NEWSLETTER

German Advisory Group

Issue Nr. 60 | August 2013

Russian bullying of Ukrainian exporters – What should be done?

Three months ahead of the expected signing of the Association Agreement/DCFTA with the EU, Ukraine faces massive economic pressure from Russia. In particular, Ukrainian exporters are confronted with highly arbitrary measures ('bullying') from the Russian customs administration. It is not clear whether Russia intends to continue or even strengthen these measures in the future. However, a prolongation of this policy would have a significant negative impact on the Ukrainian economy, since 25% of the country's exports go to Russia.

What can be done? In our view, Ukraine should seek a dialogue with Russia in which the interest of all Ukrainian exporters is represented – as opposed to the individual interest of only some exporters. Should this dialogue fail to lead to any positive results, then Ukraine should bring the case in front of the WTO, where it is likely to have the support of other members – including the EU. In addition, in order to stabilise the economic situation and be able to better withstand Russian pressure, Ukraine should secure a new IMF programme. Finally, Ukraine should sign the Association Agreement/DCFTA in November as planned, since giving way to Russian pressure would be a huge mistake.

Arbitrary trade barriers ('bullying')

Trade relations between Russia and Ukraine have never been straight forward. The so-called 'cheese war' which took place at the beginning of 2012, when Russia blocked the import of cheese products, was only one in many incidents of a troubled relationship. The recent decision of Russia's consumer protection agency 'RosPotreb-Nadzor' to enact an import ban for products of the well-known producer 'Roshen' – justified with apparent quality issues – is in the tradition of this policy.

However, unlike previous trade issues which singled out certain products, Ukrainian companies, associations and media have recently reported extensive, broad-based, administrative customs barriers which block the access of Ukrainian products to the Russian market. The extensive nature has given the disagreement a new quality, since now practically all products can be subjected to stricter customs procedures. Even industrial giants like Metinvest, a metallurgical company, report delays that subsequently lead to financial losses.

It is worth mentioning though that – despite its scale and the extensive character – the Russian measures have been implemented and carried out at customs administration level. The resulting discretionary and arbitrary character complicates a comprehensive assessment of the economic damage caused.

Russia's motives

Russia has long criticized the planned free trade agreement (DCFTA) between Ukraine and the EU and advocated a Ukrainian membership in the Customs Union between Russia, Kazakhstan and Belarus. Using a 'carrot and stick approach', Ukraine was promised gas price discounts for joining the Customs Union, while being threatened with trade barriers in case it would sign the DCFTA. Since a signing of the DCFTA by Ukraine looks ever more realistic, it is unsurprising that Russia has underpinned its threats with concrete measures. The timing before the actual signing of the DCFTA is only consequent here, since Russia aims at putting up pressure before it is too late.

Economic impact of the trade barriers

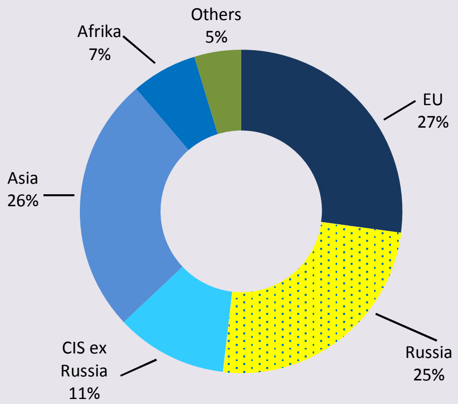
It is well-known that Ukraine's external position is fragile: The country's trade deficit in goods reached 12.9% of GDP in 2012. While the current account deficit was somewhat lower at 8.4% of GDP, this is still beyond a sustainable level.

The first half of 2013 witnessed a certain improvement of these figures, with the current account deficit shrinking to 7.0% of GDP. However, a large factor here was reduced gas imports, which declined by 35% and need to be made up for later in the year.

Thus, the recent trade disagreement with Russia poses new risks to an already unbalanced external position. In the first half of the year, Russia was the destination for 25% of Ukraine's exports and is therefore an important trade partner. Indeed, Ukraine sells goods – especially machinery and equipment, metals and food products – worth USD 1.3 bn per month to the neighbouring country.

The opaque nature of the administrative trade barriers put up by the Russian administration makes an assessment of their economic impact difficult and estimates carried out by different stakeholders are scattered over a wide range. While Ukraine's Confederation of Employers estimates a loss of USD 2.5 bn in the second half of 2013 alone, other economists suggest a loss of USD 2.3 bn for the whole year. Although the latter estimate is considerably lower, it would still amount to a substantial 1.4% of GDP and thus be of considerable economic significance.

Ukraine's export structure by region, 1st half of 2013



Source: National Statistics Office Ukraine

What should be done?

First of all, Ukraine should attempt to diffuse the difficult situation in bilateral meetings with the Russian leadership. In this context it is important though, to defend the interests of all exporters and all affected companies as opposed to only the particular interest of some.

Should those discussions with Moscow lead to no feasible results, policy makers are well advised to bring the case in front of the World Trade Organisation (WTO). However, the WTO resolution mechanism is a time intensive process and unlikely to bring any immediate results. Nevertheless this would be the right step and signal in view of any future trade conflicts. Here Ukraine can draw on the support of the EU and other WTO members.

In addition, policy makers need to come up with a plan to ensure economic stability and reduce the pressure exercised by the Russian side. In our view, any realistic plan has to involve the IMF. Consequently, Ukraine should secure a new IMF programme, which would require more exchange rate flexibility and a gradual increase of energy tariffs, as this is the only way to achieve the much needed macroeconomic stability. Once a new IMF programme is in place, additional funding from other international financial institutions and the EU might come forward.

Finally, Ukraine should sign the Association Agreement/DCFTA in Vilnius this autumn – providing the EU is also ready to sign it. The strategic decision of an approximation to the EU should not be sacrificed because of recent events.

Conclusions

Russia did not succeed in persuading Ukraine to join its Customs Union on a voluntary basis and now seeks to force Ukraine's entry through economic pressure. This approach is problematic for a number of reasons.

First of all it is questionable whether this approach is conducive for achieving Russia's objectives. The recent trade disruptions might have been an attempt to provide additional arguments for its Customs Union and against the DCFTA. However, such measures could easily backfire, leading to a stronger rejection of the Russian proposal of a Customs Union.

Additionally, Russia is not unaffected from the trade disruptions, as imports from Ukraine play an important role for some sectors of the Russian economy.

Finally, the measures are likely to have negative side effects for Russia who only recently joined the WTO. The Russian action could damage its international reputation as a modern and reliable partner. As such, it would be in Russia's very interest to stop the recent trade barriers in due course to avoid any further damage of its reputation before this episode has engrained itself in the memory of its international partners in the WTO and among the G8 countries.

Authors

Dr. Ricardo Giucci, giucci@berlin-economics.com
Robert Kirchner, kirchner@berlin-economics.com

Note: This publication is a translation of our monthly German language Newsletter, Issue 60/2013.

German Advisory Group
The German Advisory Group on Economic Reforms, which is active in Ukraine since 1994, advises the Ukrainian Government on a wide range of economic policy issues and on financial sector development. The group is financed by the German Federal Ministry of Economics and Technology under the TRANSFORM programme and its successor.

Contact
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
info@beratergruppe-ukraine.de
www.beratergruppe-ukraine.de