



EU-Ukraine Trade in commodities under the DCFTA: current state and potential for liberalisation

Svitlana Taran, Oleksandr Shepotylo, Pavlo Iavorskyi,
Yevheniia Bondarenko

January 2022

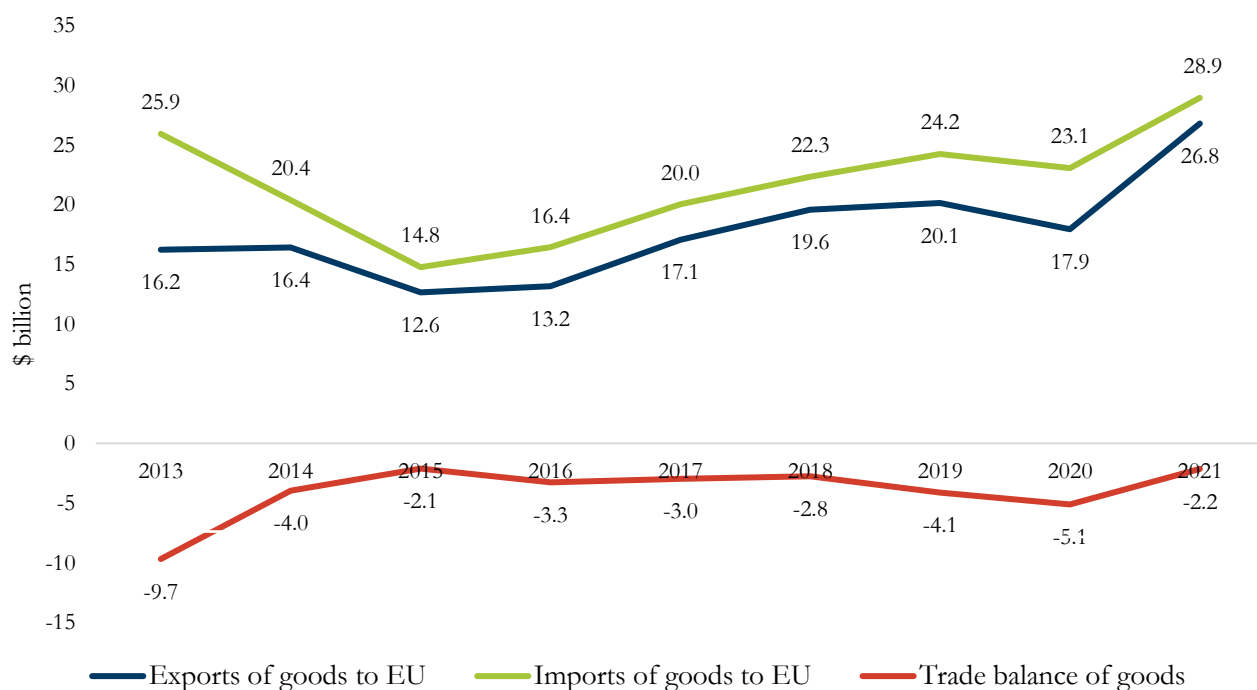
Executive summary

The Deep and Comprehensive Free Trade Agreement (hereinafter the DCFTA), concluded as part of the Association Agreement between Ukraine and the European Union (hereinafter the EU) and entered into force on 1 January 2016, has abolished most import duties, making it easier for Ukrainian firms and consumers to exchange goods and services with EU firms and consumers.

The DCFTA had a positive impact on the dynamics of EU-Ukraine bilateral trade in goods and contributed to the resumption of Ukraine's overall trade after the 2014-2015 crisis. With the entry into force of the DCFTA, the volume of EU-Ukraine trade in goods began to recover and in 2021 the volume of trade in goods with the EU-27 reached record levels for the entire period of cooperation – \$55.7 billion, which is 32.2% higher than the pre-crisis level of 2013.

Also, the deficit of trade in goods with the EU-27 has also been reduced compared to the pre-crisis level. During 2016-2019, the trade deficit with the EU-27 remained \$3.3 billion on average, while in 2013, it amounted \$9.7 billion. This reduction was due to primarily the expansion of Ukraine's exports of goods to the EU. In 2021, the deficit of trade in goods with the EU-27 has decreased even more – to \$2.2 billion.

Figure 1. Ukraine's exports and imports* of goods to the EU-27 during 2013-2021, \$ billion



Source: State Statistics Service of Ukraine

* Note: Exports and imports do not take into account the temporarily occupied territories of the Autonomous Republic of Crimea and the city of Sevastopol.

With the entry into force of DCFTA, the growth of Ukraine's exports of goods to the EU-27 resumed, with the average annual growth rate of 14.8% during 2016-2019. Overall, exports of goods to the EU-27 increased by 59.1% (+\$7.5 billion) in 2019 as compared to 2015 (before the DCFTA) and by 24% (+\$3.9 billion) as compared to the pre-crisis 2013. Imports of goods from the EU also recovered rapidly - the average annual growth of imports of goods to Ukraine from the EU was 16.1% during

2016-2019. In general, in 2019, import of goods from the EU-27 increased by 64.2% (+\$9.5 billion) as compared to 2015, but was still lower by 6.5% (-\$1.7 billion) from the pre-crisis level of 2013.

In 2020, due to the economic downturn and declining demand amid a global pandemic, EU-Ukraine trade declined. Ukraine's exports of goods to the EU-27 fell by 10.9%, imports of goods from the EU-27 decreased by 4.9%. Instead, in 2021, due to surging demand and prices in the world markets, EU-Ukraine trade in goods resumed in both export and import operations, with export growth surpassing significantly import growth. In 2021, exports of goods to the EU-27 increased by 49.4% compared to the previous year and reached \$26.8 billion, imports of goods from the EU-27 increased by 25.2% and reached \$28.9 billion.

If compared with 2013, exports of goods to the EU-27 exceeded the pre-crisis level by almost 65.3% (+\$10.6 billion) in 2021, and the corresponding increase in imports of goods from the EU-27 was much lower - by 11.7% (+\$3 billion).

During the Ukraine-EU DCFTA, the growth rate of Ukraine's exports of goods to the EU was higher than the growth rate of Ukraine's exports to the rest of the world. As of 2021, exports of goods to the rest of the world (excluding Russia) exceeded the 2013 pre-crisis level by 21.1%, while to the EU - by 65.3%. **Imports of goods from the rest of the world (excluding Russia), on the other hand, were characterized by a faster growth compared to imports from EU-27.** As of 2021, imports of goods from the rest of the world (excluding Russia) exceeded the 2013 pre-crisis level by 40.9%, while from the EU - by 11.7%.

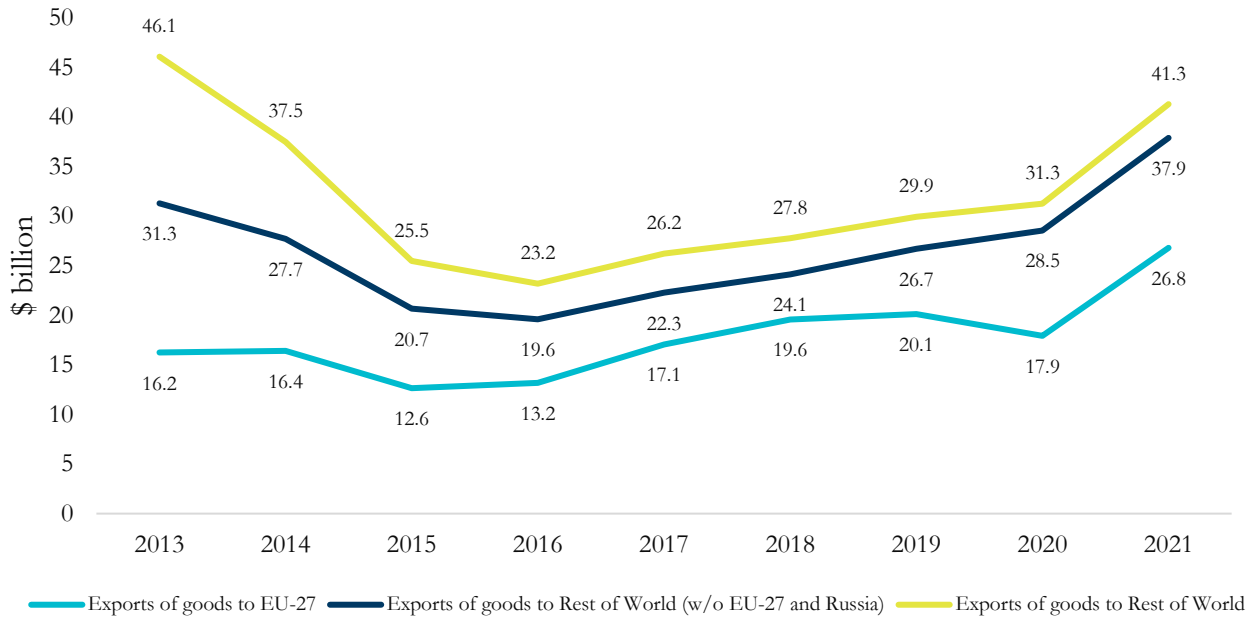
Table 1. Ukraine's trade in goods dynamics* with EU-27, Russia and the Rest of World in 2013-2021

	Volume 2013, \$ billion	Volume 2019, \$ billion	Volume 2021, \$ billion	Growth 2019 vs 2013, \$ billion	Growth 2019 vs 2013, %	Growth 2021 vs 2013, \$ billion	Growth 2021 vs 2013, %
Exports of goods							
Total exports of goods	62,3	50,1	68,1	-12,3	-19,7%	5,8	9,3%
Exports to EU-27	16,2	20,1	26,8	3,9	24,0%	10,6	65,3%
Exports to the Rest of World (w/o EU-27 and Russia)	31,3	26,7	37,9	-4,6	-14,7%	6,6	21,1%
Exports to Russia	14,8	3,2	3,4	-11,6	-78,1%	-11,4	-76,9%
Imports of goods							
Total imports of goods	75,8	60,8	72,8	-15,0	-19,8%	-3,0	-4,0%
Imports from EU-27	25,9	24,2	28,9	-1,7	-6,5%	3,0	11,7%
Imports from Rest of World (w/o EU-27 and Russia)	26,8	29,6	37,8	2,8	10,3%	11,0	40,9%
Imports from Russia	23,1	7,0	6,1	-16,1	-69,8%	-17,0	-73,7%

Source: State Statistics Service of Ukraine

** Note: Exports and imports do not take into account the temporarily occupied territories of the Autonomous Republic of Crimea and the city of Sevastopol.*

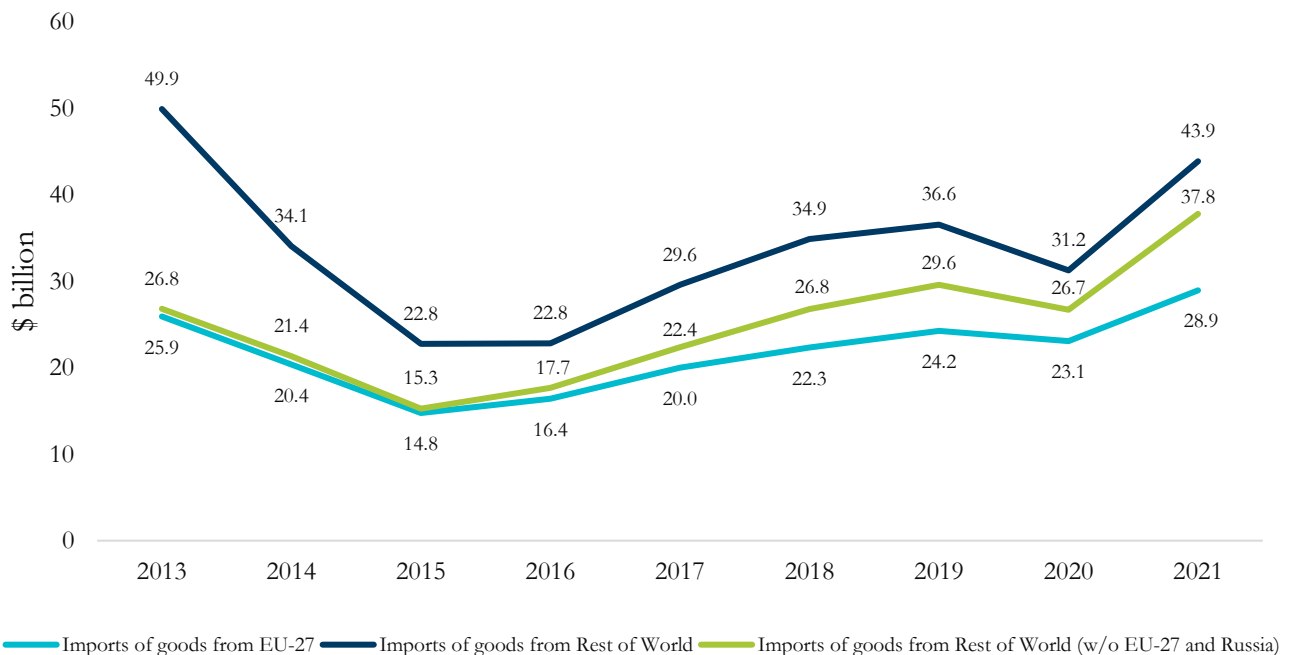
Figure 2. Ukraine's exports of goods to EU-27 and Rest of the World during 2013-2021, \$ billion



Source: State Statistics Service of Ukraine

* Note: Exports and imports do not take into account the temporarily occupied territories of the Autonomous Republic of Crimea and the city of Sevastopol.

Figure 3. Ukraine's imports of goods from EU-27 and Rest of the World during 2013-2021, \$ billion

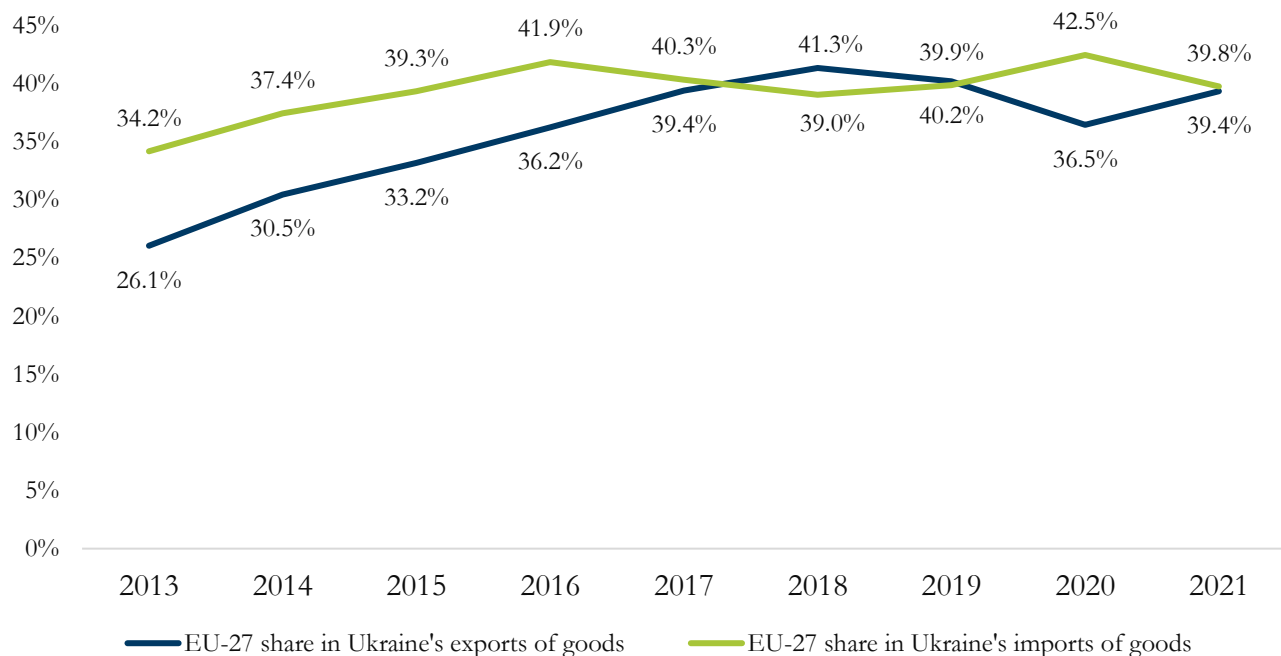


Source: State Statistics Service of Ukraine

* Note: Exports and imports do not take into account the temporarily occupied territories of the Autonomous Republic of Crimea and the city of Sevastopol.

As a result of the market access liberalization under the DCFTA and Ukraine's trade reorientation, the EU's share in Ukraine's exports and imports of goods has increased significantly. The share of the EU-27 in total Ukraine's exports of goods averaged 29.9% in 2013-2015 and 38.7% in 2019-2021. The share of the EU-27 in total Ukraine's imports of goods averaged 37% in 2013-2015 and 40.7% in 2019-2021.

Figure 4. EU-27 share in Ukraine's trade in goods during 2013-2021, %



Source: State Statistics Service of Ukraine

Under the framework of the DCFTA, Ukraine's exports to the EU have become more diversified and less concentrated. In 2021 as compared to the pre-crisis 2013 period, Ukraine's exports of all broad commodity groups to the EU-27 observed growth. At the same time, growth rates of exports of those sectors differed (see Figure 5):

- Metals and articles thereof (+\$1.95 billion, +44% 2021 vs 2013).
- Animal or vegetable fats and oils (in particular, sunflower oil) (+\$1.92 billion, +434%).
- Machinery, electrical equipment, apparatus (electrical cable and wire products, household appliances, etc.) (+\$1.31 billion, +68%).
- Vegetables and animal products (cereals, poultry, honey, eggs, dairy products, fruits and nuts, etc) (+\$1.11 billion, +36%).
- Mineral products (iron ore, etc) (+\$1,03 billion, +36%).
- Wood and articles of wood, paper (+\$0,95 billion, +141%).
- Other manufactured articles, including furniture, toys, etc. (+\$0,84 billion, +428%).
- Foodstuffs, beverages, tobacco (+\$0,34 billion, +47%).
- Plastics, rubber and articles thereof (+\$0,33 billion, +356%).
- Articles of stone, ceramics, glass (+\$0,27 billion, +436%).
- Products of chemical industry (organic chemicals, fertilizers) (+\$0,26 billion, +38%).
- Articles of the light industry (+\$0,17 billion, +22%).

- Vehicles, aircraft, vessels and transport equipment (mostly, vessels) (+\$0,07 billion, +37%).

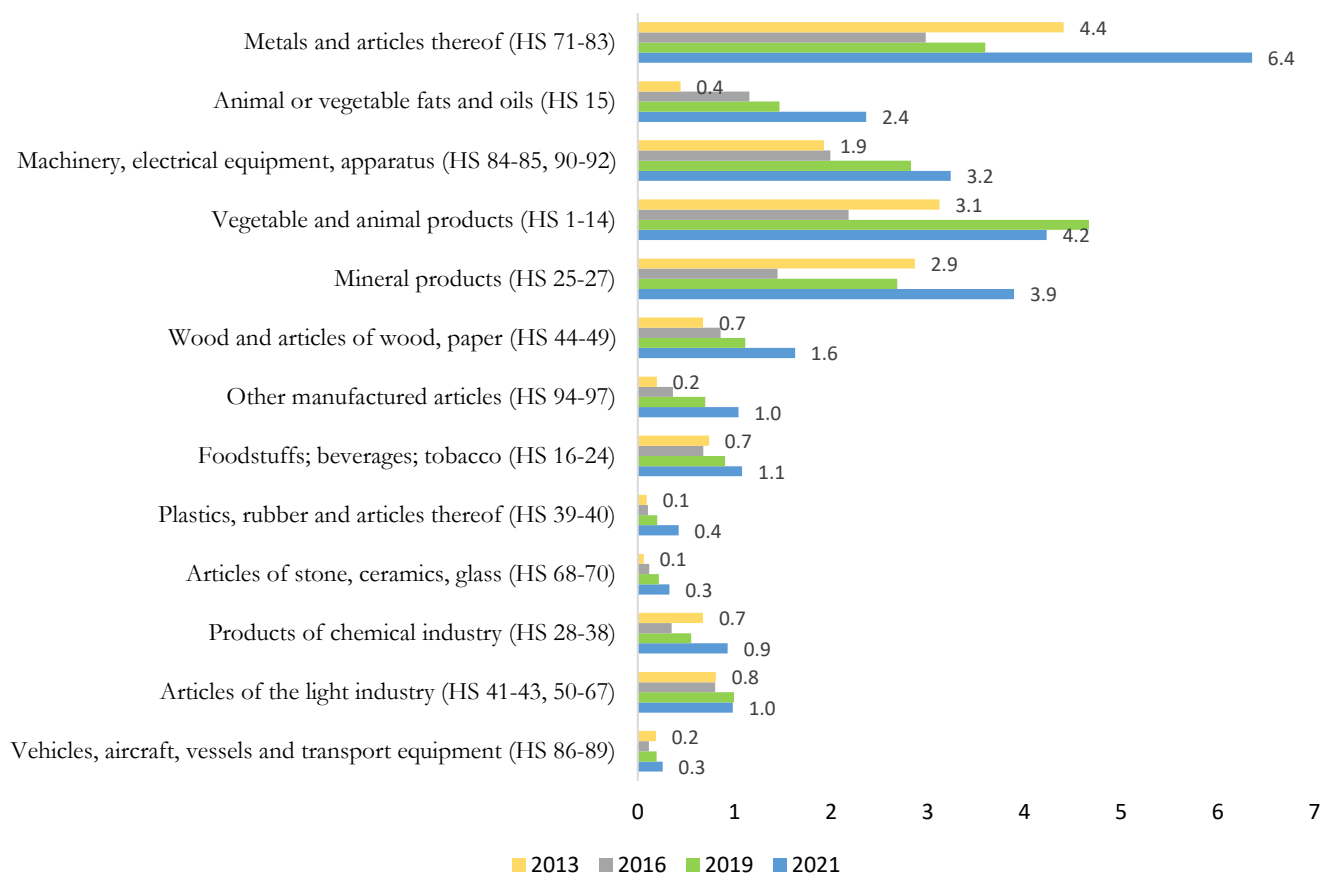
As a result, shares of these sectors in **Ukraine's exports to the EU-27 have enhanced** (2021 vs 2013):

- Animal or vegetable fats and oils - from 2.7% in 2013 to 8.8% in 2021.
- Wood and articles of wood, paper – from 4.2% to 6.1%.
- Plastics, rubber and articles thereof – from 0.6% to 1.6%.
- Other manufactured articles (furniture, toys, etc) – from 1.2% to 3.9%.
- Articles of stone, ceramics, glass – from 0.4% to 1.2%.
- Machinery, electrical equipment, apparatus - from 11,9% to 12,1%.

At the same time, the role of the following commodities **in Ukraine's exports to the EU-27 has declined**:

- Metallurgical products - from 27.2% in 2013 to 23.7% in 2021.
- Mineral products – from 17.7% to 14.5%.
- Vegetables and animal products – from 19.2% to 15.8%.
- Chemical products – from 4.2% to 3.5%.
- Articles of the light industry - from 5% to 3,7%.

Figure 5. Dynamics of Ukraine's exports of goods to the EU-27 in 2013, 2016, 2019, 2021, in \$ billion



Source: State Statistics Service of Ukraine

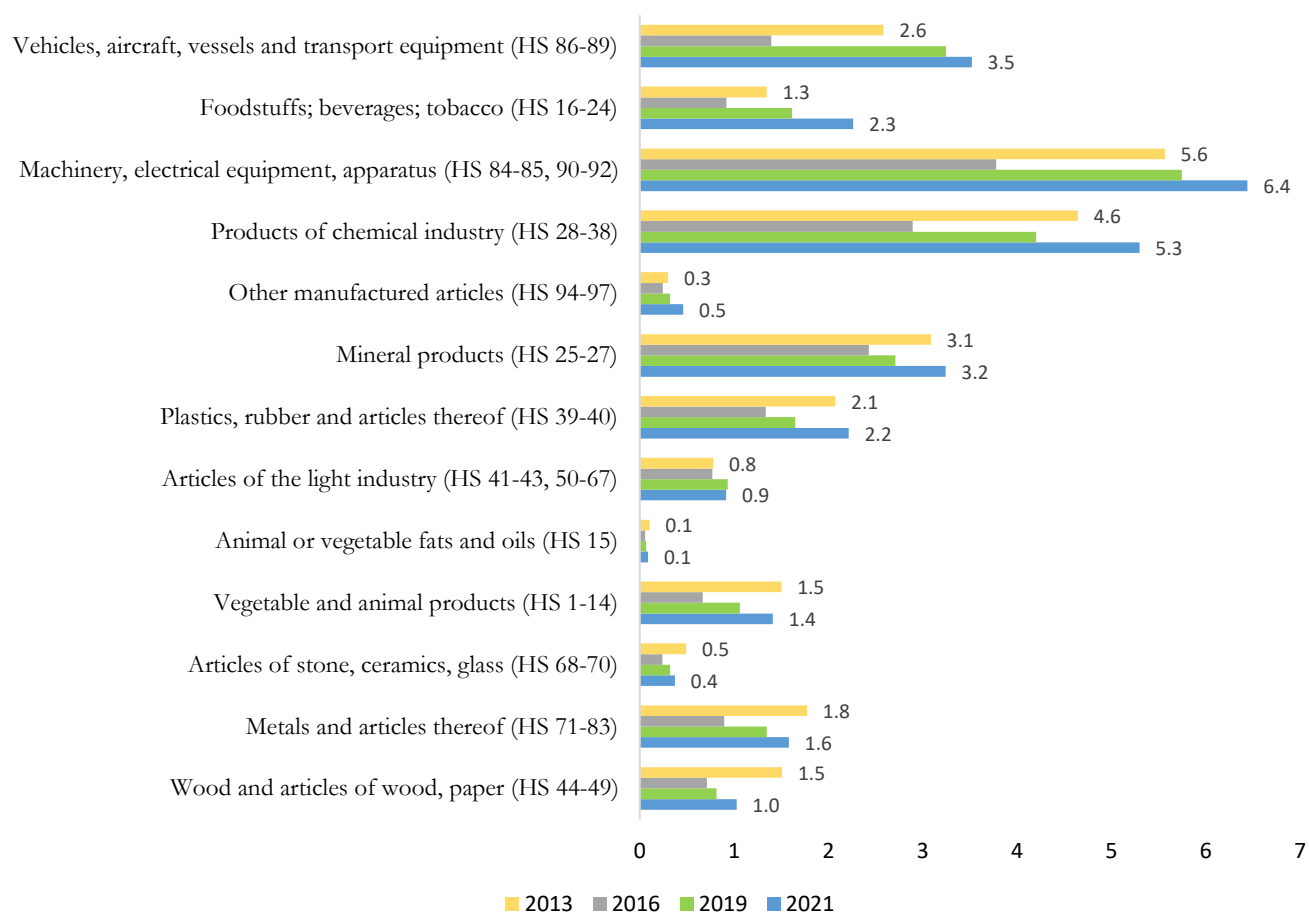
* Note: Sectors are ranked in descending order of the absolute difference between exports in 2021 and 2013

Product structure development of Ukraine’s imports from the EU under the framework of the DCFTA. In 2021 vs 2013, the following Ukraine’s imports from the EU-27 revealed growth (see Figure 6):

- Vehicles, aircraft, vessels and transport equipment (+\$0.94 billion, +36.2%).
- Foodstuffs; beverages; tobacco (+\$0.92 billion, +68%),
- Machinery, electrical equipment, apparatus (+\$0.88 billion, +16%).
- Products of the chemical or allied industries (+\$0.65 billion, +14%).
- Other manufactured articles (+\$0,16 billion, +53%).
- Mineral products (+\$0,15 billion, +5%).
- Plastics, rubber and articles thereof (+\$0,14 billion, +7%).
- Articles of the light industry (+\$0,14 billion, +18%).

At the same time, imports of some categories declined in 2021 vs 2013, such as wood and articles of wood, paper, metals and articles thereof, vegetables and animal products, articles of stone, ceramics, glass.

Figure 6. Dynamics of Ukraine’s imports of goods from the EU-27 in 2013, 2016, 2019, 2021, in \$ billion



Source: State Statistics Service of Ukraine

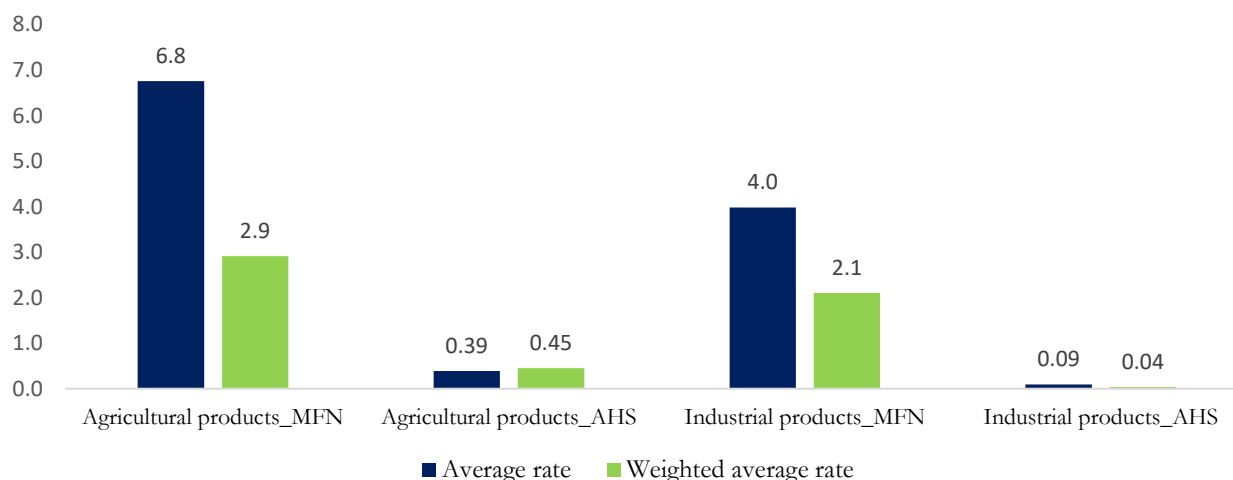
* Note: Sectors are ranked in descending order of the absolute difference between imports in 2021 and 2013

Within the framework of the DCFTA, the importance of the EU market for many positions of Ukraine’s exports has been growing, as well as the role of Ukrainian products in total supplies to the EU. The EU is a key destination market with a share of over 75% for Ukrainian exports of honey, electro cables, light industry products, household appliances, sports equipment, furniture and more. At the same time, Ukraine occupies a significant position in supplies to the EU of sunflower oil, cereals (corn, barley, wheat), honey, ferrous metals, casein, sanitary towels, processed tomatoes, organic products and more.

The EU-Ukraine Association Agreement / the DCFTA abolished most EU import duties for Ukraine, making it easier for Ukrainian companies and consumers to exchange goods and related services with EU companies and consumers. According to the WTO, 89% of EU tariff lines became duty-free for imports from Ukraine in 2014 - about 25% of the EU's lines were already duty free on an MFN basis, and 64% were abolished by the EU on April 23, 2014¹ (as Autonomous Trade Preferences (ATP) for Ukraine). According to the DCFTA tariff schedules, the liberalization process under DCFTA should be completed by 2023 for the EU and by 2026 for Ukraine. By 2023, in general, about 95.8% of EU tariff lines will become duty free for products originated from Ukraine.

Tariff liberalization under the DCFTA has significantly reduced tariff barriers in the EU market for the majority of Ukrainian goods (Figure 7). Ukrainian goods have gained market access advantages in the EU market compared to other countries, which do not have preferential trade agreements with the EU and which are subject to Most-favored nation import duties (MFN). However, as of the end of 2021, a number of sensitive goods still remained protected by EU import tariffs and tariff rate quotas (TRQ), such as certain agricultural products, foodstuffs, vehicles, fertilizers, electrical equipment.

Figure 7. EU average import duties for goods from Ukraine: affectively applied tariffs (AHS)* vs MFN rates, as of 2020



Source: WTTs, TRAINS.

* Note: AHS - Effectively applied tariffs are defined as the lowest available rates and take into account preferential duties. MFN - Most-favoured nation tariffs

The EU applies TRQs for 36 groups of agro-food products from Ukraine (plus 4 additional TRQs), these products include corn, wheat, cereals, honey, butter, sugar, poultry, processed tomatoes, apple juice, etc.

¹ <https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/REG/353-1.pdf&Open=True>

Ukraine applies 3 main TRQs (plus 2 additional TRQs) for pork, poultry and sugar. Current TRQ volumes are rather low and are based on outdated statistics on Ukraine-EU trade flows, as it has been 10 years since the DCFTA negotiations. In general, Ukrainian exporters utilised 31-32 TRQs during the last years, from which the following TRQs were usually fully exhausted: honey; processed tomatoes; apple and grape juices; barley groats, processed grain and flour; sugar; starch; processed starch; eggs (main); corn, corn flour and pellets; poultry meat (main); malt-starch processed products; cereal processed products. For most fully exhausted DCFTA TRQs, Ukraine's total exports of the covered products exceeded TRQ volumes (subject to EU tariff rates). For example, annual EU TRQ for honey is 6 thousand tonnes, while Ukraine's total exports of honey to EU was more than 50 thousand tonnes in 2020. This quota is exhausted during the first days of the year, and for over-quota supplies Ukrainian exporters have to pay an import duty of 17.3%. The EU import duty above the TRQ for apple juice is 18%, processed tomatoes - 14.4%, etc.

Non-tariff measures (NTMs) remain a major barrier for Ukrainian companies to access the EU market. Although they play an important role in ensuring the health and safety of goods and generally increase consumer welfare, they also may create significant barriers and can be used in a discriminatory and unfair manner. As a result, non-tariff measures can lead to a loss of welfare for producers and consumers in the EU and Ukraine. In general, Ukraine's exports of goods to the EU are most affected by TBT measures (technical barriers to trade) and SPS (sanitary and phytosanitary measures), as well as non-automatic licensing measures, quotas and quantitative measures.

We also analyzed the impact of EU tariff and non-tariff measures on the intensity of EU trade, focusing on EU-Ukraine trade and by using the gravity model of international trade. The analysis also assesses the impact of further liberalisation of trade between Ukraine and the EU on welfare as a result of lower trade costs associated with the application of non-tariff measures. Five scenarios for trade liberalisation with the EU have been considered. Scenario 1 envisages that all import duties between the EU and Ukraine will be abolished. Scenario 2 models Ukraine's full integration and accession to the EU. Scenarios 3-5 consider different levels of Ukraine's regulatory approximation, leading to different levels of reduction of EU non-tariff barriers for Ukraine. Scenario 3 envisages a 25% reduction in NTMs for EU imports from Ukraine. Scenario 4 envisages a 50% reduction in non-tariff barriers on EU imports from Ukraine. Scenario 5 envisages full regulatory harmonization and removal of non-tariff barriers to bilateral trade with the EU, but without Ukraine's accession to the EU.

Ad valorem equivalents of non-tariff measures were estimated as part of the analysis. According to our estimates, the total sum of all ad valorem equivalents (AVE) of NTMs rates of the EU equals 38.8%, with Technical barriers to trade (TBT) accounting for 22.3%, Licensing adding 10.8%, Sanitary and phytosanitary measures (SPS) 5.5% and Inspections 0.4%. Across products, live animals, plastic, rubber and articles thereof, and paper and paperboard products have the highest levels of protection. Highest SPS are recorded for live animals. TBTs have high NTM rates for plastic and rubber, machinery, mechanical appliances and electric equipment, and precision and medical instruments. Licensing is most protective for live animals, vegetables, food products, and chemical products. This level of protection constitutes considerable trade barriers, especially as compared with the tariff rates.

Based on the analysis of the impact of NTMs on EU trade, the following conclusions can be made:

- **Non-tariff measures of all types constitute significant barriers to trade with the EU.** According to our estimates, 1% increase in AVE SPS (sanitary and phytosanitary measures) is associated with 1.166% decline in the value of import, 1% increase in AVE TBT (technical barriers to trade) with 1.058% decline, 1% increase in Pre-shipment inspections and other formalities with 2.871% decline, and 1% increase in AVE Non-automatic licensing, quotas, prohibitions and quantitative measures with 1.166% decline.

- **Intra-EU trade is much less affected by non-tariff measures.** This means that EU members face systematically lower trade barriers than non-EU countries and have higher level of bilateral trade.
- **Regulatory convergence and further mutual recognition of NTMs between Ukraine and the EU (Scenarios 3-5) is expected to increase EU imports from Ukraine by 4.3% -17.2%.** Ukraine's full EU membership (Scenario 2) will bring the strongest growth of 40% in Ukraine's supplies of goods to the EU, with large variation in growth rates across the EU countries. Elimination of the applied tariffs (Scenario 1), on the other hand, would only increase EU trade flows from Ukraine by 0.5%. The regulatory approximation of the NTMs by Ukraine (Scenarios 3-5) would generate 4.3%-17.2% increase in Ukraine's supplies to the EU.

The simulation results confirm therefore that the higher the level of Ukraine's regulatory approximation and harmonization of NTMs with the EU, the greater the benefits of increased supplies to the EU. To improve the DCFTA effectiveness and increase EU-Ukraine trade potential, it is recommended to focus on reducing the remaining most significant non-tariff barriers within the DCFTA by stepping up Ukraine's efforts on legal and regulatory approximation to EU standards.

Recommendations. In 2021, Ukraine and EU initiated negotiations to further liberalise bilateral trade in goods under DCFTA in accordance with Article 29 (4) of the Association Agreement. The major recommendations for Ukraine's position on upgrading the Association Agreement in accordance with Article 29 include:

- Further liberalisation of bilateral trade in goods with the EU for increasing duty-free and quota-free trade (elimination of remaining import duties, review of tariff rate quotas TRQs), in accordance with Ukraine's current production and export potential and demand in the EU.
- Increasing duty-free access for Ukrainian processed and value-added products to promote their exports to the EU. Modifying the structure of some tariff rate quotas in order to increase and ensure access for such products.
- Supporting the participation of SMEs in trade with the EU - increasing access to the EU market for goods, in the production of which a significant number of SMEs are involved.
- Increasing Ukraine's participation in EU regional value chains, reducing and bringing supply chains closer to EU borders.
- Increasing access for organic exports from Ukraine to the EU for the development of regional production chains of organic products between countries, promoting the development of organic production in Ukraine in the framework of Ukraine's participation in the EU Green Deal.

In order to reduce non-tariff barriers and improve the implementation of the DCFTA, the following main steps are proposed:

- Conclude the Agreement on Conformity Assessment and Acceptance of Industrial Products (the ACAA) in the first three priority sectors (Article 57 of the Association Agreement).
- Accelerate the process of recognizing the equivalence of sanitary and phytosanitary measures (SPS) in order to open markets and facilitate exports for food and agricultural products (Article 66).
- Ukraine's accession to the EU common transit system and mutual recognition of the status of authorized economic operators to simplify customs procedures and formalities with the EU (Article 76).

- Further liberalisation of trade in services and removal of obstacles to business establishment and cross-border supply of services (Articles 89 and 96).
- Concluding special road, rail and inland waterways transport agreements with the EU to liberalise mutual market access in these transport sectors (Article 136). The priority is to resolve the issue of deregulation and liberalisation of road freight transport between the EU and Ukraine, first of all, for transit purposes.
- Gradual mutual opening of public procurement markets based on EU decision on compliance of Ukrainian legislation with the EU legislation (Article 153).

This report is prepared within the framework of the core support programme to KSE Institute, enabled by the financial support from Sweden.

Views, conclusions or recommendations belong to the authors and compilers of this publication and do not necessarily reflect the official position of the Government of Sweden. The responsibility over the content lies solely with authors and compilers of this publication.