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Ukraine Introduced New Agricultural Support System in 2017

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Report Highlights:

Upon introduction of a new agricultural support system in early 2017, Ukraine eliminated budget revenue support programs based on Value Added Tax (VAT) subsidies. A new direct budget transfer system significantly reduced support for livestock and pig farmers, while support for poultry producers will likely decline at a lesser extent. Among animal producers, dairy, beef, and pork producers are most likely to be negatively affected due to smaller expected margins. Support for bulk crops (grains and oilseeds) was cancelled; however, these losses were partially offset by more efficient export VAT reimbursement for these crops. Based on the elimination of subsidies for bulk crops, margins are expected to be lower which could result in slower growth of that sector in the longer term. The new system provides lower support to agricultural producers overall; however, it is difficult to predict specific changes in production levels across sectors.

Report Summary

Although adopted in 2016 for 2017 enactment, the new agricultural support system payment mechanisms remained dysfunctional for a number of months while necessary sub-legislative acts remained to be implemented. Post compiled this report when all subsidy support mechanisms became functional and initial payments were made, allowing for a full description of the system as well as observations of initial results of the new program. This report reflects FAS-Kyiv's understanding of the new scheme, based on comments from industry and official Government of Ukraine (GOU) documents, as of early May 2017. Due to lack of consensus among major stakeholders, it is likely to be modified in the year ahead. However, a return to the previous direct VAT-refund based system is unlikely.

The new system is likely to provide overall lower support for all agricultural producers. Although the real impact on Ukrainian agriculture will become evident closer to the end of 2017, some preliminary predictions follow. Despite cancelation of the bulk crop support, the losses to crop producers are likely to be compensated through higher farm-gate prices due to a more efficient export VAT reimbursement system. Livestock and poultry producers are likely to lose a significant share of support payments. Poultry producers are expected to suffer smaller losses in comparison to pork, beef and milk suppliers.

Industry experts estimate that the former VAT subsidy system provided Ukrainian agricultural producers with UAH 31 billion (USD 1.2 billion) in 2016, including approximately UAH 7 billion (USD 274 million) in livestock support subsidies. Based on the new regulations designed to reduce pressure on Ukraine's budget, the maximum total support can reach up to UAH 4.7 billion (USD 175.6 million) in direct subsidies to all agricultural producers.

Ukrainian Budgeting of Support

In previous years, forgone budget revenue support was not known in the beginning of the budget year because it was fully dependent on production and VAT that producers were allowed to keep. The total sum of supports was calculated during the few weeks after the year end with assistance from the State Fiscal Service of Ukraine.

Under the new system, the Parliament-adopted State Budget provides funds that are to be distributed to agricultural producers. In 2017, the [State Budget](#) (all auxiliary links are in Ukrainian and can be Google-translated by interested readers) for agricultural support is provided in the "Financial Support of Agricultural Producers" line, with Expense Code 2801580. The Budget also envisages that support will be automatically distributed among agricultural producers proportionally based on sales of agricultural products by those producers on a monthly basis (Article 20 of Ending Remarks).

[Attachment 3](#) to the State Budget of Ukraine envisages the following Expenses for 2017:

Expense Article Code	Name	General Budget Account Spending	Special Budget Account Spending	Total Spending
2801580	Financing of Agricultural Producers	UAH 1 473 million (~USD 54.2 mln)	UAH 3 301.3 mln (~USD 121.4 mln)	UAH 4 744.3 mln (~USD 175.6 mln)

*Official projected average exchange rate for 2017 budget is 27.2 UAH/1 USD

By Law, the General Budget Account expenditures are funded through budget revenues that have guaranteed replenishment by taxes and other direct budget incomes. Conversely, the Special Budget Account is replenished subject to projected additional budget revenues. In particular, replenishment of the 2017 Special Budget Account is subject to additional laws that need to be adopted by the Parliament. Adoption of those laws may provide either partial or full coverage of the Special Budget Account. Thus, the guaranteed minimal sum for agricultural support in 2017 is \$54.2 million (through the General Budget Account), while additional incomes through the Special Budget Account may range from \$0 to 121.4 million. The actual total support value will likely be known sometime during 2017

or early 2018.

Although budgeted, distribution of agricultural support was delayed until adoption of the [Order](#) on State Budget Distribution No. 83, adopted by the Cabinet of Ministers of Ukraine on February 8, 2017, and amended on March 22, 2017. Due to these delays, the first formal budget payments should have started in May 2017. However, the GOU made certain [amendments](#) to allow retroactive subsidies beginning in February 2017 (based on December 2016 agricultural product sales data).

Agricultural Subsidies for Selected Agricultural Products Eligibility

According to the Law of Ukraine [On Agricultural Support](#), all agricultural producers that apply for the subsidy must be included in the State Registry of Budget Subsidy Recipients. An agricultural producer is defined as a farm or a company that derived 75 percent of its sales over the last 12 reporting periods (months) from sales of agricultural products. Agricultural products are products referenced under HS Codes 1-24 that are produced, grown, fed, processed, caught, picked and stored by the producer, including processed products in cases where the producer owns or rents the production facility.

The list of subsidized agricultural products includes:

Vegetables and Melons

- Leaf and stem vegetables (artichokes; asparagus; cabbage; cauliflower and broccoli; lettuce, chicory and spinach)
- Melons and gourds (cucumbers and gherkins; eggplant; tomatoes; watermelons; musk melons; other melons (squash, pumpkins, etc.);
- Root vegetables (carrots; turnips; garlic; onions (including shallots); leeks and other root crops; (red beets, etc.);
- Mushrooms and truffles;
- Sugar beets;
- Root crops (potatoes; sweet potatoes; manioc; yams; other root crops)

Grapes for Wine and Table Grapes

Pome and Stone Fruits

- Apples, apricots, cherries and sweet cherries, peaches and nectarines, pears and quinces, plums, other types of pome and stone fruits.

Berries, Nuts and other Fruits

- Blueberries, currants, gooseberries, kiwi, raspberries, strawberries and wild strawberries, other types of berries;
- Almonds, cashews, chestnuts, filberts (hazelnuts), pistachios, walnuts, other types of edible nuts.

Livestock Production

- Breeding of dairy cattle, other cattle and buffalo for meat, dairy and genetic purposes;
- Milking of cattle, buffalo, horses, donkeys, sheep and goats;
- Breeding of horses and other equine animals ;
- Breeding of sheep and goats;
- Breeding of pigs (including for genetics);
- Wool production from sheep and goats.

Swine Production

- Swine production
- Swine breeding

- Semen collection

Poultry Production

- Breeding poultry for meat (chickens, turkeys, ducks, geese, guinea fowl);
- Poultry slaughter, processing and packaging of fresh and frozen meat
- Breeding poultry for eggs

Other Animal Production and Other Agricultural Activities

- Ostriches;
- Other types of birds, such as quail;
- Insects;
- Rabbits and other fur-bearing animals with valuable fur;
- Skins and hides from farm-raised reptiles and birds;
- Silkworm breeding and silk cocoon production
- Bee-keeping, honey and beeswax production

Cultivation of tobacco plants (with exception of tobacco drying, sorting, etc.);

Meat Processing

- Animal processing limited to: slaughtering, processing and packaging of meat; beef, pork, lamb, rabbit, camel meat, etc.; Production of meat in half-carcasses and cuts;
- Production of shred wool;
- Production of pig bristles;
- Poultry processing limited to slaughtering, processing and packaging of poultry. Production of fresh, chilled or frozen poultry meat in whole carcasses and in parts

Dairy

- Milk processing , butter and cheese production;
- Fluid milk production including, pasteurized, sterilized, homogenized, and baked milk;
- Production of milk-based drinks (buttermilk, sour milk, etc.);
- Production of cream, pasteurized, sterilized and homogenized;
- Sour-cream production

Production of Egg Products, Egg Albumin, Egg Powder

Post Note:

- *The list of subsidized products does not include Ukraine's bulk agricultural products such as grains and oilseeds as they are no longer subsidized under the new support system.*
- *The list includes processing of many animal products. This provision is allowable in cases when production and processing is conducted by one legal entity. Due to historic production patterns, the subsidy is likely to be predominately taken by vertically-integrated poultry producers, dairy and livestock farmers, small milk-processing and meat-packing facilities. The list promotes on-farm processing of meat and dairy products.*
- *The list includes tobacco production*

Budget Distribution Mechanism

Payment Conditions:

Due to the significant size of industrialized poultry production, the GOU-issued Order No.83 declared that poultry

producers and processors (often vertically-integrated companies or groups of companies) can receive no more than 50 percent of the total monthly budget subsidy. As mentioned in Post's most recent [Poultry and Products GAIN Report](#), concentration of the Ukrainian poultry industry is extremely high with one large producer controlling over 60 percent of the market, and the top 6 producers responsible for over 93 percent of production. The largest producer is a publicly traded corporation that also qualifies for direct subsidy payments.

The budget subsidy for a sector is calculated on a monthly basis and is proportional to overall VAT paid. The State Fiscal Service calculates support payments on a monthly basis discounting available monthly subsidies by the following conversion coefficients:

For poultry producers:

$K_p = \text{Budget Subsidy allocated to poultry producers} \div \text{poultry and related product sales VAT paid}$;

In cases when $K_p > 1$ it is reduced to 1.

For other producers:

$K_o = \text{Budget Subsidy allocated to other producers} \div \text{agricultural product sales VAT paid}$;

In cases when $K_o > 1$ it is reduced to 1.

Note: Based on these formulas, direct subsidy payments in any given month must not exceed the amount of VAT paid. That is the case for both for poultry and other product producers.

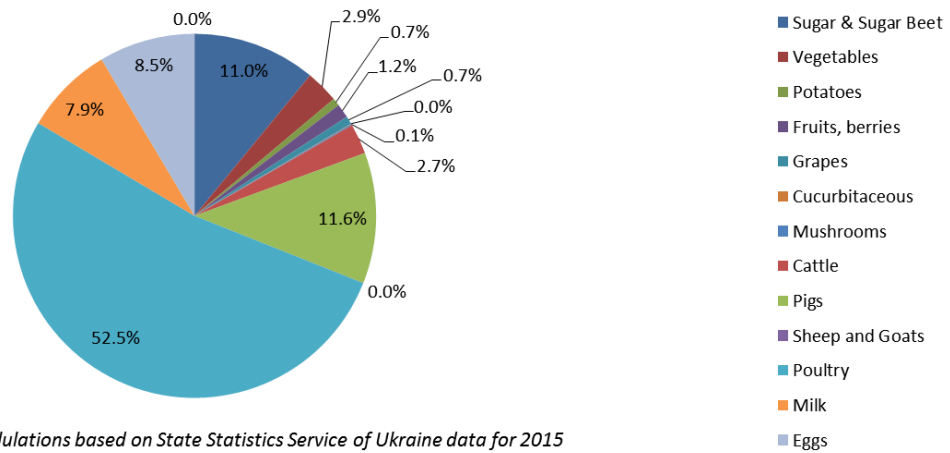
The 50 percent cap for poultry producers' share remains. In cases when VAT paid to the budget is smaller than the monthly allocated support sum, total reimbursement cannot exceed total VAT paid. The difference is then transferred to the next month.

FAS-Kyiv Comment: In cases of high seasonality of production, it is likely that sales for products of plant origin are low in winter months and their VAT paid to the budget is insignificant, and smaller than the allocated direct subsidy payment. At the same time, poultry producers would be entitled to receive up to 50 percent of the monthly subsidy allocated. In those cases, the remaining VAT sum is transferred to the next month creating a bigger payment for poultry producers in those subsequent months when they can claim their full payment share. For example, in winter months when plant-product supports are low due to the low VAT paid by those sectors, poultry processors can claim 50 percent of the budget payment plus their VAT contributions from previous months that exceeded allowable subsidy payments in those months. Concurrently, vegetable and fruit producers can only claim subsidy payments during harvest months when they sell crops and pay VAT.

As such, the new support scheme favors industries with consistent cash flow during the year, which includes animal producers and sugar processors. Although the new subsidy model envisages significantly smaller payments compared to the 100 percent VAT reimbursement model that previously existed, it disfavors vegetable and fruit producers vis-à-vis the larger agricultural companies and corporations with greater continuity of sales throughout the year.

Based on the statistical bulletin by the State Statistics Service, "Product Marketing by Agricultural Enterprises", for 2015, Post estimated the annual shares for products eligible to receive agricultural subsidies (please see the graph below).

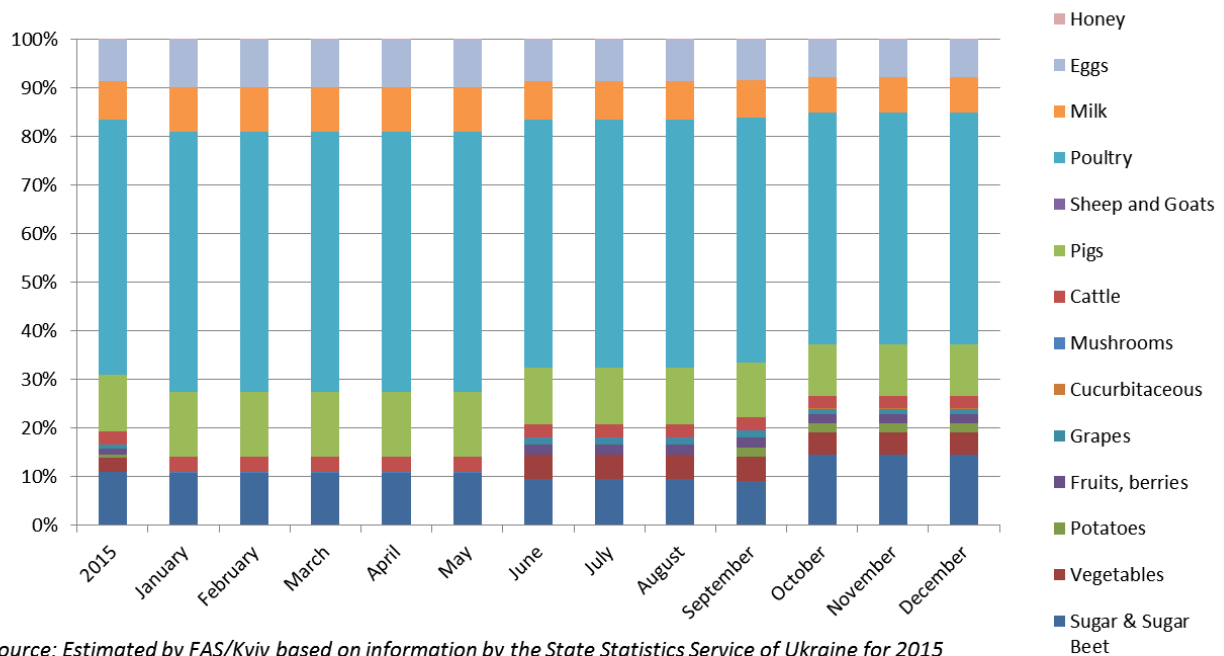
Value Shares of Products Eligible for Agricultural Subsidy



Source: FAS/Kyiv calculations based on State Statistics Service of Ukraine data for 2015

Post estimates the distribution of the state subsidies across different types of eligible products on a monthly basis in the graph below (“Projected Distribution of State Support for Various Products”). It was calculated based on the statistical bulletin by the State Statistics Service, “Product Marketing by Agricultural Enterprises” for 2015, “Animal Products Production in Ukraine” for 2015, as well as Post’s own estimates for certain products. The graph supports the assumption that the poultry industry will likely collect around 50 percent of total state supports to agriculture for any given month. Around 40 percent will be re-distributed between egg, dairy, pork and sugar producers. The smallest share (below 10%) will be received by producers of various products of plant origin (fruits, vegetables, melons etc.). These products are predominantly produced by households, which are not likely to apply for a state subsidy.

Projected Distribution of State Support for Various Products



Source: Estimated by FAS/Kyiv based on information by the State Statistics Service of Ukraine for 2015

* - estimate has been made under the condition that share of support for poultry industry cannot exceed 50% of the total for any given month and all other industries' share is 50% or more

The new subsidy system distributes a substantial share of direct budget payments to companies and agricultural corporations that, historically, show significant turnover and profits and possess significant political and lobbying power. It also discriminates against seasonal production and sales which constitute a large number of eligible products. Seasonal agricultural producers are dependent upon uneven sales across months and may lack support in months when major production costs are incurred (winter-spring).