



Agri-Food Past, Present & Future Report

Ukraine

November 2006



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Ukraine

Past Present & Future Report November 2006

Overview

Ukraine is an emerging market with considerable potential. Low labour and energy costs coupled with its proximity to the EU have made it an attractive destination for industry and investment.

After years of unpopular yet necessary political and economic reforms, Ukraine is beginning to experience the economic benefits of its struggle. Ukraine has all of the tools to become a very strong and dominant economy in the region, including rich farmlands, abundant natural resources, a well-developed industrial base, highly trained labour, excellent port facilities, and a good education system. While fundamental problems still exist throughout the Ukraine, the country's focus on entry into the WTO and future hopes of EU membership all bode well for the future.

- Recent economic growth has outpaced both India and China
- 2005 marked the beginning of accelerated growth in a number of key areas over 2004 (Foreign Investment 50%, Consumer spending 20%, Retail food sales 40%)

Canada - Ukraine Relations

Canada and Ukraine enjoy close relations, based on a historic foundation of over one hundred years of Ukrainian migration to Canada. More recent relations have been framed by Canada's early recognition of Ukraine's independence. Since then, Canada and Ukraine have signed a variety of agreements and memoranda of understanding covering such areas as trade and commerce, technical cooperation, defence and mutual legal assistance.

Canada and Ukraine have issued a declaration on the "Special Partnership" which recognizes Canada's support for the development of an independent and prosperous Ukraine. An update of this declaration was issued in December 2001.

An Intergovernmental Economic Commission (IEC) was established in 1994. The IEC exists to build Canada-Ukraine business relationships and seek ways to overcome obstacles to bilateral trade and investment. The IEC relies heavily on the involvement of the Canadian business community through working groups, including an agriculture working group.

The Canadian International Development Agency (CIDA) lists Ukraine as a priority partner country and provides assistance to the country through a technical cooperation program. Canada also signed a Double Taxation, Foreign Investment Protection and Economic Cooperation agreements with Ukraine.

Since 2001, Canada's trade total with the Ukraine has more than doubled to reach \$388 million. Canada maintains a considerable negative trade balance with the Ukraine. While Canada's exports have grown slowly, imports from the Ukraine have risen from roughly \$50 million in 2001 to almost \$300 million in 2005.

Canada-Ukraine Bilateral Trade 2005	
Ukraine Total Trade	
Exports	US\$38.2 billion
Imports	US\$37.1 billion
Trade balance	US\$1.1 billion
Canada- Ukraine Trade	
Exports	\$81.9 million
Imports	\$296.2 million
Trade balance	(\$214.3 million)
Canada- Ukraine Ag Trade	
Exports	\$2.4 million
Imports	\$1.9 million
Trade balance	\$474,189

- In 2005, Canada's top exports to Ukraine were Machinery and electrical equipment, Animal products, chemical products, textiles and vehicles and equipment.
- In 2005, Canada's key imports from the Ukraine were mineral products, base metals and chemicals.

Agricultural Trade

The Ukrainian agricultural sector is historically one of the world's strongest. However, the sector has been plagued by inconsistent production levels, poor infrastructure and limited technology. This has meant that in the last 5 years Ukraine has imported a variety of products on a regular and as needed basis. As improvements have been made in the sector as a whole, Ukraine's immediate import needs have shifted from bulk goods to semi-processed products to meet the needs of the growing processing sector.

Ukraine imported \$3.375 billion worth of agricultural products in 2005. Imports in 2005 represented a significant increase of almost \$1 billion over 2004 when imports totaled \$2.4 billion. Food imports represent 7% of total imports. Tobacco, food preparations, palm oil, coffee extracts and bananas were the top five imports with Brazil, Germany, Malaysia and Ecuador being the largest suppliers of the top five goods.

The Ukrainian economy is heavily dependant on the agricultural sector for exports. Over the past five years the Ukraine has shifted from a net food importer to a net food exporter. In 2005, agricultural exports exceeded US\$4 billion almost doubling imports.

Canada – Ukraine Agricultural Trade

Canada's agricultural trade with Ukraine is small in comparison with total trade; however, Canada has maintained a positive trade balance with Ukraine since 2003. Historically, since 2000 Canada's agricultural exports to Ukraine have remained fairly constant between a low of \$2.4 million and a high of \$4.2 million. There was one notable exception in 2003 when export totals reached \$28 million. This anomaly was due to a one time \$27 million shipment of wheat.

Canada exported roughly \$2.4 million worth of agricultural goods to the Ukraine in 2005, a decrease from exports of \$3.4 million in 2004. This decrease was due almost entirely to a decrease in exports of chicken and capon cuts. In 2004 Canada exported over 2.2 million in chicken and capon cuts while in 2005 that number fell to

\$144,000. Additionally, chicken and capon cut exports in 2004 were very large in comparison with other years and 2006 exports of this product seem to be in line with historical averages.

Despite a decline in total exports there were positives. Exports of animal products reached over \$750,000 in 2005 from zero in 2003 and 2002, and all indications at the half way point of 2006 suggest that full year totals will reach or exceeding that number. Exports of food preparations have doubled in each of the last 3 years to reach \$200,000 in 2005. Dog and cat food exports continue to be strong and exports in the first half of 2006 have already reached 2005 totals. Finally, exports of Bovine semen continue to grow and 2006 appears to be continuing the trend of year-on-year growth.

Canada's Agri-Food exports to the Ukraine in 2005 were dominated by Animal products nes (\$753,918), Pet food (\$495,342), furskins (\$425,458), food preparations (\$201,545), frozen chicken and capon cuts, (\$144,462) and animal products nes (\$105,462). All of these products, with the exception of Chicken and capon cuts represented a significant increase over 2004 totals.

- Canada did not export any bulk products to Ukraine in 2005, but total for 2006 have already reached \$420,506
- Canada exported \$1.4 million worth of intermediate goods in 2005 a \$1.1 million increase over 2004. Totals for 2006 have already exceeded \$1 million.
- Exports of consumer products fell significantly in 2005 from 2004 totals reaching \$1 million, down from \$3 million.

Canada's agri-food imports from Ukraine in 2005 were valued at \$1.9 million, a decrease of over 9%, \$200,000 from 2004. Imports were dominated by beverages (\$708,000) and preparations of vegetables (\$392,000). Beer and vodka represented over 25% of Canada's total imports from the Ukraine in 2005.

Complete Statistical Summary Available:
http://www.ats.agr.gc.ca/stats/ukraine_e.pdf

Economy

The past six years have been a relatively stable period for the Ukraine economy. GDP growth rates have maintained positive levels, eclipsing rates of Both China and India at certain points and per capita income has increased accordingly.

In 2005, the country experienced an economic slowdown that saw GDP growth fall from average levels of 8% to 2.5%. That rate has continued for most of 2006. The fall in GDP growth has been attributed to a contraction in the retail and construction sectors. However, a turnaround has been forecast for 2007 which will continue through 2008 with growth expected to return to levels above 6%.

Ukraine is heavily reliant on the import of energy. Imports are estimated to meet over 80% of national requirements. This is a major issue for the future of the economy. Russia is the Ukraine's major supplier of energy (Natural gas) and past disputes have led to a "cutting" of supply. A new deal to avoid a reoccurrence was reached between Russia and the Ukraine in 2006 to ensure a constant supply, but that deal has doubled the cost of natural gas for Ukraine. Experts are unsure on the severity of this deal on the Ukraine economy.

The Russian relationship continues to be strained, but the government has been working to improve relations. Attempts at improving the situation include a number of somewhat controversial appointments of pro-Russia ministers.

Despite these moves, the Ukraine continues to look west to Europe for its future and the EU has now displaced Russia as the countries most important trade partner, although Russia maintains its status as the most important single partner. Foreign policy, political strategies and future aspirations all surround drawing closer to its European neighbors.

Gross Domestic Product (2005)	
GDP	US\$84 billion
GDP growth	(2006) 2.3% (2007e) 6%
GDP/ capita	US\$1,700
GDP/ capita (PPP)	US\$7,200

Current:

- GDP growth continued to be below average in 2006.
- Privatization is still behind schedule but is growing providing much needed capital to the government.
- The grey market economy is estimated to be worth as much as

60% of the official economy.

- Steps have been made to limit the size of the grey market economy, by promoting business and increasing access to development capital.
- Due to slowing reforms and dependence on foreign energy most believe the Ukraine economy is still susceptible to external shocks.
- 2005 marked a watershed of sorts for foreign investment in the country as totals for the year equaled those of the combined 2001-2004 period.

Forecast:

- Inflation is expected to reach 10% in 2007
- Strong GDP growth is expected for 2007 and 2008 with levels above 6%.
- The national budget for 2007 has many expecting an increase in government spending to assist in growth sustainability.
- Grey market/ghost market will continue to be a major factor in the overall Ukraine economy. Some experts suggest that this market exists out of necessity as infrastructure is not in place to provide the necessary in puts to encourage the legal economy required for a country of this size.
- Foreign Direct Investment will continue to lag behind that of neighboring countries due to a lack of transparency in the business sector.

Promising Regions

Despite improvements to the economy as a whole, there continue to be significant regional differences as well as issues between urban and rural areas.

Kiev has a population of 2.6 million and is a major industrial centre that includes companies specializing in electronics, engineering, aviation, food and chemical production. It is situated on the banks of the Dnipro river, which has enriched its economic development linking the city to the Black Sea.

Eastern coastal ports are located in Berdyans and Mariupol along the Sea of Azov. Southern coastal ports are located in Illichevsk, Izmayil, Kherson, Mykolayiv, Odessa

and Sevastopol along the Black Sea. Kerch is a coastal port located between the Sea of Azov and Black Sea. Kiev is the only city with an inland port.

Odessa is the regional centre and has a sea port located on the south-western shore of the Black Sea, 490 km south of Kiev. It is one of the largest cities in Ukraine and serves as the southern gateway of the country. It is an important industrial, scientific, cultural, and resort centre, with a population of 1.1 million. Odessa is also an important cultural centre. Its major rivers are the Danube, Dnister, and the Southern Buh.

The Donetsk region is situated in the south-eastern part of Ukraine. The capital of the region is Donetsk city, an important administrative, industrial, scientific and cultural centre. In the east it shares a long border with Russia, which is of great importance. In the south of the region is the Azov Sea. The sea port city of Mariupol is where the sea gates of the Donetsk basin are located. This leads to the countries of the Mediterranean, and the North and Baltic Seas. In Donetsk region, there are 5.3 million inhabitants, 10% of the Ukrainian population. This region has the lowest rate of unemployment.

Kharkiv, in eastern Ukraine, is the country's second largest city with a population of 1.6 million. Most of the region is located in the Dnipro Lowland near the Dnipro River.

Consumer Market

The Ukraine's population of 46 million makes it the second largest consumer market in Central and Eastern Europe. However, the population is aging and receding due to emigration.

The consumer market of the Ukraine is helping to drive growth domestically. Per capita income is on the rise; however, income levels are still lower than the average for most developing countries. The economic growth of the economy as a whole has definitely trickled down to the average consumer. In 2005, consumer spending increased by more than 20% over 2004, despite a slowdown in overall economic growth.

Imported processed goods are a viable option for roughly 17% to 20% of the Ukrainian population. The Ukraine boasts a rapidly developing middle class which now represents 15% of the overall population, and a wealthy or upper class that represents roughly 2% of the population.

A number of factors limit the ability of imported consumer oriented goods to succeed in this market, namely price and distribution. Income levels are increasing, but levels are still far too low in the general population to make imported processed goods a viable option. The existence of a grey market economy that challenges and may even exceed the legal economy makes reliable distribution and credible buyers more difficult to find.

On the positive side, the supermarket sector is expanding at an accelerated rate due to overwhelming consumer demand. European retail giants have entered the market and helped improve price, product availability and infrastructure through stiff competition. Imports currently make up roughly 20% of supermarket inventories.

- Per Capital GDP / GDP PPP - US\$1,700 / US\$7,100 PPP
- Over half of average household income spent on food.
- Consumers of imported and processed foods centered around urban centers, lead by Kiev which controls 20% of the Ukraine food retail market.
- Population of major cities: Kiev 2.6 million, Kharkiv 1.6 million, Dniporpetrovsk 1.1 million, Lviv 800,000
- 30% of population is rural and reliant on "hobby" farming for part of their diet.
- Open air or traditional markets are still a very important part of the retail sector, but their influence is declining rapidly.
- Supermarkets picked up an estimated 20% share of the food retail sector between 2002 and 2003 at the expense of open air markets and traditional grocers.
- Consumers under the age of 40, much more likely to experiment with diet, try new foods and buy imported products.
- Elderly consumers make up a disproportionate share of the low income group in the Ukraine.
- Health and wellness products not yet a factor in this market. Consumers are not yet concerned with nutritional labeling or claims.
- Unrecognizable ingredients or contents on the ingredients list have been listed as a concern of consumers. Additives are not looked on favourably.
- Prepared meals at home still the norm in this market.
- Convenience foods for home consumption increasing in popularity.
- Frozen food sector expanding very rapidly.

Opportunities

- Poultry, Beef, Pork - shortage of local supply in all areas, product options and quality in demand
- Seafood - rapidly expanding consumer and product base driven by growing supermarket trade
- Food ingredients - very promising sector, expanding rapidly, reliant on imports

Competitors

Roughly 50% of food imported into the Ukraine comes from Europe. Ukraine's Commonwealth of Independent States (CIS) partners have a 25% share of this market due in large part to proximity and a price advantage afforded them by a free trade agreement between members. The EU-25 has a 24% share this market, again due to proximity, history and a general perception amongst buyers that EU products are of high quality and a better value than goods from the America's. Thanks to very specific export commodities Brazil, Malaysia and Ecuador are also important international trade sources.

The largest competitor in this market is domestic production. Domestic products meet the dietary preferences of local consumers, they have a large price advantage and they are recognizable. The increasingly important older population of the Ukraine is much less likely to want or be able to change their diet and therefore limits the influence of imports in the market.

Access Issues

Overview

- Import duty rates are very uneven, but provide some attractive options. Prepackaged processed goods face very high import duties while unprocessed goods or goods in bulk packages face little to no import duty. Many companies have begun taking advantage of this and have done minimal product finishing in market to avoid duty.
- Processed products will be subject to supermarket entry costs which vary in frequency depending on the retailer, and are negotiable.
- Distribution headquarters are located primarily in Kiev or the port of Odessa.
- Food retail outlets are on the decline, but square footage is on the increase. Supermarkets and hypermarkets are pushing small shops out of the market.
- Variety of non-tariff barriers have added to the cost of imported products.
- Transparency is an issue across the country and sector wide particularly affecting customs clearance rules.
- Local laws and regulations have been called "vague" and "open to interpretation" by a number of international competitors.
- The Ukraine is not a member of the WTO and does not notify its members of changes to regulatory and access requirements.
- Imported processed goods subject to a 20% VAT

Business Travel Tips

- One of the key issues surrounding imported food goods from the America's has been access to the seller. Ukraine buyers believe that EU company personnel are much more accessible than their North American counterparts simply due to proximity. Frequent contact including visits has been listed as a key component of a successful relationship in this market.
- Personal relationships are very important in Ukraine business and the telephone is not the preferred method of conflict resolution.
- Work with a Ukraine based importer who has access to a distribution network familiar with your product.
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Agriculture Sector & Policies

Overview

The agricultural sector is one of the key elements of the Ukraine economy. Despite vast improvements over the last five years, including a return to a positive trade balance, problems continue to plague the long anticipated development of the sector. The problems in the Ukrainian agricultural sector have been attributed to Ukraine's dependence upon imported energy, the absence of privatization, a lack of foreign currency to purchase necessary inputs, such as seeds and pesticides. Despite problems Ukraine's agricultural production is approximately four times larger than the output of the next highest ranking country in the area, except Russia. For this reason the Ukrainian agricultural sector is one of the brightest prospects for western trade and investment.

Despite certain perceived dangers of investing in the Ukraine, the agricultural sector continues to lure foreign capital. In fact, a majority of international investment in the Ukraine to-date has been focused in this sector.

Ukraine possesses some of the world's richest soil, with one third of the world's black soil (chernozem) located in the country. Approximately 60% of Ukraine is arable land. Agriculture accounts for about 22% of Ukraine's overall economic output, while food processing accounted for an additional 8%. The sector a very significant 30% of the country's labour force. Ukraine's primary agricultural products include grain, sugar beets, sunflower seeds, vegetables, meat and milk.

Despite potential, limitations to the sector persist. Local pesticide production currently meets only 20% of the country's needs and it is estimated that 30% of the country's agricultural production is currently lost to fungi, weeds and insects annually. The need for new agricultural machinery is huge, but existing debt in the sector makes the gap between the ability to buy and the need huge. This situation also exists in the food processing sector where it has been estimated that the sector's technology corresponds to equipment used in North America thirty years ago. This market is heavily supplied by refurbished equipment from Europe.

Reactivating and transforming Ukrainian agriculture and the entire food production system is central to Ukraine's economic recovery and reform. Ukraine's government is restructuring this sector through a nationwide agricultural strategy that focuses on developing private sector sources of inputs to agriculture, and private processing of agricultural products. A positive sign is that similar to Canadian agricultural policy, the government is tempering its goal of economic development with the goal of reducing the environmental impact of agricultural chemicals, limiting the environmental impact the sector has on the landscape.

Processing Sector

The food processing sector is a US\$10 billion industry which is developing very rapidly with the aid of foreign capital and foreign inputs. This sector presents a considerable opportunity on which a number of Canadian companies have already capitalized.

Growth in this sector since 2001 has exceeded 15% annually and this sectors share of total national manufacturing exceeds 20%. Roughly 20,000 companies are currently involved in food processing. Due to the rapid expansion currently ongoing, it is unclear whether or not this number will shrink in the near future due to consolidation.

Currently the sector simply cannot keep up with the demand. Domestic producers have been unable to produce the required inputs and imports are filling the void. Additionally, the product selection and quality of domestic products has been questioned by the processing industry and imports have become preferred in some cases.

There has been considerable investment in the areas of alcoholic beverage production (a key export product), and baby food production, but all areas involving the processing of oils, fruits and vegetables and beverage production have seen impressive expansion.

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Ukraine – Canada Policy and Trade Centre

www.infoukes.com/ukremb/

Key Resources

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