

# ICPS newsletter

## Cancellation of import duty on grain: costs and benefits

*As a result of the reduction of grain production in Ukraine by 25% in 2000, shortages of this product have occurred in the domestic market; they are especially noticeable in regions where the harvest was lowest because of unfavourable weather. For this reason, the questions have been raised regarding the expediency of introducing a preferential regime for grain duty (imports duty-free or at lower rate)<sup>1</sup>. Victoria Yakubovich, an economist at the International Centre for Policy Studies, comments on the costs and benefits related to the cancellation of grain import duties.*

### Import duty in the light of economic theory

By its nature, import duty is a tool for supporting domestic producers at the expense of consumers. Since upon the introduction of a duty the price of a good in the domestic market increases by the amount of the duty, the domestic sale price grows. The consequences of this process are as follows: (1) domestic producers receive additional income; (2) domestic consumers experience additional losses; (3) budget revenues increase; (4) society suffers net losses. The effect of introducing a duty in a country, therefore, is equivalent to imposing a tax on consumption and simultaneously subsidising producers.

### Approach to choosing policy a option

Since import duty is a tool of public policy, the interests of two categories of economic agents—producers and consumers—should be considered when decisions on duty imposition or cancellation are being made. In choosing among policy options, one of the two following approaches should be applied:

- Define your priority and select the

<sup>1</sup> An import duty on grain is imposed in accordance with the Law of Ukraine "On the state regulation of agricultural product imports" dated 17 July 1997. The duty rate totals 30% but not less than 40 euro per ton.

policy option which corresponds to this priority. In this example, if the government considers the overall low income levels of the population and wants to avoid further growth of prices on grain and, therefore, on bread, the duty should be decreased or cancelled altogether. If the government cares more about the ability of newly created private agricultural enterprises to run profitably, the duty should remain unchanged.

- Evaluate the costs and benefits of each policy option, and choose the one which simultaneously gives the most benefits and the least costs.

In our opinion, the approach which compares the costs and benefits of each policy option is more appropriate. For the Ukrainian government, the increase in standard of living of the population and the support of agricultural producers are equally important; therefore, the priority is difficult to define.

### The role of import duty on grain in Ukraine

Import duty in Ukraine is a bridge between the world and domestic market price. The current world price for grain is about 100 USD per ton. Meanwhile in Ukraine, because the demand exceeds supply, the price has reached 800 UAH, or 143 USD. The amount of the import currently duty equals 40 euro per ton (or 35 USD per ton). The domestic price on imported grain, which includes the duty, is almost equal to the price of Ukrainian grain.

### What if the duty is not cancelled

As long as the deficit of food-grain persists in domestic market, the price for bread in Ukraine will continue to increase. The difference between the domestic and the world price, to which the duty is added, will increase; and imports, therefore, will be stimulated. If the duty remains unchanged, exporting countries will not have sufficient incentives to increase imports to Ukraine. In addition, according to some forecasts, world prices on grain will also be growing. The domestic market, therefore, will be replenished by imported grain so slowly that imports will not impede the increase of the domestic price. Under this scenario, domestic producer will benefit, but Ukrainian consumers will lose.

### What if the duty is reduced or cancelled

If the duty is reduced or cancelled, the import of food-grain can activate. Theoretically, as soon as imports compensate the deficit, the domestic price will not be increasing or even decreasing (in the case when supply will exceed demand). Under this scenario, consumers will win, but farmers will lose. In reality, however, the decrease of grain prices is unlikely. Firstly, this change cannot happen immediately after cancellation of the duty since the initial higher price was shaped predominately under the influence of processes in the domestic market. Secondly, the increase in supply of imported grain will be limited because of its deficit in Europe, caused by drought and high transportation costs for delivery from remote regions. For this reason, import duty cancellation will not substantially affect Ukrainian consumers and producers.

## Duty cancellation is inadvisable

In terms of the costs and benefits to economic agents (producers and consumers), the options of not cancelling versus cancelling the duty are close to each other, and therefore do not give reasons for an obvious decision. At the same time, cancellation proves to be expedient once additional factors are considered.

Firstly, consumers do not benefit from the duty cancellation since, this decision does not fulfil its declared purpose—to protect the consumer market from shortages and price increases. We have

already shown that duty cancellation will not lead to substantial import increases and therefore to supply growth. With the current situation in external markets, only a limited number of the most powerful traders would benefit from a duty cancellation in 2001.

Furthermore, taking into account the good harvest of other crops, like potatoes, the grain shortage will not pose much danger to the domestic market in Ukraine; despite the decrease in grain supply, the demand for this product will be decreasing because it will be replaced by other crops. This process will restrain price growth.

Secondly, although duty cancellation will not hurt Ukrainian farmers in the current year, it will affect them negatively in the long run, since it undermines confidence in the stability of government policy. However, the farmers would plan for future enlargement of grain production, if they felt the support of the Ukrainian government, i.e., if it did not allow privileged imports even with the current grain deficit in the domestic market. ■

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### **Next week's events**

**"Attracting Foreign Investments: Polish Experience"**. On 13 February, the International Centre for Policy Studies and the Polish public affairs research centre (Instytut Spraw Publicznych) will hold a seminar titled "Investment Climate in Poland in the Context of European Integration: The Example for Ukraine". The seminar is organised under the project "European Choice of Ukraine: Using Polish Experience for Administrative, Budget, Regional, and Educational Reforms in the Context of European Integration". The project was made possible by support from the Freedom House Partnership for Reform Program.

The goal of this seminar is to introduce Ukrainian experts to the Polish experience of improving investment climate and attracting direct foreign investments.

The following issues are to be discussed:

- major factors which promoted the attraction of foreign investments for Polish business development;
- problems in the development of small and medium business in Poland;
- comparison of foreign investors' activities in Poland and Ukraine.

Speakers: Roman Kornacki (Polish Agency for Foreign Investments) and Miroslaw Boruc (Poland Promotion Foundation).

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## Internships to improve institutional capacity of the Verkhovna Rada

***The International Centre for Policy Studies launched the project "Institutional support for Verkhovna Rada members and staff visits". The project is undertaken under "Transatlantic Civil Society Support Programme for Ukraine". The European Institute of Public Administration (the Netherlands) is ICPS's partner in this project***

The goal of this project is to increase the institutional capacity of the Verkhovna Rada to address issues of good governance. The project includes preparation and implementation of study visits to the EU and the USA for deputies and staff of the Verkhovna Rada. Participants of the program should get acquainted with and develop skills for preparation of quality analytical documents and legislative acts.

The European Institute of Public Administration, the Delegation of the European Commission in Ukraine, the US Embassy in Ukraine, and ICPS selected 32 deputies and 8 staffers to participate in the program. The selection was based on the following criteria: parliamentary activity, membership in a relevant committee within the Verkhovna Rada, and knowledge of English. The program includes one-week study visits to the EU and the USA. Ukrainian delegation will have an opportunity to observe the work of European Union institutions and also visit national and regional or local authorities in two EU member states.

The goal of the visits is to obtain knowledge and experience which should

help to increase the effectiveness of public administration in Ukraine. For this reason, special attention will be paid to the following study topics:

- legislative process: drafting, parliamentary procedures, public participation in the legislative process;
- accountability and oversight;
- mechanisms for encouraging ethical standards and transparency in the activities of public servants and politicians;
- status and duties of elected officials.

Summary seminars will be conducted upon the return of the interns to Ukraine. During these meetings, the deputies and staff of the Verkhovna Rada will share the experience and information they acquired during their visit; they also should compare the US and European experiences and develop proposals for improving the Ukrainian system of public administration. ■

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