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Global Agricultural Information Network

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## Ukraine

### EXPORTER GUIDE ANNUAL

## Ukraine's Food Market in Crisis

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**Report Highlights:**

A sudden consumption slowdown has replaced the rapid growth period of 2004-2008. Ukrainian retail and food processing sectors are surviving through difficult times. Ukraine remains a second big market for US products among the former Soviet Union countries after Russia. The trading environment remains complicated and non-transparent. Potential exporters are advised to secure an experienced Ukrainian partner with established contacts who is capable of navigating the myriad obstacles facing imported agricultural products.

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## **SECTION I. MARKET OVERVIEW**

### **Macroeconomic performance and other indicators**

Despite a lack of economic reforms in early part of 2000's Ukraine's macroeconomic indicators had become quite stable, creating a good environment for further economic expansion. Ukraine had achieved high rates of economic growth with a relatively stable national currency (unofficially pegged to the U.S. dollar at different rates close to 5.0 Hryvnas(UAH)/\$) and sustained a gradual increase in per capita income. Most of the economic growth (especially in 2006-2008) came with foreign direct investments (FDI) inflow and led to significant growth in personal consumption and imports growth. Due to delayed tax, judicial and state governance reforms as well as widespread corruption foreign and domestic investments in many real economy sectors were limited. Investments arrived predominately in banking, insurance, trade and service sectors. Availability of cheap credit from abroad facilitated further consumption and import growth. Inflow of foreign currency through the banking system created upward pressure on UAH (vis-à-vis US \$ and EUR) provoking further import growth and sending wrong signals about the alleged health of the Ukrainian economy. Exhausted by prudent consumption in 90's the population was happy to use loans and saw no risks in the future, observing slowly appreciating local currency. Consumption of many high value added agricultural products increased dramatically.

The need for economic reforms was masked by high world prices for major Ukrainian exports in 2003-2008: ferrous metals and chemical products. Agricultural commodities joined this list in early 2008 with a surge of the world's prices for grains and oilseeds. All governments in recent Ukrainian history avoided unpopular reforms and preferred to use increased budget revenues for populist social programs instead of cushioning the negative aspects of much needed structural changes. Economic inefficiencies, corruption and hostile business environment exaggerated the world economic crisis consequences for the Ukrainian economy in 2008 and 2009.

Although in 2008 the Ukrainian economy showed 2.1% GDP growth, most of it came in the first half of 2008 the pre-crisis period of the year. A significant chunk of the outdated industrial sector did not survive the commodity price drop and contracted by 28-30% in late 2008 – early 2009. If in 2006 and 2007 Ukraine's GDP grew by 7.9% and 7.3% respectively, in 2009 it is expected to fall by 14-17% setting a regional record. Per capita income that almost doubled between 2006 and 2008 reaching \$2,651 annually is expected to contract a bit in USD terms, but will grow in UAH. The main reason for this is currency devaluation and GOU

anti-crisis policies. Facing a Presidential election January 17<sup>th</sup>, 2010, the GOU has maintained the same socially-oriented programs as in pre-crisis years. In order to keep the same social spending during time of a contracting economy and troubled banking sector, the GOU petitioned international financial organizations for support. Observers also believe that the National Bank of Ukraine is seeking a significant money base expansion mimicking US and EU actions in order to save Ukraine's banking system. The root causes of the Ukrainian economic crisis remain largely unaddressed.

The International Monetary Fund was first to help by loaning \$16.43 billion over a period of 2 years under IMF's stand-by program in exchange for a reform package. The first tranche was received in November of 2008 with a total sum of \$10.6 billion received so far. Most of the negotiated reform package is yet to be implemented by the GOU. Other international financial organizations and separate countries also offered limited assistance packages.

Many Ukrainian banks are currently experiencing difficulties because of irresponsible expansionist policies exercised in recent years. They served as outlets pumping foreign currencies from parental banks (or short term syndicated loans) into Ukraine. The biggest portion of this currency inflow was used for consumption. Although many banks managed to avoid currency risks by providing loans in \$ US and EUR, the risks absorbed by the population and business happened to be extremely high. Abrupt devaluation of UAH from 4.6 UAH/\$ to 8.5 UAH/\$ undermined the population's ability to service loans in foreign currency. The share of non-performing loans in the banking system increased to alarming levels in 2009 threatening to destroy the entire financial sector. The GOU and the National Bank intervened recapitalizing and nationalizing some commercial banks, but in many cases help was nontransparent and arrived too late to make a difference. Some financial institution collapsed despite recapitalization, some teeter on the edge of bankruptcy.

The macroeconomic situation in the country is subject to constant changes. Trade risks increased greatly in last year. Exchange rates, banking sector indicators and GOU policies are changing weekly. Political instability and an upcoming Presidential election do not contribute to stability either. An interested reader needs to refer to third party detailed analytical reports or to reports published by international organizations to get an understanding of the current situations and short term perspectives.

Ukraine possesses a sizable shadow economy that developed due to excessive tax pressures, nontransparent and frequently changing legislation, and the lack of law and contract enforcement. Crisis developments resulted in a gradual growth of the shadow economy share in 2008-09. Experts estimate the size of the parallel shadow economy to be between 50 and 60 percent of the official economy. Widespread corruption became a serious problem in the late 1990's. The country is ranked 134 out of 180 on the 2008 Transparency International Corruption Perception Index scoring 2.5, which is 0.3 below the previous year (10 = zero

corruption level).

As of September of 2009, the population of Ukraine was estimated to be 46.0 million, making it the second largest consumer market in Central and Eastern Europe after Russia. Ukraine's population is characterized by the increasing number of elderly and a slowly decreasing population. The size of the official labor force is stable at 20.2 million. In 2009, the official unemployment rate reached 10.3%, but experts point out that the actual number is higher due to unrecorded unemployment, especially in rural areas. Growing real incomes and strong demand drove the recovery in the domestic consumer market. Household gross spending in 2008 grew by 60% in real terms to \$630 a month, but a significant drop is expected in 2009.

Ukraine joined the World Trade Organization (WTO) on May 16<sup>th</sup> of 2008, decreasing most agricultural import duties to previously negotiated levels. The country is also bound by international agreements on Technical Barriers to Trade and Sanitary and Phytosanitary measures.

Agriculture accounts for a considerable share of Ukraine's gross domestic product. In 2007, agriculture (without food processing) accounted for 7.4% of GDP. The food processing industry employs only 2.1% of the population, although agriculture employs an additional 32.5%.

Because of relatively low incomes and a nearly 60% currency devaluation in 2008-09, the sale of the vast majority of U.S. food products available on the Ukrainian market is limited. Most U.S. products are of premium quality and value added and found in some niche markets frequented by wealthy consumers (1.5-1.8% of the Ukrainian population) and the growing middle class (13-17% of the population). Concomitantly, the rapid development of the Ukrainian food processing industry is opening the door for U.S. ingredient suppliers. (Please refer to [Food Processing Report UP7003](#).)

Ukraine is endowed with inputs critical to establishing a strong agricultural sector. If the government is able to sustain reforms designed to increase farm efficiency and stimulate growth, then Ukrainian agriculture will continue to grow. However, it's important to note that many policy makers are still actively attempting to decrease efficiencies by applying administrative controls to limit the increase of agricultural and food prices or limiting market development. Opponents to these measures are attempting to prevent implementation of many of these provisions because they will decrease farm efficiency, drain the national treasury and are WTO inconsistent.

## **Investments**

Due to the nontransparent business environment, the inflow of FDI is not as significant as FDI flowing into Eastern Europe and Russia. The aggregated amount of FDI into Ukraine since

Independence totaled \$37.9 billion as of July 1, 2009. In 2009, per capita FDI amounted to \$824, which is not significant compared to Poland's \$2,800 and Hungary's \$6,700. The net increase in foreign capital in 2008 was \$6.3 billion, almost \$2.23 billion less than in 2007. The U.S. is the eighth largest source of foreign investments with \$1.4 billion.

Ukrainian agriculture only attracts 5-6% of total direct investment. The following industries were recipients of FDI: tobacco, beer, beverage, confectionery, food concentrate (dry goods and condiments) and sunflower oil sectors. Additionally, investments in sugar, ice cream, meat, fish processing, dairy processing, fruit and vegetable processing have also increased considerably. Foreign investment is concentrated in certain regions and urban centers of Ukraine. Kyiv and the surrounding area received over one-third of all foreign investments.

### **Retail trade**

For most of the last decade a buoyant economy and strong growth in the local food retail sector contributed to the increase in sales of processed food products. The number of supermarkets and hypermarkets continued to expand up to the crisis. In 2002, the retail network was comprised of approximately 600 hypermarkets and supermarkets. In 2004-08, the number of outlets expanded significantly due to the overwhelming acceptance by consumers. Ukrainian supermarkets maintain the widest product mix and the largest proportion of imported products. Despite the rapid expansion of supermarkets in large urban areas, many food products continue to be sold through open-air markets and small convenience stores. In the first half of 2006, gross sales in the food retail sector reached 101 billion UAH (\$20 billion), which is 28% larger than the year before. FAS [Retail Trade Report UP9001](#) provides a detailed description of Ukraine's retail sector.

### **Foreign trade**

Upon accession to the WTO Ukraine decreased its import duties to reasonable levels. However it still maintains cumbersome systems of veterinary and sanitary control, state standards and imported goods certification. Abolishment of most of these trade barriers is yet to be done to bring the country in compliance with WTO rules. All these non-tariff barriers to trade add to high distribution and shipping costs.

Because Ukraine signed free trade agreements with Macedonia, Russia and other countries within the Commonwealth of Independent States (CIS), food and agricultural products from these countries have price advantages over imported products from the United States. In 2008, as much as 39% of Ukrainian imports were sourced from EU-27 countries, 24% from CIS states, and 7% from the United States. Despite the U.S. capturing a relatively small share of the trade, in 2008 U.S. agricultural products accounted for \$436 million, which is a significant increase over 2007's \$229 million. The opening of the Ukrainian red meat market in the end of

2008 and WTO accession further facilitated trade growth for U.S. products. (Note: These are official numbers that fail to capture the significant volume of products imported through the shadow economy.)

Ukraine is still in the process of modifying sanitary and phyto-sanitary standards to comply with international norms and standards. These changes were a requirement for accession to the WTO. Five laws are yet to be adopted to bring Ukrainian legislation in compliance with WTO rules. Some existing standards and veterinary regulations have complicated trade in U.S. ready-to-eat products, food ingredients, fish, poultry and red meats.

Despite the crisis, Ukraine will continue to be a major exporter of food and agricultural products, especially within the CIS region. Since the late 1990's, Ukraine has become an established supplier of grains and oilseeds to the world market. Most Ukrainian grain is sold to the Near East, Eastern Europe and EU countries. Once sizable, export of dairy products from Ukraine is decreasing due to a shrinking cattle population. Exports of processed and high value added products are not significant, but growing.

#### **Advantages and Challenges Facing U.S. Products**

Advantages	Challenges
Structural changes in consumption lead to greater demand for value added food products.	High trade risks due to volatile exchange rate and political instability in the country.
Investment growth in the food processing industry increases demand for additives and other ingredients not produced in Ukraine.	Strong competition in the local market from domestic producers and increasing imports from CIS (mainly from Russia), EU and Baltic countries.
Joining the WTO made access for imported goods easier.	Long-established consumer preference for domestic fresh products with no additives. Current veterinary requirements impede the import of red meat and biotech products.
Growth of international fast food and restaurant chains in Ukraine that use standard procurement systems and that source food ingredients from the U.S.	High distribution, shipping costs and technical barriers to trade.
The retail sector is looking for innovative high value added food imports.	Low awareness of U.S. products; extremely low presence of U.S. products on the shelves of supermarkets and discounters.

U.S. food and agricultural products traditionally suffer from low customer awareness in Ukraine. Several constraints and misconceptions have contributed to the small market presence of U.S. foods:

- U.S. companies have little reliable information about the country, current market opportunities and potential business partners.
- Minimum quantities offered for export are often too large for the Ukrainian market.
- A perception that persists among Ukrainian importers is that landed costs of U.S. products are higher relative to European products due to higher transportation costs.
- The perception that U.S. exporters are simply too far away to follow market trends and service the Ukrainian market.

## **SECTION II. EXPORTER BUSINESS TIPS**

### **Local Business Practices and Customs**

#### Entry Strategy

There is no single market entry strategy recommended for new-to-market exporters. First, the exporter should define whether Ukraine is a major market for the product, or if only occasional deliveries will be made. The following factors should be considered:

- Market product need, given consumers income trend and particular food sector development prospects (separate market research in order to assess product prospects maybe required);
- Availability of similar domestically produced products, (often Ukrainian producers are effective in building barriers to trade by lobbying the GOU, Parliament, veterinary or health inspection services).
- Calculation of the landed cost of a product in order to make price comparisons vis-à-vis competitors.
- Availability of similar products from EU or FSU suppliers. Also, comparative advantages / disadvantages of U.S. products relative to products from major competitors (e.g. quality, price, transportation expenses, packaging, labeling, etc.)
- Availability of a local distributor familiar with the product. It is advisable to initiate personal contact in order to discuss marketing strategies, funding for advertising, slotting allowances, BTL in-store promotions, tasting and sampling events. Suppliers may also want to consider trade fair participation to increase awareness of their products.
- Tariff and non-tariff regulations affecting the product. (Note: in some cases large Ukrainian food producers lobby tariff reductions for much needed ingredients and have the clout to settle veterinary or SPS problems should they arise.)

Currently, almost all U.S. food and agricultural product exporters work through a Ukraine-based subsidiary, importer or through the procurement service of the buyer (the latter is the

most convenient if there are only 2 or 3 potential buyers). Local distributors are more flexible, usually have established marketing channels and can provide local customers with short-term (5-30 days) credits in kind. Recently due to crisis developments in Ukraine's retail sector credits in kind tend to grow in length from 21-30 days (in average 3 years ago) to 6 months in 2009. Many Ukrainian retailers are surviving on the expense of importers and local distributors. Due to unavailability of other sales channels for many imported products distributors have no other option but to concur on new terms. Trend for financing of the retailers from the distributors' pocket was also notable before the crisis, but now this practice became widespread.

Importers are also responsible for the entire logistical chain and inland transportation. Due to frequent changes in Ukrainian legislation, non-transparent custom clearance rules, SPS and veterinary procedures and corruption, it is recommended that the Ukrainian partner handle all logistics. Some Ukrainian distributors have already established representative offices in major exporting countries.

U.S. companies should approach potential Ukrainian partners with extreme caution. While information on Ukrainian companies has improved, there is still a significant dearth of background data and credit histories on potential Ukrainian distributors. This presents the greatest obstacle to finding reliable, competent distributors. In order to obtain a due diligence report on a potential Ukrainian partner, a U.S. company is advised to contact either a law firm or an internationally accredited financial service company. It is advised that all U.S. companies consider legal counsel before and while doing business in Ukraine. Ukrainian laws and regulations are vague and open to interpretation, providing ample corruption opportunities for officials at every bureaucratic level. U.S. businesses are advised that establishing a partnership with a Ukrainian company is a challenge that is beyond the control of the U.S. partner and his legal advisors.

If the Ukrainian market looks promising, establishing a representative office is recommended to deal with buyers directly. Personal relationships are very important in Ukrainian business practices and often problems cannot be effectively resolved over the phone. It is a very common practice in Ukraine to purchase inputs directly from the producer. Even if the exporter's policy requires importers to work through the foreign-based distributor, most Ukrainian partners will still attempt to contact and work directly with the producer. In the past, many U.S. companies dealt with Ukrainian partners through a Russian-based representative office (usually Moscow). This is no longer the case because trade regulations and laws that were once common between the two nations differ more and more. (Note: the Ukrainian food ingredient market is small at the moment and relatively few products can justify a representative office in Kyiv).

Select U.S. products may also enter the Ukrainian market through a different route; via a

Ukraine-based U.S. intermediary able to manage the distribution scheme more efficiently than a Ukrainian importer. This is vital if the Ukrainian importer lacks technical skills and expertise in product promotion.

Exporters of high value-added products must note that larger Ukrainian retail chains use their own procurement centers. Few wholesalers undertake nationwide distribution, and very few carry a complete range of products. In many cases, supplier choices are based on informal personal relationships and ownership ties, rather than driven by quality and price factors.

### **General Consumer Tastes and Preferences**

Consumer preferences differ significantly among various income and age groups. Similar to other nations, young consumers tend to experiment with new products, but many of them remain at the "tasting level". Middle-aged and elderly consumers are much more conservative in their taste preferences and often treat new products with caution. Consumers of all ages and income groups are highly patriotic in their choices and often will not buy an imported product if a domestically produced one of comparable price and quality is available.

All categories of consumers analyze the content/ingredients of products with great care. There is widespread belief that preservatives, stabilizers, colorants and flavoring agents are not healthy and one should avoid them if possible. However, consumers pay little attention to fat, sugar or protein content. The trend for healthier food consumption (low fat and reduced cholesterol, sugar free) is not yet evident in Ukraine. The diet of many low-income people is not nutritionally balanced and health concerns are found only in big cities, where consumers are wealthier and can afford more expensive products.

Biotech products have a negative public perception in Ukraine and the government has imposed compulsory labeling although one will not find labeled products in the supermarkets. There are no registered GM plant varieties for human consumption and there are only intentions to have them registered for animal feed. Ukrainian legislation on biotechnology in general is in development.

With average per capita income still quite low, Ukrainians spend approximately 60% of their incomes on foodstuffs. Prepared home meals are preferred over dining out. Women account for 49% of the total work force (20.6 million people) and contribute to the increased demand for meals consumed away from home, easy to cook and ready-to-eat products. The market trend for frozen and convenience food is relatively new in Ukraine, but with a large proportion of two-income families and growing incomes of city dwellers this market segment is expanding very rapidly.

Almost 33% of the population lives in rural areas. Their incomes are quite low and many

people rely on subsidiary household plots to provide staple foods (potatoes, vegetables and fruits). Many rural families sell vegetables, meats and traditional dairy products in open-air markets. The majority of their consumers are low income and elderly (these two categories overlap considerably).

### **Food Standards and Regulations**

For an extensive explanation of Ukrainian Food and Agricultural Import Regulations and Standards, a prospective exporter should refer to FAS Kyiv's [FAIRS Report](#), which is available on the FAS/USDA web site. An abbreviated review of Ukrainian import regulations and food standards is provided below.

Ukraine maintains a complicated food safety control system that is supervised by various state agencies, which often have overlapping functions. The following agencies of the Government of Ukraine (GOU) are involved in assuring the safety of domestically produced and imported food products, and animal and plant health issues:

- State Epidemiological Service establishes food safety standards and is responsible for all aspects of food safety;
- State Committee for Veterinary Medicine is responsible for animal health, safety and wholesomeness of meat, seafood and other products of animal origin;
- Main State Phytosanitary Inspection Service is responsible for plant health issues;
- State Committee of Ukraine on Technical Regulations and Consumer Policy is responsible for compliance of food products with existing quality and safety standards;
- State Ecological Inspection Service is responsible for radiological and environmental control.

Ukrainian legislation is subject to unpredictable and sporadic changes; therefore, it is difficult for foreign suppliers to be aware of the most current food safety regulations. U.S. suppliers should work with experienced importers who are familiar with the latest import requirements. Currently, certain standards used in Ukraine are inconsistent with standards established by international standards setting bodies, and with internationally accepted trade practices.

Imported food products must meet the same requirements as domestically produced foods. While enforcement of food safety norms has been generally effective, outdated nutritional norms have not been rigorously enforced.

All food products sold in Ukraine must have Ukrainian language labels attached to the package that contain the following information:

- 1) Name of food product;

- 2) Nominal quantity of food product (weight or volume in metric system measurement);
- 3) List of all ingredients found in the food product, including other food products and food additives used;
- 4) Nutritive values and energy;
- 5) Expiry date, or the date of production with indicated shelf life;
- 6) Storage conditions;
- 7) Name, country, address of producer, packer, exporter and importer of the product;
- 8) Terms of use (if any);
- 9) Presence of genetically modified organisms (GMO) - please not text explanation on below;
- 10) Consumption of food product warnings for certain consumer categories (children, pregnant, senior people, athletes etc.)

This information must be present even on the packaging of products not intended for retail trade. Stick-on labels that meet Ukrainian food safety law requirements are allowed and can be affixed on the side or over the standard US label. Customs authorities require compliance with the Ukrainian labeling requirements prior to granting final clearance to the product. Most importers prefer to deal with products that already contain labels and meet Ukrainian requirements although some chose to attach labels in the customs licensed warehouse in Ukraine. Health claims and statements targeting particular consumer groups (children, pregnant women, athletes) are prohibited without prior approval from the Ministry of Health.

The product's expiration date (or shelf life indication containing the date of production) must appear on the label. Although Ukrainian food safety legislation allows producers to determine the shelf life of the product, it is highly advisable to verify with the importer whether it meets existing Ukrainian technical regulations (GOST or DSTU).

The GOU adopted Resolution #468 "On Approval of the Procedure for Labeling Food Products Containing Genetically Modified Organisms or Produced from Them and Put into Trade" on May 13, 2009, which introduced mandatory GMO labeling from July 2009. According to the resolution, a food product that contains more than 0.9% of GMO or a food product that has ingredients containing more than 0.9% percent of GMO, as well as a food product that does not contain GMO, but was wholly or partially produced with the use of agricultural products, the content of GMO in which was over 0.9%, shall be labeled. Further development of this issue will be notified in reports on the FAS web-site.

Ukraine maintains a positive list of food additives and establishes its own maximum residue limits for chemical and biological contaminants in food products. Recommendations from the CODEX Alimentarius Commission, an international food safety standard setting body is considered in approving new food additives; however Ukrainian authorities conduct their own risk assessment for each new substance. Importing food products that contain food additives that have not received official approval is prohibited.

Some imported food products are subject to mandatory certification in Ukraine. The applicant (either exporter or importer) is responsible for the cost of the certification. There are usually two options available to exporters and importers depending on the value and the frequency of shipments. The first option envisions compliance of a foreign facility to existing Ukrainian norms and regulations on quality and safety. The supplier receives a certificate of conformity valid for two-to-three years that avoids having to certify each shipment. The second option involves certification of each product shipment with mandatory laboratory tests upon arrival in Ukraine.

All food products of animal origin are subject to veterinary surveillance and control in Ukraine. A prospective U.S. exporter should refer to [FAIRS GAIN Report](#) for more information even if the exported commodity is not subject to veterinary controls in the United States. A Ukrainian state veterinarian conducts inspections at the border for canned products that contain any amount of meat or animal fat, animal feeds of plant origin (such as soybean meal), ready-to-eat seafood products, and frozen fish. The report also contains multiple reference lists. Legislation slated for January 2010 threatens to allow only vet-authority approved plants to export to Ukraine.

### **General Import and Inspection Procedures**

Import regulations in Ukraine are similar to regulations found in other countries. All applicable duties and taxes are collected by customs authorities upon clearance of imported goods at the border, unless the cargo is forwarded to a bonded warehouse. Almost all Ukrainian import duties are calculated on *ad valorem* basis. According to Ukraine's WTO obligations, the only commodity subject to a quota restriction is raw sugar.

Agricultural and food products imported into the customs territory of Ukraine may be subject to sanitary testing, certification, radiological, veterinary and/or phytosanitary inspections. Every shipment arriving in Ukraine is inspected and sampled regardless of the statements made in the accompanying health certificate. Custom clearances and co-related inspections are fee-based and are viewed by many regulatory agencies as a source of additional revenue. Ukrainian Customs Service often rejects the declared custom value of imported product as the basis for custom duty calculations. In this case importer should be ready to use appeal procedure and litigation in the court. The testing procedure takes up to 7 days, which makes the import of some highly perishable products difficult at best or impossible.

Due to small import volumes from overseas, U.S. exporters should be prepared to ship mixed product loads in one container. A separate health certificate is required for each homogenous product lot within the container. There may be specific import requirements (alcohol, tobacco, etc.) or prior notice requirements for certain products. At the planning stage, exporters are

advised to verify with their importer what types of controls are applicable to the product. Any food product (except those produced for personal consumption), food raw materials and agricultural products are prohibited entry into Ukraine without documented evidence of their quality and safety. Control over adherence to the procedure of food and agricultural product imports rests with the Customs Service of Ukraine. The product will not be granted final clearance until all legal procedures are met. The following documentation is required for customs clearance:

- Copy of a contract and an invoice;
- Bill of lading;
- Freight custom declaration;
- Certificate of conformity (if applicable);
- State sanitary and epidemiological expertise certificate, (or certificate on state registration of special food products);
- Veterinary certificate (if applicable);
- Import permit and original phytosanitary certificate (if applicable);
- Manufacturer's Certificate of Quality.

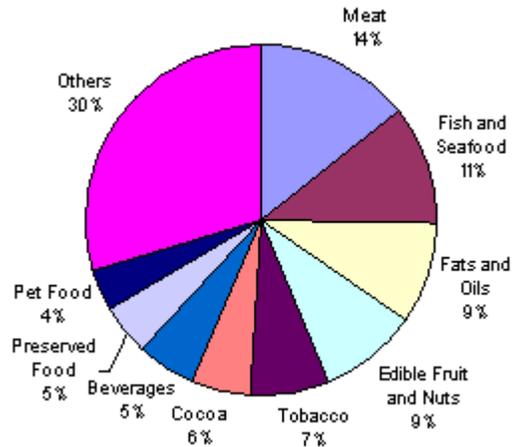
Ukrainian is the only official language recognized in Ukraine. All documents must be bilingual, submitted in Ukrainian or be accompanied by an official translation.

### **SECTION III. MARKET SECTOR STRUCTURE AND TRENDS**

#### **Competition**

For the past six years, Ukraine has been a net exporter of agricultural and food products (HTS 1-24 groups). In 2008, total exports of agricultural products from Ukraine reached \$10.8 billion dollars (73% growth from 2007), exceeding agricultural imports (\$6.4 billion dollars).

#### **Import of Agricultural Products in 2008**

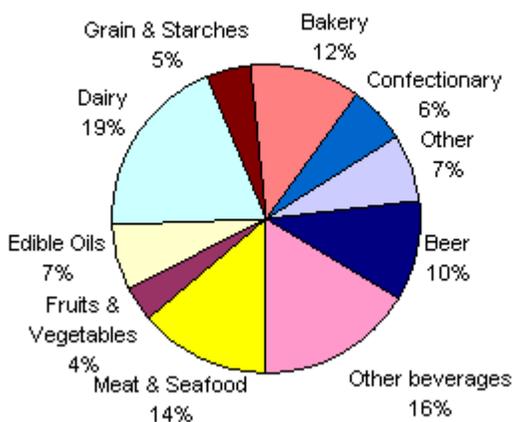


Source: State Statistics Committee of Ukraine

The development of the food industry in Ukraine has led to a significant increase in the use of raw materials and additives for foodstuff production and comprises the majority of Ukrainian imports. For more information on opportunities in Ukraine's food processing industry, please refer to FAS Kyiv's report: UP7003 [Food Processing Ingredients Sector Report](#) found on the FAS homepage.

Demand for ingredients increased due to the growth in the meatpacking and dairy processing industries, and increased production of fish products, confectionery and beverages.

### Ukrainian Food Processing Sub-Sectors\*



Source: State Statistics Committee of Ukraine

\*By volume of the produce; tobacco industry is not included

In 2005-2008, imports of the following commodities experienced the highest rates of growth:

- Food additives (stabilizers, emulsifiers, flavorings, proteins, pigments, ferments, albumin, oil-and-fat mixes, modified starch etc.)
- Palm oil or fractions
- Fish
- Swine, live except pure-bred breeding
- Grape wines
- Cocoa powder
- Spirits

Some imported soya products are used as ingredients in food and compound feed industries (such as soya meal and flour, soya protein concentrates, lecithin, vegetable oil mixes and isolates on soya base for confectionery, dairy and meat industries).

Food products imported from EU and CIS countries are now the major competitors for U.S. commodities in Ukraine and will continue to be in the foreseeable future.

U.S. suppliers have actively explored the Ukrainian market. In 2008, poultry products accounted for 57%; planting seeds 12%, seafood and tobacco 7% each of total U.S. agricultural exports to Ukraine. Below is a list of the top 10 U.S. export commodities experiencing the highest import growth rate in Ukraine (for 2007-2008 with turnover over \$5 million):

- Meat (predominately poultry)
- Seeds for Planting (Corn Hybrids)
- Miscellaneous food
- Edible Fruits and Nuts
- Preserved Food (mostly Juice Concentrates)
- Tobacco
- Pet Food
- Fish and Seafood (Whiting and Hake)

For many staple products, domestic production meets demand. Imported food and agricultural products have difficulty competing with domestic products due to the high cost of foreign exchange high import duties and generally efficient production of unsophisticated food products. Imports add to the variety of foods available on the market and also include products that are either not grown in the country or for which domestic production is insufficient to meet domestic demand.

### **Retail Food Sector**

As reported by the State Statistics Committee of Ukraine, the number of retail trade outlets

selling food products exceeded 27,000 in 2008. Over the past few years, the number of retailers was on the decline (5%-10% annually), while the average floor space increased 4-7% annually. Many small food shops continue to go out of business.

### Open Air Markets

There were 2785 open air markets in Ukraine in 2008. Given relatively low salaries in small towns and rural areas, open-air (farmers) markets continue to supply the majority of Ukrainian consumers with foodstuffs. Most salespersons in these markets are rural dwellers selling their own produce grown on household plots. Rural middlemen sell meat products they procured in neighboring villages. Some open-air market retailers open small kiosks, while others continue to use counters provided by the market administration. All products sold are subject to veterinary and sanitary surveillance, which is conducted by market veterinary and sanitary inspectors. All products that are tested in market labs are labeled.

Some consumers believe that purchasing food at open-air markets is cheaper than in supermarkets. Consumers may prefer products found at wholesale open-air markets for freshness and their ability to select.

According to some estimates, 40-50 percent of total food product transactions occurred in open-air retail outlets. For some commodities (meat products and offal), sales in open-air outlets account for 90%. Sales of fresh vegetables, fruits, honey, and dried fruits are also dominant in open-air markets. Sales of dairy, sunflower oil and alcoholic products have gradually moved from open-air markets into retail stores, mostly out of necessity. Open-air markets lacked storage equipment, had persistent quality concerns and a significant share of counterfeit alcoholic products. These markets also suffered from low service standards. Also, local authorities are pressuring these outlets to guarantee appropriate sanitary conditions. The only U.S. food product that has been spotted in many open-air markets all over Ukraine is U.S. poultry meat and offal. In many cases, these products are smuggled into Ukraine and remain popular among consumers due to very competitive prices.

Some central markets located in large cities have become elite retail institutions offering high-quality products for wealthy consumers looking for a unique shopping experience. These markets are of interest to American exporters of delicatessen meat products, seafood, semi-prepared and microwaveable foods, mixtures of exotic dried fruits, nuts, elite confectionery, and alcoholic drinks.

### Supermarkets, Hypermarkets and Discounters

This segment of the Ukrainian retail sector is developing the quickest in bigger towns and cities, despite only being responsible for approximately 30-40% of retail food sales. In larger

cities this sales channel dominates. In Kyiv over 84% of all consumers purchase their food in supermarkets. FAS [Retail Trade Report UP9001](#) provides a more detailed description of Ukraine's retail sector and its recent developments. Retail trade in food products has developed rapidly over the past 10 years. This growth has been driven by a strong economy and by an increase in consumers' incomes. Some changes in the expansion pattern were observed in 2007 – early 2008 with more emphasis on small retail formats, shopping malls development and expansion of chains into the regions. October 2008 financial crisis with consecutive consumers' incomes decline put these rapid expansion trends to the end opening a whole new period in Ukrainian retail development. Many small chains were forced to sell businesses to competitors. Big retailers which used to heavily rely on external financing for expansion are struggling to stay afloat. Many retailers use financial resources of importers and local producers to pay bank loans. Payment delays became common and importers wait for months to be paid. Dubious marketing charges skyrocketed as well as other fees. All these are happening against the background of shrinking demand.

Supermarket entry costs vary greatly in Ukraine. Charges may include a company's entrance fee, a shelving fee for each commodity, designated shelf fees, and a fee for positioning a pallet in the sales area. Entrance fees, designated shelves and pallets would amount to approximately \$100-250 each per store. Some payments are made once, and others are monthly charges. The exporter should be ready to pay the retailer a percentage of the trade turnover (calculated from sales or per 1 meter of shelf space). These payments are also made on monthly, quarterly or annual basis. There will be some payments associated with retail chain marketing costs, advertising booklets and in-store promotion actions. The total sum for all services and fees will range from \$1,000 to \$1,500, per commodity per store. All fees are negotiable and depend on a product type.

An average supermarket carries between 25 – 30,000 items. Approximately 80-90 percent of products sold are of Ukrainian origin. There is a wide range of dairy products, fish, meat, bakery, and spirits. The largest chains work with almost 1,000 different suppliers represented by large wholesale companies, producing companies, and importers. Local chains are actively introducing western standards and quality assurance mechanisms.

#### Convenience and Over-the-Counter Small Stores

The number of convenience stores in Ukraine reached 101,400 in 2008, which makes them the third largest retail business sector after open-air markets and supermarkets. Convenience stores are located all over Ukraine, in big cities, towns and big villages. Many of them are privatized Soviet convenience stores that have not changed their trade practices much. Privatized by their employees, these stores often have no resources for renovation, new refrigerators, showcases or other essential equipment. Concomitantly, some supermarket chains (ATB, Fozzi Group) are attempting to develop modern-style retail outlets by purchasing

and renovating stores in attractive locations in larger cities.

Once popular, small kiosks that offered a wide variety of food products, tobacco and alcoholic beverages, are quickly losing popularity. A significant number of these operations remain on the streets (296,600 kiosks as of 2008), but are slowly evolving into cigarette and snack dispensaries, as well as into hot-dog stands. Only non-alcoholic beverages, beer, chocolate bars and potato chips are usually sold at kiosks. Facing stiff competition from supermarkets, many convenience stores have switched to 24-hour operations and have decreased the number of food products offered.

### **HRI Food Service**

The HRI sector in Ukraine remains small, but is developing quite rapidly. In 2009, the number of restaurants, cafes, bars and other HRI institutions in Ukraine exceeded 29.4 ths. FAS Kyiv's GAIN Report #7004 provides a more detailed description of Ukraine's retail sector.

New fast food outlets and restaurants with international-style cuisines have begun to alter the structure of the food service sector. The market niche for expensive and elite restaurants is saturated, so the lower cost mass market is developing. Existing restaurants are divided into three categories: fast food, canteens and cafés, mid-level restaurants, and restaurants with "high-quality cuisine". The majority of outlets belong to the first group. With over 17.6 million visitors in 2005, tourists have become the major driving force behind the success of the HRI sector and the introduction of new food products to the Ukrainian market.

In addition to fast food establishments that offer pizzas, hot dogs and hamburgers, outlets of various ethnic cuisines, such as Mexican, Chinese, Vietnamese, Japanese, Italian, Indian and others, have entered the food service industry. However, the majority of customers prefer family-style menus featuring traditional Ukrainian food. In addition to McDonald's (with 56 restaurants in Ukraine), there are other fast-food restaurant chains like McSmak, "Pizza Chelentano" and "Kartoplyana khata" (Potato house), "Shvydko", etc.

HRI Prospects: The HRI sector will continue to grow. The number of customers is expected to increase as "eating out" habits become popular among the middle class and wealthy Ukrainians. Restaurant chains consisting of coffee bars, healthy food restaurants (separate eating, healthy food), and a fast-food fish chains, are not developed in Ukraine. These are good prospect areas for new restaurants, but the middle class is currently at the mercy of the economic crisis.

### **Food Processing Sector**

The food-processing sector in Ukraine has developed rapidly in the past 5 years (up until late

2008) with an average growth rate of over 15%. The food industry's share in manufacturing is almost 20%. In 2005, the industry grew by 13.7% with a total output of \$10.4 billion dollars (2004 - \$8.9 billion dollars – both are FAS/Kyiv estimates). Over 19,000 enterprises operate in the food processing sector of Ukraine. The fastest growth rate is found in fruit and vegetable processing, edible oils production, pastry and biscuits, baby food and alcoholic beverages production.

#### **Ukraine's Food Processing Industry Output (1,000 MT)**

	2003	2004	2005	2006	2007
Beef and veal (fresh or chilled)	186	141	143	156	159
Beef and veal (frozen)	97.9	57.0	50.1	43.9	61.5
Pork (fresh or chilled)	80.2	74.1	81.4	130	179
Pork (frozen)	18.9	13.9	18.0	25.4	24.0
Poultry (fresh or chilled)	131	201	274	326	458
Poultry (frozen)	38.5	39.8	58.0	90.5	90.1
Sausages	271	332	309	301	330
Sunflower oil (not refined)	1257	1343	1382	2078	2230
Milk fluid	645	716	863	818	866
Butter	1371	116	120	104	100
Spreads and oil mixes	...	53.0	80.3	71.1	83.8
Soft Cheese	57.7	71.3	83.5	93.2	93.2
Hard Cheese	173	224	274	217	246
Whole milk products	427	467	499	523	534
Bread	2335	2307	2264	2159	2034
Sugar	2486	2147	2139	2592	1867

*Source: State Statistics Committee of Ukraine*

Imports of food ingredients are estimated at \$3.2 billion for 2008 (including products for further re-packing). Major imported products for the processing industries included poultry, fish, palm oil, cocoa products, juice concentrates, spices and seasonings, vegetables, additives, tobacco and others.

The development of the food processing industry is currently impeded by inadequate domestic supply of raw agricultural products and limited export possibilities. Only a few food processors comply with EU quality requirements and packaging standards (mainly dairy, meat, confectionery, and beverages). Large food processors purchase raw materials and food ingredients directly from foreign exporters. Large wholesalers and distributors also supply the sector.

Sector trends: The Ukrainian food processing industry will be driven mainly by domestic demand, through production of dairy products, especially hard cheese and whole milk products. Production of beef will be driven by demand in Russia and some Former Soviet Union countries.

Note: Please refer to the diagram “Ukrainian Food Processing Sub-Sectors” under the Competition section, page 11.

**SECTION IV. BEST HIGH VALUE PRODUCT PROSPECTS**

Given the potential of the Ukrainian agricultural industry and relatively low incomes, U.S. high value added products will penetrate some niche markets, especially for those products that are not produced in Ukraine or are produced in limited quantities. In many cases, Ukrainian agriculture is not capable of producing products of consistently high quality (e.g. high quality beef steaks and pork medallions). There are markets for specialty products including low-fat, low-salt and sugar-free products, cake & bread mixes, corn meal, Graham Crackers and chocolate chips. U.S. suppliers could also supply new market segments that are just beginning to develop. This includes microwaveable and semi prepared food as well as TV-dinners. Potential importers must be aware that promotion of innovative or new to market products is expensive.

Other potential U.S. export items include snack foods, raisins, dried foods, nuts, spices, peanut butter, frozen and dried yogurt, soft drinks, frozen juices, fruit & vegetable pure and concentrates, fresh fruits and vegetables, wine, frozen foods, meat (especially chicken and turkey), pasta preparations, frozen and canned seafood, frozen and canned vegetables and fruits, soft cheese, soya sauces, salad dressings and breakfast cereals, baking improvers and bread mixes, and dry gluten. Quick-to-prepare main and side dishes as well as ethnic international foods are all gaining popularity.

**Products with Best Sales Prospects in Ukraine**

<b>Product Category</b>	<b>2008 Market Size</b>	<b>2008 Import</b>	<b>3-Yr. Avg. Annual Import Growth</b>	<b>Import Tariff Rate*</b>	<b>Key Constraints Over Market Development</b>	<b>Market Attractiveness for the USA</b>
<b>Poultry</b>	822 ths. tons	252 ths. tons	34%	5-15% for poultry parts and whole birds;	Cumbersome Veterinary Regulations; Supplies limited to processing; Competition EU producers; Quick growth of domestic production; Perception of U.S. product as cheap and of low quality.	U.S. product has well-established positions; Low prices attract a lot of buyers. Local producers will not be able to satisfy demand in near future. U.S. product is priced correctly and the price/quality ratio has an advantage over EU product.
<b>Beef</b>	522 ths.	27 ths.	101%	15%	Consumer	Insignificant

	tons	tons			unawareness of U.S. high quality beef; Sizable domestic production, Complicated import procedures.	specialized beef production; Niche markets for meat delicacies (steak, etc.) and meat offal; Fast HRI development.
<b>Pork</b>	850 ths. tons	238 ths. tons	61%	10-12%	Competition from EU pork, complicated import procedures; supplies limited to processing	Shortage of pork in the country; high prices; Demand for stable deliveries of both cheap and high quality product.
<b>Fish and Seafood</b>	771 ths. tons (including catch for own use)	571 ths. tons	28%	0 – 5% for all frozen fish; 10% for prepared fish, live fish, Mackerel, Trout, some Crustaceous, Anchovy, Salmon and Lobsters.	Regular deliveries of high quality product from Norway; Shortage of suitable equipment at retail trade outlets; Deficit of proper storage facilities.	Growing demand for higher quality seafood from consumers; Very modest assortment in markets; High demand from supermarkets and HRI sector.
<b>Dried fruits and nuts</b>	2 ths. tons	1 ths. tones	6%	From 0% to 20%	Sharp competition with Iran and Turkey. Desire of packers to save on raw stock, procuring low quality stock from Iran, Uzbekistan, and Afghanistan	Intensive development of confectionery industry and start of retail sales of rare dried fruits (exceed world prices by 3 – 6 times). High quality of U.S. product;
<b>Wine and spirits</b>	Over 616 ths liters	69 ths liters	Over 95%	Significantly Varies by product	High import duties, tough competition with Ukrainian-made spirits and drinks produced in the CIS states	Relatively high level of alcohol consumption; Demand for exotic drinks (whiskey, gin, rum, bourbon).
<b>Pet food</b>	N/a	71 ths. tons	52%	5-10%	Large supply of Russian-made cheap pet food; Smuggling; Strong tradition of feeding pets with table scraps; Long registration	Traditionally large number of home pets; Increased population incomes followed by growing demand for ready to use pet food.

					and certification procedures.	Comparatively low import duty
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*\* All imported products are subject to 20% VAT tax*

## **SECTION V. KEY CONTACTS AND FURTHER INFORMATION**

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## ATTACHMENTS

**TABLE A. KEY TRADE & DEMOGRAPHIC INFORMATION**

	<b>2006</b>	<b>2007</b>	<b>2008</b>
Agricultural Imports From All Countries (\$ million) /U.S. Market Share (%)*	3166/5	4111/6	6457/7
Consumer Food Imports From All Countries (\$ million)/U.S. Market Share (%)	148/0.5	201/1.6	251/1.3
Edible Fishery Imports From All Countries (\$ million)/U.S. Market Share (%)*	445/7	532/9	721/5
Total Population (Millions)/Annual Growth Rate (%)	46.9/-0.6	46.6/-0.6	46,4/-0,6
Urban Population (Millions)/Annual Growth Rate (%)	31.9/-0,4	31,7/-0,3	31.7/-0.4
Number of Major Metropolitan Areas	7	7	7
Size of the Middle Class (Millions)**	3.2	4.1	8.4
Per Capita Gross Domestic Product (U.S. \$)	2303	3069	3898
Unemployment Rate (%)	12.8	6.4	6.9
Per Capita Food Expenditures (U.S. \$), per year	869	1002	1205
% of Female Population Employed	48	47	47
Average Exchange Rate US\$1	5.05 UAH	5.05 UAH	5.27 UAH

Source: State Statistic Committee of Ukraine

\*HTS 1-24 groups

\*\* Pazumkov Center Studies, Gorshenin Center Studies, FAS/Kiev own Estimates

**TABLE B. Ukraine's Agricultural Product Imports from the U.S. (2005/2009)**

Product	January - December				January - July Comparisons		
	2005	2006	2007	2008	2008	2009	% Chan.
Bulk	13290	40749	98463	10466	8,117	7,788	-4.05
Wheat	18	38	6	0	0	7	-
Rice	85	278	888	729	403	569	41.34
Soybeans	0	356	3	256	0	0	-
Tobacco	12814	40047	96393	8297	6575	7144	8.65
Pulses	306	0	0	0	0	0	-
Peanuts	9	0	4	0	0	0	-
Other Bulk	58	30	1169	1184	1139	35	-96.93
Intermediate	16150	8074	11602	20395	14460	13169	-8.93
Soybean Meal	0	0	0	175	169	6075	3501.1
Soybean Oil	0	0	23	53	22	0	-100
Vegetable Oils (Ex Soy)	148	37	66	0	0	0	-
Feeds & Fodders	1944	1495	58	139	89	0	-100
Live Animals	366	0	975	660	405	0	-100
Hides & Skins	61	128	79	368	368	86	-76.56
Animal Fats	2091	0	0	0	0	0	-
Planting Seeds	8555	4987	6286	12220	9978	5048	-49.41
Sugar, Sweetner, Bases	409	445	810	1078	477	767	60.84
Other Intermediate	2576	981	3303	5693	2949	1193	-59.55
Consumer-Oriented	72027	59609	100895	251965	101223	66668	-34.14
Snack Foods	416	308	1018	555	303	369	22.09
Breakfast Cereals	23	35	131	277	217	82	-62.23
Red Meats, Fr/Ch/Fr	0	106	1644	30791	1356	3,094	128.25
Poultry Meat	62400	49586	83969	192919	85840	51682	-39.79
Dairy Products	318	794	625	803	648	219	-66.12
Eggs & Products	259	307	0	0	0	5776	-
Fresh Fruit	0	3	635	919	70	118	68.01
Fresh Vegetables	5	0	289	74	38	33	-12.17
Processed Fruit & Veg	450	289	905	588	328	114	-65.39
Fruit & Veg Juices	62	93	329	411	269	43	-83.88
Tree Nuts	1122	826	3176	9285	4266	1337	-68.66
Wine And Beer	132	57	0	35	0	0	-
Nursery Products	30	29	78	807	807	0	-100
Pet Foods	4264	6004	6701	10115	5867	2501	-57.37
Other Consumer Oriented	2546	1172	1394	2855	1214	1298	6.92
Seafood Products	17940	43938	66766	54414	22000	16869	-23.32
Salmon Whole/Evis	2940	5416	15844	16954	6103	1822	-70.14
Salmon Canned	92	72	0	20	20	0	-100
Surimi (Fish Paste)	648	235	184	529	251	0	-100
Roe/Urchin/Fish Eggs	3310	6601	10329	9145	1803	359	-80.07
Other Seafood	10950	31615	40409	27766	13823	14,688	6.25
Agricultural Total	101467	108432	210959	282826	123800	87625	-29.22
Ag,Fish,Forest Total	121426	155108	281730	353041	155809	104714	-32.79

Source: U.S. Bureau of the Census Trade Data (new trade data from UN Statistics Division for Ukraine is not available)

**TABLE C. TOP 15 SUPPLIERS OF CONSUMER FOODS AND EDIBLE FISHERY PRODUCTS to Ukraine (\$ Million)**

CONSUMER-ORIENTED AG TOTAL*				FISH & SEAFOOD PRODUCTS			
Country	2006	2007	2008	Country	2006	2007	2008
Russia	57.9	83.6	104.7	Russia	57.9	83.6	104.7
Germany	31.4	48.2	65.4	Germany	31.4	48.2	65.4
Hungary	12.6	11.6	15.7	Hungary	12.6	11.6	15.7

Netherlands	12.6	15.6	12.6	Netherlands	12.6	15.6	12.6
United Kingdom	4.1	3.6	10.1	United Kingdom	4.1	3.6	10.1
Switzerland	3.9	4.5	7.4	Switzerland	3.9	4.5	7.4
Poland	3.5	2.3	5.4	Poland	3.5	2.3	5.4
Austria	1.6	2.1	4.1	Austria	1.6	2.1	4.1
Belarus	0.9	2.8	3.3	Belarus	0.9	2.8	3.3
United States	0.8	3.1	3.2	United States	0.8	3.1	3.2
Italy	0.5	2.3	1.9	Italy	0.5	2.3	1.9
Sierra Leone	0.0	0.0	1.9	Sierra Leone	0.0	0.0	1.9
China	1.2	1.2	1.8	China	1.2	1.2	1.8
India	1.5	1.2	1.5	India	1.5	1.2	1.5
Japan	0.3	0.4	1.3	Japan	0.3	0.4	1.3
--The World--	148.1	201.7	250.7	--The World--	445.2	532.6	721.7

*Source: State Statistic Committee of Ukraine (trade data from UN Statistics Division for Ukraine is not available);*

*\* Based on Ukrainian Statistics and BICO definition of Consumer-Oriented Products by 10-digit HS Code.*