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Foreword

This Review has been undertaken under the aegis of the OECD Investment Committee and as part of the OECD-Eurasia Competitiveness Programme, for which the Swedish International Development Agency and the Polish government have provided financial support.

OECD Investment Policy Reviews *aim to facilitate dialogue between OECD and partner countries, share experience and support investment policy reforms. The objective of the 2011* Investment Policy Review of Ukraine *is to assess the country's ability to comply with the principles of liberalisation, transparency and non-discrimination and its policy convergence with recognised international investment standards such as the OECD* Declaration on International Investment and Multinational Enterprises. *It also considers the interaction and coherence of Ukraine's investment policy with other areas such as investment promotion and facilitation, trade and competition policy and responsible business conduct practices in light of the OECD* Policy Framework for Investment. *A separate chapter deals with Ukraine's specific challenge to attract investment in support of energy efficiency.*

The work on Ukraine's Review has been carried out in close co-operation with the Ukrainian authorities, in particular the Ministry of Economic Development and Trade. Representatives of several OECD member countries joined the OECD mission in Kyiv in January 2011 to finalise policy recommendation of the Review. The examination of the background report by the Investment Committee's Advisory Group on Investment and Development took place on 22 March 2011 at the OECD headquarters in Paris in the presence of the Ukrainian delegation led by Anatolyi Maksyuta, Deputy Minister of Economic Development and Trade.

The report was prepared by Blanka Kalinova and Stephen Thomsen, Senior Economists in the Investment Division of the OECD Directorate for Financial and Enterprise Affairs (DAF) and Wojciech Paczynski from the Center for Social and Economic Research (Chapter 4), based on information provided by the Ukrainian authorities and including comments by the delegates to the Investment Committee. The information is current as of 15 April 2011.

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The 2011 OECD *Investment Policy Review of Ukraine* assesses the country's ability to comply with the principles of liberalisation, transparency and non-discrimination and to bring its investment policy closer to recognised international standards such as the OECD Declaration on International Investment and Multinational Enterprises (MNEs). Based on the OECD Policy Framework for Investment, the *Review* considers the interaction and coherence of investment policy with other areas such as investment facilitation, trade and competition policy as well as responsible business conduct practices critical for enhancing the investment climate. It also highlights specific challenges faced by Ukraine to attract investment in support of energy efficiency. The *Review* shows that Ukraine has made progress in developing a legal framework for attracting foreign direct investment (FDI), but implementation problems continue to affect domestic and foreign investors alike and prevent the country from mobilising private investment commensurate with its economic potential and investment needs.

In line with recent world investment trends, Ukraine's FDI inflows declined considerably in 2009 and picked up in 2010 but remain below pre-crisis levels. Financial services and manufacturing together absorb 62% of the total inward FDI stock. EU27 countries are the main source of Ukraine's FDI, representing over 75% of the total stock. Foreign investors have participated in a number of privatisation deals, in particular in the metallurgical sector in 2005, but the privatisation process has stalled in recent years. The 2010 governmental reform programme stresses the contribution of foreign investment not only as a source of external financing but also as a market transformation and competition-enhancing tool and encourages increased participation of foreign investors in the revamped privatisation process.

Since its initiation in 1991, Ukraine's legislation has embodied the principle of non-discrimination of foreign investment and general provisions on foreign investment protection, including against nationalisation and changes in relevant legislation as well as guarantees for compensation and the repatriation of profits. Since the dismantling in April 2010 of temporary financial crisis-related measures applied specifically to foreign investment, all categories of investment are now subject to the same establishment procedures, notably state registration, business permits and, for the activities concerned, licensing. The current legal framework thus provides for national treatment for firms' establishment but in practice new foreign investors, who are less familiar with local practices than incumbent firms, have been discouraged by complex, protracted and costly procedures and resulting regulatory uncertainty. The government's recent efforts to streamline administrative procedures (for example in the area of licensing) should be pursued.

Ukraine applies several trans-sectoral and sectoral restrictions on foreign investment which qualify for the list of exceptions to national treatment and measures reported for transparency in the meaning of the OECD *Declaration on International Investment and Multinational Enterprises*. The trans-sectoral restrictions concern the prohibition of FDI in unspecified strategic sectors and territories in cases where foreign capital would lead to Ukraine's "critical dependence on the business cycles of international markets" or "jeopardise its economic independence". According to the 1992 privatisation law, legal entities in which more than 25% of equity is owned by a state cannot participate in the privatisation of state and municipal property. Defining clearly the scope of "strategic" sectors closed to foreign investors or subject to authorisation procedures would considerably reduce any current legal uncertainty concerning foreign investment in these sectors. More generally, while safeguarding its essential national security interests the country's policy should be designed and implemented to ensure the smallest possible impact on investment flows and be guided by the principles of non-discrimination, proportionality, transparency and accountability as recommended in the OECD *Guidelines for Recipient Country Investment Policies relating to National Security* adopted by the OECD Council in May 2009.

Despite the possibility of short- and long-term land leasing, the moratorium on foreign ownership of agricultural land, prolonged until 2012 is perceived by foreign investors as a significant limitation on their activities especially given additional bottlenecks such as the absence of a unified registration system for land and real estate. As part of its WTO accession commitments, Ukraine has opened a number of sectors to foreign investment, including transport, telecommunications and banking. Several remaining restrictions, notably on providing insurance services by direct branches of foreign insurance companies and a 30% limit on foreign ownership in the wholesale trade of books, magazines and newspapers, have to be eliminated within 5 years after the country's WTO accession, *i.e.* by May 2013.

Among other measures which qualify for the list of measures reported for transparency under the OECD *Declaration on International Investment and Multinational Enterprises*, Ukraine would notify a significant number of public monopolies, specifically in energy transport, distribution and transmission of electricity, railways and local telephone communications. Taking into account the existing statutory FDI restrictions, Ukraine's score under the OECD FDI Restrictiveness Index is higher than the OECD members' average but lower than the average of non-OECD countries covered by the FDI Index. Ukraine's relatively favourable performance with respect to formal FDI restrictions captured by the OECD FDI Index contrasts with a poor perception of its investment climate in most international comparisons, which assess actual implementation of existing laws and regulations.

Based on the OECD *Policy Framework for Investment*, which evaluates various policies relevant for the country's investment climate, Ukraine has made progress in several important areas such as investment facilitation and promotion, trade and competition policies, but more remains to be done to create a favourable investment environment. General transparency in terms of access to investment-related information has improved, but public consultations and public-private dialogue though referred to in the law have not yet been generalised. Investment policy implementation continues to suffer from a lack of regulatory transparency due to frequent changes in legislation, the complexity of existing measures and the absence of, or the delays in issuing, implementing regulations. This shortcoming allows too much room for administrative discretion and hence the possibility of corruption. Protection of intellectual property rights is probably one of the most critical areas where the gap between national legislation – generally in line with internationals standards – and its inadequate enforcement in practice is particularly harmful to foreign investment. Ukraine's investment promotion activities have been subject to frequent reorganisations resulting in the multiplication of various agencies with often overlapping responsibilities. It is essential that the new State Agency for Investments and National Projects, created at the end of 2010, and the restructured Council of Local and Foreign Investors become efficient tools for enhancing policy implementation in close association with the investment community.

The OECD *Declaration on International Investment and MNEs* includes the Instrument on Investment Incentives and Disincentives, which encourages adherent countries to make such measures transparent so that their scale and purpose can be easily determined. After its unsuccessful experience with Special Economic Zones (SEZs), Ukraine has abolished the differentiated tax and customs regime applied in SEZs in 2005 but is now considering reintroducing a preferential investment regime in selected areas. The government's commitment gradually to reimburse export VAT-refund arrears, which have constituted one of the major disincentives to firms' operations and investment, is part of an ambitious tax reform package aimed at reducing the weight of taxes in business costs and improving tax management.

Ukraine's accession to the WTO in May 2008 has enhanced trade policy transparency and predictability. The country has concluded a number of free trade agreements, mainly with the countries of the former Soviet Union. Efforts to streamline border procedures and trade facilitation measures should be intensified, especially the introduction of electronic customs documents and procedures as well as the adoption of international technical standards and conformity certification procedures. In the area of competition policy, Ukraine has gradually put in place an appropriate legal and institutional framework but the development of a competitive environment remains constrained by the size of the public sector, particularly the large number of public monopolies operated by state-owned enterprises, the scope of price controls and the pervasive system of licensing and business permits, which prevent the entry of new firms.

Public policies promoting principles for responsible business conduct, such as those embodied in the OECD *Guidelines for MNEs*, contribute to attracting investment in support of sustainable development. But, in many relevant areas, both public awareness and responsible business practices, such as compliance with, and reporting on, environmental performance and management, are still less common in Ukraine than in other emerging economies. Corruption remains the key investment impediment and the main reason for the country's poor ranking in available international business surveys. Recent delays in adopting new anti-corruption legislation cast doubts on the authorities' willingness to deal with this issue.

Ukraine faces specific challenges in attracting energy investment required to reduce its currently high energy intensity, increase its energy production and upgrade its deteriorating energy infrastructure. Energy efficiency efforts and investment have been hampered by distortions in energy price setting and the energy market structure, dominated by state-owned firms. The June 2010 government economic reform programme addressed these critical issues and set objectives for accelerating the privatisation process in the energy sector and for gradually adjusting energy prices to the market level. Given that public financing will be unable by itself to cover the huge needs for energy efficiency investment, implementing these reforms without delays is essential in order to attract private, including foreign, investment.

Although for the near future, energy efficiency remains the main focus of Ukraine's energy policy, the importance of developing renewable energy resources should not be underestimated, particularly when there are synergies between energy efficiency and environment-friendly energy production and technologies, for example in the case of heat production based on biomass and waste. Ukraine has developed a basic policy framework in support of environmentally friendly energy resources and technologies, but in the absence of energy price reforms the incentives for such investment have been limited. The government has an important role to play in promoting both public awareness and corporate initiatives aimed at improving the measurement and reporting of environment performance. Foreign investment and international assistance could be a potential source of "greening" effects, both directly through transfers of more energy-efficient and environmentally friendly technologies and indirectly by facilitating spillovers to domestic firms through best practices in environmentally friendly production, technologies and management.

Policy recommendations of the *Review* (see Boxes below) focus on specific aspects of investment policy. Although necessary macroeconomic reforms are not expressly addressed here, they remain a prerequisite for putting the country firmly on the map of foreign investors, especially given the current risk-averse behaviour of most investors. To encourage capital inflows, the country has to stabilise its public finance deficit and reform its fiscal system to support public and private investment, particularly in infrastructure. Proposed investment policy recommendations thus have to be a part of broader reforms which target public and private investment, including foreign capital, and which remove entry and exit barriers for all categories of firms. The following recommendations are divided into three categories: *i)* general investment policy recommendations; *ii)* recommendations for improving the investment climate, and *iii)* recommendations related to energy efficiency investment.

Box 1. **General investment policy recommendations**

- Define the strategic sectors in which foreign investment is prohibited or subject to specific authorisation procedures; specify relevant authorisation procedures, including the conditions/documents required for applications and the deadline for reply to applicants by the responsible authority.
- Specify clearly the conditions for foreign participation in the privatisation process in the new law on privatisation currently under preparation and avoid leaving room for administrative discretion in selecting those sectors and firms excluded from privatisation.
- Observe the guiding principles of non-discrimination, proportionality, transparency and accountability in implementing investment measures related to national security, as expressed in the 2009 OECD *Guidelines for Recipient Country Investment Policies relating to National Security* and consider the formal acceptation of these recommendations.
- Make sure that the new law on investment currently in preparation confirms the non-discrimination principle for foreign investment.
- Implement e-registration and continue to simplify business permit procedures, including applying the "declarative principle" as foreseen by the law.
- Abolish the moratorium on agricultural land ownership in 2012 as currently foreseen and accelerate the implementation of the unified registration of land and real estate property.
- Remove remaining foreign investment and trade restrictions in line with WTO commitments.
- Develop implementing regulations to make possible the rapid and effective application of the law on public-private partnerships.

Box 2. **Recommendations for improving the investment climate**

- Develop public-private consultations on business-related legislation and regulations with the business community, including foreign investors, notably within the new Council of Local and Foreign Investors.
- Take into account the interests and concerns of foreign investors in small and medium-sized enterprises, which are particularly affected by frequent legislative and regulatory changes and related regulatory uncertainty.
- Consider setting up an ombudsman office to tackle concrete problems faced by new and established foreign investors in Ukraine.
- Ensure that the State Agency for Investments and National Projects established in December 2010 fulfils its main tasks in line with the planned schedule, notably the creation of the single window facility for foreign investors before 2012.
- Finalise refunding of VAT arrears and improve VAT administration as foreseen by the IMF agreement and the government's plan.
- Carry out a thorough costs-benefit analysis before reintroducing the preferential investment regimes in special economic zones and priority development territories.

Box 3. **Recommendations related to energy efficiency investment**

- Comply with the objectives and the planned schedule set up for the energy sector in the 2010 Government Economic Reform Programme, namely phasing out of all energy tariff subsidies before the end of 2012, launching privatisation in the energy sector, unbundling of *Naftogaz* activities and ensuring the independence of the energy regulatory agency.
- Implement the new gas law allowing access to pipelines by other operators.
- Put in place a transparent and predictable legal and regulatory framework to mobilise investment in energy efficiency and renewable energy resources financed by international programmes and through the development of private-public partnerships.
- Promote public awareness and corporate initiatives aimed at improving the measurement and reporting of energy efficiency and environment performance.

Chapter 1

Ukraine's Opening to International Investment

In line with recent world investment trends, Ukraine's FDI inflows declined considerably in 2009 and picked up in 2010 but remain below pre-crisis levels. Financial services and manufacturing together absorb 62% of the total FDI stock. EU27 countries are the main source of Ukraine's FDI, representing over 75% of the total stock. Foreign investors participated in a number of privatisation deals, particularly in the metallurgical sector. The 2010 government reform programme stresses the contribution of foreign investment not only as a source of external financing but also as a market transformation and competition-enhancing tool and encourages increased participation of foreign investors in the revamped privatisation process.

After peaking in 2008, FDI inflows halved in 2009 before recovering somewhat in 2010

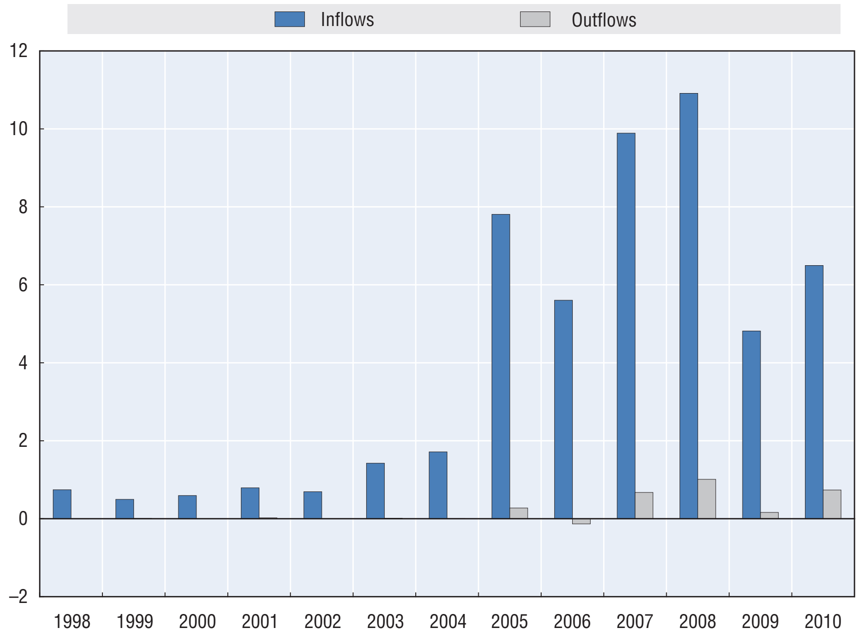
Ukraine's foreign direct investment inflows peaked in 2008 at almost USD 11 billion together with other investment liabilities, mainly short and long-term trade loans, which also surged in 2007-2008. Since then, Ukraine's FDI inflows have been strongly affected by the world economic crisis: in 2009, FDI inflows fell by 56% and other investments also contracted strongly. Portfolio investment, which is traditionally more reactive to the general economic and political environment, started to decline already in 2008. Outward direct investment flows have followed a similar trend as inward flows: after the record amount observed in 2008 (USD 1 billion), they fell back to their pre-2007 low levels in 2009. Ukraine has nevertheless remained a net FDI recipient during the whole period, but the surplus has halved from USD 9.9 billion in 2008 to USD 4.7 billion in 2009.

Table 1.1. **Ukraine's international investment (million of USD)**

	2005	2006	2007	2008	2009	2010
Inward direct investment flows	7 808	5 604	9 891	10 913	4 816	6 495
Equity capital	7 489	4 504	8 364	9 440	4 434	5 550
Reinvested earnings	4	35	17	172	22	0
Other capital	315	1 065	1 510	1 301	360	945
Inward portfolio investment	2 757	3 586	5 782	–1 292	–1 551	4 434
Other investment liabilities	5 453	9 780	22 553	27 568	2 867	10 609
Outward direct investment flows	275	–133	673	1 010	162	736
Equity investment	27	–8	975	796	115	692
Reinvested earnings	0	0	0	1	0	0
Other capital	248	125	-302	213	47	44
Outward portfolio investment	0	3	29	–12	8	17
Other investment assets	7 913	15 580	22 838	22 884	10 822	10 817
FDI stocks						
Inward	17 209	23 125	38 059	46 997	52 021	57 985
Outward	468	344	6 077	7 005	7 262	7 966
Memorandum items						
Inward flows as % of gross fixed capital formation	*42*	*23*	*27*	*36*	*25*	*36**
Inward stock as % of GDP	*20*	*21*	*27*	*38*	*46*	*42*

* First nine months of 2010.
Source: National Bank of Ukraine, *Balance of Payments Statistics*.

Figure 1.1. **FDI in and from Ukraine 1990-2009**
(USD billion)



Source: National Bank of Ukraine.

FDI inflows grew by 35% in 2010, reaching USD 6.5 billion. Portfolio inward investment was also dynamic in 2010, indicating investors' current preference for a short-term involvement. The business community view on the country's political and economic climate has improved since March 2010. The European Business Association (EBA) Investment Attractiveness Index,[1] which provides a quarterly evaluation of the country's investment climate by 100 leading companies operating in Ukraine, shows that after a prolonged period of investor pessimism after October 2008, investment conditions were perceived to have improved in 2010 even if the surveyed companies consider that problems, such as corruption and land ownership issues, persist.

In relative terms, annual FDI inflows have represented well over 20% of Ukraine's domestic investment (annual gross fixed capital formation) since 2006. This proportion is higher than the average for developing and transition economies (14% in 2008), including Russia (15%), but reflects essentially the weakness of Ukrainian domestic investment.

Since 2005, the inward FDI stock has increased

According to data from the National Bank of Ukraine (see Box 1.1), the inward FDI stock amounted to almost USD 58 billion in 2010. Although this

Box 1.1. **Ukraine's international investment statistics**

Statistics on Ukraine's FDI are compiled and disseminated by both the National Bank of Ukraine (NBU) and the State Statistics Service of Ukraine (SSS), which replaced in December 2010 the State Statistics Committee. The SSS data are based on quarterly enterprises surveys. The time series provide inward and outward FDI stocks by main partners and sectors as well as aggregate FDI attracted by Ukraine's regions.

The NBU quarterly and annual balance-of-payments reports are compiled on the basis of the International Transactions Reporting System (ITRS), with FDI data based on the SSS quarterly enterprise surveys supplemented by banks' reports on cross-border capital flows and data on privatisation revenues from non-residents provided by the State Property Fund. The NBU series include, in addition to FDI data, statistics on portfolio and other investment. Direct investment components are equity capital, reinvested earnings and other capital (inter-company loans). In compliance with IMF statistical requirements, the NBU also publishes Ukraine's international investment position broken down by portfolio, direct and other investment, and reserve assets.

Differences in data collection sources and methodologies imply some discrepancies in the FDI data disseminated by the NBU and the SSS. Although such discrepancies exist in some other countries such as in the Russian Federation, they make it difficult to interpret investment trends and therefore complicate the policy decision-making process. In common with other international organisations such as the World Bank, EBRD and UNCTAD, this OECD report refers to NBU data for annual FDI flows and stocks and uses SSS data for the geographical and sectoral breakdown given that such data are not systematically available in the NBU balance-of-payments reports.

To begin harmonising FDI data between the two national sources and with international standards, the Ukrainian authorities might envisage carrying out a self-evaluation based on the OECD's *Survey of Implementation of Methodological Standards for Direct Investment* (SIMSDI), which allows for a comprehensive analysis of a country's FDI data sources, data collection and dissemination practices and the applied methodologies. This self-evaluation would be a first step in bringing Ukraine's statistical methodology into line with the international standards of the *OECD Benchmark Definition of Foreign Direct Investment, 4th revision* (BMD4, published in April 2008). BMD4 offers detailed operational guidance on how to compile comprehensive breakdowns by types of operations, partner countries and industrial activities. It conforms to the *IMF's Balance of Payments and International Investment Position Manual, 6th edition,* as well as the *System of National Accounts* (2008).

For more information on OECD Investment statistics : *www.oecd.org/investment/statistics*.

represents an increase of 10% over the previous year, it is nevertheless a significant slowdown compared to earlier years when cumulative FDI increased by more than 20% annually (in 2006 and 2008) and even by 65% in 2007. The record share of the inward stock in Ukraine's GDP in 2009 (46%), *i.e.* the same level as in Poland and higher than in Russia (20% in 2009), is due mainly to Ukraine's general economic under-performance in 2009 rather than to favourable FDI developments that year.

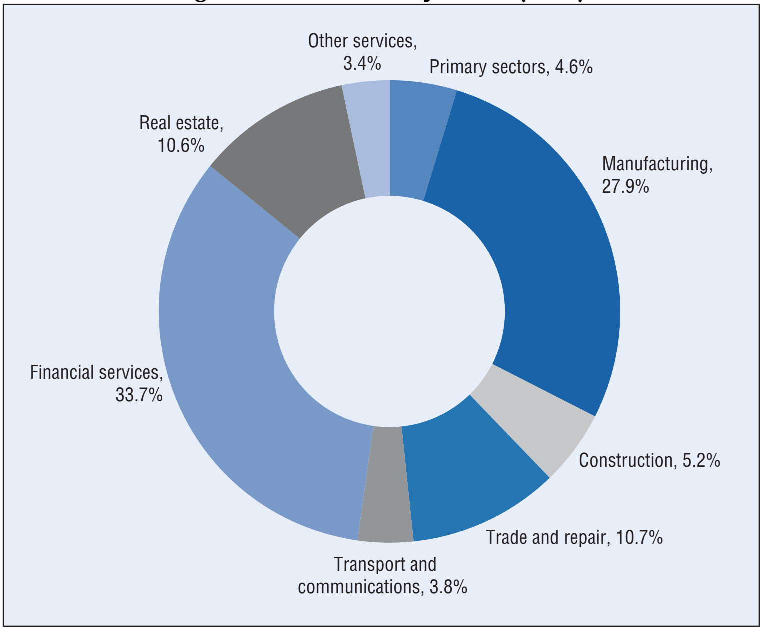
Ukraine's outward FDI stock has started to increase since 2007 but remains modest (USD 8 billion in 2010 as reported by the NBU) compared to most other Central and Eastern European countries or the Russian Federation, though the Ukrainian data probably underestimate the actual amounts[2] (notwithstanding the 1993 Decree on Currency Regulation and Currency Control, which requires the NBU's approval for residents' money transfers abroad for the purpose of direct or portfolio investment). In many cases, Ukrainian investments abroad have been driven by political concerns, such as possible expropriation, rather than by a strategy of internationalisation. Recent regulations[3] stipulating that dividends from foreign affiliates will no longer be subject to Ukrainian corporate profit tax should encourage future outward investments (Kononov, 2010b).

Foreign investors target mainly financial services and manufacturing

By the end of 2010, financial services had absorbed one third of the total inward stock, followed by manufacturing (28%). Investments in the real estate sector and trade and repair have also been important representing each more than 10% of the total inward stock (see Figure 1.2). Despite the country's comparative advantage in agriculture, the share of this sector in the total FDI stock remains modest (2%), reflecting existing limitations on ownership of agricultural land, current grain trade restrictions and an emerging trend towards an increasing state control over trade in agricultural products.[4]

Most FDI flows are due to large deals, mainly in the metallurgical sector and financial services (see Table 1.3). Foreign investment plays an important role in these sectors, especially in banking. At the beginning of 2010, there were 51 foreign banks in Ukraine (of which 18 banks with 100% foreign ownership) out of a total of 182 registered operating banks, representing 36% of the banking sector's statutory capital (National Bank of Ukraine). UNCTAD reported no cross-border acquisitions over USD 1 billion in 2009 involving Ukrainian firms.

Figure 1.2. **FDI stock by sector (2010)**



Source: State Statistical Service.

Table 1.3. **Major FDI deals in Ukraine**

	Sector	Acquired company	Acquiring company	Value (USD million)
2005	Steel	Kryvorizhstal	Mittal Steel	4 800
2005	Banking	Post Pension Bank Aval	Raiffeisen International	1 000
2005	Banking	UkrSibbank	BNP Paribas	360
2006	Banking	OJSC Ukrsotsbank	UniCredit Group	2 100
2007	Banking	Bank Forum	Commerzbank	600
2007	Banking	TAS-Kommerzbank	Swedbank	735
2008	Banking	JSC-Pravex Bank	Infesa SanPaolo SpA	750
2008	Iron ores	Sukhaya Bulka GOK	Evraz Group SA	2 189

Source: UNCTAD cross-border M&A database.

More than two thirds of Ukraine's FDI come from EU countries

Based on the Ukrainian State Statistics Service data, EU countries are the main source of Ukraine's FDI, representing over 75% of the total FDI stock by the end of 2010 (see Statistical Annex B), although this can include some investment by EU-based affiliates of non-EU countries' firms. In addition to Cyprus[5] (22% of the total), the most important investors are Germany (16%), the Netherlands (11%) and Austria (6%). Among non-EU countries, the major partners are the Russian Federation (almost 8% of total FDI stock) and the United States (3%). The predominance of Cyprus in both inward (USD 10 billion) and outward FDI stocks (USD 6 billion or 86% of the total) corresponds to its role in round-tripping flows, *i.e.* investment by Ukrainian companies transiting through Cyprus (Kononov, 2010a). It probably also reflects investment transactions realised through offshore units of other countries, which are then recorded as investment to the offshore centre (*e.g.* Cyprus) rather than to the final destination (Ukraine).

Russia's FDI presence in Ukraine is probably more important than reflected in available statistics. Some of Russia's investment in early 2000 resulted from debt-to-equity swaps related to Ukraine's energy-related debt to Russia. Russia's investment in Ukraine may also be realised by Russian companies already present in Ukraine and is treated as domestic investment and possibly excluded from the cross-border investment statistics of both Russia and Ukraine.

Table 1.4. **FDI stocks in Ukraine from OECD member countries**

(2007 or latest year)

Germany	11 728
Austria	3 444
France	1 396
Switzerland*	1 071
Italy	907
Norway	843
United States*	793
Poland*	747
Netherlands*	720
Sweden	616
Greece	358
United Kingdom*	236
Other OECD	718
OECD	23 577

* denotes data for 2009.
Source: OECD International Investment Statistics Yearbook.

According to OECD countries' statistics, the OECD total FDI stock in Ukraine in 2008 amounted to USD 23 billion, *i.e.* below the level reported by Ukraine that year (USD 32 billion). Germany represents one half of total FDI by OECD-based investors in Ukraine, followed by investors from Austria (Table 1.4). Some OECD countries report information on the activities of their foreign affiliates including employment: altogether, OECD based investors employed roughly 175 000 workers in Ukraine in 2007-08 (Table 1.5).

By region, Kyiv City is by far the largest recipient of FDI in Ukraine: despite the general FDI slowdown in 2009, its annual inflows continued to grow and

Table 1.5. **Employment by foreign affiliates in Ukraine***
(2007 or latest year)

Germany (2008)	81 000
Austria (2008)	49 377
Slovakia	6 062
Sweden	5 496
Estonia	3 138
Lithuania	2 081
Cyprus	1 738
Finland	1 164
Greece	910
Czech Republic	463
Slovenia	360
Bulgaria	315
Belgium	312
Latvia	141
EU14	152 557
United States (2008)	22 400

* Not all investor countries provide such data.
Source: Eurostat and national governments' statistics.

the city maintained its leading share among the Ukrainian regions, corresponding to 39% of the total inward FDI stock by the end of 2009. The Dnipropetrovsk region is the second major FDI destination in Ukraine but with a considerably lower share (7%), followed by Kharkiv (5%).

Participation of foreign investors in the privatisation process has been uneven

As a result of slow progress in privatisation, Ukraine's private sector accounts for 63% of the country's GDP,[6] 50% of total employment and less than 50% of the country's capital stock. This is confirmed by modest privatisation revenues representing in cumulative terms 15.5% of GDP by the end of 2008 (EBRD, 2009b). Successive privatisation plans have usually not been fulfilled with the exception of the period 2003-05; the re-privatisation of the major steel producer *Kryvorizhstal* boosted budget revenues to their highest level in 2005 and was to a large extent responsible for the record level of FDI inflows in that year. Several major sales have been subject to long court battles, notably of the leading domestic producer of rail locomotives *Luganskteplovoz,* or were repeatedly postponed (*e.g.* the Odessa Portside Plant for ammonia and nitrogen fertilisers). The long-planned sale of a 92.79% state stake in the fixed-line telecommunication provider *Ukrtelekom* has been carried out in 2010-2011 under the restrictive terms of the tender excluding any local or foreign company with more than 25% state ownership or companies having already at least a 25% share of the domestic telecoms market (EIU, 2011). As a result, the deal attracted only one bid. The privatisation of a 61.58% stake in flag carrier Ukraine International Airlines (MAU) will likely be sold without an auction.

During the past decade, participation of foreign investors in the privatisation process has varied considerably: negligible in 1998, 2002 and 2004, it generated a major share of privatisation revenues in 2001 and 2005. In overall terms, foreign investment represented 65% of cumulated privatisation revenues in 1998-2009 (Table 1.6). However, foreign participation has lacked a clear legal basis and regulatory transparency, notably as regards their possible involvement in privatisation deals in "strategic sectors" (see Chapter 2). From a legal point of view, the situation could improve following the signature of Presidential Decree in December 2010, which requires the State Property Fund to organise preliminary presentations of state properties available for sale and to carry out the privatisation deals via open tenders. The 2011 budget target of privatisation revenues of UAH 10 billion was already reached due to the finalisation of the sale of *Ukrtelecom*.

Table 1.6. **Ukraine's privatisation revenues and the contribution of foreign investment (1994-2009)**

	Total privatisation revenues (UAH mn)	Share of planned receipts (%)	*Of which* foreign investment (UAH mn)	Foreign share of total privatisation revenues (%)
1994	15	n.a.	..	
1995	17	n.a.	..	
1996	37	n.a.	..	
1997	75	16	..	
1998	361	35	2	0.5
1999	695	87	124	18
2000	2 076	81	52	2
2001	2 132	37	1 333	63
2002	576.1	18	2	0.3
2003	2 016	101	824	41
2004	9 415	184	21	0.2
2005*	20 699	300	24 204	117
2006	553	25	78	14
2007	2 459	23	820	33
2008	482	79	0	0
2009	808	9	26	3
2010 (preliminary)	6 400	700		
Total	**48 781**		**27 486**	**65**

* Sale of Kryvorizhstal.
Source: State Property Fund of Ukraine (2009).

New reform programme sets ambitious privatisation goals and stresses the role of FDI

Ukraine's prospects for attracting FDI have improved with the better macroeconomic outlook, notably higher real GDP growth in 2010 (4.2%) and its expected acceleration in 2011 (4.5%) driven by both domestic demand and private and public investment. However, the country's fiscal balance (-5.9% of GDP in 2010) and its deteriorating current account deficit (2.6% of GDP in 2010) remain a concern, especially if the disbursement of the next tranche of an IMF loan foreseen initially for March 2011 is further delayed due to the non-fulfilment of Ukraine's reform commitments. The government has hesitated launching the much-needed pension reform, has postponed the increase of consumer heating tariffs, at the origin of *Naftogaz* deficit, and has not yet completely resolved the problem of refunding of VAT arrears. As much as these delays signal a slowdown in general reform efforts, they risk inevitably discouraging foreign investors from launching new projects or expanding their operations in Ukraine.

The Government's new reform programme published in June 2010 (Committee on Economic Reform, 2010) recognises that the contribution of privatisation should not only be considered as a source of budget revenue, but also as a tool to transform the market and enhance competition. The Government's objectives are to increase budget revenues from privatisation (to UAH 50-70 billion by 2014) and to reduce the share of the public sector from the current 37% to 25%-30%. The government should seek, on the one hand, to identify clearly the sectors in which the state will maintain exclusive or majority ownership and, on the other hand, to co-ordinate its privatisation and sectoral strategies, especially in the infrastructure, electricity, coal industry and gas sectors with the aim of encouraging private investment in these areas.

The reform agenda stresses the need to improve openness, transparency and fair competition of the privatisation process, simplify land privatisation procedures and clarify and reinforce the role of the State Property Fund. The 2010 programme recognises that a change in ownership is not sufficient to increase competition and efficiency if not accompanied by other competition-enhancing reforms: reducing market concentration, exposing state enterprises and industries classified as "natural monopolies" to market discipline and facilitating the entry of new firms and the exit of unviable ones.

Notes

1. The Investment Attractiveness Index prepared regularly by the European Business Association – Ukraine (EBA) since September 2008 is based on a quarterly assessment of investment conditions and their expected evolution by some 100 leading companies operating in Ukraine. Regular updates of the Investment Attractiveness Index are available at: *www.eba.com.ua*. See EBA (2010).

2. For example, according to Poland's statistical data, Ukraine's FDI stock in Poland in 2009 was almost 10 times higher than the amount of Ukraine's outward FDI stock in Poland as recorded in the Ukrainian statistics.
3. The Law of Ukraine on Amending the Corporate Profit Tax Regarding the Taxation of Dividends (27 April 2010).
4. This trend appears in a new draft law which would require that grain trade be carried out only by companies with at least 25% of state ownership.
5. Footnote by Turkey: The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

   Footnote by all the European Union Member States of the OECD and the European Commission: "The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus."
6. According to Eurostat, the public sector, including the social sector, represents 37% of Ukraine's GDP and is higher than either Poland (25%) or Germany (20%), for example.

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Chapter 2

Foreign Direct Investment Regime

Ukraine's legislation embodies the principle of non-discrimination of foreign investment and general provisions on foreign investment protection. Its legal framework provides for national treatment for firms' establishment, but despite recent efforts to enhance the country's business environment foreign investors have often been discouraged by complex, protracted and costly procedures and resulting regulatory uncertainty. Ukraine applies several trans-sectoral and sectoral restrictions on foreign investment which qualify for the list of exceptions to national treatment and measures reported for transparency in the meaning of the OECD Declaration on International Investment and Multinational Enterprises. Taking into account the existing statutory FDI restrictions, Ukraine's score under the OECD FDI Restrictiveness Index is higher than the OECD members' average but lower than the average of non-OECD countries covered by the Index. Ukraine's score considering formal FDI restrictions as captured by the Index contrasts, however, with a poor perception of its investment climate in most international comparisons which assess actual implementation of existing laws and regulations.

Guarantees for protection of foreign investment but registration required

The Commercial Code of Ukraine defines foreign enterprises as those with at least 10% foreign investment in their charter capital. All investment, profits, legitimate interests and rights of foreign investors in Ukraine enjoy the following protection and guarantees:[1]

- Protection against changes in foreign investment legislation for a period of 10 years after their introduction (Article 8).
- Protection against nationalisation except in the case of emergency measures (*e.g.* national disasters or epidemics) and only if based on the decision of the Cabinet of Ministers of Ukraine. In case of nationalisation, a foreign investor must be compensated in the currency in which the investment was made or in any other currency acceptable to the investor. Decisions on requisition of foreign investment and compensation may be appealed in the courts (Article 9).
- Guarantee of compensation and reimbursement of losses resulting from actions, the omission of actions or the improper performance by state or municipal bodies (Article 10).
- Guarantee in the event of the termination of investment activity to remit the revenues and withdraw the investment without paying export duties within six months after the termination of the investment activity (Article 11).
- Guarantee of repatriation of profits after the payment of taxes, duties and other mandatory payments (Article 12).

To qualify for these guarantees, foreign investors have to register. Registration is not mandatory, but unregistered foreign investment does not benefit from the guarantees provided by the law (Article 13). Some bilateral investment treaties, such as with Poland, provide for the same guarantees without registration. State registration of foreign investment is performed within three working days by the Government of the Autonomous Republic of Crimea or regional state administrations of the cities of Kyiv and Sevastopol. Registration can be refused only if the documentation is incomplete or the investment is considered contrary to Ukraine's legislation. Refusals have to be communicated in writing and can be appealed in the courts.

It should be noted that the legal obligation to provide protection against changes in foreign investment legislation for a period of 10 years was breached when special economic zones were abolished in 2005, resulting in the elimination of preferences to foreign and domestic investors in these zones without any compensation.

After temporary derogations, the non-discrimination principle has been reinstated

Under Ukraine's Constitution, the State protects property rights and economic activity for all subjects which are equal before the law (Article 13). The non-discrimination principle for foreign investors is enshrined in the 1991 legislation on investment activities,[2] which guarantees protection to all investment in Ukraine irrespective of the nationality of investors.

In response to the 2009 economic crisis, temporary measures[3] were introduced which were initially expected to apply until January 2011. Foreign investors were obliged to register with the National Bank of Ukraine (NBU) and to make their monetary contribution exclusively through "investment accounts" opened with Ukrainian banks. The investment in foreign currency had to be converted into Ukraine's national currency, *hryvnia* (UAH). These measures were considered burdensome by foreign investors and were eliminated in April 2010.[4]

Complex establishment procedures

When establishing, foreign investors face the same requirements as domestic investors: obtaining state registration and business permits and, for certain activities, licensing. The law on state registration[5] effective since 1 July 2004 list the documents required for state registration.[6] If the procedure concerns a foreign legal entity, an additional document is required to confirm its registration in the country of residence, *i.e.* an extract from the trade, banking or judicial registry. The law also sets up the timeframe for this procedure (three working days) as well as the amount of the fees (UAH 170).[7] The registration certificates are valid without time limits. The state registration is carried out by some 680 registration offices throughout Ukraine operating as "single window" facilities. A new law adopted in October 2010[8] urges rapid implementation of e-registration for businesses, allowing them to reduce the number and duration of registration procedures and making possible an electronic exchange of information among all participants involved in state registration.

The 2005 law[9] codified procedures for business permits and defined the role and responsibilities of various state agencies in charge of issuing them, such as the State Committee on Industrial Safety, Labour Protection, the Sanitary and Epidemiologic Service or the State Fire Safety Department. These agencies have to make publicly available free-of-charge all information related to the procedures of issuing permits. They should also keep the register of issued permits open for consultation. The law clarifies the main procedural aspects such as the nature of documents to be submitted by the applicants and different steps in the delivery of permits. In the case of refusal of a business permit, the applicant can lodge a lawsuit and the non-respect of existing legal provisions by public servants is subject to sanctions foreseen by the Code of Administrative Violations. Although the business permit law establishes the main conditions and principles, in practice procedures for delivering business permits remain regulated by the decisions of the Cabinet of Ministers and the responsible agencies.

The main innovation of the 2005 business permit law was the introduction of the "declarative" or self-certification principle which allows companies to undertake their activities before receiving the business permit if they submit the documentation to relevant administrative or inspection agencies certifying their conformity with relevant legal and technical requirements. Until recently, the possibility of self-certification has been offered only by the State Fire Safety Department, thereby shortening delays and reducing costs for business.[10] In the absence of similar procedures offered by other agencies issuing required business permits, notably the State Committee on Industrial Safety, Labour Protection and the Sanitary and Epidemiologic Service, the number of days required to collect all necessary permits remained important. The 2005 Law also foresaw the establishment of local centres (one stop-shops) which would bring together all agencies involved in issuing business permits.

Recent initiatives to streamline establishment procedures

The recent legislation adopted in 2010[11] allows most businesses to start their operations immediately based on their own declaration of conformity to responsible state agencies, except for 91 specific permits covering 144 activities and services[12] which remain subject to prior authorisation before starting their operations. The activities excluded from the application of the declarative principle include production, processing and distribution of food products under the control of the sanitary and veterinary services, exports and imports of grain and grain products, production of oil and gas and some categories of construction works.

A number of laws adopted in 2009-2010 revised several legal provisions to facilitate administrative procedures related to establishment by both domestic and foreign entrepreneurs, in particular:

- The Law "On Companies" (19 September 1991 as amended): the minimum charter capital of a limited liability company has been considerably decreased from the equivalent of 100 minimum salaries to one minimum salary (EUR 65).
- The current number of procedures (10) and the period required for establishment of a company (27 days) have to be reduced.[13]
- The Law "On Business Permits": most business permits (except some particular cases subject to specific laws) should be issued within 10 days. The adoption of the principle "silence is consent" implies that if an applicant has not received a reply from the relevant agency after this fixed period, a permit is considered to be granted.
- Specific provisions for small enterprises:[14] a moratorium on all state controls and inspections of these enterprises applied until January 2011, except for some specific cases such as high-risk activities, on-site inspection by tax services, pension fund and customs services. The State Property Fund is prohibited from increasing lease payments of state property for these enterprises.
- The amendments to the Law on state registration creating a unified system of state registration of legal entities, simplifying the procedures of state registration and abolishing the obligation of state registration for some categories of legal entities.[15]

All these recent legislative initiatives respond to many long-standing concerns of the business community and address the most serious obstacles faced by local and foreign companies in establishing and operating in Ukraine. It is important to ensure a prompt and thorough application of the new legislation by responsible agencies at all levels so as to avoid – as often happened in the past – that well-conceived laws and regulations have not been adequately implemented.

Licensing procedures

The 2000 Law on licensing[16] provided initially the list of 60 different activities subject to mandatory licensing. Since then, various amendments have been introduced to reduce the number of activities and to clarify and facilitate licensing procedures, notably in June 2009:[17]

- No new activities subject to licensing may be added to the existing list without adequate justification.

- New licences are granted for an unlimited time period; only certain specific activities subject to licences issued by the Cabinet of Ministers are delivered for periods limited to 5 years (see below); the licensing fees remain unchanged and fixed at the equivalent of one minimum salary.
- The period for appeal by an applicant against a decision of the licensing authorities has been extended from 10 to 30 days.
- The administrative liability of officials of licensing authorities has been included in the Code of Administrative Violations.

Furthermore the State Committee on Issues of Regulatory Policy and Entrepreneurship, the main licensing authority, has introduced additional measures aimed at streamlining licensing procedures. First, the list of documents attached to the application for a licence has been considerably reduced. Second, the licensing authorities responsible for specific licences have to publish information on required documents and procedures on their websites. Finally, the role of independent experts and representatives of the business community in licensing procedures has been strengthened: their participation in the expert and appeal council that makes recommendations on licensing procedures and reviews complaints has been increased from 20% to 50% of the seats.

The list of activities subject to mandatory licensing has been gradually reduced, most recently in October 2010 to cover currently 45 sectors (see below).

Efforts to reduce the administrative burden have to be pursued

According to the latest *2011 World Bank Doing Business* database (World Bank, 2010b), recent streamlining of establishment procedures has been acknowledged as the main business reform successfully carried out by Ukraine in 2010, which has allowed it to improve its international ranking (from 147 in 2010 to 145 in 2011 out of 183 economies). The country's overall and regional rankings nevertheless remain unsatisfactory as many other countries of the former Soviet Union perform better in this World Bank international comparison, notably Georgia (12), Kazakhstan (59) and Russia (123).

The main problems remain inadequate enforcement of existing legislation due to delays in adopting implementing regulations and often insufficient administrative and technical capacities of responsible executive agencies. Several draft laws are awaiting discussion and approval by the Verkhovna Rada (Parliament), such as on unifying requirements for issuing business permits by authorities at different government levels. The Parliament has to consider a draft law "On Accreditation of Representative Offices and Branches of Foreign Companies in Ukraine" proposing to include these entities in the Uniform Registrar of Legal Entities and Individual

Entrepreneurs, a publicly available computerised information system on companies in Ukraine. Some business facilitation measures are not yet completely operational, such as electronic registration allowing enterprises to make their declaration with tax, social security and statistics authorities automatically. The involvement of various agencies and interlocutors at different governmental levels and the lack of harmonisation in procedures inevitably leave room for discretion with an inherent risk of corruption. While the use of national treatment provided in legislation as a guiding principle is welcome, current regulatory uncertainties have a dissuasive effect especially on new foreign investors less familiar with local practices than incumbent firms.

Employing foreigners

Foreign citizens seeking employment in Ukraine have to apply and obtain work permits issued for a period of up to one year and up to three years for intra-corporate transferees, which can be extended. Recent regulations[18] specify the list of documents to be submitted for the application, including a certificate by a future employer confirming that he has no debts to the State Insurance Fund against Unemployment and a certificate that the future employee is not under a criminal investigation. The applications for work permits are considered by a commission consisting of representatives of the Ministry of Interior, the State Security Service, the State Tax Service and the Ministry of Labour. Work permits are issued by the relevant regional employment centres within 30 calendar days from the date of the submission of the application. State fees for issuing a work permit amount to the equivalent of four minimum monthly wages. To obtain a work permit, an employer should present supporting evidence that there are no local employees able to perform the work proposed to foreigners.

The foreign business community considers that the formalities necessary to obtain visa, temporary stay and work permits remain difficult in practice notably because of complex procedures and numerous registration requirements often subject to different interpretations by administrative officers.

Foreign exchange regulations

Ukraine's national currency was introduced in September 1996. On 24 September 1996, Ukraine accepted the obligations of Article VIII of the IMF Articles of Agreement and thus a commitment to maintain an exchange system free of restrictions on payments and transfers for current international transactions. Foreign currency operations are regulated by a 1993 Decree[19] and by numerous implementing rules issued by the National Bank of Ukraine.

Foreign investors are entitled to repatriate profit, income or other investment-related funds without any restrictions, after the payment of applicable taxes. They are guaranteed the right to the prompt and unimpeded repatriation of profits and other funds in foreign currency resulting from their investments in Ukraine. Conversion of funds for repatriation is processed through the Ukrainian Inter-bank Currency Exchange.

The turnover tax on wholesale currency exchange operations introduced in 1999 payable to the State Pension Fund was gradually reduced from the initial 2% to 0.5% in 2010 and finally abolished in 2011. Foreign investors are nevertheless concerned about the prohibition of foreign exchange orders and complex procedures for foreign currency exchange of more important amounts. In response to the 2008 financial crisis and in an attempt to prevent capital outflows, the government adopted a number of temporary provisions such as the obligation for foreign investors to open two bank accounts in Ukraine, which has been now eliminated. The 180-day limit on prepayment of imports and exports continues to apply.[20]

Foreign companies have to transfer at least 50% of their charter capital in cash or in kind before registering a company. After the registration with relevant state authorities, the company can open an operational or current bank account. Foreign firms operating in Ukraine are free to open and maintain their bank accounts in foreign currency.

National security considerations and "strategic sectors"

Investment failing to meet sanitary, hygiene, radiation or environmental requirements or infringing the rights and interests of Ukraine's citizens and legal entities is prohibited.[21] These general provisions apply equally to both foreign and domestic investors.

Several Ukrainian laws refer to national security and strategic sectors, which – according to the Commercial Code (Article 117) – could justify sectoral and territorial restrictions on FDI. The law "On the Fundamentals of National Security of Ukraine" provides the following definition of economic threats to national security: "critical dependence on the business cycles of international markets" and "increases in the share of foreign capital in the strategic sectors of the Ukrainian economy such that they jeopardise its economic independence" (Article 7), without, however, listing the sectors concerned.

The 1992 privatisation law stipulates that legal entities in which more than 25% of equity is owned by a state cannot participate in the privatisation of state and municipal property.[22] Based on this provision, such companies were barred from participating in bids for privatisation of the fixed-line telecommunication monopoly *Ukrtelekom* in 2010. There are, however, no restrictions on the resale of privatised shares by residents to non-residents or established foreign-controlled enterprises on the secondary market.

Neither domestic nor foreign investors may participate in a number of activities defined as "strategic" which have to remain in the hands of more than 1000 state-owned enterprises and are therefore excluded from privatisation. The 1992 privatisation law established that participation of foreign investors in privatisation of "strategic" enterprises (the so-called G-group) requires a special permit of the Parliament and the Cabinet of Ministers but has not specified the modalities of authorisation procedures. This incomplete legislative framework has opened the possibility for non-transparent privatisation deals, enabling certain investors from countries with better local connections to get stakes in key industries, which can be considered "strategic", such as the oil industry or the gas transport network (Dubrovskiy *et al.*, 2007).

As already mentioned the government's economic reform programme for 2010-2014 underlines the role of privatisation and encourages participation of foreign investment in the modernisation of the national economy. It sets the objectives on one hand to define clearly the sectors and enterprises in which the state will continue to maintain exclusive or majority ownership and, on the other hand, to foster privatisation, including with foreign participation, in other sectors. The new law on privatisation currently under preparation intends to introduce a methodology for determining the "critical" level of foreign ownership in "strategic" sectors, which would then be used by state agencies managing state property to define the level of foreign ownership in specific "strategic" sectors.

Ukraine's current legislation hence refers to the terms "national security" and "strategic sectors" in relation to foreign investment in different contexts without clearly defining the sectors concerned and specifying relevant authorisation procedures for possible entry or participation in privatisation by foreign investors. New legislation in preparation seems to aim to define more precisely the notion and coverage of "strategic sectors" in the context of privatisation, but procedures envisaged for selecting sectors and determining the level of authorised foreign participation in privatisations appear to leave considerable room for administrative discretion.

The Ukrainian authorities should consider adhering to the recommendations of the OECD *Guidelines for Recipient Country Investment Policies relating to National Security* (OECD, 2009), which were adopted by the OECD Council in May 2009. These *Guidelines* help countries to design and implement national security goals with the smallest possible impact on investment flows by complying with the principles of non-discrimination, proportionality, transparency and accountability. The *Guidelines* recommend that governments treat similar investors in the same way, make transparent their regulatory objectives and practices, notably by publishing relevant laws and consulting interested parties when considering legal or regulatory changes. To ensure procedural fairness and predictability, the review or authorisation procedures for foreign investment should be based on clear criteria and specify the modalities, including the documents to be submitted by applicants, the timeframe for replies by relevant authorities and the possible appeal or redress procedures against administrative decisions. Such measures would help reduce the current legal and regulatory uncertainty not only in the area of strategic sectors and national security but also, more generally, enhance the transparency and predictability of the investment regime in Ukraine.

Persistent problems with ownership registration for land and other forms of property

As in other transition economies, Ukraine has had to establish a formal ownership registration for land and other forms of property. Progress in this area has been gradual: many property titles have not been formalised and the unified property and land cadastre is not yet operational. As a result, the risk of misappropriations and fraudulent transactions remains high, provoking a considerable number of disputes in courts.

Foreign companies can buy privately-owned, non-agricultural land within city limits for construction or business purposes and outside of city limits when they buy real estate. The purchase of publicly-owned land is possible but subject to complex procedures and requires consent by relevant ministries or the Parliament. Leasing of land in public (state or municipal) ownership is either decided by the respective local council or is subject to tender procedures.

According to the Land Code of Ukraine, which came into force on 1 January 2002, foreign entities are not allowed to own agricultural land. The Forest Code (Articles 7 and 10) also prevents foreigners from owning forests. Foreigners can nevertheless lease agricultural land either on a short-term (up to 5 years) or long-term (up to 50 years) basis. After the repeated rejection by the Parliament of the draft laws on the land market and the land cadastre, the moratorium on sales of agricultural land to foreigners was extended in 2009 and will continue to apply until 2012.

A 2009 law[23] clarified the procedures for expropriating land and real estate property based on "public needs", due to "social necessity" or justified by construction of communications, utilities and transport or energy infrastructure. Such expropriations can only arise based on a decision by administrative courts, and the former owners are entitled to receive full compensation for the value of the property.

Despite several government programmes targeted at rural areas and a number of specific laws on land protection and land leasing, Ukraine's property market remains underdeveloped, with adverse effects on private investment especially in agriculture, real estate and housing. In the 2011 World Bank *Doing Business* database, Ukraine continues to perform poorly under the indicator "registering property" and its current ranking (164 out of 183 economies) has even worsened in 2011 compared to 2010. Registering property in Ukraine requires many procedures (10 compared to fewer than 6 on the average in Eastern Europe and Central Asia) and long delays (117 days against 38.3 in the region). Ukraine's worst ranking (179) is in the related area "dealing with construction permits" (World Bank, 2010b).[24] The recently adopted law on city planning[25] developed in accordance with the objective of the 2010 government programme should reduce significantly the number of required permits and streamline licensing procedures in construction.

In addition to removing the moratorium on the sale of agricultural land, the business community proposes the following steps to tackle existing bottlenecks in land ownership and management:

- Unify land and real estate registers currently kept at the regional level; establish a common national register and make it publicly available.
- Simplify and improve the transparency of procedures for changing the land purpose (agricultural/non-agricultural).
- Clarify the criteria of state-owned and communal land plots and generalise tender procedures for their sale and lease.

Economic activities subject to mandatory licensing under general legislation

Mandatory licensing is governed by the 2000 Law "On licensing of certain activities" (hereinafter the Licensing Law) and its numerous amendments, including recent ones introduced at the end of 2009 (see above) and most recently in October 2010.[26] The law specifies the main procedures and responsibilities of licensing bodies and stipulates that licensing cannot be used to limit competition (Article 3).

The law lists a number of economic activities which are subject to specific licensing procedures as defined in relevant laws, namely:

- banking;
- professional activities in the securities market;
- provision of financial services;
- foreign trade;

- radio and TV broadcasting;
- electricity and nuclear energy;
- education services;
- intellectual property rights;
- production and trade of ethanol, alcoholic beverages and tobacco;
- telecommunications;
- construction activities.

Production and trade of narcotics, drugs and psychotropic substances as well as lotteries and gambling, are also subject to specific legislation. In 2009, several activities were eliminated from the list of mandatory licensing such as medical, legal and psychological services for disabled persons or disaster victims; seed sales, sale of art and the organisation of art auctions; and the design and reconstruction of objects of cultural heritage. In October 2010, further activities were removed so that the total number of business activities which are subject to mandatory licensing covers at present 45 sectors, including:

- production and repair of ammunition and arms;
- development, manufacturing, trade and repair of weapons, military equipment and explosives;
- production of industrial explosives, dangerous chemicals; operations in hazardous waste handling, collection and storage of some types of waste as secondary raw materials;
- production, wholesale and retail trade of pharmaceuticals;
- production of veterinary medicines and preparations, wholesale and retail trade of veterinary medicines and drugs;
- trade in pesticides and certain agrochemicals (growth plant regulators);
- development, production and trade of special techniques for removing information from information channels;
- centralised water supply and sanitation;
- development, production and exploitation of carrier rockets, space vehicles and space infrastructure;
- medical and veterinary practices;
- provision of transport services of passengers and cargo by air, river, sea, road and rail;
- processing and storage of ferrous and non-ferrous metals;
- tourist operator services;
- services related to land management, assessment and land auctions;

- industrial fisheries, except in inland waters;
- production of thermal energy, its transportation, local distribution and heat supply network;
- genetic engineering activities in a closed system;
- trade in liquid fuels from biomass and biogas.

The 2000 Licensing Law has introduced specific procedures for some activities involving the use of limited resources, which remain under the responsibility of the Cabinet of Ministers. Licences for these activities are obtained through tenders and, following the 2009 amendments, are issued for five years. After recent amendments,[27] which cancelled mandatory licensing for mining of natural resources from deposits of national importance included in the State Fund of Mineral Reserves, the following activities remain subject to licensing procedures based on tenders: *i)* extraction of precious metals and precious stones, *ii)* transport via pipelines of oil and gas; supply of natural gas subject to regulated or non-regulated tariffs and *iii)* storage of natural gas in volumes exceeding the threshold. Licensing authorities should establish and maintain the specific register of licences granted for such activities.

The Ukrainian authorities have repeatedly emphasised, notably during the WTO accession negotiations, that existing licensing procedures do not discriminate against foreign investors. Despite an important reduction of activities covered by mandatory licensing, there are still some concerns regarding the complexity of licensing procedures and insufficient harmonisation in issuing procedures for national and local licences.

Sector-specific regimes

Natural resources

Ukrainian and foreign legal entities, as well as individuals, require authorisation to use the Ukrainian subsoil which remains the exclusive property of the State.[28] Most activities concerned are subject to standard mandatory licensing covered by the amended Licensing Law. The 2010 law[29] has cancelled licensing requirement for mineral prospection and extraction from deposits registered in the State Fund of Mineral Reserves. Some other activities require special licences delivered by the Cabinet of Ministers, including for extracting deposits considered of state importance and for extracting and producing precious metals and precious stones (see above). If a deposit has been already explored and registered in the State Fund of Mineral Reserves of Ukraine, the interested company has to reimburse the state for the completed geographical survey (the so-called “geological information package”), which varies depending on the composition of the particular deposit.

In line with current legislation, subsoil rights have to be granted on a competitive basis, *i.e.* through tenders or auctions. A subsoil right user is not authorised to bestow, sell or otherwise transfer the rights granted by a permit.

Production sharing agreements (PSAs) may be concluded by foreign investors with the Cabinet of Ministers, together with the relevant local authorities, for certain mining activities for a period agreed by the parties but not exceeding 50 years.[30] The state retains ownership of the deposits and foreign investors, selected through tenders, have to undertake activities at their own expense. They are entitled to a share of the output, which may not exceed 70% of total quarterly production. Foreign investors enjoy some additional incentives, in particular exemptions from VAT and customs duties on imported equipment and on exports of products resulting from PSA activity and an exemption from the profit repatriation tax. So far, only one PSA has been concluded. According to international energy companies interested in investing in Ukraine, future PSAs should include a "stability clause".

The trunk pipeline transport system is run by the state and is excluded from privatisation. Industrial pipeline transport facilities for oil and gas, as well as storage of natural gas are subject to licensing from the National Energy Regulation Commission.

Ukraine's WTO accession commitments provide for full transparency in formulating, adopting and applying measures affecting market access to, and service delivery in, pipeline transport services. Ukraine adheres to the principle of non-discriminatory treatment for access to, and use of, the pipeline network under its jurisdiction, within the technical capacities of these networks, with regard to the origin, destination or ownership of the product transported, without imposing any unjustified delays, restrictions or charges, and with no discriminatory pricing based on origin, destination or ownership (WTO, 2008).

Electricity generation, transmission and distribution

Privatisation of the electricity sector has been carried out in several waves: some thermal generation and distribution companies were privatised in 1995, followed in 1999 and 2002 by the sale of controlling (50%) and blocking (25%) shareholdings in Ukrainian energy distribution companies to private investors through open tenders. In 2004, the remaining state-owned shares of energy distribution companies were transferred to the national joint stock "Energy Company of Ukraine". Privatisation of nuclear and hydropower stations is prohibited by law.

Ukraine's Unified Energy System (UES) brings together all electricity generation, transmission and distribution networks. The State controls the majority of regional power generation companies, but a part of the shares is privately owned and listed on the Kyiv Stock Exchange. Electricity transmission is a state monopoly, controlled by the state-owned company *Ukrenergo*. State ownership also dominates in electricity distribution: 27 regional distributors purchase electricity on the wholesale electricity market and sell it at a regulated retail tariff, set up by the National Electricity Regulatory Commission of Ukraine. The government envisages gradually opening regional electricity companies to investors (see Chapter 4).

The authorities have developed several action plans for gradual liberalisation of the wholesale electricity market with the objective of achieving a competitive market operating on the basis of bilateral contracts between producers, suppliers and consumers in line with the EU Directives on Electricity. To enhance competition, the construction of new generation plants is subject to tender procedures and the export, import and transit of electricity must be carried out in accordance with EU energy legislation.

Transport and communications

There are no limitations on foreign equity in transport services. Recent amendments[31] abolished mandatory licensing requirements for transporting passengers and cargo by air, river, sea, road and rail and maintained it only for transporting dangerous commodities. Local incorporation is required for road (freight and passenger) transport companies.

As in most other countries, Ukraine has gradually liberalised its telecommunication sector. The first "Communication Law" introduced in 1995 was replaced in 2003 by the new law "On Telecommunications", which regulates fixed-line and mobile telephone communications, air and cable broadcasting and television networks as well as the leasing of electronic communications services based on the Internet protocol. As part of its WTO/GATS commitments, Ukraine opened its telecommunications services to foreign investment.

The main regulator – the National Commission on Regulating Communications, established in January 2005 – is responsible for issuing licences and allocating radio frequencies. The following telecommunications activities are subject to licensing:

- provision of local/inter-city/international fixed-line telephone communications services, including those using wireless access to the telecommunications network;
- provision of mobile telephone communication services;
- provision of services on maintenance and exploitation of telecommunication networks, air and cable broadcasting and television network;
- provision of local/inter-city/international electronic communications channels.

Internet service provider services are not subject to licensing.

Radio/television broadcasting, news agencies and wholesale trade of books, newspapers and magazines

Restrictions on the share of foreign capital in the charter fund of television and radio broadcasting companies were eliminated in 2006.[32] The amendments to the 2003 law "On Information Agencies" established the maximum level of foreign capital in the charter funds of information agencies at 35%. Ukraine currently limits foreign participation to 30% in wholesale trade of books, newspapers and magazines but accepted to eliminate this restriction five years after its WTO accession.[33]

Banking

The main legal acts concerning the banking sector are the 2000 Banking Law,[34] as amended, and the 2001 Financial Services Law.[35] The level of authorised funds in the banking sector is the same for domestic and foreign banks. The last amendments to the Banking Law, which entered into force on 16 May 2008, abolished the previous 35% threshold on foreign participation in the charter capital of Ukrainian commercial banks and, in line with Ukraine's WTO accession commitments, made it possible for foreign banks to open branches in Ukraine. Prior permission by the National Bank of Ukraine (NBU) is required for establishing a commercial bank with foreign participation or when converting an existing commercial bank into one with foreign participation.

Banks with foreign participation are subject to the same requirements as Ukrainian banks and must obtain a licence for conducting standard or specific categories of banking transactions. They should also meet the same requirements concerning the level of provisions for different categories of loans and regarding the disclosure of consumer information on the cost of credit. All banks irrespective of their ownership have to obtain permission from the NBU each time there are changes in the equity thresholds (10%, 25%, 50% or 75%) in banks' charter capital or the voting rights in their governing bodies.

Among 182 operating banks registered in Ukraine at the beginning of 2010, the two large state-owned banks (the Ukrainian Export-Import Bank: *Ukreximbank* and the State Saving Bank: *Oschadsbank*) represented 11% of total assets. The capital of 51 banks with foreign participation (18 of which are fully foreign-owned) corresponds to almost 36% of the total statutory capital of the Ukrainian banking sector.

Insurance

The 1996 Insurance Law,[36] amended in 2002 and 2006, stipulates that insurance activities can be provided only by a Ukrainian legal entity in the form of a joint-stock company (open or closed), which has been properly registered with the State Register of Financial Institutions and has obtained an insurance licence.

To register as a financial institution with the State Register of Financial Institutions, the company's charter capital has to be at least EUR 1 million for an insurance company and EUR 1.5 million for a life insurance company. The company should also have the required number of qualified staff, adequate office premises and technical equipment. The insurance licence is delivered by the State Commission for the Regulation of Financial Services Markets, which imposes additional requirements, in particular regarding qualification of key personnel of insurance companies (the general manager and the chief accountant) and documents such as a bank or auditor certificate confirming the amount of paid charter capital. The State Commission is also authorised to examine and inspect insurance companies. All these regulations apply irrespective of the origin of investors.

As a part of its WTO commitments, Ukraine will allow foreign insurance companies to deliver insurance services through their branches five years after its WTO accession, *i.e.* in 2013 (WTO, 2008).[37]

Professional and other services

Ukraine's legislation imposes a Ukrainian nationality requirement for providing notary services.[38] As this measure concerns natural persons, it is not taken into account in the list of measures qualifying for exceptions to national treatment in the meaning of the OECD *Declaration on International Investment and Multinational Enterprises* given that the scope of the OECD National Treatment instrument covers incorporated enterprises. The sectoral legislation amended in 1993 has removed nationality requirements for auditing and legal services.

In addition to professional qualification requirements, medicals professions, including paramedical personnel, should be provided by persons speaking Ukrainian. Postal and courier services, comprising handling of registered letters, parcels and packages up to 30 kg are no longer subject to licensing but remain under a general universal service obligation.

Primary, secondary and higher education institutions, irrespective of the type of ownership, may be headed only by a Ukrainian citizen.

Monopolies

Ukrainian legislation defines a natural monopoly as an activity in which the absence of competition is beneficial for the market due to specific features of production or produced commodities and when products/services provided by natural monopolies cannot be replaced by other goods/services.[39] The current list of natural monopolies includes the following nine activities:

- transport of oil and oil products by major pipelines: national shareholding company *Naftogaz* represented by the open joint stock company *Ukrtransnafta*;
- transport of natural gas by major pipelines: national shareholding company *Naftogaz* represented by its subsidiary *Ukrtransgas*;
- transmission of electricity via national and international electricity grids: state enterprise *National Energy Company Ukrenergo*;
- railways, dispatcher services, railway stations and other rail infrastructure: state administration of Ukraine's railway transport *Ukrzalinitsya*;
- air traffic control services: state enterprise *Ukraerorukh*;
- specialised services of transport terminal and warehouses for ammonia: open joint stock company *Odessa Preport Plant*;
- universal postal services: state enterprise *Ukrposhta*;
- technical broadcasting means and services related to radio broadcasting; business holding *RRT*;
- local telephone communications, services related to electricity-based communications channels: open joint stock company *Ukrtelekom*.

A 1999 law contained the initial list of state-owned enterprises (SOEs) which could not be privatised; it has since been amended several times to reduce gradually the number of enterprises concerned.[40] The list covers currently 1538 enterprises, including some 500 agricultural entities, some of them part of the state holding *Ukrspyrit* specialised in ethyl and alcohol production.

State-owned enterprises, defined as entities in which the share of the State exceeds 50%, included more than 1000 joint-stock companies, 90 limited liability companies and 32 national State holding companies. The State Property Fund has the right to be represented on the supervisory boards of joint-stock companies when the State's share exceeds 25%. Ukraine's legislation does not provide for a "golden share" mechanism. State-owned enterprises are present in most sectors of the economy and represented in 2006 an important share of output in transport and communication (43%) and to a lesser extent in industry (21%) and agriculture/forestry and construction (10%) (WTO, 2008).

New developments in legislation on concessions

Ukraine's legislation on concessions introduced in 1999 and amended in 2010[41] stipulates that individuals and business entities, both resident and non-resident, can bid for concessions. It also establishes the possibility to lease state and municipal property for up to fifty years for the purpose of concession arrangements. The 1999 law was supplemented by specific legislation to design and manage concession deals for constructing and operating motorways, and more recently (October 2010) on concessions for municipal heating and water and sewage systems. As there is no official and centralised register of concession deals, it is difficult to know how many actual projects have been carried out under the initial legislation.

The Law "On Public-Private Partnership" (PPPs), which supplements the law on concessions was adopted on 1 July 2010 and entered into force in November 2010. As with the Concession Law, the new legislation (Article 1) also stipulates that foreign investors can participate in public-private partnerships, defined as co-operation between the State of Ukraine and territorial communities and, on the other side, individual entrepreneurs based on an agreement, which can be maintained for a period of five to fifty years. Such co-operation can take the form of a concession, production sharing agreement or joint activities. The law outlines general principles of PPP projects, in particular a fair allocation of risks and access to land plots. It specifies that PPPs may be established in the following activities:

- exploration, prospecting of mineral deposits and production thereof;
- heat production, transport and supply, and natural gas distribution and supply;
- construction and/or operation of highways, roads, railroads, runways at airports, bridges, overhead roads, tunnels and subways, river and sea ports and infrastructures thereof;
- machine building;
- water collection, purification and distribution;
- health care;
- tourism, leisure, recreation, culture and sports;
- support of operation of irrigation and land improvement systems;
- waste management;
- electric power production, distribution and supply;
- property management.

To ensure effective realisation of PPP projects, this general legal framework should be accompanied by more detailed regulations, regarding *i.a.* permit procedures, tariff-setting rules and state budgetary regulations.

Foreign investors enjoy non-discriminatory access to government procurement but problems remain

Until recently, government procurement in Ukraine was regulated by a 2000 law[42] based on the UNCITRAL model law on government procurement. The law incorporated some provisions of the WTO on government procurement and European Union Directives. It contained provisions regulating tender procedures for public procurement financed by the state budget and local governments. Open international tenders had to be used for procurement financed by an entity outside of Ukraine. The law referred explicitly to the principle of non-discrimination, stating that no supplier can be excluded from procurement procedures based on its national affiliation. The law also specified the appeal procedures in the case of complaints. The March 2007 amendments established an Interdepartmental Commission on Public Procurement to oversee procurement practices, imposed stricter advertising requirements and eliminated preferential provisions in favour of domestic bidders on tenders below certain values.

The new law on implementation of public procurement adopted in June 2010[43] maintains the non-discrimination principle, allowing foreign entities to participate in public procurement tenders on equal terms (Article 5). All government procurement of goods and services valued at least UAH 100 000 are subject to the provisions of the law. The Ministry of Economic Development and Trade is responsible for regulating and controlling government procurement procedures and the Antimonopoly Committee is in charge of considering claims of tender participants. Article 10 of the law specifies the obligations of the Ministry of Economic Development and Trade to provide all relevant information on government procurements on its official website – Ukrainian Public Procurements Portal (*https://tender.me.gov.ua*). Although the law stipulates that open tenders should remain the main method to carry out government procurement, it refers to other possible procedures including the two-stage tender, the preliminary participant qualification and procurement from one participant if negotiations confirm its qualification requirements.

Amendments to the law on implementation of public procurement have introduced exceptions limiting the scope of the law. In early 2011, the parliament further amended the law by excluding energy commodities and utility services from competitive bids.[44]

Although the new legislation does not restrict foreign enterprises from participating in the procurement process, foreign companies often consider that they face additional difficulties, particularly insufficient public information on tender rules and requirements and an ineffective dispute resolution mechanism. Ukraine is not a signatory of the WTO Agreement on Government Procurement.

OECD FDI Restrictiveness Index of Ukraine

The OECD FDI Restrictiveness Index (FDI Index) seeks to gauge the restrictiveness of a country's FDI rules (see Box 2.1). The FDI Index is currently available for 34 OECD countries, 8 countries adhering to the OECD *Declaration on International Investment and Multinational Enterprises* and a number of other countries, including China, Indonesia and Russia (OECD, 2010). It constitutes one component of indicators used for the OECD's *Going for Growth* policy recommendations. It is also used on a stand-alone basis to assess the restrictiveness of FDI policies in reviews of candidates for OECD accession and in OECD Investment Policy Reviews, including reviews of new adherent countries to the OECD *Declaration*.

Box 2.1. **Calculating the FDI Restrictiveness Index**

The OECD FDI Restrictiveness Index covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transports, construction, distribution, communications, real estate, financial and professional services).

For each sector, the scoring is based on the following elements:

1) the level of foreign equity ownership permitted;
2) the screening and approval procedures applied to inward foreign direct investment;
3) restrictions on key foreign personnel; and
4) other restrictions such as on land ownership, corporate organisation (*e.g.* branching).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a weighted average of individual sectoral scores.

The measures taken into account by the index are limited to statutory regulatory restrictions on FDI without assessing their actual enforcement. The discriminatory nature of measures, *i.e.* when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored.

For the latest scores, see *www.oecd.org/investment/index* and for a discussion of the methodology: *OECD Working Paper on International Investment* No. 2010/3 *OECD's FDI Restrictiveness Index: 2010 Update* available at *www.oecd.org/dataoecd/32/19/45563285.pdf*.

The FDI Index does not provide a full measure of a country's investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the nature of corporate governance, the extent of state ownership, and institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the FDI index, used in combination with other indicators measuring various aspects of the FDI climate, contributes to assessing countries' international investment policies and to explaining variations among countries in attracting FDI.

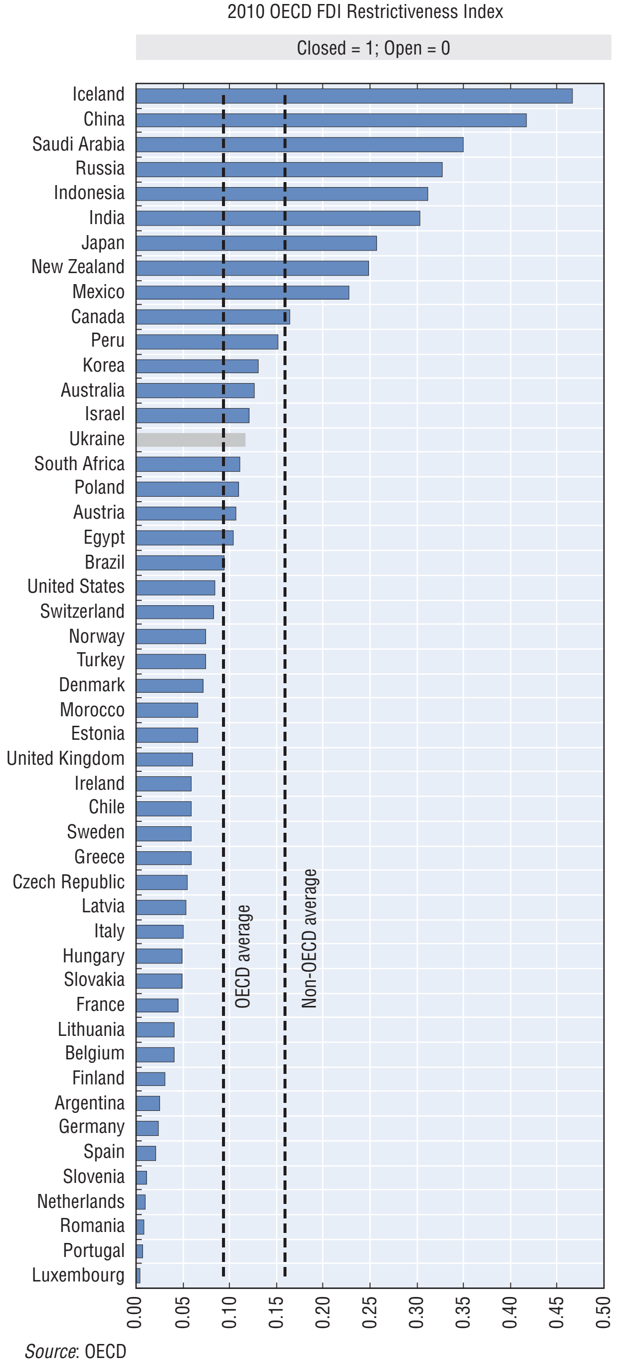
With a total score of 0.116, Ukraine ranks above the OECD average and below the average of non-OECD countries (Figure 2.1). Its score reflects the restrictions on equity in two sectors (information agencies and wholesale trade of books and newspapers), which are to be eliminated in 2013, and a number of operational restrictions, notably in insurance (branching not allowed) and agriculture (agricultural land ownership not allowed). In line with the FDI Restrictiveness Index methodology, Ukraine's current prohibition of foreign investment in unspecified "strategic sectors" and related non-transparent authorisation procedures are taken into account and considered as equivalent to general screening and approval procedures.

Figure 2.2 provides the correlation between the FDI Index scores and FDI stocks expressed as a share of GDP. Countries with more restrictions tend to receive less FDI relative to the size of their economy. Given that Ukraine, despite its comparatively moderate FDI index score, still attracts relatively limited FDI, this would suggest that Ukraine could perform much better in attracting FDI, even under the current investment regime.

For a more complete picture of countries' FDI attractiveness, it is useful to go beyond formal FDI restrictions and to consider other measures of the business climate, particularly the time and costs required to comply with various establishment procedures as regularly evaluated by the World Bank's *Doing Business* indicators. According to the last 2011 survey, Ukraine ranked 145th out of 183 countries which is only a slight improvement from 147th in the previous year. It also ranks poorly in a group of 13 neighbouring or former Soviet Union countries (Figure 2.3).

Figure 2.4 compares the Ukrainian performance against the best and worst scores observed for each individual measure reported by *Doing Business* for 12 other countries listed in Figure 2.3. A lower number implies a better performance by a country within the group. Figure 2.4 shows that although Ukraine does relatively well in terms of getting credit and enforcing contracts, it is still well behind the top performers even in these two areas. In almost all other areas, Ukraine is either the worst or one of the worst performers.

Figure 2.1. **2010 FDI Indexes by country**



Source: OECD

Figure 2.2. **FDI stocks and the FDI Index**

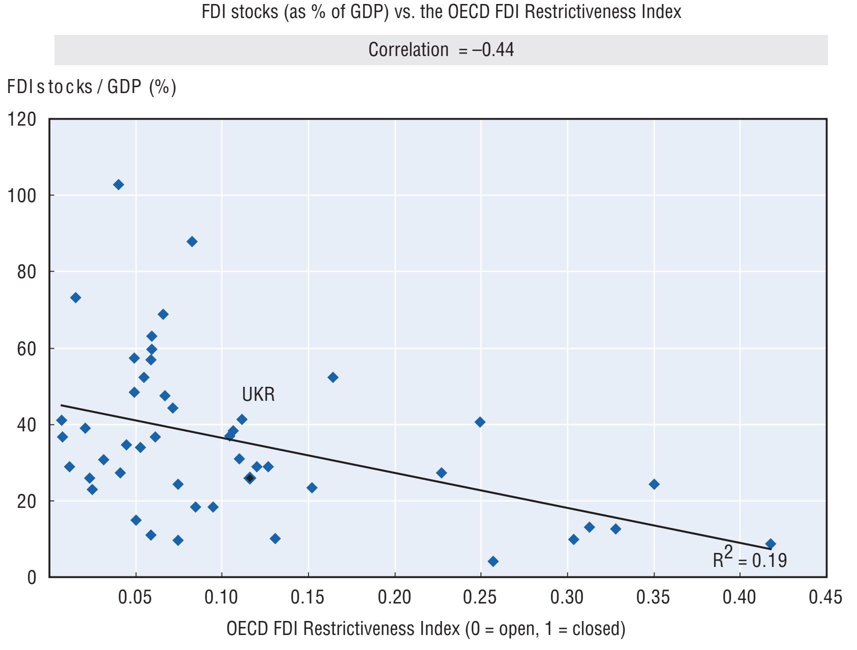
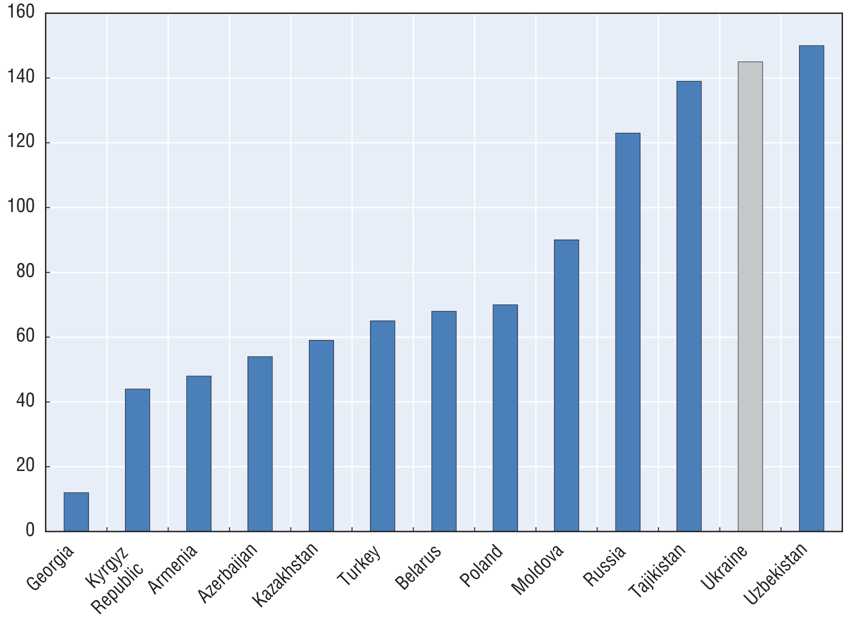
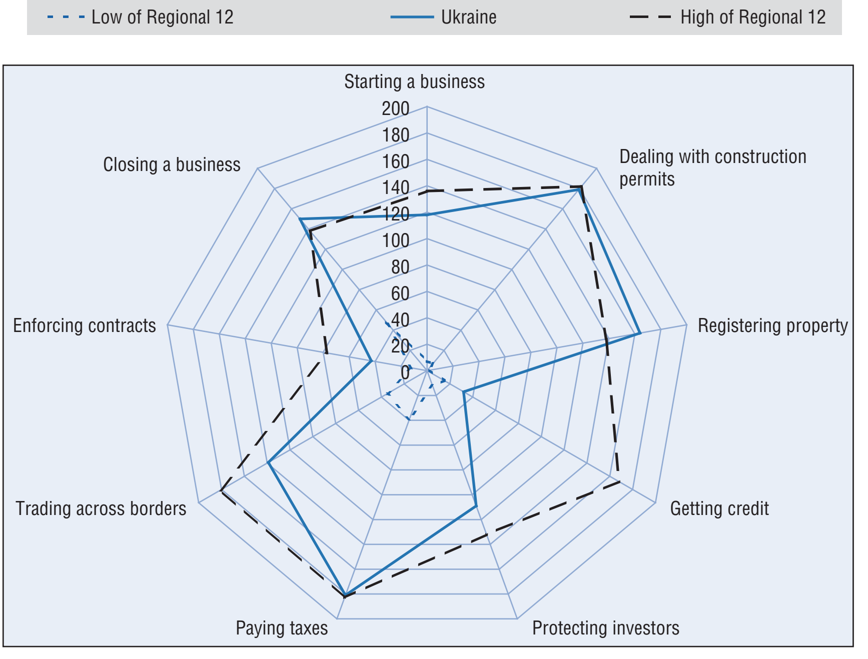


Figure 2.3. **Ease of Doing Business Rankings in selected countries**



Source : Doing Business 2011, World Bank.

Figure 2.4. **Ukraine's business climate in a regional context (ranking by measure, 183 countries)**



Source : World Bank, Doing Business 2011.

Notes

1. Law No. 93/96-VR "On the Regime of Foreign Investment" (19 March 1996) as amended.
2. Law No. 1560-XII "On Investment Activity" (18 September 1991).
3. Law No. 1533-VI "On Amending Certain Laws of Ukraine to Prevent Negative Consequences of the Financial Crisis" (23 June 2009).
4. Amendments to Legal Acts of Ukraine to Stimulate Foreign Investment and Crediting (27 April 2010).
5. Law No. 755-IV "On the State Registration of Legal Entities and Individual Entrepreneurs" (15 May 2003).
6. The following documents should be submitted in view of the state registration: *i)* the charter; *ii)* minutes of founders' meeting; *iii)* application form (registration card); *iv)* banking document confirming payment of registration fees; *v)* proof of payment of minimum capital requirement.
7. On 29 April 2011, the Hryvnia (UAH) exchange rate was 1 USD/UAH 7.97 and 1EUR/ UAH 11.85.
8. Law No. 2609-VI "On Amending the Law On State Registration of Legal Entities and Individual Entrepreneurs to Conduct Electronic Registration" (19 October 2010).

9. Law No. 2806-IV "On the Permit System in the Field of Economic Activity" (6 September 2005).

10. Self-certification by companies to the State Fire Safety departments increased almost four-fold between 2006 and 2008 and the time to prepare, submit necessary documentation and obtain a fire permit was considerably reduced. See the 2009 Survey by the International Finance Corporation, IFC (2009).

11. Law No. 2451-VI "On amending the Law on licensing in the sphere of economic activity" (7 July 2010).

12. Resolution of the Cabinet of Ministers No. 725 "On approval of the list of certain activities related to business activity or types of business activity which cannot be conducted on the basis of submitting the Declaration of conformity of the material and technical conditions of the business entity to the requirements of the legislation" (25 August 2010).

13. Law No. 1759-VI "On Amending the Law on Liberalising Conditions for Doing Business in Ukraine" (15 December 2009).

14. According to the Ukrainian Commercial Code, small enterprises are defined as entities with up to 50 persons employed during one year and with an annual income not exceeding UAH 70 million (USD 8 million).

15. Law No. 2555 "On Amending the Law on State Registration of Legal Entities and Individual Entrepreneurs" (23 September 2010); Law No. 7516 "On Amending Certain Legislative Acts regarding the Cancellation of Certificates of State Registration of Legal Entities and Individual Entrepreneurs" (24 December 2010); Law No. 8294 "On Amending Certain Legislative Acts to Liberalise/Simplify Launching of Business Activities" (24 March 2011).

16. Law No. 1775-III "On Licensing of Certain Economic Activities" (1 June 2000).

17. Law No. 1571-VI "On Amending Certain Laws of Ukraine on Further Improving Business Licensing Procedures" (25 June 2009).

18. Resolution of the Cabinet of Ministers No. 322 "Regulation on the Issuance, Extension and Annulment of Work Permits for Foreigners and Stateless Persons" (8 April 2009).

19. Decree of the Cabinet of Ministers "On the System of Currency Regulation and Currency Control".

20. Law No. 185/94-BP "On Payments in Foreign Currency" (23 September 1994) as amended on 11 February 2010.

21. Law "On Investment Activity" (18 September 1991).

22. Law No. 2544-XII "On Privatisation of State Property" (7 July 1992), Article 8.

23. Law No. 1720-IV "On Amendments of Certain Ukrainian Legislation to Counteract Illegal Takeovers and Acquisitions of Enterprises" (17 November 2009).

24. At the beginning of 2011 the Parliament adopted a new law "On development of municipal territories", which could facilitate procedures related to construction permits. The President vetoed the law and sent it back to the Parliament with his remarks.

25. Law No. 3038-VI "On regulation of city planning" (17 February 2011).

26. Law No. 1775-III "On Licensing of Certain Economic Activities" (1 June 2000) as amended on 19 October 2010.

27. Law No. 2608 “On amending some legal acts with respect to limiting the state regulation of economic activities (19 October 2010).
28. Ukraine’s Code “On the Subsoil”.
29. Law No. 2608 “On Amending Some Legal Acts of Ukraine with respect to Limiting the State Regulation of Economic Activity” (19 October 2010).
30. Law No. 1039-XIV “On Production Sharing Agreements” (14 September 1999).
31. Law No. 2608 “On amendments to some legislative acts on deregulation of economic activities (19 October 2010), Article 76.
32. Law No. 3317-IV “On Introducing Amendments to the Law on Television and Radio Broadcasting” (12 January 2006).
33. Law 317-V “On Amendments to Article 25 of the Law of Ukraine “On Publishing” (2 November 2006).
34. Law No. 2121-III “On Banks and Banking” (7 December 2000).
35. Law “On Financial Services and the State Regulations of the Market of Financial Services” (12 July 2001).
36. Law No. 85/96 “On Insurance” (7 March 1996). Law 357-V “On Amendments to the Law of Ukraine “On Insurance” (16 November 2006) applies currently. Law No. 2774-IV “On Amendments to the Law of Ukraine “On Insurance” (7 July 2005) will take effect in 5 years after Ukraine’s WTO accession.
37. Law No. 250-VI “On Ratification of the Protocol on Ukraine’s Accession to the WTO” (10 April 2008).
38. Law No. 3425-XII “On Notariat” (2 September 1993).
39. Law No. 1682-III “On Natural Monopolies” (20 April 2000) as amended.
40. Law No. 847-XIV “On the List of State Property Assets not Subject to Privatisation” (7 July 1999).
41. Law No. 997-XIV “On Concessions” (16 July 1999), amended on 23 September 2010.
42. Law No.1490-HI “On Procurement of Goods, Works and Services” (22 February 2000) as amended.
43. Law No. 2289-VI “On Implementation of Public Procurement” (1 June 2010).
44. Yuriy Onyshkiv, “Disappointed with corruption, EU holds us aid to Ukraine”, *KyivPost*, 11 January 2011.

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Chapter 3

Ukraine Policy Framework for Investment

Based on the OECD Policy Framework for Investment *(PFI), this chapter analyses the contribution, interaction and coherence of selected policy areas in support of a sound investment environment. It shows that while Ukraine has made progress in several areas covered, notably investment policy transparency and predictability, investment promotion and facilitation and trade policy, more remains to be done in particular with respect to policy implementation, policy dialogue and streamlining of administrative procedures to reduce the risks of administrative discretion and hence the possibility of corruption. The recent establishment of the new State Agency for Investments and National Projects and the reorganisation of the Council of Local and Foreign Investors should permit to enhance the country's investment promotion activities and improve policy dialogue between the government and investors. Public policies promoting principles for responsible business conduct, such as those embodied in the OECD* Guidelines for Multinational Enterprises, *contribute to attracting investment in support of sustainable development. But in many relevant areas, both public awareness and responsible business practices are still less common in Ukraine than in other emerging economies.*

Legal provisions governing foreign investors' establishment and operations as described in the previous chapter and captured by the OECD FDI Restrictiveness Index are only the first step in assessing a country's investment environment. The objective of the OECD *Policy Framework for Investment* (PFI) is to explore various policy domains which influence countries' investment climate (Box 3.1) and analyse their contribution, interaction and coherence in support of a sound investment environment. Based on the selected areas of the PFI, this chapter focuses on a range of

Box 3.1. **The Policy Framework for Investment**

The *Policy Framework for Investment* (PFI) helps governments to mobilise private investment in support of steady economic growth and sustainable development, thus contributing to the prosperity of countries and their citizens and to the fight against poverty. The *Framework* was developed at the OECD by representatives of 60 OECD and non-OECD governments in association with business, labour, civil society and other international organisations and endorsed by OECD ministers. It offers a list of key questions to be examined by any government seeking to create a favourable investment climate.

The *Framework* is a flexible instrument that allows countries to evaluate their progress and identify priorities for action in ten policy areas: *i)* investment, *ii)* investment promotion and facilitation, *iii)* trade, *iv)* competition, *v)* tax, *vi)* corporate governance, *vii)* promoting responsible business conduct, *viii)* human resource development, *ix)* infrastructure and financial sector development, and *x)* public governance. Three principles apply throughout the *Framework*: policy coherence, transparency in policy formulation and implementation, and regular evaluation of the impact of existing and proposed policies.

By encouraging a structured process for formulating and implementing policies at all levels of government, the *Framework* can be used in various ways and purposes by different constituencies, including for self-evaluation and reform design by governments and peer reviews in regional or multilateral discussions.

For more information on the PFI and its User's Toolkit, see: *www.oecd.org/daf/investment/pfi* and *www.oecd.org/investment/pfitoolkit*.

policies shaping Ukraine's investment environment, particularly investment policy transparency and predictability, investment promotion and facilitation, trade policy and policies for promoting responsible business conduct. It also highlights aspects of other policy areas covered by the PFI, such as competition policy and infrastructure development.

1. Investment policy

> The quality of investment policies directly influences the decisions of all investors, be they small or large, domestic or foreign. Transparency, property protection and non-discrimination are investment policy principles that underpin efforts to create a sound investment environment for all.

The main elements that determine investment policy transparency and predictability are: broad and timely access to relevant information by economic operators; clear and unambiguous regulations and procedures; and public consultations with the private sector, including with foreign investors.

Access to information

To enter into force, all laws, international treaties and normative acts of the *Verkhovna Rada*, the President and the Cabinet of Ministers have to be published no later than fifteen days after their adoption in the official gazette, *Officyinyi Visnyk Ukrainy,* also available electronically, or other official specialised periodicals such as *Uriadovyi Kur'er* (Government Messenger) or *Vidomosti of Verkhovnoj Rady Ukrainy* (Parliament News). All laws, normative acts and international treaties should be included in the State Registry for Normative Acts and their Enforcement. Moreover, draft legal acts and regulations should be published on the website of the lead drafter and made available for discussion on the Internet before their submission to the Parliament (*www.zakon.com.ua*).

Selected laws or their summaries in English are available free of charge (*www.rada.kiev.ua*). Several legal databases provide the complete texts of the laws for a fee, for instance *www.ligazakon.kiev.ua*. Copies of legal texts in Ukrainian can be obtained upon request against payment from any state authority. As part of its WTO commitments, Ukraine agreed to establish within two years after the country's accession an official journal or website which will publish, update on a regular basis and make publicly available all regulations and measures pertaining to or affecting trade in goods, services and trade-related intellectual property rights prior to their enactment. It was also agreed that proposed WTO-relevant measures should be open for public comments for no less than thirty days before their implementation, except for regulations and measures related to an emergency situation in the country or national security issues, or in the cases when publicity may harm the law's implementation.

In January 2011, the Parliament approved new legislation[1] which should considerably improve public access to information. It stipulates that government bodies, local government and government agencies, including those with "special status" such as the Tax Administration, Security Service of Ukraine and the State Property Fund, should answer public inquiries in five working days and nominate special public officials responsible for handling such information requests. Information considered as an "official secret" defined in the law on state secrets will be significantly reduced. Implementation of the new laws will depend on the approval of other necessary bylaws to avoid possible contradictions with existing legislation, notably "On Personal Data", which bans the publication of information stored in electronic databases. Relatively modest fines imposed in the case of refusal to respond to public inquiries (UAH 425 to 850) could nevertheless hamper the application of the new legislation.

Regulatory and procedural transparency

A 2003 law[2] and several related decisions adopted by the Cabinet of Ministers in 2004 foresee less government intervention in economic activities and the removal of administrative and other obstacles to economic development. The law reiterates the obligation for regulatory agencies to provide timely information to the public and economic agents on their current activities and planned regulatory initiatives and to ensure openness of their actions at all stages of their operations. For each draft regulation, the responsible agency should prepare a regulatory impact analysis (RIA); both the proposed law and its RIA should allow at least one month for public comments. The final legal proposal should take into account all comments raised during public consultations.

Regulatory reform has been undertaken and carried by the State Committee of Ukraine for Regulatory Policy and Entrepreneurship (SCURPE) in charge of implementing the 2003 Law "On Public Policy Regulating Economic Activity". In 2005-2006, some 9 500 regulations were reviewed by central and local authorities and, based on this assessment, 55% of them considered not to be in compliance with existing laws of Ukraine were amended or cancelled. The Committee has undertaken several studies of the regulatory environment in specific areas such as land use, construction and tourism, which have allowed some regulations to be streamlined. Its regulatory assessment has also led to important legislative changes in several sectors, notably in transport. The SCURPE has carried out public hearings on proposed legislation, such as with representatives of the pharmaceutical industry on legislation concerning pricing of medicines and medical products (OECD, 2009a).

Public consultations

Although public discussion of draft regulations has not been carried out systematically, there have been some examples where interested parties were associated in the decision-making process and closely involved in the implementation phase. This was notably the case of stakeholders' participation in business registration reforms (World Bank, 2009b). The reform carried out in 2002-2004 was relatively successful (reducing the number of procedures from 15 to 10 and the delays from 40 to 33 days), thanks to the association of the main supporters of the reform in its early stage by establishing a specific structure to design the reform agenda (State Committee for Entrepreneurship Development), organising roundtable discussions and public hearings and launching a public information campaign to identify critical problems in the registration process. In the middle of the reform, several pilot one-stop-shop facilities were established in selected regions and cities with the active support of the municipalities concerned. Positive results were shared through broad information campaigns.

Protecting and enforcing intellectual property rights protection

Has the government implemented laws and regulations for the protection of intellectual property rights and an effective enforcement mechanism?

Ukraine has included the main provisions on protecting intellectual property in its general legislation, notably the Civil Code, and has adopted a number of specific laws regulating various intellectual property rights such as copyright, trademarks, geographical indications, industrial designs, patents, plant variety protection and layout design of integrated circuits. The process of harmonising the country's legal framework with international standards was accelerated by WTO accession with the objective of complying with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Various laws concerning specific IPRs now grant national and MFN treatments in their respective areas.

Among important legal amendments introduced in compliance with the WTO TRIPs, several are worth mentioning. The amended law "On medicinal drugs" provides a five-year period for the protection of pharmaceutical test data submitted to government authorities to obtain market approval. Agricultural chemicals benefit from ten years of protection. Discriminatory fees on the testing and registration of plant varieties were abolished in 2006. To be granted protection, goods with trademarks and copyrights have to be registered in the Customs' rights holder database. The 2006 amendments to the Customs Code allow customs officials to use *ex officio* authority to seize suspected pirated or counterfeit goods. Amendments to the Civil and Criminal Codes introduced in 2007 provide for the seizure and destruction of IPR-infringing goods and equipment in line with Article 46 of TRIPs.

The State Department for Intellectual Property (*www.sdip.gov.ua*), a part of the Ministry of Education and Science, is the main agency responsible for designing and implementing policies in this area. The Ministry of Internal Affairs and the State Customs Service have also established special units to deal with IPR violations. The Antimonopoly Committee is in charge of preventing anti-competitive behaviour in the area of IPRs. Relevant civil judicial procedures and remedies are foreseen in the Civil and Criminal Codes as well as in the Code on Administrative Offences. Since 2003, disputes related to IPR are dealt with by specialised chambers of economic and appeal courts. IPR violations could be subject to fines, temporary prohibition of business activities, confiscation of equipment or goods or criminal penalties, including imprisonment from two to five years. Lowering the threshold for IPR violations in 2006 has permitted an increase in the number of prosecutions and convictions of IPR-related crimes. Administrative decisions related to IPR can be appealed to the Appellate Chamber of the State Department for Intellectual Property.

Despite the government's efforts to strengthen legal provisions and improve their enforcement, IPR violations remain frequent in Ukraine. Furthermore, foreign investors continue to have difficulty defending their interests in Ukraine's courts as demonstrated by the recent ruling on trademark protection.[3] Problems also remain concerning the production and distribution of counterfeit products such as audiovisual works and phonograms, and the duplication and distribution of unlicensed computer software, often aggravated by difficulties to control efficiently the borders with neighbouring countries especially Russia. Domestic and foreign investors consider that IPR protection still remains weak in the area of software copyrights.

To redress the situation, the business community has recommended amending existing legislation to make possible criminal pursuits in case of the use of unlicensed software and enhancing enforcement procedures by increasing the number, and improving the qualifications of, specialised police officials and judges. Legal experts and government officials have also called for the establishment of a special patent court in Ukraine to adjudicate patent cases. Another important impediment to efficient IPR protection in Ukraine has been the lack of public awareness of IPR issues, which needs to be addressed more vigorously, notably through public campaigns to prevent and combat piracy. The authorities should also lead by example by using exclusively licensed software.

Ukraine is a member of the World Intellectual Property Organisation (WIPO) and has adhered to a number of relevant international agreements and conventions, in particular the Paris Convention for the Protection of Industrial Property (December 1991), the Patent Cooperation Treaty (December 1991), the Berne Convention for the Protection of Literary and Artistic Works (May 1995), the Madrid Agreement Concerning the International Registration of Marks (June 2000) and the Universal Copyright Convention. Ukraine is also considering adhering to several other international treaties such as the Strasbourg Agreement Concerning the International Patent Classification, the Locarno Agreement Establishing Classification of Industrial Designs and the Brussels Convention Relating to the Distribution of Programmes Carrying Signals by Satellite.

Investment promotion and protection agreements

> Are investment authorities working with their counterparts in other economies to expand international treaties on the promotion and protection of investment? Has the government reviewed existing international treaties and commitments periodically to determine whether their provisions create a more attractive environment for investment?

As of September 2010, Ukraine had concluded 73 bilateral investment treaties (BITs), of which 26 with OECD countries (see Annex C). Ukraine has not developed a Model BIT but, with few exceptions, most current treaties contain similar provisions.

Ukrainian BITs take a broad definition of investment that includes a non-exhaustive list of assets. Investors are usually allowed to change the form of their investment, although in some cases this should be in line with legislation of the Party where the investment takes place (*e.g.* BITs with Portugal, Latvia, Russia, Albania, Bosnia and Herzegovina) or should comply with permits issued for the initial investment (Jordan). The definition of investor in all reviewed BITs covers both natural and legal persons.

Some BITs extend protection to indirect investment, through:

- a broad definition of investment or investor/assets directly or indirectly controlled (Kuwait, United States), invested directly or through a subsidiary

(Italy), investment by a third country legal person effectively controlled by an entity from one of the Parties (Canada, Sweden, Switzerland, Netherlands);

- an explicit provision: the BIT protects an investment in the host country made by a locally incorporated entity, which is owned or controlled by a company from another Party to the agreement (Finland).

In line with general practices, Ukraine's BITs contain substantive investment protection: fair and equitable treatment, non-discrimination, national treatment and most favoured nation (MFN) treatment (whichever of two is the more favourable) and compensation for expropriation. Exceptions to national treatment and MFN treatment can be based on:

- Privileges granted to investors of third countries under current or future agreements on customs unions, economic unions, common market, free trade zones, monetary unions, or other forms of regional economic co-operation.
- Tax treaties and, in some cases, national tax provisions (*e.g.* Brunei, Slovak Republic, Sweden, UK).
- In some cases, exemptions can result from agreements on facilitation of border trade (Italy, China) and agreements in certain economic sectors (Canada).

Provisions on expropriation in BITs concluded by Ukraine comply with general practice and international law by stipulating that direct or indirect expropriation should be for public purposes, non-discriminatory and carried out according to the law and under due process. Compensation should be guaranteed, prompt, adequate and effective, in a freely convertible currency and freely transferable. Most of the BITs also specifically mention the right of the investor to challenge the expropriation in courts or other independent domestic dispute resolution bodies. A separate BIT provision concerns compensation of losses caused by war, armed conflict, a state of national emergency, revolt or other similar events.

Ukrainian BITs provide for the unrestricted transfer of investments and returns in various forms to be effected without undue delay. The BIT with Canada includes a list of exceptions when a Contracting Party may prevent such a transfer through the equitable, non-discriminatory and good faith application of laws relating to: *a)* bankruptcy, insolvency, protection of the rights of creditors; *b)* issuing, trading or dealing in securities; *c)* criminal offences; *d)* reports of transfers of currency or other monetary instruments; *e)* ensuring the enforcement of judgments. The BIT with the United States contains exceptions mentioned in points *a)*, *d)*, *e)* above, as well as imposing taxes on dividends or other transfers.

The subrogation clauses are found in all Ukraine's BITs and provide for an assignment of the insured investor's claim against the host State to the insurer upon payment of the claim arising from the insurance, defined usually as the guarantee provided by the State or a State agency to an investor in the foreign State.

Dispute resolution provisions cover State-to-State and Investor-State disputes. For State-to-State disputes, the resolution mechanism commonly provides for reaching settlement by means of negotiations or, failing this, binding arbitration. Disputes subject to resolution in Ukraine's BITs are generally defined broadly (*e.g.* "any dispute", "all disputes related to investment"). All treaties provide that amicable resolution through negotiations should first be attempted before submitting the dispute for arbitration. Most of the BITs stipulate a 6-month mandatory waiting period before recourse to arbitration, with only a few exceptions when a 3-month period is imposed (Finland, Netherlands and UK).

Ukraine is a Party to the International Centre for Settlement of Investment Disputes (ICSID) Convention. Arbitration under the Rules of UNCITRAL is often provided as an alternative (*e.g.* Canada, Slovak Republic, San Marino, Canada, Panama, Albania, Korea, Jordan, Finland, Lithuania and Kazakhstan). Several BITs also provide for other international arbitration venues, such as the International Court of Arbitration under ICC (Jordan, UK), the Arbitration Institute of the Stockholm Chamber of Commerce (Russian Federation) or "any other arbitration institution, or in accordance with any other arbitration rules, as may be mutually agreed between the parties to the dispute" (United States).

In many cases arbitration in the national court of the host country is also allowed, but certain restrictions can apply: resort to international arbitration and resort to domestic judicial procedures are mutually exclusive (*e.g.* United States and Albania); once a case is submitted in the court of the host country it can be withdrawn and referred to international arbitration, but only before the end of the domestic procedure (*e.g.* Finland, Slovak Republic). In BITs with San Marino, Albania, Kazakhstan and Vietnam, a domestic remedy is an equal alternative for international arbitration procedures without any restrictions. The establishment of an *ad hoc* arbitration tribunal as the only way to resolve disputes is provided in the treaty with Armenia.

Contract enforcement

> Is the system of contract enforcement effective and widely accessible to all investors?

The Civil Code and the Commercial Code, which both entered into force in January 2004, define contract procedures. They establish the principle of freedom of contract allowing the parties to select the type of contract appropriate to their situation. The contracts between domestic and foreign companies have to be drafted in Ukrainian and in one language used by the foreign party. The absence of the bilingual form of foreign contracts can justify their invalidation by courts. A representative office of a foreign company is not considered as a legal entity and should be registered with the Ministry of Economic Development and Trade, tax authorities and the Statistics Committee. It can be exempted from corporate profits tax if provided by international double taxation treaties concluded by Ukraine. To be valid, some contracts have to be registered with the Ministry for Economic Development and Trade (*e.g.* for export of scrap metals) or with the State Agrarian Stock Exchange and/or the State Agrarian Fund (for grain exports).

The most common forms of business in Ukraine are joint-stock companies (JSCs) and limited liability companies (LLCs). In addition to the requirements concerning the minimum amount of charter capital (recently reduced to one minimum wage), the legislation stipulates the rules for establishing governing, executive and controlling bodies of different types of companies. According to the 2011 World Bank *Doing Business* database, Ukraine's performance in enforcing contracts is much better than for other aspects of the business climate and comparable to the OECD average in terms of the number of procedures, time and cost involved in payment disputes. The World Bank considers that the law on joint-stock companies was Ukraine's most positive reform in 2009 as it increased disclosure requirements and made it easier to sue directors in cases of prejudicial transactions between interested parties (World Bank, 2010a).

The business community nevertheless has some concerns about current corporate legislation, notably the lack of effective legal instruments enabling minority shareholders to protect their rights, such as by preventing profit-skimming or asset-stripping by controlling shareholders. Foreigners may also be reluctant to invest in Ukrainian companies given the practice of work contracts of managers that limit their liability (to one month salary) and due to an extended use of disclaimers by auditors that make companies' financial reports often unreliable (UNDP, 2010).

Dispute resolution

Has the government ratified and implemented binding international arbitration instruments for the settlement of investment disputes?

According to the 1996 Law "On the Regime of Foreign Investment", a business-related dispute between a foreign investor and the State of Ukraine must be settled in Ukrainian courts, unless otherwise provided by international treaties. For other disputes involving a foreign investor, the parties are allowed to select a forum for its resolution, including Ukrainian courts (the International Commercial Arbitration Court of the Chamber of Commerce and Industry of Ukraine) or other organs of dispute resolution chosen by the parties.[4]

The law "On International Commercial Arbitration" (24 February 1994) limits the jurisdiction of international arbitration tribunals to civil law disputes arising from international economic operations (*i.e.* if the commercial enterprise of at least one party exists outside of Ukraine), disputes between international organisations and enterprises with foreign investment in Ukraine, and intra-company disputes of these enterprises. It also specifies that foreign investors and Ukrainian enterprises with foreign participation have the right to bring a dispute to an *ad hoc* arbitration tribunal or to a permanent arbitration institution, *e.g.* the arbitration tribunal of the Chamber of Commerce and Industry of Ukraine. The Parties are also free to choose international institutions, such as the arbitration of the International Chamber of Commerce of Paris or Stockholm.

As a signatory to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (on 10 January 1961), Ukraine has committed to enforce arbitral awards in accordance with that Convention. On 16 March 2000, Ukraine also ratified the Washington Convention on the Settlement of Investment Disputes. On average, and assuming that there is no appeal, it takes around seven weeks to enforce an arbitration award rendered in Ukraine, from filing an application to a writ of execution attaching assets. It takes roughly 13 weeks to enforce a foreign award (World Bank, 2010a).

As of the end of 2010, there have been ten disputes involving Ukraine in the International Centre for Settlements of Investment Dispute (ICSID), four of which were concluded and six are pending.[5] So far, no investor has successfully won an award against Ukraine in ICSID. The Latvian investor failed to prove the violation in the recent case *Limited Liability Company AMTO v. Ukraine* dealt with by the Arbitration Institute of the Stockholm Chamber of Commerce (Arbitration Institute of the Stockholm Chamber of Commerce, 2008).

A recent law adopted in January 2010[6] should make recognition and enforcement of foreign court judgments in Ukraine easier since it abolished the reciprocity principle as a condition for enforcement. Under previous legislation, foreign court judgments could not be recognised or enforced in Ukraine in the absence of an international agreement or unless Ukraine had signed an *ad hoc* agreement on reciprocal enforcement with a country in which the judgment was made. Ukraine signed such agreements mostly with the countries of the former Soviet Union.

The 2002 Presidential Decree on Dispute Settlement[7] defines pre-trial dispute settlements or mediation procedures as extra-judicial settlements of a dispute entailing the threat of a law suit or an action submitted to a foreign jurisdiction that may be prevented through conciliation. The alternative dispute resolution (ADR) mechanism has been introduced in Ukraine only recently and is assured by several mediation centres in Kyiv (the Ukrainian Centre for Common Ground), Odessa, Lviv, Kharkiv and Luhansk. A planned Ukrainian Commercial Mediation Centre in Kyiv will specialise in ADR for commercial and intellectual property.

2. Investment promotion and facilitation

> Investment promotion and facilitation measures, including incentives, can be effective instruments to attract investment provided they aim to correct for market failure and are developed in a way that can leverage the strong points of a country's investment environment.

Government's strategy for attracting foreign investment

> Does the government have a strategy for developing a sound, broad-based business environment and within this strategy, what role is given to investment promotion and facilitation measures?

The objective of the government's *Programme for the Development of Investment Activity for 2002-2010* agreed in 2001[8] was to improve Ukraine's attractiveness and facilitate growth of foreign investment through various means, notably by deregulating and liberalising entrepreneurial activities, improving corporate rights and bankruptcy procedures, facilitating privatisation and developing infrastructure. In December 2008, the *Programme Counteracting the Effect of the World Financial and Economic Crisis on Continued Development* again emphasised the key contribution of foreign direct investment to the country's technological modernisation, international competitiveness and energy efficiency. A new *Strategy of the State Target Programme on the Development of Investment Activity in 2011-2015* and the Resolution of the Cabinet of Ministers on the *Concept of the State Targeted*

Economic Programme for Developing Investment Activities for 2011-2015 adopted in September 2010 confirm the objective to stimulate public and private investment in support of sustainable development, modernise the economy and infrastructure by continuing to improve legislation and remove obstacles to investment.

In the absence of political and macroeconomic stabilisation in the country, most previous general declarations encouraging and attracting foreign investment have remained to a large extent ineffective. With greater political stability and economic growth resuming, Ukraine is now in a better position to implement the new strategy and address persistent problems highlighted by the business community such as an excessive administrative burden and corruption.

Institutional framework for investment promotion

> Has the government established an investment promotion agency (IPA)? To what extent has the structure, mission, and legal status of the IPA been informed and benchmarked against international good practices?

In 2008, investment promotion agencies in 181 countries were compared based on the information content of their websites and their capacity to deliver information requested by prospective investors. In light of these criteria, the performance of Ukraine's main investment promotion agency *Invest Ukraine* was assessed as weak. Ukraine's underperformance contrasted with its potential competitors among the countries of Europe and Central Asia as most of them, especially in Central and Eastern Europe, have considerably improved their investment promotion activities in recent years (World Bank, 2009a).

Probably the most important weakness of Ukraine's investment promotion activities has been frequent changes in the institutional and organisational structure, leading to the multiplication of agencies with often unclearly delineated and overlapping responsibilities. The Ukrainian Centre for Promotion of Investment, founded in 2005 initially as an independent non-profit organisation, was supervised by a board composed of representatives from the public and private sectors. The Centre became a member of the World Association of Investment Promotion Agencies (WAIPA). Its main role was to promote Ukraine worldwide as an investment destination and to provide information and methodological and organisational support to the National Agency for Foreign Investment and Development. This Agency placed under the direct responsibility of the Cabinet of Ministers had to promote foreign investment, supervised strategic investment projects selected by the government and implement a number of specific tasks, in particular establishing a "single window" facility for foreign investors.

In December 2010, the authorities undertook a new overhaul of the institutional framework for investment promotion with the aim of streamlining and rationalising the country's activities in this area. The State Agency on Investment and Development and the State Agency for Managing National Projects were merged into the new single State Agency for Investment and National Projects, supervised by the Ministry of Economic Development and Trade. The new Agency combines the two main tasks of the two previous organisations, including preparing, implementing and monitoring strategic national and other investment projects, developing a positive investment image of Ukraine and strengthening its competitive advantages. It also has to establish Ukraine's Development Bank and the Regional Development Fund and supervise the creation of industrial parks (Box 3.2).

The new Agency will also be in charge of implementing the long-awaited target of creating a "single window" facility for investors. According to the law adopted in October 2010,[9] this facility should be available in 27 regional centres for investment operating in all regions as well as in Kyiv and Sevastopol. The new facilities which are to be operational by 1 January 2012 will have to consider documents submitted by applicants within five days after the registration of their demand.

In September 2010, the former Foreign Investors Advisory Council was reorganised to become the Council of Local and Foreign Investors.[10] Chaired by Ukraine's President with the deputy head of the Presidential Administration acting as its executive secretary, it will be assisted by local consultative and advisory bodies established at the regional level. The main role of the Council is to involve local and foreign investors in the reform and decision-making process through a high-level policy dialogue. The Council will participate in designing national policies to improve the country's investment climate, attract private investment and accelerate Ukraine's integration into the world economy. While including both domestic and foreign investors in one consultative body with direct links to the central government accords with international good practices, it has to be seen how the new organisation structure will ensure that all constituencies are effectively represented. The goals of the Council are also currently defined in a very general way, making any assessment of progress difficult.

Frequent organisational changes and shifting responsibilities do not usually facilitate transparency and accessibility of a country's foreign investment promotion activities, especially for new foreign investors

Box 3.2. **State Agency for Investment and National Projects**

The Agency created by Presidential Decree No. 1085 of 9 December 2010 will carry out the following investment reforms:

- Participate in the preparation of a new law on investment to be submitted to the Parliament covering both foreign and domestic investment.
- Implement the "single investment window" facility for foreign investors by 2012.
- Create a register of investment projects based on the UNIDO international standards.
- Ensure promotion of selected investment projects abroad.
- Elaborate the mechanism for launching national projects based on the PPP principle.
- Prepare the establishment of the Ukrainian Development Bank.

In 2011, the Agency should accomplish the following concrete tasks:

- Attract foreign direct investment into at least three national projects.
- Launch at least three national projects under the PPP scheme, including at least one concession project.
- Prepare the draft Law of Ukraine on National Projects to be submitted to the Parliament.
- Organise an annual high-level International Investment Forum under the aegis of the President of Ukraine and participation of Heads of State and Governments and major world investors.
- Present national and other investment projects in 25 world financial centres supported by an international media campaign (investment roadshows).

The 2011 annual budget of the Agency amounts to UAH 1 159 billion (USD 145 million). Current staff of the Agency consists of 35 persons of the former State Agency for National Projects (*www.ukrproject.gov.ua*) and 130 persons of the former State Agency for Investment and Development (*www.in.gov.ua*). It is planned that the total staff of the Agency will reach 190 persons.

unfamiliar with the local economic and legal environment, though this category of investors is in principle one of the main target groups of investment promotion agencies. Consolidating all investment promotion activities in the new Agency for Investment and National Projects with direct links to the government is therefore a welcome step in enhancing the efficiency and relevance of investment promotion in Ukraine. The new Agency must have sufficient human and financial resources to handle its vast responsibilities covering many different areas and fulfil its tasks in respecting the deadlines of its ambitious agenda. In the context of intense world competition to attract FDI, the ongoing reform of Ukraine's investment promotion activities has to focus on key functions in this area, notably developing an updated information service to prospective investors both on-line and in response to their direct inquiries and providing active support for foreign investors when establishing and operating in the country. Keeping existing investors happy pays substantial dividends in enticing new investors. Given the many problems still faced by both new and established foreign investors in Ukraine, the authorities could envisage creating an office of ombudsman for foreign investors similar to what exists in some countries such as Korea.[11]

Investment incentives

> What mechanisms has the government established for evaluating the costs and benefits of investment incentives, their appropriate duration, their transparency, and their impact on the economic interests of other countries?

The OECD *Declaration on International Investment and Multinational Enterprises* includes the Instrument on Incentives and Disincentives, which encourages adherent countries to make such measures as transparent as possible so that their scale and purpose can be easily determined. The Instrument also provides for consultations and review procedures among adherent countries to facilitate international co-operation in this area. Ukraine's adherence to the OECD Declaration would be a good opportunity to improve transparency of the current incentive schemes and evaluate the costs and benefits of existing investment incentives and their impact on investment.

The OECD *Checklist for FDI Incentive Policies* lists policy choices for consideration in designing investment incentives, thereby helping governments to assess the costs and benefits of using incentives to attract FDI, to provide operational criteria for avoiding wasteful effects and to warn against the pitfalls and risks of excessive reliance on incentive-based strategies. Incentives should be transparent to maximise their intended effects, reduce incentive-related tax planning opportunities and facilitate cost-benefit analyses. Since incentives in one country may affect others, international co-operation can be beneficial. Adherents to the OECD *Declaration* commit to making incentives as transparent as possible and to conducting consultations and reviews.

Ukraine established a specific customs and tax regime for Special Economic Zones (SEZs) and priority development territories (PDT), allowing business entities operating in these areas to benefit from VAT exemption. In March 2005, the regime was used by 680 economic entities with foreign investment participation amounting to USD 2.5 billion. The cost of these SEZs in terms of tax avoidance and evasion represented more than 3% of GDP annually (World Bank, 2010b). The differentiated tax and customs treatment attracted local rather than foreign investors, were difficult to manage and increased the risks of discretionary behaviour and abuse. The 2005 law[12] abolished both the customs regulations and the special tax regime granted to these zones and, as a result, all existing projects have been cancelled either after the expiration of their contracts or at the initiative of investors.

Despite this unsuccessful experience, the 2010 State Programme for Economic and Social Development envisages reactivating a special regime to stimulate employment, increase exports, use local resources and modernise infrastructure in specific areas. The Ministry of Economy has prepared a draft law "On special (free) economic zones" proposing to create special regimes for individual SEZs and PDTs with specific preferential treatment and procedures. According to the government, the new scheme aims at attracting investment, especially in processing industries, and encouraging employment in specific geographical areas. International experience indicates that SEZs are difficult to manage, often attract rent-seeking activities rather than long-term investments and might postpone general business-improving reforms in the country as a whole. It is therefore critical that before embarking on this new experiment, the authorities perform a thorough cost-benefit analysis and seek to avoid general pitfalls of the SEZ regimes.

Foreign investors have benefitted from some specific tax exemptions and incentives. Direct investment in corporate rights in cash or in property by creditors and recipients is not subject to taxation. The tax of 15% applies on the income of non-residents resulting from their investment, such as dividends and interest on debt liabilities. Foreign investors can also benefit from specific provisions of the Tax Code applied to small and medium-sized enterprises (SMEs). Such SMEs are not be subject to corporate tax if they are established after April 2011 and for already established firms if they declared annual benefits below UAH 3 million during the last three years and if during the same period their workforce has not exceed 20 persons. This preferential taxation system associated with the possibility of simplified accounting and reporting aims at encouraging the development of SMEs in Ukraine.[13]

VAT refund

Many companies operating in Ukraine consider delays in VAT refunding procedures as a major obstacle to their operations, aggravating companies' general cash constraints and threatening their future investment.[14] The situation has been particularly harmful for export-oriented sectors, deterring FDI in agribusiness, for example. Newly-established companies have also been affected as under existing provisions they have been unable to apply for VAT refund within the first 12 months of their operations. The total VAT arrears exceeded 2% of GDP in mid-2010 (EBRD, 2010).

The Programme of Economic Reform 2010-2014 developed by the 2010 Committee on Economic Reforms included reimbursing overdue VAT payments and eliminating delays in VAT refunding among the objectives of the first stage of the tax reform. Following the IMF-Ukraine agreement reached in July 2010, the government started in August to issue VAT conversion bonds with the objective of redeeming all export VAT-refund arrears by end-2011. The IMF agreement also foresees implementing the automatic VAT refund system, which should cover 70% of all claims by end-2011.[15] Introducing on-line VAT administration reduces paperwork, minimises tax officers' interference and allows rapid interaction between taxpayers and tax officials. Such measures would also help to reduce currently frequent VAT inspections which are onerous not only for inspected entities but also for the government.

Ongoing reforms

The VAT-related measures are part of an ambitious tax reform package seeking to reduce the share of taxes in business costs and to ease tax-related management for enterprises. The package includes adopting the new Tax Code, eliminating ineffective taxes and duties, introducing the single social tax, the immovable property tax and the environmental taxation mechanism, as well as improving the risk-based tax control system. The government's explicit goal is to improve the country's current poor performance within the World Bank *Doing Business* database (Ukraine ranked 181st out of 183 countries in both 2010 and 2011) by at least 30 points before the end of 2014 (Committee on Economic Reform, 2010).

The business community has been actively involved in discussions of the draft Tax Code, which entered into force on 1 January 2011. Enterprises with foreign participation will benefit from new general provisions including a lowering of the corporate profit tax from the current 25% to 16% and the reduction of the VAT rate from 20% to 17%, to be phased in by 2014. As domestic firms, foreign investors will also be able to enjoy temporary exemptions from corporate tax granted in particular to publishers (exemption valid until 31 December 2014), producers of bio fuels and machinery for bio fuel production (valid until 31 December 2019), for construction or modernisation of hotels, aircraft and shipbuilding industries as well as production of agricultural machinery (valid until 31 December 2020) and for newly created economic entities (valid until 31 December 2015). The new Code eliminated the income tax discrimination of foreigners who legally reside in the country. Some other aspects of the new Code are nevertheless considered as less favourable for business, notably the exclusion of some entrepreneurial activities from simplified taxation such as financial and real-estate operations, wholesale trade, advertising, accounting and legal and other consulting services.

Promoting foreign-local business linkages

> What steps has the government taken to promote investment linkages between business, especially between foreign affiliates and local enterprises? What measures has the government put in place to address the specific investment obstacles faced by SME?

Expected FDI benefits stemming from the diffusion of new technologies and management expertise depend to a large extent on the capacity of the host country to encourage linkages between foreign and local enterprises. International surveys (World Bank, 2009c) show that so far many foreign affiliates in Ukraine continue to import most of their value-chain components from parent companies and have a more limited export orientation than their counterparts in other Eastern European countries. This would indicate that foreign-owned firms in Ukraine have often been unable to find adequate supplies locally and that the range and quality of their local production still does not correspond to international standards. Consequently, promotion of investment linkages between foreign affiliates and local enterprises should be one of key priorities of Ukraine's investment policy.

3. Trade policy

> Policies relating to trade in goods and services can support more and better quality investment by expanding opportunities to reap scale economies and by facilitating integration into global supply chains, boosting productivity and rates of return on investment.

Ukraine is highly open to trade: in 2009, exports of goods and services represented 46% and imports 48% of its GDP. By increasing transparency and predictability of trade policy, Ukraine's WTO accession and trade negotiations with its main partners have improved the general business climate and thus facilitated Ukraine's integration into the world economy. Whereas some sectors, such as metallurgy or textiles, have gained a wider access to world markets, some other industries have faced increased competition at home.

Some export-oriented sectors producing mostly less-processed commodities, such as non-precious metals (one third of total exports in 2009), have attracted significant FDI while the agricultural sector notwithstanding its considerable natural endowments has been less successful in this area also because of a number of trade impediments, notably the existence of quotas on grain exports. Ukraine now seeks to offer more investment opportunities in sectors less vulnerable to external market volatility and world price fluctuations.

> How actively is the government increasing investment opportunities through market-expanding international trade agreements and by implementing its WTO commitments?

WTO accession

Ukraine applied to join the WTO in November 1993 and became a member on 16 May 2008. For acceding countries, WTO membership entails acceptance of a range of important commitments but is also expected to bring both immediate and longstanding economic benefits. Ukraine has agreed to decrease import tariffs, especially on food products, gradually reduce export duties on some agricultural goods and ferrous and non-ferrous scrap and abolish quantitative restrictions on grain exports. In turn, Ukrainian exporters should benefit from a decrease of customs tariffs by its trading partners on some important commodities, the abolition of quantitative limitations on exports of metal products and a future reduction in anti-dumping investigations affecting Ukrainian companies (UNDP, 2009).

Already during the long accession process and as a part of its final commitments, Ukraine adopted a new customs tariffs and a new customs nomenclature. It has also carried out an overhaul of its legal and policy framework to comply with international standards and best practices in the areas covered by the WTO such as harmonising its specific national technical requirements and certification procedures with international technical standards, modifying state support for agriculture and improving intellectual property rights protection. All of these areas are of key importance for foreign investors. For instance, the new laws on standardisation, metrology, and conformity assessment, accreditation of conformity assessment as well as on consumer protection adopted by Ukraine in 2001-2006 were frequently requested by foreign investors to facilitate their imports of equipment and encourage their exports. They have welcomed the objective of the State Programme on Standardisation which has foreseen harmonising 8 570 Ukrainian standards with international and EU norms by the end 2010 and reducing the number of categories of products subject to mandatory certification. However, progress in this area has been uneven as only a few products were excluded from the mandatory certification list in 2010 and 36 groups of industrial products continue to be subject to this procedure.

International trade agreements

In parallel with its multilateral trade integration efforts, Ukraine has actively pursued bilateral trade diplomacy, concluding a number of bilateral free trade agreements (FTA) such as with the countries of the Commonwealth of Independent States (CIS). The FTAs with the CIS partners, which generally remain weakly enforced, provide for the exemption of mutual customs duties but do not contain provisions with regard to services, investment or government procurement. At the same time, Ukraine has been involved – usually as an observer – in several initiatives aimed at (re)establishing a common economic space in the territory of the former Soviet Union. The country has recently demonstrated more interest in joining CIS economic integration efforts. Ukraine has associate status in the Eurasian Economic Community (EURASEC) signed in October 2000 by five CIS (Belarus, Kazakhstan, the Kyrgyz Republic, the Russian Federation and Tajikistan), but it has not joined the agreement creating a customs union between Belarus, Kazakhstan and the Russian Federation initiated in 2006.

Table 3.1. **International Trade Agreements concluded by Ukraine**

Agreements	Date of signature
Partnership and Co-operation Agreement Ukraine – EU	14 June 1994
FTAs:	
Ukraine – EFTA (European Free Trade Association)	24 June 2010
Ukraine – Armenia	7 October 1994
Ukraine – Azerbaijan	28 July 1995
Ukraine – Belarus	17 December 1992
Ukraine – Georgia	9 January 1995
Ukraine – Kazakhstan	17 September 1994
Ukraine – the Kyrgyz Republic	26 May 1995
Ukraine – Moldova	29 August 1995
Ukraine – the Russian Federation	24 June 1993
Ukraine – Turkmenistan	5 November 1994
Ukraine – Uzbekistan	29 December 1994
Ukraine – Former Yugoslav Republic of Macedonia	2001

Consultations on free trade agreements are in progress with Canada, Israel, Serbia, Singapore, Syria and Turkey.

In March 2007, the EU and Ukraine started negotiations on an Association Agreement which should replace the current Partnership and Co-operation Agreement. The ongoing negotiations cover political dialogue, foreign and security policy, justice and freedom as well as economic and sectoral co-operation and aim at establishing a comprehensive or "deep" free-trade agreement (FTA plus). This new type of agreement is expected to bring significant benefits in terms of welfare gains, GDP growth as well as increasing real wages and expanding international trade – estimated at 5.8% of GDP in the case of Ukraine (Maliszewska *et al*; 2009). Another important contribution of the agreement would be to provide an external anchor for domestic reforms. The country's commitments to respect an agreed timetable in adopting the EU *acquis communautaire* in some areas, such as public procurement or state aids, would stimulate its policy convergence with relevant international best practices.

Streamlining border procedures

> What recent efforts has the government undertaken to reduce the compliance costs of customs, regulatory and administrative procedures at the border?

Despite the government's efforts to liberalise trade through multilateral and bilateral trade agreements, recent progress in trade facilitation has been modest. Ukraine's rank in the World Bank *Doing Business* database for the "trade across borders" indicator has remained mediocre in 2010 and in 2011 (139th out of 183 economies). The number of requested documents, necessary time and costs involved for both export and import transactions are considerably higher than the OECD average and generally also more important than in other countries of the region (World Bank, 2010a).

Export-oriented firms continue to express concern over a non-transparent allocation of export grain quotas and regarding bureaucratic customs clearance, custom overvaluation and frequent controls which entail risks of abuse by public officials. Harmonising Ukraine's measures with international practices depends mainly on the rapid adoption of electronic customs documents and procedures and the use of international prices for customs evaluation. The business community also insists on the need to accelerate the harmonisation of Ukrainian technical standards and regulations with European and international norms and conformity assessment procedures. As a first step in response to this criticism and in accordance with Ukraine's WTO commitments, the government abolished in March 2010 mandatory certification for some categories of food products, including coffee, chocolate, oils, butter, cheese and smoked ham.

The delays in introducing WTO commitments[16] especially concerning harmonisation of national specific technical requirements and certification procedures with international technical standards and in pursuing customs administration reform are constraining Ukraine's external trade and discouraging FDI in both import-dependent and export-oriented sectors.

4. Competition policy

> Competition policy favours innovation and contributes to conditions conducive to new investment. Sound competition policy also helps to transmit the wider benefits of investment to society.

Legal and institutional framework

Ukraine's first legislation in the area of competition policy was adopted in 1992 and subsequently amended by two laws which entered into force in 1996[17] and 2001.[18] The provisions of the 1996 Law on Protection against Unfair Competition were developed according to the Paris Convention for Protection of Industrial Property, to which Ukraine is signatory. The 2001 Competition law applied since March 2002 is modelled on the EU competition regime and addresses five categories of anti-competitive activities: *i*) "concerted" actions; *ii*) abuse of dominance; *iii*) concentrations; *iv*) "restricting and discriminating" activities of business entities and associations, and *v*) anti-competitive actions of government bodies (OECD, 2008).

Competition law applies to all entities engaged in commercial activities and treats foreign and domestic firms equally. Practitioners and the business community consider that enforcement procedures such as permits for concentrations and concerted actions are transparent and implemented in accordance with clearly established deadlines.[19] Decisions by the AMC in the case of violations and permit applications may be subject to appeal by defendants or applicants in the commercial courts for cases involving business entities or in the administrative courts for cases concerning government agencies. The AMC can impose penalties in the case of violations under the Competition Law and the Unfair Competition Law or in the absence of compliance with its recommendations. Effectively collected penalties increased during the two last years up to 87% of assessed payments.

Box 3.3. **Antimonopoly Committee of Ukraine**

The Anti-Monopoly Committee (AMC) of Ukraine was created in 1993 with the main task of helping to design and implement the country's competition policy in line with the provisions of the Law "On the Anti-Monopoly Committee" (see *www.amc.gov.ua*).

The chairman of the AMC is appointed and dismissed by the President upon the approval of Parliament for a seven year term (once renewable). The President also appoints the AMC commissioners on the recommendation of the Prime Minister, based on the AMC chairman's proposal. The AMC staff should be independent from national and local government bodies, business entities, political parties and other associations.

The AMC has its headquarters in Kyiv and 27 regional offices, including in the 24 Ukrainian *oblasts*, in the Autonomous Republic of Crimea and the cities of Kyiv and Sevastopol. In 2009, the AMC's total budget amounted to € 5.4 million. The Agency employs 924 persons, of which two thirds work in its regional offices. Between 2003 and 2009, the Agency's staff increased by 2.2% whereas its workload measured by the number of opened cases grew by 22%.

To what extent, and how, have the competition authorities addressed anti-competitive practices by incumbent enterprises, including state-owned enterprises, that inhibit investment?

The competence of the competition authority is mainly limited by the 2000 law on natural monopolies,[20] defined as entities operating in a market characterised by the absence of competition due to specific technology or economies of scale in the production of goods or services with no close substitutes. The law provides the list of natural monopolies, which includes pipeline transport of oil, oil products, natural gas and other substances; distribution and storage of natural gas; transmission and distribution of electric energy; railway services; air traffic control; supply of heating; centralised water and sewage systems; specialised services in transport terminals, ports and airports (see Chapter 2).

The AMC compiles and maintains a list of those business entities operating in designated natural monopoly markets, which contains currently 1 650 companies. The 2000 law on natural monopolies envisaged creating specialised regulatory agencies to manage licensing, price regulation and network access in different activities concerned. At present, two such agencies operate: the National Commission on Regulation of the Power Industry and the National Commission on Regulation of Communication. Telecommunications which were included in the list of the natural monopolies until 2003 are now subject to separate regulatory provisions designed and implemented by the National Commission for Communication Regulation.

> To what extent are competition authorities working with their counterparts in other countries to co-operate on international competition issues, such as cross-border mergers and acquisitions, bearing on the investment environment?

In promoting international co-operation, the AMC has concluded a number of bilateral and multilateral co-operative arrangements. Existing bilateral agreements with the Russian Federation, Georgia, Azerbaijan, Armenia, Bulgaria, Hungary, Latvia, Lithuania, Poland and the Slovak Republic provide for *i*) notification of anticompetitive conduct or enforcement activities that affect the interests of the other country; *ii*) exchange of information on business entities involved in enforcement investigations, and *iii*) joint co-ordination of enforcement activities. Ukraine is a signatory to the Agreement of the CIS on Pursuing Coordinated Antimonopoly Policy promoting co-operation, exchange of information and interaction among CIS competition authorities. Agreements involving joint consultations on general policy topics and analytical and technical expertise have been concluded with the Austrian and Romanian competition authorities. Negotiations on the broader agreement with the EU include a section on competition.

Future reform challenges in competition policy

From a legal point of view, the proposed changes concern: *i*) amending the competition-related provisions of the Commercial Code which are inconsistent with the competition laws; and *ii*) introducing new legislation on controlling state aid in compliance with EU standards. As for implementing competition policy, several provisions are considered to better manage the AMC's current workload, allowing it to focus more fully on its core activities. Relatively low thresholds for merger notifications[21] impose notification requirements on too many transactions, many of which are unlikely to represent a threat to competition.

The AMC, which has been given extended responsibilities in the public procurement process, has intensified since 2008 its efforts regarding the role of competition law in this area and created a special department for this purpose. The amended Law on Public Procurement, which came into force on 1 July 2010 and aims at increasing transparency and ensuring non-discrimination, gave the AMC the responsibility to review complaints relating to public procurement procedures. The AMC should also strengthen its co-operation with other government agencies to prevent corruption in this area. The AMC has recently become more active in monitoring price arrangements among economic entities, especially between major producers and wholesale distributors with the declared aim of controlling price increases of consumer goods.

Strengthening the competitive environment

Ukraine's capacity to create a competitive environment has been constrained by the size of its public sector, the persistence of price controls,[22] the pervasive licensing and permits system and other complex business-related rules and procedures. A World Bank study (World Bank, 2009c), based on the firm census dataset of some 560 000 companies operating in Ukraine between 2001-2007, shows that the average firm size tends to be larger and the share of employment of smaller firms lower in Ukraine than in other emerging economies, due mostly to excessive regulations and significant barriers to entry and exit, especially of large state-owned enterprises. The resulting low level of competition and excessive concentration in most sectors imply an inefficient allocation of factors of production across firms and sectors, restraining productivity growth. Several other factors captured by the OECD indicator of product-market regulation (Gianella, Tompson, 2007) also point to the need to strengthen competition, for example the large scope of explicit legal limits on the number of competitors allowed in several sectors, and the power of the government to override decisions of the competition authority.

The 2010 government reform programme addresses some of these problems and seeks to reduce the role of natural monopolies, over-sized and dominant SOEs and the high degree of market concentration. The main remedies proposed are to intensify the privatisation programme and put in place a more efficient mechanism for the entry of new private firms and for the exit of inefficient ones. The role of competition policy is to ensure a level playing field for SOEs and private firms based on competitive neutrality, defined as a legal and regulatory environment in which all enterprises, public or private, face the same set of rules such as with respect to the tax burden or in the context of public procurement (OECD, 2009b).

5. Policies promoting responsible business conduct

> Public policies promoting recognised concepts and principles for responsible business conduct, such as those recommended in the OECD *Guidelines for Multinational Enterprises*, help attract investments that contribute to sustainable development. Such policies include: providing an enabling environment which clearly defines respective roles of government and business; promoting dialogue on norms for business conduct; supporting private initiatives for responsible business conduct; and co-operating internationally in support of responsible business conduct.

This section describes Ukraine's existing public policies and international commitments for promoting responsible business conduct and identifies areas where the country can further enhance its conformity with the OECD *Guidelines for Multinational Enterprises*. Although the country has made some progress in a number of areas covered by the *Guidelines*, its adherence would facilitate future reform efforts, in particular thanks to the establishment of a National Contact Point as foreseen by the *Guidelines*. National Contact Points promote the *Guidelines* and act as a forum for discussion of all matters relating to the *Guidelines*.

Protection of human and labour rights

In addition to Ukraine's Constitution, which defines human and labour rights in general terms, the main legal basis for employer-employees relations is the Labour Code, which entered into force in 1972, *i.e.* at the time of the former Soviet Union. The Code presents a comprehensive set of rules related to practically all employment-related aspects, including the establishment of employment agreements and contracts, working hours, vacations, compensation, social benefits, employment of women and minors, resolution of employment disputes and respective liabilities of employees and employers. Both the Constitution of Ukraine and the Labour Code preclude discrimination based on race, political, religious and other beliefs, gender, ethnic and social origin, property status, place of residence, linguistic or other characteristics. There is a specific law concerning trade unions and the right to organise and participate in collective bargaining. The largest Federation of Trade Unions of Ukraine (FPU) claims more than 10 million members.

Since the 1972 Labour Code has not undergone any major amendments, it can hardly respond to Ukraine's present situation. Business associations consider that it imposes too many formalities on employers and, at the same time, provides rather favourable conditions to employees for example with respect to dismissal reasons and procedures (Articles 36 and 40 of the current Labour Code). In 2003, the Parliament examined a new draft Labour Code, which specified the extent to which Ukrainian labour laws apply to foreign participants. The new Labour Code has not yet been adopted.

The main responsibility for implementing state labour and employment policies rests with the Ministry of Social Policy of Ukraine, the State Centre for Employment and their respective local branches. The State Labour Inspectorate is responsible for monitoring and enforcing various legal provisions, including minimum wages, but a chronic lack of staff prevents it from fulfilling its extensive responsibilities.

Ukraine adhered to the 1998 ILO Declaration on Fundamental Principles and Rights at Work, which commits signatory countries to respect and promote principles and rights in four categories: freedom of association and the effective recognition of the right to collective bargaining; the elimination of forced or compulsory labour; the abolition of child labour and the elimination of discrimination in respect to employment and occupation.

Ukraine has signed eight relevant fundamental Conventions, namely:

- Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87): signed in 1956.
- Right to Organise and Collective Bargaining Convention, 1949 (No. 98): signed in 1956.
- Forced Labour Convention, 1930 (No. 29): signed in 1956.
- Abolition of Forced Labour Convention, 1957 (No. 105): signed in 2000.
- Minimum Age Convention, 1973 (No. 138): signed in 1979.
- Worst Forms of Child Labour Convention, 1999 (No. 182): signed in 2000.
- Equal Remuneration Convention, 1951 (No. 100): signed in 1956.
- Discrimination (Employment and Occupation) Convention, 1958 (No. 111): signed in 1961.

Recent enterprise surveys show some specific features of Ukraine's labour market and its workforce that differ from the situation in other countries of Eastern Europe and Central Asia.[23] Ukrainian firms are among the largest in the region, with the highest average of both permanent (57%) and temporary workers (9%) compared to the regional average of 44% and 6% respectively. This pattern suggests a lack of flexibility in the country's labour market. As regards the gender composition of its workforce, Ukraine, with 28% firms managed by women, exhibits the third highest percentage of female top managers in the region (behind Latvia and Poland). Female managers are particularly frequent in small firms (38% are run by women) compared to only 17% of medium-sized and 12% of large firms.

Environmental protection

The 1996 Constitution (Article 50) guarantees citizens the right to a healthy and safe environment and to compensation for damages caused by violations of this right. In line with Principle 10 of the Rio Declaration, each citizen has to have free access to information on the state of the environment. The 1991 law on environmental protection[24] refers to a number of key principles, including priority of environmental safety requirements, access to information, openness and transparency of decision-making with an impact on the environment. It also contains provisions on the authority and obligations of different governmental bodies responsible for environmental protection as well as enforcement mechanisms and administrative, civil and criminal responsibility for environmental violations.

A number of laws governing specific economic activities include provisions regarding environmental protection, such as the Code of Mineral Resources (1994), the Forest Code (1994), the Water Code (1995), laws on the Protection of Atmospheric Air (1992), the Protection of Natural Reserves (1992) or the National Program of Handling Toxic Wastes (2000). The Law on Environmental Expertise (1995) introduced the obligation of an environmental impact assessment for all draft legal proposals with a possible negative impact on the environment and the principle of public participation, public hearings and comments on laws and decision-making in this area. The Code on Administrative Violations (2000) contains special chapters dealing with environmental violations. Several sector-specific laws, such as the Law on Transport (1994), Road Traffic (1993) or Electric Energy (1997) require enterprises involved in these activities to protect against a possible adverse environmental impact. In line with the EU Directive 67/548, which defines dangerous substances and products, the 1995 Decree of the Cabinet of Ministers of Ukraine provides a list of 22 activities with potentially high ecological risks, including nuclear energy, chemical and biochemical industries, oil and gas extraction and refining and the coal industry.

Monitoring and enforcing environmental measures is the responsibility of State Ecological Inspection of the Ministry of Environment and Natural Resources, in co-operation with some other ministries (*e.g.* Ministry of Health), local governments and the prosecutor's offices and courts. The public environmental finance system is managed by the State Environmental Protection Fund of Ukraine created on the basis of the 1991 environmental protection law. According to the Performance Review of the Fund carried out by the OECD in 2006 (OECD, 2006b), Ukraine's system could be substantially improved by adopting a number of organisational and institutional reforms, based in particular on the OECD *Good Practices for Public Environmental Expenditure Management*. Although the Fund's revenues have increased and its consolidation with the state budget has improved state control over its spending, the Fund continues to lack sufficient and experienced staff to select, monitor and evaluate projects and has so far been unable to play a major role in mobilising foreign sources of finance.

Ukraine has signed and ratified most of key multilateral environmental agreements, namely the Convention on International Trade of Endangered Species (CITES), the Bern Convention on Protection of Wild Fauna and Flora, the Basel Protocol on Liability and Compensation for Damage Resulting from Transboundary Movement of Hazardous Waste and Their Disposal, the Aarhus Convention on Access to Information, Public Participation and Access to Justice in Environmental Matters, the Kyoto Protocol to the United Nations Framework Convention on Climate Change (in 2004), the Montreal Protocol on Substances That Deplete the Ozone Layer (in 2006), and the Stockholm Convention on Persistent Pollutants (in 2007). Ukraine also participates in several regional initiatives, including the Program on Protection and Renewing the Environment of the Sea of Azov and the Black Sea (2001) and the Agreement on the Conservations of Cetaceans in the Black sea, Mediterranean Sea and Contiguous Atlantic Area (2003).

Fighting corruption

Corruption in Ukraine has been recognised as a major impediment to business by the government and in available international comparative studies. Ukraine's international ranking measuring corruption perceptions remains unfavourable and has even worsened in recent years. In the 2010 *Corruption Perception Index* (Transparency International, 2010), Ukraine is rated 134th out of 178 economies and its ranking has even deteriorated over time. According to the 2010-2011 *Global Competitiveness Report* (World Economic Forum, 2010), corruption is considered to be the second biggest problem in doing business in Ukraine after political instability. Available business surveys indicate the country's poor performance also in the regional context: according to the World Bank Enterprise Surveys (World Bank, 2009c), 23% of firms in Ukraine report making informal payments to public officials to obtain required authorisations, as do 28% of firms when dealing with tax officials, which is considerably higher than the average observed in 29 countries of Eastern Europe and Central Asia. Foreign firms appear to be particularly affected, as 87% of foreign firms reported that they are expected to offer gifts to get construction permits, compared to 57% of domestically-owned companies.

Successive Ukrainian governments have included the fight against corruption among their key political goals. They have sought to put in place the legal framework corresponding to recognised international standards in this area and to create specialised anti-corruption institutions empowered with adequate responsibilities and sufficient technical and human capacities. The so-called “anti-corruption package” included notably the Framework Law on preventing and combating corruption and amendments concerning administrative and criminal corruption offences and corporate liability for corruption offences, which are needed to ensure the compliance of Ukraine’s legislation with the UN and the Council of Europe standards. The package prepared initially in 2006 was adopted in June 2009, but its enactment was postponed several times. The Parliament eventually abolished this legislation in 2010 before it could be enacted. This decision also resulted in the abrogation of the 1995 Law on combating corruption. Instead, the Parliament is currently considering a new anti-corruption bill proposed by the President, which mainly duplicates provisions of the initial package. The recent law on public access to information, obliging the state administration to make publicly available most information (see above), if properly implemented, might increase general transparency and therefore contribute to fighting corruption.

In parallel with these legislative steps, several institutions were created, notably the Government Agent on Anti-Corruption Policy in April 2009 responsible for developing the anti-corruption policy, supervising its implementation and carrying out anti-corruption research and education campaigns. However, this instance was abolished in 2011. Established in February 2010, the National Anti-Corruption Committee chaired by the President, who also appoints its members, has to make recommendations and proposes draft legal acts dealing with anti-corruption issues to the President, but so far this Committee has not been particularly active (OECD, 2010b).

As a result, the legal framework has a number of significant loopholes which impede the detection and sanction of corruption offences while weak public institutions and widespread impunity for high-level corruption still make possible the capture of public administration by vested interests. Insufficient precision and coherence of business-related legislation and regulations gives wide discretion to public officials thus entailing high legal uncertainty and risks of unequal implementation and arbitrariness. Weak law enforcement reflects the critical condition of Ukraine’s judiciary, which lacks necessary financial and human resources sometimes compensated by private donations and local authorities, all of which poses inherent risks for judges’ integrity and accountability. For foreign investors, the consequences of this situation are particularly serious with respect to the protection of intellectual and physical property rights.

For the business community, the fight against corruption remains the first priority. To make the public sector less vulnerable to corruption and red-tape, the following measures have been proposed by the European Business Association in 2010 (EBA, 2010): *i*) improving predictability in implementing fiscal policy; *ii*) maintaining a direct dialogue between the government and the business community; *iii*) eliminating numerous legal ambiguities, inconsistencies and poor legal drafting in existing legislation; *iv*) ensuring a clear-cut separation of regulatory and commercial functions of all governmental bodies and state-owned companies.

Progress in fighting corruption is closely linked with judicial reform. According to business representatives, strengthening judicial independence requires the following measures: *i*) clarifying the role of different jurisdictions so as to avoid having some cases considered in parallel by courts of general jurisdiction, commercial courts and administrative courts; *ii*) improving the organisation of the courts and enhancing judges' qualifications; and *iii*) simplifying enforcement procedures to prevent the improper execution of courts' decisions.

It is essential that new anticorruption legislation is adopted and enacted as soon as possible. It should be followed by other necessary legislation, including regulations on conflict of interests and assets disclosure, administrative procedures, transparency of political party finances, corruption proceeds confiscation, and a specialised anti-corruption law enforcement agency.

Ukraine has ratified the main international anti-corruption treaties and participates in several anti-corruption initiatives. It signed the United Nations Convention against Corruption (UNCAC) in 2003, ratified it in 2006 and became a Party to it in April 2010. The Council of Europe Criminal Law Convention, ratified by Ukraine in 2009, entered into force in March 2010. The country participates in several monitoring and peer review mechanisms, including the Council of Europe's Group of States against Corruption and the OECD Anti-Corruption Network for Eastern Europe and Central Asia. Under this last initiative, Ukraine went through a second round of monitoring in December 2010, where it was considered that a number of recommendations of the previous monitoring round in 2006 have only partially been fulfilled. The report stated that "the political will to fight corruption has not yet translated into real action and implementation" (OECD, 2010b).

Responsible business conduct reporting by enterprises operating in Ukraine

While financial reporting is mandatory for all legal entities in Ukraine and must be submitted to the state register,[25] disclosure practices and reporting on different aspects of responsible business conduct by large companies are still less common in Ukraine. Such disclosure constitutes an important indication of the business community's awareness of, and its general attitude to, these issues. A recent survey of annual reports and websites published by the ten largest companies in each of 11 Central and Eastern European countries, as well as in Brazil, Russia, India, China and Ukraine provides a useful international comparison of responsible business reporting in these countries (Partners for Financial Stability Program, 2009). The survey examines companies' annual reports and websites published in English and the information they contain on corporate governance issues (such as compliance with a Corporate Governance Code, audit information, policy on shareholders rights, the existence of an internal Code of Business Conduct), on environmental policy (including compliance with industry-specific, national or international environmental standards, information on the department responsible for environmental management and compliance, a report on energy/water use, reports on environmental performance and integration of environmental aspects into the supply chain management policy) as well as on social policy (notably compliance with national or international labour standards, information on employee development and benefits, health and safety).

The 2009 survey shows that disclosure practices and reporting by the ten largest Ukrainian companies[26] generally lag behind their peers in the other emerging economies. While 41% of CEE and 48% of BRIC surveyed companies issued stand-alone, English-language environmental, social and governance (ESG) reports in 2009, only one Ukrainian company did so. Contrary to the majority of the published ESG reports by BRIC and CEE companies, which use recognised standards (*e.g.* the *Global Reporting Initiative* – GRI) and often provide a third-party assurance, only one Ukrainian company surveyed published an ESG report. English-language websites are also much more widespread outside of Ukraine: 97% of CEE and 100% of the BRIC companies had such website in 2009 compared to 60% of the surveyed Ukrainian firms, albeit a significant improvement over 2007-2008 when only 20% of Ukrainian firms made their annual English report available online.

The surveyed Ukrainian firms also reported much less than their peers in CEE and BRIC on specific aspects of corporate governance, environmental and social policy issues. For instance, the websites of 90% of BRIC and 65% of CEE companies provide information on their shareholder rights policy compared to only two of ten companies in Ukraine. Reporting on environmental issues also remains poor among large Ukrainian companies (Table 3.2): only one firm reported on its compliance with environmental standards and performance compared to some 50% in CEE and even more than 60% among BRIC firms. Similarly, Ukrainian firms' external communication on social policy is also less frequent than in CEE and BRIC countries: employment policy, employee development/benefits or health and safety policy are mentioned in three annual reports or websites in Ukraine whereas the corresponding shares in CEE and BRIC countries is usually higher (between 40 and 60%).

Limited reporting on responsible business conduct (RBC) by Ukrainian firms suggests that the country's business community is not yet fully aware of, and does not pay sufficient attention to, these issues. Although the country's

Table 3.2. **Web-based reporting on environmental policy by large companies in BRICs and Ukraine**

	Brazil	Russia	India	China	Ukraine
Compliance with environmental standards	9	8	4	3	1
Assign specific responsibility for environmental issues	5	2	2	2	0
Integrate environmental considerations into supply chain management	3	3	2	5	0
Report on energy and water use	5	9	6	6	1
Report on environmental performance	7	8	4	6	0

Source: Survey of Reporting on Corporate Social Responsibility by the Largest List Companies in 11 Central and Eastern European countries and Comparison with Peers in Brazil, Russia, India, China (BRIC) and Ukraine, September 2009.

growing investment openness and the increasing participation of foreign investors will certainly help to disseminate such practices more widely in Ukraine, the government also has an important role to play in encouraging incumbent companies to respect international standards of RBC, notably by developing public campaigns and targeted programmes in this area. Ukraine's possible adherence to the OECD *Guidelines for Multinational Enterprises* would help the government to pursue its efforts to promote and encourage RBC practices by all enterprises operating in Ukraine as well as by Ukrainian firms investing abroad.

6. Infrastructure and financial sector development

Sound infrastructure development policies ensure scarce resources are channelled to the most promising projects and address bottlenecks limiting private investment. Effective financial sector policies facilitate enterprises and entrepreneurs to realise their investment ideas within a stable environment.

In spite of its rapid development, the Ukrainian financial sector has not yet been able to respond fully to business needs as indicated by the still relatively low use of bank financing and the stringency of collateral requirements applied in the country. According to the World Bank Enterprise Survey (World Bank, 2009c), nearly 68% of Ukrainian firms have not used bank financing for their investments and continue to cover their financing needs from internal sources. Moreover, the share of loans requiring collateral and the value of collateral needed for a loan were higher in Ukraine than the regional average. Firms with foreign ownership and exporters were generally required to present higher values of collateral as a percentage of the loan.

Ukraine's infrastructure, especially in transport which has suffered from a long period of under-investment, has been deteriorating and high railway freight and port tariffs as well as the lack of reliable transport services have seriously handicapped private sector development, especially for export-oriented firms. Ukraine has one of the lowest road network densities in Europe and a large part of the existing road network is obsolete and does not comply with European standards. Nor does the country have adequate warehousing and storage facilities, owing partly to the difficulties in acquiring land and obtaining construction permits.

Recently introduced legislation on public-private partnerships (PPP) covering numerous activities (see Chapter 2) aims to develop PPPs in infrastructure projects, notably in road construction, water and communal heating. Public-private partnerships should also be one of the main forms of implementing the ambitious programme of 11 national projects established in 2010 (Box 3.4). The selected national projects will be managed on the basis of the public procurement law and therefore subject to open bids with all related information being publicly available during the whole process. The national projects, for which no governmental guarantees will be available, could be financed by the state budget only up to 15% of the total amount of each national project.

Box 3.4. **National projects**

The list of 11 national projects established in August 2010 by the Presidential Committee for Economic Reforms and approved by the December 2010 legislation is divided into 4 main categories, each involving a number of specific projects:

1. *New Energy Priority*: LNG Terminal (sea terminal for liquefied natural gas on the Black Sea coast); "Natural Energy" (construction of small scale hydro, wind and solar power stations; production of solid alternative fuel).
2. *New Quality of Life Priority*: "Affordable Housing" (system of projects construction); "Clean City" (system of waste recycling complexes); "Clear Water" (programme for supply of high quality water); "Open World" (creation of information and communication 4G educational network at the national level); "City of Future" (elaboration of strategic system plan and city development projects); "New Life" (preservation of maternity and childhood protection).
3. *New infrastructure priority*: "Aeriar Express" (railway passenger service from Kyiv to Boryspil International Airport); "Danube Corridor" (development of transport connection and navigation in the Danube region).

Box 3.4. **National projects** *(cont)*

4. *Olympic hope 2022 priority*: creation of sports and tourism infrastructure and raising tourist attractiveness of the Carpathian region and Ukraine in general.

In September-October 2010, working groups for specific national projects were established and their heads appointed. Their main functions are: to develop an overall strategy and roadmap for specific projects, prepare terms of reference for bids for feasibility studies and organise expert roundtables. An international advisory group, chaired by the former President of EBRD Jean Lemierre, was also created. A state enterprise is expected to be created for each project.

By the end of 2010, work on several national projects had started, notably "Clean City", "LNG-Terminal", "Open World" and "Affordable Housing". Meetings presenting specific national projects were organised with potential investors in various international forums. A project proposal database was also created, with more than 700 project proposals made by the State authorities, research institutions and NGOs.

A special Bona Fide Act has been developed to ensure the Agency's high corporate standards in compliance with international norms.

The following objectives, in particular with respect to financing resources, have been set up:

- realise at least 10 national projects attracting USD 14-15 billion of direct investments;
- ensure participation of international financial institutions;
- the financial participation from the state budget should not be more than 10% of the amount of individual national projects;
- implementing national projects should increase Ukraine's GDP by 4.5%.

The presidential administration is currently working on two additional national projects – *"Ukrainian grain"* and *"Modern livestock farming"* – which should support the development of the country's agricultural sector.

Notes

1. Law No. 2939-VI "On Access to Public Information" and "Amendments to the Law 'On Information'" (13 January 2011).
2. Law No. 1160 "On Principles of Public Regulatory Policy of Economic Activity" (11 September 2003).
3. In January 2011, the Higher Economic Court of Ukraine cancelled the trademark rights protection of chocolate products Raffaello, produced by Ferrero (Italy). This ruling is perceived especially by foreign investors as a negative signal indicating

the risk to see their reputation and know-how violated in Ukraine's market without having a possibility to defend their legitimate interests in the courts.

4. In July 2010, the Ukrainian Prosecutor General's Office launched a court challenge to the 2009 amended agreement between a major foreign-owned steel producer (ArcelorMittal Kryviy Rih) and Ukraine's State Property Fund, which allowed this foreign-owned company to delay its initial investment obligations due to a global economic downturn. If recognised, the violation of the contract's obligations would lead to the seizure of the foreign investor's property and would raise the issue of security of property rights in Ukraine. The lawsuit was finally dropped in October 2010 (Business Eastern Europe, 2010; EIU, 2010).

5. According to the ICSID database, the following cases are pending:

   - *Joseph C. Lemire (USA) v. Ukraine* (ICSID Case No. ARB/06/18): on 14 January 2010, the Tribunal formulated its preliminary ruling on jurisdiction. Case proceedings continue.

   - *Alpha Projektholding GmbH (Austria) v. Ukraine* (ICSID Case No. ARB/07/16); the final ruling by the Tribunal expected.

   - *Bosch International, Inc. (USA) and B&P, LTD Foreign Investments Enterprise v. Ukraine* (ICSID Case No. ARB/08/11): the parties have exchanged written statements in compliance with the set schedule; hearings by the Tribunal took place on 6-10 October 2010; the outcome of hearings shall form grounds for the ruling.

   - *Inmaris Perestroika Sailing Maritime Services GmbH (Germany) and others v. Ukraine* (ICSID Case No. ARB/08/8): the Tribunal held its session on 20-21 July 2009 and examined the jurisdiction issue; the outcome of hearings shall form grounds for the ruling on jurisdiction.

   - *GEA Group Aktiengesellschaft (Germany) v. Ukraine* (ICSID Case No. ARB/08/16): the parties have exchanged written statements in compliance with the set schedule; hearings by the Tribunal took place on 5-9 July 2010, the outcome of hearings shall form grounds for the ruling.

   - *Global Trading Resource Corp. and Globex International, Inc. (USA) v. Ukraine* (ICSID Case No. ARB/09/11): it is expected that the Tribunal holds its first session at the date to be defined at the teleconference on 3 May 2010.

6. Law No. 1837-VI "On Amendments to Certain Legislative Acts on Private International Law Issues" (21 January 2010).

7. Presidential Decree on"Procedures to Protect Ukraine's Interests and Rights in Dispute Settlements and Case Proceedings at Foreign Jurisdictions Involving a Foreign Entity and Ukraine" (25 June 2002).

8. Regulation of the Cabinet of Ministers No. 180 (28 December 2001).

9. Law on "Preparation for implementation of 'single window' facility for investment projects" (21 October 2010).

10. Presidential Decree No. 892 "On the Council of Local and Foreign Investors" (1 September 2010).

11. See Kim Wan-Soon (2000) for a description of the Korean Office of the Investment Ombudsman.

12. Law No. 2505 "On the Introduction of Amendments to the Law of Ukraine on the State Budget of Ukraine for 2005 and Some Other Legislative Acts of Ukraine" (25 March 2005).

13. In 1999, there were 28 600 small and medium enterprises in Ukraine, increasing to 143 000 entities in 2008 employing almost one million persons.
14. For example, in the case of *ArcelorMittal Kryvyi Rih*, the major foreign investor in Ukraine, the cumulative amount of unreturned VAT (UAH 1.4 billion at the beginning of 2010) corresponded to almost 80% of investment planned by the firm for the same year. See *Kyiv Post* (2010a).
15. This target seems difficult to reach given that in March 2011, out of 2000 firms which applied to use the automatic VAT refund mechanism, only 24 were accepted.
16. Several pieces of legislation required for WTO compliance are still waiting for approval by the Verkhovna Rada, notably the law on quality and safety of food products and food raw materials (draft law No. 3322), the law on market surveillance (draft law No. 1365), the law on the general safety of products (draft law No. 3421) and the law on changes to the law on customs tariffs (draft law No. 3444).
17. Law No. 236/96 "On the Protection against Unfair Competition" (7 June 1996).
18. Law No. 2210-III "On the Protection of Economic Competition" (11 December 2001).
19. After an application is submitted, the AMC has 15 calendar days to check whether the notification complies with the procedural requirements and the following 30 calendar days to conduct the examination. The processing fees for a prior authorisation amount to EUR 500.
20. Law No. 1682-III "On Natural Monopolies" (20 April 2000) and its subsequent amendments.
21. According to Article 24.1, notification of proposed concentration to the AMC is required if *i*) the previous aggregate worldwide assets value or turnover of the participants exceeded EUR 12 million, and *a)* at least two participants had a worldwide asset value or turnover of over EUR one million each and *b)* the asset value or turnover in Ukraine of at least one participant exceeded EUR one million; or *ii*) the individual or aggregate market share of the participants exceeds 35% of the relevant market. .
22. The share of administered prices in the consumer price index (CPI) increased to 10% in 2008 compared to 8% in 2007, EBRD (2009).
23. Ukraine's sample included 851 firms surveyed between June and August 2008. The Survey seeks to capture data on the business environment and its effect on competitiveness and firm performance, the relative importance of various constraints to employment and productivity and business perceptions of the biggest obstacles to enterprise growth. See World Bank (2009c).
24. Law No. 1364-XII "On Environmental Protection" (25 June 1991) as amended.
25. According to the Law "On the State Registration of Legal Entities and Private Entrepreneurs" (Article 17), all enterprises, except those financed from the state budget, should submit their financial reports to the state register not later than 1 June of the year following the reporting period. Information contained in the Unified State Register shall be open and publicly available.
26. The 10 surveyed Ukrainian companies include: Zakhidenergo, Ukrnafta, Centerenergo, Ukrtelecom, Ilyich Iron and Steel Works, Motor Sich, Dniproenergo, NITR-INERPIPE, Azovstal Iron and Steel Works and Enakievo Metallurgical Plant. See PFS Program (2009).

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Chapter 4

Investment in Support of Energy Efficiency

Ukraine faces specific challenges in attracting energy investment required to reduce its currently high energy intensity, increase its energy production and upgrade its deteriorating energy infrastructure. Energy efficiency efforts and investment have been hampered by distortions in energy price setting and by an energy market structure dominated by state-owned firms. The June 2010 economic reform programme addresses these critical issues and sets objectives for accelerating privatisation in the energy sector and for gradually adjusting energy prices to the market level. Ukraine has developed a basic policy framework in support of environmentally friendly energy resources and technologies, but in the absence of energy price reforms the incentives for such investment have been limited.

Overview[1]

Ukraine is an important energy producer with significant reserves of coal and gas. Energy imports nevertheless cover almost half of the country's energy consumption owing mainly to high energy intensity. Ukraine uses around 2.5 times more energy per unit of GDP calculated in purchasing power party (PPP) terms than the average in OECD countries. Energy efficiency efforts and investments have been hampered by distortions in energy price setting and the energy market structure. Most energy sub-sectors remain state-owned and energy prices are regulated with price levels below production costs and subject to cross-subsidisation within various sub-sectors and among different categories of consumers (Section 1).

Available estimates of future investments required to enhance energy efficiency, increase energy production and upgrade energy infrastructure vary depending on the sources and the underlying energy policy priorities, but all reach considerable amounts. As the state budget will be unable to cover more than 15% of future energy investments, there is an urgent need to find other sources of financing. Whereas some financing might be available from international organisations such as the World Bank and the EBRD, the main source has to be private investment, both domestic and foreign, or in the form of private-public partnership arrangements (Section 2).

To attract investments into the energy sector, Ukraine has to pursue price and market liberalisation in the sector. The June 2010 government economic reform programme addresses most critical issues, setting the objectives to accelerate the privatisation process in the energy sector and adjust gradually energy prices. Ukraine's international commitments and co-operation can help the country to accelerate its energy reform and allow it to mobilise required energy investments, including from external sources (Section 3).

Although for the near future energy efficiency remains the main focus of energy policy, development of renewable energy resources should not be underestimated, in particular when synergies between energy efficiency and environment-friendly energy production/technologies exist for example in the case of heat production based on biomass and wastes. Ukraine has developed the basic policy framework in support of environmentally-friendly energy resources and technologies, but in the absence of energy price reforms the incentive for such investments has been limited. The country's difficult budgetary position means that among available policy instruments green taxes have to be privileged over costly green subsidies. To promote development of environmentally-friendly energy production and technologies, the government has a key role to play in promoting public awareness and corporate initiatives aimed at improving the measurement and reporting of environment performance which are still less common in Ukraine than in other emerging economies. Foreign investment and international assistance could be a potential source of "greening" effects, both directly through transfers of more energy-efficient and environment-friendly technologies and indirectly by facilitating spillovers to domestic firms through best practices in environment-friendly productions, technologies and management (Section 4).

1. Energy profile of Ukraine

Energy production and consumption

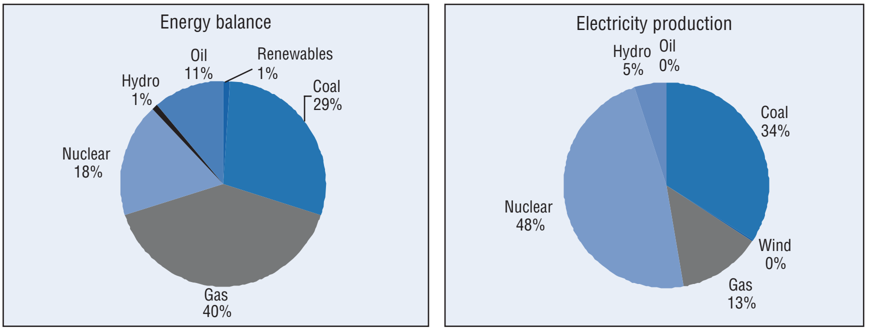
The energy sector represents a significant part of the Ukrainian economy, accounting for some 8% of GDP, 25% of industrial output and some 12% of total investment in fixed assets.[2] It contributes to a large extent to foreign trade earnings as more than half of export revenues are generated by energy-intensive products, especially ferrous metallurgy and chemicals. These export-oriented sectors have also attracted an important share of FDI (20% of the FDI stock). By ensuring transit of natural gas from Russia to Europe, Ukraine also plays a strategic role in international energy relations.

Ukraine produces significant quantities of coal and natural gas and has substantial reserves of both commodities. Its total primary energy supply (TPES) is dominated by four energy resources: natural gas represents 41%, followed by coal (29%), nuclear energy (18%) and oil (11%). Electricity production comes mainly from nuclear power plants (48%), followed by coal power generation (34%) (Figure 4.1). Heating depends almost exclusively on gas.

Situation in energy sub-sectors

Despite some efforts to exploit further its oil reserves, Ukraine's annual crude oil production stagnated at some 3 million tonnes and covers currently some 20% of its domestic needs. Following the upward trend in domestic oil consumption, the country's import dependence on oil deliveries mostly from Russia and Kazakhstan has increased. Oil and gas exploration and production are dominated by the state-owned *Naftogaz*. Prospective fields situated in the Carpathian basin and offshore in the Black Sea-Azov Sea will be more difficult to explore than the existing sites (*e.g.* in Dnipro-Donetsk) and will require deploying more advanced technologies.

Figure 4.1. **Total Primary Energy Supply (TPES) mix and electricity mix in Ukraine (2008)**



Source : IEA, Statistics by country.

The oil refining sector is dominated by six privately-owned refineries with total annual processing capacity of some 50 million tonnes. The sector needs significant investments to replace outdated equipment to improve its productivity and quality of products, which do not correspond to domestic demand for higher quality oil products currently covered to a large extent (more than 40% in 2010) by imports.

Gas production has been flat since mid-1990s stabilising at around 20 billion cubic meters (bcm), covering some 25% of domestic requirements, almost all produced by the state-owned company *Naftogaz*. With consumption fluctuating at above three times domestic output, the resulting gap has been met by imports from Russia and Turkmenistan. According to the Ukrainian State Agency for Energy Efficiency and Energy Savings (replacing the former National Agency for Ensuring Efficient Use of Energy Resources – NAER), domestic gas production could be increased up to 60% of domestic demand. Ukraine possesses large gas storage capacities.

Ukraine's proven coal reserves (34 billion tonnes) are the sixth largest in the world. After a significant decline in the early 1990s, total coal output has stabilised at around 60 Mt, which covers almost all domestic consumption (65 Mt/year).[3] State-owned mines provide 57% of total output, but the most effective mines are private and owned by large vertically-integrated enterprises that have built their production chains starting from coal extraction to electric power generation and distribution. Most of domestic coal production, which is hard to extract and generally of poor quality, is sold at a loss to the steel industry enabling it to be profitable. With a workforce of some 500 000 people, the coal sector remains one of the largest employers in the country. A lack of investment is the main reason for poor safety record of Ukraine's coal mines, confirmed by the highest incidence of fatalities in the world after China.

Ukraine inherited a large electricity generation capacity from the Soviet period, with installed capacity of around 54 GW. Domestic electricity demand strongly contracted in the 1990s and started to recover only after 2002. The overall output capacity has thus remained sufficient for the needs of the Ukrainian economy and allowed the country to be a net exporter of electricity to neighbouring countries. The country compares relatively well in terms of access to power infrastructure relative to other Eastern European countries.[4] The excess capacity has nevertheless hindered investments during the past two decades entailing the deterioration of existing facilities and decreasing efficiency in generation, transmission and distribution infrastructures.

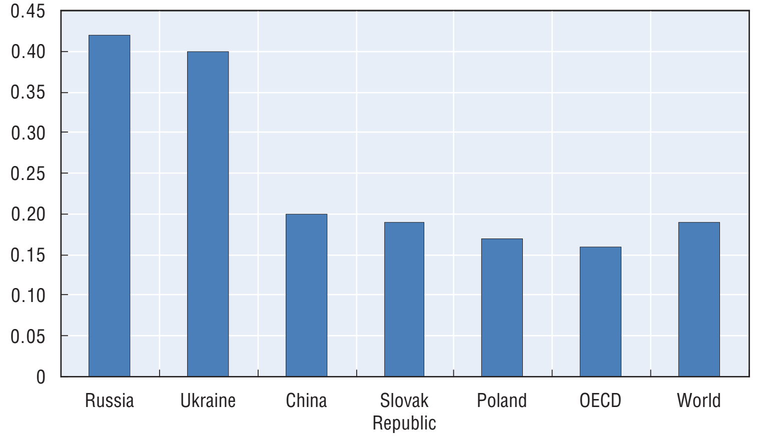
Electricity produced from renewable resources has not played an important role so far. In 2010, installed capacity of renewable power plants (not taking into account large hydropower plants) reached 14.12 MW. By the end of 2010, installed wind power capacity was significantly lower than in neighbouring countries such as Romania, Hungary or Poland (European Wind Energy Association, 2011). The production of biomass has just started to develop. The experience of other countries suggests that after having attaining a certain technological level, wind production capacities may increase rapidly though the intermittence of wind power requires adapting the electricity grid. Several wind power projects are currently under preparation, notably by the largest private vertically integrated energy holding DTEK, part of the financial and industrial group System Capital Management, which plans to invest EUR 1.85 billion in the construction of two wind farms in the Zaporizhia and Donetsk regions. Despite Ukraine's significant potential in producing biomass and biofuel, the exploitation of these sources is only in its initial stage with one of the first bio gas plant with the generating capacity of 2.5 MW being launched in 2010 in the Cherkasy region.

Energy-intensity

Ukraine is one of the most energy-intensive economies in the industrialised world. Its ratio of total primary energy supply to GDP is more than ten times higher than the OECD average and also significantly higher than the average of the former Soviet Union countries.[5] The gap is less striking when GDP is calculated in purchasing power parity (PPP) terms, but even then Ukraine uses around 2.5 times more energy per unit of GDP than the OECD average (Figure 4.2). As in most other countries, industry and transport are the main energy users but, compared to the OECD economies, Ukraine's industry has a higher share in total final energy consumption (41%), whereas transport accounts only for 15%.[6]

The country's high energy consumption in industry is mainly due to its energy-intensive and export-oriented sectors, especially metallurgy and chemicals, which often use energy-inefficient technologies imposing large

Figure 4.2. **Energy intensity in Ukraine and selected countries in tonnes of oil equivalent per thousand USD of value added (at PPP exchange rate)**



Source : IEA (2010a).

energy losses. For instance, smelting one tonne of steel in outdated open-heart furnaces consumes almost four times more energy in Ukraine than in EU countries or China (National Agency on Efficient Energy Use, 2009). Glassmaking and sugar production require roughly twice as much energy input per unit of final product in Ukraine as the EU average. The country's annual energy consumption is strongly correlated with the fluctuations in domestic and especially external demand for industrial products. In 2009, a 50% contraction in Ukraine's exports of basic metals and chemicals triggered a 9% drop in electricity demand then a strong rebound in the early 2010 following the resumption of exports.

Ukraine's high energy consumption suggests that an energy strategy should prioritise energy savings and improvements in energy efficiency rather than seeking to develop at any costs domestic energy production. There is a large potential for energy efficiency gains in all economic sectors, especially in industry but also in power generation and distribution, household consumption, transport and agriculture. District heating also represents a considerable opportunity for energy savings requiring probably comparatively less significant investments than in other areas.

Role of the state

Following delays in the privatisation process, the state continues to play a key role in most energy sub-sectors (Table 4.1). The predominant state ownership, often associated with vertically-integrated monopolies, means that competitive pressures are very limited in the energy sector, especially in the gas sector where the state-owned monopoly (*Naftogaz*) is present at all stages of the gas value chain (Box 4.1).

The difficulties of privatisation can be illustrated by the example of the coal sector. In 2008, a Presidential Decree stopped the privatisation of the energy enterprises until the adoption of the energy sector development programme. However, a new draft privatisation programme prepared by the Ministry of Coal Industry[7] was also rejected. Finally, a list of 99 coal mines to be privatised was approved in April 2009, but so far no privatisation has actually been carried out, partly also because most of state-owned mines are not profitable.

In the electricity sector, the privatisation process has also faced many problems. In early 2008, the government announced the plan to sell 25% of equity in six electricity distribution companies (*oblenergos*). The privatisation programme included a number of obligations for potential investors such as improving power plants' effectiveness, reducing emissions and participating financially in future integration of the Ukrainian power system within the EU network. The first auction of the 25% stake in "*Poltavaoblenergo*" scheduled for April 2008 was cancelled after the minority shareholders blocked the process through a court decision, which stopped the whole privatisation programme. A new plan to sell 25% to 60% of the shares in a number *oblenergos* was announced in August 2009 specifying a series of obligations for investors, notably upgrading production facilities, implementing the EU integration requirements and nominating the representative of the state on the supervisory board of companies with a blocking stake of 25% of shares plus one share. Several sales were realised in 2009 and 2010, notably of *Lvivoblenergo*, *Cernihivoblenergo* and *Poltavaoblenergo*. The 2011 programme proposes for sale shares in four companies, including in *Dniproenergo* (25% minus one share), *Zakhidenergo* (45% minus one share), *Centrenergo* (53.3% minus one share) and *Donbasenergo* (60.8% minus one share). Subsequently, the sale of a further 19 *oblenergos* is foreseen with the shares proposed for sale amounting to up to 75% in some companies.

The dominance of public ownership has generated various forms of state support, particularly in the coal sector often depending on the lobbying power of individual enterprises. In January 2009, the Cabinet of Ministers established a list of 27 state-owned mining enterprises which have been granted access to electricity at a price 25% below that paid by other enterprises. In April 2009, in response to the economic crisis that drastically reduced demand for coal from the power generation sector, the Cabinet of Ministers obliged state-owned electricity generation companies and other enterprises affiliated to the central government to buy coal exclusively from the state-owned mines. In December 2009, the Parliament extended until 2013 the ban on bankruptcy procedures of mining companies in which the state ownership amounts to at

Table 4.1. **The role of the state in the energy sector**

Sector	Extent of state-ownership/ control	Remarks
Oil exploration and production	Dominance of a state-owned company	State-owned holding *Naftogaz* accounted for 92% of production in 2008-2010 (97% in 2005).
Oil transport	Monopoly of a state-owned company	Operated by subsidiary of *Naftogaz* – no unbundling.
Oil refining and processing	Some state ownership: one refinery, representing 25% of total output	Participation of foreign capital, mainly Russian oil majors: TNK-BP, Lukoil.
Oil distribution and trade	Limited state ownership	Fragmented industry with the 9 largest retailers controlling some 50% of the market; presence of both domestic and foreign firms.
Gas exploration and production	Dominance of a state-owned company	*Naftogaz* accounted for 91% of production in 2008-2009 (96% in 2005).
Gas transmission	Monopoly of a state-owned company	Operated by subsidiary of *Naftogaz* – no unbundling. Privatisation prohibited by law.
Gas distribution and trade	Some state ownership	*Naftogaz* owns controlling or minority stakes in several of 42 distribution companies. Strong presence of private, including foreign (mostly Russian) capital with limited transparency of ownership structures.
Electricity production	Dominance of state-owned companies	Privatisation of nuclear and hydropower stations is prohibited by law. State keeps control in four out of five regional thermal power generation companies (*gencos*). Remaining shares in *gencos* are privately owned and listed on the Kyiv Stock Exchange.
Electricity transmission	Monopoly of a state-owned company	Ukrenergo administers the National Dispatch Center. The company owns and operates the high-voltage network.
Electricity distribution	Dominance of state ownership	Public control (majority stakes) in most of 27 regional distribution companies (*oblenergos*) that operate the low-voltage networks. *Oblenergos* also own some generation capacity (mostly combined heat and power plants).
Coal	Significant state ownership (above 50% of coal output)	State-owned mining companies are supported by the state, leading to significant market distortions.
Renewable	State ownership of large hydropower stations.Private ownership in small scale renewable.	Only the hydropower sub-sector is significant, the remaining of the sector is currently small.

least 25% of capital. In January 2010, the state-owned mines have been granted further exemptions from mandatory social security and other tax payments.

Energy pricing

The energy pricing system is a key factor determining energy consumption and investment. In Ukraine, the level and the modalities of price regulations vary in different sub-sectors (Table 4.2), but the main problems are common to all energy sub-sectors, notably:

- low average tariff levels, often below production costs;
- non-transparent price setting mechanisms and related uncertainties concerning future price levels;
- a complex and non-transparent system of subsidies across sectors.

Box 4.1. ***Naftogaz***

The state holding company *Naftogaz*, created in 1998, is a dominant player in most subsectors of the oil and gas industry, including:

- oil and gas exploration and drilling: due to the company's financial difficulties, its activities in these areas have considerably declined since the mid-2000s;
- hydrocarbon production: whereas gas output has stabilised since the mid-2000s, oil production has declined; in 2010 *Naftogaz* subsidiaries produced 18.3 bcm of gas, *i.e.* 91% of the total Ukrainian output, and 3.3 Mt of the oil and gas condensate, *i.e.* 92% of the total;
- oil and gas transport (including transit of Russian natural gas and Russian and Kazakh oil to third countries): *Naftogaz* subsidiaries own and operate the two large pipeline systems; the total volume of gas transported to third countries declined to 99-96 bcm in 2009-2010 from 120 bcm in 2008;
- gas underground storage facilities with working capacity of around 32 bcm;
- processing of the gas and the condensate: *Naftogaz* remains a significant player also in this segment;
- supply of gas, compressed and liquefied gas and oil products to Ukrainian customers: *Naftogaz* subsidiaries, notably Gas of Ukraine, own and operate the system of low-pressure distribution gas pipelines and provide gas to households, district heating companies, public sector consumers and small business; *Naftogaz* also has its own network of petroleum filling stations throughout the country.

In 2010, *Naftogaz* holding companies had 175 000 employees. The company is closely linked to the government. Since 2009, the company's financial problems have intensified after the collapse of the cross-subsidy scheme due to higher gas import prices and the budget crisis. The scheme relied on income from industrial customers and state subsidies to cover the losses resulting from the below-cost tariffs paid by households and the district heating companies. In 2009, *Naftogaz*' deficit was estimated at around 2.5% of Ukraine's GDP. The Ukraine-IMF agreement includes the commitment by the government to reduce the deficit of *Naftogaz* to 1% of GDP in 2010 and to eliminate it thereafter. It was recently reported that the government envisages transforming *Naftogaz* into a publicly traded company by selling some of its shares through an initial public offering (IPO).

Source: IMF – Ukraine Technical Memorandum of Understanding, *IMF Country Report* No. 09/270, September 2009.

Table 4.2. **Price structure in the energy sector**

Sector	Scope of price controls and tariffs levels	Remarks
Oil and petroleum products	Market-determined prices.	Competitive retail market in petroleum products and competition in oil refining (including from imports).
Gas	Administratively regulated tariffs. Differentiation between households, industrial consumers, district heating companies and budget-financed organisations. Prices below cost-recovery levels for households and district heating companies.	Additionally, non-payment is an issue. In 2010, only 82% of the gas sold by *Naftogaz* was paid. District heating companies and households are mainly responsible with non-payment at 34% and 20%, respectively. High cross-subsidies.
Electricity	Mixed price setting (market and administrative elements). A complicated system with differentiated tariffs for various classes of consumers and additional discounts. Very low tariffs for households. significantly higher for industry.	Single buyer model: nuclear and hydro-power sold to state company Energorynok at prices set by the regulator (NERC). Thermal power generation companies (gencos) are to compete to sell to Energorynok but in practice no real competition. Energorynok sells power to regional energy supply companies (oblenergos) and large industrial firms. Prices for transmission and distribution set by NERC. Oblenergos sell to customers at rates based on the wholesale price plus the transmission and distribution tariff. Tariffs for households which remained more or less stable since September 2006 have started to be gradually adjusted in 2011 to the economically justified level.
Coal	Administrative price setting for the majority of the market.	Since 2006, a single state-owned company Coal of Ukraine acts as a market operator setting the prices (based on actual costs, subsidies for loss-making companies and a notional profit margin) and buying coal from mining companies and then selling it further, also at the regulated price that is established in the negotiation process involving four different ministries.
Renewable	Guaranteed feed-in electricity tariffs defined in relation to conventional energy prices.	In place since 2008-2009.

One of the consequences of the current pricing scheme has been chronic under-investment in building, maintenance, and upgrades of all energy infrastructure, including pipelines and the electricity grid. For the same reason, both energy producers and energy consumers have no incentive to invest in energy efficiency improvements. The current price system makes most energy sub-sectors economically unviable without massive public subsidies and other administrative support, for instance to prevent bankruptcy.

Artificially low coal prices provide indirect subsidies to industry, coal-fired power plants, heating utilities and households. Since 2006, a state-owned company *Coal of Ukraine* acts as a market operator and sets the level of coal prices, based on actual costs, subsidies for loss-making companies and a notional profit margin. It buys coal from mining companies and then sells it at the regulated price negotiated with four different ministries. The price levels set in this negotiating process have been typically below the average production costs of state-owned companies and, as a result, most companies have been confronted with a serious deterioration of their financial condition leading to payment arrears and recurrent demands for ever higher subsidies. In 2008, some attempts to liberalise the price policy in the coal sector were undertaken, notably based on auctions for coking coal. In a number of transactions the resulting prices were higher than the regulated ones. However, in the aftermath of the economic crisis and the related decline in coal demand and prices, the auction modalities were no longer adapted to the new situation and the auction system effectively ceased operating in August 2009.

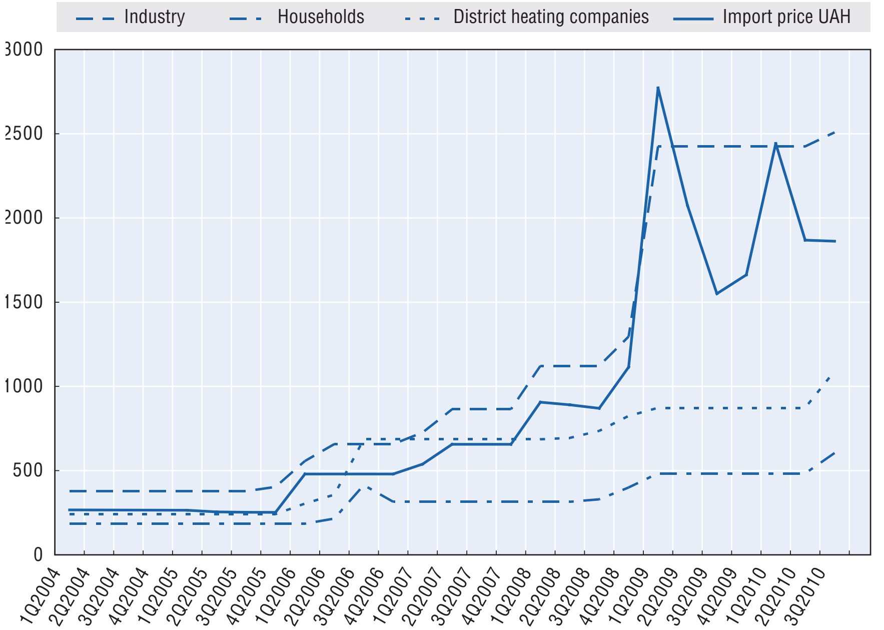
Average coal production costs remain below the price of most other energy sources, including imported coal, oil or natural gas. Special permits for coal exploration and extraction granted in compliance with the Subsoil Code are currently sold at open auctions organised by the Ministry for Environmental Protection and the procedures for obtaining them take around six months. There has been some discussion about lowering the price for licences and simplifying the procedures for coking coal exploration activities.

Despite, or perhaps because of, its key economic role, the gas sector is the least reformed among the energy sectors with serious consequences for the country's production and consumption. Due to the political sensitivities, gas tariffs for households have been kept low, corresponding in the first half of 2010 to 20-25% of the gas price as imported from Russia. District heating companies paid less than half of the import price but non-payments by these companies and by individual consumers have nevertheless been widespread. In contrast, the tariffs for industrial consumers have been increased more or less in line with gas import prices and are therefore close to levels observed in most western European countries (Figure 4.3).

The gas price reform features prominently in the Ukraine-IMF programme approved in July 2010. The programme outlines a comprehensive consolidation strategy to safeguard fiscal sustainability and restore the financial viability of *Naftogaz*. In line with the objective of the IMF programme, gas prices for households and utility companies were increased by 50% with effect from August 2010. A further 50% increase was planned for April 2011 with semi-annual increases thereafter until import parity is reached.[8] As regards industrial consumers, in addition to the commitment to set gas prices in line with import parity, the authorities have also abolished price subsidies for the sugar, fertiliser, and metallurgy industries. Payment discipline by the district heating companies should be strengthened through the creation of an independent regulator responsible for setting the heating tariffs, and implementing an automated system for collecting payments.

Figure 4.3. **Gas import prices and tariffs for various consumers, 2004-2010**

(UAH per thousand cubic meters)



Source : Based on published tariffs and using official exchange rate.

2. The government's energy strategy and future energy investment requirements

The government's energy sector strategy

Since the mid-1990s, successive Ukrainian governments have issued a number of documents outlining an energy policy strategy and specific plans for different energy sub-sectors.[9] In general, the main underlying priorities have been energy security and reducing energy import dependency. The key text presenting long-term energy policy orientations is Ukraine's Energy Strategy until 2030 was adopted in 2006 (Box 4.2).

Given the critical importance of the energy sector for the country's future economic development, the Economic Reform Programme for 2010-2014 published in June 2010 gives a prominent role to energy policy issues. It provides a very critical assessment of the current situation in the major energy subsectors and identifies their underlying weaknesses. The Programme establishes a precise timetable for required reforms, including for the adoption of proposed laws and regulations. The reform strategy is divided in three phases: 2010, 2011-2012, and until end-2014 and specifies the objectives for different energy sub-sectors (Box 4.3). The declared target of the

Box 4.2. **Ukraine's energy strategy until 2030**

The *Strategy* focuses on the energy supply side and defines the following main policy objectives:

- establish a favourable environment for the safe, reliable and sustainable operation of the energy sector and its most efficient development;
- improve national energy security;
- limit a negative environmental impact of the energy sector;
- implement energy saving technologies and policies to limit the growth of energy demand;
- integrate the United Power System of Ukraine into the European power system, with the objective of increasing Ukrainian electricity exports and strengthening the role of the country in the international transit of oil and gas.

The "baseline scenario" sets up the following targets:

- Doubling of electricity production between 2005 and 2030 allowing for a substantial increase in electricity exports.
- Increasing generation of thermal power plants with a major shift away from gas-fired units towards units fuelled by domestically produced coal.
- Increasing nuclear power generation.

The 2006 Energy Strategy also refers to a low carbon development (LCD) scenario containing several specific measures in the energy sector:

- Rehabilitating fossil fuel power plants and increasing their energy efficiency.
- Accelerating the construction of new nuclear power plants.
- Building a new combined cycle and combined heat-power plants.
- Increasing electricity production from hydro-power plants.
- Renovating the gas transmission network, in particular replacing inefficient compressor units.
- Improving energy efficiency in the industrial sector.
- Improving the efficiency of the housing and communal sector, *e.g.* by replacing low-capacity and low efficiency boilers, refurbishing heat distribution networks and improving the thermal insulation of buildings.

Programme is to change radically the market structure of the energy sector and to achieve its liberalisation, notably by abolishing the price subsidy schemes and other market distortions, opening large parts of the sector to privatisation and establishing an independent market regulator with important prerogatives.

Box 4.3. **The 2010 Economic Reform Programme: Objectives for the main energy sub-sectors**

In the **power industry:**

- Gradual phasing out of all tariff subsidies;
- End of the moratorium on privatisations in the sector in 2010 – complete privatisation of electricity generation by end-2014 with a view of ensuring investment resources for modernisation;
- Ensuring independence of the regulator by end-2012.

In the **oil and gas** sector:

- Gradual phasing out of all tariff subsidies (by end-2012);
- Improvements in the system of permits for oil and gas field development and other investment-friendly measures related to oil and gas production;
- Restructuring of *Naftogaz*.

In the **coal** sector:

- Coal market liberalisation;
- Privatisation of viable coal mines and restructuring (including closures) of mines with no outlook for profitability.

Source: The full text of the Reform Programme is available at *www.president.gov.ua/content/ker-program.html*.

Energy efficiency issues were explicitly addressed in the 1997 Comprehensive State Program of Energy Saving of Ukraine, but it is difficult to verify its fulfilment as the objectives were expressed in terms of total energy consumption and not as energy efficiency indicators. A new Energy Efficiency Program 2010-2015 initially approved in early 2010 was revised in July 2010 (Energy Efficiency Program, 2010). Its main objectives include a 20% decline in the energy intensity of the Ukrainian economy compared to the 2008 level (not necessarily an ambitious target in light of historical trends), a change in the energy mix by lowering the share of imported energy commodities, especially natural gas, and their replacement by alternative energy resources. The programme sets up a range of targets with the list of measures required for their achievement, such as designing energy efficiency standards and adopting specific investment measures to modernise energy infrastructure and launching information campaigns on energy efficiency. The State Agency for Energy Efficiency and Energy Savings (former National Agency for Ensuring Efficient Use of Energy Resources – NAER) is the main agency responsible for implementing this programme (Box 4.4).

Box 4.4. **The State Agency for Energy Efficiency and Energy Savings: Status, responsibilities and recent activities**

As a part of a large administrative overhaul in December 2010, the National Agency for Ensuring Effective Use of Energy Resources (NAER) created in 2006 as a successor of the State Committee for Energy Conservation was reorganised and became the State Agency for Energy Efficiency and Energy Savings, supposedly maintaining the responsibilities of the former NAER, notably:

- designing and implementing state policy on efficient energy use and conservation;
- increasing the share of non-traditional and renewable energies;
- establishing a system to monitor energy production, consumption, exports/imports;
- improving the registration and control system of energy consumption; and
- ensuring the functioning of the system of industrial energy consumption norms.

In 2010, the Agency was granted funds to support energy-saving projects foreseen by the 2010 Energy Efficiency Programme and has to participate in financing projects, including those involving the private sector.

Source: The interview the Head of the NAER, *Business Review*, 16 August 2010, *http://naer.gov.ua/archives/2863*

Future energy investment requirements

Limited investments in the energy sector in the past two decades have resulted in the gradual deterioration of the existing energy infrastructure, growing inefficiencies and technical losses, low productivity and a rising environmental burden. The large electricity generation capacity inherited from the Soviet period has made it possible to postpone investment projects, but the situation is no longer sustainable and substantial investment efforts are necessary to cope with the increase in domestic and international energy prices. There is a broad consensus on two points:

- energy investment needs are considerable and to attract such investment a supportive policy environment is required;
- delaying required investments would have adverse consequences on the country's economic and social development and possibly its political stability given current high energy import dependence on a sole supplier.

Estimates of Ukraine's future investment needs vary according to different sources depending on their assumptions and factors taken into account. World Bank estimates suggest a figure of USD 3.5 billion or 3% of GDP annually (World Bank, 2010). The baseline scenario of Ukraine's 2006 Energy Strategy assumed combined investment outlays of some USD 200 billion at 2005 prices over the 2006-2030 period, *i.e.* approximately USD 8 billion annually. In the electricity sector, major investment needs have been identified for constructing new nuclear power units, rehabilitating existing thermal power plans and modernising power network connections. In the oil and gas sectors, the main investment needs have been identified in exploration and production as well as the reconstruction of the gas transmission system.

As the exclusive owner of nuclear power plants, the State bears the main responsibility for investment needs of this sector, which covers almost half of the country's total electricity consumption and is therefore critical for the country's energy security. Ukraine has ambitious plans to build several new reactors over the next decade. The contract agreement on the two most advanced projects – *Khmelnitski* 3 & 4 – was signed in February 2011 with *Atomstroyexport, a* Russian nuclear power equipment and service export monopoly. An earlier intergovernmental agreement envisages financing through a Russian loan of around EUR 5-6 billion.

The state has controlling stakes in four out of five regional thermal power generation companies (*gencos*). Their economic viability and investment attractiveness is determined by the prices of fuels (coal and natural gas) and electricity tariffs, which both depend mainly on politically sensitive tariff decisions. Investments in this sector thus remain a risky undertaking, despite the significant business potential for electricity exports to neighbouring countries, notably Belarus, Poland and Slovakia.

Large hydropower plants fully controlled by the state have attracted some financing from international financial institutions (World Bank), essentially for their maintenance and upgrades. New generation capacity has also been developed: the first unit of the Dnister pumped-storage hydroelectric power plant started operating by the end of 2009 and with additional units planned in coming years this plant might become one of the largest of its type in Europe. Other segments of the renewable sub-sector remain for the moment dominated by small-scale units, mostly privately-owned.

Experience with nuclear safety gained after the Chernobyl accident and the vital interest of foreign partners in nuclear security in Ukraine have created favourable conditions for investments in security improvements and have allowed the country easier access to foreign financing. Nuclear safety is probably the most successful field of Ukraine's co-operation with the EU which provides and supports the country's access to grants and loans. Future investment needs in this sphere continue to be substantial: a recent nuclear safety improvement programme developed by *Energoatom*, the power plant operator, estimates additional expenses in next few years at some EUR 1 billion.

The gas transmission system requires large investments to improve its operation security and reduce its current losses. However, several factors which are essentially outside of the Ukrainian authorities' control, such as the building of alternative pipelines in Europe and the development of new technologies, might put into question the planned upgrading of existing facilities or their extension. For example, a combination of political and economic factors has prompted Gazprom, the Russian gas monopoly, to diversify its gas export routes, which circumvent Ukraine's territory. Moreover, since future trends in gas supply and demand are increasingly uncertain, the demand for gas transit services on Ukrainian territory may become less favourable in the horizon of 5 to 10 years. The list of national projects includes the construction of the sea terminal for liquefied natural gas on the Black Sea coast.

Until recently, the development of renewable energy resources has not featured prominently in investment programmes, but the "Natural Energy" project is listed among the eleven national projects foreseen for next few years, envisaging the construction of small scale hydro, wind and solar power stations and production of solid alternative fuel.

The 2010 Energy Efficiency Programme for 2010-2015 sets an ambitious investment target of EUR 28 billion for the five year period, of which some EUR 3 billion are to be covered from the central state budget and EUR 1.5 billion from the budgets of other levels of government, while the remaining 85% of the total cost is expected to come from other sources. The contribution of other sources of financing, including private domestic and foreign investment as well as various international sources, should gradually increase from EUR 1.2 billion in 2010 to some EUR 6.5 billion in 2015. However, based on past experience, energy saving investment could be difficult to mobilise. The Comprehensive State Programme of Energy Saving 1997-2010 envisaged the investment for energy savings from all sources at UAH 30 billion, but only UAH 10 billion were actually made available, of which only some 5% came from the state budget.

3. Main reform challenges

To mobilise the considerable investment required to increase production in traditional and renewable sources of energy, upgrade energy infrastructure and enhance energy efficiency, Ukraine has to create a favourable investment climate able to compete with the conditions offered by other countries also seeking to attract energy investments. Although certain progress has been achieved for example in eliminating barter transactions in gas transit operations (IMF, 2009b), Ukraine's reform agenda in the energy sector remains vast. The combination of state control and differentiated energy pricing schemes has constrained investment and also added up to a significant energy subsidy bill which represents a considerable drain on public finances.

The IEA estimates that in 2009 the level of energy subsidies in Ukraine was equivalent to some 4.7% of the country's GDP, *i.e.* around twice the levels observed in Russia and Kazakhstan (IEA, 2010b). But interventions in the currently distorted price structure remain a highly sensitive political issue both as regards energy prices paid by households and the tariffs applied in industry, especially for export-oriented sectors whose competitiveness depends to a large extent on their energy bill.

Ukraine's energy reform process has been facilitated by the country's international commitments and co-operation, especially with the EU and the IMF. The recent IMF agreement has prompted progress in energy price reforms and the energy policy dialogue with the EU aiming at gradual convergence of Ukraine's energy sector with the EU internal market has been instrumental in efforts to liberalise Ukraine's internal gas market and modernise its regulatory framework. These reforms are indispensable for putting in place and implementing energy-related projects co-financed by international agencies. Access to international know-how on financing options and technologies is important, especially in the sphere of energy efficiency and renewable energy investments.

International co-operation and agreements

The Ukraine-EU dialogue on energy based on the Memorandum of Understanding of December 2005 established as the main objective the "gradual convergence of Ukraine's energy sector with the EU's internal market, aiming at its integration". Ukraine received observer status in the European Energy Community in November 2006 and expressed its interest in full membership. The Ministerial Council made membership conditional on concrete legislative amendments, notably in the gas sector in compliance with the European Commission's Directive 2003/55/EC. The law promulgated in July 2010 responds to this requirement by introducing the principle of free choice of distributor and supplier for customers, free access of gas companies to the pipeline system guaranteed by the obligation for operators to make infrastructure available to all interested parties under the same conditions (Centre for Eastern Studies, 2010). Following these recent legislative changes, the Protocol on the Accession of Ukraine to the European Energy Community was signed in September 2010 and Ukraine became a full member of this organisation on 1 February 2011.

Ukraine's membership in the European Energy Community also requires the revision of the role of its energy regulatory agencies, in particular strengthening of the prerogatives and independence of the National Electricity Regulatory Commission (NERC) in line with EU rules. The NERC, which was established in 1994, saw its mandate extended to other energy sub-sectors with a large range of responsibilities. In particular, the NERC issues licences for all activities in the electricity sector, including power generation, distribution and supply to end-users, as well as for oil and oil products transport, gas transport, storage, distribution and supply. The NERC sets wholesale electricity prices and establishes retail electricity tariffs, sets the caps on gas prices, and fees for delivering, transporting and storing gas, oil and oil products. Its independence has nevertheless been constrained due notably to the modalities by which the chairmen and commissioners are appointed. The June 2010 Economic Reform Program envisages achieving the independence of the NERC by the end of 2012.

The new law on gas approved in July 2010 foresees the creation of an independent regulatory agency, which will set tariffs for gas transport, storage and distribution. However, to become operational in practice and allow for real competition in the internal gas market, the law should be followed by some additional steps, in particular further restructuring and unbundling of *Naftogaz* and its daughter company *Ukrtransgaz*, which currently dominate the market. It also requires that an independent regulator sets tariffs for access to pipelines according to the EU guidelines. The 2010 Law "On the National Residential Services Regulatory Commission" also established a new regulatory agency, which will be responsible for regulating the prices of heating and other communal services starting 2011. Other ongoing and planned reforms in the electricity sector have been designed in accordance with EU legislation and requirements, in particular the Action Plan which has to be carried out in four stages until 2015 when a competitive electricity market should be in place. Another Action Plan approved in October 2010 sets up a timetable for adapting Ukraine's legislation to EU requirements, notably in the area of construction of power generation plants.

The Energy Charter Treaty to which Ukraine is a party has several implications for the country's energy policy, in particular as regards investment protection. The Charter covers energy transit, and includes a specific mechanism for the resolution of energy transit disputes. The Charter thus provides a basic framework underpinning the rights of investors in the energy sector though its practical application has so far been limited. The Charter's Investor-State Dispute Settlement mechanism was used once in the case of Ukraine (Energy Charter, 2009) and the Charter's energy transit provisions were not very instrumental in resolving Ukraine-Russia natural gas transit disputes in 2006 and 2009.

The realisation of a number of energy-related projects co-financed by international agencies depends to a large extent on Ukraine's thorough implementation of its energy policy commitments, in particular the alignment of the Ukrainian gas market regulations with the EU *acquis*. One of the most ambitious programmes has been the upgrading of the Ukrainian gas transit system, decided at the International Investment Conference in March 2009 jointly by the Ukrainian government, the European Commission and the international financial institutions, notably EIB and EBRD. Required investment was estimated at USD 3 billion over a seven year period (EU-Ukraine Gas Conference, 2009).

International experience with energy efficiency reforms

Limiting state interference in the energy sector and eliminating current distortions in the energy price structure are necessary but not sufficient conditions for Ukraine to generate significant energy efficiency gains. The experience of OECD and non-OECD countries shows that energy efficiency programmes often fail to deliver fully the expected gains in the absence of an effective system of energy efficiency governance defined as the combination of an enabling legal and institutional framework, funding and co-ordination mechanisms and accountability arrangements, including evaluation and oversight. There is no single model of energy efficiency governance and countries have to adapt their approach to local conditions. Many different measures and mechanisms have proven their efficiency in other countries (IEA, 2010c).

From an investment policy perspective, several recommendations based on international experience are relevant for Ukraine. First, energy efficiency strategies should be integrated into a broader policy framework of economic development and foresee a reliable source of financing for energy efficiency investment. Energy and environment taxes represent a powerful fiscal instrument yielding a double dividend: by increasing the costs associated with high energy consumption or emissions, they discourage these practices and, at the same time, generate revenues, which could be earmarked for supporting public energy efficiency activities.

Successful energy efficiency initiatives in many countries have taken the form of private-public partnerships (PPPs), which involves the private sector in developing and implementing energy efficiency policy and projects. This approach has been particularly important in developing and transition economies as it allows mobilising private sector resources, including its technical, managerial and financial capacities, to deliver public services. Similarly, private energy service companies can also be instrumental to help overcome frequent barriers in energy efficiency projects by facilitating access to financing and mitigating aversion risks often associated with this kind of project. Public authorities should also seek the active involvement of the private sector in developing technical standards and conformity assessments. To prevent the risk of capture by private and sectoral interests, however, the government has to ensure the oversight and accountability of energy efficiency initiatives involving the private sector.

4. From energy efficiency towards the development of environment-friendly energy resources

The magnitude of energy inefficiency in the Ukrainian economy means that energy savings must remain the immediate goal of Ukraine's current energy policy and investment. But the country also has to gradually develop favourable conditions for enhancing environmental protection and developing environment-friendly energy resources and technologies. The first step could be to exploit more systematically potential synergies between energy efficiency projects and the development of environmentally sound production and technologies.[10] Further development in this area requires collaborative efforts involving the authorities, the business community and the public at large. International technical assistance and financial support also play an important role in supporting the development of renewable energies and environmentally-friendly technologies.

Exploiting investment synergies between energy efficiency and environment-friendly energy resources

Energy-saving investment projects often address directly or indirectly a number of environmentally-relevant objectives since cutting energy costs is expected not only to decrease the dependence on energy imports and improve international competitiveness but also to have a positive impact on energy-related pollution. Easy access to cheap energy has so far made such investment unattractive in Ukraine. Moreover, awareness among many companies in Ukraine of the potential for energy-saving and of available options to finance energy saving investments has generally been limited (Box 4.5).

Despite potential synergies between energy efficiency and renewable energy projects, there are some important differences in the required size, purpose, expected outcome and financial benefits between the two categories of investment (Table 4.3). They should be taken into account in designing and undertaking corresponding investment projects.

Public initiatives encouraging the development of projects presenting synergies between energy-savings and renewable energies can have a significant demonstration effect and serve as an example for the private sector. Possible opportunities include modernising heating in public buildings

Box 4.5. **Ukrainian company views on energy efficiency**

According to an IFC survey carried in mid-2008 among some 100 industrial companies in Ukraine:

- More than 80% of surveyed firms acknowledged the importance of energy efficiency but underestimated the possibilities to achieve energy savings.
- Most companies have not yet put in place appropriate energy management practices: only 15% of surveyed firms have deployed automated energy metering systems and less than half of them have developed a plan to increase energy efficiency.
- Half of the surveyed companies mentioned a lack of funds as the main reason for not implementing energy efficiency measures; only 15% of respondents applied to banks or international institutions to finance their energy saving investments.

Source: IFC, *Energy Efficiency: A New Resource for Sustainable Growth*, Researching Energy Efficiency practices among Ukrainian companies, undated report available at *www.ifc.org/ifcext/ueep.nsf/Content/ProgramMaterials*.

Table 4.3. **Possible differences between investment in energy efficiency and renewable energy**

Parameters	Energy efficiency	Renewable energy
Purpose of investment project in relation to firm's main activity	Auxiliary	Core
Size of investment projects	Small to medium	Small to large
Motivation, skills and awareness of potential benefits of investment project's proponents	Can be low	High
Financial benefits from the project	Cost reduction due to energy savings	Revenues from power/heat sales or cost reduction on power/heat (if captive use)
Non-technical risks	Output of the main activity	Adverse changes in regulatory framework (*e.g.* feed-in-tariff relative to wholesale power price); reliability of partners purchasing electricity, maintaining the grid, etc.

Source: Based on Table 1.2 in UN Economic Commission for Europe, "Financing Global Climate Change Mitigation", *ECE Energy Series* No. 37, March 2010.

involving a switch from natural gas to viable renewable energy options or in the municipal sector, which can generate both long-term savings for local budgets and stable revenues for investors. To promote such projects, which have for the moment been limited due to insufficient institutional capacities and a lack of information on such undertakings, the authorities might develop training and information exchange to enhance awareness of energy saving benefits and their positive environmental impact.

Renewable energy

Except large scale hydropower installations, energy from renewable resources has long remained a largely untested concept in Ukraine, but in the last 2-3 years, investors' assessment of Ukraine's potential in this area has improved. By the end of 2009, 90% of surveyed multinational enterprises considered such investment attractive, compared to just above 30% in 2007 (SEOLA, 2009). Ukraine's potential for renewable energy resources is substantial, especially in biomass and wind and possibly solar energy (NAER, 2009). In the short to medium term, heating based on biomass, biofuels and wind electricity generation are generally seen as the most promising areas.

The economic viability of specific technologies will depend to a large extent on the regulatory framework and technical development. Due to current cost differences between traditional and renewable sources of energy, progress in renewable energy will depend on the availability of state support schemes based on transparent and predictable regulations. Among different support schemes for electricity produced from renewable resources, feed-in tariffs are commonly perceived as the most effective approach that has been deployed in several European countries. The mechanism consists of guarantees of (priority) grid access for providers' of renewable energy and the purchase at a fixed price of their deliveries that varies depending on production technologies (*e.g.* wind, solar, biomass, etc.). Prices are set in such a way that they guarantee the economic viability of the renewable business compensating for higher production costs of renewable energy using current technologies. Importantly, the price formula is usually guaranteed over a long time horizon, *e.g.* 20 years.

Ukraine first introduced the "green" feed-in tariffs in 2008 and then made some important modifications in April 2009.[11] The green tariff law fixes the tariff path until 2029 at a level that is linked to conventional energy prices with an additional guarantee against exchange rate movements (the formula contains a floor for prices expressed in EUR). The rates differ depending on the technology and the size of the operation. The entity paying for energy deliveries is the Wholesale Energy Market which simplifies matters for the producers as they do not need to negotiate with local distribution companies (*oblenergos*) to whose networks they are physically connected. In addition to the feed-tariffs, the Tax Code sets up a range of tax benefits in favour of renewable energy production, including the reduction of taxes on land used for the construction of renewable energy facilities and the exemption from corporate tax on sales of power generated by renewable sources (available until January 2021). Imports of equipment and components used for energy savings are exempted from import duties and VAT if they are not produced in Ukraine. The 2011 budget foresees the allocation of public funds and support for cheaper loans to finance energy savings projects.

The business community has raised some issues related to the application of feed-in tariff regulations, notably the costs of connecting renewable energy facilities to the grid and the lack of clarity of certain provisions in the green tariff law. It considers in particular that the investment risk of renewable projects could be mitigated if access to green tariffs would be guaranteed already at the stage of issuing relevant building permits and not only after the plants start producing electricity (International Chamber of Commerce-Ukraine, 2010). However, such modifications would probably increase considerably the risks for the state and the grid operators given frequent delays in the finalisation of renewable energy projects.

Ukraine's level of feed-in-tariffs can be considered fairly generous and allowing for the development of renewable electricity production from the currently negligible level. The financial viability of projects can be further enhanced by the application of Kyoto's Joint Implementation mechanisms (see below). At the same time, it is important that existing provisions are transparent to prevent politically connected insiders from grasping most of the available benefits. At present, most of the sector can only operate thanks to large public subsidies, which will be difficult to expand under current tough budget constraints. Available analyses of the situation in other countries, such as Russia or Poland, suggest that energy saving measures could be a more immediate and cost-effective way to reduce emissions than electricity generation from renewable resources (McKinsey, 2009).

Public strategy and policies for environment protection

The basic principles of environmental protection are enshrined in the Constitution of Ukraine which defines the State's obligation to ensure environmental safety, the right of citizens to a healthy and safe environment, and the right of free access to information regarding the environment. The 1991 Law on the Protection of the Environment, which represents the key legal reference in this area, sets the main environmental standards and introduces the basic instruments to achieve them. It stipulates the modalities for granting permits for the emission of pollutants into the air, waste water emissions and deposits of waste, based on standards established for emission limits by particular pollutants, and sets up respective payment schedules. Some other important issues such as soil contamination, noise, odour, vibration, electromagnetic radiation, and other environmental aspects are not yet fully addressed in Ukraine's current legislation.

Ukraine has to deal with the specific environmental challenge related to the long-term effects of the Chernobyl nuclear power plant disaster and more generally with nuclear power safety problems stemming from its strong nuclear industry inherited from the Soviet period, notably fifteen nuclear reactors, three uranium mines and large nuclear fuel storage facilities. With the planned expansion of the nuclear sector, the need for the integrated oversight of the nuclear power system will increase and make it necessary to strengthen the regulatory and supervisory role of the State Nuclear Regulatory Committee of Ukraine.

Environmentally-friendly behaviour is generally promoted by an appropriate combination of positive and negative incentives. Ukraine has put in place various administrative enforcement tools such as the monitoring of allowed pollution/emission limits and charging penalties for breaches of these limits. Compliance assistance and promotion have been so far less developed (UNECE, 2007).

Ukraine has adopted the "polluter pays" principle, applying pollution taxes and charges for emissions. As of 2010, there are three types of environmental charges respectively on:[12]

- special use of natural resources;
- environmental pollution;
- deterioration of the quality of natural resources.

At present, such payments are too low to provide strong incentives for energy saving or pollution reduction as indirectly indicated by the low level of fiscal revenues generated by these taxes. According to available data, environment-related taxes represented in 2007 0.26% of GDP in Ukraine compared to more than 2% in OECD countries.[13] Another illustration is the level of fines paid by firms for energy consumption exceeding established norms. The IFC survey from mid-2008 reveals that 37% of Ukrainian surveyed companies paid such fees but their average amount represented only 0.2% of the average energy bill per company, *i.e.* a level unlikely to encourage companies to reduce their excessive energy consumption.

The Environmental Protection Law contains a comprehensive list of advantages which could be granted to enterprises adopting the environmentally-friendly measures, including:

- tax benefits for physical and legal entities introducing measures related to the rational use of natural resources; environmental protection; cleaning and decontamination installations, metering devices to control the emission of pollutants;
- access to preferential loans;
- access to grants from "environmental funds" for the entities limiting their pollution levels or developing environmentally-friendly technologies.

In practice access to such advantages remains limited. Preferential loans and grants are to be provided through the system of environmental funds of Ukraine: the State Environmental Fund and the Republican Environmental Fund of Autonomous Republic Crimea, 27 regional and several thousand local funds. The total resources distributed through this system have declined and became negligible in 2009-2010.[14] There have also been some concerns regarding transparency of the process in awarding preferences. For example, in 2007-2009, the Ministry of Environmental Protection of Ukraine organised a competition to select the entities with environmentally-friendly projects that could receive interest rate subsidies but the results of these competitions do not appear to be publicly available.[15]

Ukraine has introduced a VAT exemption on imports of materials, parts and final products that either use alternative or renewable energy or are used for production of alternative fuels or are in some other way related to energy efficiency improvements. These VAT exemptions apply only to products which are not available or produced in Ukraine. The list of eligible items is defined by the Cabinet of Ministers.[16]

Corporate initiatives in support of environmentally friendly energy and technologies

It is not yet common practice for businesses in Ukraine to report regularly on the environmental impact of their activities and their actions in favour of energy efficiency improvements and environmental protection. In 2010, only a few among the major Ukrainian energy companies included special sections dedicated to environmental issues on their websites, but the situation in this area has been rapidly evolving, partly under the influence of foreign firms that introduce their home country's corporate practices in Ukraine.

Some corporate initiatives have been launched through international assistance programmes such as the *Go-Green Declaration,* signed in 2008 by 23 Ukrainian business and civil society leaders, which contains their commitments to protect the environment locally and globally. The Declaration has been accompanied by a series of events, including a promotion campaign for responsible behaviour, an international conference on policy issues and specific actions such as cleaning of neighbourhoods by corporate volunteers. Many business organisations and associations have recently developed specific initiatives aimed at increasing public and business awareness of environmental matters. Among the most active in this area is the International Chamber of Commerce-Ukraine, which has recently put in place a Green Commission, proposing a number of concrete measures to the government to encourage development of environmentally-friendly energy resources and technologies (Box 4.6).

Recent OECD work (OECD, 2010b) shows that, as the pressures on companies to address climate change are growing, companies are increasingly adopting responsible business practices. Companies usually start by measuring their greenhouse gas (GHG) emissions and disclosing their

Box 4.6. **International Chamber of Commerce Green Commission**

The International Chamber of Commerce-Ukraine (ICC-Ukraine) is a non-profit business association. Following a number of internal discussions on *i.a.* the legislation on the feed-in electricity tariffs, the ICC-Ukraine decided to establish in June 2009 a permanent *Commission on Green Investments, Alternative and Renewable Energy Sources*. The Commission's objectives are to develop a position on regulations affecting the business environment in the sphere of environmentally-friendly energy resources and technologies and promote it in fora such as the Entrepreneurs Council under the Cabinet of Ministers of Ukraine and the NAER.

performance in this area. To encourage companies to reduce their emissions, strong incentives, in particular price signals, remain nevertheless critical.

International assistance and programmes for environmental protection in Ukraine

The contribution of international environment-related assistance and programmes has been essential in Ukraine given the country's limited domestic public and private financial resources and the lack of technological and financial know-how in this area. Existing programmes carried out by a number of OECD countries, such as Germany and Sweden, and by international agencies cover a large spectrum consisting of technical assistance with a focus on different aspects of effective environment policy and institutional building as well as on the financing of concrete investment projects for energy savings and the development of renewable energies (Table 4.4). For example, the UNDP helped Ukraine to improve the integration of environmental considerations in different policy areas, including through the implementation of the Strategic Environmental Assessment (SEA). In 2008, the United Nations Office in Ukraine launched promotion campaigns to increase public and corporate awareness of environment protection and encourage environmentally responsible business conduct.

Ukraine is an Annex I country under the Kyoto protocol and declared in 2009 its readiness to take certain international commitments under the post-Kyoto agreement on greenhouse gas emissions. Specifically, the Ukrainian offer consisted of 20% emission reductions by 2020 compared to the 1990 base year. This appears not to be a very ambitious target given that current emission levels are around half of the 1990 baseline year.

The Kyoto Protocol provides for market-based mechanisms allowing countries accepting the commitments under the Kyoto Protocol to fulfil a part

Table 4.4. **Examples of international programmes supporting energy saving and renewable energy**

Institution/ Instrument	Description	Budget	Period
EBRD	A large and diversified project portfolio, including oil and gas production, district heating, electricity grid, hydropower. Ukraine Energy Efficiency Programme (UKEEP): credit lines to local banks to finance energy efficiency improvements in industrial small and medium-sized enterprises and/or the residential sector, etc. Several projects in the pipeline, *e.g.*: Ukraine Renewable Energy Direct Lending facility: an instrument to extend debt financing for renewable energy projects in Ukraine.	Portfolio of EUR 650 million under the Sustainable Energy Initiative EUR 150 million EUR 50 million	Ongoing 2008-2011 Planned
Climate Investment Funds	Investment Plan for Ukraine prepared in March 2010 with a focus on *1)* large scale renewable energy, *2)* energy efficiency improvements in the housing sector, *3)* smart grids design and implementation and *4)* power generation from waste heat recovered from compressors in Ukraine's gas network.	USD 350 million co-financing for projects worth USD 2.6 billion	March 2010: under preparation
World Bank	3 currently running projects on hydropower rehabilitation and power transmission. New projects in the pipeline (*e.g.* Ukraine Energy Efficiency Project).	USD 366 million	2005-ongoing

Source: Websites of the donor agencies.

of their obligations by actions carried out in other countries. These mechanisms have proved to be an important driver for change in Ukraine. Following the establishment of the domestic institutional framework for Joint Implementation (JI) projects, Ukraine has emerged as one of the countries with the highest number and size of JI projects as measured by the Emission Reduction Units.[17] Many of the current projects target the rehabilitation of district heating systems, energy companies (*e.g.* a coal mine, a gas distribution company) and enterprises from the energy-intensive industrial sectors (*e.g.* cement, steel).[18]

The role of foreign investment

Foreign companies can significantly contribute to the development and dissemination of environmentally-sound technologies and procedures, equipment, goods and services as well as organisational and managerial knowhow in Ukraine. These technologies and products can be diffused

Box 4.7. **Examples of Kyoto Joint Implementation Projects in Ukraine**

A. Rehabilitation of the district heating system in Crimea

The project implemented in 2004-2008 focused on rehabilitating and replacing the existing heat generation and distribution equipment in the Autonomous Republic of Crimea so as to increase the efficiency of the district heating system, contributing to fuel saving and thus also a reduction of greenhouse gas emissions. The main measures included:

- Replacement of inefficient oil-fired boilers with more efficient gas-fired ones;
- Combustion improvement by upgrading the boilers' burners;
- Replacement of heat exchangers;
- Improvement of the network (adding insulation and the installation of new pre-insulated pipes);
- Installation of cogeneration units at five boiler houses;
- Gas extraction at Simferopol city landfill and its utilisation in selected boiler houses.

B. Utilisation of the coal mine methane at the Zasyadko coal mine

The project implemented in 2008-2012 seeks to reduce methane emissions into the atmosphere by collecting methane drained and recovered in the operating mine works, from mine ventilation as well as methane produced by surface wells at the Zasyadko Mine and using it to:

- produce electricity for mine works and the public grid (if there is a surplus);
- replace heat currently produced by coal- and gas-fired boilers, including municipal boilers;
- produce gas for use as a vehicle fuel.

through a variety of channels, including foreign trade, foreign direct investment (FDI) or licensing. In the case of FDI, the following mechanisms can be at play:

- Vertical linkages: multinational enterprises (MNEs) may transfer technology to firms that supply them with intermediate goods, or to buyers of their own products;
- Horizontal linkages: local firms may imitate MNEs' technologies or may be forced to improve their own technologies due to increased competition from MNEs;

- Labour mobility: workers employed and trained by MNE affiliates may transfer their knowledge to other local firms when switching employers or when setting up their own business;
- Internationalisation of R&D: the R&D activities of MNEs, even when predominantly located abroad, may contribute to creating the local knowledge generation capacity.

The potential of FDI to facilitate green technology transfers and contribute to energy savings, the "greening" of the energy sector and the dissemination of environmentally-responsible business practices is important though difficult to quantify.[19] Such potential gains do not materialise automatically but depend on the innovative and absorptive capacities of a host country and on the availability of a technically educated workforce. In these two areas, Ukraine appears to be relatively well positioned, but given increasing international competition, it has continually to support actively its domestic innovation capacity and skill upgrading.

Box 4.8. **Foreign investors as the promoters of PPP**

In 2007, the local council in the south-central Ukrainian city of Zaporozhia (around 1 million inhabitants), entered into a public-private partnership (PPP) with Remondis, an international water and environmental service company. The PPP aimed to renew the waste collection vehicle fleet, construct new facilities for the separation of recyclable materials, introduce a modern recycling system and bring in a more responsible way of dealing with waste as a resource. The town's appearance has also benefited because city cleaning, care of green spaces and winter service are also in the hands of the PPP.

Source: Company's information.

Notes

1. This chapter was prepared in co-operation with Mr. Wojciech Paczynski, Senior Researcher, Center for Social and Economic Research (CASE), Warsaw, with research assistance of Ganna Tsarenko and Viachaslau Herasimovich, acting as external consultants for the OECD Investment Division.
2. Estimates based on 2008 data using the methodology applied in European Commission/CASE (2008).
3. Based on IEA data; the figures reported in Ukrainian statistics are higher owing to a different methodology applied.
4. The 2008 Business Environment and Enterprises Performance Surveys (BEEPS) of Ukraine found that companies operating in Ukraine experience significantly less

power outages per month compared to the average of the Eastern Europe and Central Asia region. However, a typical outage lasted somewhat longer in Ukraine than the regional average. See World Bank (2009).

5. In 2008, Ukraine's TPES/GDP (toe/000 2000 USD) ratio stood at 2.55, compared to the OECD average of 0.18, global average of 0.3 and the former Soviet Union region average of 1.59, IEA (2010a).

6. According to the IEA data, in Poland industry and transport sectors accounted respectively for 26% and 23% of total final energy consumption.

7. As a part of the administrative reform and reorganisation of the government, the Ministry of Coal Industry and the Ministry of Fuel and Energy were merged in December 2010 into the Energy and Coal Industry Ministry.

8. At the beginning of 2011, the Ukrainian government declared that it would seek to postpone indefinitely this 50% increase in prices of natural gas supplied to households.

9. Among sector-specific programmes adopted between 1994 and 2002, the following could be mentioned: Creation of the Nuclear Fuel Cycle (1994); Development of Hydrocarbon Resources in the Ukrainian Sector of the Black and Azov Seas (1996); Energy Conservation (1997); Construction of Wind Power Stations (1997); Oil and Gas of Ukraine until 2010 and Thermal Power Plant Reconstruction (2002).

10. According to the EBRD, Ukraine residential buildings would require some EUR 60 billion, enabling energy savings equivalent to almost 10 billion cubic meters of imported gas or 25% of all Ukraine's natural gas imports. The EBRD technical assistance programme to improve energy performance of private dwellings introduced in 2010 will examine the legal and regulatory framework, general awareness, capacity and low penetration of energy efficient technologies in the country (EBRD, 2010).

11. Law No. 1220-VI "On Amendment of the Law of Ukraine 'On Electrical Energy' Regarding Stimulation of Usage of Alternative Sources of Energy" (1 April 2009).

12. Law of Ukraine No. 1264-XII "On Environmental Protection" (25 June 1991).

13. Ukraine is not covered by the OECD/EEA database on instruments used for environmental policy and natural resources management (*www2.oecd.org/ecoinst/queries/*). The available comparison referred to here may underestimate the size of relevant charges in Ukraine given the different classification system of certain environmental fees and charges.

14. According to the state budget data published by the Ministry of Finance, the resources devoted to these objectives declined from USD 6 million in 2007 to USD 1.3 million in 2008 and close to zero in 2009-2010. See *e.g.* Provisions of State Budget of Ukraine for 2008, Appendix 3, State Budget Expenses, *http://gska2.rada.gov.ua/pls/zweb_n/webproc4_1?pf*3511=31 175

15. The competitions were organised in line with the Ministry of Natural Resources of Ukraine, Decree No. 182 (6 April 2007), *http://zakon.nau.ua/doc/?code=*z0484-07.

16. The VAT exemption applies in 2008-2011 and is based on Law No.168/97-VR "On Value-Added Tax" (3 April 1997) and Law No. 760-V "On Amendments to Some Legislative Acts of Ukraine on Encouragement of Energy-Saving Activities" (16 March 2007).

17. Joint Implementation (JI) is one of the Kyoto Mechanisms, together with Emission Trading and the Clean Development Mechanism. Article 6 of the Kyoto Protocol allows a country with an emission level commitment under the Kyoto Protocol (Annex I Party) to earn emission reduction units (ERUs – equivalents of one tonne of CO2) from a project reducing emissions in another Annex I Party. JI offers Parties more flexibility and allows for more cost-efficient emission reductions. Countries hosting JI projects further benefit from foreign investment and technology transfer. In the case of Ukraine, additional benefits of JI relate to capacity building supporting the country's readiness to participate in international climate policies in the future.
18. The list of projects is available at *http://ji.unfccc.int/JI_Projects/ProjectInfo.html*.
19. The review of literature studying these points can be found *e.g.* in OECD (2010), Popp (2009) and WWF (2003).

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ANNEX A

Ukraine's Exceptions to National Treatment in the Meaning of the OECD Declaration on International Investment and Multinational Enterprises

A. Exceptions at the national level

I. Investment by established foreign-controlled enterprises

Agricultural land: Foreign legal entities are not authorised to own agricultural land and participate in privatisation of state and municipality owned land. They can lease agricultural land either on a short-term (up to 5 years) or long-term (up to 50 years) basis.

Source: Law No. 2768-III: Land Code of Ukraine of 25 October 2001.

Forestry: Forests can be owned only by Ukrainian citizens and legal entities.

Source: Law No. 3852-XII: Forest Code of Ukraine of 21 January 1994.

Insurance: Direct branching by foreign insurance companies is not authorised but will be allowed five years after WTO accession (May 2013).

Sources: Law No. 2774-IV "On Amendments to the Law On Insurance" of 7 July 2005; Law No. 250-VI "On Ratification of the Protocol on Ukraine's Accession to the WTO" of 10 April 2008.

News information agencies: Foreign ownership is limited to 35% of the charter capital.

Source: Law No. 74/95-BP "On Information Agencies" of 28 February 1995 as amended.

Wholesale trade of books, newspapers and magazines: Foreign ownership is limited to 30% of the charter capital. This restriction will be removed five years after the WTO accession (May 2013).

Sources: Law No 317-V "On Publishing" of 2 November 2006; Law No. 250-VI "On Ratification of the Protocol on Ukraine's Accession to the WTO" of 10 April 2008.

Strategic sectors: Enterprises and governmental agencies in which state ownership exceeds 25% are not authorised to participate in the privatisation of Ukrainian enterprises. Unspecified restrictions exist on foreign direct investment in strategic sectors in the case of economic threats to national security. The law defining the scope of foreign participation in priority sectors is currently under preparation.

Source: Law No. 2544-XII "On Privatisation of State Property"; Law No. 964-IV "On the Fundamentals of National Security of Ukraine" of 22 July 2003 as amended.

II. Official aids and subsidies

None.

III. Tax obligations

None.

IV. Government purchasing

None.

V. Access to local financing

None.

B. Exceptions at the territorial subdivisions

None.

Measures Notified by Ukraine for Transparency in the Meaning of the OECD Declaration on International Investment and Multinational Enterprises

A. Measures reported for transparency at the level of national government

I. Measures based on public order and essential security considerations

a) Investments by established foreign-controlled enterprises

Strategic sectors: Unspecified restrictions exist on foreign direct investment in strategic sectors in the case of economic threats to national security. The law defining the scope of foreign participation in priority sectors is currently under preparation.

Source: "On the Fundamentals of National Security of Ukraine" of 22 July 2003 as amended.

II. Other measures reported for transparency

a) Corporate organisation

Road transport: Local incorporation is required for road (freight and passenger) transport.

Source: Law No. 250-VI "On Ratification of the Protocol on Ukraine's Accession to the WTO" of 10 April 2008.

Insurance: Insurance activities can be provided only by a Ukrainian legal entity in the form of a joint stock company.

Sources: Law No. 85/96 "On Insurance" of 7 March 1996 as amended on 4 October 2001.

Medical, dental and paramedical services: Service providers require professional qualifications according to Ukrainian legislation and must speak Ukrainian.

Source: Resolution of the Verkhovna Rada of Ukraine No. 2802-XII "Fundamentals of the Ukrainian Law on Health Protection" of 19 November 1992.

Primary, secondary and higher education services: These educational institutions should be headed by a citizen of Ukraine.

Source: Law No. 2984-III "On Higher Education" of 17 January 2002; Law No. 651-XIV "On General Secondary Education" of 13 May 1999; Law No. 18411-III "On Off the School Education" of 22 June 2000; Law No. 2628-II "On Pre-School Education" of 1 July 2001.

B. Measures reported for transparency by territorial subdivisions

None.

C. Private or mixed monopolies

At the national level

I. Public monopolies

Transport of oil by major pipelines

Transport of natural gas by major pipelines

Transmission of electricity via national and international electricity grids

Use of railway lines, dispatcher services and other railway infrastructure

Air traffic control services

Specialised transport terminal services for ammonia

Universal postal services

Technical broadcasting means

Local telephone communication, services related to electricity-based communication channels

Source: Law No. 1682-III On natural monopolies of 20 April 2000 and its subsequent amendments.

II. Private monopolies

None.

III. Concessions

None.

B. Measures reported for transparency by territorial subdivisions

None.

ANNEX B

Statistical Annex

Table B1. **Cumulative inward foreign direct investment – main partners**

Millions USD

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	**3 875**	**4 555**	**5 472**	**6 794**	**9 047**	**16 890**	**21 607**	**29 543**	**35 616**	**40 053**	**44 708**
United States	640	777	891	1 060	1 191	1 387	1 397	1 430	1 465	1 309	1 192
Cyprus	378	493	672	902	1 101	1 636	3 187	5 946	7 646	9 005	9 915
United Kingdom	312	414	534	701	955	1 175	1 563	1 976	2 250	2 308	2 299
Netherlands	362	374	396	460	637	920	1 534	2 509	3 197	3 955	4 708
Russian Federation	287	316	323	389	721	836	1 002	1 462	1 847	2 566	3 403
Virgin Islands	193	275	346	368	582	737	806	1 067	1 294	1 343	1 461
Germany	241	250	318	452	654	5 504	5 578	5 918	6 393	6 602	7 077
Switzerland	163	224	272	322	442	456	567	648	718	796	859
Austria	125	144	215	252	361	1 439	1 634	2 067	2 444	2 605	2 658
Poland	63	69	98	153	195	226	395	672	690	867	936
Sweden	77	89	90	103	120	134	137	987	1 263	1 276	1 730
Italy	72	81	87	95	103	117	133	150	914	982	982
Ireland	91	74	78	77	46	46	72	117	134	140	139
Hungary	52	58	80	129	177	191	371	411	595	712	724
Canada	58	53	63	80	118	154	170	144	112	109	103
Norway	24	41	48	68	74	75	76	77	80	81	9
Slovakia	43	51	49	46	93	94	100	103	106	64	63
France	40	24	40	59	79	88	830	1 045	1 231	1 631	2 367
Other countries	653	746	873	1 078	1 398	1 674	2 054	2 814	3 237	3 702	4 083

Source: State Statistics Service of Ukraine, *www.ukrstat.gov.ua*.

Table B2. **Cumulative inward foreign direct investment – main sectors**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	**3 875**	**4 555**	**5 472**	**6 794**	**9 047**	**16 890**	**21 607**	**29 543**	**35 616**	**40 053**	**44 708**
Agriculture, forestry	73	87	113	206	224	310	404	557	813	793	834
Fisheries	0.5	0.5	0.5	0.5	3	1	1	1	6	6	13
Mining and quarrying	121	154	191	185	173	331	433	1 054	1 071	1 050	1 208
Manufacturing	1 920	2 207	2 546	3 160	3 738	8 984	9 762	11 085	11 128	11 917	12 488
Construction	100	117	172	197	275	513	840	1 632	1 937	2 206	2 339
Trade and repair	647	769	940	1 134	1657	1 956	2 626	3 072	3 709	4 317	4 765
Hotels and restaurants	109	118	162	187	262	267	374	428	414	445	458
Transports and communications	245	309	396	532	814	961	1 137	1 431	1 568	1 627	1 711
Financial services	313	355	421	504	694	1 897	3 561	6 836	10 496	12 431	15 060
Real estate	152	178	240	392	674	1 056	1 769	2 669	3 614	4 269	4 754
Education services	3	3	3	4	19	34	37	18	13	14	17
Health and social services	116	117	121	137	164	170	179	190	124	121	131
Communal and cultural services	53	59	82	107	163	197	210	286	454	549	584
Other sectors	22	82	85	50	186	213	276	282	271	310	347

Source: State Statistics Service of Ukraine, www.ukrstat.gov.ua

Table B3. **Cumulative outward foreign direct investment – main partners**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	**170**	**156**	**144**	**167**	**199**	**220**	**243**	**6 197**	**6 203**	**6 226**	**6 871**
Cyprus	2	2	2	2	2	2	10	5 826	5 826	5 779	6 343
Russian Federation	68	85	73	88	97	103	104	149	100	166	194
Poland	0.3	0.4	0.3	0.4	21	21	24	30	47	49	49
Georgia	1	1	1	2	2	2	3	28	27	33	31
Latvia	0	0	0	0	0	0	4	31	32	32	88
Kazakhstan	0	0	0	0	0	0	0.2	1	27	27	25
Virgin Islands	0	0	0		0	0	0	11	14	21	26
Others	99	68	68	75	77	92	98	121	130	119	115

Source: State Statistics Service of Ukraine, *www.ukrstat.gov.ua*

Table B4. **Cumulative outward foreign direct investment – main sectors**

Millions USD

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	**170**	**156**	**144**	**166**	**199**	**220**	**243**	**6197**	**6203**	**6226**	**6871**
Agriculture	0	0	0	0	*	*	1	1	0.3	0.3	7
Machinery	20	19	15	15	16	16	21	33	47	95	130
Construction	3	3	3	3	4	2	2	2	2	2	2
Trade and repair	1	1	1	2	26	29	37	95	143	125	132
Hotels and restaurants	0	0	1	1	1	*	0	0	*	*	*
Transport and communications	85	56	56	55	55	55	60	43	45	45	54
Financial services	2	3	3	8	11	34	50	617	618	596	628
Real estate	52	65	62	66	71	68	55	5 386	5 333	5 348	5 903
Other services	7	9	3	16	15	16	17	20	15	15	15

* Confidential data according to the Law of Ukraine "On state statistics"

Source: State Statistics Service of Ukraine, *www.ukrstat.gov.ua*.

Table B5. **Simplified energy balance of Ukraine in 2008**

	Coal and peat	Oil and oil products	Gas	Nuclear	Hydro	Other renewable	Electricity	Heat	Total
Production	33 683	4 345	17 982	23 413	979	887	0	0	81 289
Imports	8 557	14 258	44 094	0	0	0	181	0	67 090
Exports	–3 080	–3 889	–4	0	0	0	–759	0	–7 732
TPES	**40 783**	**14 652**	**55 990**	**23 413**	**979**	**904**	**–579**	**0**	**136 143**
Electricity plants	–18 402	–171	–1 297	–23 413	–979	–4	14 894	0	–29 372
Heat and CHP plants	–962	–12	–20 845	0	0	0	1 658	12 821	–7 341
Losses	–14	–20	–878	0	0	0	–1 923	–3 205	–6 041
TFC	**11 685**	**13 472**	**31 839**	**0**	**0**	**540**	**11 598**	**9 531**	**78 665**
Industry	8 844	1 492	9 471	0	0	54	5 774	5 128	30 763
Transport	33	8 571	3 036	0	0	2	918	0	12 560
Other	1 659	1 990	14 526	0	0	484	4 905	4 403	27 968
Of which: Residential	1 407	667	13 822	0	0	422	2 674	4 403	23 394

Notes: TPES: total primary energy supply.

TFS: total final consumption.

The totals may not add up due to omission s of certain items, *e.g.* statistical stock changes, statistical differences, etc.

Source: International Energy Agency.

Table B6. **Selected energy indicators: Ukraine and selected countries (2008)**

	Former Soviet Union	OECD	Poland	Russian Federation	Slovak Republic	**Ukraine**
TPES/population (toe/capita)	3.65	4.56	2.5	4.84	3.39	**2.94**
TPES/GDP (toe/thousands of 2000 USD)	1.59	0.18	0.41	1.6	0.55	**2.55**
TPES/GDP (PPP) (toe/thousands of 2000 USD	0.4	0.16	0.17	0.42	0.19	**0.4**
Electricity consumption / population (kWh/capita)	4 660	8 486	3 733	6 443	5 268	**3 534**
CO_2/TPES (t CO_2/toe)	2.34	2.33	3.05	2.32	1.98	**2.27**
CO_2/population (t CO_2 / capita)	8.53	10.61	7.84	11.24	6.7	**6.69**
CO_2/GDP (kg CO_2 / 2000 US$)	3.71	0.41	1.26	3.71	1.1	**5.79**
CO_2/GDP (PPP) (kg CO_2 / 2000 US$)	0.95	0.38	0.53	0.97	0.38	**0.91**

Source: International Energy Agency, Key World Energy Statistics 2010.

ANNEX C

Bilateral Investment Treaties Concluded by Ukraine

Partner countries	Date of signature	Date of entry into force	Comments
OECD countries			
Austria	08.11.1996	01.12.1997	
Belgium and Luxembourg	20.051996	27.07.2001	
Canada	24.10.1994	24.07.1995	
Chile	30.10.1995	29.07.1997	
Czech Republic	17.03.1994	02.11.1995	Amendments to the Treaty signed on 16.09.2008; Ratified by Ukraine on 20.01.2010; Date of entry into force: 17.05.2010
Denmark	23.10.1992	29.04.1994	
Estonia	15.02.1995	05.07.1995	
Finland	07.10.2004	07.12.2005	
France	03.05.1994	26.01.1996	
Germany	15.02.1993	29.06.1996	
Greece	01.09.1994	04.01.1997	
Hungary	11.10.1994	20.12.1996	
Israel	16.06.1994	18.02.1997	
Italy	02.05.1995	12.09.1997	
Korea	16.12.1996	03.11.1997	
Netherlands	14.07.1994	01.06.1997	
Poland	12.01.1993	14.09.1993	
Portugal	25.10.2000	18.07.2003	
Slovak Republic	26.02.2007	20.08.2009	
Slovenia	30.03.1999	01.06.2000	
Spain	26.02.1998	13.03.2000	
Sweden	15.08.1995	01.03.1997	
Switzerland	20.04.1995	21.01.1997	
Turkey	27.11.1996	21.05.1998	
United Kingdom	10.02.1993	10.02.1993	
United States	04.03.1994	16.11.1996	

Partner countries	Date of signature	Date of entry into force	Comments
Non-OECD countries			
Albania	25.10.2002	30.04.2004	
Argentina	09.08.1995	06.05.1997	
Armenia	07.10.1994	07.03.1996	
Azerbaijan	21.03.1997	09.12.1997	
Belarus	14.12.1995	11.06.1997	
Bosnia and Herzegovina	13.03.2002	22.01.2004	
Brunei	18.06.2004	25.04.2006	
Bulgaria	08.12.1994	10.12.1995	
China	31.10.1992	30.05.1993	
Congo	11.10.2000		Ratified by Ukraine: 17.11.2010
Croatia	15.12.1997	16.05.2001	
Cuba	20.05.1995	04.12.1996	
Equatorial Guinea	15.12.2005		Ratified by Ukraine: 19.09.2008
Egypt	22.12.1992	13.10.1993	
Gambia	12.07.2001		Ratified by Ukraine: 19.01.2006
Georgia	09.01.1995	18.12.1996	
India	01.12.2001	12.08.2003	
Indonesia	11.04.1996	06.08.1997	
Iran	22.05.1996	05.07.2004	
Jordan	30.11.2005	17.04.2007	Ratified by Ukraine: 15.03.2007
Kazakhstan	17.09.1994	04.08.1995	
Kuwait	12.01.2002	11.06.2003	
Kyrgyzstan	23.02.1993		
Latvia	24.07.1997	30.12.1997	
Lebanon	25.03.1996	26.05.2000	
Libya	23.01.2001	23.04.2003	
Lithuania	08.02.1994	27.02.1995	
Macedonia TFYR	02.03.1998	25.03.2000	
Moldova	29.08.1995	27.05.1996	
Mongolia	05.11.1992	05.11.1992	
Morocco	24.12.2001	28.04.2009	
Oman	01.01.2002		Ratified by Ukraine: 06.02.2003
Panama	04.11.2003	13.06.2007	
Romania	23.02.1995		Not yet ratified by Ukraine
Russian Federation	27.11.1998	27.01.2000	
San Marino	13.01.2006	15.10.2008	
Saudi Arabia	09.04.2008		Ratified by Ukraine: 18.02.2009
Serbia	09.01.2001	14.08.2001	
Singapore	18.09.2006	14.07.2007	
Sudan			Ukraine's proposal submitted in 2009
Syria	21.04.2002	16.03.2003	
Tajikistan	06.07.2001	27.05.2003	
Turkmenistan	29.01.1998	28.09.1999	
United Arab Emirates	22.01.2003	09.04.2004	

Partner countries	Date of signature	Date of entry into force	Comments
Uzbekistan	20.02.1993	26.05.1994	
Vietnam	08.06.1994	08.12.1994	
Yemen	19.02.2001		Ratified by Ukraine: 07.02.2002

Source: Ukraine's authorities, Database of Ukrainian legislation (*http://zakon.rada.gov.ua*)

DOUBLE TAXATION TREATIES CONCLUDED BY UKRAINE

Partner countries	Date of signature	Date of entry into force (date of ratification by Ukraine)	Type of arrangement
OECD countries			
Austria	16.10.1997	20.05.1999	Income and Capital
Belgium	20.05.1996	25.02.1999	Income and Capital
Canada	04.03.1996	22.08.1996	Income and Capital
Czech Republic	30.06.1997	20.04.1999	Income and Capital
Denmark	05.03.1996	21.08.1996	Income and Capital
Estonia	10.05.1996	24.12.1996	Income and Capital
Finland	14.10.1994	14.02.1998	Income and Capital
France	30.01.1997	01.11.1998	Income and Capital
Germany	03.07.1995	04.10.1996	Income and Capital
Greece	06.11.2000	26.09.2003	Income and Capital
Hungary	19.05.1995	24.06.1996	Income and Capital
Iceland	08.11.2006	09.10.2008	Income and Capital
Israel	26.11.2003	20.04.2006	Income and Capital
Italy	26.02.1997	25.02.2003	Income and Capital
Japan	18.01.1986	27.11.1998	Income
Korea	29.09.1999	19.03.2002	Income and Capital
Netherlands	24.10.1995	02.11.1996	Income and Capital
Norway	07.03.1996	18.09.1996	Income and Capital
Luxembourg	06.09.1997	Not ratified by Ukraine	Income and Capital
Poland	12.01.1993	11.03.1994	Income
Portugal	09.02.2001	11.03.2002	Income and Capital
Slovak Republic	23.01.1996	22.11.1996	Income and Capital
Slovenia	23.04.2003	25.04.2007	Income and Capital
Spain	01.03.1985	07.08.1986	Unspecified
Sweden	15.08.1995	04.06.1996	Income and Capital
Switzerland	30.10.2000	26.02.2002	Income and Capital
Turkey	27.11.1996	29.04.1998	Income and Capital
United Kingdom	10.02.1993	11.08.1993	Income and Capital
United States	04.03.1994	05.06.2000	Income and Capital
Non-OECD countries			
Algeria	14.12.2002	01.07.2004	Income and Capital
Armenia	14.05.1996	19.11.1996	Income and Capital
Azerbaijan	30.07.1999	03.07.2000	Income and Capital
Belarus	24.12.1993	30.01.1995	Income and Capital
Brazil	16.01.2002	26.04.2006	Income

Partner countries	Date of signature	Date of entry into force (date of ratification by Ukraine)	Type of arrangement
Bulgaria	20.11.1995	03.10.1997	Income and Capital
China	04.12.1995	18.10.1996	Income
Croatia	10.09.1996	01.06.1999	Income and Capital
Cuba	27.03.2003	20.11.2003 (ratified by Ukraine)	Income and Capital
Cyprus	29.10.1982	26.08.1983	Income and Capital
Egypt	29.03.1997	27.02.2002	Income and Capital
Georgia	14.02.1997	01.04.1999	Income and Capital
India	07.04.1999	31.10.2001	Income and Capital
Indonesia	11.04.1996	09.11.1998	Income
Iran	22.05.1996	21.07.2001	Income and Capital
Jordan	30.11.2005	23.10.2008	Income and Capital
Kazakhstan	09.07.1996	14.04.1997	Income
Kuwait	20.01.2003	22.02.2004	Income and Capital
Kyrgyzstan	16.10.1997	01.05.1999	Income and Capital
Latvia	21.11.1995	21.11.1996	Income and Capital
Lebanon	22.04.2002	06.09.2003	Income and Capital
Lithuania	23.09.1996	25.12.1997	Income and Capital
Libya	04.11.2008	31.01.2010	Income
Macedonia TFYR	02.03.1998	23.11.1998	Income and Capital
Malaysia	31.07.1987	04.07.1988	Income
Moldova	29.08.1995	27.05.1996	Income and Capital
Mongolia	01.07.2002	03.11.2006	Income and Capital
Morocco	13.07.2007	30.03.2009	Income; air and see
Pakistan	23.12.2008	18.11.2009 (ratified by Ukraine)	Income
Romania	29.03.1996	17.11.1996	Income and Capital
Russian Federation	08.02.1995	03.08.1999	Income and Capital
Serbia	22.03.2001	29.11.2001	Income and Capital
Singapore	26.01.2007	18.12.2009	Income
South Africa	28.08.2003	23.12.2004	Income
Syria	05.06.2003	04.05.2004	Income
Tajikistan	07.09.2002	01.06.2003	Income and Capital
Turkmenistan	29.01.1998	21.10.1999	Income and Capital
Thailand	10.03.2004	24.11.2004	Income and Capital
United Arab Emirates	22.01.2003	09.03.2004	Income and Capital
Uzbekistan	10.11.1994	25.07.1995	Income and Capital
Vietnam	08.04.1996	19.11.1996	Income and Capital

Source: Ukraine's authorities, Database of Ukrainian legislation (*http://zakon.rada.gov.ua*).

ANNEX D

Adherence of Ukraine to International Agreements and Conventions

International Agreements/Conventions	Date of signature by Ukraine
1948 Universal Declaration of Human Rights	
1995 Copenhagen Declaration for Social Development	
ILO Tripartite Declaration of Principles concerning MNE and Social Policy (1977 Tripartite Declaration)	
ILO Declaration of Fundamental Principles and Rights at Work (1998 Declaration)	
8 Core ILO Conventions	
Convention 29: Elimination of all Forms of Compulsory Labour	Ratified by Ukraine: 10.08.1956
Convention 87: Freedom of Association and Protection of the Right to Organise	Ratified by Ukraine: 14.09.1956
Convention 98: Right to organise and Collective Bargaining	Ratified by Ukraine: 14.09.1956
Convention 100: Equal Remuneration	Ratified by Ukraine: 10.08.1956
Convention 105: Elimination of Forced Labour	Ratified by Ukraine: 05.10.2009
Convention 111: Principle of non-discrimination with respect to Employment and Occupation)	Ratified by Ukraine: 04.08.1961
Convention 138: Minimum Age for Admission to Employment	Ratified by Ukraine: 03.05.1979
Convention 182: Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour	Ratified by Ukraine: 14.12.2000
ILO Recommendation 94 of 1952 (Consultation and Co-operation between Employers and Workers at level of Undertaking)	
1992 Rio Declaration on Environment and Development	
Agenda 21	
Convention on access to information, public participation in decision-making and access to justice in environmental matters (Aarhus)	Signed by Ukraine: 25.06.1998
ISO Standards on Environmental Management System	
1999 UN Revised Guidelines for Consumer Protection	

UN Global Compact	
UN Convention against Corruption (2003)	Signed by Ukraine: 11.12.2003
UN Convention against Transnational Organised Crime (2000)	Signed by Ukraine: 12.12.2000
UN Millennium Development Goals	
1972 Declaration of UN Conference on Human Environment, Stockholm	
2002 Johannesburg Declaration on Sustainable Development	
1992 UN Convention on Biological Diversity	Signed by Ukraine: 11.06.1992
UN Framework Convention on Climate Change (1992)	Signed by Ukraine: 11.06.1992
Kyoto Protocol to the UN Framework Convention on Climate Change (1997)	Signed by Ukraine: 15.03.1999
Convention on the Settlement of Investment Dispute between States and Nationals of other States (ICSID) (1965)	Signed by Ukraine: 03.04.1998

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