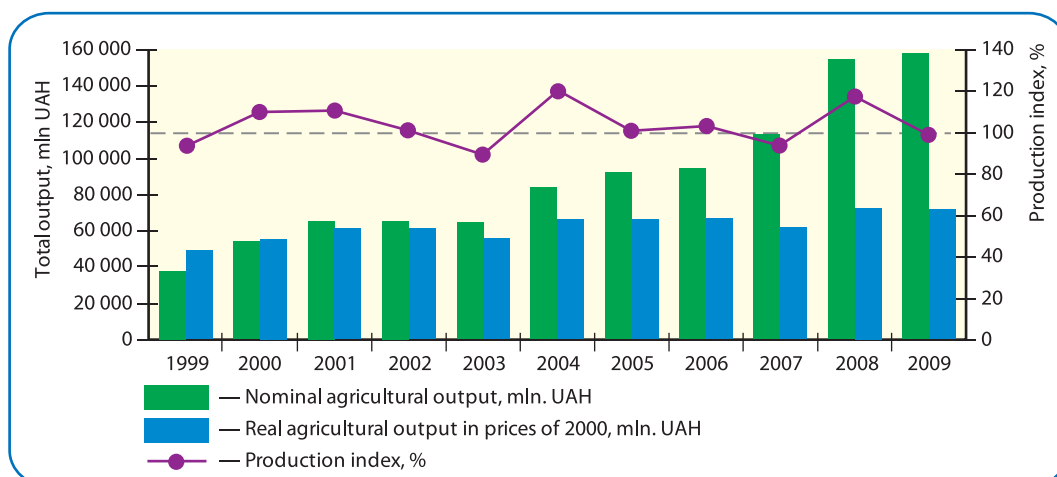
## 3.2. Agricultural production

### General characteristics

Many countries recognize the enormous agricultural potential of Ukraine but the lack of investments, outdated technologies, and low productivity do not allow the sector to achieve sustainable development.

Growth of gross agricultural production is shown in Figure 3.2.

Along with the aforementioned problems, the structure of agricultural production is not optimal. In some industries (in particular, livestock and vegetable production), individual farms produce up to 80-90% of gross output.



Graph 3.2. Gross agricultural production, 1999-2009.

Nevertheless, this situation provides additional opportunities to expand production in the corporate sector as production of individual farmers is being reduced. An increase in production of poultry enterprises within recent years is a prominent example in this respect.

### Structural changes

Along with the formation of agriholdings, significant changes have occurred at the level of medium and small farms. The data for large and medium-sized agricultural enterprises in Ukraine are presented in Table 3.3.

The general tendency is that the number of farms is declining, while their size and production volumes grow. This reflects the fact that larger farms have greater productivity and profitability, which encourages their expansion.

Table 3.3. Agricultural sector on the level of agricultural enterprises.

|   | 2005 | 2006 | 2007 | 2008 |
|---|------|------|------|------|
| <b>Land use</b>                               |      |      |      |      |
| Number of enterprises                         | 8366 | 7460 | 8243 | 8987 |
| Land area, Mio. ha                            | 16,3 | 15,6 | 16,7 | 18,2 |
| Average size of an enterprise, ha             | 1943 | 2085 | 2028 | 2021 |
| <b>Livestock</b>                              |      |      |      |      |
| Number of enterprises                         | 5689 | 4777 | 4183 | 3694 |
| Heads in total, Mio.                          | 1,63 | 1,50 | 1,32 | 1,15 |
| Average size of an enterprise, heads          | 287  | 314  | 317  | 313  |
| <b>Pork production</b>                        |      |      |      |      |
| Number of enterprises                         | 5108 | 4610 | 4406 | 4036 |
| Number of pigs, Mio. heads                    | 1,63 | 2,03 | 2,25 | 1,97 |
| Average size of an enterprise, heads          | 319  | 441  | 512  | 489  |
| <b>Poultry production</b>                     |      |      |      |      |
| Number of enterprises                         | 595  | 554  | 444  | 390  |
| Poultry numbers, Mio. heads                   | 46   | 67   | 65   | 85   |
| Average size of an enterprise, thousand heads | 77   | 120  | 146  | 218  |

Note: This data includes enterprises that cultivate above 100 ha of land and involve more than 50 hired employees.

### Public companies in agriculture

Rapid growth and the development of large agricultural companies in Ukraine in the last few years as well as ambitious plans for the future have prompted many of them to search for alternative sources of funding. Such a source has become the placement of shares of companies on international stock markets.

Twelve Ukrainian agricultural business groups (see Table 3.4) were launched on the world stock markets within the last three or four years. Most of them made a placement of shares on Frankfurt, London and Warsaw stock exchanges.

According to the experts of Ukrainian Agribusiness Club, the total capitalization of agricultural companies being traded at international stock exchanges amounted to 5.1 billion US dollars in April 2010, which is almost 45% more than in early 2010.

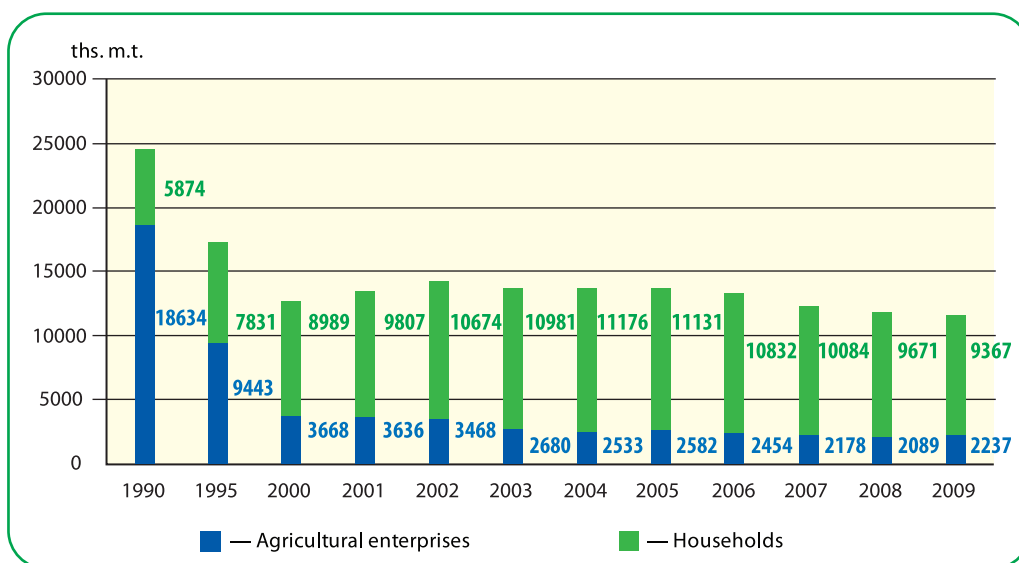
The growth of shares of Ukrainian agricultural enterprises is explained by several factors. First of all, Ukrainian agriculture demonstrated stability in 2009 when the im-

Table 3.4. Ukrainian public agricultural companies that are quoted in the international stock markets.

| Company title         | Trading floor  | Capitalization, Mio. USD (by April 10, 2010) |
|-----------------------|----------------|--|
| Agrogeneration        | Euronext Paris | 88,3   |
| Agroton               | DBG            | 151,   |
| Astarta               | WSE            | 533,7  |
| Avangardco            | LSE            | 875,0*                                       |
| Kernel                | WSE            | 1328,6                                       |
| Landkom               | LSE            | 34,7   |
| MCB Agricole          | DBG            | 56,8   |
| MHP                   | LSE            | 1484,1                                       |
| Mriya Agro            | DBG            | 637,7  |
| Sintal Agriculture    | DBG            | 140,0  |
| Tsukrovyy soyz UKRROS | DBG            | 66,1   |
| Ukrprodukt            | LSE            | 19,3   |

\* by May 18, 2010.

Source: UCAB calculations based on official data.



Graph 3.3. Production of milk in Ukraine, ths. tonnes.

impact of the financial crisis on economy of the country reached its peak. Second, in financial terms, Ukrainian agriholdings, especially those listed on European stock exchanges, performed well.

In the first half of 2010, Ukrainian agricultural companies attracted about 600 million US dollars of finance through the sale of Eurobonds and shares. By the end of this year, the Ukrainian public companies from agricultural sector intend to attract 1 billion US dollars which is several times more than in 2009.

### 3.3. Changes in selected industries

#### Dairy sector

Since the 90s, the dairy industry in Ukraine was characterized by annual decline in total numbers of cows and milk production as well as by a changing structure of production.

For example, starting from 2005, the number of cows has been falling by 7-8% each year, compared to the previous year. In 2009, the rate of decline slowed down to 3%. As of January 1, 2010, there were 2,757 thousand heads of cattle in Ukraine. At the same time, the rate of decline of milk production, starting from 2005, was at the level of 4-8%. In 2009, milk production totalled 11 604 tons.

It is worth noting that individual households still have a leading role both in production volumes and supply of raw milk for processing although their share is steadily declining. Thus, by 2009 the share of households in total milk production accounted for more than 82%. Further, according to the results of 2009, this figure was 80.7%, and in the first quarter of 2010 it decreased to 75.7%. However, despite the further reduction of cattle livestock in agricultural enterprises, milk production increased by 7% in 2009 compared to 2008 and amounted to 2 237 tons. The share of agricultural enterprises in the supply of raw milk for processing has been steadily increasing. According to the results of 2009, it stood at 40%. There is also

an increase in volumes of deliveries of high quality milk. Thus, the share of extra-class milk that amounted to 1.5% in total volume of supplies for processing by agricultural enterprises in 2009 was almost 4% in the first quarter of 2010. This milk is mainly classified in the highest (32.8%) and first quality (59.3%) classes.

Agricultural enterprises are still not able to compensate for the overall decline in milk production; there is, also, increasing competition in raw milk acquisition, especially in autumn and winter. For example, in 2009, the volume of milk received for processing decreased by 700 thousand tons (or 13%) compared to 2008.

In 2009, 4 671 tons of milk were delivered for the processing. Of these, 50% were used in the production of cheese, 35% in the production of dairy products, 13% in the production of butter, milk powder and casein, and 2% for ice cream.

The financial crisis, reduction of the demand for dairy products in the world, and reduction of prices in the world market affected domestic production of dairy products in Ukraine. In 2009, there was a decrease in production of many products, e.g. almost 30% reduction of milk and dry cream and 3% of fat cheeses. However, in 2009, compared to 2008, there was an increase in production of cheese rennet (+0.7%), butter and fat milk with more than 85% of fat (+6.2%), and not flavored yogurt (+41.9%).

In addition, there was a significant decrease in exports. In value terms, exports decreased from 722.3 million US dollars in 2008 to 423.6 million US dollars in 2009. At the same time, exports to Russia which remains the main export market for the Ukrainian dairy industry also decreased. As a continuous trend of 2008, imports of dairy products increased to 112.1 million US dollars, primarily through increased imports of butter, for example from Belarus and the EU. The reason was a significant reduction of domestic production of oil within the first half of 2009. Despite this, the dairy sector in Ukraine remains a net ex-

porter. While exports total about 1.2 million tons, only about 0.38 million tons were imported.

In regard to the structure of the dairy industry in Ukraine, the industry is fairly consolidated. 30 leading companies cover about 76% of the market. The remaining part is covered by 200 smaller companies. The trend towards consolidation and reduction of the number of dairy plants will remain relevant in the nearest future.

**The Meat Sector in Ukraine---Dynamics of development**

Since 2005, meat production in Ukraine has been steadily increasing, although the structure of production is significantly changing. This trend will become even more evident in 2010. Low domestic demand associated with the economic crisis will still be able to restrain the development of the industry. According to the experts of the Ukrainian Agribusiness Club, an increase of meat production by 7.6% is expected in 2010, while there was almost no production growth in 2009, and meat production accounted for 1.664 thousand tons in slaughter weight (according to Ukrainian Agribusiness Club).

The slowdown of recent years is due to substantial reduction in beef production, stable volume of pork production and a moderate pace of poultry market development. According to Ukrainian Agribusiness Club, the share of beef in the overall structure of meat production will decrease from 19,6% in 2008 to 15% in 2010, while the market share of poultry meat will increase from 49% in 2008 to almost 54% in 2010 (see Fig. 3.4.).

**Beef**

In recent years, there have been vigorous ongoing changes in the beef market. Prior to 2006, Ukraine considered this industry as an export-oriented, despite the reduction of livestock and the projected shortfall of meat. Then, in 2008, exports decreased significantly due to the high demand for this product in the domestic market. In the last three years, reduction of domestic consumption

of beef continues, despite the increase in the production of meat products and meat in general. Thus, according to the Ukrainian Agribusiness Club, domestic beef consumption will amount to 329 thousand tons this year. Reduction of consumption occurs primarily due to reduction of the supply of domestic raw materials: in 2006 it accounted for 456 thousand tons; in 2009 it dropped to 304 thousand tons; and, expectedly, it will not exceed 300 thousand tons this year.

As a result of production decline, beef meat was replaced by other types of meat.

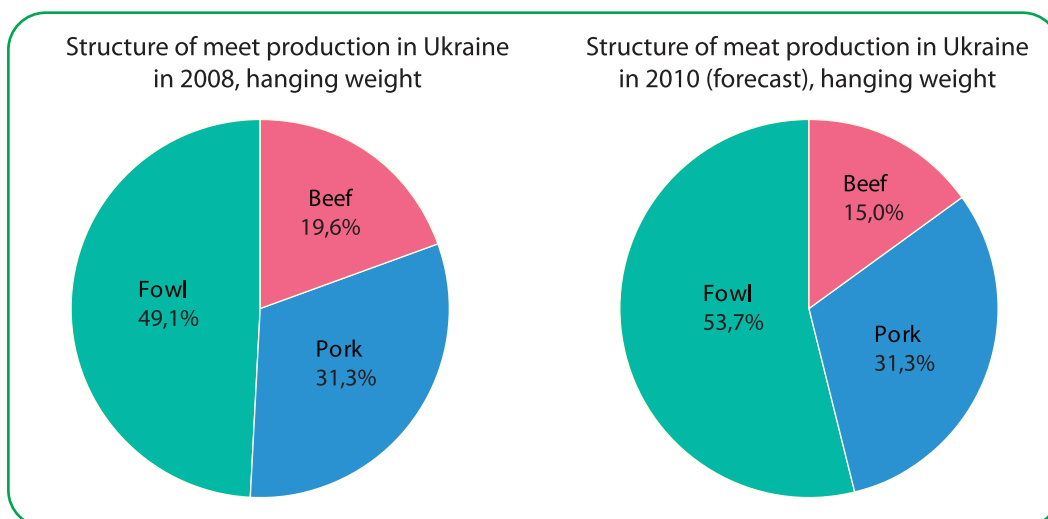
**Pork**

Despite the recession and the post-crisis period that have undoubtedly affected the demand for meat in general and pork in particular, record grain harvests in 2008 and 2009 served as a sound basis for the start of the next wave of hog farming. Accordingly, the numbers of hog livestock in agricultural enterprises have substantially increased.

Despite the reduction of a total demand for pork in slaughter weight to 615 thousand tons in the current year, the supply of domestic raw materials will increase because of the pork production growth. Thus, it can be expected that the reserves will increase and the price of this raw material will reduce. This tendency is confirmed by the results of the enterprises for the first 4 months of the year. In general, it is expected that pork production will increase by 80 thousand tons to 640 thousand tons before 2014. Opening of export markets for Ukrainian raw materials can serve as a motivation for further development of the industry although the volumes of export markets are unlikely to exceed 20 thousand tons in the next years.

**Poultry**

The domestic market of poultry has developed most rapidly and dynamically. According to Ukrainian Agribusiness Club and based on data from the State Statistics Committee, production of poultry meat in slaughter we-



Graph 3.4. Structural change in meat production in Ukraine.



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ight was 587.4 thousand tons in 2006; whereas, in 2009, this figure reached 860 thousand tons. Based on initial estimates, production of the current year may reach 940 thousand tons. Noteworthy, there is a significant proportion of imported products in the market. According to Ukrainian Agribusiness Club, total imports of poultry meat were 185 thousand tons in 2006 and 218 thousand tons in 2009. In this year, the number is likely to fall to 115 thousand tons. This indicates a significant deficit in the market, especially in the view of a high demand for low-cost raw meat which is mainly supplied by imports. Total demand for poultry meat reaches 1 million tons in slaughter weight. Already in 2011, Ukrainian producers of poultry meat will be able to cover fully domestic consumption. Further growth in production is possible mainly due to exports and due to growth in domestic consumption. At the same time, it is more likely that the tendency toward consolidation of the market in the hands of big players at the expense of small and medium-sized producers will continue.

It should be noted that balances that are relatively favorable for domestic producers (reduction of import volumes in 2010) are based not only on the willingness and ability of Ukrainian producers to take a larger market share but also on considerable strengthening of veterinary control of imports. Additional influence is made by Customs Service that seeks to maximize the customs value in the structure of revenue growth through import duty and VAT.

To a certain extent, it compensates unprecedented low customs protection of the domestic market experienced by Ukraine when joining the WTO.

However, risk factors related to the presence or absence of the administrative influence on imports should be taken into account (for both balance and domestic prices). This is especially true for the pork market that suffers from significant depreciation of euro against dollar and faces fierce competition from the EU pork suppliers.

You can get more detailed information about the world and Ukrainian meat markets from the study of Ukrainian Agribusiness Club “Meat market: production, trade, capacity”.

### 3.4. Labor force in agriculture

In addition to land and capital, labor plays an important role in agricultural production. The impact of labor on the ultimate success of the business can be hardly overemphasized because the efficiency of a company as a whole, involves effective action by each employee.

Of 20 million people employed in Ukraine, about 3.5 million people work in agriculture (as of 2009). About 85% of them are working in the informal sector, i.e. private

farms. Only 600 thousand people are engaged in the production process in agricultural enterprises.

At the end of 2009, the demand for labor in agriculture amounted to 2.2 thousand vacancies, which is two times lower than the pre-crisis indicator. If one looks at the figures at the end of March 2010 before the start of spring field works, the rate of incidence decreased to 25%.

This is due to the fact that the demand for labor in agriculture is very much affected by seasonal performance of works in this industry.

Experts with knowledge of foreign languages, work experience abroad or in large agribusiness enterprises are in most demand. The most common vacancies are: agronomists, sales managers agricultural products and machinery, and senior managers.

The recent resumption of economic growth in the first quarter of 2010 has also led to an increase in the number of vacancies for skilled workers in agriculture. According to AgriJob recruiting agency the growth rate is about 5%. At the same time, there is high competition in the labor market where 8 candidates compete for one vacancy. One reason for this is the influence of the financial crisis that made many job seekers to return to their homeland. In addition, experts from other industries are looking for success in the relatively stable agricultural sector.

In the nearest future, a growth in the number of vacancies can be expected due to the increased interest of foreign companies in Ukrainian agriculture with subsequent opening of representative offices in Ukraine.

### 3.5. Brands in agricultural input markets

In recent years, the demand for branded agricultural products increased drastically. This can be explained by the necessity to be convinced about the quality of resources used in production. Cheaper products of unknown origin, such as seeds and herbicides, often do not bring the desired effect, and sometimes may even lead to huge losses.

In this context, a nation-wide contest “Agrobrand” was established. “Agrobrand” is an annual award of the most successful brands among input suppliers for agricultural production. The contest is based on a survey of popular brands among customers, i.e. agricultural enterprises.

The purpose of this competition is to create and develop brand awareness among farmers and agronomists by conducting an objective assessment of the effectiveness of marketing policy by input suppliers as well as by providing an opportunity to study the development of successful brands in agricultural markets, taking market dynamics and changing consumer demands into account.

Winners in each category are determined based on the results of a national survey of agricultural enterprises.



Table 3.5. Winners and laureates of the “AGRO-BRAND-2010” competition

| Winners   | Laureates         |
|---|-------------------|
| Best producer of agricultural machinery   |                   |
| JOHN DEERE  | MTZ               |
|   | CLAAS             |
| Best producer of agricultural products  |                   |
| SYNGENTA  | Bayer CropScience |
|   | BASF              |
| Best producer of agricultural crop seeds  |                   |
| PIONEER   | Syngenta          |
|   | Sady Ukrainy      |
| Best company-dealer in the sphere of resource provision of the agro-industrial complex of Ukraine |                   |
|   | Rise              |
|   | Eridon            |
|   | Amako             |

The customer survey covers all regions of Ukraine. The method of the survey is telephone interviews with the managers or agronomists of agricultural enterprises.

**Principles of the survey are the following:**

- objectivity - control of data collection and analysis at all stages, impartiality of the organizers;
- representativeness - poll results reflect opinions of the entire target audience (the most active representatives of agricultural enterprises: visitors of agricultural exhibitions, conferences, seminars, etc.). Survey of 1000 agricultural enterprises in Ukraine provides sampling error of  $\pm 3\%$  at a confidence level of  $P = 0,954$ ;
- efficiency - an annual contest allows to track changes in expectations of Ukrainian farmers and popularity of brands;
- openness – media representatives, members of companies, producers, experts, etc. may be present during interviews and ensure impartiality in conducting research and objectivity of the results .

**Nominations:**

1. Best producer of agricultural machinery
2. Best producer of agrochemical products
3. Best producer of seed crops
4. Best company-dealer in the area of resource maintenance of the agro-industrial complex of Ukraine.

The list of winners and laureates of “Agrobrand-2010” is presented in Table 3.5.

**POINT OF VIEW**

**Peter Krimm, General Manager of John Deere Ukraine LTD**



The John Deere Company is the world leader in agricultural equipment, technology for logging industry, gardening equipment, machinery and equipment for other areas.

From the date of creation of the company in 1837, we formed clear business principles which are honesty, innovation, quality and dedication throughout the world.

Although the usage of John Deere equipment has a long history in Ukraine, our presence at InterAGRO-2010 exhibition demonstrated a growing commitment to this important market.

We have always considered Ukraine, with more than 32 million hectares of arable land, as a key agricultural region of Central and Eastern Europe. One of our main tasks is to help improve the performance of Ukrainian farmers and support the development of farms using the latest equipment and systems for precision farming.

These innovative components will significantly reduce costs, and improve performance of technology. We are confident that they will enable agricultural enterprises to be more effective and successful.

Today, funding is provided by «John Deere Credit» in collaboration with partners, such as Hermes, Ek-simbank and other commercial banks.

In addition, John Deere, together with its distributor partners, offers a variety of financial options for cooperation with its customers. Despite the global financial crisis, one of our current goals is to ensure Ukrainian farmers with the possibility to finance equipment. Future progress of Ukrainian farms, which have high potential, mainly depends on availability of credit and introduction of advanced agricultural technologies.

John Deere Company is fully committed to support this progress in Ukraine for the restoration of the status of Ukraine as the breadbasket of the world.



## 4. Taxation

### 4.1. Tax system

In 2009, no significant improvements regarding tax administration in Ukraine occurred. This fact, in conjunction with the rise of huge economic problems, had a serious impact on taxation.

In particular, tax authorities often simply refuse to accept the declarations of the value added tax (VAT) if the amount of budget reimbursement of this tax is indicated as it happens, for example, in the case of export operations. A VAT refund to agricultural companies was not actually given since the second half of 2009, while the barter of grain from the Agrarian Fund was implemented in the first half of 2009 to repay the VAT debt to exporters.

Thus, the VAT refund has been considerably reduced to the amount necessary to go through the bureaucracy level quicker. However, at the beginning of 2010, the pro-

cess abruptly stopped. The State Treasury did not have sufficient funds to secure the fulfillment of its obligations. The former Prime Minister Yulia Tymoshenko stated that there were two choices: either to pay the debt for VAT refund or to pay pensions. The second option would have been finally chosen.

The new government adopted a more liberal position that the VAT debt to be converted into government bonds and that the current debt will be repaid on time. At the time of writing this text, the conditions of issuing the VAT-governmental bonds are still not defined. According to unofficial sources, the government is about to set the rate of return at the level of 5-5,5% per annum, which is two times lower than the market parameters currently set and may presuppose a substantial discount while the bonds are traded.

Current problems in the tax system may still not be the worst part because a number of new propositions that are being actively discussed within governmental circles can create more strenuous conditions for the taxpayer. One of the propositions to potentially become legislation is the imposition of income tax on business entities, and levying of social payments for a number of officials (for example, directors and accountants) based not on the actual wages paid but on a certain indicative level of wages. It is also possible to legalize norms that will make the entity be responsible for its bad behavior towards the counteragent. For example, if in the chain of VAT payment a bogus company is revealed, an exporter of respective goods will lose the right for budgetary reimbursement of its tax payment. It is difficult to predict when and to what extent these innovations will be implemented and become statute.

It should be noted that the agricultural tax system is significantly different; it provides VAT exemption and the

Table 4.1. General tax rates for enterprises in Ukraine\*

|  |        |
|--|--------|
| VAT rate   | 20%    |
| Tax on profits of companies                              | 25%    |
| Employers' social payments (percentage of payroll)       | 37-38% |
| Including:   |        |
| Pension Fund   | 33,2%  |
| Employment Fund  | 1,3%   |
| Social insurance Fund                                    | 1,5%   |
| Income tax for individuals (hired workers)               | 15%    |
| Social payments to hired workers (percentage of payroll) | 2-4%   |

Source: Laws of Ukraine.

\* — For small enterprises and private entrepreneurs, there is a simplified order of taxation, in particular, the payment of a single tax which is calculated as a percentage of turnover.

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**WTO regulations**  
Agricultural tax



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switching to a flat tax (more on this below). VAT exemption amounts up to 10 billion UAH and exceeds considerably the direct budget support for the industry. Thus, its role can be hardly overestimated. In addition, a 'preferential tax treatment' somewhat smoothes out the rough edges of the common system of taxation.

Two risk factors for the preferential taxation system must be considered: a) IMF's (International Monetary Fund) requirements, and b) the next edition of the Tax Code.

It has been already published that the IMF, while discussing a potential new program for cooperation with Ukraine, posed the VAT exemption call off as one of the demands for Ukraine. This demand appeals also agricultural producers. It was proposed to convert the VAT exemption into a kind of direct state support. In our view, this alternative is a much worse scenario for agriculture because of the potential complications the administration of such support may cause in accordance with the WTO requirements. Additionally, difficulties may occur in the allocation of this support during the annual budget evaluation process. The final decision on this issue has not yet been announced but the consultation process with IMF is being prolonged.

To some extent, this VAT preferential treatment can change after the adoption of the Tax Code, even if this document may affect the flat agricultural tax. In previous attempts to compose the Budget Code, the authors suggested a few changes to the system of the flat agricultural tax (henceforth FAT). Among the most significant propositions of that period was that livestock farms, instead of paying FAT on the basis of cultivated land area and property owned by them, should pay tax in accordance to the livestock farming turnover. These proposals may be rekindled in the future.

## 4.2. Flat tax (fixed)

In accordance with Ukrainian Law regarding the "flat agricultural tax," agricultural producers can switch between tax procedures from the usual tax to the flat agricultural tax. This is a specific tax arrangement which, in particular, replaces the income tax, land tax and others.

The principles of FAT for agricultural producers is, specifically, as follows:

- Agricultural enterprises are entitled to pay FAT if more than 75% of their income is derived from agricultural activities.
- The basis of FAT is the normative value of agricultural land.
- Depending on the three types of agricultural land, tax rates are as follows: (1) 0,15% of the cost of land per year for arable(tillable) land, hayfields and pastures; (2)

0,09% of the cost for perennial plantings; and (3) 0,45% of the cost for water funds in inland waters.

- FAT is paid monthly but the amount of payment varies each quarter: in the first and second quarter, 10% of the total amount of payment is paid; in the third and fourth quarter, 50 and 30% are paid, respectively.

## 4.3. VAT exemption

Additionally, there is a special tax treatment of value added tax for agricultural producers. The Law of Ukraine "On Value Added Tax," contains several articles that regulate these exemption, specifically:

**Article 8-1.** The sum of value added tax which is counted by an agricultural enterprise on the basis of the value of sold agricultural products remains in full possession of agricultural enterprises and can be used for industrial purposes.

**Article 11.21.** The sum of value added tax that must be paid to the state budget by meat and dairy enterprises must be directed to payments of subsidies to agricultural producers and private households for the milk and meat in live weight sold to these enterprises.

According to the 2009 amendment, the latter article is valid without limitation but only if the Cabinet of Ministers that is responsible for preparing the draft budget bill for the next year does not decide to centralize these funds to pay subsidies for cows.

Such a rule was provided by the Ukrainian Law "On State Budget of Ukraine for 2010". According to this law, the payment of subsidies to milk and meat producers by means of processing enterprises ceased from the moment of the enactment (April 30, 2010).

At the same time, the state was not prepared to administer a system of budgetary subsidies for approximately 1.8 million private households that breed cattle. Benefits for business during the transition to direct budget subsidies are also not obvious. As a result, the government had to draft a law to postpone the transition to budget support until January 1, 2011 (Registration No. 6317-1). The draft bill was adopted by the Verkhovna Rada and came into force.

In this case, there is a high probability that the VAT exemption for the milk- and meat processing enterprises will be replaced by subsidies for cows from January 1, 2011. Support measures will focus on dairy farming. Among other things, this means that animal husbandry can lose some support. At the same time, animal husbandry constitutes about 7% of the income of agricultural enterprises and up to 20% of the revenue of private households that produce livestock and poultry and supply their production to meat processors. In general, we can talk about a fiscal redistribution of more than 2 billion UAH support.



## 5. Measures of state support

Budget financing of the Ukrainian agro-industrial complex is carried out in the three major areas - funding of the expenses of the Ministry of Agrarian Policy, crediting of the expenses of the Ministry of Agrarian Policy, and the use of Stabilization Fund.

The costs on the credit resources of the Ministry of Agrarian Policy cannot be fully considered as public support since these funds must be returned in subsequent budget periods. By the way, just by crediting, the intervention activities of Agrarian Fund and the state leasing supplies of equipment are maintained.

A summary of the financial support to agriculture is provided in Table 5.1.

Noteworthy, the sustainability of sources of the Stabilization Fund can not be trusted hundred percent as these resources come from privatization activities or borrowing from the Ministry of Finance.

Because of this, financing by the Stabilization Fund is very uncertain. For example, in 2009, only about 15% of the expenses of the Stabilization Fund went in the agro-industrial complex.

In this context, it is necessary to note that only the funding of the development of the horticultural sector is expected in 2010, and the funds will be derived directly

Table 5.1. Financial measures to support agricultural producers, bln UAH.

| Year                    | 2005 | 2006 | 2007 | 2008 | 2009 | 2010  |
|-------------------------|------|------|------|------|------|-------|
| State budget financing* | 1,78 | 2,80 | 4,04 | 4,50 | 2,65 | 0,681 |
| Stabilization Fund      |      |      |      |      | 2,2  | 3,033 |

\* —UCAB estimates based on Laws of Ukraine on state budgets.

from the budget (without the use of the Stabilization Fund). The rest of the programs should be funded by the Stabilization Fund.

Considering the fact that the state budget for 2010 was adopted only in late April and the parameters of specific programs of support are annually approved based on a respective budget law, government resolutions on the financing program in 2010 were still at the discussion stage in the time of writing this brochure. Therefore, support options will be analyzed on the basis of the draft documents.

It is assumed that the main areas of direct state budget support for agricultural enterprises will be the areas listed in Table 5.2.

Table 5.2. The main areas of direct state support for agricultural enterprises in 2010

| Directions of support  | Amount of support, mln. USD |
|--|-----------------------------|
| Partial compensation for the cost of construction of livestock complexes.                      | 1000                        |
| Partial compensation of interest rate  | 787                         |
| Compensation of costs for cultivation of sugar beet and flax                                   | 415                         |
| Financial support of the establishment of wholesale markets for agricultural production        | 200                         |
| Partial compensation of the cost of agricultural machinery                                     | 150                         |
| Support of crop production on irrigated land   | 75                          |
| Support of purchase of agricultural machinery and genetic resources based on financial leasing | 50                          |

The expected conditions of state support for various programs are described below.

Partial compensation for the cost of construction of livestock complexes.

Currently, there is no particular order of the distribution of funds under this program. It is assumed that the Ministry of Agrarian Policy will gather information on the investment projects in the livestock industry and will determine the conditions.

The share of funding by the state is based on the limit of the program and the total volume of investments in the announced projects. It is possible that the share of the state will differ for different branches of animal husbandry: poultry, pigs and cattle.

#### Partial compensation of interest rate.

Agricultural enterprises can obtain compensation of the interest rate on loans in national or foreign currency. This holds for the following types of loans:

- Short-term loans (up to 12 months). Among other things, the compensation aims to cover current expenses, such as the purchase of fuel, fodder, spare parts, fertilizers, protection from pests, insurance payments and others;
- Medium-term loans (up to 36 months). The support relates to the purchase of breeding stock, equipment, implementation of investment projects, etc.; and
- Long-term loans (up to 60 months) for fixed capital investment.

Compensation of the interest rate in domestic currency is 1.5 of the current interest rate of the National Bank of Ukraine (it was at the level of 9.5% per annum on June 8, 2010); for loans in foreign currency, compensation of the interest rate is 10% but not higher than recorded in the loan agreement.

According to a number of projects, 90% of lending rates can be compensated, for example, for the construction of elevators, vegetable stores, livestock farms and wholesale markets.

The decisions on the allocation of subsidies for this program are made by the competition commissions at a regional level.

Partial compensation of costs for agricultural machinery.

Under this program, the state compensates 30% of the price of agricultural machinery and equipment of domestic production to the producers of the agricultural sector and food industry.

The decisions on allocation of compensation subsidies for equipment are made by the competition commissions.

Leasing supplies of agricultural machinery and livestock breeds.

Recipients of support are agricultural enterprises, cooperatives and private households. Priority areas for the funding are determined by the competition commission of the Ministry of Agrarian Policy.

The terms of supplies presuppose the payment of 5% of the unrecovered cost of the leased asset per annum to the leasing company.

#### Subsidies for crop production.

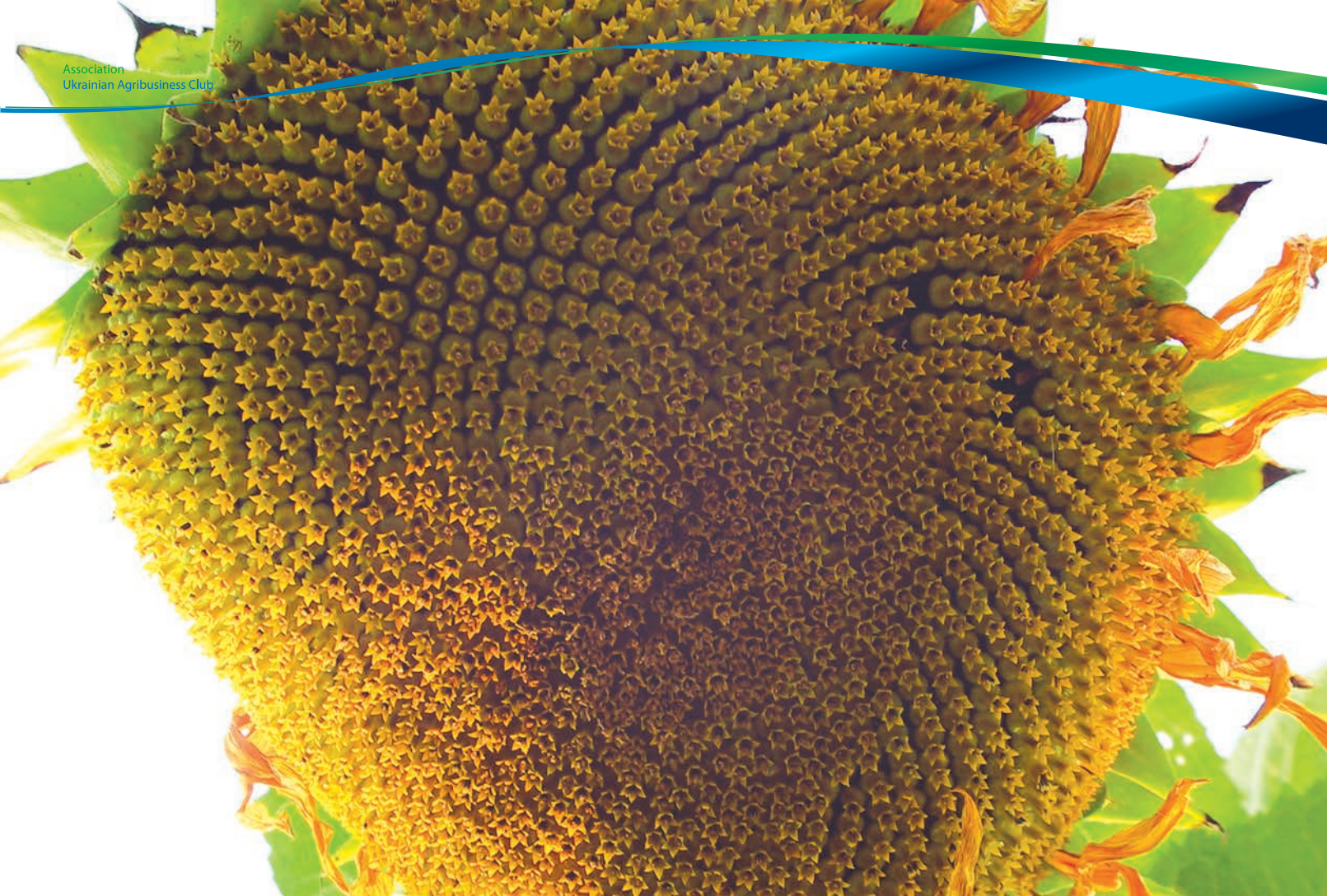
In 2010, the expected subsidy per hectare of harvested sugar beets accounts for 1000 UAH, provided that the yield is not less than 30 tons / ha, and at least 20% of sugar beet will be insured. 40% is allocated on the inspection of crops, and 60% after the harvest on the condition of achieving the required yield. There are also subsidies for flax cultivation.

Grants for the development of horticulture and viticulture are directed to compensation of costs related to the laying of gardens and vineyards in accordance with the normative costs per 1 ha that are approved by the Ministry of Agrarian Policy. Part of the support can be allocated for investments such as the construction of refrigerators with controlled gas environment. Documents required for the payment of grants are to be submitted to the Ministry of Agricultural Policy. The Ministry forms the register of agricultural enterprises eligible for the payment of subsidies and defines limits of the volume of financing in the context of enterprises.

Support for crop production on irrigated land.

Compensation to farms of not more than 50% of the cost of electricity used for irrigation as well as of the cost of fuel used for pump stations is provided.





## 6. About UCAB

### 6.1. General Information

Association "Ukrainian Agribusiness Club" (UCAB) is a business association which represents and promotes the interests of leading companies in the agricultural and food sector of Ukraine. Its main objectives are the creation of a more favourable economic and political environment for agribusiness and the formation of a framework of new agricultural policy.

The team of UCAB consists of internationally trained young professionals who have successfully implemented a number of projects aimed at improving the business conditions for members of the Association within a short period of work (since December 2007).

The credibility of UCAB makes it the most quoted organisation in the agricultural sphere by both print and electronic mass media.

The association has a full range of tools to deal effectively with its tasks. These tasks include the provision of high quality analytics and business correspondence with public authorities and management; the institutionaliza-

tion of cooperation between business and government; arrangement of conferences, roundtables and seminars; active media campaigns; the development and implementation of individual projects, etc.

UCAB is always in direct contact with owners and top managers of leading companies; it is an association of individuals sharing common views on the development of the agro-industrial complex of Ukraine.

#### Members of the Association

Members and partners of the Association are large agro-industrial companies in Ukraine that have already become the visiting cards of Ukrainian agriculture and have the potential to become global food companies. The sphere of interests of the UCAB members includes dairy and meat production, livestock, horticulture, vegetable, and sugar production.

The members of UCAB involve companies such as John Deere, Milkiland, TerraFood, Agrosolutions, Ukrros, Agrosoyuz, Agrofusion, Industrial Milk Company, Ram-burs, Chista Krynica, Kozyatinsky Poultry Factory, Agro-complex "Zelenaya Dolina", Melitopolskaya Chereshnia, KWS, the Kiev International Contract Fair, and a number of other companies.

## 6.2.UCAB Services

|  |   |
|--|---|
| <p><b>AgriEvent</b><br/>www.agrievent.com.ua</p>                         | <p>Conference Management, Event Management, Agriculture &amp; Food Fair Service, Business Trips, Venue Search Service, Technical Service, Catering, Transportation, Translation Service.</p>  |
| <p><b>AgriJob</b><br/>www.agrijob.com.ua</p>                             | <p>First specialized project for successful recruitment in all sectors of the agro-industrial complex of Ukraine.</p>   |
| <p><b>AgriSurvey</b><br/>www.agriefficiency.com.ua</p>                   | <p>The full range of information on the agricultural sector of Ukraine. We offer market research, surveys, interviews, focus groups and so on.</p>  |
| <p><b>AgriEfficiency</b><br/>www.agriefficiency.kiev.ua</p>              | <p>Detailed analysis of farm productivity. Detection of weaknesses and strengths of the entities and advice on efficiency.</p>  |
| <p><b>AgroBrand</b><br/>www.agribusiness.kiev.ua</p>                     | <p>Identification of the most recognizable agricultural brands. We detect the best known producers of equipment, seeds, plant protection etc.</p>   |
| <p><b>AgriContact</b><br/>www.agribusiness.kiev.ua</p>                   | <p>Contact information of more than 8000 agricultural enterprises in Ukraine: farm name, address, phone, contact person, basic farm info.</p>   |
| <p><b>AgroMonitor</b><br/>www.agribusiness.kiev.ua</p>                   | <p>Price indicators and comments on the meat, dairy and sugar markets. Weekly issue. Free distribution among 500 subscribers.</p>   |
| <p><b>AgriLink</b><br/>www.agribusiness.kiev.ua</p>                      | <p>Linking the agricultural community in Ukraine and abroad. Procurement of services, provision of information, knowledge transfer, establishment of contacts. Initiation and implementation of joint projects with partners and clients.</p> |
| <p><b>Doing Agribusiness in Ukraine</b><br/>www.agribusiness.kiev.ua</p> | <p>UCAB's annual issue on the conditions of making agribusiness in Ukraine. Brief comprehensive vital information for our foreign partners.</p>   |



### 6.3. Activities programme

**June 25, 2010** – Practical seminar “Technologies of Bayer CropScience” for students and graduates of agronomic faculties of Higher Education Institutions of Ukraine

The event aims to provide comprehensive information for students and graduates of agronomic specializations in Ukraine related to modern technologies of agricultural crop cultivation and their peculiarities. Practical demonstration at the research station “Bayer Agro Arena”.

**September 16, 2010** - International Conference “Large Farm Management”

Among the topics to be discussed: optimal management models for large-size agricultural enterprises; growth dynamics of agriholdings; preconditions for attraction of investments; ways to increase efficiency and others.

**September 29, 2010** – Investment Forum in Frankfurt am Main, Germany.

At the business forum, potential investors will get a better idea of the investment potential in Ukraine. Among the topics to be discussed: political, economic and legal conditions, efficiency and competitiveness of agricultural enterprises and agriholdings, and financing options.

**November 4, 2010** - International Conference “Ways to improve the efficiency of Ukrainian farms: know how from the agri benchmark network”

This conference will be based on the project “Implementation of agri benchmark in Ukraine and the Russian Federation” initiated by UCAB in 2008. The experts from Ukraine and Germany will present the results of the analysis of Ukrainian farms in different

branches (milk, beef, cash crops, etc.) in comparison with enterprises of other countries, their features, advantages and deficiencies, both technologically and financially. Dairy project activities are carried out in collaboration with “European Dairy Farmers” (EDF). Meeting of managers of the EDF members from East Germany with the Ukrainian participants of the benchmark comparison, discussions and exchange of experience, and a visit to a dairy farm are scheduled.

**December 9, 2010** - II International Conference “Doing Agribusiness in Ukraine: Prospects for 2011”

This conference will provide a complex presentation of the agribusiness prospects for 2011, ranging from the environment of agricultural product and raw material markets to government support and technological aspects of agricultural production.

**February 16-17, 2011** - II International Conference “Horticulture in Ukraine 2011”

The topics to be discussed include global developments in horticulture, floriculture and landscaping, prospects of the domestic market, and risks of establishing a free trade zone with the EU.

**May 19, 2011** - II International Conference “Animal production and meat processing in Ukraine 2011”

The objective of the conference is to evaluate the current situation and developments of Ukrainian livestock sector, investment opportunities and future prospects of the meat market. Among the topics to be discussed: modern technologies of growing and feeding livestock, advantages of modern genetic materials in cattle breeding, financing of livestock projects, market conditions for meat and meat products and various others.



**AgriEvent**

*Event management  
for agribusiness*

For more information on the above mentioned activities please contact Anatoliy Tsyrukun, the project manager of **AgriEvent** by phone: +380 44 201 4950, +380 44 201 4951, mobile +380 67 656-83-32 or by email [info@agrievent.com.ua](mailto:info@agrievent.com.ua). You can also find information at [www.agrievent.com.ua](http://www.agrievent.com.ua).

## 6.4. The team



**President**  
**Alex Lissitsa**

Leading expert in Ukraine in the fields of strategic management, operational management, efficiency and productivity analysis in agriculture and food processing industry.



**Director General**  
**Volodymyr Lapa**

Specialist in the field of regulatory policy, market regulation, taxation and public support in agriculture.



**Adviser to the President of UCAB**  
**Heinz Strubenhoff**

Expert on the development of agribusiness and international agricultural economy with over twenty years of experience.



**International Projects Manager**  
**Karen Fisher**

Specialist for cooperation with European and international structures of the agrarian sector.



**Adviser on crop markets**  
**Roman Slastion**

Specialist in the field of grains, oilseeds, genetically engineered crops, and horticultural products.



**Adviser on meat and meat products**  
**Elizabeth Svyatkivska**

Expert in the field of production and processing of beef, pork and poultry.



**Senior Adviser of AgriEvent Project**  
**Anatoly Tsyrukun**

Specialist in organization of conferences, trainings, presentations, business forums and other events.



**Adviser on milk markets and dairy products**  
**Inna Iliencko**

Specialist in the field of production and processing of milk and dairy products.



**Coordinator of governmental affairs**  
**Tatiana Varchenko**

Specialist in work with government agencies with significant experience in the Ministry of Agrarian Policy.



**Adviser on milk markets and dairy products**  
**Taras Gagalyuk**

Specialist in the field of strategic management in the dairy industry.



**Coordinator of AgriJob Project**  
**Andrei Stepanov**

Professional recruiter for the agricultural sector. .



**Chief Accountant**  
**Galina Romanchuk**

Specialist with extensive experience in Ukrainian and international organizations.



**Project manager**  
**Catherine Stetsko**

Responsible for administrating the internet resources of UCAB and organizational work.



**Project Manager**  
**Maxim Lapa**

Responsible for administrating the internet resources of UCAB and organizational work.



**Project manager**  
**Daria Belkevich**

Daria has extensive organizational experience and excellent communication skills.

## 7. List of useful contacts

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| The Ministry of Economy of Ukraine   | Address: 01008, Ukraine, Kiev, ul. Grushevskogo, 12 / 2<br>Tel.: +380 44 253-9394; +380 44 253-9394; Fax: +380 44 226 3181<br>meconomy@me.gov.ua <a href="http://www.me.gov.ua">http://www.me.gov.ua</a>          |
| State Statistics Committee of Ukraine  | Address: 01023, Kiev-23, MPS, ul.Shota Rustaveli, 3<br>Tel.: +380 44 287 2433; +380 44 287 2433; fax +380 44 235 3739<br>office@ukrstat.gov.ua; <a href="http://www.ukrstat.gov.ua">http://www.ukrstat.gov.ua</a> |
| State Committee of Veterinary Medicine   | Address: 01001, Str. B. Grinchenko, 1<br>Tel.: +380 44 279 1270; +380 44 279 4883<br><a href="http://vet.gov.ua">http://vet.gov.ua</a>  |
| State Committee for Land Resources   | Address: 03151, Str. People's Militia, 3<br>Tel.: +380 44 244 8247; +380 44 244 8247<br><a href="http://dkzr.gov.ua">http://dkzr.gov.ua</a>   |
| Institute for Economic Research and Policy Consulting<br>German-Ukrainian Policy Dialogue in Agriculture | Address: 01034, Str. Reitarska 8/5-A,<br>Tel.: +380 44 278 6342; +380 44 278 6342; 278 6360, Fax: +380 44 278 6336<br><a href="http://www.ier.kiev.ua">http://www.ier.kiev.ua</a>                                 |
| National University of Life and Environmental Sciences of Ukraine  | Address: 03041, Kiev st. Heroes of Defense, 15.<br>Phone: +380 44 527 8233; +380 44 527 8233<br><a href="http://nubip.edu.ua">http://nubip.edu.ua</a>   |
| Ukrainian Laboratory of Quality and Safety of Agricultural Products                                      | Address: Kiev region., Smt. Shepherds, st. Engineering, 7<br>Tel.: +380 44 527 8943; +380 44 527 8943<br>info@quality.ua; <a href="http://www.quality.ua">http://www.quality.ua</a>                               |
| National Association of Milk Producers of Ukraine "Ukrmolprom"   | Address: 01001, Str. B. Grinchenko, 1<br>Tel.: +380 44 226 2783; +380 44 226 2783<br>mail@ukrmolprom.kiev.ua; <a href="http://www.ukrmolprom.kiev.ua">http://www.ukrmolprom.kiev.ua</a>                           |
| Union of Dairy Enterprises of Ukraine  | Address: 02660, Str. M. Raskovoyi 4a, of.410<br>Tel.: +380 44 451 4228; +380 44 451 4228<br>molsouz@i.kiev.ua   |
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| Association of Ukrainian manufacturers «Ice cream and frozen foods»                                      | Address: 02090, Kiev st. Prague, 5, of.514<br>Tel. / fax: +380 44 292 8293<br>auvm@auvm.com.ua; <a href="http://www.auvm.com.ua">http://www.auvm.com.ua</a>   |
| Ukrainian Grain Association  | Address: 01033, Str. Saksaganskogo, 53/80, off. 308<br>Tel: +380 44 246 6201; +380 44 246 6201; +380 44 246 6202<br>inbox@uga.kiev.ua; <a href="http://www.uga-port.org.ua">http://www.uga-port.org.ua</a>        |
| Informational-analytical agency "APK-Inform"   | Address: 49006, Dnepropetrovsk, ul.Chicherina , 21, fl. 3<br>tel. / fax: +380 44 278 3560<br>info@apk-inform.com; <a href="http://www.apk-inform.com">http://www.apk-inform.com</a>                               |
| All-Ukrainian public organization "Ukrainian Agrarian Confederation"                                     | Address: 01033, Str. Saksaganskogo, 53/80, off. 807<br>Tel. / fax: +380 44 287 6566, +380 44 289 9721<br>agroconf@agroconf.org; <a href="http://www.agroconf.org">http://www.agroconf.org</a>                     |
| European Business Association  | Tel.: +380 44 496 0601; +380 44 496 0601; Fax: +380 44 496 0602<br>office@eba.com.ua; <a href="http://www.eba.com.ua">www.eba.com.ua</a>  |
| "Association of Poultry Breeders of Ukraine"   | Tel.: +380 44 494-4930; +380 44 494-4930<br>karpenko@ptaha.kiev.ua; <a href="http://ptaha.kiev.ua/">http://ptaha.kiev.ua/</a>   |
| Agrarian Union of Ukraine  | Address : 01001, Str. Khreshchatyk-24, room 504,<br>Tel: +380 44 226-30-42, fax: +380 44 278-29-84;<br>agrouu@gmail.com; <a href="http://www.aau.org.ua">http://www.aau.org.ua</a>                                |

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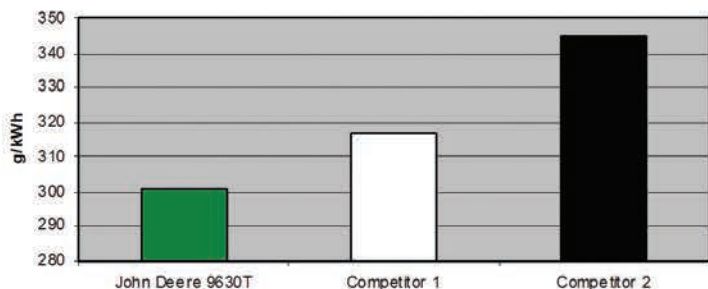
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