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### **Dairy trade dispute between Ukraine, Russia, and Belarus: The beginning of a new trade war?**

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### February and early March were marked by dairy trade restrictions imposed by Russia and Ukraine that risk developing into a big agro-trade war.

In February, Russia suspended imports of cheese from seven Ukrainian manufacturers. In turn, on March 1, Ukraine suspended imports of meat and dairy products from Belarus, a member of a Customs Union with Russia and Kazakhstan (CU RBK). The CU RBK, as a result, threatens to ban the imports of Ukrainian sunflower oil, corn, confectionary, and sugar. These developments create a risk of a big agricultural trade war between the CU RBK and Ukraine.

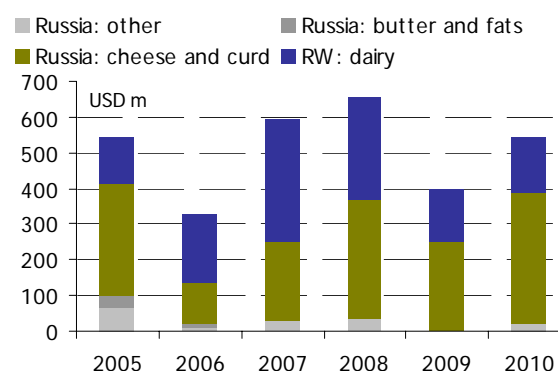
The formal reasons for trade restrictions by both Russia and Ukraine were ensuring food safety and quality. Russia explained ban on cheese imports by violations of dairy technical standards by selected Ukrainian producers. In particular, Russian authorities reported about availability of palm oil in Ukrainian cheese. In turn, Ukraine suspended Belarusian meat and dairy imports because of the excessive amounts of veterinary drugs residues in dairy products. From the very onset, the evolution of these two disputes has been accompanied by non-transparent, swift and seemingly ad-hoc decisions. Moreover, there was not a single publicly available official document with scientific evidence on a breach of national food safety and quality standards. So, although food safety and quality standards might indeed be at stake in the ongoing dispute between Ukraine and members of the CU RBK, it seems that economic and political incentives dominate the entire play.

Traditionally, Russia has been a key export market for export-oriented dairy industries in both Ukraine and Belarus. As the figures below demonstrate, Russia has been a destination for about 80% of Ukrainian and for more than 90% of Belarusian dairy exports.

Such a high degree of export concentration on Russia is critical for Ukraine and Belarus as they export about 40% and more than 80% of its cheese output, correspondingly. Furthermore, according to the OECD forecast, Russia will remain a key and growing importer of dairy products, especially in the cheese segment. This will be driven by growing food demand due to global population growth and increasing income (especially in developing and emerging economics), and at the same time by its shift towards higher valued food and to livestock products (including dairy

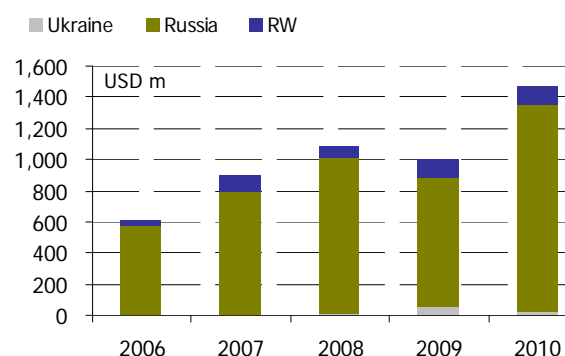
products). On the other hand, Russia has been developing its own dairy industry that fiercely competes for its domestic market with Ukraine and Belarus, and the two trade wars with Ukraine in 2006 and with Belarus in 2009 clearly witness for this.

**Figure 1** The destinations of Ukrainian dairy exports



source: UN comtrade; Note: RW – rest of the world

**Figure 2** The destinations of Belarusian dairy exports



source: UN comtrade; Note: RW – rest of the world

The dairy dispute is aggravated by the fact that Russia's formal entry to WTO is expected in mid-2012 only, following ratification of its WTO accession terms in accordance with its constitutional procedures. Only then Russia will be obliged to follow basic obligations for non-discrimination and apply similar requirements for the advance notification on sanitary and phytosanitary (SPS) measures. Furthermore, Russia's measures become then accessible for claims via SPS trade dispute settlement procedures. In the meantime, the Russian cheese market is lost for some of the Ukrainian dairy manufacturers, while market shares of competitors increase.

Many experts emphasize more the political component of the trade dispute between Ukraine and Russia. Against the background of ongoing gas price and gas transport system

negotiations between Ukraine and Russia, the dairy trade conflict is considered as an additional leverage to persuade Ukraine to the membership in the CU RBK. This becomes a real threat for Ukraine's aspirations towards the DCFTA with the EU.

The suspension of Belarusian dairy import to Ukraine might be considered as a counteraction against Russia's step. However, as the figures above show, the volumes of Ukrainian cheese exports to Russia by far exceed Belarusian dairy export to Ukraine to talk about effective counteraction from Ukrainian side, if there is indeed any.

As in 2006, this conflict demonstrates that Ukraine urgently needs to reduce its high degree of dependence on the Russian market. In fact, the Ukrainian dairy sector made a good progress in diversification of dairy exports in the aftermath of the previous dairy war. Since 2009, however, Russia's share in Ukraine's dairy export structure returned to the pre-war level. Diversification of export markets could prevent significant losses in such situations. Ukraine could, for example, target countries in Northern Africa, the Middle East and East Asia, where the market for dairy products is forecast to grow rapidly in the coming years.

To successfully diversify its exports, Ukrainian dairy industry should improve productivity and

competitiveness of the entire dairy supply chain, from the field to the shelf. The following factors, just to name a few, undermine the competitiveness of dairy supply chain in Ukraine, and consequently its ability to diversify exports:

- relatively low cow yields and shorter lifespans of dairy cows,
- high percentage (about 80%) of households in the total raw milk supply, and resulting low quality of milk and low milkfat and protein content,
- relatively extensive fodder production and far from optimal feeding practices,
- incompliance of Ukrainian food safety and quality standards with international ones,
- poor management practices and glaring shortage of human capital, and
- ad-hoc agricultural policy environment.

Last but not least, this conflict emphasizes important benefits of the WTO membership. This international organisation helps to converge standards and provides members with an access to trade conflict resolution mechanisms, making it more open, transparent and not so discretionary as in the current case.