

EU Integration of Ukraine – discussing some agricultural policy and development issues

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Abstract

Ukraine's path toward the European Union is related to the development of its agricultural sector and its transformation in line with the EU acquis. An EU membership for Ukraine would be enormously significant for the global status of the EU in the trade of grains and oilseeds given Ukraine's role as a staples' superpower. Nevertheless, it would also entail major budgetary reallocation costs for several current EU member-states within the context of the EU Common Agricultural Policy (CAP). Ukrainian administrative and private sector challenges should also not be underestimated. Identifying efficient CAP tradeoffs between current EU member-states and Ukraine is a key condition for the successful EU integration of Ukraine.

Introduction

Despite defending against a full-scale invasion against Russia, Ukraine continues to advance its European ambitions. The European Council granted Ukraine candidate status in June 2022 and eventually opened accession negotiations in December 2023 (EU Commission 2024a). The EU Commission, however, assesses Ukraine to be in the early stage of preparation for accession in agriculture and rural development, and moderately prepared in the food safety, veterinary, and phytosanitary policy domain (EU Commission 2024b). As agriculture, together with the upstream and downstream sectors, generates about 20% of Ukraine's GDP and more than 60% of Ukraine's exports, this implies a substantial public and private challenges ahead of Ukraine that will make its path toward the EU membership long and difficult.

Furthermore, Ukraine has traditionally been highly competitive in major staple foods (grains and oilseeds) and established itself as one of the key global agricultural exporters and due to a substantial productivity gap, it is able to contribute even more to global food security (von Cramon-Taubadel 2022; Glauben et al. 2022). Other products that have gained international competitiveness include poultry meat (Nechyporenko, 2024) and sugar (von Cramon-Taubadel and Nivievskyi 2024). From both Ukraine's and a global food security perspective, it is essential that Ukraine, even being as an EU member, continues to maintain its competitiveness and to increasingly contributes to feeding a growing global population.

Ukraine has already paid a high price for its European aspirations that significantly intensified with the Revolution of Dignity in 2013, annexation of Crimea and partial occupation of Donbass by Russia in 2014 as a retaliation, and a full-scale Russo-Ukrainian war from February 2022. Despite this external and existential threat, the political economy behind the EU enlargement inside the EU itself is very difficult. In the fear of increasing competitive pressure from Ukraine's agriculture, farmers and their associations have been actively protesting against agricultural imports from Ukraine and even blocked it for some considerable period of time; they also quite successfully pressure the European Commission to restrict agricultural imports and generally agricultural trade regime with Ukraine (Nivievskyi 2024; von Cramon-Taubadel and Nivievskyi 2024). These fears are often grounded on the argument that structurally Ukrainian agriculture is predominantly large-scale and thus very efficient, or that Ukraine's competitive strength and pressure is based on unfair cost advantages because Ukrainian farmers face fewer environmental, traceability, food safety and other standards than their counterparts in the EU. Hence, Ukrainian integration into the EU grain market may pose challenges both to EU competition law and the grain revenues of East European economies that are already member-states of the European Union. While on the one hand the Ukrainian cereals dominance can strengthen the trade advantage of the EU in emerging markets, it may also create, on the other hand, additional costs hampering the overall economic growth of its East European region. At the same time, France and Germany are also particularly strong in their share of EU

grain production and they would have to readjust their strategies of allocation between EU and international markets.

Another emerging contentious issue is the expected agricultural support to Ukraine or the budgetary implications for the EU's Common Agricultural Policy (CAP in the following) because of Ukraine's EU accession. The existing estimates vary in the range of 10-13.8 billion euros or almost a third of the current CAP budget (Matthews 2024) which implies a substantial additional fiscal pressure on the EU and its CAP budget. So additional spending on the EU CAP literally implies that the existing EU members should be ready to get less generous agricultural transfers from the EU and most likely this will not be politically acceptable, unless the existing CAP allocation rules and policies are changed. Potential Ukrainian claims to the CAP budgetary pie will certainly be met with negative reactions by EU member-states whose agricultural incomes depend to a great extent from the CAP transfers (OECD 2023). Given Ukraine's global importance in international grain markets, a redesign of CAP allocative rules is required. Either the EU will have to reduce CAP subsidies to current EU members to compensate for Ukrainian entry by pointing out that EU member-states could compensate their losses in emerging markets that Ukraine would have to give up in order to consolidate its market position inside the EU. Or CAP subsidies could be used to alleviate the potential Ukrainian grain power by creating several production tiers inside the common market to facilitate competition. Ukraine could then compensate its EU-wide losses through world exports.

This paper discusses how the trade regime with the EU and the EU integration of Ukraine will affect Ukraine's agricultural competitiveness and its contribution to the global food security. On the other hand it also discusses a need for the EU agricultural policy to change in the face of Ukraine's accession. The paper in the following is organized as follows: in the next section we set up a theoretical framework for conceptualizing the impact on competitiveness and use it in the following several sections to discuss sequentially on the impact of the EU-Ukraine trade regime and Ukraine's integration into the EU on Ukraine's agricultural competitiveness. Conclusions wrap up the paper

1 Setting the discussion framework for Ukraine's agriculture and its EU membership

To discuss the implications of the EU membership for Ukraine's agricultural competitiveness, let us first set up a theoretical framework. In general, (international) competitiveness¹ is a product of many factors and the interactions among them. The change in a firm's international competitiveness from one period to the next can be decomposed into the following components (Nivievskyi et al. 2010):

$$\% \Delta \text{Competitiveness} = \% \Delta \text{Productivity} + \% \Delta \alpha * P_{\text{output}} - \% \Delta \beta * P_{\text{input}} \quad (1)$$

where $\% \Delta$ refers to 'percentage change'. P_{output} and P_{input} are undistorted output and input prices, and α and β are revenue and cost shares so that the last two terms on the right-hand side of equation (1) refer to weighted average output and input price changes, respectively.

The intuition behind (1) is quite straightforward: i) a firm's competitiveness over time is determined by changes in its productivity, ii) changes in average (undistorted) output and input prices, respectively; if output (input) prices increase, competitiveness will improve (be reduced) as a result.

¹ International competitiveness refers to a firm's ability to offer goods on the global market at prices that yield sufficient returns on the resources used in their production. For major internationally tradable agricultural commodities such as grains, oilseeds, meat, and many dairy products, world market prices serve as a benchmark for assessing competitiveness. For instance, a farm is considered internationally competitive in wheat production if it can sell wheat at the prevailing world market price while ensuring that the revenue covers the costs of all inputs, also assessed at world market prices, used in the production process.

Prices for inputs and outputs are often distorted by government policies (mainly trade policies, like import/export restrictions, or domestic policies, like price supports, minimum/maximum prices, subsidized inputs or other forms of support). As a result, a firm that is lacking competitiveness at undistorted world market prices for inputs and outputs might appear to be competitive at the policy-distorted domestic prices that it faces, or vice versa. Also if a trading partner restricts imports by erecting trade tariff and non-tariff barriers, it decreases exporting country competitiveness on its destination markets.

As it was mentioned above, firm's competitiveness development is determined by changes in its productivity – one of the major agricultural policy goals across the globe. Governments achieve the goal of increasing productivity by various measures, including by governmental support in the form of direct subsidies and tax breaks. Other trade and domestic policies also indirectly affect firm's productivity and thus their competitiveness. In the following we discuss these policy measures and other factors that might affect Ukraine's agricultural competitiveness.

2 Agricultural structures in the EU and Ukraine

Agriculture plays a substantially larger economic role in Ukraine than in the EU, in terms of the agricultural land cover, share of national income, and trade. Agriculture alone accounts for about 10% of GDP, but together with upstream (e.g. agricultural machinery) and downstream (e.g. food processing) industries, the entire agri-food sector's share of Ukrainian GDP amounts to roughly 20%. Both EU and Ukrainian sectors are predominantly crop-based, but crops dominate substantially more in Ukraine (Figure 1). Grains and oilseeds in Ukraine have increasingly becoming a backbone of agricultural growth and accounting for almost 90% of the total arable land (Figure 2; Figure 3; Nivievskiy et al. 2022).

Farms in the EU are indeed considerably smaller on average than in Ukraine. But these averages mask a huge heterogeneity of farms primarily in Ukraine. About 4 million of small-sized farms (about 3 ha on average), which include individual commercial and household farms constitute the largest group by total land area, with 20.1 million ha compared to 17.1 million ha operated by medium and large-sized commercial agribusinesses, producing about a half of the gross agricultural output (Nivievskiy et al. 2021). In the EU, there were 9.1 million farmers (agricultural holdings) in the EU in 2020, about two-thirds (63.8 %) of which were less than 5 ha in size. By farm count Romania dominates by far with almost a third of these 9 million farms, then comes Poland with its 1.3 million farms, Italy with 1.1 million farms and Spain with 0.9 million (Eurostat 2022).

Farm size is a central issue when it comes to land inequality in advanced and emerging markets. Farm consolidation in Ukraine as part of the process toward EU membership may vary in terms of scale and speed, because of diverging incentives. On the one hand, big farms allow usually for higher levels of productivity and efficiency, while smaller farms prevent ownership concentration and land inequality.

Farms structures in the EU and in Ukraine, however, do not stand still, they are following a general consolidation pattern: less farms remain in business but their average size increases (e.g. Matthews 2021; Nivievskiy et al. 2022). And this is a positive signal towards both EU and Ukraine's farms productivity and thus their competitiveness. More recent global evidence demonstrates that with economic and market growth, there are positive productivity returns to farms' size (Rada and Fuglie 2019). So provided policy makers do not interfere into favoring certain farm sizes, larger and more consolidated Ukrainian agriculture should only strengthen its competitiveness.

3 Trade Regime between the EU and Ukraine

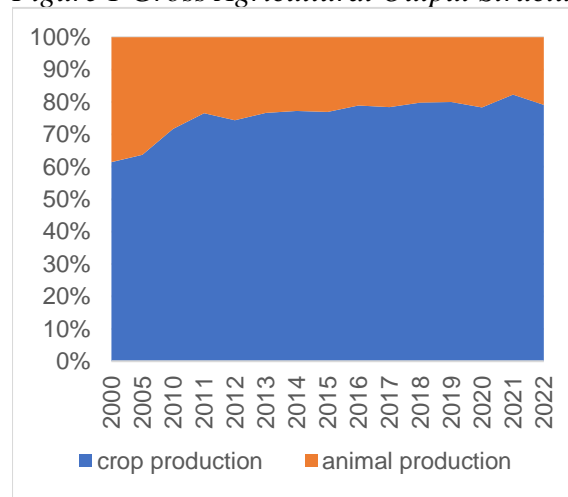
Since 2016 Ukraine almost fully liberalized its trade with the EU, as a large chunk of agricultural tariffs was lifted under the Deep and Comprehensive Free Trade Area (DCFTA) with the EU. The remaining trade barriers from the EU were the TRQs for altogether 40 product lines (grain, beef, pork, sheep and poultry meat, sugar, eggs, selected dairy products, selected vegetables, selected fruit juices, ethanol, and cigarettes), that in total made up only 35% of total Ukraine's agricultural export to the EU in 2021.

In June 2022 (in response to Russia's full-scale invasion of Ukraine) the EU introduced so-called European Solidarity Lanes (ESLs) initiative that included temporary Autonomous Trade Measures (ATMs) that removed the remaining trade barriers. In response to this trade facilitation, Ukrainian exports of agricultural products (mainly grains and oilseeds, also sugars) to the EU grew rapidly. Farmers in some regions as well as the representatives of some agricultural processing industries expressed their concerns that imports from Ukraine represented unfair competition that was depressing prices in the EU and lobbied in Brussels for restricting agricultural imports from Ukraine. In June 2024, the EU Commission announced that it was revising the ATMs to introduce an "emergency brake" that would automatically reintroduce the TRQs for seven agricultural products if their import volumes reached the average annual levels registered between July 2021 and December 2023 (Nivievskyi 2024a; von Cramon-Taubadel and Nivievskyi 2024). The next milestone is June 2025 when the current ATMs might be prolonged or reconsidered (EU Commission 2024). It is highly unlikely, however, for Ukraine to expect a surge in the trade barriers with the EU, at least beyond the ones under the DCFTA framework. So in terms of the competitiveness change formula in (1), the change in output and input prices as a result of the trade tariffs with the EU, will most likely be favorable for the competitiveness of Ukraine's agricultural products on the EU market.

The reduction of the yields gap between Germany and Ukraine (Figure 4) underscores a convergence between the two economies, which may ease the competitiveness burdens for several European economies, which might find it hard to compete with Ukrainian grain and oilseed products. The formation of a common market would entail an intermediate path between protectionism and free trade such that Ukraine could maximize its profit in the European market, while certain policy thresholds were in place in favor of current EU producers.

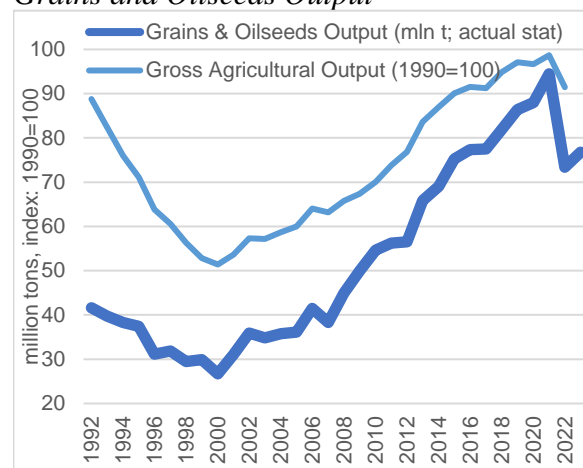
Moreover, evidence available so far tells for a beneficial effect of a fully liberalized trade for the EU itself. Countryman et al (2024) analyzed the global effects of 'weak' and 'strong' ESLs, which is a sort of a trade restricted and fully liberalized trade between the EU and Ukraine, using CGE model. Results are available for all global regions and reflect the welfare loss for the EU of USD 520 million under the weak ESLs, and almost USD 2 billion welfare gain under the strong ESLs scenario.

Figure 1 Gross Agricultural Output Structure



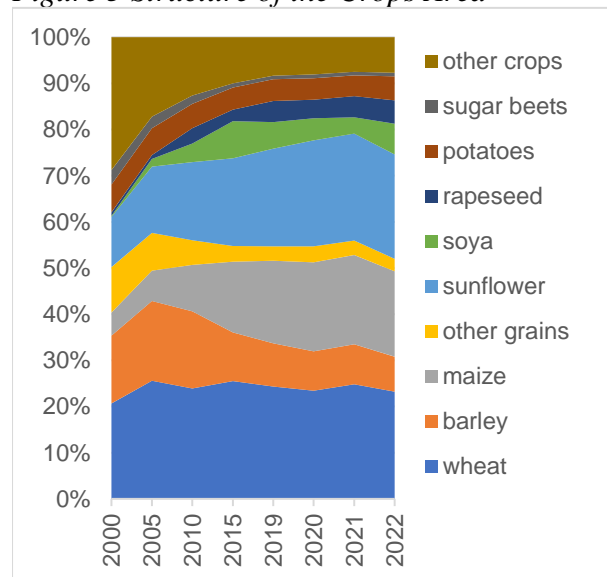
Source: own presentation using Ukrstat data

Figure 2 Agricultural Growth driven by Grains and Oilseeds Output



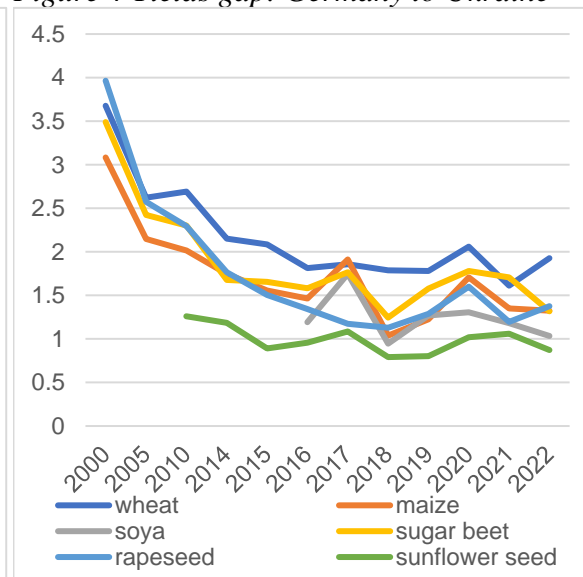
Source: source: own presentation using Ukrstat data; up to 2021 the time series are presented as 3-year moving averages to smooth out short-run fluctuations

Figure 3 Structure of the Crops Area



Source: own presentation using Ukrstat data

Figure 4 Yields gap: Germany to Ukraine



Source: own presentation using Ukrstat data

4 EU Food Policy and Ukraine's Administrative Challenges

EU membership and the entire accession process implies a substantial challenge to Ukraine's public authorities due to existing institutional capacity gap (Nivievskyi 2024b). By the day of accession, Ukraine must be able to implement the administratively complex and financially demanding EU CAP, which itself could be a moving target. Furthermore, Ukraine should be able to implement the extensive EU 'agricultural acquis' which, together with the CAP, includes regulation of markets and standards in the areas of farming practices, animal and plant health, food safety, and environmental and animal welfare. These factors mean that Ukraine's preparations for EU accession will require substantial additional public investments in the competent authorities and their capacities to implement and enforce the EU agricultural acquis (Nivievskyi 2024b).

This is a crucial element in supporting Ukraine's agricultural productivity and competitiveness growth, as opposed to the direct support in the form of direct subsidies and tax privileges.

Investments in public services play a significant role in attracting private investments. Global experience shows that each additional dollar invested in public services typically attracts about two dollars of private investments in OECD countries, particularly in economic infrastructure and human capital. In Ukraine, the leverage could be even higher, potentially up to 3.4, based on evidence from comparable countries such as the Baltic states or Poland. This is badly needed for the country like Ukraine in mobilizing private investments under the tremendous fiscal pressures due to war expenditures and due to recovery and reconstruction needs resulting from the enormous damages and losses, including in agriculture (World Bank 2024). So, a due focus is devoted to the capacity of public authorities and overall to the institutional capacity of the Ukraine in the process of the EU integration, and this is more likely to happen as the EU usually have substantial pre-accession programs focused on, more efficient public services and institution should crowd in private investments thus contributing to agricultural productivity and competitiveness of Ukraine.

Ukraine's path toward the European Union is related to the development of its agricultural sector and its transformation in line with the EU acquis. An EU membership for Ukraine would be enormously significant for the global status of the EU in the trade of grains and oilseeds. At the same time, the status of European farmers would be challenged, as the dominant position of Ukraine in the internal market would challenge the EU administrative structures efficiency and agricultural policy.

5 EU Food Policy and Ukraine's Private Sector Challenges

EU integration also implies additional challenges for the private sector of Ukraine to comply with the EU agricultural acquis. Current agricultural competition advantages from Ukraine are sometime attributed to unfair cost advantages because Ukrainian farmers face fewer environmental, food safety and other standards than their counterparts in the EU. Indeed, the extensive EU agricultural acquis which, together with the EU CAP measures, includes regulation of markets and standards in the areas of farming practices, animal and plant health, food safety, and environmental and animal welfare that would require additional investments from agricultural producers to comply with. We are aware of no recent comparative studies on the expected compliance costs in the EU that Ukraine's farmers might face. The stock of past studies is also thin. The evidence available there suggests that the costs of compliance with EU agricultural acquis (e.g. EU Commission 2014) are not critically high and that other cost components (labour, land rent) play much more important roles. Based on the EU Commission (2014) study we expect that Ukraine farmers might face additionally up to 10% costs increase (differentiated across the subsectors) due to the need to comply with more stringent EU regulations. This is certainly not a critical factor that should undermine Ukraine's agricultural comparative advantages. Moreover, emerging evidence suggests that, on average, producers of grains and oilseeds in Ukraine have a capacity to increase their output by almost 20% and simultaneously contract harmful environmental impact by 16% (Halytsia et al. 2024). This in turn can compensate for the additional compliance costs mentioned above, thus it will sustain Ukraine's agricultural competitiveness. Furthermore, some other studies demonstrate a positive link between the EU environmental practices and the competitiveness of farms, in particular via a more efficient use of inputs (Beck et al. 2024).

6 EU Common Agriculture Policy and Support to Ukraine's Agriculture

Ukraine's agricultural productivity has been increasing but it is still performing at least 30% below its potential (Nivievskyi and Bogonos 2024) and is capable to contribute even more to Ukraine's economic development and global food security. Figure 5 demonstrates that Ukraine's productivity growth over the last two decades was enormous compared to the EU's key agricultural countries and other key agricultural players in the region. Old EU member

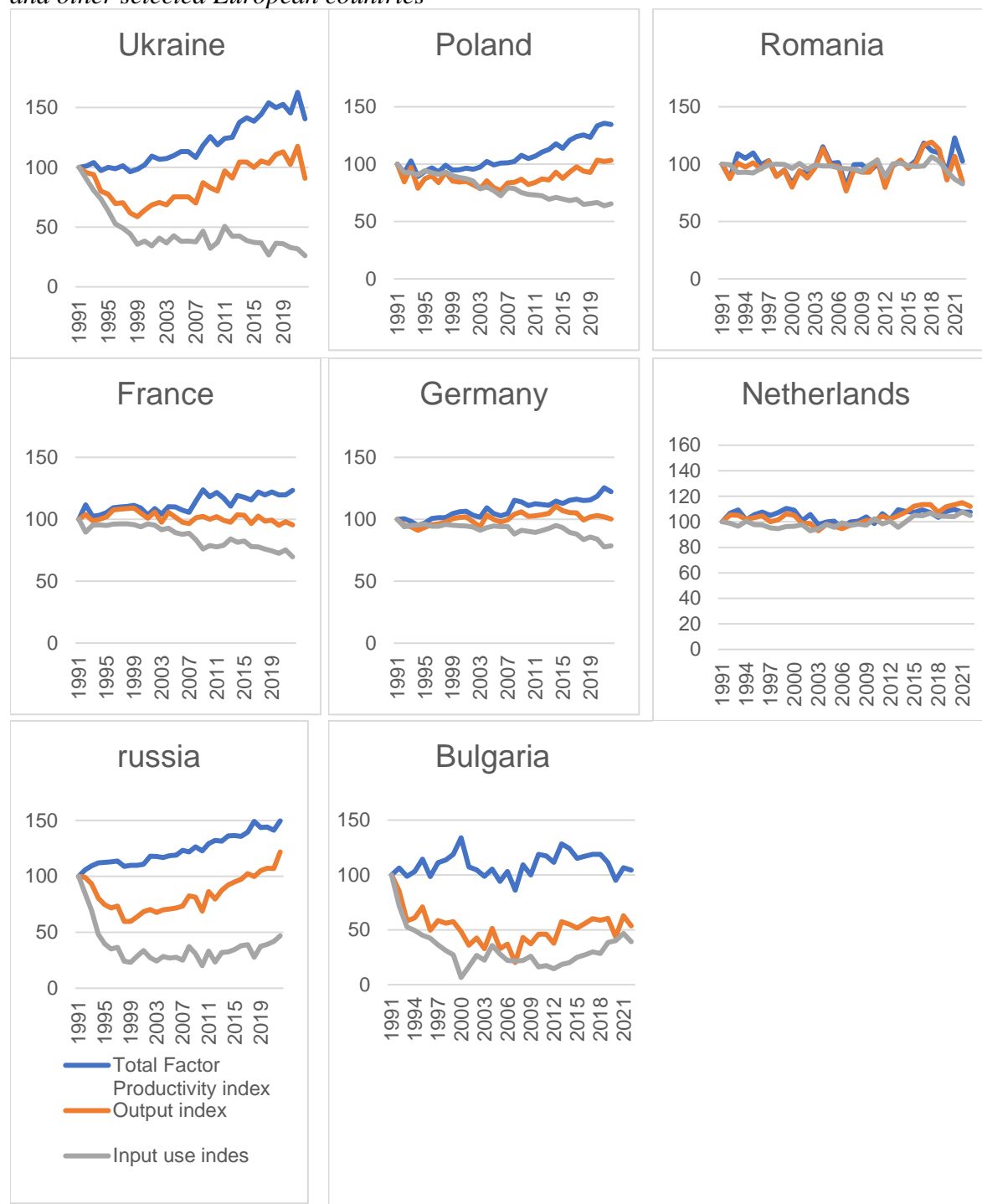
states operated already ‘on a production frontier’ so one should probably not expect a drastic TFP growth in these countries. Central European countries or new EU members, however, do not demonstrate a comparable to Ukraine agricultural productivity growth. Romania’s and Bulgaria’s productivity growth is essentially flat over the last two decades.

Unlike in many other countries, especially in the EU region, this Ukraine’s agricultural growth was achieved with the relatively low state support (World Bank 2024). During the last twenty years Ukraine’s annual public agricultural expenditures averaged US\$600 million. In 2019-21, this translated into 0.33% of GDP, and less than 2% of gross agricultural output (GAO), and US\$14 per hectare (ha) of agricultural land. For comparison, budgetary support in the OECD countries averaged 0.47% of GDP, 17% of GAO, and US\$216 per ha of agricultural land. This is an important finding, given current Ukraine’s low fiscal space and pressure. The quality of agricultural public spending is more important than quantity as not all public spending is equal and beneficial for agricultural growth. There is empirical evidence, for example, that commodity specific direct subsidies and tax benefits had only counteracted to Ukraine’s agricultural productivity growth in the past (Neyter and Nivievskyi 2023; Nivievskyi and Deininger 2019; Nivievskyi 2018) and this finding is aligned with the global experience of subsidies impact on efficiency and productivity (World Bank 2024).

Now, Ukraine as a candidate country can expect budgetary transfers under the CAP and under the existing rules and policies. The existing estimates of expected transfers vary in the range of 10–13.8 billion Euros (Matthews 2024) which implies a substantial additional fiscal pressure on the EU CAP budget that has been politically kept from expanding over the past decade (Nivievskyi 2024b). So additional spending on the EU CAP literally implies that the existing EU members should expect to receive less generous agricultural transfers from the EU and most likely this will not be politically acceptable in the EU, unless the existing CAP allocation rules and policies are changed. This implies, that most likely, from a political economy perspective, Ukraine will have to make concessions on agricultural subsidies against the full access to the EU single agri-food market. This is not a downside of the EU accession, considering the empirical evidence of negative impact of specific direct subsidies and tax benefits on agricultural efficiency and productivity growth. It is a bit more complex with the effect of co-called de-coupled payments that are a backbone of the current CAP. Some recent analysis using a farm-level data from the EU countries suggests a positive impact of de-coupled payments on agricultural productivity (Mennig and Sauer 2023), while a global-wide and country-level analysis demonstrates that decoupled subsidies reveal no significant impact on various productivity measures (Mamun 2024).

The symmetric adjustment of CAP transfers in the aftermath of Ukrainian integration into the EU could generate short-run costs for current EU member-states, which, however, could be alleviated through the gains from international trade. Another solution would be the establishment of a compensation mechanism that would offer redistributive compensation to EU affected agricultural producers that would suffer significant losses as a result of Ukrainian accession to the EU, provided the evidence of losses is technically sound and causality to the Ukraine’s accession is technically established. Furthermore, an agreement could also be made that would restrict Ukrainian position in the internal market while allowing Ukraine to draw compensatory profits from the world economy (a two-tier system).

Figure 5 Trends in agricultural output, inputs and total factor productivity (TFP) in Ukraine and other selected European countries



Source: own presentation using the USDA ERS data on International Agricultural Productivity data product

7 Further Discussion

Despite the full-scale invasion by Russia in 2022, Ukraine's commitment to EU integration only strengthened, culminating in candidate status and the start of accession talks. Economic ties between the EU and Ukraine have also strengthened, with the EU now being Ukraine's largest trading partner and total trade reaching €61.9 billion in 2023.

Recent agricultural trade tensions with the EU neighboring countries and ongoing discussions suggest that Ukraine's accession journey will be challenging. On the one hand the adoption and implementation of the EU agricultural acquis and CAP will require substantial efforts by the government of Ukraine. The private sector will also face additional compliance costs to comply with the EU agricultural acquis. On the other hand, concerns over competition from highly competitive Ukraine's agriculture sector develop within the EU and farmers and their associations push in Brussels for additional trade restrictions with Ukraine.

How will all these complex and interrelated challenges in the face of the EU membership affect Ukraine's agricultural competitiveness? Ukraine has traditionally been highly competitive in major staple foods (grains and oilseeds), establishing itself as one of the key global agricultural suppliers. Other products that have gained international competitiveness include poultry meat and sugar. From both Ukraine's and a global food security perspective, it is important that Ukraine, even as an EU member, continues maintaining its competitiveness and supporting its post-war recovery and increasingly contributing to feeding a growing global population. In particular, we examined how the following elements of EU accession/membership might affect Ukraine's agricultural competitiveness:

1) Trade regime with the EU. As it is unlikely for Ukraine to expect a surge in trade barriers with the EU, and a negative impact on Ukraine's agricultural competitiveness as a result. But still, it is important for maintaining Ukraine's agricultural competitiveness to advocate for a fully liberalized trade regime with the EU.

2) Implication of a more complex and demanding EU agricultural acquis and CAP for public institutions and possible bottleneck for Ukraine's agricultural competitiveness. Ukraine's preparations for EU accession will require substantial additional public investments in the competent authorities and their capacities to implement and enforce the EU agricultural acquis. Failure to do so is expected to negatively impact agricultural competitiveness of Ukraine and delay the whole accession for Ukraine.

3) Implications of a complex and demanding EU agricultural acquis and CAP for private sector: additional compliance costs and agricultural competitiveness. We expect that Ukraine farmers might face additionally up to 10% (differentiated across the sectors) costs increase due to more stringent EU regulations. This is certainly not a critical and should not ruin Ukraine's comparative advantage in agriculture. Moreover, there is an evidence that Ukrainian farmers can their output and simultaneously contract harmful environmental impact, thus potentially compensating for the additional compliance costs

4) Expected EU CAP transfers and agricultural competitiveness. Ukraine as a candidate country can expect 10 to 14 billion Euros of budgetary transfers under the CAP and under the existing rules and policies. This implies a substantial additional fiscal pressure on the CAP budget that has been politically downscaled over the past. So additional spending on the EU CAP literally implies that the existing EU members should be ready to get less generous agricultural transfers from the EU and most likely this will not be politically acceptable, unless the existing CAP allocation rules and policies are changed. Most likely, from a political economy perspective, Ukraine will have to come up with a politically acceptable compromise on subsidies to proceed with accession talks, possibly even making some concessions. This is not necessarily a downside, as the CAP support not necessarily contribute to productivity and competitiveness growth.

Ukraine's accession to the EU will have not only significant political implications for European identity, but also key economic and in particular trade and food security implications. While a deal between Ukraine and the EU on the share of CAP transfers and the strengthening of the EU as a global grain power is possible, one should not underestimate domestic challenges and

supranational policy necessities to reach an agreement on the redesign of CAP and the redeployment of the EU in global food security chains against Russia.

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