

*Macroeconomics*

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**CONSEQUENCES OF WTO MEMBERSHIP
FOR TRANSITION COUNTRIES
AND IMPLICATIONS FOR UKRAINE****Abstract**

The article analyses the consequences of WTO membership for transition countries. The analysis reveals the realization of potential benefits and reduction of risks and threats of WTO membership to be dependent upon a number of economic and political factors and achievable only in combination with them. This applies to growth of foreign direct investments, decline in corruption, and maintenance of a due level of domestic market protection.

Key words:

Domestic market, transition countries, liberalization of trade and investment regimes, foreign direct investments, aggregate support level, cost of WTO rules implementation.

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Introduction

The aim of this paper is to forecast possible positive and negative consequences of Ukraine's joining the World Trade Organization (WTO). Major motives of integration into the world trade system, as well as benefits and threats for domestic market, external trade, and specific industries and markets were broadly discussed in the works of Ukrainian politicians and economists [1; 2; 3]. However, the debate about the necessity to join the WTO is still going on among scientists and practitioners, the study of many problems still being in the early stage. The analysis of these problems is especially urgent and important, as there is no other alternative than joining the WTO. Due to sluggish negotiation process, Ukraine has already lost some of its positions.

In the early 2004, the WTO included 145 member countries. They account for 97% of the world trade in commodities and services. The main reason for Ukraine to join the WTO is to avoid trade and economic isolation from Central and Western Europe, Eastern Europe and Baltic countries, especially after the European Union enlargement.

The forecasts of potential consequences of the Ukraine's WTO accession are usually based on the analyses of WTO rules and regulations, bilateral agreements reached during negotiations, competitiveness of certain industries, and a current level of domestic market protection. This paper takes an alternative approach. Here, an attempt is made to estimate the potential consequences of Ukraine's WTO accession on the basis of studying the positive and negative factors which accompanied the WTO requirements execution process in other transition countries. The consequences of WTO membership for transition countries are discussed in terms of trade and investment regimes, as well as institutional and political changes, including the influence upon corruption, the cost of WTO rules implementation, etc. The research results in providing substantiation for the need to elaborate and realize the socio-economic development strategy aimed at investment climate improvement and institutional changes, capable of turning the potential benefits from the WTO membership into reality.

Since, indeed, the consequences of food and agricultural markets liberalization give major concern, the positive and negative factors of influence of the WTO agreements on the food and agricultural markets, agriculture, and rural areas of transition countries were analyzed in detail. The research brought forward two conclusions. First, under limited budgetary funds, the level of agricultural support will be determined for the most part by the budgetary capabilities rather than by the WTO requirements. Second, in consequence of the WTO requirements execution, the agricultural policy in Ukraine will gradually be reoriented from agricultural sector support to rural area development.

1. Domestic Market Liberalization

To ensure an unbiased study of the impact of WTO membership upon transition countries, it would be useful to use both the WTO expert materials and the surveys carried out in transition countries. The overviews of trade policy, regularly submitted to WTO Secretariat by governments in order to monitor the tendencies that can influence global trade policy [4; 5; 6; 7; 8; 9], are also viewed as information sources on the consequences of WTO membership for transition countries. Overviews include information about all elements of trade policy, institutional sphere, and economic environment.

Summaries of the impact of WTO membership on economic policy and institutional reforms in transition countries conducted within the WTO framework were also used in the research. The surveys of WTO experts cover the spheres of trade policy, market access, structural reforms, trade, investments, etc. [10].

Worth noting is the fact that the WTO membership was the first step toward integration into the world market and joining the world community for all transition countries. Six transition countries signed GATT before 1994: Poland (1967), Romania (1971), Hungary (1973), Czech Republic (1993), Slovakia (1993), and Slovenia (1994). The other eleven countries have already joined the WTO (in order of accession): Bulgaria (1996), Mongolia (1997), Kyrgyzstan (1998), Latvia (1999), Estonia (1999), Georgia (2000), Albania (2000), Croatia (2000), Lithuania (2001), Moldova (2001), Armenia (2003). Obviously, the terms of accession affected the consequences of WTO membership. It is considered that the process of accession is largely determined by the unwritten rules derived from precedents [10]. Such unwritten rules refer, in particular, to the status of a candidate country. In general, the WTO does not define the «developed» and the «developing» countries. A member's status is determined by the measures of «special and differentiated regime» employed with regard to it. A country can present itself in the WTO as developing, but the other member countries can dispute this definition. Therefore, the terms of the WTO accession for a particular country are determined by the selected strategy of membership acquisition and the negotiation skills.

In the last decade, the countries of Central and Eastern Europe have made significant steps towards liberalization of their trade and investment regimes. Notice that the WTO membership contributed to the process of market liberalization though did not play a key role in it. Trade and investment regimes were established in the process of conducting negotiations about the EU membership acquisition, regional agreements on free trade, customs agreements, and agreements on investment protection between the countries. The WTO requirements were stricter only in specifying technical, sanitary, and phyto-sanitary standards.

To illustrate the degree of openness of the domestic markets in the WTO transition member countries and the limited impact of WTO requirements on

trade regime liberalization, we cite the data on average actual rate and bounded (agreed with WTO) rate of import tariffs on industrial goods in a number of countries (Table 1).

Table 1.

**Bounded and Real Import Tariff Rates on Industrial Goods
in a Number of Transition Countries**

Country	Average weighted bounded rate of import tariff, %	Dynamics of average weighted actual rate of import tariff	
		Year	%
Bulgaria	23.8	1997	15.5
		1998	15.3
		1999	12.6
		2000	11.0
		2001	10.0
Czech Republic	4.3	1996	5.6
		1997	5.3
		1998	5.0
		2000	4.5
Estonia	7.1	1996	0.1
		1997	0.1
		1998	0.0
		1999	0.0
		2000	0.0
Hungary	7.4	1996	8.7
		1997	8.2
		1998	7.8
		1999	7.4
		2000	7.3
Latvia	9.4	1998	2.7
		2000	10.5
Poland	10.4	1999	17.5
Romania	30.8	1.04.03	8.32
Ukraine	5.02		

Sources: The WTO Secretariat: www.wto.org; Materials of Public Hearings «Ukraine's WTO Membership Acquisition: Problems and Perspectives»// Ukrainian Association of Industrialists and Entrepreneurs, Chamber of Commerce and Industry of Ukraine. – Kyiv. – 2003.

The data in Table 1 shows no unreasonable WTO pressure on the transition countries to open the domestic markets. Many countries liberalized their domestic markets irrespective of the WTO requirements, and, as a result, their WTO obligations are even less «liberal» than the actual level of market openness. First of all, this refers to the countries which joined the WTO after 1995, except for the countries which have been the GATT members: Poland (since 1967), Hungary (since 1973), and Czech Republic (since 1993). However, their real protection level of domestic markets is low. Bulgaria and Romania succeeded to «bind» the import tariff rates at a rather high level.

2. Attracting Foreign Direct Investments

Being the member of the WTO was a significant, but not the only factor of foreign direct investments (FDI) attraction to transition countries.

Poland, Czech Republic and Slovakia are in the lead of transition countries in terms of foreign investments attraction. In 2002, these countries took in 61% of total foreign investments to transition economies (Table 2). For analytical convenience, the shaded cells in Table 2 designate the period of WTO membership of a country starting with the year of accession, provided the country joined the WTO during the transition period. The data in Table 2 proves no direct relation between the WTO membership acquisition and the FDI growth. Since the WTO accession, the amount of FDIs has not changed significantly in Estonia and Latvia and sharply decreased in Kyrhyzstan. Lithuania joined the WTO in 2001, but however growing was the FDI volume in 2001–2002, it nevertheless did not reach the 1998 level. In the post-WTO-accession Georgia the annual FDI inflows did not surpass the 1998 level either. In Moldova, which joined the WTO in 2001, the FDIs in 2002 were lower than in 2000.

Total non-residents' capital in the CEE countries in 2002 was, according to provisional data, 20.8% of GDP in average, while in Ukraine it made 12.9%. The highest level of foreign investments as a share of GDP was accumulated (in 2002) by Estonia, Czech Republic, and Moldova (65.9%, 54.8%, and 45% of GDP respectively).

Foreign direct investments are attracted to CEE countries due to highly skilled and cheap labour force and an increasing orientation toward the European markets. To increase FDI inflows, the countries resort to additional measures as well.

For example, in 1998 Romania introduced the principle of equal national and foreign investors. In Slovakia, after adoption of the Strategy for Foreign Direct Investment Promotion, the FDIs increased, exceeding in 2000 the aggregate FDI volume of 1996–1999. The government of Poland introduced a new initiative for foreign investments attraction in 2002. Before that similar initiatives were introduced in Hungary and Czech Republic.

Table 2.

Foreign Direct Investments (FDIs) in Transition Countries

Country	FDI Inflow, US\$ mln.					Total Non-Residents' Capital,% of GDP		
	1998	1999	2000	2001	2002	2000	2001	2002*
Czech Republic	3700	6310	4984	5639	9319	42.1	47.4	54.8
Hungary	2037	1977	1646	2440	854	42.5	45.4	38.2
Slovenia	216	107	136	503	1865	15.5	16.4	23.1
Poland	6365	7270	9341	5713	4119	21.7	22.4	23.9
Bulgaria	537	819	1002	813	479	21.6	25.2	24.0
Romania	2031	1041	1025	1157	1106	17.5	19.0	20.5
Slovakia	684	390	1925	1579	4012	23.6	30.4	43.2
Estonia	581	305	387	542	307	51.5	57.2	65.9
Lithuania	926	486	379	446	732	20.9	22.2	31.4
Latvia	357	347	410	164	396	29.1	30.4	32.4
Russian Federation	2761	3309	2714	2469	2421	6.9	6.5	6.5
Ukraine	743	496	595	792	693	12.4	12.3	12.9
Georgia	265	82	131	110	146	14.0	16.7	19.9
Moldova	76	38	129	156	111	34.6	40.5	45.0
Central and Eastern Europe	22479	25145	26373	25015	28709	18.3	19.1	20.8
Kyrgyzstan	109	44	-2	5	-12	32.1	28.0	25.9
Armenia	221	122	104	70	100	26.8	26.4	28.7

* Provisional data.

Source: UNCTAD,World Investment Report 2003: FDI Policies for Development: National and International Perspectives. Annexes:
http://www.unctad.org/en/docs/wir2003annexes_en.pdf

In 2001, despite a more than 40% decline in the world foreign investment inflows, this figure for the CEE countries increased by 2%.

The WTO membership acquired by the countries of this region is viewed by perspective investors as a significant element of open, transparent, and stable policy.

3. Institutional Changes

The system of free trade provides conditions for rise in efficiency and transparency of political decisions, reduction of corruption, and improvement of legal basis. In particular, the level of corruption decreases as the restrictions on using import quotas (which induce corruption among the officials distributing the quotas) is employed.

In analyzing the impact of the WTO membership on the fall of corruption in the transition countries, the data of the leading non-governmental organization «Transparency International» is used. Table 3 quotes the dynamics of the Corruption Perception Index calculated by this organization yearly (since 1995) by surveying entrepreneurs and analysts. The index ranges from 0 (high level of corruption) to 10 (nil corruption).

Table 3.

The Transparency International Corruption Perception Index: 1996–2003

Country	1996	1997	1998	1999	2000	2001	2002	2003
Slovenia				6.0	5.5	5.2	6.0	5.9
Estonia			5.7	5.7	5.7	5.6	5.6	5.5
Hungary	4.86	5.18	5.0	5.2	5.2	5.3	4.9	4.8
Belarus			3.9	3.4	4.1		4.8	4.2
Lithuania				3.8	4.1	4.8	4.8	4.7
Bulgaria			2.9	3.3	3.5	3.9	4.0	3.9
Poland	5.57	5.08	4.6	4.2	4.1	4.1	4.0	3.6
Czech Republic	5.37	5.2	4.8	4.6	4.3	3.9	3.7	3.9
Latvia			2.7	3.4	3.4	3.4	3.7	3.8
Slovakia			3.9	3.7	3.5	3.7	3.7	3.7
Russia	2.58	2.27	2.4	2.4		2.3	2.7	2.7
Romania		3.44	3.0	3.3	2.9	2.8	2.6	2.8
Georgia				2.3			2.4	1.8
Ukraine			2.8	2.6	1.5	2.1	2.4	2.3
Moldova				2.6	2.6	3.1	2.1	2.4

Data source: Transparency International Corruption Perception Index 2003, 2002, 2001, 2000, 1999, 1998, 1997, 1996, 1995: [http:// www.transparency.org](http://www.transparency.org).

The shaded cells in Table 3 mean that a country was the WTO member during a corresponding year. Slovenia, Estonia and Hungary are permanently the three least corrupt countries. Slovenia and Hungary were the WTO members during 1996–2003; Estonia joined the WTO in 1999, but it had already had a rather high corruption perception index before acquiring the membership. In some WTO member countries the level of corruption declined (Bulgaria, Lithuania, Latvia), though it increased in other countries (Moldova, Georgia, Romania, Czech Republic, Poland). Thus, the data lacks uniformity and, therefore, prevents from making a conclusion that it is the WTO membership which affects the level of corruption in the transition countries. In any case, it is not a determinative factor.

Worth considering is still another aspect of the WTO membership impact upon the countries in transition – the costs of implementing the institutional changes related to participation in the world trade system. Implementing the WTO agreements requires not only adoption of the changes in the legal basis. The highest costs attribute to implementation of sanitary and phyto-sanitary standards, which include expenses for equipment, legal implementation of respective norms, and personnel training. As proves the experience of the transition countries, these expenditures are quite essential (Table 4).

Table 4.

Value of the World Bank Projects on WTO Agreements Implementation

Type of Projects	Country	Project Goal	Period of Realization, Years	Value, US\$ mln.
Customs Valuation	10 Eastern European Countries	Institutional reform: modernization of customs offices	7	108
	Armenia	Customs offices modernization: legal basis development, personnel training, computerization	4	2
Sanitary and Phyto-Sanitary Measures	Russia	Implementation of sanitary and phyto-sanitary standards: testing and improvement of food processing.	3	150
	Poland	Component of sanitary and phyto-sanitary standards within the framework of Exports Development Project	5	71
	Hungary	Modernization of slaughterhouses	6	41

Source: The World Bank: <http://www4.worldbank.org/sprojects>.

Implementation of these measures through World Bank credits increases external debt of a transition country. The majority of the countries have problems with introducing sanitary and phyto-sanitary measures and technical standards exactly because of the lacking budgetary funds.

4. Agriculture

The WTO accession affects different commodity markets in different ways. These effects depend on the level of competitiveness of national producers, current agreements on market protection, and the degree and efficiency of state support, etc. Of major concern are the consequences of agricultural markets liberalization. Recently, a trend toward unprofitability of the enterprises in the agricultural sector of Ukraine has set in again. In 2002, unprofitable were 44% of enterprises. According to the provisional data, in 2003 as much as one half of the enterprises were unprofitable. Thus, it is unreasonable to discuss the competitiveness of the agricultural sector now.

The terms of the Ukraine's accession into the WTO depend on the results of the negotiations which are currently in progress. Since these conditions are not yet defined, it is difficult to forecast the consequences of their realization for the Ukrainian rural economy. A great deal depends on how successful will be the Ukrainian side in «bargaining» with the WTO for particular concessions. Our only hope to pin on is the fact that the process of WTO accession was relatively painless for agricultural producers and markets in the other transition economies.

Moreover, the WTO accession played a positive role in the economic development of the transition countries. One reason for this was favourable agricultural requirements gained during the negotiations. Another reason was that the CEE countries did not hesitate and joined the WTO before or at the beginning of the transition period. As a result, they gained a number of advantages, since the base period for calculations fell on the years when their economies have yet been non-market, the level of domestic market protection was rather high, and non-tariff protection instruments prevailed. Consequently, the authorized level of protection for domestic agricultural markets after the WTO accession appeared to be rather high. In particular, 1986–1988 were taken as base years in Poland, and, as a result, the level of domestic market protection after tariffication of some products is even higher than in the EU.

According to the WTO regulations, all measures of state agricultural support are divided into three groups or ascribed to three colour boxes: «green», «blue», and «yellow».

The «green box» measures are not targeted at supporting the prices or volumes of production and, therefore, do not break the principles of fair competition. Such measures include scientific research, information and consulting services, veterinary and phyto-sanitary measures, food safety control, improvement

of infrastructure, environmental protection, improvement of land tenure system, etc. The WTO member country is entitled to finance the «green-box» measures at any level, depending on its budget potential.

There are also no objections to budgetary financing of the «blue-box» measures, since they are targeted at restraining the overproduction (reduction of livestock, sown areas, etc).

The «yellow box» measures are the main issue under discussion in the WTO accession process. They include the measures of domestic support which cause distortions in trade and production.

In case of the «yellow-box» measures, the country must assume obligations to curtail budgetary financing. The Aggregate Measurement of Support (AMS) is the annual sum of all types of state support, which fall under the curtailment obligations. During the 6-year transition period the AMS must be reduced by 20% (for developed countries). The WTO member country has the right to non-reduction of the «yellow-box» expenditures if it commits to provide a support no higher than 5% (for developed countries) and 10% (for developing countries) of the gross value of agricultural production.

Almost all measures of state support to Ukrainian agriculture for the last three years come under the «yellow-box» measures (in particular, the introduction in 2000 of partial interest rate compensation from the state budget for credits taken by agricultural producers, additional payments from the state budget for delivering products of certain quality, cancellation of debts, etc.), and most likely, are subject to restriction.

These strict requirements of the WTO are aimed primarily at the developed countries, which have a significantly higher potential for support of domestic producers. But when joining the WTO, Ukraine strives to receive the status of a developed country with a developed market economy (because of political reasons). And in conformity with this status it will have to commit itself to either reducing the «yellow-box» financing by 20% during the next 6 years or setting a limit of this financing at the level no higher than 5% of gross agricultural production value.

As shows the experience of the CEE countries, the level of agricultural support is determined not so much by their obligations to reduce the AMS as by the budgetary capabilities (Table 5).

Specifically, the authorized level of support to agricultural goods producers through the «yellow-box» measures is fixed at such a high level in Czech Republic and Poland that the actual level of support is no higher than 11% of the level allowed by the WTO. The most «intense» is the fulfilment of the obligations to reduce agricultural support in Slovenia. Slovenia, however, holds the nearest (of all the transition countries) position to the EU countries in terms of GDP per capita and, therefore, has larger potentialities of supporting domestic agricultural goods producers. Moreover, a share of agricultural producers in total population employed is not as significant as it appears in other Eastern and Central European countries, not to mention Ukraine. The specificity of Slovenia does not allow viewing its situation with

agricultural support as typical of the transition economies. Slovenian agriculture is for the most part located in highland areas and is insignificant in terms of production volumes (main producers being small cattle-breeding farms).

Table 5.

**Changes in Aggregate Measurement of Support (AMS)
in a Number of Post-Socialist WTO Member Countries***

Member of the WTO	AMS					
	1996		1997		1998	
	% against previous year	% real against author- ized	% against previous year	% real against author- ized	% against previous year	% real against author- ized
Czech Republic	141.4%	10.3%	64.7%	6.9%	96.1%	6.9%
Poland	89.0%	5.8%	130.4%	7.9%	101.7%	8.3%
Slovak Republic	98.2%	59.0%	118.7%	72.7%	93.0%	70.2%
Slovenia	100.0%	97.2%	100.0%	100.0%	94.3%	98.5%

* calculated on data of the WTO Secretariat.

As a result of WTO requirements fulfilment, the structure of domestic support to agriculture in transition countries gradually changes toward increases in the share of «green-box» measures. In particular, in Czech Republic, Poland, and Slovenia the «green-box» measures account for the largest share in the structure of domestic agricultural support (Table 6).

In fact, this means the reorientation of domestic agricultural policy towards rural areas development.

Thus, Ukraine can be said to lose some of its positions because of the delay in joining the WTO. The rules of this organization are not always favourable for new members, especially for the countries which have not yet overcome the crisis and depression of their agricultural sectors. The latter still face the possibility for existing large gap between the domestic market support level in old and new members to increase further. For example, the current tariff rates on imported beef in the majority of the NIS countries is not higher than 15%, while in the EU countries in 2001 it made 108%. The rate of import tariff for white sugar is 80% in the EU, while it is 30% in Ukraine. Obviously, the requirement to reduce the already low tariff rates by one-third will only enlarge the difference between the old and the new WTO members.

Table 6.

**Changes in the Share of «Green-Box» Measures
in Some Post-Socialist WTO Member Countries in 1995–1998
(% of Total Domestic Support Value)***

The WTO members	The Value of «Green-Box» Measures, % of Domestic Agricultural Support Cost			
	1995	1996	1997	1998
Czech Republic	75,3%	76,0%	78,5%	86,2%
Poland	63,2%	70,8%	74,4%	73,8%
Slovakia	0,4%	0,6%	1,4%	4,7%
Slovenia	48,1%	50,8%	57,9%	60,8%

* calculated on data of the WTO Secretariat.

Conclusions

As seen from the experience of the transition countries, there are no crucial negative consequences of the WTO membership for domestic markets, and, however, the benefits are as clear as well. Also, the realization of potential benefits of the WTO membership depends on a large number of other factors and is possible only in combination with them. This is true for the increase of foreign direct investment inflows, decline in corruption, support of reasonable protection level for national markets, etc.

Therefore, a complete realization of the opportunities provided to Ukraine by the WTO membership and minimization of social and economic costs are possible only under the conditions of development and efficient implementation of the long-run socio-economic strategy of the country.

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