



# **Cancellation of FTA between Ukraine and Russia?**

## **Estimation of impact on Ukrainian exports**

**Ricardo Giucci, Mykola Ryzhenkov, Veronika Movchan**

German Advisory Group in cooperation with the IER Kyiv

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# Summary: Impact of FTA cancellation

- **Scenario:** Russia might cancel the current free trade agreement with Ukraine and introduce Most-Favoured-Nation (MFN) status instead
- **Tariffs:** In this case, Russian weighted average import tariffs for Ukrainian goods would increase from 0% to 7.6%
- **Aggregate impact:** Based on data from H2-2014 - H1-2015, Ukrainian exports to Russia would decrease by 14% or USD 897 m per year, equivalent to 0.89% of annual GDP

Sectoral impact	Export reduction, %	Export reduction, USD m	Contribution to export decline, p.p.
Base metals	16.5	251	3.9
Machinery	7.9	121	1.9
Chemical products	9.5	86	1.3
Paper products	14.1	73	1.1
Transport equipment	17.1	57	0.9
Other	19.4	309	4.8
<b>Total</b>	<b>14.0</b>	<b>USD 897 m</b>	<b>14.0</b>

# Summary: Implications of results

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- RU implemented several measures to deter UA imports in recent past
- In particular: Import bans for a large number of Ukrainian products

**Implication 1:** Potential FTA cancellation would not imply a new direction of RU trade policy vis-a-vis Ukraine but a continuation of current policy stance

- UA exports to RU declined heavily in recent past:
  - In 2012: USD 17.6 bn
  - H2-2014 - H1-2015: Only USD 6.4 bn (36% of 2012 value)

**Implication 2:** FTA cancellation today would have a much smaller impact in absolute as well as relative terms than a few years ago

Data basis	Export reduction	GDP equivalent
Average 2010 - 2012	USD 3,000 m	1.7%
H2-2014 - H1-2015	USD 897 m	0.89%

**Overall conclusion:** Today's relevance of possible FTA cancellation – in terms of policy signaling and in quantitative terms – is much lower than a few years ago

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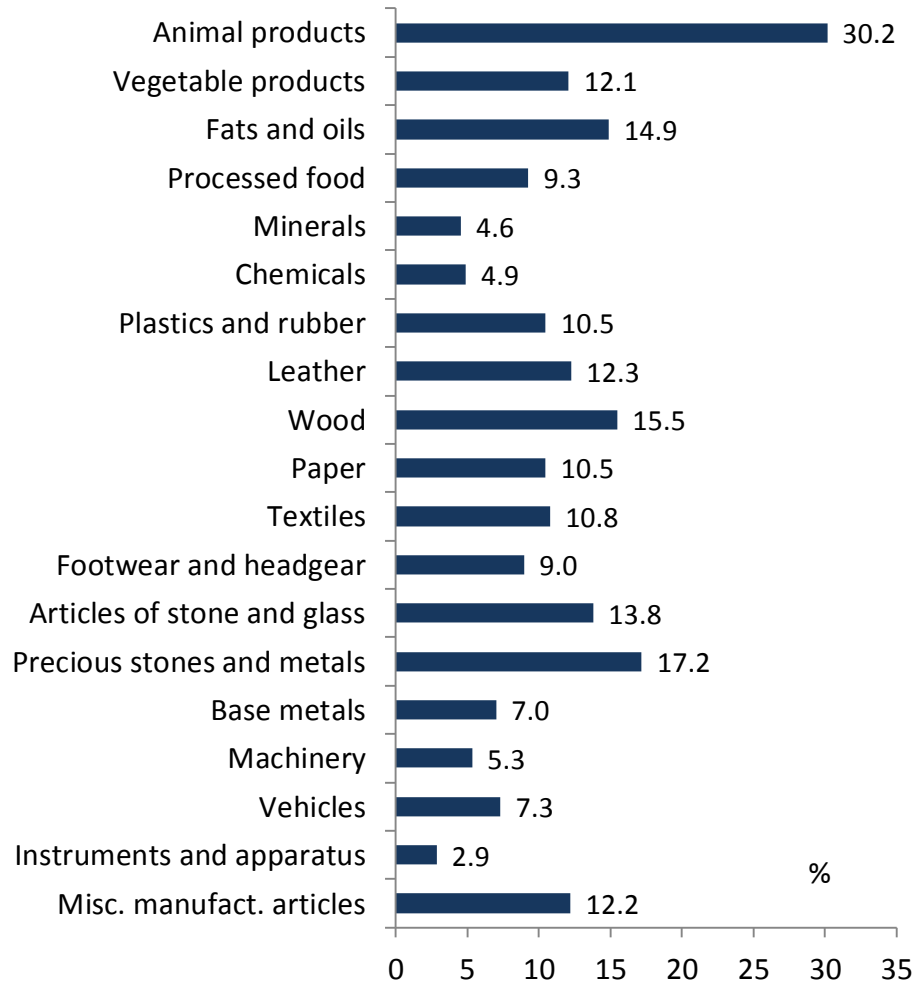
# 1. Introduction

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- The Russian Federation might unilaterally cancel its current free trade agreement with Ukraine and introduce Most-Favoured-Nation (“MFN”) status instead
- Russia justifies this potential move by the risks involved in the implementation of the EU-Ukraine DCFTA starting on 1 January 2016
- While this justification is highly questionable, there is not much Ukraine can do to avoid such a move
- **Objectives of this policy brief**
  - Estimation of impact of FTA cancellation on UA exports (Part 2.)
  - Implications of results (Part 3.)

## 2. Impact on Ukrainian exports: Higher import tariffs

### Weighted MFN tariffs



- Under the current FTA, Russian tariffs for all Ukrainian imports amount to 0%
- If FTA is canceled, import tariffs would increase significantly
- However, the level of new tariffs would vary strongly across products
- Animal products, precious stones and metals, wood products and animal/vegetable fats and oils would be subject to the highest import tariffs

# Aggregate impact on Ukrainian exports

## Main indicators of aggregate impact

Average import tariff	8.4%
Weighted import tariff	7.6%
Number of products where trade stops*	5
Impact on exports, absolute terms	- USD 897 m
Impact on exports, relative terms	-14.0%

\*Product lines at 4-digit-level

## Main aggregate results

Data base: H2-2014 - H1-2015

### Significant increase in tariffs

- Average import tariff increases from 0% to 8.4%
- Weighted import tariff increases from 0% to 7.6%

### Sizeable decline in exports to RU

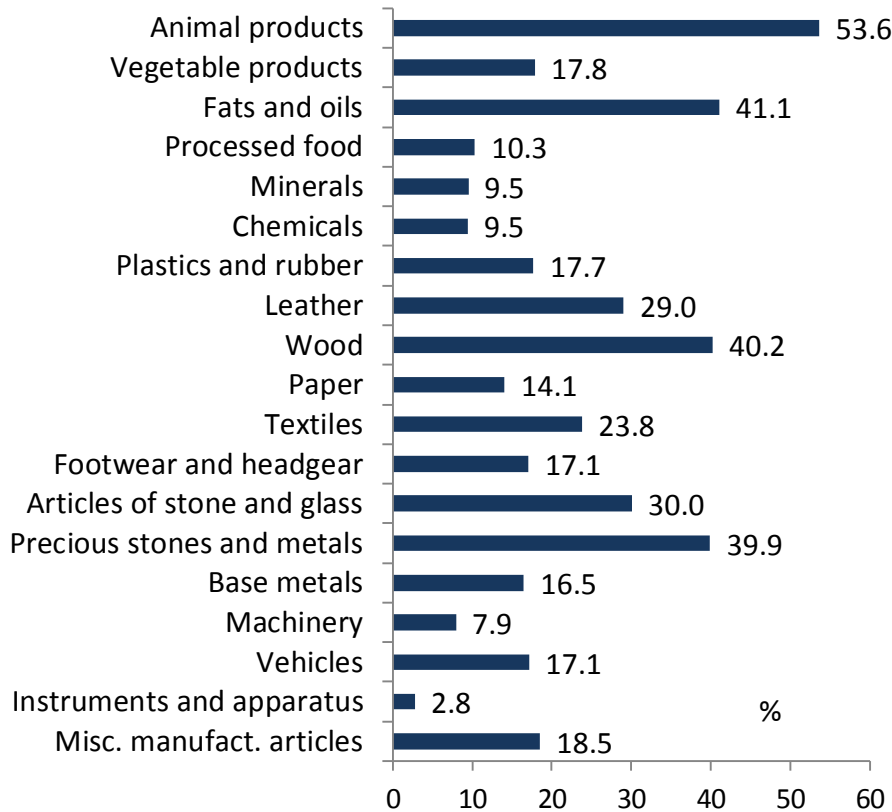
- Decline of 14.0%
- Absolute terms: USD 897 m

### GDP equivalent

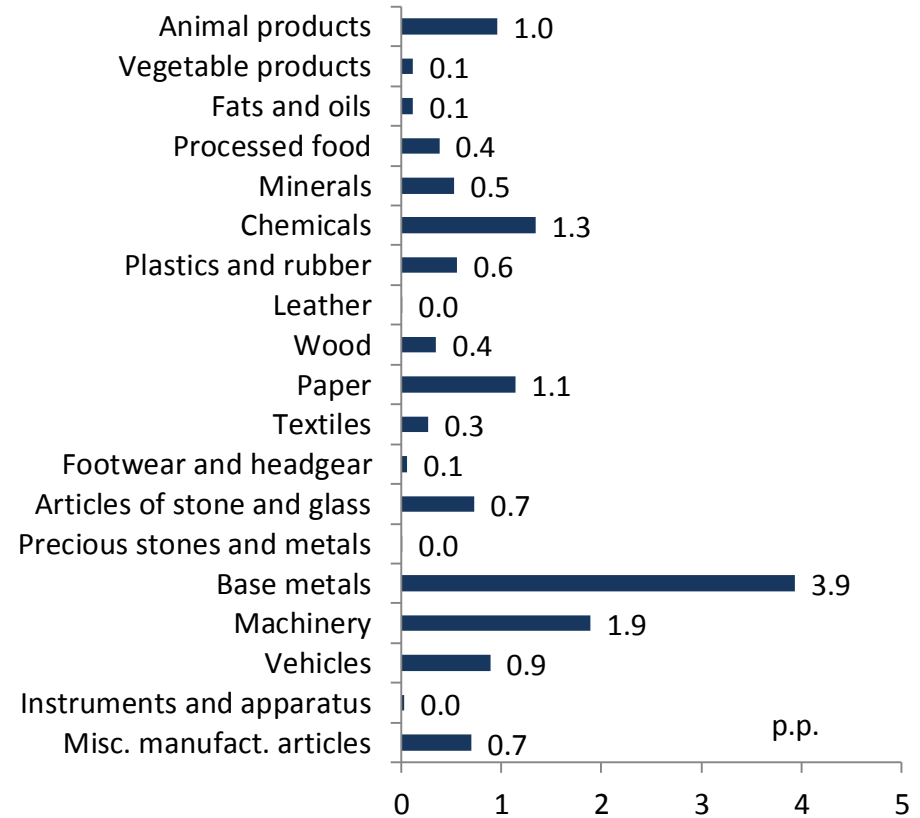
- 0.89%

# Sectoral impact on Ukrainian exports

## Reduction in Ukraine's exports



## Contribution to total export's drop



**Strongest sectoral impact:** Animal products, fats and oils, wood products

**Major contributors:** Base metals, machinery and chemicals account for more than 50% of the total drop in exports



### 3. **Implication 1: No new direction of RU trade policy**

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- RU has implemented a variety of measures to limit imports from Ukraine in recent past
- Most prominent: Import ban for a large number of Ukrainian products, official justification either by SPS or TBT (see Annex 1)
- Anecdotic evidence: Significant difficulties with customs clearance for UA products at the Russian border; long delays

→ Possible FTA cancellation would be just one additional instrument of import deterrence among several others

**Implication 1:** FTA cancellation would not imply a significant change of RU trade policy vis-a-vis UA but a continuation of recent policy

## Implication 2: Limited impact of FTA cancellation

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Ukrainian exports to Russia declined heavily in recent past:

- In 2012: USD 17.6 bn
- H2-2014 - H1-2015: Only USD 6.4 bn (36% of 2012 value)

### Implication 2:

- Limited impact on Ukrainian exports and GDP
- In particular: Much lower impact than a few years ago

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Data basis	Export reduction	GDP equivalent
Average 2010 - 2012	USD 3,000 m	1.7%
H2-2014 - H1-2015	USD 897 m	0.89%

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### Overall conclusion:

- FTA cancellation would have a negative impact on Ukraine
- But impact - both in terms of RU policy signalling and in quantitative terms – would have been much stronger a few years ago

# Annex 1: List of RU import bans for UA products

Product	Date	Type of measure	HS07 code*	Trade value**
Rail-cars (4 companies)	Sep-Oct 2013	TBT ban	8603-8607	USD 1261.2 m (2013)
Confectionery (Roshen)	July 2013	SPS/TBT ban	1806	USD 413.0 m (2012)
Raw milk and dairy products	July 2014	SPS ban	0401-0406	USD 374.2 m (2013)
Confectionary	Sep 2014	SPS/TBT ban	1806	USD 306.6 m (2013)
Cheeses	Apr 2014	SPS/TBT ban	0406	USD 301.4 m (2013)
Alcohol products (three companies)	Aug 2014	SPS/TBT ban	22	USD 230.7 m (2013)
Vegetable and fish cans	July 2014	SPS/TBT ban	20;1604	USD 209.4 (2013)
Soya beans, sunflower seeds, maize goats, soya residuals	July 2014	SPS ban	1201; 1206; 1103; 2304	USD 98.4 m (2013)
Sanitary pads	May 2015	SPS/TBT ban	4818	USD 81.2 m (2014)
Poultry (biggest company)	Feb 2014	SPS/TBT ban	0207	USD 71.6 m (2013)
Detergents	Apr-Jun 2015	SPS/TBT ban	3402	USD 49.6 m (2014)
Cheese-like products	Nov 2014	SPS/TBT ban	1516-1517	USD 28.5 m (2013)
Wood chipboard	Oct 214	SPS ban	4411	USD 24.5 m (2013)
Potatoes	Jun 2014	SPS ban	0701	USD 1.3 m (2014)

Notes: \*HS code is tentative based on available product description.

\*\* Trade value is provided for tentative HS codes and doesn't take into account that in some cases products of only selected companies are banned. Thus, trade impact is likely to be overestimated and should be considered as upper bound estimate

# Annex 2: Impact of partial FTA cancellation

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## Scenario: Partial FTA cancellation

**Basis for scenario:** Russian decree #959 from 19.09.2014

- Russia will apply MFN tariffs for selected Ukrainian imports, as soon as Ukraine starts implementing the DCFTA
- Thus: This scenario depicts current official plans, that will come into force on 1 January 2016, provided no changes in policy take place

## Estimation of impact

Scenario	Export reduction	GDP equivalent
Partial FTA cancellation	USD 230 m	0.23%
Full FTA cancellation	USD 897 m	0.89%

**→ Impact of planned partial FTA cancellation is significantly weaker than hypothetical scenario of full FTA cancellation**

# Annex 3: Impact of import ban for UA agro-food products

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**Scenario:** Russian bans imports of Ukrainian agro-food products

**Basis for scenario:** Russian decree #842 from 13.08.2015

- UA to be added to list of countries subject to Russian agro sanctions
- Start: 1 January 2016, i.e. when DCFTA comes into force
- Thus: Scenario depicts current official plans, that will come into force on 1 January 2016, provided no changes in policy take place

## Estimation of impact

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Scenario	Export reduction	GDP equivalent
Ban on agro-food products	USD 410 m	0.41%
Partial FTA cancellation + ban on agro-food products	USD 550 m	0.55%

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**→ Impact of current combined plans would not be very strong, since access to Russian market for relevant goods is already very restrictive**

# Annex 4: Methodology and data

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## Modelled scenario “full FTA cancellation”:

- Russia raises its import tariffs vis-à-vis Ukraine from zero to MFN level
- Only tariff measures are considered; a possible increase in non-tariff barriers is not depicted in this scenario
- Note: In the modelled scenario only Russia, not the Eurasian Economic Union, increases tariffs vis-à-vis Ukraine

## Methodology:

- Assessment of changes in exports: SMART partial equilibrium modelling tool
- Assessment of changes in GDP: IER forecasting tool

## Data:

- Current Russian MFN tariff schedule (TRAINS)
- Ukrainian exports to Russia during July 2014 - June 2015 aggregated at 4-digits of HS 2012 classification (State Fiscal Service of Ukraine)
- Russian import demand elasticities (TRAINS)
- Note: Mirror statistics effects are not taken into account in the calculations



German  
Advisory Group  
Ukraine

# Contact



## Dr Ricardo Giucci

[giucci@berlin-economics.com](mailto:giucci@berlin-economics.com)

## Veronika Movchan

[movchan@ier.kiev.ua](mailto:movchan@ier.kiev.ua)

## Mykola Ryzhenkov

[ryzhenkov@ier.kiev.ua](mailto:ryzhenkov@ier.kiev.ua)

German Advisory Group

c/o BE Berlin Economics GmbH

Schillerstr. 59, D-10627 Berlin

Tel: +49 30 / 20 61 34 64 0

Fax: +49 30 / 20 61 34 64 9

E-mail: [info@beratergruppe-ukraine.de](mailto:info@beratergruppe-ukraine.de)

[www.beratergruppe-ukraine.de](http://www.beratergruppe-ukraine.de)

Twitter: [@BerlinEconomics](https://twitter.com/BerlinEconomics)

