

ICPS newsletter

How much does Ukraine stand to lose from the admission of new EU member states?

Over 2004–2005, Ukraine's foreign trade will lose from 320 to 340 million USD annually. The quality of Ukraine's protection of its foreign trade interests, and in particular Ukraine's accession to the World Trade Organization, will have the greatest effect on the situation in future years. The optimistic scenario is that Ukraine can improve its standing in external markets, resulting in increased revenues of up to 60 million USD per annum. The pessimistic view is that losses to the Ukrainian economy will increase by 150 million USD per annum. These are the findings of a recent study conducted by ICPS economists of the impact of EU enlargement in 2004 on Ukraine's foreign trade

Ukrainian goods are price-inelastic, that is, demand for goods will increase negligibly despite a significant decrease in prices. Conversely, the optimistic scenario assumes that Ukrainian goods are price-elastic, meaning that even a slight decline in prices would result in a significant increase in demand. If the optimistic scenario holds true, Ukraine's export revenues will increase by 30 million USD per annum, while the pessimistic forecast predicts a 10 million USD increase.

Non-tariff barriers will have the greatest impact

EU anti-dumping proceedings and measures with regard to goods originating from Ukraine pertain to chemicals and ferrous metals. In light of the fact that the level of the EU anti-dumping duty is significantly higher than the average EU duty, non-tariff barriers will hinder positive moves forward on tariff reductions for chemicals and ferrous products. At the same time, once candidate countries accede to the EU, they will cancel any special customs tariffs currently applied to Ukrainian goods. Nevertheless, this positive effect will be insignificant, due to the small number of anti-dumping measures by candidate states, compared with similar measures exerted by the EU.

According to our calculations, short-term losses (2004–2005) from anti-dumping and special measures with regard to chemicals and ferrous metals will reach 40 million USD per annum (exports to candidate countries subject to EU anti-dumping and special measures). Exports of metal products to candidate states will be reduced in the short term, due to existing import quotas for metal products to EU states, which are significantly lower than those of candidate states. Currently, Ukraine is negotiating to raise quotas to the EU in conjunction with the accession of the ten new countries. However, in 2004–2005 Ukraine could lose 260 million USD per annum (exports of metal products to candidate states), if the negotiations are drawn out.

In May 2004, the European Union will enlarge; as a result, Ukraine will be contiguous with the EU. This event will have both political and economic effects. Specifically, candidate countries will adopt a common foreign trade policy in accordance with EU requirements. In light of the fact that certain candidate states (namely, Poland and Hungary) are key trading partners of Ukraine, it is essential that the positive and negative implications of the EU enlargement be assessed and that recommendations be designed to minimise adverse effects and make use of the opportunities presented by the EU enlargement.

Candidate states will increase their export advantage over Ukraine

The markets of candidate countries may be regarded as central to Ukraine's foreign trade. In 2002, Ukrainian merchandise exports to candidate states exceeded 2 billion USD in value or 12.4% of total exports, while the proportion of exports to the EU-15 was 19.7%. At the same time, merchandise imports to Ukraine constitute a comparatively negligible share of the exports of candidate countries, because they are principally oriented towards EU markets.

The breakdown of Ukrainian exports to candidate states is similar to that to the EU member states. At the same time, the export breakdown of candidate states to the EU differs significantly to that of Ukraine to this region; they mainly export high value-added products to the 15 current member states, whereas Ukraine's exports to such

states are dominated by products with low value-added. This is evidence of an imbalance in trade between the EU and Ukraine, which can exacerbate if structural changes are not made in Ukraine's economy.

Currently, candidate states have greater access to EU commodity markets, thanks to the extant free trade agreement between these countries and the EU. In addition, candidate states are actively working to create a customs union with the EU; a common customs tariff is to be introduced once countries enter the EU. Competition in trade between Ukraine and candidate countries in specific commodity groups (in particular, ferrous metals) may intensify due to the introduction of the common customs tariff by candidate countries and the EU.

Ukrainian exports will increase thanks to revised tariffs

We calculate that in the wake of the revocation of free-trade agreements with the Baltic states joining the EU the tax burden upon Ukrainian producers will increase by 10 million USD per annum. At the same time, a reduction in customs tariffs in other EU candidate countries will reduce the tax burden on Ukrainian producers by 15 million USD per annum. Accordingly, as a result of changes in tariffs Ukrainian producers will realise a net benefit of 5 million USD per annum.

The demand dynamics of EU-candidate states for Ukrainian goods in the wake of price changes depends on the price elasticity of Ukrainian goods. The pessimistic scenario assumes that

Tighter technical, sanitary, phyto-sanitary, and veterinary control will lead to a significant reduction in exports of agricultural commodities from Ukraine if their quality is not brought into line with EU standards. In the most pessimistic case, we calculated that losses from reduced exports of agricultural commodities would amount to 80 million USD per annum.

We considered both pessimistic and optimistic scenarios for developments in the medium term (2006–2007). The pessimistic scenario holds that the EU would not relax non-tariff restrictions to the level required by Ukraine (regarding quotas for metal products and anti-dumping measures), while the quality of agricultural commodities would improve only in specific areas. Some positive developments would allow a reduction in losses from non-tariff limitations by only 50%. Therefore, under the pessimistic scenario short-term losses from non-tariff limitations would reach 190 million USD per annum.

In the optimistic scenario, the impact of non-tariff limitations would be reduced or eliminated by higher standards of Ukraine's products (in particular, agricultural commodities) and its strengthened standing in trade disputes as a result of its accession to the WTO in 2005. In this scenario, Ukraine would suffer no losses from the EU enlargement in the medium term.

Favourable export conditions continue

During 2004–2007, newcomers to the EU will see their markets expand, as a result of accelerated growth in these countries. We predict that increased demand by new EU members will encourage the EU-25 to reduce non-tariff restrictions on Ukrainian products, which will positively affect Ukrainian exports. Our assumption is that Ukraine's export growth rate to candidate countries will on average amount to 1–1.3%. Our calculations show that the increase in exports will run to 23 million USD in the near term, and will reach 26 million USD in the medium term.

Ukraine's service exports to EU candidate states comprise 6.6% of total services, while those to member states comprise 17.1%. Transport services constitute the largest portion of service exports to both EU member and candidate states. We

expect no significant changes in exports of pipeline services following the EU enlargement, although they may increase due to higher demand for gas from the EU-25. The journal *Natsionalna bezpeka i oborona* (National Security and Defence) reports that its analysis of EU energy strategy indicates that in the medium term, the EU plans an increase of Russian imports and a concurrent diversification of its transportation routes, which may cause problems for Ukraine as a transit junction.

Ukrainian transporters will suffer losses resulting from higher technical standards for vehicles entering the territory of candidate countries. Apart from this, volumes of passenger transportation will decrease due to the introduction of a visa regime. Revenues of Ukrainian transporters will decrease, but given that transportation constitutes an insignificant portion of service exports, this will not have any significant effect upon their overall level.

We expect that net FDI from the 15 current EU members to Ukraine will increase by 50 million USD in 2004 and 100 million USD per annum in 2005–2007.

Comparatively small investment volumes in 2004 will be mostly due to political risks, associated with the presidential election in the fall although thereafter the situation will stabilise. We believe that foreign direct investments to Ukraine from European Union countries will increase, thanks to the following factors:

- The EU-25 market will expand, because of accelerated growth in candidate states. Consequently, Ukraine will increase its output of export-oriented products, which in turn will stimulate investment;
- The increased cost of labour in candidate states will lead to a partial transfer of production facilities to Ukraine; and
- There will be more goods produced, trade in which will be liberalised in the wake of the EU enlargement, which will increase Ukraine's investment appeal.

Following tighter cross-border controls and the introduction of a visa regime, volumes of cross-border trade may fall, mainly because of decreased trade volumes of private entrepreneurs and small businesses. The main obstacles for small businesses will be the non-conformity of vehicles entering EU territory with EU requirements, and visa-related expenses. At the same

time, medium- and large-scale enterprises will find it easier to overcome these obstacles. With time, cross-border trade from Ukraine will recover its pace. A positive effect of EU enlargement will be reduced smuggling.

A possible adverse implication of EU enlargement is the transfer of ecologically hazardous modes of production to the territory of Ukraine.

How to minimise potential losses

In the short term, Ukraine will lose EU markets through non-tariff restrictions. In the medium term, the effects of EU enlargement will predominantly depend on the quality of Ukraine's foreign trade policy and Ukraine's accession to the WTO.

The following factors are critical in the exploitation of potential opportunities and the minimisation of negative implications of EU enlargement:

- Ukraine's accession to the WTO, which will allow more effective protection of Ukraine's interests when settling trade disputes;
- observance of the Partnership and Cooperation Agreement between Ukraine and the EU, in particular, faster harmonisation of Ukraine's legislation to that of the EU. (The execution of the first two points is a prerequisite of signing a EU-Ukraine free-trade agreement);
- the EU granting Ukraine market economy status;
- efforts to expand quotas for goods, deliveries of which are currently restricted in the EU, to levels equivalent to those in EU-candidate states;
- facilitation of the partial transfer of the production of "sensitive" goods to EU territory (national financial and industrial groups are already exhibiting interest in moving the production of metal products to the territory of candidate states); and
- stimulation of cross-border cooperation and preservation of cross-border trade, and introduction of a simplified visa regime for Ukrainian entrepreneurs. ■

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