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Permanent Normal Trade Relations (PNTR) Status for Ukraine and U.S.-Ukrainian Economic Ties

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Summary

The 109th Congress may consider legislation to grant Ukraine permanent normal trade relations (PNTR), that is nondiscriminatory, trade status. The importance of the issue has been elevated since the “Orange Revolution” in Ukraine that led to the election of Viktor Yushchenko as President of Ukraine. The issue before Congress would be whether to remove the requirements of Title IV of the Trade Act of 1974, including the so-called Jackson-Vanik amendment, and authorize the President to extend unconditional nondiscriminatory treatment to trade with Ukraine. On November 18, 2005, the Senate passed S. 632 without amendment by unanimous consent. This report will be updated as events warrant.

Permanent normal trade relations (PNTR) status has been an issue in U.S.-Ukrainian relations since the country obtained its full sovereignty with the collapse of the Soviet Union in December 1991. Legislation to grant PNTR to Ukraine had been introduced in previous Congresses but received no further action as critics raised concerns about some Ukrainian trade practices, among other issues. Recently, the significance of the issue has been elevated in the wake of the “Orange Revolution” in Ukraine that led to the election of President Viktor Yushchenko at the end of 2004. At his April 4, 2005, Washington summit meeting with President Yushchenko, President Bush pledged to work towards securing PNTR for Ukraine. In his April 6, 2005 address to a joint meeting of the U.S. Congress, President Yushchenko urged Members of Congress to grant Ukraine PNTR.

While ostensibly a trade issue, granting PNTR is seen by many as also a foreign policy instrument to convey U.S. support for a democratically-elected leader who has indicated his intention to strengthen ties with the United States and Western Europe and reduce dependence on Russia. Yushchenko has made PNTR a top priority in U.S.-Ukrainian relations.¹ At the same time, some view a debate on PNTR as an opportunity

¹ See CRS Report RL32845, *Ukraine’s Orange Revolution and U.S. Policy*, by Steven Woehrel.

for the Congress to weigh in on U.S. policy toward Ukraine and to make sure that U.S. economic interests, as well as foreign policy interests, are considered.

Granting Ukraine PNTR status requires a change in law because Ukraine is denied unconditional and permanent NTR under Title IV of the Trade Act of 1974, which includes the so-called Jackson-Vanik amendment.

What is NTR Status and the Jackson-Vanik Amendment?

“Normal trade relations” (NTR), or “most-favored-nation” (MFN), trade status is used to denote nondiscriminatory treatment of a trading partner compared to that of other countries.² Only a few countries do not have NTR status in trade with the United States. In practice, duties on the imports from a country which has been granted NTR status are set at lower, concessional rates than those from countries that do not receive such treatment. Thus, imports from a non-NTR country can be at a large price disadvantage compared with imports from NTR-status countries.

Section 401 of Title IV of the Trade Act of 1974 requires the President to continue to deny nondiscriminatory status to any country that was not receiving such treatment at the time of the law’s enactment on January 3, 1975. In effect this meant all communist countries, except Poland and Yugoslavia. Section 402 of Title IV, the so-called Jackson-Vanik amendment, denies the countries eligibility for NTR status as well as access to U.S. government financial facilities, such as the Export-Import Bank or the Overseas Private Investment Corporation (OPIC), as long as the country denies its citizens the right of freedom of emigration. These restrictions can be removed if the President determines that the country is in *full compliance* with the freedom-of-emigration conditions set out under the Jackson-Vanik amendment. For a country to maintain that status, the President must reconfirm his determination of full compliance in semiannual reports (due by June 30 and December 31) to Congress. His determination can be overturned by the enactment of a joint resolution of disapproval concerning the December 31st report.

The Jackson-Vanik amendment also permits the President to waive full compliance with the freedom-of- emigration requirements, if he determines that such a *waiver* would promote the objectives of the amendment, that is, encourage freedom of emigration. This waiver authority is subject to annual renewal by the President and to its possible congressional disapproval via a joint resolution.³ Before a country can receive NTR treatment under either the presidential determination of full compliance or the presidential waiver, it must have concluded a bilateral agreement that provides for, among other

² The term “MFN” has been used in international agreements and until recently in U.S. law to denote the fundamental trade principle of nondiscriminatory treatment. However, “MFN” was replaced in U.S. law, on July 22, 1998, by the term “normal trade relations, “ or some other appropriate term (Title V, P.L. 105-206). MFN is still used in international trade agreements. The terms are used interchangeably in this report.

³ For more information on the Jackson-Vanik amendment see CRS Report 98-545, *The Jackson-Vanik Amendment: A Survey*, by Vladimir Pregelj.

things, reciprocal extension of NTR or MFN treatment. The agreement and a presidential proclamation extending NTR status cannot go into effect unless a joint resolution approving the agreement is enacted.

The United States extended NTR treatment to Ukraine under the *presidential waiver* authority beginning in June 1992 after the two countries signed and entered into force a bilateral agreement as required under Title IV of the Trade Act of 1974. Since June 1997, Ukraine has received NTR status under the *full compliance* provision. Presidential extensions of NTR status to Ukraine have met with virtually no congressional opposition. Thus, for Ukraine permanent normal trade relations (PNTR) status is mostly symbolic because its tariff status would not change.

While Ukraine remains subject to the Jackson-Vanik amendment, some of the other former Soviet republics have been granted PNTR by the United States. For example Kyrgyzstan and Georgia received PNTR in 2000. Most recently, Armenia received PNTR in January 2005.

U.S.-Ukrainian Economic Ties

During the Cold War, U.S.-Soviet economic ties were very limited. They were constrained by national security and foreign policy restrictions, including the Jackson-Vanik amendment. They were also limited by Soviet economic policies of central planning that prohibited foreign investment and tightly controlled foreign trade.

Since the collapse of the Soviet Union, Ukraine has struggled with shedding the structures of a planned economy and building a market economy. These problems hampered Ukraine's economic growth early in the transition period. In the last few years, Ukraine's gross domestic product (GDP) has grown at fairly rapid rates, but many observers contend that Ukraine needs to address problems with contradictory and excessive government regulations and corruption if it is to reach its economic potential.

Ukraine remains heavily tied economically to Russia. It is highly dependent on Russia for energy, and Russia accounts for around 18% of Ukraine's exports and 40% of Ukraine's imports. However, Ukraine has been diversifying its trading partners. The EU has become an important trading partner.⁴

The United States has encouraged closer economic ties with Ukraine since the collapse of the Soviet Union. Along with granting conditional NTR status, the United States has made government loan guarantees from the U.S. Export-Import Bank available to U.S. exporters to Ukraine and has made insurance and credit programs from the government-operated Overseas Private Investment Corporation (OPIC) available to U.S. investors in the Ukraine.

Although increasing, U.S.-Ukrainian trade remains very small. In 2004, Ukraine was the 79th export market for the United States and the 71st source of imports. It accounted for about 0.5% of total U.S. exports and 0.5% of total U.S. imports in 2004. In 2004, the

⁴ Economist Intelligence Unit. *Country Risk Service: Ukraine*. March 2005. P. 17.

United States accounted for about 3% of Ukrainian exports and 2% of Ukrainian imports. In 2004, over half of U.S. imports from Ukraine consisted of steel and steel products plus coke that is used in making steel. The sharp increase in U.S. imports from Ukraine in 2004 was due largely to the lifting the U.S. government restrictions on steel imports that had been in place from March 2002 to December 2003. Anhydrous ammonia, a fertilizer, accounted for another 14% of U.S. imports from Ukraine.

Poultry and other meats accounted for slightly over one-fifth of U.S. exports to Ukraine in 2004. The Ukrainian government lifted a two-year ban on imports of U.S. poultry in December 2003 after the two countries agreed to a new veterinary certificate, leading to a sharp increase in U.S. exports to Ukraine in 2004. Machinery, especially agricultural machinery, is another major U.S. export to Ukraine.

Foreign investment in Ukraine is modest. Excessive government regulation, an inadequate commercial code, corruption, lack of enforcement of property rights, and an underdeveloped banking system have contributed to a poor investment climate.⁵ As of January 1, 2005, the volume of foreign direct investment (FDI, investment in production facilities, real estate, etc.) in Ukraine stood at \$8.4 billion. Of that amount, investors from the United States accounted for \$1.2 billion, or 14%, and were the leading source of FDI in Ukraine.⁶

Issues in U.S.-Ukrainian Economic Ties

Several economic issues may arise during a debate on PNTR for Ukraine. From the U.S. perspective, one of the most serious issues is the lack of Ukrainian enforcement of intellectual property rights (IPR). The United States Trade Representative (USTR) identified Ukraine as a priority foreign country in 2002, 2003, and 2004, under the section 182 of the Trade act of 1974, as amended, also called "Special 301." At this time, Ukraine is the only country that the USTR has so identified, although other countries have been identified as potentially problematic.⁷ The USTR took this action because of Ukraine's failure to adequately prevent the production and distribution of pirated optical disks, CDs and CD-ROMs. As a result, the United States withdrew GSP benefits for Ukraine in August 2001, a benefit that the United States had extended to promote trade and economic development in Ukraine. In January 2002, the United States also imposed 100% tariffs under 23 tariff items with an annual value of around \$75 million.⁸ On August 31, 2005, the United States announced that it was going to lift the tariff-sanctions in recognition of steps Ukraine had taken to improve its IPR laws. The Office of the USTR indicated that

⁵ U.S. Department of Commerce. U.S. and Foreign Commercial Service. *Doing Business in Ukraine: A Country Commercial Guide for U.S. Companies*. February 2005. Not paginated.

⁶ Ibid and the Ukrainian Statistical Office.

⁷ Office of the United State Trade Representative. *Special 301 Report*. Washington. 2004.

⁸ Under "special 301," the USTR is required to identify each year trading partners that do not adequately protect intellectual property rights. If that country fails to remedy the situation, then the USTR is required to apply trade sanctions commensurate with the losses to U.S. holders of the IPR.

it would conduct an “out-of-cycle” review of Ukraine’s IPR regime that could eventually lead to its reinstatement as a GSP beneficiary.⁹

U.S. exporters and investors have cited other problems that plague the business environment in Ukraine. For example, the Ukrainian government prevents foreign banking and insurance providers from establishing branches. In addition, U.S. exporters consider some Ukrainian government health and safety regulations and certification procedures to be unnecessarily burdensome and government procedures for privatizing state-owned assets to be insufficiently transparent. U.S. agricultural producers consider Ukraine’s restrictions on imports of American pork, poultry, and beef to be unscientifically based and unnecessary.¹⁰

Along with the current application of the Jackson-Vanik amendment, Ukrainian officials have raised other issues in its trade relations with the United States. Foremost among them is the application of “nonmarket economy” (NME) status by the U.S. Department of Commerce to trade with Ukraine. Under U.S. antidumping laws, “fair prices” for imports from nonmarket economies are calculated differently than prices on imports from market economies. The methodology used to make these calculations leads to higher antidumping margins and, therefore, places imports from Ukraine at a competitive disadvantage vis-a-vis other imports or U.S. domestic production. In August 2002, the Department of Commerce indefinitely deferred its final decision on whether to eliminate the NME designation for Ukraine and told Ukraine it needed to resubmit its request for such status. The Ukrainian government did so in March 2005.

Prospects, Implications and Legislation

Although PNTR has been an issue in U.S.-Ukrainian relations for many years, trade issues and political issues such as allegations of official Ukrainian involvement in the September 2000 murder of Ukrainian investigative journalist Georgy Gongadze had caused U.S. political leaders to distance themselves from the regime of then-Ukrainian President Kuchma. The election of President Viktor Yushchenko has elevated the priority of PNTR for the Bush administration and the Congress. Support for PNTR for Ukraine appears strong. Nevertheless, concerns about IPR protection in Ukraine and other trade issues are likely to arise during a debate on PNTR. Some non-trade issues may arise as well. For example, while the representatives of the Jewish community acknowledge improvement in the lives of Ukrainian Jews, they have expressed concerns about what they consider to be the slow pace at which Jewish community property, seized during the Holocaust and the Soviet period, is being returned its owners.

Granting Ukraine PNTR status will have little direct impact on U.S.-Ukrainian trade. Ukrainian imports have entered the United States on an NTR or most-favored-nation (MFN) basis since 1992. However, Ukraine is negotiating with the United States and other members of the World Trade Organization to enter the WTO. WTO members must

⁹ *International Trade Reporter*. September 8, 2005. p. 1419.

¹⁰ Office of the United States Trade Representative. *National Trade Estimates Report on Foreign Trade Barriers*. March 2005.

extend reciprocal MFN (PNTR) treatment to one another. If Ukraine becomes a WTO member and the United States does not grant Ukraine PNTR, it would force the United States to invoke the nonapplication Article XIII of the WTO agreement which would prevent the application of the entire WTO agreement, including all of Ukraine's concessions) between the United States and Ukraine.

PNTR has considerable political importance to Ukraine. It would signify Ukraine's treatment as a "normal" country by the United States. The timing of extending PNTR could have political implications as well, especially relating to Russia. Russian President Putin has been pressing the United States to grant it PNTR. President Bush has pledged to him on several occasions to work with the Congress to obtain PNTR but legislation introduced in the 107th and 108th Congresses to do so received no further congressional action because of concerns regarding Russian IPR and other trade practices. The Russian political leadership would likely be upset if Ukraine received PNTR from the United States before Russia.

To date, six bills have been introduced in the 109th Congress that would authorize the President to grant Ukraine PNTR status. Four bills — S. 410 (McCain) and H.R. 885 (Hyde), which are identical bills, S. 632 (Lugar), and H.R. 1053 (Gerlach) — would simply authorize the President to determine that Title IV of the Trade Act of 1974, as amended, would no longer apply to Ukraine and to proclaim non-discriminatory treatment (normal trade relations status) to the products of Ukraine.¹¹ Once the President has taken these actions, Title IV (including the Jackson-Vanik amendment) would no longer apply to Ukraine, according to these bills. On November 18, 2005, the Senate Finance Committee discharged S. 632 without amendment by unanimous consent and on the same day the Senate passed S. 632 without amendment by unanimous consent.

The other two pending bills — S. 46 (C. Levin) and H.R. 1170 (S. Levin) — would authorize the same measures as the other four bills would authorize but with additional provisions for congressional oversight. Both bills stipulate that the United States would continue to enjoy rights under the 1992 U.S.-Ukrainian bilateral agreement as long as that agreement remains in force, especially the right to impose safeguard measures against imports from Ukraine in response to import surges that cause or threaten to cause disruption of the U.S. market for like products. In addition, both bills would provide the opportunity for the Congress, if it should so chooses, to express its view that a U.S.-Ukrainian bilateral agreement on conditions of Ukraine's accession to the WTO "does not adequately advance the interests of the United States."¹² S. 46 also includes a "Sense of Congress" provision that the United States remain committed to encouraging Ukraine to ensure the protection of human rights and civil liberties to its citizens to carry out political, economic and judicial reforms.

¹¹ On April 5, 2005, Sen. McCain (AZ) introduced an amendment (S.Amdt. 267) to S. 600, a bill to authorize funding for the State Department, that would eliminate the Jackson-Vanik requirements for Ukraine. The amendment is pending at this writing.

¹² As part of the WTO accession process, applicant-countries must negotiate a bilateral agreement with each WTO member that desires to do so. The agreement stipulates conditions on which the country will be allowed to enter the WTO.