

ICPS newsletter[®]

Supporting domestic car-makers: when compromise is impossible

The fierce debates around policies in support of the domestic automobile industry show that it is sometimes impossible to reach a compromise that will suit all stakeholders. Today, Ukraine is in the tricky situation of having to meet its obligations before the investors in car manufacturing enterprises, on the one hand, and to satisfy demands by international bodies that it eliminate sector-specific privileges, on the other. Moreover, the car-makers themselves are in disagreement about the right approach. This makes it even more imperative, when the government has to make decisions that will be inevitably unfavorable for one of the sides involved, it needs to take into account all the positions and carefully weigh the social significance of the issue, its own policy options and the possible impacts

On 25 February 2004, ICPS, together with the New Concept Independent Media Initiatives Support Fund held a roundtable entitled "Do domestic car-makers really need special privileges?" This roundtable was held in response to the 5 February 2004 approval in the Verkhovna Rada of Draft Law #3677 on the development of the domestic car-manufacturing industry. Supporters of the law argue that it will help domestic car-makers without creating any obstacles to Ukraine's accession to the World Trade Organization (WTO). Their opponents maintain that protectionist policies are not the best approach for the domestic car industry.

The roundtable was attended by lawmakers, representatives of the Ministry of Industrial Policy, and representatives of Ukrainian car manufacturers and importers:

- ZAZ, the Zaporizhzhia car plant,
- KrASZ Ltd., a Kremenchuk car plant,
- AvtoKrAZ, a Kremenchuk car plant,
- Bohdan, a bus manufacturer,
- Eurocar, a Zakarpattia car assembly plant (Skoda, etc), and
- the Ukrainian Association of Car Importers and Dealers.

Most participants said the Government should support the revival of the

domestic car industry. Representatives of manufacturers and the Ministry of Industrial Policy insisted that car manufacturing is a key industry for Ukraine, referring to substantial Budget revenues and the significant role the industry plays in the economy in terms of job creation. "All Ukrainian car-makers have been provided with good conditions for developing by national and international agreements and programs," said the Ministry of Industrial Policy representative.

But representatives of importers noted that their activity in a market where some models are collected on some models is higher than the taxes paid by domestic manufacturers—who have tax breaks—for the same model.

Policy priorities for the car industry

Future development of the domestic car market depends on the ability of the Government to resolve the current controversy over the various options for stimulating the industry. On one hand, WTO terms and certain clauses in the Partnership and Cooperation Agreement (PCA) with the European Union require equal conditions for both domestic and foreign manufacturers. The current Ukrainian practice of exempting individual enterprises from customs duties, reducing tax rates, or even removing tax obligations altogether contradicts the principles and standards

Moldova will launch its own "Quarterly Predictions"

On 3-6 March 2004, ICPS hosted a delegation from IDIS Viitorul, a Moldovan think-tank, to share with them the know-how involved in providing independent economic analysis, instruments for forecasting, and approaches to publishing its quarterly economic study "Quarterly Predictions."

During the visit, Moldovan specialists were acquainted with the process of preparing the publication, approaches to forecasting, principles of work with outside experts, rules for providing forecasts for media coverage, and publication distribution policy.

The transfer of the "Quarterly Predictions" experience is unique for post-Soviet countries, as this publication is based on technologies created jointly by experts from the New Zealand Institute for Economic Research (NZIER) and ICPS. With the help of ICPS, quarterly forecasts were also launched in the Ministry of Economy and European Integration, and by the Soros Foundation-Kazakhstan. The Center regularly receives requests for transferring its know-how to other countries.

Independent economic research is an important instrument for developing public policy, one that can help both the government and the public to evaluate the quality of the economic policy and to get reliable information on new prospects or threats to the economy.

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of these international organizations. On the other hand, the government has

legally binding obligations before investors to maintain certain preferences until 2008, particularly in the case of ZAZ. The Government's refusal to honor its obligations could worsen the business climate and increase investor distrust in Ukraine.

Still, the Ukrainian Government has committed itself to a policy of removing tax breaks and it needs to stick to this strategy. Shortening the list of tax privileges is one of the prerequisites for effective tax reform, and the broadening the tax base and the number of taxpayers has been declared a national priority in current Government's agenda.

Pros and cons of the car industry bill

Although most participants admitted that the current car industry draft law is more appropriate for the current state of the car industry than its predecessor, divergences in their views as to certain standards and implications in the draft law became evident during the discussion.

Most opponents of the draft noted the following weaknesses:

- The actual amount of state support needed is not specified. It offers manufacturers tax privileges which, in contrast to targeted subsidies, do not lead to more efficient redistribution of Budget resources directed at the industry and do not provide a clear picture of what this support will really cost the state.
- Tax breaks are offered according company and not, say, according to type of production. This could lead to monopolization on the new car market. This approach will provide incentives across the board for all activities in the privileged manufacturers and motivate them to develop other areas of production, particularly the assembly of large components, where they will compete unfairly with assembly plants that do not have the same breaks.
- The conditions for approving the draft law and bringing it into effect violate the principles of the Budget and Customs Codes.

- Certain parts of the draft law violate the principles of open competition. In particular, Para. 2 of the final provisions maintain privileges for companies that already have approved investment programs under to the Law on stimulation of automobile production in Ukraine, including ZAZ and LAZ, the L'viv car plant. This will result in discrimination against car manufacturers who have not received approval for an investment program.
- Parts of the draft law contradict Presidential Decree #1313 of 18 November 2003, which calls for cutting state support to car production and complying Ukrainian legislation to WTO principles and requirements.

Proponents of the draft maintained that:

- Extra benefits to certain companies make sense if those companies produce cars with greater added value, maintaining more jobs and paying more taxes. This is the main reason why the car industry is monopolistic in many countries.
- The means and extent of privileges in the draft law do not contradict the WTO principles, particularly because of the transition period granted new WTO member, allowing a country to maintain trade restrictions in some sectors for up to three years.
- The methods for redistributing financial resources in support of the car industry through the Budget are inappropriate because the fiscal system needs reworking.
- The proposed increase in customs duty is not large enough to harm auto importers.

Yet opponents and supporters alike were critical of the draft law. Proponents criticized amendments made to Art. 4 during vote in the legislature. They said those changes effectively cancelled all other provisions for support to domestic car-making. This Article sets the criteria for defining the country of origin of cars, motorcycles and other vehicles,

How important is car manufacturing?

- The Ukrainian market for new cars is worth US \$1-1.5 billion annually.
- According to statistics, one worker in the car industry provides jobs for 10 workers in related industries.
- Car manufacturing is one of the engines driving developed economies and accounts for 7-25% of GDP.

stating that enterprises that produce autos of Ukrainian origin are freed from import duty on goods and components needed for the production purposes. The original Article defined an auto as made in Ukraine when more than half of its added value was generated in Ukraine. The new version of the draft law sets country of origin criteria according the Customs Code's Art. 277-279, which are less clearly formulated and can be interpreted in favor of any automobile manufacturer, regardless of the extent of its production cycle.

Aftermath:

The president's veto

At the beginning of March, the president vetoed Bill #3677, returning it to the Verkhovna Rada for further work. The president was critical of Art. 4 in the final provisions, the same Article that was highlighted during the roundtable. In particular, he noted that criteria in the Customs Code are generalized and cover a broad range of goods, so they cannot be used to objectively assess the output of a specific manufacturer. ■

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ICPS organizes regular discussions on topical policy issues. If your organization would like to co-organize a roundtable, please contact Andriy Blinov at +380-44-236-1292 or e-mail at ablinov@icps.kiev.ua.

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