



MINISTRY FOR FOREIGN  
AFFAIRS OF FINLAND



Blue Ribbon Analytical and Advisory Centre

The Project is funded by EU, co-funded and implemented by UNDP

AID FOR TRADE NEEDS ASSESSMENT

Ukraine

# TRADE AND HUMAN DEVELOPMENT



Kyiv 2011



All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission.

This is an independent publication commissioned by UNDP with the assistance of the European Union. The views expressed in this publication are those of the author(s) and do not necessarily represent those of the United Nations, including UNDP, the European Union or their Member States.

ISBN 978-966-2316-35-3

© UNDP 2011

All rights reserved.

UNDP Regional Bureau for Europe and the Commonwealth of Independent States

Manufactured in Ukraine

**AID FOR TRADE NEEDS ASSESSMENT**

**Ukraine**

**TRADE AND  
HUMAN  
DEVELOPMENT**

**Kyiv 2011**

The **Aid for Trade project** is one of the most important development-related outcomes of the 2005 World Trade Organization (WTO) Ministerial Conference in Hong Kong. It targets developing countries by strengthening their productive capacities and trade-related infrastructures as well as their ability to compete in regional and global markets. Trade plays an important role in development, although the relationship between trade and human development is not automatic.

In order for trade to be inclusive, it must be incorporated into a human development framework. It needs to be conceived as a tool to enhance people's abilities and widen their choices. The Aid for Trade initiative covers the following categories:

- trade policies and regulations;
- trade development;
- developing productive capacities;
- trade related adjustment; and
- other trade-related needs.

UNDP's regional **Aid for Trade project** *Wider Europe: Aid for Trade for Central Asia, South Caucasus and Western Commonwealth of Independent States (CIS)*, financed within the framework of Finland's Wider Europe Initiative, focuses on identifying capacity gaps and technical assistance needs both at the national and sub-regional level in Central Asia, South Caucasus and Western CIS. It also provides support to economic development in the areas located along the selected transport corridors, helping small entrepreneurs capitalize on new trade opportunities.

The **Wider Europe Initiative**, Finland's harmonized regional development framework, targets the following themes: security, trade and development, information society development, energy and the environment, and social sustainability. The framework includes three regional cooperation programmes — in Eastern Europe (Belarus, Moldova and Ukraine), the South Caucasus (Armenia, Azerbaijan and Georgia) and Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan).

The **Needs Assessments** produced in the framework of the Aid for Trade project are part of a long-term vision of developing trade capacities, which will benefit human development in the region.

# ACKNOWLEDGEMENTS

**Authors**

Igor Burakovsky  
Veronika Movchan

**Advisory Group**

Jacek Cukrowski  
Marcin Swiecicki

**Coordination**

Katerina Rybalchenko  
Iryna Kobouta

**Editor**

Julian Exeter

This research has also benefited from the valuable inputs by Oleksandra Betliy, Yana Dvorak, Oleksandr Kaliberda, Sergiy Kandul, Alla Kobylanska, Vitaliy Kravchuk, Oksana Kuzyakiv, Hanna Kuznetsova, Kateryna Kutsenko, Oleg Nivjevskyi, Dmytro Naumenko, Kateryna Pilkevych, Yevgen Razdorozhnyi, Nataliya Sysenko, Hanna Chukhay, Kateryna Shynkaruk.

The team of researchers was supported by the Blue Ribbon Analytical and Advisory Centre (BRAAC), a project funded by EU, co-funded and implemented by UNDP in Ukraine. In particular, Iryna Kobouta, BRAAC Team Leader, coordinated the team of researchers and liaised with the national counterparts, Vitaliy Zhygadlo, BRAAC Analyst, provided necessary data and information and Andriy Zayika, BRAAC Communication Officer, managed outreach and communications activities related to this research.

We appreciate the financial support of the Ministry for Foreign Affairs of Finland and the European Union, which made this research available.

# TABLE OF CONTENTS

<b>LIST OF ABBREVIATIONS</b>	<b>9</b>
<b>INTRODUCTION</b>	<b>10</b>
<b>SECTION 1. SOCIOECONOMIC SITUATION IN UKRAINE</b>	<b>11</b>
1.1. MACROECONOMIC SITUATION	12
1.1.1. General trends of economic development	12
1.1.2. Monetary policy and exchange rate policy	15
1.1.3. Fiscal policy and the budget situation	18
1.2. BUSINESS CLIMATE IN UKRAINE	23
1.2.1. Administrative barriers for the development of enterprise	23
1.2.2. Financial system as an enterprise development factor	27
1.2.3. The country's competitiveness	29
1.3. THE LEVEL OF HUMAN DEVELOPMENT IN UKRAINE	32
1.3.1. Poverty and inequality	32
1.3.2. Other aspects of human development in Ukraine	35
<b>SECTION 2. TRADE AND INVESTMENT POLICIES</b>	<b>39</b>
2.1. DYNAMICS OF TRADE IN GOODS AND SERVICES	40
2.1.1. General patterns	40
2.1.2. Export concentration and specialisation	42
2.2. UKRAINE'S TRADE POLICY	45
2.2.1. Overview	45
2.2.2. Key commitments of Ukraine as a WTO member	46
2.2.3. Ukraine's regional trade agreements	49
2.3. INSTITUTIONAL MAP	54
<b>SECTION 3. TRADE FACILITATION</b>	<b>61</b>
3.1. INTERNAL TRADE RESTRICTIONS	62
3.1.1. Customs and other procedures related to trade	62
3.1.2. Transport and logistics services	65
3.1.3. The system of technical regulation	69
3.2. EXPORT PROMOTION POLICY	72
3.3. ENTREPRENEURS' ASSESSMENTS OF TRADE RESTRICTIONS	74
<b>SECTION 4. ANALYSIS OF HUMAN DEVELOPMENT IN SENSITIVE ECONOMIC SECTORS</b>	<b>77</b>
4.1. IMPORTANCE OF TRADE FOR HUMAN DEVELOPMENT	78
4.2. AGRICULTURE AND FOOD INDUSTRY	79
4.2.1. The role of agriculture and the food industry in Ukraine's economy	79
4.2.2. Specificity and problems of Ukraine's agriculture and food industry	82
4.2.3. Prospects and barriers for increasing exports	84
4.2.4. Impact of international trade agreements on human development	85

4.3. MACHINE-BUILDING	86
4.3.1. Review of the Ukrainian machine-building sector	86
4.3.2. Specific issues and problems of Ukraine’s machine-building sector	90
4.3.3. Prospects and barriers for exports expansion	91
4.3.4. Impact of international trade agreements on human development	92
4.4. MANUFACTURE OF METALS AND METAL PRODUCTS	93
4.4.1. Overview of the sector of metallurgical production and the manufacture of finished metal products in Ukraine	93
4.4.2. Specific issues of the sector of metallurgical production and manufacture of fabricated metal products	96
4.4.3. Prospects and barriers for increase of exports	98
4.4.4. Impact of international trade agreements on human development	99
<b>SECTION 5. CONCLUSIONS AND RECOMMENDATIONS</b>	<b>101</b>
5.1. CONCLUSIONS	102
5.2. ACTION MATRIX: SOURCE CONSIDERATIONS FOR DESIGN	103
5.3. DATABASE OF DONORS ENGAGED IN AID FOR TRADE	110
<b>REFERENCES</b>	<b>116</b>
<b>ANNEXES</b>	<b>119</b>
<b>ANNEX 1. Methodology of the quarterly survey of Enterprises</b>	<b>120</b>
<b>ANNEX 2. Some development indicators for agriculture and the food industry</b>	<b>121</b>
<b>ANNEX 3. List of concessions on taxes and dues (compulsory payments)</b>	<b>123</b>

## List of tables

Table 1.1. Transfers from the State Budget to the Pension Fund, 2005-2010	18
Table 1.2. Planned state borrowing in the State Budget for 2010	21
Table 1.3. Ceiling on the cash deficit of the general government	22
Table 1.4. Obstacles to the growth of production, 2005-2010	25
Table 1.5. Global Competitiveness Index for Ukraine	29
Table 1.6. Global Competitiveness Index for Ukrainian oblasts in 2010	31
Table 1.7. Poverty indicators, 2005-2009	33
Table 1.8. Inequality indicators estimated in terms of overall income, 2007-2009	35
Table 1.9. Ukraine’s human development ranking, 2010	35
Table 1.10. Trends in Ukraine’s Human Development Index	36
Table 2.1. Ukraine’s foreign trade, 2000-2009	41
Table 2.2. Structure of foreign trade in goods, 1996-2009	41
Table 2.3. Ukraine’s export concentration indicators, 1996-2009	42
Table 2.4. Export concentration indicators for Ukraine and selected countries, 1996-2009	43
Table 2.5. Structure of commodity exports for Ukraine and selected countries, by stage of processing, 2009	44

Table 2.6. Ukrainian-made goods having competitive advantages in the world market, 2005-2009	45
Table 2.7. MFN structure of import duty rates for agricultural goods in Ukraine after the WTO accession	46
Table 2.8. MFN structure of import duty rates for manufactured goods in Ukraine after accession to the WTO	47
Table 2.9. Changes in export duty rates according to Ukraine's commitments to the WTO	48
Table 2.10. Ukraine's regional trade agreements	49
Table 2.11. Rates of import duty for some products in Ukraine and in the Customs Union of Russia, Belarus and Kazakhstan	52
Table 3.1. Share of revenue from Customs procedures in total tax receipts in Ukraine, 2005-2010	62
Table 3.2. Logistics Performance Index (LPI) for selected countries, 2010	69
Table 3.3. List of investigations carried out against Ukrainian-made products as of October 2010	73
Table 3.4. Cost of undergoing procedures related to foreign trade: estimates by entrepreneurs in 2010	76
Table 4.1. Net exports of main agricultural product categories, 2000-2010	81
Table 4.2. Yields of main cereal crops in Ukraine and in the World, 2007-2011	81
Table 4.3. Annual indicators of CFP growth in Ukraine and other countries and regions of the World, 1993 - 2007	82
Table 4.4. Investments in Ukraine's agriculture, 2004-2009	82
Table 4.5. SWOT analysis of agriculture and the food industry	86
Table 4.6. Key indicators of Ukraine's machine-building sector, 2005-2008	87
Table 4.7. Growth rates of production and labour productivity in machine-building, 2001-2009	87
Table 4.8. Employment and investment in machine-building, 2005-2009	88
Table 4.9. Structure of sales in Ukraine's machine-building sector	88
Table 4.10. Structure of foreign trade in machine-building products, 2009 (%)	89
Table 4.11. SWOT analysis of the machine-building sector	92
Table 4.12. Key indicators of metallurgical production and the manufacture of finished metal products in Ukraine, 2005-2008	93
Table 4.13. Growth rates of production and labour productivity in the manufacture of metals and metal products, 2001-2009	94
Table 4.14. Employment and investment in metallurgical production and in the manufacture of fabricated metal products, 2005-2009	95
Table 4.15. Structure of sales of metals and fabricated metal products	95
Table 4.16. Ukraine's main partners in trade in metals and metal products, 2009	97
Table 4.17. SWOT analysis of the sector of metallurgical production and manufacture of finished metal products	99
Table A1-1. Sample structure by staff count	120
Table A1-2. Regional sample structure	120
Table A2-1. Performance indicators of Ukraine's agriculture and food industry	121



Table A2-2. Output of main agricultural crops in Ukraine, 1990-2009	122
---	-----

## List of figures

Figure 1.1. Growth of real GDP, 2000-2010	12
Figure 1.2. Growth of real final households' consumption and of real gross fixed capital formation, 2005-2010	13
Figure 1.3. Quarterly growth of GDP, 2005-2010	14
Figure 1.4. Growth of real exports and imports of goods and services, 2005-2010	14
Figure 1.5. Trends in real households' disposable income and unemployment, 2005-2010	15
Figure 1.6. Official exchange rate of the hryvnia, 2002-2010	16
Figure 1.7. Capital expenditures of the consolidated budget, 2005-2009	19
Figure 1.8. VAT refund arrears, 2005-2009	20
Figure 1.9. Ukraine's state debt, 2005-2010	20
Figure 1.10. Assessment of the business climate by entrepreneurs, 1998-2010	24
Figure 1.11. Share of enterprises reporting the 'unfavourable regulatory climate' as an obstacle to the growth of production, 2001-2010.	25
Figure 1.12. Hours per year spent on average by an average medium-size company to comply with tax laws, 2008	26
Figure 1.13. Credits into the country's economy, 2002-2010	27
Figure 1.14. Interest rates on credits for non-financial corporations, 2006-2010	28
Figure 1.15. Global Competitiveness Index in 2010/2011	30
Figure 1.16. Poverty levels in Ukraine, 2005-2009	32
Figure 1.17. Minimum wage and minimum pension, 2000-2010	34
Figure 1.18. Distribution of staff members by wage size, 2005-2009	34
Figure 2.1. Foreign trade in goods and services, 1996-2009	40
Figure 2.2. Geographical structure of Ukraine's trade turnover, 1996-2000	41
Figure 2.3. The range of exports in Ukraine and selected other countries, 2009	43
Figure 2.4. The share of hi-tech goods in total exports, 2009	44
Figure 2.5. Institutional framework for the implementation of Ukraine's foreign trade policy	55
Figure 3.1. Main shortcomings in the work of the customs bodies	64
Figure 3.2. Corruption in customs procedures	64
Figure 3.3. Freight traffic via Ukraine's borders, 2000-2009	66
Figure 3.4. Structure of foreign economic freight traffic via Ukraine's borders by main modes of transport, 2009	66
Figure 3.5. Trade in transport services, 1999-2009	67
Figure 3.6. The number of technical regulations adopted in Ukraine as of October 2010	70
Figure 3.7. Trade restrictions causing substantial problems for importers: estimates by entrepreneurs in 2004 and 2010	75

Figure 3.8. Trade restrictions causing substantial problems for exporters: estimates by entrepreneurs in 2004 and 2010	75
Figure 3.9. Time required for certain procedures related to foreign economic activities: estimates by entrepreneurs in 2004 and 2010	76
Figure 4.1. Household share in output of some agricultural products	80
Figure 4.2. Foreign trade in machine-building products, geographical structure, 2000-2009	89
Figure 4.3. Capital investment in the sector of metallurgical production and in the manufacture of finished metal products, 2001-2009	95
Figure 4.4. Foreign trade in metals and finished metal products, 2000-2009	96
Figure 4.5. Structure of Ukraine's foreign trade in metals and metal products	97
Figure A1-1. Sectoral sample structure	120

## LIST OF ABBREVIATIONS

AfT	Aid for Trade
BRIC	Brazil, Russia, India, and China
CCI	Chamber of Commerce and Industries of Ukraine
CEA	Central executive authorities
CIS	Commonwealth of Independent States
CMU	Cabinet of Ministers of Ukraine
DGLB	Domestic government loan bonds
EBRD	European Bank for Reconstruction and Development
EFTA	European Free Trade Association
EU	European Union
EurAsEC	Eurasian Economic Community
FDI	foreign direct investments
FTA	Free Trade Area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GNP	Gross National Product
HDI	Human Development Index
IBRD	International Bank for Reconstruction and Development
IER	Institute for Economic Research and Policy Consulting
IISW	integrated iron-and-steel works
IMF	International Monetary Fund
IPO	Initial public offering
ITC	International transport corridor
LHS	Left-hand scale of the figure
LPI	Logistics Performance Index
MES	Ministry of Education and Science of Ukraine
MEU	Ministry of Economy of Ukraine
MFN	most favoured nation
MFA	Ministry of Foreign Affairs of Ukraine
MIA	Ministry of Internal Affairs of Ukraine
MMC	Mining and metallurgical complex
MoH	Ministry of Health of Ukraine
MPE	Mining and processing enterprise
MTCU	Ministry of Transport and Communications of Ukraine
NAER	National Agency of Ukraine on Ensuring Efficient Use of Energy Resources
NBU	National Bank of Ukraine
NCRC	National Commission for Regulation of Communications of Ukraine
OECD	Organization for Economic Co-operation and Development
PCA	Partnership and Cooperation Agreement
PPP	Purchasing power parity
R&D	Research and development
RF	Russian Federation
RHS	Right-hand scale of the figure
RTA	Regional trade agreement
SDR	Special Drawing Rights
SES	Single Economic Space
SITC	Standard International Trade Classification
SSU	Security Service of Ukraine
STA	State Tax Administration of Ukraine
TFP	total factor productivity
UAE	United Arab Emirates
UCAB	Ukrainian Agribusiness Club
UK	United Kingdom
UN	United Nations
USA	United States of America
USCRF	Ukrainian State Centre of Radiofrequencies
USSR	Union of Soviet Socialist Republics
UTS	Unified Tariff Schedule
UZ	Ukrzaliznytsia (Ukrainian Railways)
VAT	Value-added tax
WTO	World Trade Organisation
yoy	Year-on-year

## INTRODUCTION

There is considerable evidence of a positive mutual relationship between the openness of international trade and economic growth that in turn is necessary to secure a continuous reduction in poverty and the promotion of human development.<sup>1</sup> However, reduced trade barriers and improved access to markets are often insufficient to let countries – especially emerging or developing ones – make use of all the potential advantages of trade liberalisation. An important prerequisite consists of the availability of relevant institutions and capacities in these countries that would maximize the advantages of the new business opportunities provided by better access to other countries' markets, new technologies and resources.

The WTO Ministerial Conference in 2005 in Hong Kong adopted the Aid for Trade (AfT) initiative, which is intended to improve a country's ability to use the advantages provided by more liberal international trade, including the development of the necessary infrastructure.

According to the recommendations of the WTO Task Force, which was established following the Ministerial Conference in Hong Kong, Aid for Trade should cover six major areas:<sup>2</sup>

- 1) improving trade policy and regulations, including the training of trade officials and support to governments to facilitate the implementation of trade agreements and compliance with rules and standards;
- 2) promoting trade development, including business support services, promotion of financial and investment activities, market analysis and the introduction of e-commerce systems;
- 3) improving trade-related infrastructure, including the building roads and ports;
- 4) building productive capacity, including increasing a country's ability to produce goods and provide services in various economic sectors;
- 5) assisting in necessary trade-related adjustment, including through the provision of financial aid to compensate for adaptation costs related to trade policy reform. This would arise, for example, in cases where it was necessary to address problems arising in the balance of payments due to a loss of tariff income or because of a loss in a country's preferential access to market;
- 6) other trade-related needs not mentioned above.

The Task Force did not provide any suggestion on the exact amounts of necessary funding; the possible sources of such funding or on the priority areas for

attention. Instead, the needs and priorities related to Aid for Trade should be determined by each country independently. However, where such needs and priorities have yet to be clearly defined, the first stage should include an assessment of national needs based on the trade regulations existing in the country and on their impact on human development and poverty reduction.

The continuous monitoring of country progress in Aid for Trade is carried out by both the OECD and the WTO with the results presented in their respective annual reports.<sup>3</sup> In addition, the OECD has prepared a brief review of Aid for Trade implementation priorities for each partner country. In the particular case of Ukraine, according to the OECD estimates, trade issues are completely integrated in the national development plan, but the country is substantially behind the European average in terms of such indicators as trade facilitation, export diversification and trade-related infrastructure.<sup>4</sup> This monitoring is extremely important to understand Ukraine's position among other countries of the world in Aid for Trade matters but, according to a chosen monitoring format, information for each country is quite limited.

This Report contains a thorough analysis of the current situation and identifies national needs and priorities in Aid for Trade for Ukraine. The study is part of systemic examination of these issues in the East European and Central Asian countries. An important task for each country is to prepare a matrix of actions that should become a foundation for the national action plan to address the country-specific issues in trade stimulation and thus in promoting human development.

The Report is structured as follows. Ukraine's current economic situation including macroeconomic trends, monetary and fiscal policies, business climate and the level of human development are reviewed in Section 1. An analysis of Ukraine's policy on trade and investments and the country's institutional map in trade policy are presented in Section 2. The Section 3 contains an analysis of internal trade restrictions based both on regulatory, legal and statistical information and on results of a survey of entrepreneurs. The issue of the trade impact on human development in selected economic sectors is considered in Section 4. Conclusions and recommendations, particularly a matrix of actions, are provided in Section 5.

The Report is based on statistical information, legal acts and information about public authorities' functions in the sphere of international trade available as of October 2010.

<sup>1</sup> Lammersen, Hallaert & Roberts (2010)

<sup>2</sup> UNDP (2009)

<sup>3</sup> OECD/WTO (2009)

<sup>4</sup> OECD (2009)

# SECTION 1

## SOCIOECONOMIC SITUATION IN UKRAINE

## SECTION 1. SOCIOECONOMIC SITUATION IN UKRAINE

### 1.1 MACROECONOMIC SITUATION

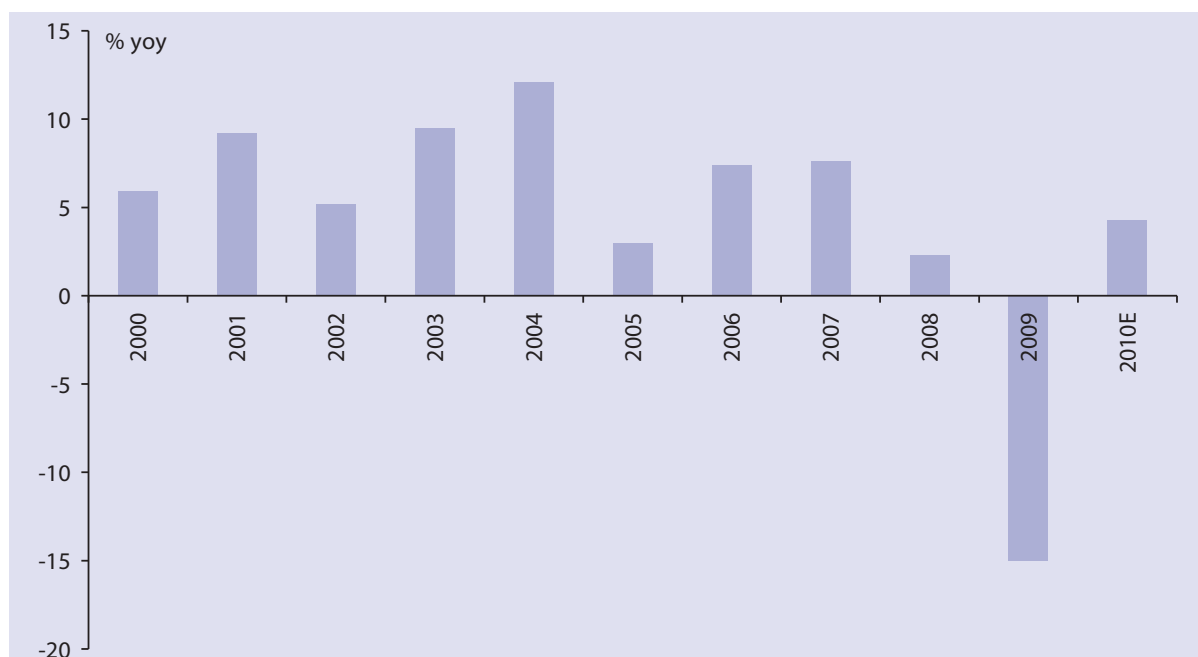
#### 1.1.1 General trends of economic development

Ukraine's economy is heavily influenced by trends in global goods and capital markets. During the 1990s Ukraine experienced a decade of decline in real GDP caused by the problems in the transforming economy. However, in 2000 an increase in real GDP was recorded in Ukraine for the first time since independence and was primarily related to strong growth in exports.<sup>5</sup> The growth partly reflected the favourable external environment in global markets for steel and chemical products that were and remain Ukraine's basic export commodities. The revitalisation of exports and, within a few years, improvements in the access to external financing, bolstered domestic consumption and investment, which provided additional stimuli to economic growth.

However, the revival of economic activity in Ukraine was connected not only with external drivers, but also with important changes that occurred in the country. Economic growth reflected improved macroeconomic stabilisation, including stronger fiscal discipline, as well as a series of economic reforms, particularly in the fields of energy, regulatory reform, public administration reform as well as land reform.<sup>6</sup>

The average annual rate of real GDP growth amounted to 6.9% between 2000 and 2008. However, against the background of the economic upturn and an easing of social problems, the structural and institutional reforms necessary to secure sustainable long-term economic development were retarded. As a result, when the external market environment deteriorated during the second half of 2008, the economy's reaction to the negative outside shock was sharp. Ukraine's real GDP dropped by 15.1% in 2009.

This was not the first time that Ukraine had experienced an abrupt deceleration in its economic development owing to negative external shocks. For example, Ukraine's GDP growth rate slowed to 3.0% in 2005 after growing by over 12% in the previous year. The decline mainly reflected the sharp decrease in exports caused by a crisis in the world steel market where Ukraine is one of the leading players. However, the situation in global commodity markets stabilised in 2006, which allowed Ukraine to strengthen its exports, contributing to an average real GDP growth of 7.5% in 2006 and 2007 (Figure 1.1). The increase in GDP was also due to the growth of domestic private consumption, the result of both higher real disposable income and a strong expansion of bank lending. Banks, in their turn, raised considerable



**Figure 1.1. Growth of real GDP, 2000-2010**

Source: State Statistics Committee of Ukraine

Note: E – IER estimate

<sup>5</sup> Movchan (2002)

<sup>6</sup> Åslund (2002)

amounts of funds in external markets, mainly in the form of syndicated loans.

A considerable increase also took place in real gross fixed capital formation in 2006-2007 (Figure 1.2) that was financed both from the proprietary funds of companies and increasingly by borrowing, including bank loans. Funds mobilised abroad, particularly due

possibility of obtaining new loans and refinancing old ones. As a result, companies had to reduce their funding of existing investment projects and postpone the implementation of new ones. In the fourth quarter of 2008, real gross fixed capital formation had dropped by 23.1% (yoy), while the decline in real GDP amounted to 7.8% (yoy) (Figure 1.3).

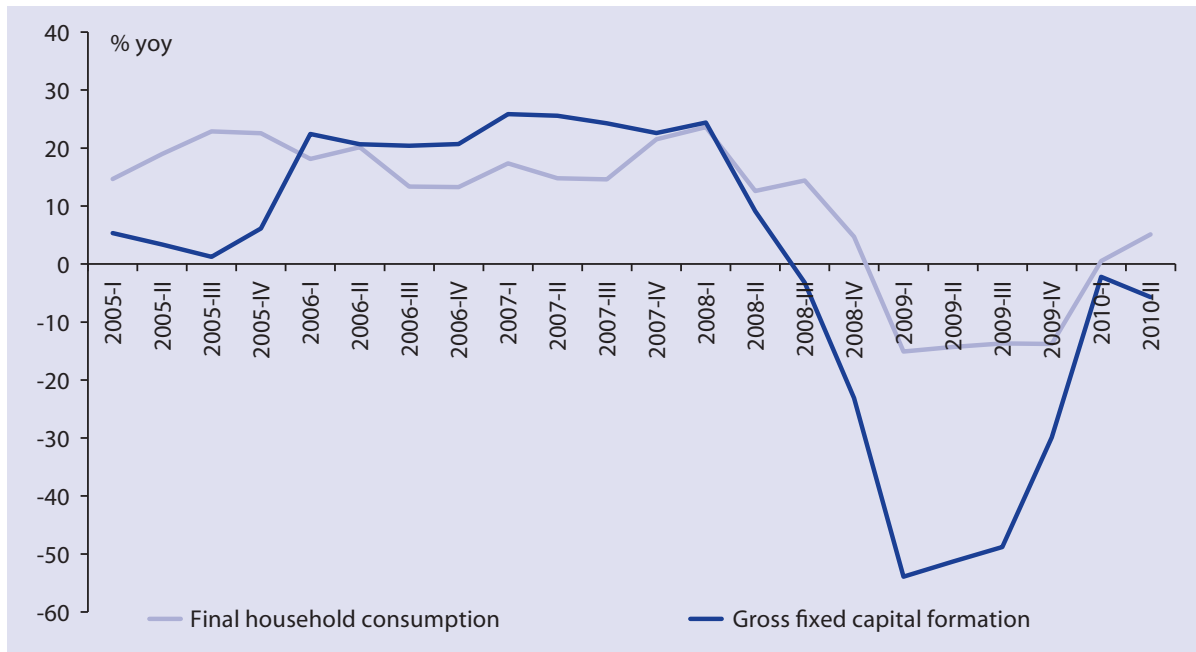


Figure 1.2. Growth of real final households' consumption and of real gross fixed capital formation, 2005-2010

Source: State Statistics Committee of Ukraine

to IPOs, were also becoming a more important source of funding for corporate investments. As a result, the external debts of the banking and corporate sectors grew swiftly.

The global financial and economic crises, which caused radical changes to the world economy, also had serious implications for Ukraine. The financial crisis that began in the autumn 2007 and reached its peak in September 2008 seriously affected foreign capital flows so that Ukrainian entities found it almost impossible to access external financial resources. In addition, the commencement of the global recession resulted in a sharp decline in the demand for Ukraine's major exports, namely metals and chemical products.<sup>7</sup> As a result, in the fourth quarter of 2008, Ukraine experienced a decline in export receipts and a 'drying-up' of capital flows. At the same time, the country needed to make repayments on external loans in late 2008 and in 2009. These pressures gave rise to swift hryvnia devaluation during the fourth quarter of 2008.

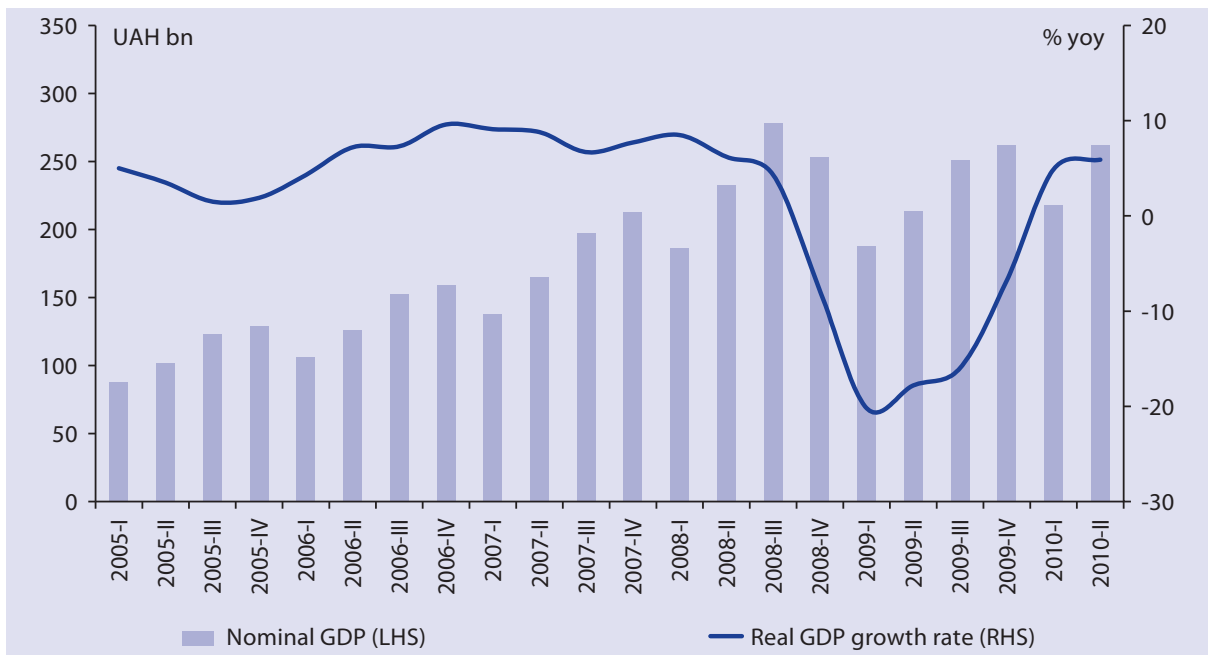
At the same time, problems arose in the banking system due to an outflow of deposits and because of the impact of the hryvnia devaluation on foreign-currency denominated loans so that the share of troubled loans increased and banks' losses rose. The financial conditions of many enterprises also deteriorated owing to lower demand and due to the limited

The economic crisis in Ukraine deepened in the first quarter of 2009 when real GDP fell by 20.2% (yoy). Demand and prices in global commodity markets, particularly in the steel and chemical fertiliser markets, were much lower compared with the corresponding period of 2008 due to the fall in demand and industrial output in developed countries. Stagnation in those markets resulted in a sharp decline in output from Ukraine's export-oriented companies and led to a drop in goods and service exports (Figure 1.4).

Companies experienced a sharp reduction in their profits, which, together with the actual termination of borrowing, resulted in a drop in real fixed capital formation of almost 54% (yoy) during the first three months of 2009. Companies also began to cut labour costs by lowering employment and reducing labour remuneration rates, resulting in a decrease in people's real disposable income. The latter, after allowing for net payments on bank loans, resulted in a fall in real household's final consumption. As both investment and consumption fell, real goods and service imports shrank by 38.1% in the first quarter of 2009 (Figure 1.4).

During the second quarter of 2009, the economic situation stabilised, and a gradual recovery of economic activity commenced, though on a much lower level than before the crisis. By the fourth

<sup>7</sup> Burakovsky et al. (2009), IER (2009)



**Figure 1.3. Quarterly growth of GDP, 2005-2010**

Source: State Statistics Committee of Ukraine



**Figure 1.4. Growth of real exports and imports of goods and services, 2005-2010.**

Source: State Statistics Committee of Ukraine

Note: This figure contains estimates of the changes in the physical volumes of goods and service exports and imports based on the methodological principles of the System of National Accounts (SNA) and international standards by the State Statistics Committee of Ukraine.

quarter of 2009, the decline in real GDP had slowed to 6.8% (yoy) against a low statistical base. The main drivers of the revival in economic activity consisted of a moderate demand recovery in global commodity markets, particular in Asia where national governments took measures aimed at supporting industry and infrastructure. This allowed Ukrainian steel exporters to increase output. However, domestic demand remained low throughout the year.

The economic situation continued to improve in 2010. In particular, real GDP grew by 4.9% (yoy) and

5.9% (yoy) during the first and the second quarters, respectively. The growth of economic activity in the first quarter mainly reflected external factors, especially the restoration of external demand for Ukrainian-made goods. In the second quarter, the growth of external demand was supplemented by a gradual recovery of domestic final demand. Real private final consumption increased by 5.1% (yoy) between April and June 2010 owing to a rise in social standards including minimum pension and minimum wage, an improved labour market



situation and a lower debt burden. All these factors resulted in an increase in real households' disposable income (Figure 1.5). However, investment continued to decline in the first half of the year.

within these limits, the NBU bought and sold foreign currency to balance demand and supply. However, during this period, the supply of foreign currency generally exceeded demand, especially after a wide



**Figure 1.5. Trends in real households' disposable income and unemployment, 2005-2010**

Source: State Statistics Committee of Ukraine

Note: E – IER estimate

Given structural factors, further recovery of Ukraine's economy will depend primarily on developments in the world economy. Economic growth in Ukraine's major trading partners will ensure a recovery of demand for export products, particularly for steel, chemical fertilisers and machine-building products. To renew investment activity, it will be important to restore access to external financial markets for both the financial and the real sectors.

At the same time, the rapid and deep downturn of Ukraine's economy in 2009 highlighted the numerous internal problems that need to be resolved to secure stable long-term economic growth. They include, inter alia, incomplete institutional reforms, the low level of modernisation of many enterprises, outdated infrastructure, fiscal disequilibrium and an unattractive investment climate. We would emphasise the importance of developing and implementing a policy to stimulate exports, which remain a key driver of economic development.

### 1.1.2 Monetary policy and exchange rate policy

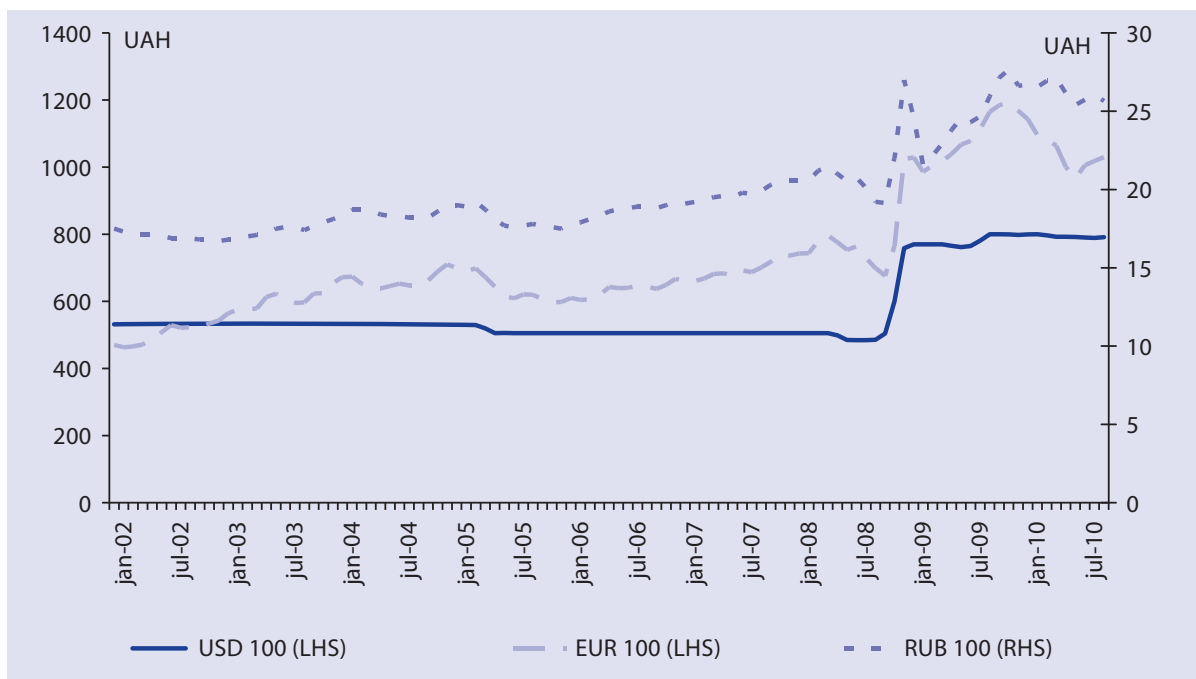
#### Exchange rate policy

During the recent decade, the National Bank of Ukraine (NBU) generally pursued a policy of pegging the hryvnia to the US dollar so that monetary policy was subordinate to exchange rate policy. The hryvnia's exchange rate to the US dollar on the interbank market remained within the range of 5.00-5.10 UAH/USD between April 2005 and March 2008, with rare exceptions. To maintain the exchange rate

range of Ukrainian borrowers entered global financial markets.

As far back as in the *Basics of Monetary Policy for 2004*, the NBU declared there would be a gradual transition from a fixed exchange rate regime to inflation targeting. This declaration was reiterated in later documents, but practical steps in that direction were quite limited. It was not until March 2008 that the NBU widened the exchange rate fluctuation range on the interbank market, which resulted in a gradual strengthening of the hryvnia against the US dollar. However, fluctuations in the exchange rate remained limited, and the NBU continued to buy foreign currency.

Although the NBU had planned to make the rate for the hryvnia more flexible in the future, the impact of the global crisis in September-October 2008 forced it to give up its gradual approach. Panic in the markets resulted in a sharp rise in the demand for foreign currency on the part of individuals and companies. The former were buying up foreign currency in cash while companies were withdrawing their funds to accounts in foreign banks and were in no hurry to convert export receipts in hryvnia. Under such conditions, the NBU was not able to balance demand and supply in the currency markets without spending a significant portion of its reserves even after the introduction of restrictions on capital outflows from Ukraine. As a result, the hryvnia depreciated against the US dollar from 4.6 UAH/USD in August 2008 to almost 8 UAH/USD by December 2008, although the



**Figure 1.6. Official exchange rate of the hryvnia, 2002-2010**

Source: NBU

NBU spent USD 10.9 billion between October and December to support the hryvnia.

In the framework of negotiations with the IMF to obtain the second tranche of a stand-by loan in May 2009, the NBU undertook to cancel most of the remaining capital restrictions introduced during the crisis and to limit its currency market interventions to certain amounts. This could have resulted in greater exchange rate fluctuations, but a decline in speculative demand for foreign currency and a decrease in capital outflows allowed the NBU to pursue a policy aimed at gradually reducing the hryvnia's fluctuations while at the same time meeting its commitments to the IMF. After a temporary weakening of the hryvnia in August 2009, the supply of foreign currency became equal to demand and even exceeded it in later months. Since March 2010, the amounts of foreign currency bought by the NBU began to exceed its sales, but a rise in demand in the cash market in September and October 2010 forced the NBU to revert to foreign currency purchases. In recent months, the NBU has actually reverted to a tightly controlled policy with respect to the exchange rate. From late March to October 2010, the fluctuations range was only between 7.88-7.95 UAH/USD.

#### Capital movement restrictions

For historical reasons, the NBU enjoys wide-ranging powers to control capital movements. Prior to the crisis of 2008, capital movements both within and from Ukraine were relatively free although reporting requirements for currency transactions were significant and some types of transaction were prohibited. The main practical restrictions consisted

of the requirements under the Law of Ukraine on the Procedure of Settlements in Foreign Currency. Export proceeds had to be paid into accounts with Ukrainian banks within 180 days, whereas advance payments for imports earlier than 180 days were prohibited.<sup>8</sup> In addition, the NBU set maximum interest rates for residents' foreign borrowings that remained unchanged until the crisis. They amounted to between 9.8% and 11% per annum depending on the length of the borrowing period for fixed-rate loans, and the 3-month LIBOR+7.5% per annum for floating-rate loans. Such restrictions were set at a level higher than the market rate for most large borrowers in Ukraine, and they had limited impact on capital movements.

In June 2007, the NBU decided to restrict short-term capital inflows to Ukraine and obliged banks to keep 20% of the short-term funds raised (up to 183 days) on a special account with the NBU. In November 2007, the NBU extended the reserve requirements to the funds raised from non-residents. However, those measures were too late and had a minor impact upon capital inflows to Ukraine.

As the crisis began, the NBU introduced temporary restrictions on capital outflows, which remained in force in October and November 2008. Some were cancelled in December, although a number were maintained and subsequently cancelled between April and June 2009. Such restrictions included a ban on imports of goods and services without bringing them into Ukraine, a limit on the transfer of funds abroad by natural persons (maximum UAH 75,000 per month), a five-day delay of fund transfers from accounts of non-residents in Ukrainian banks, and a

<sup>8</sup> During the crisis, stricter limitations were introduced. These reduced the period for the return of export proceeds and for the prepayment for imports to no more than 90 days. The limitations remained in force until February 2010.

ban on the early repayment by banks of their external liabilities. Some restrictions remain in force to date. For example, Ukrainian residents are still required to use foreign currency purchased for declared purposes within five working days of the purchase date. Banks have the right to buy foreign currency for their own needs only if they have liabilities requiring payment.

On the other hand, the restrictions on capital inflows were reduced. The reserve requirement for short-term capital was suspended in September-October 2008, while interest rates for external borrowings longer than a year were unlimited. For borrowings shorter than a year, the maximum rate was increased to 11% per annum from the earlier limit of 9.8%. However, these measures were also temporary. In September 2009, the maximum interest rates for external loans were reset at their pre-crisis level, and the reserve requirements for short-term capital were restored in September 2010.

### Monetary policy

Before the crisis began in September-October 2008, the behaviour of the monetary aggregates was mainly determined by the amount of the NBU's interventions in the currency market as well as by the increase in the money multiplier due to a credit boom in the economy. As a result of the large volume of capital inflows to Ukraine, the NBU's interventions in the currency market prior to the crisis resulted in foreign currency purchases and injections of hryvnia into the economy. For example, the NBU bought UAH 48 billion worth of foreign currency in 2007 whereas the monetary base grew by UAH 45 billion. Banks also increased their lending to companies and natural persons, which resulted in yet faster growth of the money supply.

The traditional tools of monetary policy, such as changes of reserve ratios and adjustments of refinancing interest rates and deposit rates, played a relatively minor role. The role of the policy interest rates set by the NBU was also insignificant due to the quantitative restrictions on the refinancing amounts that could be obtained by individual banks. In 2006, the NBU revised its regulations on liquidity and introduced some new monetary instruments. In particular, it broadened the set of repo transactions, added swaps, and replaced bank deposits with the NBU with deposit certificates, which were transferrable between banks. The new instruments, however, were rarely used. The NBU's transactions with government bonds were also limited because the amount of the bonds in circulation was small.

The NBU attempted to use the reserve requirements for banks to encourage the mobilisation of funds in national currency. Whereas the reservation rates for deposits in foreign and national currency were the same in 2005, (6% for term deposits and 8% for demand deposits), in October 2006 they were lowered for deposits in national currency to 0.5-1% for term deposits and

4-5% for demand deposits. As a result, there was a slight fall in the share of deposits denominated in US dollars: the foreign currency percentage in the M3 measure of the money supply fell from 29% in October 2006 to below 25% in late 2007.

As the crisis began in autumn 2008, the NBU faced an outflow of liquidity from the banking system caused by deposit withdrawals from banks and an increase in demand for foreign currency. In response, the NBU dramatically expanded the refinancing of banks and simplified the process of meeting the reserve requirements both to replace the lost funds and to support the operation of the payments system. However, the NBU was not always consistent in refinancing and did not always assess the suggested collateral thoroughly. As a result, a considerable quantity of refinancing credits was restructured in 2009, and they are subject to repayment during the period 2010-2016.

Following a short period of active bank financing, the NBU moved to a more restrictive monetary policy. Its main tool consisted of withdrawing liquidity from the economy within the framework of its currency market interventions. The NBU also gradually increased reserve requirements and reduced the amount of bank refinancing, focusing its funding on the most troubled banks. When bank liquidity increased, the NBU also placed 30-90 day deposit certificates.

On the other hand, the NBU started to build a portfolio of domestic government loan bonds (DGLB) that partially compensated for the outflow of the hryvnia because of its currency interventions. The NBU was obliged by law to buy government bonds issued for the recapitalisation of troubled banks. The government used that mechanism for quasi-fiscal purposes through the recapitalisation of state-owned banks and of Naftogaz Ukrainy. In addition, the NBU bought DGLBs to assist the government fiscal policy. After the end of the crisis, and following the transition to a floating exchange rate, the NBU's transactions with government bonds could begin to replace its currency market interventions as the main tool of monetary policy.

However, the funds the NBU injected into the economy by refinancing and buying out government bonds in late 2008 and 2009 were not sufficient to compensate for the loss of liquidity through the NBU's interventions and the lending crisis. In 2009, the money supply (M3) decreased by 5.5% (December-to-December).

In 2010, monetary policy eased following a change in the direction of the NBU's interventions so that the NBU became a net buyer of foreign currency. However, the NBU partially sterilised the liquidity created through its currency market interventions, through an increase in the issue of deposit certificates and through the withdrawal of compulsory reserves to a special account with the NBU. The NBU also substantially reduced interest rates

for refinancing transactions, although the amount of such transactions was minimal.

In summary, despite the NBU's intention of moving towards inflation targeting in the medium-term and thus limiting its active control of the exchange rate, the latter remains a key factor in the NBU's activities.

### 1.1.3 Fiscal policy and the budget situation

#### Fiscal policy

Systemic problems of Ukraine's fiscal position during the past five years have included a distorted structure of fiscal expenditures, the implications for spending of the populist policies of the authorities, the extreme centralisation of public finance, an inadequate model of budget powers division and the absence of any clear system of public financial control for fiscal expenditure. Ukraine's fiscal policy has been marked by short-term planning and spontaneous

State Budget of Ukraine in 2009 (including the official and hidden deficits) amounted to UAH 103.8 billion<sup>9</sup>, as estimated by the Ministry of Finance, whereas the planned figure was UAH 33 billion. Public debt increased 3.6 times between 2005 and 2009. During 2009, the real situation in the execution of the State Budget was concealed by amending the budget schedule, by illegally including receipts from the use of SDRs obtained from the IMF in fiscal revenues and by engaging economic entities' floating capital in the form of accumulated VAT refunds arrears.

During the period 2005-2010, there had been a steady increase in recurrent social expenditures. In addition, since 2005, a considerable share of the expenditure of the Pension Fund had been financed with subsidies from the State Budget (Table 1.1) rather than by employers' and employees' insurance contributions. Moreover, loans to the Pension Fund

**Table 1.1. Transfers from the State Budget to the Pension Fund, 2005-2010\***

	2005	2006	2007	2008	2009	2010E
Total expenditure of the Pension Fund, % of GDP	14,8	13,7	14,1	15,1	18,1	17,8
Overall transfer from the State Budget,* % of GDP	5,2	4,5	3,5	4,2	4,8	6,0
<i>Of which:</i>						
Transfer to cover the State's special pension obligations	1,5	3,2	3,5	4,2	3,3	3,5
Transfer to finance the Pension Fund's deficit	3,7	1,3	-	-	1,5	2,5

Source: State Treasury reports

Notes: \* – without loans provided by the State Treasury; E – IER estimate

changes as far as revenues and expenditures are concerned. It has also been aggravated by an inadequate tariff policy at the communal level, by lack of necessary reforms to both the pension and tax systems and by the absence of a clear and efficient system for state aid provision.

Even when fiscal receipts contracted sharply due to the decline in economic activity during the crisis year of 2009, it failed to provide an impulse for change. This was largely due to lack of political will. The fiscal problems that had accumulated before the crisis, and the authorities' inability to limit social spending during the crisis, resulted in an unbalanced fiscal system. The result was an increase in the deficit of the Consolidated Budget as well as strong growth of state debt. For example, the actual deficit of the

from the Single Treasury Account were actively used in that period, which allowed the Fund's liquidity gap to be eliminated.<sup>10</sup> Under the conditions of incomplete reforms to the system of social support, the increase in social expenditure did not solve the problem of eliminating poverty, but created a threat to the stability of the fiscal system as a whole<sup>11</sup>.

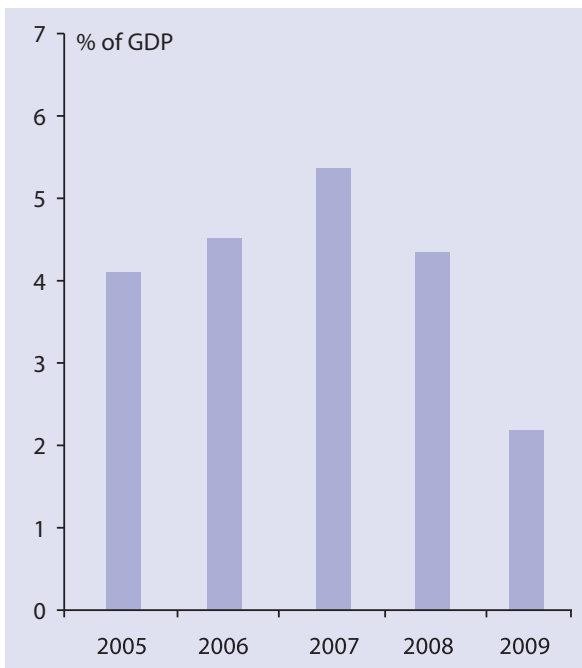
At the same time, capital expenditures decreased from 4.1% GDP in 2005 to 2.2% GDP in 2009, despite the declarations about an investment-oriented model of economic development and the high levels of depreciation of fixed assets in infrastructure, housing and utilities services (Figure 1.7).

The growing fiscal expenditures required funding. The tax burden in Ukraine (including deductions to social insurance funds) remains higher than the

<sup>9</sup> Apart from the actual fiscal deficit of UAH 19.9 billion, it also includes the amounts for bank recapitalisation (UAH 19.6 billion), capitalisation of NJSC Naftogaz Ukrainy (UAH 24.4 billion), special drawing rights (UAH 15.7 billion) and unreimbursed VAT (UAH 24.2 billion).

<sup>10</sup> According to the Accounting Chamber of Ukraine, the outstanding loans granted to the Pension Fund from the single treasury account amounted to UAH 22.1 billion as of 1 January 2010.

<sup>11</sup> The share of such spending in the Consolidated Budget doubled to between 22-28% during the period 2005-2009 compared to its share between 1999-2001.



**Figure 1.7. Capital expenditures of the consolidated budget, 2005-2009.**

Source: reports of the State Treasury of Ukraine

average of the new EU member states, which distorts economic competition and is one of the reasons for the growth of the shadow economy, contributing to growing losses of fiscal receipts. The Tax Code, approved by the Parliament of Ukraine in late 2010, provides for lower rates for the main taxes, but nevertheless fails to solve the above-mentioned problem and requires substantial refinement.<sup>12</sup>

The country's fiscal needs were financed not only by the high tax burden but also through advance payments<sup>13</sup>, the accumulation of indebtedness on VAT refunds to exporters as well as by borrowing.

The need to make timely VAT refunds to exporters was an important problem that remained unresolved during 2005-2010. It poses both a threat to the country's macroeconomic stability and is an obstacle to a successful policy to promote exports. In 2009 alone, the amount of the VAT not refunded increased almost twice and totalled UAH 24.2 billion as of early 2010 (Figure 1.8).<sup>14</sup> It created an extra burden for the current year's budget and substantially aggravated the financial conditions of economic entities, especially for exporters. Considering the need to stimulate exports to renew economic growth following the crisis, an

additional tax on exporters in the form of delayed VAT refunds is extremely harmful. The partial repayment of that debt by means of issuing VAT bonds began in August 2010. This measure, however, is short-term and does not solve the above-mentioned problem in a comprehensive way.

A positive development in fiscal policy was the approval of new version of the Budget Code in 2010.<sup>15</sup> According to the new Code, the Government is expected to implement medium-term planning and develop result-oriented budgeting, as well as to increase the level of financial support for local self-government functions by assigning additional revenue sources to them. Other important changes include increasing the investment component in local-budget revenues by extending the list of receipts to the budget for development, and encouraging local authorities to boost budget revenues. At the same time, the problems of dividing functional powers among the different levels of authority, increasing the efficiency of budget funds at the local level and improving the methods of interregional financial equalisation were not addressed fully in the Code.

#### Public debt policy

The crisis year of 2009 saw a rapid growth in public borrowing in both external and domestic markets and, accordingly, a marked increase in public debt. The amount of Ukraine's public debt is now close to the level regarded as critical for emerging market economies and, if the riskiest categories of the government's contingent liabilities are included, has already exceeded it. For example, the total amount of public debt was 34.6% of GDP in early 2010, almost three times higher than its level in early 2007 (Figure 1.9).

When the crisis began in international capital markets in 2008, the Government concentrated on raising loans from domestic sources as well as external loans from official creditors. A total of UAH 62.8 billion worth of domestic state bonds were issued in 2009, including UAH 44 billion to recapitalise banks and Naftogaz Ukrainy, and UAH 4.7 billion to replenish the Stabilisation Fund. A further UAH 58.2 billion was raised from external sources in 2009, most of which were loans provided by the IMF.

Owing to a falling market demand for domestic state bonds, a considerable share of these bonds was purchased by the NBU. The domestic government's

<sup>12</sup> The new draft Tax Code was adopted by the Parliament of Ukraine on 2 December 2010. The basic provisions of the suggested draft include:

- changes in tax administration and in taxation rules to reduce tax evasion;
- gradual decrease of the rate of corporate profit tax from the current 25% to 16% in 2016;
- tax holidays for 5-10 years for newly founded enterprises, small businesses and certain sectors;
- gradual decrease of the VAT rate from 20% to 17% beginning from 2014;
- a differentiated rate for individual income tax;
- introduction of a real-estate tax;
- new rules for the simplified taxation system.

<sup>13</sup> In particular, according to the Accounting Chamber of Ukraine, overpayments to the State Budget in 2009 from economic entities' personal accounts increased by UAH 5.7 billion, or by 1.7 times, and amounted to UAH 14.3 billion as of 1 January 2010.

<sup>14</sup> According to updated data by the Ministry of Finance concerning execution of the State Budget for 2009.

<sup>15</sup> Law of Ukraine No. 2456 of 8 July 2010

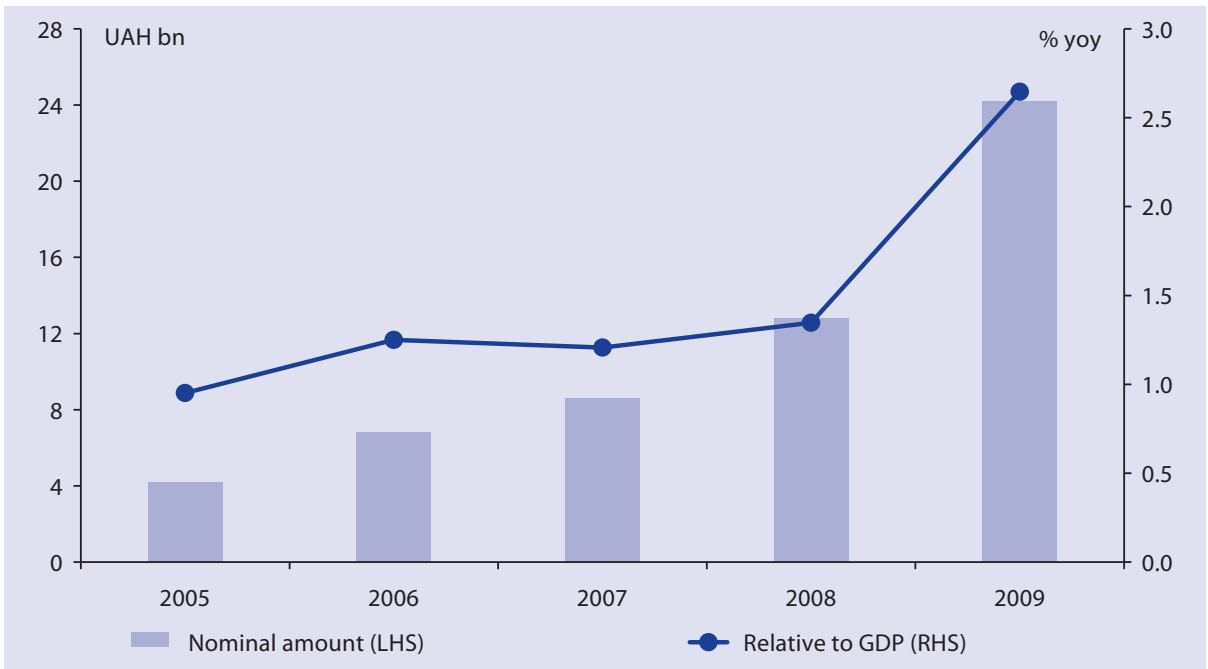


Figure 1.8. VAT refund arrears, 2005-2009\*

Source: Administration of the President of Ukraine, Ministry of Finance of Ukraine

Note: \*year-end data

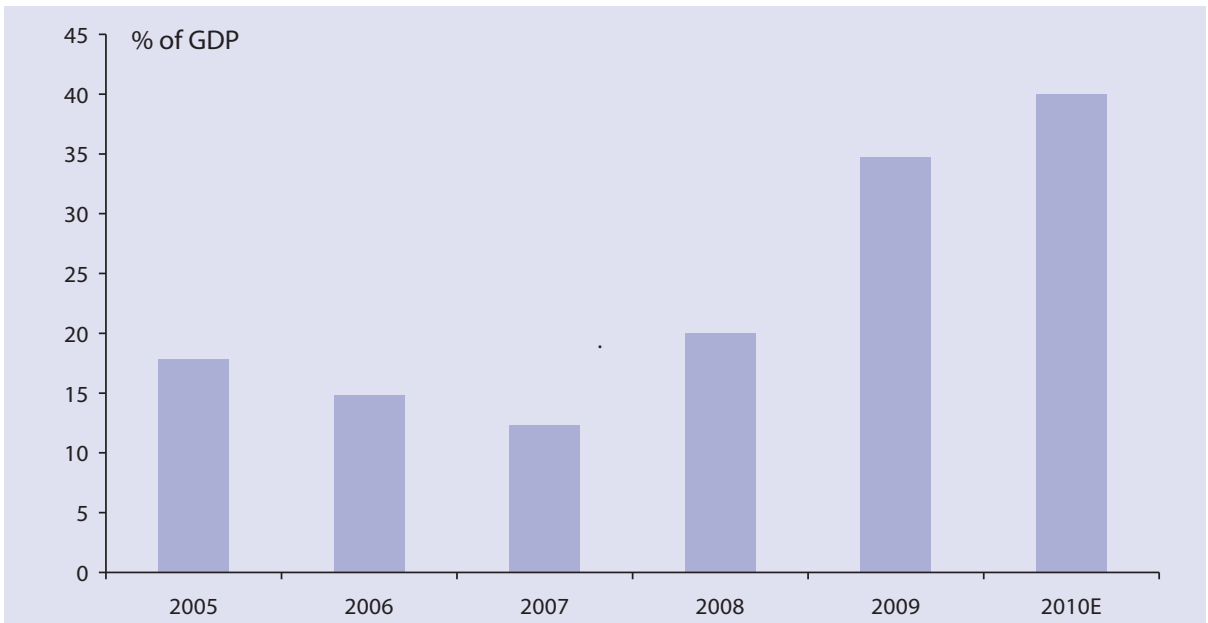


Figure 1.9. Ukraine's public debt, 2005-2010

Source: Ministry of Finance of Ukraine

Note: E – IER estimate

debt grew by UAH 54.1 billion in 2009. The amount of DGLB owned by the NBU increased by UAH 41.6 billion over the same period. Since the NBU in effect acted as a creditor for the government's domestic borrowings, the implications of financing the State Budget deficit in this manner are a threat to macroeconomic stability.

The debt burden continued to grow in 2010 as the government undertook domestic borrowing. The direct internal state debt grew by 47% to UAH

134 billion (about USD 17 billion) between January and September. In addition to the sale of ordinary domestic state bonds, the government placed VAT bonds (amounting to UAH 16 billion) and special bonds related to the recapitalisation of state-owned banks and Naftogaz Ukrainy NJSC.<sup>16</sup> The issue of VAT bonds was provided for in the State Budget Law for 2010.<sup>17</sup> These bonds, with five-year maturity and a 5.5% per annum yield, were given to companies that had confirmed VAT refund arrears as of 1 January

<sup>16</sup> Betliy (2010)

<sup>17</sup> Law of Ukraine No. 2154 as of 27 April 2010

2010. Some companies almost immediately sold their bonds in the secondary market to improve their own liquidity despite having to accept a 20% discount.

The share of DGLB owned by the NBU gradually decreased in 2010, which reduces the extent of the monetisation of public debt. As estimated by the NBU, 6.4% of bonds were owned by non-residents as of early October 2010 while the share owned by banks is growing.

In September, Ukraine returned to the international capital markets for the first time since 2007 and successfully placed USD 2 billion worth of Eurobonds.<sup>18</sup> The government issued USD 0.5 billion worth of Eurobonds with five-year maturity at 6.875% per annum and USD 1.5 billion worth of bonds with a ten-year maturity at 7.75% per annum. The latter rate was close to the interest on the ten-year bonds issued by the government in 2007 - 6.75%. The bond yield was favourable to Ukraine considering the fact that the yield on Greek bonds was 11.8% per annum for five-year bonds and 11.5% per annum for ten-year bonds.

Earlier in 2010, the Government had raised a USD 2 billion credit from the Russian VTB and a USD 1 billion loan from the IMF to finance its liabilities. As a result, direct external state debt rose to USD 21.4 billion, having increased by 25% from the end of 2009. Another IMF tranche amounting to USD 1 billion was expected to be provided for budgetary purposes late in the end of 2010.

Overall, total public debt grew by 27% between January and September 2010 and exceeded USD 50 billion. The share of domestic debt in total public debt increased by 4 percentage points, to 37%. If the IMF grants another tranche within the Stand-By Arrangement, the ratio of public debt to GDP is likely to reach almost 40% by late 2010.

The State Budget Law for 2010 poses additional fiscal risks (Table 1.2). In particular, according to Article 78 of the law, the Cabinet of Ministers has received the right to cover gap in general fund revenues with public borrowings as well as to make public borrowings over and above the amounts set by the Law, thereby exceeding the public debt limit. This risks increasing the deficit, adding to the debt burden of the State Budget. Under such conditions, the problem of using borrowed funds remains a key one. In particular, the raised funds are likely to be spent not on increasing assets that would enable the government to repay the debt and receive dividends later on, but on current consumption<sup>19</sup>.

Ukraine also faces the issue of the stability of the financial system and the risks for the country's contingent debt liabilities, an issue which requires an urgent solution. The Government has still not implemented a centralised management system aimed at preventing the risks of conversion of indirect

**Table 1.2. Planned state borrowing in the State Budget for 2010\***

	UAH billion	% of GDP
<i>Borrowings</i>	100.3	9.3
Domestic	66.2	6.1
External	34.1	3.1
<i>Repayment</i>	23.8	2.2
Domestic	17.1	1.6
External	6.7	0.6

Source: Law of the State Budget of Ukraine for 2010 approved on 27 April 2010

Note: \* recapitalisation not included

liabilities into direct public debts and also has yet to create special government financial reserves which would be required in critical conditions. In addition, it has not yet established common standards of reporting for the disclosure of public information concerning all the components of public debt liabilities.

The risks of a dangerous explosion in the growth of public debt over the medium-term could provoke a crisis of public indebtedness. The proportion of funds required to service and repay public external debt is likely to grow, initially when the preferential terms of official external loans have expired and then due to stricter conditions attached to loans by other outside lenders. A substantial build-up of public debt gives rise to the risks of hyperinflation, of destabilising the balance of payments, and of the persistence of chronically high interest rates. These are integral attributes of high fiscal deficits that will create obstacles to the recovery of investments and for economy's transition to a path of sustainable growth.

#### Relations with the IMF

After the recovery of economic growth in Ukraine, active cooperation with the International Monetary Fund (IMF) within the credit facility framework was discontinued in the early 2000s. However, the Government met its debt repayments to the IMF and continued its consultations on the conduct of economic policy. However, a year before the Government had completed full repayment of its previous borrowings from the IMF, it had to apply for a new credit owing to the onset of the economic crisis inside the country and due to the emergence of a double deficit in the balance of payments.<sup>20</sup> In October 2008, the Government of Ukraine and the IMF signed the Memorandum of Economic and Financial Policies that provided a foundation for granting Ukraine a loan on stand-by terms amounting to SDR 11 billion (802% of Ukraine's quota) for the period from November 2008 to October 2010.

<sup>18</sup>Betliy (2010)

<sup>19</sup>The funds raised by the Government in 2009 were used mainly to help finance social spending, to stabilise the banking system and support the national currency. Only a minor share was raised to finance infrastructure projects for EURO 2012

<sup>20</sup>Movchan (2009)

Ukraine received the first tranche of the loan, amounting to SDR 3 billion (USD 4.5 billion) in November 2008 following approval of the arrangement. Cooperation with the IMF continued in 2009 when Ukraine received SDR 3 billion in two tranches: SDR 1.875 billion in May and SDR 2.125 billion in July<sup>21</sup>. Hence, by late 2009 Ukraine had obtained almost two-thirds of the funding provided for by the Stand-By Arrangement.<sup>22</sup>

However, actual cooperation with the IMF within the framework for the Stand-By Arrangement became extremely complicated. This resulted in a delay in the

permitted the IMF to unfreeze the payment of the second tranche and pay the third one on time. It is extremely interesting that, contrary to the IMF's usual practice, half of the second tranche and the entire third tranche of the Stand-By Arrangement were used to fund the central fiscal deficit, particularly to ensure the country met its external obligations in a timely manner, rather than to increase the reserves of the NBU.

The third review under the Stand-By Arrangement, which began in October 2009, was not completed. The IMF representatives were concerned about the adoption of a law on raising social standards by the

**Table 1.3. Ceiling on the cash deficit of the general government, UAH bn**

	September 2008	December 2008	March 2009	June 2009	September 2009, forecast	December 2009,
(1)	-4.994	9.930 forecast	0.000 forecast	-2.000 forecast	-5.000	0.000
(2)		30.026 actual	11.040 actual	22.500 actual	40.000	55,000

Source: [www.imf.org](http://www.imf.org)

Note: (1) IMF (2008); (2) IMF (2009a)

payment of the second tranche. Consequently, a new Memorandum of Understanding was signed in July 2009. But due to breached commitments, Ukraine failed to receive the fourth tranche of the loan and finally the Arrangement was terminated.

When the initial Memorandum<sup>23</sup> was signed in October 2008, it was expected that Ukraine would have a zero cash general government deficit by the end of 2009. This was to be achieved by limiting the growth of the minimum wage, of average wages in the public sector, of pensions and other social payments to the expected inflation rate in 2009. In addition, the financial position of the Naftogaz Ukrainy was to be stabilised partly by unifying the prices of domestic and imported gas as through a reduction in the price subsidies for imported natural gas consumed by communal heating entities. However, the zero cash deficit limit was not observed. Due to dramatic aggravation of the economic situation in the country and a difficult political situation, Ukraine failed to meet its obligations in the fiscal sphere by early 2009.

As a result of negotiations, Ukrainian and IMF representatives agreed to revise the programme criteria to take account of the steep decline in economic activity in the country and this was later recorded in a Technical Memorandum of Understanding.<sup>24</sup> This

Parliament of Ukraine that provided for a dramatic growth of public liabilities not backed by proper financial resources either in 2009 or in 2010. This was obviously in conflict with Ukraine's commitments to the IMF.<sup>25</sup>

Cooperation with the IMF within the loan arrangement framework was only renewed in July 2010 when a new Memorandum of Economic and Financial Policies was signed.<sup>26</sup> The signature of the new Memorandum became possible owing to the accomplishment of several reforms. These included in particular decisions in the summer of 2010 to strengthen the NBU's independence, to increase gas tariffs starting from 1 August 2010, and to amend the Law on the State Budget 2010.<sup>27</sup> The latter amendments assume budget sequestrations would reduce the fiscal deficit in 2010 from 5.33% to 4.99% of GDP (by UAH 3.65 billion).<sup>28</sup> To achieve this, the excise duty for most excisable goods and the fee for using radiofrequency resources were increased, the subsidies to various sectors of economy were substantially reduced and the transfer to the Pension Fund was lowered.

The new programme of cooperation with the IMF provides for USD 15.15 billion (SDR 10 billion) total funding over a period of two and a half years.

<sup>21</sup> IMF, <http://www.imf.org/external/np/fin/tad/exfin2.aspx?memberKey1=993&date1key=2010-02-05>

<sup>22</sup> Movchan (2010)

<sup>23</sup> IMF (2008)

<sup>24</sup> IMF (2009a)

<sup>25</sup> IMF (2009b)

<sup>26</sup> IMF (2010)

<sup>27</sup> Law of Ukraine No. 2461 of 8 July 2010

<sup>28</sup> Due to a UAH 13.4 billion cut in budget revenues, and a UAH 17.1 billion decrease in expenditures (including a UAH 8.9 billion decrease in spending of the Stabilisation Fund, and a UAH 3.0 billion decrease in transfers to cover the Pension Fund's deficit).



Of this amount, USD 2.0 billion will be transferred to the budget in 2010 and the balance will be added to the NBU's international reserves during the period 2010-2012. According to the memorandum, the Government undertook to reduce the deficit of the general government (excluding bank recapitalisation and the issue of VAT bonds) from 5.5% GDP in 2010<sup>29</sup> to 3.5% GDP in 2011 and to 2.5% GDP in 2012. In addition, it was agreed to set a limit on the ratio of public and publicly guaranteed debt to GDP for Ukraine, and to stabilise it below 35% by 2015.

To mobilise additional revenues to the budget, it is planned to reduce the threshold of turnover for payers within the simplified taxation system, strengthen the fight against fraudulent schemes through broadening the powers of tax inspectors and secure timely and complete payment of VAT refunds. In order to reduce general government expenditures, it is planned to restrict the amount of state guarantees (to UAH 15 billion in 2010) and eliminate the deficit of the Naftogaz Ukrainy commencing in 2011. In addition, the Government is expected to abstain from raising wages in the budget-funded sector, balance the Unemployment Insurance Fund, the Fund for Insurance against Temporary Loss of Capacity for Work, and the Fund for Insurance against Accidents at Work. The Memorandum also provides for the commencement of pension reform. It is proposed to gradually increase the pension age for women from 55 to 60 years (with annual 6-month increases beginning from 2011), increase the minimum insurance period (from 5 to 15 years) and adjust the formula for the calculation of pensions assigned.

Ukraine received the first tranche of the IMF loan amounting to USD 1.89 billion in early August. Of this amount, USD 1 billion was allocated for budgetary purposes and the balance of USD 890 million was added to the NBU's currency reserves. The second tranche is expected in December 2010 subject to compliance with all the parameters of the programme of cooperation with the IMF. Generally, one should expect the IMF to be rather stricter in ensuring compliance with the programme requirements than before since the peak of the crisis has already passed and Ukraine's credit history is extremely complicated.

## 1.2 BUSINESS CLIMATE IN UKRAINE

### 1.2.1 Administrative barriers to the development of enterprise

In Ukraine, economic growth was not driven by a favourable regulatory environment. Ukrainian business often grew not in response to regulatory reform but despite administrative barriers. The administrative

barriers to the development of enterprises in Ukraine are high, which is confirmed by entrepreneurs themselves, experts and international ratings.

The complexity of doing business in Ukraine is expressed in the large number of types of entrepreneurial activity which are subject to licensing, the great quantity of permits and certificates that have to be obtained, the large number of administrative services and controlling bodies whose powers often change and whose activities are often motivated by fiscal considerations, the high rate of corruption and the low efficiency of the judicial system.

In particular, 63 economic activity types are subject to licensing in Ukraine,<sup>30</sup> including medical and veterinary practices, production and operations dealing with the handling of hazardous substances/waste, transport services, postal services, activities of tour operators, activities concerning land development and assessment, mineral exploration, insurance activities. Licenses are issued by 34 licensing bodies specified by the Cabinet of Ministers.<sup>31</sup>

At the same time, the efforts of executive and legislative authorities in recent years have been aimed at improving the situation. In 2009, the Law on Joint-Stock Companies took effect. It is intended to strengthen the protection of property rights and the rights of minority shareholders. In addition, the regulatory system is being reformed gradually. The number of activity types subject to licensing as well as the quantity of, permits, certificates etc. has decreased; the validity period of licenses has been lengthened; a one-stop shop for enterprise registration and permit issuance has been formally implemented.

For example, an important change occurred in 2010 in the functioning of the country's permit system. Amendments to the law on the permit system<sup>32</sup> were passed in July according to which economic entities may conduct economic activity or certain types thereof without an authorisation document, except for certain types of activity, which are specified by the Cabinet of Ministers. Previously, the opposite applied whereby specific types of activity could be carried out without permits only by submitting a declaration of compliance.

In support of these legislative changes, the Cabinet of Ministers has approved a list of 94 economic activity types that may not be conducted based on the submission of a declaration of compliance of an economic entity's material and technical base with legislative requirements and, hence, require permit.<sup>33</sup> In the past about 250 permits were required for different types of economic activity in Ukraine.

Problems remain, however. As far as the execution of the law of the permit system is concerned, according to information provided by the Blue Ribbon Analytical

<sup>29</sup> Or 6.5% including Naftogaz Ukrainy NJSC deficit.

<sup>30</sup> According to the Law of Ukraine No. 1775 of 1 June 2000 in the wording valid since 24 July 2010.

<sup>31</sup> Resolution of the Cabinet of Ministers of Ukraine No. 1698 of 14 November 2000 in the wording of 2 September 2010.

<sup>32</sup> Law of Ukraine No. 2806 of 6 September 2005 in the wording of 29 July 2010.

<sup>33</sup> Resolution of the Cabinet of Ministers of Ukraine No. 725 of 25 August 2010.

and Advisory Centre,<sup>34</sup> local authorities encountered a series of substantial practical problems in the organisation of the work of the permit centres. The key problems included strong resistance of the permit authorities to the principles of the one-stop shop document issuance, their refusal to cooperate with permit centre administrators; the lack of necessary methodological information concerning the organisation of the permit centres' proper work; a lack of material resources to provide the permit centres with necessary premises and highly skilled personnel.

Many other issues remain insufficiently addressed such as bankruptcy, judicial reform, technical standards, sanitary and phytosanitary standards.

### Assessment of the business climate by entrepreneurs

Several research organisations conduct surveys of entrepreneurs to develop a business climate assessment. The Quarterly Enterprise Survey by the Institute for Economic Research and Policy Consulting (IER) is the oldest one. The survey uses the *business tendency surveys* method designed by the IFO, a Munich-based institute (see Annex 1 for more details of the methodology and sample).

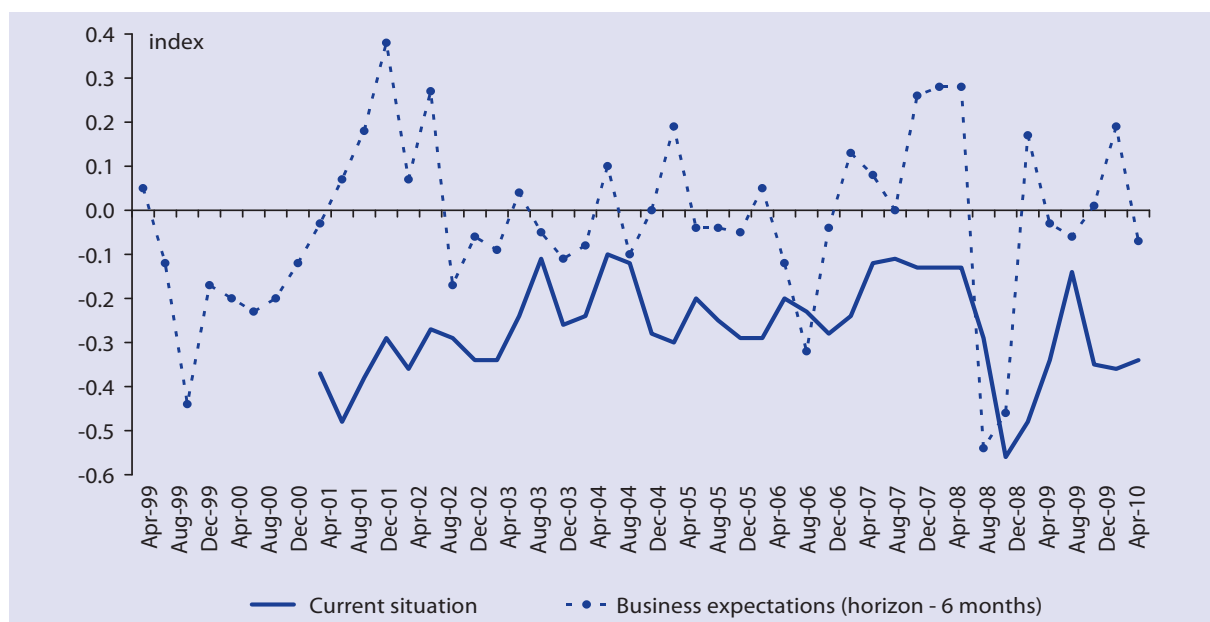
According to the surveys, variations in the estimates of the current business climate quality in the country were insignificant from 2003 until the onset of the economic crisis (Figure 1.10). The assessment has always been rather pessimistic. The number of enterprise managers stating an improved business climate steadily remained lower than those enterprises concerned about the difficulty of the business climate in the country. However, the

situation deteriorated sharply as the crisis worsened. The balance of business expectations fell abruptly in the fourth quarter of 2008, reaching its lowest level since 1999 by January 2009 (-0.56). There had been a substantial improvement in the assessment of the economic situation and the business climate in the country only by the third quarter of 2009 when the recovery of external demand and, accordingly, domestic industrial production began.

In 2010, the assessment of the current quality of business climate by enterprise managers declined again, to -0.36 in January and to -0.34 in July, deterioration after the optimism recorded in the latter part of 2009. It was probably caused by the lack of fast progress both in restoration of external and domestic demand and with economic reforms to foster entrepreneurial activity in the country.

The entrepreneurs' high positive expectations concerning an improvement in the quality of the business climate (Business Expectations Index) seen in January and April 2010 gave way to apathy or pessimism in the following six months. Business Expectations Index was 0.01 in January and grew to 0.19 in April, but then fell by 26 points to -0.07 in July. The decline was accompanied by a simultaneous decrease in the percentage of "optimists" (from 32.2% to 17.1%) and an increase in that of "pessimists" (from 16.7% to 31.8%). However, more than half of all entrepreneurs (51.2%) did not expect any changes in the general economic situation in the following six months.<sup>35</sup>

According to the July 2010 survey data, the greatest obstacles to the growth of production were low demand (63.9%) and excessive taxation (60.2%) (Table 1.4). The unfavourable regulatory



**Figure 1.10. Assessment of the business climate by entrepreneurs, 1998-2010**

Source: IER Quarterly Enterprise Survey

Note: scale from -1 to 1

<sup>34</sup> UNDP (2009)

<sup>35</sup> Kuziakiv, Dvorak (2010)

**Table 1.4. Obstacles to the growth of production, 2005-2010, share of managers (%)**

	July 2005	July 2006	July 2007	July 2008	July 2009	July 2010
Low demand	62.5	63.3	58.8	59.7	65.9	63.9
Excessive taxation	50.4	51.3	40.7	55.2	49.2	60.2
Unfavourable regulatory climate	19.3	18.1	19.2	30.4	49.0	48.5
High regulatory pressure	13.2	13.1	13.7	23.8	39.1	36.5
Changes in economic legislation	6.8	2.5	4.9	2.2	10.5	15.7
Corruption	1.4	4.5	3.8	9.4	14.7	14.0
Liquidity problems	27.9	24.1	33.5	18.2	36.4	46.8
Credit accessibility	7.5	8.5	4.4	17.7	24.8	31.4
High competitive pressure	38.6	43.7	36.8	42.5	25.2	29.4
High crediting rates	27.1	36.7	20.3	37.0	18.6	23.7
Lack of raw materials	26.8	16.6	29.1	31.5	17.1	22.1
Outdated technologies	11.1	12.1	7.1	16.0	5.8	14.4
Unstable political situation	3.2	23.1	9.3	7.2	39.1	11.7
Insufficient number of skilled staff	11.4	12.6	23.6	34.8	3.5	11.0
Energy supply problems	0.0	11.1	8.2	9.4	8.5	7.7
Lack of production capacities	5.4	5.5	3.8	5.0	3.9	6.0

Source: IER's Quarterly Enterprise Survey

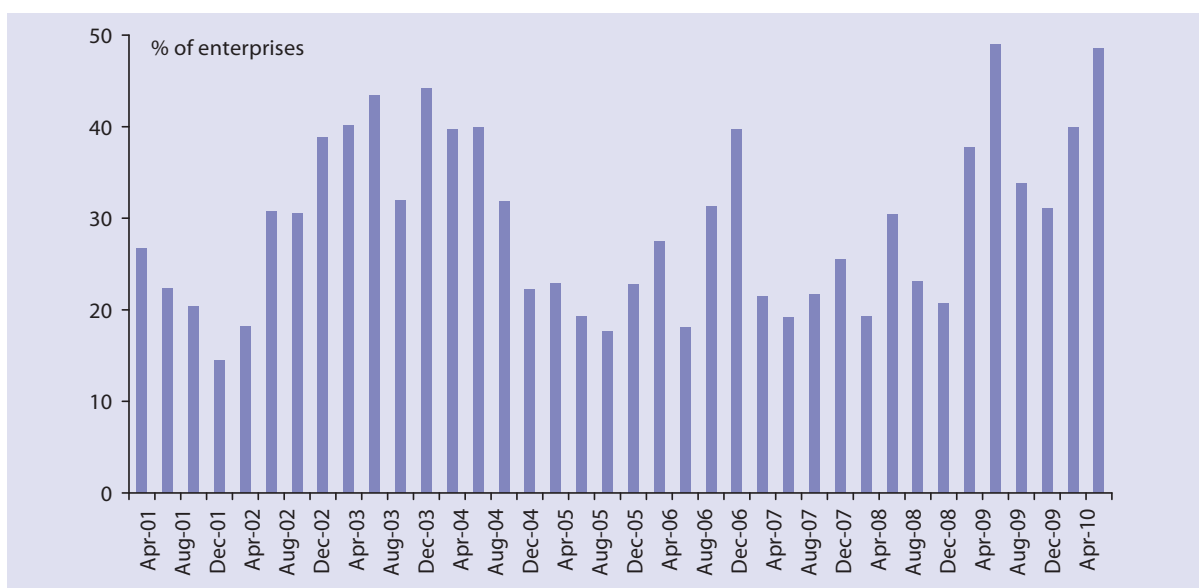
climate was the third major obstacle for entrepreneurs, identified by 48.5% managers in July. The significance of this obstacle gradually rose during the year, given that only 31.1% of managers pointed to this factor as a barrier to the growth of production in January 2010.

The value of the regulatory indicator varies by enterprise size. The unfavourable regulatory climate is a significant problem for small enterprises, noted by 53.8% of the small enterprise managers polled. It is lowest (44.1%) for large and medium-size enterprises (the value of the indicator for large enterprises alone is 46.5%).

The indicator of the unfavourable regulatory climate shown in Table 1.4 is a compound indicator consisting of three indicators – high regulatory

pressure, corruption, and frequent changes in economic legislation. The greatest problems, from the managers' point of view, are generated by the high regulatory pressure, indicated as an obstacle by 36.5% of managers. Changes in economic legislation and concerns over corruption created obstacles for 15.7% and 14% of managers respectively.

The worsening economic situation in the country exacerbated entrepreneurs' perception of the regulatory climate as unfavourable. When the economy was growing strongly, most entrepreneurs placed relatively low importance on the unfavourable regulatory environment, but the acute deterioration in economic conditions and the decrease in demand emphasized the significance of these regulatory problems to producers. In July



**Figure 1.11. Share of enterprises reporting the 'unfavourable regulatory climate' as an obstacle to the growth of production, 2001-2010.**

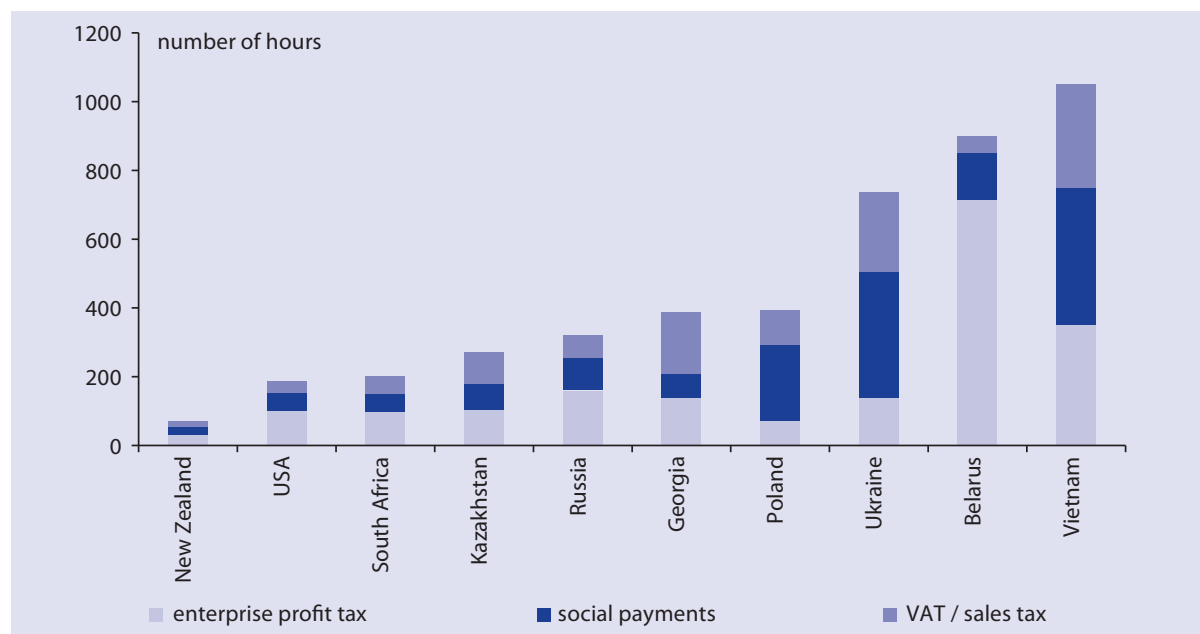
Source: IER Quarterly Enterprise Survey

Note: scale from 0 to 100%

2007, when the global crisis was only commencing in the U.S. mortgage market, only 19.2% of enterprises identified the unfavourable regulatory environment as a obstacle to growth, but the share rose to 30.4% in July 2008 and then to 49.0% and 48.5% in July 2009 and July 2010, respectively. All the three components of the index - high regulatory pressure, changes in economic legislation, and corruption, were perceived as greater problems.

and trading across borders (139<sup>th</sup>). It is, however, relatively easy for companies to obtain credit (30<sup>th</sup>) and to enforce contracts (43<sup>rd</sup>).

In particular, the time spent by companies on paying taxes in Ukraine is extremely high, although the situation is gradually improving. According to the IFC's estimates presented in its annual *Doing Business* reports, the time taken to pay taxes in Ukraine has more than halved since its 2008 Report (from 2085



**Figure 1.12. Hours per year spent on average by an average medium-sized company to comply with tax laws, 2008**

Source: IFC/PriceWaterhouseCoopers (2010)

### Ukraine in international business environment ratings

The concerns over the business environment in Ukraine appear even worse when the country is compared with other countries of the world. Estimates of Ukraine's business environment are very low in all international ratings. According to the IFC's *Doing Business 2010* international rankings, the conditions for doing business in Ukraine are among the worst in the world. Ukraine was ranked 142<sup>nd</sup> out of 183 countries<sup>36</sup>, similar to the scores for Honduras, Gambia, Syria and the Philippines in the rating. Within the region (Eastern Europe and Central Asia), Ukraine's ranking is 25<sup>th</sup> out of 27 positions, leaves behind only Uzbekistan and Tajikistan.

In the IFC survey the most difficult issues in Ukraine included dealing with construction permits and paying taxes (where Ukraine was ranked 181<sup>st</sup> out of 183 for both items), closing a business (145<sup>th</sup>)

hours in 2008 to 736 hours in 2010).<sup>37 38</sup> This latter figure, however, is still more than twice as high as the hours spent on similar procedures by countries in Eastern European and Central Asian.<sup>39</sup>

According to the report *Investment Climate in Ukraine As Seen by Private Businesses*<sup>40</sup> the greatest regulatory obstacles of the business environment and investment climate in Ukraine include the taxation system, the permit regime, the inspection process and technical regulations. The regulatory environment is the most burdensome for small and medium-size enterprises. As the report points out, a whole range of laws, decrees and regulations have been adopted over the past five years but their implementation is quite slow.

According to findings presented in the *Business Environment and Enterprise Performance Survey 2008-2009 (BEEPS IV)*, enterprises still regard the management of the judicial system as arbitrary and unfair, and consider corruption to be widespread.<sup>41</sup>

<sup>36</sup> IFC (2009b)

<sup>37</sup> *Doing Business 2010* uses information on the tax payment procedures valid in the 2008 fiscal year. For details see the methodology of IFC/PriceWaterhouseCoopers (2010) and IFC (2009b).

<sup>38</sup> Analysis of tax laws, accounting procedures, tax reporting, and tax/charge payment procedures showed that a company spent 1137 hours on average on various procedures related to tax accounting and payment. See IFC (2009c)

<sup>39</sup> *Doing Business 2010 Rankings*. <http://www.doingbusiness.org/ExploreEconomies/?economyid=194>

<sup>40</sup> IFC (2009a)

<sup>41</sup> EBRD (2010)

In other reviews of the business environment and the quality of management, Ukraine is ranked below other countries in the region.

In the Corruption Perception Index, Ukraine was ranked 146<sup>th</sup> in 2009 whereas Romania and Bulgaria were both ranked 71<sup>st</sup>.<sup>42</sup> Moreover, the country's ranking declined during the year as it was ranked 134<sup>th</sup> among 180 countries in the corresponding survey for 2008.

In conclusion, both domestic entrepreneurs and international agencies have found that administrative barriers to the development of enterprises in Ukraine are very high, indeed among the highest in the world, and that more active regulatory reforms are required. One should keep in mind, however, that Ukraine's problems do not always lie in incomplete laws. In many cases, a key obstacle consists of improper implementation of and a lack of compliance with the laws.

## 1.2.2 Financial system as an enterprise development factor

### General credit market trends

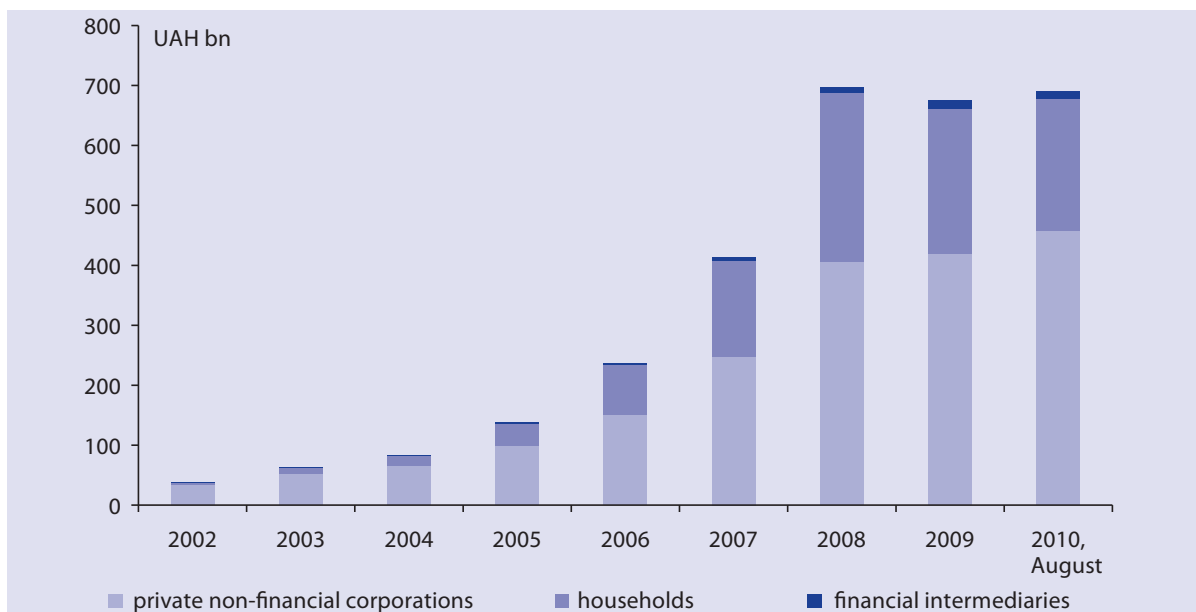
During the period of economic growth, particularly between 2005 and 2008, the demand for credit on the part of businesses was very high. It was primarily connected with the growing demand for industrial products. It received further stimulation by consumers who sought loans issued for consumer purposes or for the purchase of housing; enterprises then tried to boost production and the provision of services which, in turn, increased the demand for credit for operational and investment activities. As

a result, amount of credit granted to nonfinancial corporations as well as to financial intermediaries increased by 57.5% annually whereas the annual growth rates of household credit amounted to 100% during this period (Figure 1.13).

The largest part of the growth in credit was spent on the current needs of enterprises, hence the share of short-term credits was large, accounting for about 45% of the credits granted to nonfinancial corporations and financial intermediaries throughout the observation period.

Another feature of enterprise borrowing was that a considerable portion of the credit was granted in foreign currency (about 42% in 2006 and 2007<sup>43</sup>). An important driver was the attractive offer of such credits by the banking sector that was developing rapidly as foreign investors demonstrated a growing interest in it and, accordingly, the share of foreign capital in the banking system increased. Given the stability of the exchange rate and the relatively low interest rates for foreign-currency credits, these credit offers were attractive to business.

However, the lack of effective mechanisms for hedging currency risk and then the large devaluation of the hryvnia posed problems with the servicing of these foreign-currency credits during the crisis period of 2008-2009. The need to build considerable provisions for troubled debts resulted in the banking system reporting a loss of about UAH 28 billion in 2009. From that point on, foreign-currency lending was actually banned<sup>44</sup>, which resulted in a growing percentage of hryvnia credits in the total amount of credits granted.



**Figure 1.13. Credits into the country's economy, 2002-2010\***

Source: NBU

Note: \* – end of period

<sup>42</sup> Corruption Perception Index. [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2009](http://www.transparency.org/policy_research/surveys_indices/cpi/2009)

<sup>43</sup> The share of foreign-currency credits granted to households amounted to about 63% during the period in question.

<sup>44</sup> NBU Resolution No. 406 of 19 December 2008. The resolution introduced a 50-100% reserve provision for credits granted to legal persons having no permanent source of foreign currency.

Another feature of crediting in Ukraine was the rather high interest rates that were charged (Figure 1.14), a factor connected primarily with high inflation. Accordingly, taking credits both in pre-crisis and post-crisis periods was fraught for most companies with high expenses. Therefore, the majority of loans were taken by companies in highly profitable sectors.<sup>45</sup>

that it was small and medium-sized businesses that suffered most from the shortage of credits during the crisis.<sup>47</sup>

The significance of credit resources in enterprise operations can be judged from the enterprise debt statistics. For example, short-term bank crediting as well as long-term debts, accounted for about 16%<sup>48</sup>

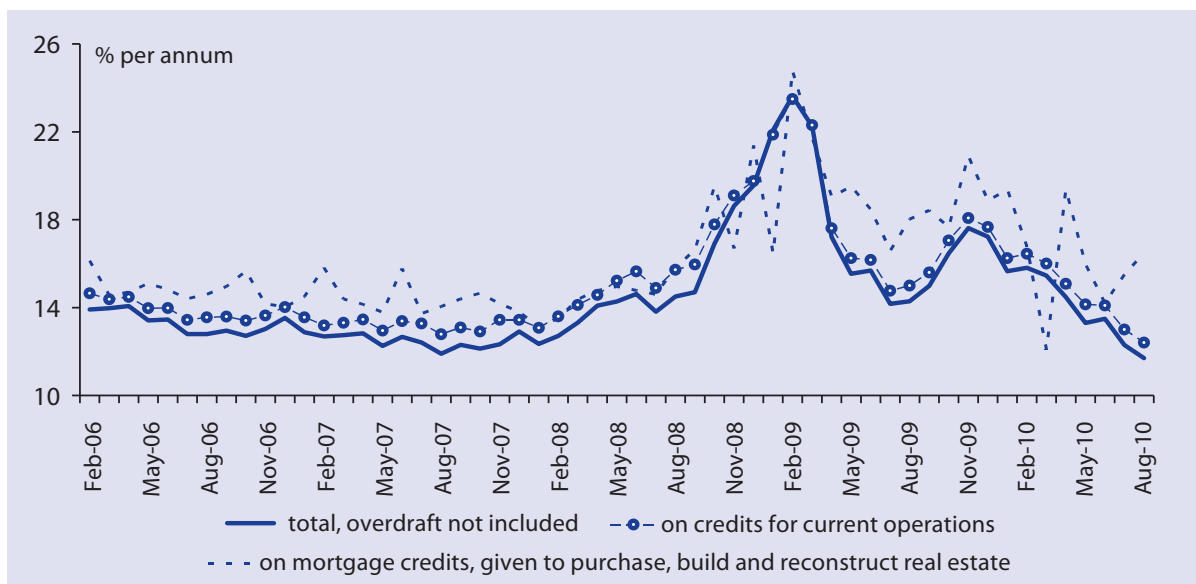


Figure 1.14. Interest rates on credits for non-financial corporations, 2006-2010

Source: NBU

The majority of credits as of August 2010 were given to sectors such as trade, manufacturing industry<sup>46</sup> and real-estate operations (together they accounted for about 75% of the UAH 477.9 billion of credits given to nonfinancial corporations as of late August). Despite a growing share of troubled credits, which rose from 2% in the pre-crisis period to about 11% during the crisis, these sectors kept obtaining loans, which indicates that they had some cushion of liquidity. While industry was given loans mainly on a long-term basis, enterprises engaged in trade generally obtained shorter-term loans since they used the loans to service current operations and foreign economic contracts.

Despite agriculture's high demand for credit resources, the amount of credits given to that sector has remained comparatively low. This mainly reflects the pledge problem since Ukraine has no official market for agricultural land.

The growth of credit to nonfinancial corporations slowed noticeably with the onset of the crisis, falling from growth of 61% (yoy) in 2008 to 26% (yoy) in 2009. This was caused primarily by the absence of credits in foreign-currency and then by the difficulty in obtaining credits in hryvnia. It is important to note

of corporate liabilities at the end of the first quarter 2010 (small and medium-sized businesses are not included). In 2008, the figure was marginally higher, indicating a rather low level of involvement of enterprises overall in the crediting process.

#### Credit requirements and support for crediting of small and medium-sized business

The main requirements for enterprises to obtain credit can be listed as follows. A client may be a legal entity or a private enterprise. There are requirements concerning the period of doing business: it is at least six months for production and three months for trade and services. Accordingly, the bodies making the credit decision analyse the financial statements of enterprises for that period as well as the activities of related enterprises, if any. The banks' requirements for pledged assets are high. A pledge may consist of movable or immovable property including goods in circulation (the pledge value must be equal to at least 125% of the credit amount). The pledge must be insured, which imposes additional costs on borrowers since the cost of insurance sometimes increases the credit servicing expenses. Many banks also allow credits to be taken in tranches. Own funds invested

<sup>45</sup> The peak in the cost of credit in late 2008 and early 2009 was mainly caused by an increase in deposit rates reflecting the lack of confidence in the banking system.

<sup>46</sup> Especially enterprises in the food and metallurgy industries.

<sup>47</sup> Guicci, Kirchner and Kravchuk (2010)

<sup>48</sup> Data of the State Statistics Committee of Ukraine. The percentage for companies engaged in trade and real-estate operations is the largest, and is about 30% in these sectors. This is mainly caused by their high demand for current assets.

in a project against which credits are taken in various banks varies within 10-30%. Naturally, crediting conditions, including credit costs and requirements to pledge assets, became tougher as the crisis set in.

Both the EBRD and the German-Ukrainian Fund have active programmes in Ukraine under which loans are provided to small and medium business. These are loans of up to one year for working capital or for up to two years for the purchase of fixed assets. Crediting under the EBRD programme is provided through such banks as Raiffeisenbank Aval and VABank. The key purposes of such credits include the short-term financing of the costs of raw materials and spare parts for further processing or use in production; long-term financing of the means of production and related increase in regulatory working capital; financing of leasing. However, credits are not provided to cover private companies' existing liabilities to bank institutions nor for investments in securities. In addition, there are some

banks to boost their client base currently consists of providing related services and building long-term partner relations with existing clients.

### 1.2.3 The country's competitiveness

The years of economic crisis and transformation in Ukraine during the 1990s were notable for the spread of corruption, the exhaustion of infrastructure, the creation of weak institutions and the very slow pace of reform. During the recent years of economic growth, the authorities did not manage to complete structural reforms while the business sector failed to invest sufficient funds to upgrade their production technologies. These factors were among the reasons for Ukraine's sharp economic downturn during the recent crisis, so that Ukraine's ranking in the World Economic Forum's competitiveness ranking in 2010 was 89<sup>th</sup> (out of 139 countries), a fall of 7 places compared to the previous measurement.<sup>49</sup> (Table 1.5).

**Table 1.5. Global Competitiveness Index for Ukraine**

	2007/2008	2008/2009	2009/2010	2010/2011
<b>Global Competitiveness Index</b>	<b>73</b>	<b>72</b>	<b>82</b>	<b>89</b>
<i>Total number of countries</i>	131	134	133	139
<b>Basic requirements</b>	<b>90</b>	<b>86</b>	<b>94</b>	<b>102</b>
1st pillar: Institutions	115	115	120	134
2nd pillar: Infrastructure	77	79	78	68
3rd pillar: Macroeconomic stability	82	91	106	132
4th pillar: Health and primary education	74	60	68	67
<b>Efficiency enhancers</b>	<b>66</b>	<b>58</b>	<b>68</b>	<b>72</b>
5th pillar: Higher education and training	53	43	46	46
6th pillar: Goods market efficiency	101	103	109	129
7th pillar: Labour market efficiency	65	54	49	54
8th pillar: Financial market development	85	85	106	119
9th pillar: Technological readiness	93	65	80	83
10th pillar: Market size	26	31	29	38
<b>Innovation and sophistication factors</b>	<b>75</b>	<b>66</b>	<b>80</b>	<b>88</b>
11th pillar: Business sophistication	81	80	91	100
12th pillar: Innovation	65	52	62	63

Source: WEF (2007), WEF (2008), WEF (2009), WEF (2010)

restrictions on the type of company activities that can be financed. Some banks, such as Ukreximbank, Raiffeisenbank Aval, Ukrsibbank, Forum, Svedbank and the Credit Europe Bank cooperate with both the EBRD and the IFC within their respective trade financing programme frameworks.

To sum up, enterprise crediting in Ukraine developed strongly prior to the crisis, although its potential in the financing of entrepreneurial activities and in upgrading production was obviously not used to the full. Nevertheless, the rapid development allowed standardised processes of crediting and some unifying of the relevant bank products to emerge. The main factor allowing

Market size is Ukraine's main competitive advantage. In addition, the country's ranking in the higher education and training pillar remains high, mainly explained by the large number of people who have undergone higher education. However, about 20% of companies indicated the mismatch between graduates' skills and employers' requirements was one of the obstacles to business development.<sup>50</sup>

The ranking on labour market efficiency in Ukraine is also quite high, which can be attributed to the relatively simple procedure for hiring and firing staff as well as by the comparatively low remuneration rates. This result is also confirmed by the IFC's *Doing Business* study<sup>51</sup> where Ukraine was ranked 83<sup>rd</sup> in the employing workers index.

<sup>49</sup> Or 5 places down if compared only with the countries included in the previous measurement of the index. See WEF (2010).

<sup>50</sup> EBRD-WB (2005)

<sup>51</sup> IFC (2009b)

Ukraine's main problem with respect to competitiveness has always been, and remains today, the existence of inefficient institutions whose modernization and reform has yet to be completed after almost twenty years of independence. In addition, the low level of efficiency in the goods markets remains a major issue, partly due to high taxes, inconvenient tax administration, problems with protection in the market, high trade non-tariff barriers and complicated customs procedures. However, the Global Competitiveness Index (GCI) ranking for 2010 indicated there was a comparatively low level of tariff restrictions on trade.

In international comparisons based on the GCI (Figure 1.15), Ukraine is roughly in the middle of other CIS countries, but is below the level of the EU member states. In particular, Ukraine lags considerably behind European countries in terms of the development of institutions, goods markets efficiency and technological readiness. The latter is largely caused by the use of energy and material-intensive outdated technologies.

Overall, Ukraine's ranking in terms of competitiveness is low. The indices clearly indicate the weakest areas and thus those points, which the Ukrainian authorities should pay attention to. In particular, further economic development requires the government to place particular focus on the improvement of institutions, increasing the efficiency of financial markets and implementing tax reform. To foster the development of trade, non-tariff restrictions should be reduced and customs procedures should be simplified. The reforms

would promote an improvement in the investment environment in the country, which, in turn, would promote technological readiness and goods market efficiency.

**Competitiveness of Ukraine's oblasts.** Results of the studies in Ukraine's oblasts conducted jointly by the Foundation for Effective Governance and the World Economic Forum confirm considerable stratification in both the level of development as well as in the competitiveness of the country's regions.<sup>52</sup>

According to the 2010 report (Table 1.6), competitiveness is the highest in Kyiv, whose score corresponds to the indicator for Hungary (4.21), as well as in the Dnipropetrovsk oblast whose score (4.12) is similar to that of the Russian Federation in terms of competitiveness. The following two positions are occupied by Zakarpattia and Lviv oblasts (4.09 each), which corresponds to the development level of Kazakhstan and Latvia. The conventional top seven is Kharkiv oblast having 4.04, ranked 76<sup>th</sup> in the international ratings between Columbia and Egypt. The Vinnytsia oblast recorded the lowest rate of competitiveness, which placed it 111<sup>th</sup> among 152 countries (equal to Senegal).

The dispersed ratings of the Ukrainian oblasts prove that there are considerable differences in the rates of economic and institutional development between the regions of the country and, accordingly, means that the state needs to pursue a concerted policy of regional development. That will be promoted by budgetary reform leading to greater fiscal independence of the oblasts.

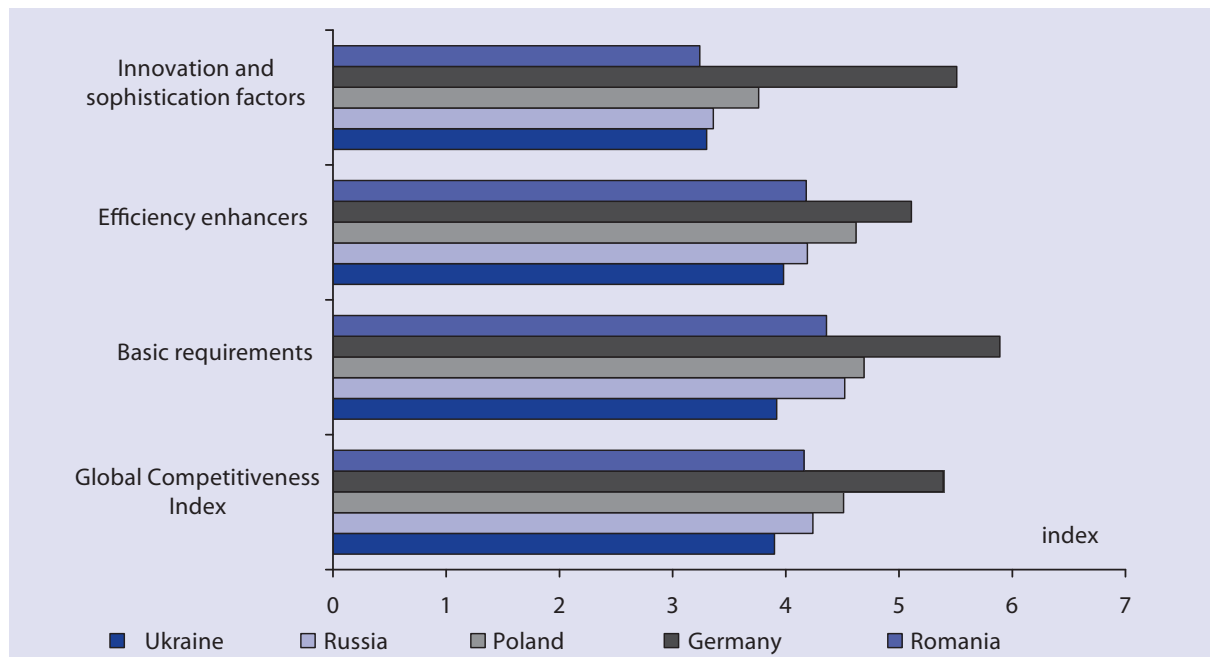


Figure 1.15. Global Competitiveness Index in 2010/2011.

Source: WEF (2010)

<sup>52</sup> Ranking the competitiveness of Ukraine and of the Ukrainian regions – Foundation for Effective Governance [http://www.feg.org.ua/ua/cms/projects/studying\\_Ukraine\\_competitiveness](http://www.feg.org.ua/ua/cms/projects/studying_Ukraine_competitiveness).



Table 1.6. Global Competitiveness Index for Ukrainian oblasts in 2010

	Kyiv City	Dnipropetrovsk oblast	Zakarpattia oblast	Lviv oblast	AR Crimea	Donetsk oblast	Kharkiv oblast	Poltava oblast	Cherasky oblast	Khmelnytsky oblast	Zaporizhia oblast	Odesa oblast	Luhansk oblast	Kherson oblast	Volyn oblast	Rivne oblast	Ivano-Frankivsk oblast	Sunny oblast	Zhytomyr oblast	Vynnytsia oblast
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
<b>Regional Competitiveness Index, out of 152 countries</b>	<b>59</b>	<b>65</b>	<b>67</b>	<b>69</b>	<b>72</b>	<b>73</b>	<b>76</b>	<b>89</b>	<b>88</b>	<b>89</b>	<b>92</b>	<b>95</b>	<b>96</b>	<b>100</b>	<b>102</b>	<b>103</b>	<b>104</b>	<b>106</b>	<b>107</b>	<b>111</b>
<b>Basic requirements</b>																				
1st pillar: Institutions	17	13	1	3	19	7	9	11	6	18	14	15	2	12	4	8	16	10	5	20
2nd pillar: Infrastructure	3	2	10	4	1	5	9	8	13	6	11	7	17	14	19	18	16	12	20	15
3rd pillar: Macroeconomic stability	1	11	5	7	2	19	4	8	16	3	12	13	20	17	6	9	14	18	15	10
4th pillar: Health and primary education																				
<b>Efficiency enhancers</b>	<b>1</b>	<b>4</b>	<b>7</b>	<b>6</b>	<b>2</b>	<b>5</b>	<b>3</b>	<b>9</b>	<b>17</b>	<b>10</b>	<b>8</b>	<b>15</b>	<b>12</b>	<b>13</b>	<b>14</b>	<b>11</b>	<b>18</b>	<b>20</b>	<b>16</b>	<b>19</b>
5th pillar: Higher education and training	1	5	10	4	20	12	3	8	2	6	13	16	7	9	15	18	14	19	11	17
6th pillar: Goods market efficiency	2	3	1	19	5	11	8	14	12	15	18	6	17	9	16	13	7	10	4	20
7th pillar: Labour market efficiency	2	6	19	1	20	4	9	11	10	3	8	14	5	18	12	7	15	13	16	17
8th pillar: Financial market development	1	4	2	6	10	3	5	13	7	17	14	9	18	8	12	16	15	19	11	20
9th pillar: Technological readiness																				
10th pillar: Market size	5	1	4	16	3	6	9	10	14	12	7	8	2	18	11	15	13	20	17	19
<b>Innovation and sophistication factors</b>	<b>1</b>	<b>3</b>	<b>4</b>	<b>2</b>	<b>15</b>	<b>5</b>	<b>6</b>	<b>9</b>	<b>11</b>	<b>20</b>	<b>7</b>	<b>17</b>	<b>8</b>	<b>10</b>	<b>13</b>	<b>19</b>	<b>12</b>	<b>14</b>	<b>18</b>	<b>16</b>
11th pillar: Business sophistication																				
12th pillar: Innovation																				

Source: Foundation for Effective Governance (presentation of the World Economic Forum report)

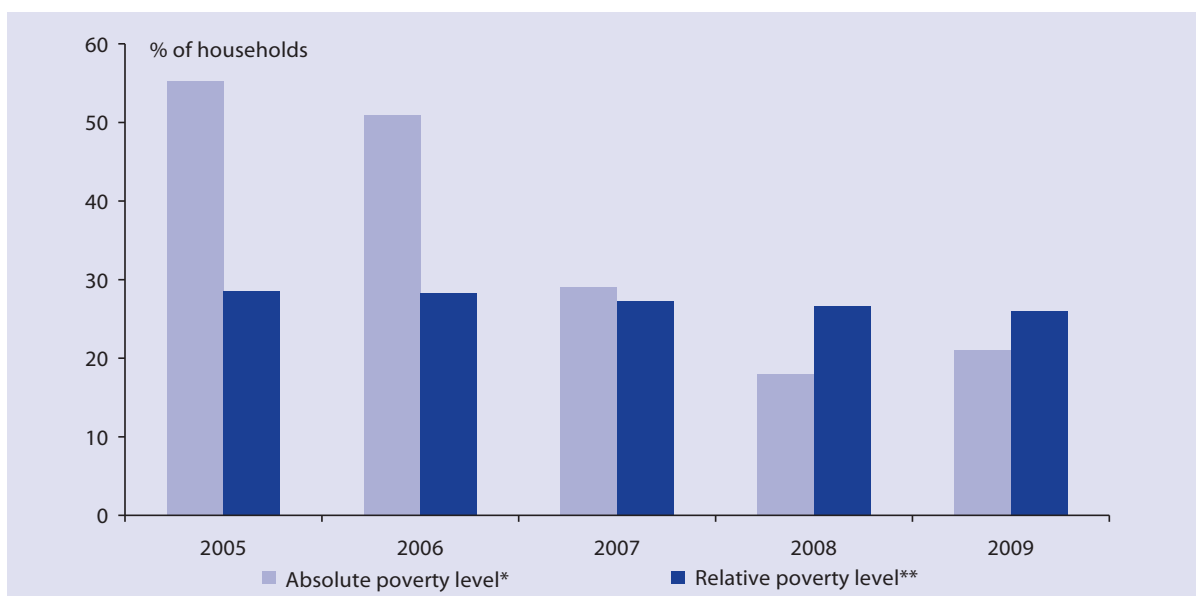
## 1.3 THE LEVEL OF HUMAN DEVELOPMENT IN UKRAINE

### 1.3.1 Poverty and inequality

Poverty reduction has been a priority for the country's state policy in recent years. Before 2009, the government adopted an annual action plan to implement the Poverty Reduction Strategy, which had been approved by the President in 2001. The measures envisaged in the Strategy concerned employment and labour remuneration, education and social support for various population groups. They were to be implemented in three stages: 2001-2002, 2003-2004

which can be indicative of an inefficient state policy of support for such families. In addition, poverty is higher in rural than in urban areas. That reflects the low level of rural development and a lack of sufficient attention to this problem by the State.

According to an elaborated draft State Programme for Overcoming and Preventing Poverty in Ukraine, it is envisaged that extreme poverty will be eliminated between 2010-2015, i.e. to considerably reduce the share of the population whose daily consumption is below USD 5.05 (in PPP terms).<sup>54</sup> At the same time, the Programme forecasts that relative poverty will not change substantially (25% in 2015). It is planned to reduce the poverty incidence among children from



**Figure 1.16. Poverty levels in Ukraine, 2005-2009**

Source: State Statistics Committee

Note:

\* Absolute poverty is measured as the percentage of households having aggregate per capita income lower than the minimum level of subsistence.

\*\* Relative poverty level is calculated according to an officially approved methodology as a percentage of households having an aggregate income, which is lower than the 75% of median cumulative monthly equivalent spending per capita.

and 2005-2009. The goals of the first two Strategy implementation stages were partially achieved: extreme poverty was reduced while there was a steady growth in people's income. This reflected a period of economic growth, that being the best way to combat poverty. Wages grew due to higher productivity and due to a higher minimum wage. Households obtained access to bank credits that also promoted an increase in final consumption. However, the level of absolute poverty rose again in 2009 due to the economic crisis.<sup>53</sup> At the same time, the level of relative poverty remained stable, owing to the stratification of households in terms of income (Figure 1.16).

At the same time, the level of poverty among households with children remains a major problem,

35% in 2009 to 29% in 2015. In addition, measures are envisaged to reduce poverty among working persons.

Ukraine's authorities gradually increased social standards between 2004 and 2009, including increases to the minimum wage and minimum pension. This partially compensated for the impact of higher inflation on the poor. The average annual rate of consumer price growth was 14.1% during that period.

It should be noted, however, that imbalances were observed during the period of the increases in the minimum pension and the minimum wage (Figure 1.17). In particular, the minimum monthly pension was increased during 2004 from UAH 102.8 in January to UAH 284.6 in September, which was mainly explained by the government's populist decisions on the eve

<sup>53</sup> According to data from the State Statistics Committee, poverty levels had increased by the end of the first quarter of 2010. The percentage of the population whose per capita income was lower than the minimum subsistence level increased by 9 percentage points, to 30% compared with the first quarter of 2009.

<sup>54</sup> MEU (2010)

**Table 1.7. Poverty indicators, 2005-2009**

	2005	2006	2007	2008	2009
The share of the population whose daily consumption is below US\$ 5.05, measured in PPP terms, %	9.0	6.0	6.6	3.8	3.5
Relative poverty of families having children, %	35.4	35.3	33.9	33.1	33.6
Relative poverty of families having no children, %	17.7	19.3	19.4	19.7	22.3
Percentage of the poor among children, %	36.7	36.6	36.3	35.1	37.1
Relative poverty of rural families, %	35.2	38.4	37.9	38.2	36.4

Source: MEU (2010)

of elections.<sup>55</sup> The minimum pension was increased again in 2005 to UAH 332 following the adoption of a law on setting the minimum pension equal to the level of subsistence minimum established for persons who had lost the ability to work. As a result, the minimum wage was lower than the minimum pension during the period from September 2004 to September 2005, which was not an economically sensible policy.

Since the nominal pension increases were considerably higher than the growth of consumer prices, real minimum pension payments went up 2.9 times in January 2005 compared to January 2004. Thereafter the minimum pension remained relatively stable until the 2008 crisis set in. In late 2008 and early 2009, there was a decline in the real minimum pension because of the country's fiscal problems, which made any significant pension rise impossible.

Moreover, the large increases in minimum pensions during the period of strong economic growth were not supported by reform of the entire pension system. This resulted in a considerable Pension Fund deficit since the labour remuneration fund, the base for calculating pension contributions, grew at a slower pace. As a result, the current pension system is extremely unstable, thereby creating additional economic risks for the poor of the country.

The rise in the minimum wage partially explained the growth of the average monthly wage, which rose from UAH 806 in 2005 to UAH 1906 in 2008. Another driver behind the growth of wages consisted of higher labour productivity on the back of more intense production and better financial indicators of companies. The percentage of staff members receiving wages lower than the level of subsistence minimum fell from 26.5% in December 2005 to 13.4% by December 2008 (Figure 1.18).

The percentage of persons receiving less-than-minimum wages declined to 10.7% in December 2009 due to the introduction of a legislation that provides for setting the minimum wage equal to the level of subsistence minimum established for working able persons since November 2009. As a result, due

to legislation amendments there has been a slight decrease in the percentage of the working poor.

Generally, the employment of household members does not guarantee a sufficient level of the household's earnings. In particular, 79% of the poor are currently members of households with at least one working member.<sup>56</sup> This can be explained by the comparatively low labour remuneration rates in Ukraine, a consequence of low labour productivity that is, in turn, often caused by using out-of-date equipment and resource-intensive technologies in production.

The largest fall in the percentage of workers, whose wages are lower than the minimum level of subsistence, occurred in budget-funded sectors, particularly education and health care. This can be explained by the stepwise introduction of the Unified Tariff Scale (UTS) for labour remuneration in budget-funded sector institutions, approved by a resolution of the Cabinet of Ministers.<sup>57</sup> The UTS was partially implemented from September 2005: the salary of a wage grade I employee was set as equal to the minimum wage, but with less differentiation in wage levels between various employees. The UTS was implemented completely in September 2008, but only for two months. Owing to a decline in fiscal revenues in late 2008, the government decided to fix the UTS wage level for grade I for December 2008 and for the whole of 2009 at the November 2008 level, although the minimum wage was further increased gradually. The wage for the first tariff scale was increased insignificantly in 2010 resulting in further reduction in wage differentiation in the public sector.

Increases in other social payments, particularly a large rise in the benefit for childbirth, also contributed to people's growing income. However, despite the efforts of the State, the revision of social standards failed to result in any decline in inequality, which indicates the comparatively faster growth of the incomes of high earners. The situation changed slightly in 2009 since the economic crisis led to a reduction in business profits whereas the income of the poorer groups of the population kept growing

<sup>55</sup> In September 2004, the Cabinet of Ministers decided to increase the minimum pension payment. Accordingly, each pensioner whose pension was lower than the specified minimum pension payment obtained an additional payment. The minimum pension payment in this report is regarded as the minimum pension because no pensioner may receive a pension lower than the specified minimum pension payment.

<sup>56</sup> MEU (2010)

<sup>57</sup> Before the implementation of the Unified Rate Schedule, wages in the budget-funded sector were specified by the Cabinet of Ministers resolutions that clearly set salary rates for various employees.

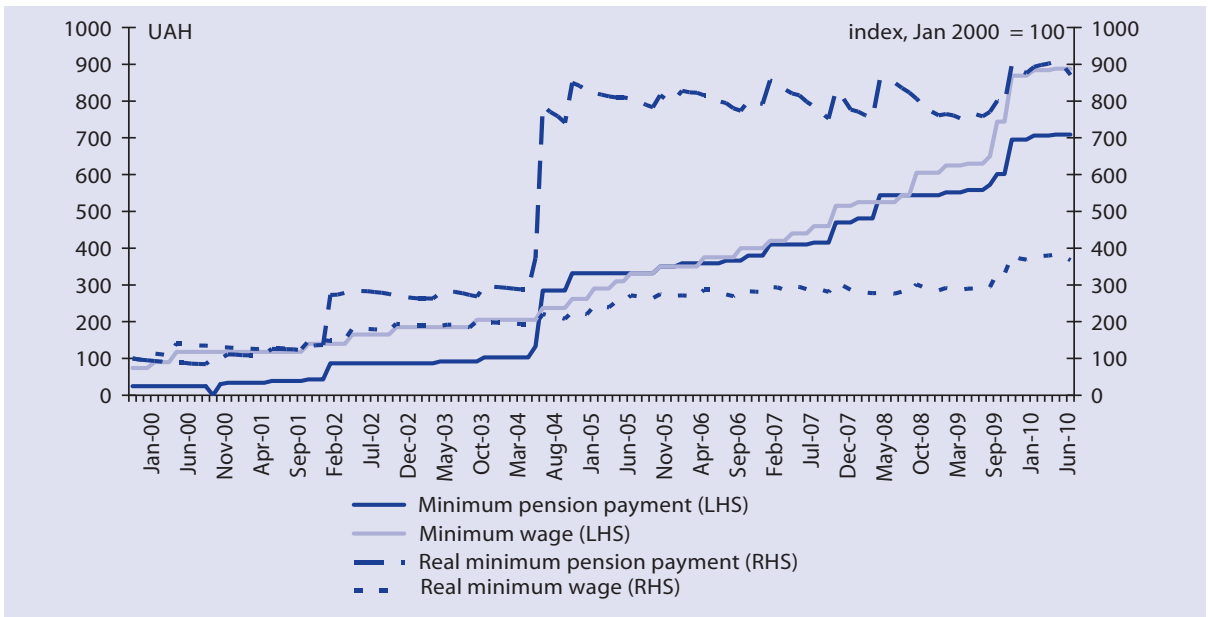


Figure 1.17. Minimum wage and minimum pension, 2000-2010

Sources: Laws on the State Budget



Figure 1.18. Distribution of staff members by wage size, 2005-2009 \*

Source: State Statistics Committee of Ukraine

Notes:

\* Data is provided for the staff members who worked 50% and more working hours

\*\* Subsistence minimum for working able persons

as both pensions and the minimum wage were increased. However, given lower labour demand, there was no substantial change in the indicators of inequality during the crisis (Table 1.8).

During the years of independence, Ukraine's governments failed to properly reform the provision of social benefits. The system features numerous social privileges which are granted in-kind such as reduced tariffs for housing and utility services, gas, electricity, transport, installation and use of telephone lines, purchase of certain medicines, sanitarium treatment, etc. Furthermore, no restriction on the use of these privileges (e.g. transportation) has been set.

The privileges are granted to pensioners, labour and war veterans and their families, and victims of the Chernobyl accident. Another group entitled to these privileges includes civil servants, militiamen, military servicemen, and people who provided services to the Fatherland. More than a third of the population were entitled to privileges in 2009. Thus, targeting social benefits on the poorest groups of the population remains low because the privileges are provided to various groups based mainly on their services rather than on their income level.

As a result, richer households receive considerably more privileges and benefits than poorer ones.

**Table 1.8. Inequality indicators estimated in terms of overall income, 2007-2009**

	2007	2008	2009
Income ratio between the richest 10% and the poorest 10% of the population	5.2	5.4	5.3
Gini index	0.252	0.259	0.257

Source: State Statistics Committee of Ukraine

Furthermore, not all poor households are able to enjoy their privilege entitlement.<sup>58</sup> Besides, cash benefits to disadvantaged families are now provided subject to the guaranteed level of subsistence minimum rather than the subsistence minimum level itself.

In 2009, the government approved the Strategy to Streamline the Privilege System until 2012. Within the strategy, there is no plan to introduce targeted social benefits or to cancel privileges granted on an occupational basis. However, these steps are envisaged in the Programme of Economic Reforms developed by the Committee for Economic Reforms under the President of Ukraine in 2010.

To sum up, it should be emphasised that the State has pursued a rather populist social policy in recent years. In particular, social standards were increased considerably, including higher minimum pensions and minimum wages. At the same time, the system of social benefit provision was not reformed, so it remains inefficient. Absolute poverty in Ukraine has decreased as a result of the government's actions, but relative poverty remains high. To promote further poverty reduction, the government should implement comprehensive reforms that would support further economic growth and, accordingly, an improvement in household wellbeing. At the same

time, it is necessary to introduce a targeted social benefit system that will help the poorest section of the population.

### 1.3.2 Other aspects of human development in Ukraine

In the ranking presented by the United Nations Development Programme, which was calculated in 2010 according to a new methodology, Ukraine is among the countries with high levels of human development (its Human Development Index, or HDI, is 0.710) and was ranked 69<sup>th</sup> out of 169 countries of the world.<sup>59</sup> However, Ukraine's ranking has fallen by three steps over the past five years.

Ukraine's current Human Development Index is comparable to the average level for Europe and Central Asia (0.702) as well as Latin America and Caribbean states (0.704). At the same time, Ukraine's HDI lags behind the average for group of countries with the high HDI (0.717).

It can be seen from Table 1.9 that Ukraine's ranking reflects the low level of its gross national income and low life expectancy at birth. At the same time, Ukraine is highly ranked for its level of education.

Over the past twenty years for which the HDI has been calculated, Ukraine has experienced a considerable worsening of the GNI per capita indicator, which was mainly caused by the transformation structural crisis of the country's economy. Life expectancy at birth is another indicator that has declined over the period 1980-2010. Average life expectancy was 70.1 years in 1985, but the figure for 2010 is 68.6 years (Table 1.10).

The low levels of life expectancy are an indicator of the low health levels of Ukraine's population. It is very difficult to compare Ukraine's mortality and

**Table 1.9. Ukraine's human development ranking, 2010**

Human Development Index	Life expectancy at birth (years)	Mean years of schooling (of adults) (years)	Expected years of schooling (of children) (years)	GNI per capita (constant 2008 USD in PPP*)
1. Norway (0.938)	1. Japan (83.2)	1. Norway (12.6)	1. Australia (20.5)	1. Liechtenstein (81011)
67. Azerbaijan (0.713)	111. Micronesia (69.0)	16. Japan (11.5)	40. Liechtenstein (14.8)	96. Suriname (7093)
68. Bosnia and Herzegovina (0.710)	112. Moldova (68.9)	17. Canada (11.5)	41. Seychelles (14.7)	97. Turkmenistan (7052)
69. Ukraine (0.710)	113. Ukraine (68.6)	18. Ukraine (11.3)	42. Ukraine (14.6)	98. Ukraine (6535)
70. Iran (0.702)	114. Iraq (68.5)	19. Netherlands (11.2)	43. Belarus (14.6)	99. Salvador (6498)
71. Macedonia (0.701)	115. Kyrgyzstan (68.4)	20. Bahamas (11.1)	44. Chile (14.5)	100. Namibia (6323)
169. Zimbabwe (0.140)	183. Afghanistan (44.6)	173. Mozambique (1.2)	190. Somalia (1.8)	185. Zimbabwe (176)

Source: UNDP (2010)

<sup>58</sup> Handrich, Betliy (2008)

<sup>59</sup> UNDP (2010)

**Table 1.10. Trends in Ukraine's Human Development Index**

Years	Life expectancy at birth (years)	Expected years of schooling (of children) (years)	Mean years of schooling (of adults) (years)	GNI per capita (constant 2008 USD in PPP*)	Human Development Index
1980	69.3	11.9	7.4		
1985	70.1	12.2	8.2		
1990	69.7	12.4	9.1	8928	0.690
1995	67.8	11.9	10.4	4153	0.644
2000	67.4	12.9	10.7	3882	0.649
2005	67.9	14.2	11.1	5976	0.696
2010	68.6	14.6	11.3	6535	0.710

Source: UNDP (2010)

morbidity indicators with those of other European countries since most general health indicators in Ukraine are very low and more comparable to such indicators for developing countries.

Moreover, the country has experienced a steady decline in its population: the rate of population's decline in Ukraine is currently the highest in Europe. The number of working-age men has fallen extremely quickly. The life expectancy for men is 12 years less than that for women.

According to the World Bank estimates<sup>60</sup>, Ukrainians have fewer years of good health compared to other Europeans. Ukrainians experience bad health for 12% of their lives. In other words, Ukrainians' chances of living a long life and maintaining good health are limited whereas good health is one of the basics of human development.

According to data from the State Statistics Committee of Ukraine, most deaths in Ukraine are caused by cardiovascular (63%) and oncological (12%) diseases. In addition, there is also a high rate of mortality from external causes (injuries, suicides, murders, road accidents) – 8%.

Another worrying factor is the sharp increase in the number of AIDS patients as well as persons sick with tuberculosis. Mortality caused by these diseases was the highest in Europe as of early 2005.<sup>61</sup> According to the UNAIDS, about 1.33% of Ukraine's adult population are currently HIV-positive, which, unfortunately, implies there is an HIV/AIDS epidemic in Ukraine.

The high mortality and low life expectancy indicators in Ukraine are not purely a medical problem. Along with a low level of health care services, the health crisis in Ukraine is caused by unfavourable social and environmental conditions, unsatisfactory working conditions, unhealthy lifestyles, and the generally low culture of caring for one's own health.

Another aspect of human development is an access to high quality education as educated people generally live better. Ukraine's population is well educated; adult literacy rate is almost 100%. 85% of

Ukraine's population aged between 25 and 64 have at least secondary education.<sup>62</sup> As a result, Ukraine is ranked highly in terms of adult literacy among the other countries.

However, the quality of education is a different matter. Rather considerable amount of funds is spent on education in Ukraine. Education spending accounts for about 20% of budget expenditures and for 6% of GDP. At the same time, investments in improving the quality of education are small because 85% of expenditures are to pay the salaries of education workers and to meet the utility bills of educational institutions.

As a result, the access of Ukrainians to high quality and modern education that provides favourable job opportunities is rather limited. There is a mismatch between education levels and labour demand in Ukraine. As previously mentioned, one-fifth of companies indicated the mismatch between graduates' skills and employers' requirements as one of the obstacles for business development.<sup>63</sup>

The growing inequality and poverty in the world was one of the main reasons for expansion of HDR family of indices. Since 2010 the Inequality-adjusted HDI, the Gender Inequality Index, and the Multidimensional Poverty Index have been additionally measured.

If the HDI value is inequality-adjusted, the HDI for Ukraine falls to 0.652 due to the negative impact of inequality upon the country's human development level, and it is generally typical for all countries. However, the country's position in the ranking increases in this case: Ukraine ranks 39<sup>th</sup> in this indicator among 140 countries for which it is calculated.

Ukraine ratified all the fundamental conventions on securing equal rights for women and men. In particular, Ukraine acceded to the Convention on the Elimination of All Forms of Discrimination against Women and its Optional Protocol. It also ratified all the International Labour Organisation's conventions including the Convention concerning Equal Remuneration for Men and Women Workers

<sup>60</sup> WB (2009)

<sup>61</sup> *Ibid.*

<sup>62</sup> State Statistics Committee of Ukraine

<sup>63</sup> EBRD-WB (2005)

for Work of Equal Value (No. 100), the Discrimination (Employment and Occupation) Convention (No. 111) and the Convention concerning Equal Opportunities and Equal Treatment for Men and Women Workers: Workers with Family Responsibilities (No. 156).<sup>64</sup> The basic principles specified by these conventions are also enshrined in the Constitution and other legislative acts of Ukraine.

However, despite official declarations of non-discrimination principles, signs of gender discrimination can be seen in Ukraine. In terms of the Gender Inequality Index, Ukraine is ranked 44<sup>th</sup> with a score of 0.463, roughly halfway between 0 (full equality) and 1 (full inequality). Inequality shows itself in the fact that women earn 26.3% less on average than men and work for 4-6 hours longer, but this labour – housekeeping – is not considered productive. Thus, this work is unpaid and is not taken into account for the purposes of calculating the size of pension.

Women earn less than men do since most of them (more than 60%) work in traditional female occupations which tend to be low-paid, such as care, public catering, cleaning, office work, and as cashiers. Ukraine ranks 105<sup>th</sup> in the world in females political empowerment out of 134 countries, although Ukraine's overall ranking in Global Gender Gap Index is 63.<sup>65</sup> The percentage of women in the Parliament of Ukraine is 8.2% whereas women account for 35% of all members in the newly elected European Parliament.<sup>66</sup> Women in Ukraine control only 5-10% of economic resources<sup>67</sup>; there are only 38% women among private entrepreneurs; and women manage 26% of small businesses, 15% of medium-sized enterprises and 12% of large ones.<sup>68</sup>

Hence, despite the high levels of education among Ukraine's population, its level of human development almost has not changed over last 20 years, mainly due to low indicators of life expectancy and incomes.

<sup>64</sup> *The Rights of Women and Children in Ukraine project. Funded by the EU.* [http://vsirivni.com.ua/page38.htm#\\_ftn9](http://vsirivni.com.ua/page38.htm#_ftn9)

<sup>65</sup> WEF (2010b)

<sup>66</sup> European Parliament <http://www.europarl.europa.eu/parliament/public/staticDisplay.do?id=45&pageRank=3>

<sup>67</sup> Institute of Demography, National Academy of Sciences of Ukraine

<sup>68</sup> EU (2009)





# SECTION 2

## TRADE AND INVESTMENT POLICIES

## SECTION 2. TRADE AND INVESTMENT POLICIES

### 2.1 DYNAMICS OF TRADE IN GOODS AND SERVICES

#### 2.1.1 General patterns

The country's economic growth during 2000-2007 and the favourable external economic conditions were reflected in foreign trade patterns. The turnover of trade in goods and services in 2008 was 4.5 times larger when compared to 1996. The greatest share of that growth was provided by trade developments between 2003 and 2008: during that period, exports of goods and services increased 2.8 times and imports grew 3.8 times.

The country's economy is open. During 2005-2009, exports of goods and services amounted to about 47% of GDP whereas imports totalled nearly 50%. Thus, the growth of real GDP in Ukraine is highly sensitive to world market fluctuations, exchange rates and trends in economic development in partner countries.

The balance of foreign trade in goods and services was positive prior to 2005 (Figure 2.1). However, as lending for consumer needs developed and no substantial changes in the structure of production and exports occurred (about 75% of the total exports consist of intermediate consumption goods), the growth in the volume of commodity imports exceeded that of exports, resulting in a negative balance of trade in goods and services from 2005. It should be noted that a surplus in trade of services was recorded throughout the period.

The global crisis had a considerable negative impact on the development of foreign trade. Exports

of goods and services contracted by 37.4% (dollar equivalent) in 2009 whereas imports dropped by 45.0%. The decrease in exports of goods and services, which occurred, reflected lower sales of metals as external demand fell sharply because investment projects in developed countries were cut back. Imports of goods and services also decreased mainly due to the lower demand for investment (durable) goods and mineral products. Since no structural change was implemented during the crisis year of 2009, the gradual recovery in foreign trade that has taken place in 2010 was due to the recovery of exports and imports of relevant commodity categories.

Ukraine's main trade partners are the CIS and EU countries. The share of the CIS in Ukraine's foreign trade has fallen steadily: it accounted for 58.8% of total trade turnover in 1996 but fallen to 37.8% by 2009 (Figure 2.2). This development took place amid an increase in the share of the EU countries and, in recent years, of Asian states in Ukraine's foreign trade in goods and services. Ukraine was a net importer in its trade with the CIS countries throughout this period, mainly due to its considerable imports of energy products. Since 2005 Ukraine has also become a net importer in its trade with the EU countries as demand for durable goods and equipment rose. A positive balance in trade in goods and services with African and Asian countries emerged due to large exports of metals and agricultural products. The CIS countries accounted for 33.9% of Ukrainian commodity exports and 43.3% of commodity imports as of mid-2010

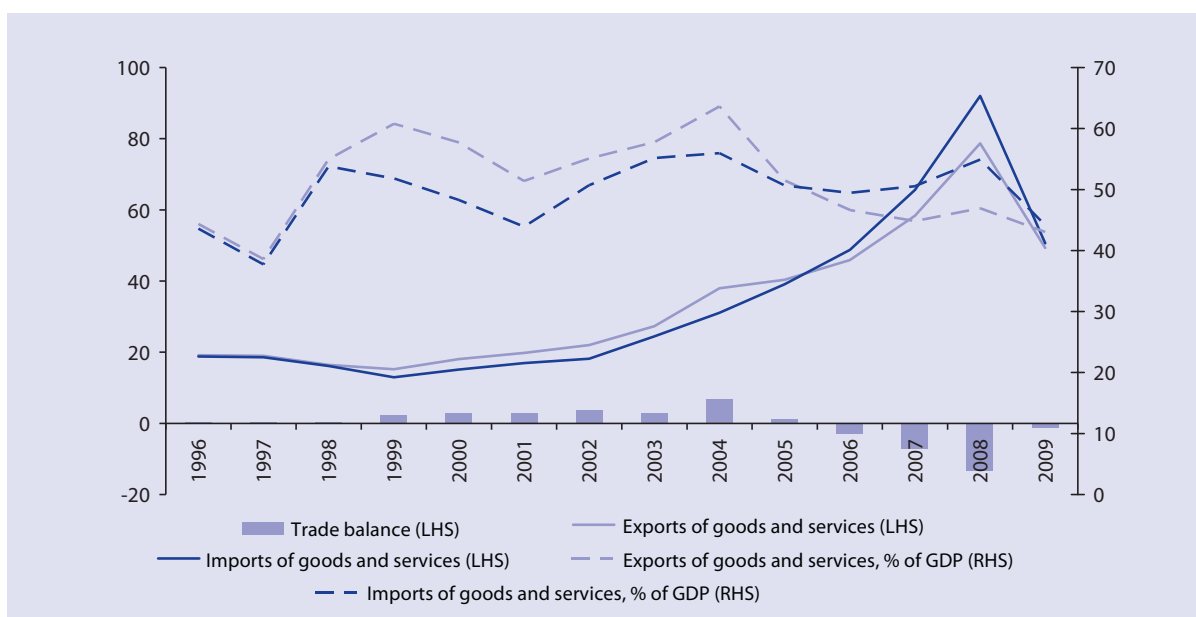
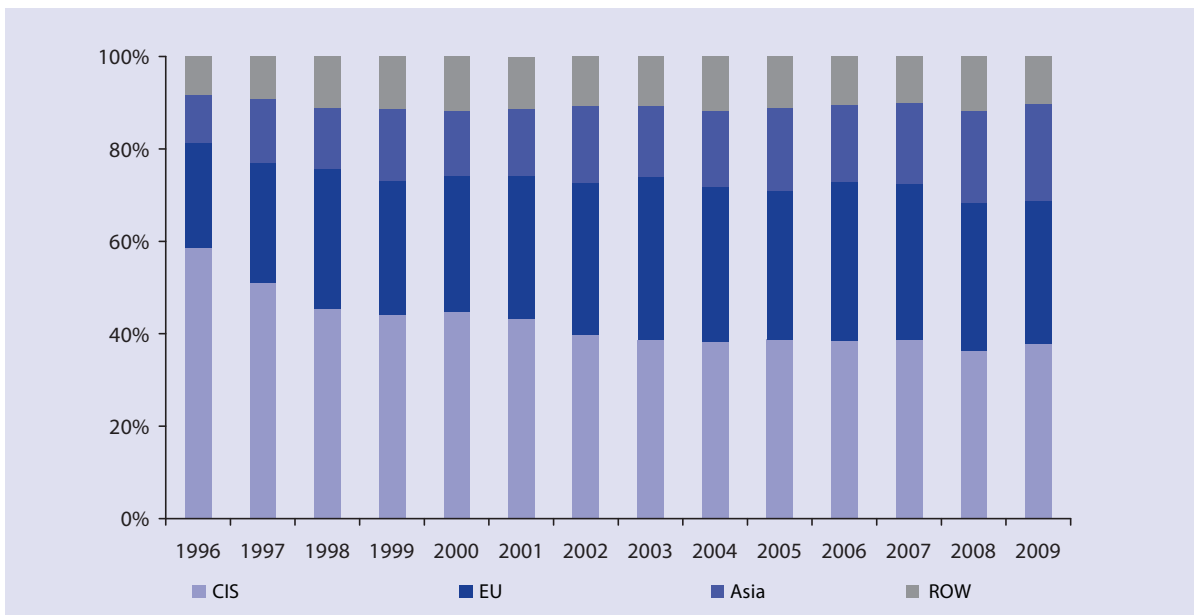


Figure 2.1. Foreign trade in goods and services, 1996-2009.

Source: State Statistics Committee of Ukraine, IER calculations



**Figure 2.2. Geographical structure of Ukraine's trade turnover, 1996-2009**

Source: State Statistics Committee of Ukraine, IER calculations

whereas the respective figures for the EU were 23.9% and 33.9%.

Although goods account for the lion's share in Ukraine's foreign trade, the percentage of services in both exports and imports rose gradually on the back

unchanged – such as manufactured goods, mineral fuels, food and live animals, and inedible crude materials – there were some changes in their share of total exports. The main categories of imports of goods include machinery and transport equipment, mineral

**Table 2.1. Ukraine's foreign trade, 2000-2009**

		2000	2005	2006	2007	2008	2009
Exports of goods and services	million USD	19522	44378	50239	64001	85612	54253
Percentage of exports of services	% of total volume	19.5	21.1	22.5	22.1	20.9	25.5
Imports of goods and services	million USD	19897	43707	53307	71877	100132	56275
Percentage of imports of services	% of total volume	15.1	17.3	17.2	16.0	15.5	19.9

Source: NBU

of a general tendency toward a greater role of the service sector in Ukraine's economy.

In addition to changes in the pattern of foreign trade in goods and services and in its key characteristics, certain changes also occurred in the structure of trade during the recent decade. Although the main commodity export categories remained

fuels (the share of which has decreased considerably over the past ten years), manufactured goods and chemicals. It should be stressed that intermediary consumption goods account for the bulk of both exports and imports of goods.

Transport services, travel and financial services dominate the structure of foreign trade in services.

**Table 2.2. Structure of foreign trade in goods, 1996-2009**

	Exports				Imports			
	1996	2000	2005	2009	1996	2000	2005	2009
Total volume, billion USD	14.4	14.6	34.2	39.7	17.6	14.0	36.1	45.4
% of total volume								
Food and live animals	14.8	5.6	9.0	15.2	6.1	4.6	5.3	8.2
Beverages and tobacco	1.3	0.7	1.4	1.6	1.4	1.3	1.3	1.4
Crude materials, inedible	9.1	12.7	7.2	9.6	4.7	5.5	4.0	3.4
Mineral fuels	4.5	5.6	9.8	5.4	47.8	43.0	29.6	32.2
Animal and vegetable oils	1.3	1.6	1.7	4.4	0.2	0.3	0.5	0.7
Chemicals	12.7	9.0	9.0	6.2	6.7	8.6	11.7	15.3
Manufactured goods	36.9	45.1	43.6	36.1	11.5	12.8	14.8	13.7
Machinery and transport equipment	14.6	12.9	13.8	16.6	17.1	17.6	26.5	18.5
Miscellaneous manufactured articles	3.6	4.5	3.7	4.0	3.7	3.5	5.5	5.8
Commodities not classified elsewhere in the SITC	1.2	2.4	0.8	0.9	0.9	2.7	1.0	0.8

Source: UN Comtrade

The structure of foreign trade in services has changed considerably compared to 1998. The percentage of transport services in exports of services has fallen from 81% in 1998 to 45% in 2009 due to the reduction in the significance of pipeline services whereas the percentage of imports of transport services increased due to the general increase in exports of goods and the resulting increase in demand for transportation services. The development of financial intermediation in Ukraine resulted in a growing share of financial services in imports of services from 4% in 1998 to 12% in 2009.

A positive balance in trade in services has been recorded since 2004<sup>69</sup> with all groups of countries, with only minor exceptions (e.g. a small deficit was recorded with the EU countries in 2009). The geographical concentration is more pronounced for trade in services than for trade in goods. Imports of services are dominated by the EU countries, which accounted for 58.8% of imports as of late 2009. This can be explained both by the considerable turnover of trade with the EU states and by the high demand for tourist services for those countries. The CIS accounts for only 15.2% of the total Ukrainian imports of services. The respective percentages of the EU and the CIS in the exports of services amount to 31.5% and 39.9%, with the share of the CIS having dropped substantially compared to 1996.

The development of trade in recent years has undergone certain changes that were caused both by structural transformations inside the country and by developments in the external environment. However, overall there was little change in either Ukraine's major trade partners or in the shares of the country's main export and imports.

### 2.1.2 Export concentration and specialisation

A high level of export concentration is known to be an important factor in assessing a country's sensitivity to external shocks in commodity markets. We have used a number of indices to estimate the concentration level of Ukraine's commodity exports:

- the Hirschman index, with a value varying between 0 and 1; higher values correspond to a higher level of a country's export concentration. The index is calculated as a square root of the sum of squares of each commodity's share in the country's total exports;<sup>70</sup>
- an index of export diversification by commodity group, which is calculated as half of the sum of the absolute values of differences between each commodity's share in the country's exports and in global exports. Higher values of this index indicate the country has a relatively high export concentration compared to the global export structure;
- the total number of export tariff lines according to SITC Rev.3 classification on the five-digit level, showing the extent of the range of goods sold by the country in the global market.

Analysis of the Ukraine's exports shows a rather high level of concentration (Table 2.3). In particular, the Hirschman index increased from 0.163 in 1996 to 0.171 in 2009. The export diversification index varied between 0.582 and 0.620. The lowest value of this index showed that the greatest diversification of exports was recorded in 2003.

Ukraine's level of export concentration evaluated by the Hirschman index is higher compared to many other Central and East European countries, developed countries as well as some developing

**Table 2.3. Ukraine's export concentration indicators, 1996-2009**

	Diversification index*	Hirschman index *	Number of export tariff lines **
1996	0.604	0.163	2232
1997	0.606	0.181	2154
1998	0.617	0.179	2177
1999	0.620	0.185	2142
2000	0.616	0.187	2163
2001	0.605	0.176	2154
2002	0.617	0.180	2131
2003	0.582	0.178	2165
2004	0.590	0.189	2182
2005	0.608	0.198	2214
2006	0.593	0.196	2219
2007	0.587	0.192	2239
2008	0.606	0.203	2286
2009	0.599	0.171	2290

Source: UN Comtrade, author's calculations

Note: \* According to SITC Rev.3 classification on the three-digit level, 261 items in total

\*\* According to SITC Rev.3 classification on the five-digit level, 3121 items in total

<sup>69</sup> Before 2004, a services trade deficit was registered in trade with some regions

<sup>70</sup> World Bank (2004)

**Table 2.4. Export concentration indicators for Ukraine and selected countries, 1996-2009**

		Hirschman index *	Diversification index*
Ukraine	1996	0.163	0.604
	2009	0,171	0,599
Austria	1996	0.123	0.363
	2009	0,116	0,361
Belarus	1998	0.153	0.505
	2009	0,348	0,620
Brazil	1996	0.145	0.526
	2009	0,172	0,510
China	1996	0.130	0.472
	2009	0,164	0,452
Germany	1996	0.143	0.276
	2009	0,150	0,297
India	1996	0.175	0.598
	2009	0,202	0,476
Poland	1996	0.136	0.474
	2009	0,142	0,420
Romania	1996	0.183	0.624
	2009	0,153	0,450
Russia	1996	0.302	0.685
	2009	0,389	0,666
Turkey	1996	0.163	0.631
	2009	0,140	0,509
U.S.	1996	0.135	0.267
	2009	0,144	0,245

Source: UN Comtrade, own calculations

Note: \* According to SITC Rev.3 classification on the three-digit level, 261 items in total

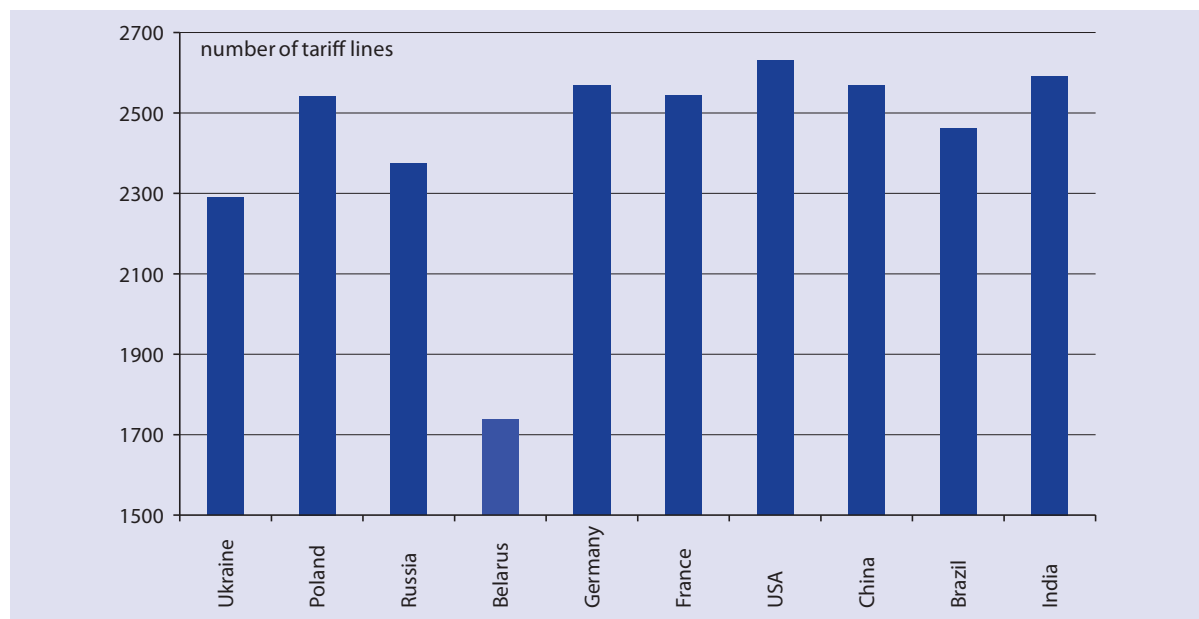
countries such as Brazil and China (Table 2.4). At the same time, the country's concentration level is much lower than that of Russia and Belarus, and is comparable to that of India.

Compared to the structure of global exports, Ukraine's exports are more concentrated than that of developed countries although comparable to the export diversification levels in Russia and Belarus. While Ukraine's diversification level remained almost unchanged during the period 1996-2009, many

countries, for example Romania, Turkey, Poland, India and Brazil, recorded a marked decrease in their degree of export concentration.

The range of exports of goods estimated from the number of commodity items (tariff lines) exported by the county is also low in Ukraine compared with other countries in the region, developed countries, and BRIC (Figure 2.3).

For a country with a high level of the export commodity concentration, a factor, which can



**Figure 2.3. The range of exports in Ukraine and selected other countries, 2009**

Source: UN Comtrade

potentially reduce export sensitivity to fluctuations in world markets, is specialisation in the production of hi-tech goods, the demand for which has a lower elasticity compared to other goods.

However, the proportion of hi-tech products in Ukraine's overall export structure is rather low. According to the International Trade Centre, it was 3% in 2009 whereas countries known for their specialism

– in Ukraine's export structure is about 14%, one of the lowest figures among countries in the transition region, with the exception of some CIS states.

The indices of competitive advantage – the Balassa and Lafay indices – show that the most competitive Ukrainian-made goods include iron and steel, articles of iron and steel, cereals, oil crops, fertilisers and railway equipment (Table 2.6). The

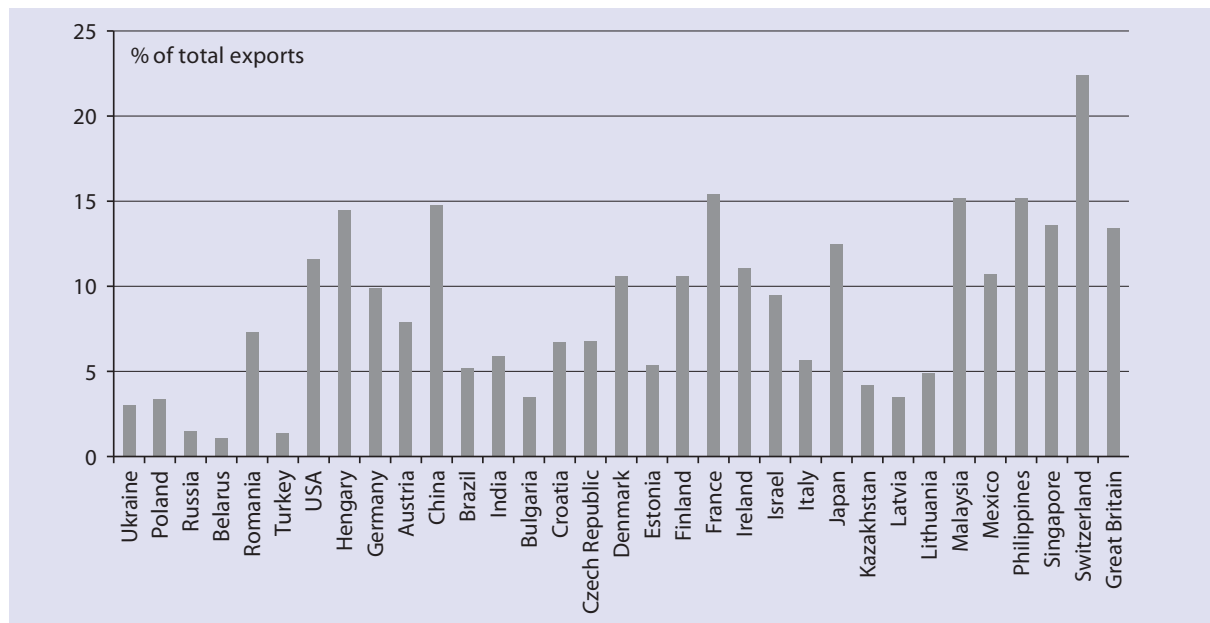


Figure 2.4. The share of hi-tech goods in total exports, 2009

Source: ITC Trade Competitiveness Map

in hi-tech exports have considerably higher figures. For example, the share of hi-tech exports in total exports is 9.9% in Germany, 13.6% in Singapore and 22.4% in Switzerland (Figure 2.4). The share of hi-tech goods in China's exports is 14.8%.

Ukraine's exports consist mainly of semi-finished goods, which accounted for 68.6% of total exports of goods in 2009. This figure is comparable to that of Belarus, but considerably exceeds the level recorded by many other developing countries as well as developed countries (Table 2.5). The share of end-use goods – capital equipment and consumer goods

latter's competitive advantage is not so much an achievement of engineering for Ukraine in the years after independence as a heritage of the Soviet era from which Ukraine inherited that production. The CIS countries, especially Russia, are the main importers of the Ukrainian-made railway equipment. There has been fairly no change in the list of goods in which Ukraine has a competitive advantage in world markets in recent years, confirming the low diversification and structural rigidity of Ukrainian exports.

Thus, Ukraine's commodity exports are clearly rather highly concentrated and the years of

Table 2.5. Structure of commodity exports for Ukraine and selected countries, by stage of processing, 2009, % of total exports

Country	Primary goods	Intermediary goods	Capital equipment	Consumer goods
Poland	5.1	53.4	15.0	20.6
Russia	52.7	38.8	2.7	1.0
Belarus	5.6	76.5	8.8	7.0
Romania	7.0	51.2	19.6	19.6
Turkey	7.1	58.7	8.5	24.4
U.S.	9.4	42.8	27.9	9.5
Hungary	4.7	40.1	34.6	15.9
Germany	2.5	50.4	27.0	12.7
China	1.9	29.3	41.6	27.0
Brazil	31.0	55.6	7.8	3.8
India	8.8	54.4	9.5	22.8
Ukraine	16.1	68.6	8.9	5.3

Source: ITC Trade Competitiveness Map

Table 2.6. Ukrainian-made goods having competitive advantages in the world market, 2005-2009

	Balassa index			Lafay index		
	code	label	value	code	label	value
2005	86	Railway, tramway locomotives, rolling stock, equipment	12.8	72	Iron and steel	15
	72	Iron and steel	12.6	73	Articles of iron and steel	2
	31	Fertilisers	12.3	10	Cereals	2
	10	Cereals	9.6	31	Fertilisers	1
	15	Animal, vegetable fats and oils, cleavage products, etc.	4.8	86	Railway, tramway locomotives, rolling stock, equipment	1
2009	86	Railway, tramway locomotives, rolling stock, equipment	13.4	72	Iron and steel	12
	72	Iron and steel	11.9	73	Articles of iron and steel	2
	31	Fertilisers	10.0	26	Ores, slag and ash	2
	15	Animal, vegetable fats and oils, cleavage products, etc.	7.4	10	Cereals	1
	12	Oil seeds, oleagic fruits, grain, seed	5.9	86	Railway, tramway locomotives, rolling stock, equipment	1

Source: ITC Trade Competitiveness Map

Note: For Balassa index, a country reveals comparative advantages in products for which this indicator is higher than 1.

For Lafay index, positive values indicate the existence of comparative advantages in a given item; the larger the value the higher the degree of specialisation

economic growth did not change the situation but, on the contrary, strengthened export concentration levels. Ukraine specialises in the export of semi-finished goods while the proportion of hi-tech goods in its overall export structure remains at about 3%. Accordingly, Ukraine's economy has been, and remains, highly sensitive to external shocks in commodity markets, which was once again confirmed by the crisis in 2008-2009.

## 2.2 UKRAINE'S TRADE POLICY

### 2.2.1 Overview

The current foreign trade regime in Ukraine has been shaped by the influence of internal economic reforms, Ukraine's obligations arising from a wide range of international agreements, and in the course of negotiations on Ukraine's accession to the WTO. The Ukrainian trade regime has changed notably in the years since the country gained independence. In 1993, exports and imports in Ukraine were restricted by tough non-tariff measures such as licensing, quota allocation and state trade. There were also strict limitations on currency transactions.<sup>71</sup> Most of those measures have long since been repealed. The country has undertaken a considerable liberalisation of its trade regime, largely within the framework of the entry negotiation to the WTO, a process that was completed successfully in 2008. Hence, Ukraine's current statutory trade regime is rather liberal, although the actual operations of the institutions

dealing with the implementation of foreign trade transactions still pose major obstacles to trade.

The evolution of trade policy in Ukraine can be divided into four stages:<sup>72</sup>

- **First stage (1991-1994).** In the early 1990s, Ukraine's foreign economic regime reflected the heritage of a planned economy to a great extent and featured large-scale use of restrictive measures, mainly of a non-tariff nature.

- **Second stage (1994-1999).** Trade policy remained rather unstable; initial substantial liberalisation was accompanied by interventions in specific markets and by the gradual erection of a "wall" made of non-quantitative non-tariff measures.

- **Third stage (1999-2008).** More consistent efforts were made to liberalise trade policy, partly due to the WTO entry negotiations and partly because EU integration was identified as the country's strategic priority.

- **Fourth stage (2008-present).** This stage began with Ukraine having gained WTO membership, which meant that the existing level of trade protection in the country could not be increased. A key area of current trade policy consists of measures to improve liberalisation on a bilateral basis, both within the framework of negotiations on the creation of a deep and overarching free trade area with the EU and through negotiations with other countries.

Below we consider Ukraine's current trade regime by separating it into commitments to the WTO and into those commitments, which either exist or are expected within regional trade arrangements.

<sup>71</sup> World Bank (2004)

<sup>72</sup> Burakovsky, I. (2001), World Bank (2004)

### 2.2.2 Key commitments of Ukraine as a WTO member

Ukraine became a WTO member on 16 May 2008 following almost 15 years of negotiations. Ukraine reached a mutual understanding on trade in goods and services with 52 member states of the Working Party. The lengthy negotiation process enabled Ukraine to gradually implement certain commitments before its official accession into the WTO. However, not all commitments were fulfilled because transition periods were envisaged for them and some changes need time to be implemented.

**Import tariffs.** Three main types of import duties are currently in force in Ukraine: (a) Preferential duty rates applied to the goods coming from those countries which are part of customs unions or special customs areas jointly with Ukraine, as well as in the case where a special privileged customs regime is specified in relevant international treaties and agreements to which Ukraine is a party; (b) Privileged import duty rates applied to the goods originating from the countries or economic alliances enjoying the

Transition periods are set for 320 tariff lines, accounting for about 3% of the total trade classification of Ukraine. They include certain sorts of meat, fish, seeds, spirits, polymeric materials and rubber, metals, furniture as well as products of engineering, including some kinds of vehicles. The maximum transition period is five years till 2013, although most of them expire in 2010-2011.

After the transition periods are over, the average weighted rate of the applied custom tariff will be 5.1% in 2013 (10.1% for agricultural products and 4.8% for industrial products). In addition, Ukraine will have zero import duty rates for 10% of agricultural products' tariff lines and for more than one-third of industrial products' tariff lines. The maximum bound rates can be applied on specific food products, namely sugar and sunflower seed oil.

*Import duties for agricultural and food products*<sup>73</sup>

WTO membership assumes a substantial reduction of the average level of tariff protection, the binding of import duties for agricultural goods as well as almost full replacement of specific import duty rates with ad valorem duties (Table 2.7).

**Table 2.7. MFN structure of import duty rates for agricultural goods in Ukraine after the WTO accession**

	At the accession	Final bound rates (2011)
Zero rate tariff lines (% of all tariff lines)	9.6	10.0
Ad valorem tariff lines (% of all tariff lines)	62.7	95.5
Average arithmetic rate of the applied import tariff <sup>a</sup>	13.84	11.16
Average weighted rate of the applied import tariff <sup>a</sup>	18.19	10.07
Minimum rate	0.0	0.0
Maximum rate (for ad valorem rates only)	30.0	50.0
International tariff peaks (% of all tariff lines) <sup>b</sup>	44.3	21.4
'Noise' rates (% of all tariff lines) <sup>c</sup>	5.2	2.8

Source: Ukraine's Customs Tariff at the accession to the WTO, Schedule of Ukraine's Tariff Commitments to the WTO, estimates by the Ministry of Economy of Ukraine and USAID, IER estimates

Notes:

a – calculations by the Ministry of Economy of Ukraine and USAID based on trade data for 2004-2005

b – international tariff peaks are determined as rates higher than 15%

c – 'noise' rates – import rates varying between 0% and 2%

most favoured nation (MFN) treatment in Ukraine; (c) Full import tariffs for all other goods.

Following the WTO accession, Ukraine changed its tariffs by bringing import duty rates into conformity with their bound levels set in the Tariff Schedule for Ukraine that has become part of its national legislation.

Ukraine committed to join 16 out of 19 sector initiatives. Import duties were brought into conformity with majority of initiatives upon the WTO accession. An exception was the civil aviation initiative, which Ukraine joined in 2010, and 'distilled spirits' initiative where Ukraine should impose zero import duty rates in three years after the WTO accession.

<sup>73</sup> IER (2008)

The reduction of tariff protection will be done not by means of the wide-scale introduction of zero import duty rates, but through a considerable decrease in the number of so-called tariff peaks, i.e. those import duty rates, which considerably exceed the average or marginal values. For example, the percentage of zero rates in the total agricultural and food products classification is to be kept at about 10% whereas the number of tariff lines for which import duty rates were higher than 15% will decline more than twice, from 44% to 21% of the total number of tariff lines. Maximum import duty rates are set for sugar (50%) and sunflower seed oil (30%).



Transition periods (the time during which import duties for agricultural and food products must be gradually reduced) are envisaged for 91 tariff lines including certain sorts of meat, seeds, fruit and vegetable products, and spirits. The transition period for meat is two years (until 2010); for spirits, it is three years (until 2011).

*Import duties for industrial products*<sup>74</sup>

According to the Schedule of Ukraine's Tariff Commitments, the average arithmetic bound import duty rate for industrial goods is higher than the rate that was in force in Ukraine at the time of the WTO accession (Table 2.8). Besides, no revision of the number of zero-level-bound tariff lines actually occurred. The maximum import duty rate applied in Ukraine to industrial goods remained unchanged at 25%.

An important positive development consisted of decrease in the number of so-called 'noise' rates, i.e. import duties, the values of which vary between 0% and 2%, which do not create substantial trade

for some kinds of vehicles, vessels, and fishery and seafood products.

**Quantitative restrictions.** According to its commitments, Ukraine will not introduce, re-introduce or apply any quantitative import restrictions or non-tariff measures such as licensing, prohibitions, permissions, requirements of prior validation and other restrictions with the same effect that that could not be substantiated according to the WTO agreement.

In the framework of the WTO agreement, the only tariff rate quota was set for imports of raw cane sugar (260 thousand tonnes annually and increasing to 267.8 thousand tonnes by 2010). The quota distribution will be set on a first-come first-served method that Ukraine is to adopt within three years of the date of WTO accession.

Ukraine committed to abolish export prohibitions except for gold, silver, and diamonds. All the requirements for export licensing and other export

**Table 2.8. MFN structure of import duty rates for manufactured goods in Ukraine after accession to the WTO**

	At the accession	Final bound rates (2013)
Zero rate tariff lines (% of all tariff lines)	35.5	35.2
Ad valorem tariff lines (% of all tariff lines)	98.1	100.0
Average arithmetic rate of the applied import tariff <sup>a</sup>	4.40	4.85
Average weighted rate of the applied import tariff <sup>a</sup>	6.11	4.77
Minimum rate	0.0	0.0
Maximum rate (for ad valorem rates only)	25.0	25.0
International tariff peaks (% of all tariff lines) <sup>b</sup>	1.43	0.58
'Noise' rates (% of all tariff lines) <sup>c</sup>	10.6	3.4

Source: Ukraine's Customs Tariff at the accession to the WTO, Schedule of Ukraine's Tariff Commitments to the WTO, estimates by the Ministry of Economy of Ukraine and USAID, IER estimates

Notes:

a – calculations by the Ministry of Economy of Ukraine and USAID based on trade data for 2004-2005

b – international tariff peaks are determined as rates higher than 15%

c – 'noise' rates – import rates varying between 0% and 2%

barriers (they only protect domestic manufacturers to a minor degree), but result in additional transactional costs both for importers and the government in administering the duty.

A noticeable reduction in import duties is expected to affect only certain industrial sectors, namely wood processing and paper industry, non-ferrous metallurgy (copper production) and some branches of machine-building (mainly transport machine-building). The noticeable decrease in the average weighted import duty rate for industrial products (from 6.11 at accession to a final bound tariff of 4.77) is largely explained by the considerable share of machine building in imports.

Transition periods for the reduction of import duties are envisaged for some industrial goods. The longest transition periods – until 2013 – are provided

restrictions and control are to be applied in accordance with the WTO rules.

**Export duty rates.** Prior Ukraine's accession to the WTO, export duties were applied to some categories of goods, particularly oil seeds, livestock, leather raw materials, and ferrous and non-ferrous metal scrap. Ukraine committed to decrease them gradually (Table 2.9). In addition, Ukraine undertook not to apply any obligatory minimum export prices.

**Subsidies.** Ukraine committed not to apply export subsidies in agriculture. Industrial subsidies can be introduced only in accordance with provisions of the Agreement on Subsidies and Countervailing Measures.

According to Ukraine's commitments, the annual value of the aggregate measure of support for agriculture within the amber box set at the level of UAH 3,043.4 m. Ukraine is also allowed to spend

<sup>74</sup> IER (2008)

**Table 2.9. Changes in export duty rates according to Ukraine's commitments to the WTO**

Commodity	Duty rate before the WTO accession	Duty rate immediately after the WTO accession	Rate reduction step	Final rate after the WTO accession
Oil seeds	17%	16%	1% annually	10%
Livestock	50%, 55% or 75% depending on livestock type	50%	5% annually	10%
Leather raw materials	27% or 30% depending on leather raw material	30%	1% annually	20%
Ferrous metal scrap	EUR 30/t	EUR 25/t	First year – decrease to EUR 18/t; then by EUR 1.6 annually	EUR 10/t
Non-ferrous metal scrap	EUR 30/t	30%	3% annually	15%

Sources: Sources: Law of Ukraine on Amending the Law of Ukraine on Export Duty Rates for Seeds of Some Oil-Yielding Plants (No. 2773-IV as of 7 July 2005), Law of Ukraine on Amending the Law of Ukraine on Export Duty Rates for Live Cattle and Leather Raw Materials (No. 356-V as of 16 November 2006), Law of Ukraine on Amending the Law of Ukraine on Export Duty Rates for Waste and Scrap of Ferrous Metals (No. 400-V as of 30 November 2006), Law of Ukraine on Export Duty Rates for Scrap of Ferrous and Non-Ferrous Metals and Semi-Finished Products Manufactures with their Use (No. 441-V as of 13 December 2006, Report of the Working Party on the Accession of Ukraine to the World Trade Organization (WT/ACC/UKR/152 as of 25 January 2008).

additionally up to 5% of the value of annual gross agricultural production on amber box policies.

**Technical norms and standards.** Following its accession to the WTO, Ukraine undertook to give priority to international standards as the basis for national standards, technical regulations and associated conformity assessment procedures. By 30 December 2011, all Ukrainian technical regulations must use relevant international standards as the basis.

From the date of accession, all the existing national and regional standards are voluntary, except for those referred to or set out in technical regulations developed to protect the country's national security interests, to prevent deceptive practices, to protect the health and life of people, animals or plants and to protect the environment, etc.

Ukraine committed to keep reducing the number of product categories subject to mandatory certification, in order to disseminate the practice of acceptance of manufacturer's supplier declaration of conformity. Ukraine must provide the revised list of products subject to certification to the WTO by 31 January 2012.

**Sanitary and phytosanitary measures.** Ukraine has undertaken, since its accession to the WTO, to apply all sanitary and phytosanitary measures according to the requirements of the WTO Agreement including the Agreements on the Application of Sanitary and Phytosanitary Measures, and Import Licensing Procedures, without any transition periods.

Ukraine will not prohibit the use of antibiotics and hormones for increasing the growth rates of livestock, and Ukraine committed to allow the import of meat and meat products treated with growth promoting hormones. Since its WTO accession, Ukraine uses only those maximum residue limits based on the standards established in the Codex Alimentarius.

**Investment measures.** From its accession, Ukraine applies an investment regime which conforms to the WTO Agreement, including the Agreement on Trade-Related Investment Measures (TRIMs), without using any transition periods or discriminatory conditions for imports from all the WTO Members and domestic products.

**Intellectual property rights.** Ukraine undertook to fully comply with the Agreement on Trade-Related Aspects of Intellectual Property Rights upon its accession date without any transition period.

**Trade in services.** Ukraine bound itself with commitments regarding market access and national treatment in 11 key sectors and several other services. Ukraine entered into additional commitments on certain communication services, maritime transport and pipeline transport services. For the services included in the Schedule of Specific Commitments, Ukraine must guarantee that its licensing procedures and the terms of provision will not act as barriers to market access.

The MFN exemptions are the production and sale of audio-, video-, cinema and television products; and services of computer reserve systems in aircrafts. Road, rail, inland waterways and related auxiliary services are not fully covered in the Schedule of Specific Commitments of Ukraine, because they are regulated by provisions of bilateral and multilateral intergovernmental agreements. The existing MFN exemptions in inland waterways transport will be eliminated gradually within eight years after the date of accession to the WTO.

In the banking sector, foreign banks have been allowed to open branches in Ukraine since the date of WTO accession. Foreign insurance companies have the right to open their branches after a five-year transition period.

**Government procurement.** Ukraine has not joined the WTO Agreement on Government Procurement. It should initiate negotiations to join the agreement after its accession. In 2009, Ukraine acquired observer status in the WTO Agreement on Government Procurement. During a transition period, procurement should be conducted in transparent manner and correspond to the MFN regime. 1 June 2010, the Parliament of Ukraine adopted a new version of the law<sup>75</sup> on government procurement. This included amendments made by the President which are in conformity with the EU requirements and the World Bank's recommendations. The law entered into force on 30 July 2010.

To summarize, Ukraine's accession to the WTO resulted in considerable liberalisation of trade, with many changes having occurred prior to, or immediately after the accession date. Nevertheless, Ukraine has not yet met all of its commitments to the WTO, although this partly reflects an agreed transition period in some cases while in others it reflects the time required to make legislative amendments (for example, in case of general product safety).

### 2.2.3 Ukraine's regional trade agreements

For many years, Ukraine's regional trade policy was focused mainly on the CIS. The major free trade agreements included the agreements within the

framework of the CIS – a multilateral agreement on CIS and bilateral agreements with its member states. It was only in 2001 that the first agreement with a European country, Macedonia, was signed and negotiations on bilateral trade agreements with other partner countries became somewhat more active.

Until recently, Ukraine's foreign trade policy was aimed mainly at joining the WTO, which was achieved in 2008. WTO membership was a prerequisite for commencing Ukraine-EU negotiations on a 'deep and comprehensive' free trade agreement that began in the winter of 2008. Signing an agreement with the European Free Trade Association (EFTA) on 24 June 2010 was a great achievement in Ukraine's bilateral relations with European countries. Table 2.10 lists Ukraine's regional trade agreements that will be reviewed in more detail below.

#### Ukraine's regional trade agreements during the post-Soviet era

##### The Commonwealth of Independent States (CIS)

The CIS Agreement that Ukraine ratified on 10 December 1991 was its first multilateral trade agreement.<sup>76</sup> The CIS Agreement was signed on 8 December 1991 by Russia, Ukraine and Belarus and shortly afterwards acceded to by Azerbaijan, Armenia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan and Uzbekistan.

**Table 2.10. Ukraine's regional trade agreements**

	Agreement type	Date of signing	Entry into force
<b>Post-Soviet countries</b>			
Armenia	RTA, goods (GATT XXIV)	7 October 1994	18 December 1996
Azerbaijan	RTA, goods (GATT XXIV)	28 July 1995	2 September 1996
Belarus	RTA, goods (GATT XXIV)	17 December 1992	11 November 2006
Kazakhstan	RTA, goods (GATT XXIV)	17 September 1994	19 October 1998
Kyrgyzstan	RTA, goods (GATT XXIV)	26 May 1995	19 January 1998
Russia	RTA, goods (GATT XXIV)	24 June 1993	21 February 1994
Tajikistan	RTA, goods (GATT XXIV)	6 June 2001	11 July 2002
Turkmenistan	RTA, goods (GATT XXIV)	5 November 1994	4 November 1995
Uzbekistan	RTA, goods (GATT XXIV)	29 December 1994	1 January 1996
Georgia	RTA, goods (GATT XXIV)	9 January 1995	4 June 1996
Moldova	RTA, goods (GATT XXIV)	13 November 2003	19 May 2005
CIS*	RTA, goods (GATT XXIV)	15 April 1994	30 December 1994
SES**	RTA, goods (GATT XXIV)	19 September 2003	20 April 2004
<b>Europe</b>			
Macedonia	RTA, goods (GATT XXIV)	18 January 2001	5 July 2001
EU	RTA (goods, services)	negotiations since 2008	
EFTA	RTA (goods, services)	24 June 2010	
Turkey	RTA (goods, services)	negotiations	
<b>Asia</b>			
Singapore	RTA (goods, services)	negotiations	

Source: [www.wto.org](http://www.wto.org)

Notes:

\* Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine, Uzbekistan. Turkmenistan is an associated member. Georgia withdrew in August 2009.

\*\* Single Economic Space: Russia, Belarus, Kazakhstan, Ukraine

<sup>75</sup> Law of Ukraine No. 2289 of 1 June 2010.

<sup>76</sup> Resolution of the Parliament of Ukraine on Ratification of the Agreement on the Foundation of the Commonwealth of Independent States, No. 1958-XII as of 10 December 1991 Parliament.

According to the CIS Agreement, the parties undertook to develop equal and mutually beneficial cooperation between their nations and States in politics, the economy, culture, education, health care, environment protection, science, trade, in humanitarian and other areas as well as to promote a wide-scale information exchange. The Agreement specifies the countries' consent to joint activities implemented on an equal basis through joint coordinating institutions of the Commonwealth. A number of documents were also signed within the CIS framework setting out the key principles of economic cooperation among the participating states. However, not all of the internal CIS agreements were ratified by the participating states.

The CIS Free Trade Agreement was signed on 15 April 1994. Officially, the agreement aimed to:

- cancel duties and equivalent taxes and dues as well as quantitative restrictions;
- eliminate other obstacles to the free movement of goods and services;
- create and develop an efficient system of mutual settlements and payments for trade and other operations;
- cooperate in pursuing a trade and economic policy in industry, agriculture, transport, finance, investments, social issues as well as in the development of fair competition, etc.;
- foster intersectoral and intrasectoral cooperation and scientific and technological collaboration;
- harmonise and/or unify legislation of the parties to the extent required for proper and efficient functioning of the free trade area.

In particular, the countries agreed not to provide export-related and other subsidies, which would distort fair competition, agreed on the need to unify customs procedures, agreed not to apply duties and quantitative restrictions on goods originating from the customs territory of one party and destined for the customs territories of other parties.

However, Russia did not ratify the free trade agreement because it was not willing to give up the fiscal and trade advantages that it enjoyed under the existing trade regime among the CIS countries, without securing control over that RTA. In fact, this free trade area is currently not working.

The inefficiency of 'large-scale' integration in the CIS economic space resulted in the emergence of a sub-regional integration process, particularly the signing of free trade agreements between individual CIS member states.<sup>77</sup> Ukraine signed bilateral free trade agreements with all the CIS countries (Table 2.7).

The texts of the bilateral free trade agreements between the CIS member states are all rather similar<sup>78</sup>. They provide for duty-free trade in all commodity groups with certain exceptions as well as free transit of goods across the territories of the signatory states.

<sup>77</sup> Burakosvky (2003)

<sup>78</sup> Freinkman, Polyakov, Revenco (2004)

<sup>79</sup> Ibid.

Exceptions from the free trade regime are implemented by special protocols which are an integral part of the free trade agreements. Goods excluded from the free trade regime are usually charged with duties at the rates set for the most favoured nation regime.

The most common exceptions from the free trade regime provided for by some or other countries in protocols, include sugar, cigarettes, and alcoholic beverages. An important exception is the provision that a commodity charged with an export duty by a party to the agreement shall be excluded from duty-free trade by the other party. Exceptions to the free trade regime are provided for in most of the agreements signed by Ukraine, but the list of goods excluded from the free trade regime is rather limited. Accordingly, the implications of the exceptions of trade in these goods depends on the commodity structure of trade, but usually the implications are not that significant.

The free trade agreements also provide for the possible use of temporary protection, antidumping and other measures. Ukraine has used such measures actively. Temporary (most often for up to two years) quantitative restrictions on imports or exports may be introduced in case of an acute shortage of a certain commodity in the domestic market, a considerable deficit in the balance of payments, potential or actual damage to a national manufacturer, or within the framework of re-export control measures.

The existing bilateral trade agreements between the CIS member states contain the following major problems, according to World Bank experts:<sup>79</sup>

- potential exceptions are not formulated in the texts of the free trade agreements thereby leaving an opportunity for the parties to restrict trade, which creates instability in matters of market access;
- the texts of the agreements are subject to change;
- conditional safeguards allowed by the free trade agreements are often applied and changed, thereby resulting in uncertainty.

Thus, the multilateral agreement on a free trade area among the CIS countries was in practice replaced with a series of bilateral free trade agreements. However, exceptions to the free trade regime hinder the efficient application of the existing bilateral agreements. Another problem of these agreements is that they are narrow in their scope. Many foreign trade issues, particularly trade in services and the protection of intellectual property rights, remained outside the scope of the agreements, which limits their significance to interstate economic relations.

According to recent information provided by the Ministry of Economy of Ukraine, the main objective of Ukraine's state policy on foreign trade for the medium-

term will consist of developing trade and economic cooperation based on a full-scale free trade area between Ukraine and the CIS countries, continuing to liberalise trade regimes and minimise the barriers to Ukrainian-made goods to other CIS markets, and promote the implementation of mechanisms for state support for exports.<sup>80</sup> Hence, the CIS countries remain priority areas in Ukraine's foreign economic policy.

### The Single Economic Space (SES)

Ukraine, Russia, Belarus and Kazakhstan signed the Agreement on the Formation of the Single Economic Space on 19 September 2003. The Agreement was ratified on 20 April 2004. Ukraine signed the instrument with a reservation saying that its Constitution and international obligations prevail over the SES agreements.

The main goal of Ukraine's involvement in the formation and operation of the Single Economic Space is to create a free trade area with no exceptions and restrictions, taking into account the WTO standards and principles as well as the requirements ensuing from Ukraine's integration in the European Union.<sup>81</sup>

To support the signed SES Agreement, preliminary preparation of 92 draft international legal documents concerning the formation of the SES was completed in late 2004. The key elements of the free trade area were to include the non-application of export duties, quantitative restrictions, and exceptions from the free trade regime in mutual trade as well as limited use of antidumping, countervailing and safeguard measures.

In order to shape the free trade area, the parties prepared a list of 29 agreements, which was approved by their Presidents as far back as 15 September 2004. However, the Russian, Kazakh and Belarusian parties agreed and promoted another set of top-priority agreements - elements of a Customs Union in the framework of the Eurasian Economic Community (EurAsEC).<sup>82</sup>

During the preparation of the SES-related international legal instruments for signing, Ukraine did not accede to the proposed instruments. Ukraine insisted on gradual integration, establishing, as the first stage, a FTA without any exceptions,<sup>83</sup> but Russia sought a faster integration process.

Ukraine's key observations included:

- a package-based principle of entry into force of international legal instruments;
- formulation of provisions of articles on the Dispute Settlement Body in international legal instruments;
- delegation of authorities to a single regulatory body;
- assigning depository functions to the single regulatory body.<sup>84</sup>

The negotiation process within the SES framework is now suspended because of reorientation of Belarus, Kazakhstan and Russia to the creation of a Customs Union.

### The Customs Union of Russia, Belarus and Kazakhstan

The question of Ukraine's participation in the Customs Union with Russia, Kazakhstan and Belarus arose together with the intensification of cooperation between Ukraine and Russia in the winter of 2010 and discussion on the terms of Russian gas supplies to Ukraine.

The Customs Union was created on 1 January 2010 when the common tariffs were introduced. The Customs Code of the Customs Union took effect on 1 July 2010 for Russia and Kazakhstan, and on 6 July for Belarus.<sup>85</sup> The Code defines competencies, the rights and responsibilities of the organisation members, including law enforcement, as well as the rights and responsibilities of participants. It provides for the compilation of a unified commodity nomenclature of foreign economic activities, determination of country of origin of goods and their customs value, determination of types of customs payments as well as their application and collection procedures.

This Customs Union is mainly focused on trade in goods, and does not cover trade in services and other trade-related issues that generate improvements connected with trade.<sup>86</sup>

To date Ukraine has refused to take part in the Customs Union. If Ukraine were to join the Union, the government would have to commence a series of multilateral international negotiations and coordination within the WTO framework. If the existing list of the Customs Union tariffs was taken as a basis,

<sup>80</sup> Ministry of Economy of Ukraine. [http://www.me.gov.ua/control/uk/publish/article?art\\_id=149509&cat\\_id=38461](http://www.me.gov.ua/control/uk/publish/article?art_id=149509&cat_id=38461)

<sup>81</sup> Decree by the President of Ukraine On the Resolution of the Council for National Security and Defence of Ukraine as of 20 May 2005 on the Formation of the Single Economic Space No. 952 as of 15 June 2005.

<sup>82</sup> The EurAsEC was launched in January 1995 when Belarus and the Russian Federation signed the Agreement on the Customs Union, which was subsequently joined by Kazakhstan. In March 1996, Belarus, Kazakhstan, Kyrgyzstan and the Russian Federation signed the Treaty on In-depth Integration in Economic and Humanitarian Areas that was acceded to by Tajikistan in 1999. In February 1999, all these countries signed the Treaty on the Customs Union and the Single Economic Space. In 2000, the Presidents of Belarus, Kazakhstan, Kyrgyzstan, the Russian Federation and Tajikistan signed the Treaty on the Foundation of the Eurasian Economic Community that entered into force in 2001. Uzbekistan became another EurAsEC member in January 2006. Thus, the EurAsEC currently consists of six CIS member states. The UN registered it as an international organisation.

<sup>83</sup> A FTA with exceptions had already existed de facto between these countries because they had signed appropriate trade agreements.

<sup>84</sup> The Ministry of Economy of Ukraine [http://www.me.gov.ua/control/publish/article/main?art\\_id=139035&cat\\_id=74823](http://www.me.gov.ua/control/publish/article/main?art_id=139035&cat_id=74823)

<sup>85</sup> The Customs Code of the Customs Union of Russia, Belarus and Kazakhstan was signed by the Heads of State on 27 November 2009. <http://www.tsouz.ru/db/ettr/tnved/Pages/default.aspx>

<sup>86</sup> Movchan, Guicci and Kutsenko (2010)

Ukraine would have to agree such changes with all the WTO members concerned and pay compensation because the Customs Union import duties are often higher than the corresponding bound tariff rates in Ukraine (Table 2.11).

Hence, despite deeper cooperation with Russia, Ukraine has already concluded that a free trade agreement with the EU and further European integration as its main priority<sup>87</sup>.

### Regional trade agreements with European countries

#### Free trade agreement with Macedonia

The Free Trade Agreement with the Republic of Macedonia signed in 2001 is the first and, until recently, the only free trade agreement between Ukraine and a non-CIS country. It mainly covers trade in goods, and includes customs procedures, antidumping measures, and rules of origin, although it also deals with the protection of intellectual property rights. According to the agreement, a 10-year transition period will precede formation of the free trade area. However, the obligations of the parties on trade in goods will apply in full once the agreement enters into force.<sup>88</sup> Ukraine committed on 84.54% tariff lines,

of which 97.32% is manufactured goods, 9.32% being agricultural products.

#### Free trade agreement with the European Free Trade Association (EFTA)

The EFTA countries invited Ukraine to launch negotiations on a free trade area in August 2007. EFTA is a free trade area covering the customs territories of four European states that did not join the European Union, namely the Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway and the Swiss Confederation. The free trade area secures its member states a regime of free trade in goods and services and also guarantees the free movement of capital and individuals.

Three EFTA member states, namely Iceland, Liechtenstein and Norway, are members of the European Economic Area (EEA), an agreement that was signed in May 1992. The EEA covers the markets of 27 EU member states and 3 EFTA member states.

Ukraine signed the Free Trade Agreement with EFTA on 24 June 2010. It is the first comprehensive agreement the EFTA concluded with a European country. In the agreement, the parties enshrined the

**Table 2.11. Rates of import duty for some products in Ukraine and in the Customs Union of Russia, Belarus and Kazakhstan \***

HS code	Product description	Bound tariff (Ukraine)	Import duty (Customs Union)
870323	Motor cars and other motor vehicles principally designed for the transport of persons (of a cylinder capacity exceeding 1500 cc but not exceeding 3000 cc)	5% - 10%	From 30%, but not lower than EUR 1.5/cc to EUR 4/cc
271000	Petroleum oils and oils obtained from bituminous minerals except crude	0% - 10%	5%
260200	Manganese ores and concentrates	2%	5%
710813	Gold, in other semi-manufactured forms	2% - 5%	20%
870324	Motor cars and other motor vehicles principally designed for the transport of persons (of a cylinder capacity exceeding 3000 cc)	5% - 10%	Medical vehicles: 0% Other vehicles: from 35%, but not lower than EUR 2.8/cc, to EUR 5.8/cc
870710	Bodies for the vehicles of heading 8703	1% - 10%	0% - 15% but not lower than EUR 5000/unit
270112	Bituminous coal	2%	5%
270400	Coke and semi-coke of coal	0%	5%
300490	Medicaments, other	0%	10%
840734	Reciprocating piston engines with a cylinder capacity exceeding 1000 cc	5% - 12%	0% - 10%
151110	Crude palm oil	0%	0% - 15% but not lower than EUR 0.12/kg
390760	Polyethylene terephthalate	6.5%	5%
640299	Footwear with outer soles and uppers of rubber or plastics, other	10%	10% but not lower than EUR 1/pair

Source: list of Ukraine's import tariffs ([www.wto.org](http://www.wto.org)), Customs Tariff of the Customs Union

Note: the list of products was compiled on the basis of Ukraine's key import items in 2008 by country, excluding import from the countries with which Ukraine signed FTA agreements.

<sup>87</sup> Article 11(2)(12) of the Law of Ukraine on the Basics of Foreign and Domestic Policy, No. 2411-VI of 1 July 2010.

<sup>88</sup> WT/REG248/1/Rev.1

mutual non-application of antidumping measures while Ukraine retained the right to resort to export duties as required. The reduction of duties with the EFTA countries will take place during a ten-year transition period. The agreement also provides for a regular monitoring mechanism and the possible adjustment of the arrangements subject to changing circumstances.

### **Negotiations on a deep and comprehensive free trade agreement with the EU**

Trade relations between the EU and Ukraine are currently determined by the Partnership and Cooperation Agreement (PCA) that entered into force in 1998, and the provisions of the Generalised System of Preferences (GSP).<sup>89</sup>

According to the PCA, the parties offer each other most-favoured-nation treatment (MFN) and a reduction in the possibility of introducing import and export restrictions, whereas GSP allows for the application of lower duties than the MFN rates for more than 6,000 products. The existing scheme provides for a considerable proportionate decrease of duties for most manufactured goods, but a relatively low proportionate reduction is envisaged for agricultural products. At present, the EU applies the GSP+ and Everything But Arms<sup>90</sup> regimes for some countries, but Ukraine is not entitled to use them<sup>91</sup>.

Ukraine and the EU started negotiations in March 2007 on a new strengthened agreement in order to replace the PCA. Both parties agreed that the new agreement would be grounded on the principles of political association and economic integration. Thus, they decided to identify that document as an Association Agreement providing for the creation of a Deep and Comprehensive Free Trade Area (FTA) with the EU.

Upon approval by the WTO General Council of the package on Ukraine's accession on 5 February 2008, the EU and Ukraine commenced talks concerning an agreement on a deep and comprehensive FTA. These followed preliminary consultations between the parties, which had begun much earlier. Within the framework of the future Association Agreement, the FTA should deepen Ukraine's access to the European market and promote further European investment in Ukraine.

The FTA will be integral part of the future Association Agreement. This FTA is supposed to become the first of a new type of 'deep and comprehensive' trade agreement involving the EU. It will cover a wide range of trade-related matters and aims to remove barriers to trade not only related to 'behind the border' obstacles to trade, but also to provide for deep regulatory rapprochement, thus

partially opening the EU's internal market to Ukraine. The agreement must be compatible with the rules of the WTO and take the possible results of the WTO Doha Round into consideration.

The negotiations have been going on in 15 working groups in the following 18 areas:

- A. Trade in goods
  - 1) Tariff offer
  - 2) Trade in goods, including technical barriers in trade
  - 3) Trade protection instruments
  - 4) Sanitary and phytosanitary measures
  - 5) Trade facilitation, customs cooperation
  - 6) Administrative cooperation on customs matters
  - 7) Rules of origin
  - 8) Trade relations in energy
- B. Services, establishment, investment, and capital movements
  - 9) Services, right of establishment, investments, capital movement, and current payments
- C. Rules of trade
  - 10) Intellectual property rights
  - 11) Geographical indications
  - 12) Competition policy: anti-monopoly measures
  - 13) Competition policy: state aid
  - 14) Public procurement
  - 15) Trade and sustainable development
  - 16) Dispute settlement
  - 17) Dispute settlement in energy
  - 18) Transparency

Thirteen rounds of negotiations concerning a FTA between Ukraine and the EU took place between February 2008 and October 2010, resulting in considerable progress in discussions on most issues. The parties agreed upon a general structure and form of the agreement during the first round of negotiations. The following rounds were more detailed and focused on a wide range of specific items of the agenda. The parties also discussed the specific conditions of access to respective markets, including a scheme of adaptation of the Ukrainian legislation to that of the EU, as well as the scale of the necessary institutional changes in Ukraine.

Negotiations have been completed on a preliminarily basis on the sections dealing with customs and trade facilitation, public procurement, transparency, dispute settlement, and intellectual property rights (except geographical indications). The section on the rules of origin has been generally agreed upon.<sup>92</sup> As to the section on trade in goods, the parties have agreed on a gradual approach to the harmonisation of Ukrainian laws concerning conformity assessment. The most recent round

<sup>89</sup> EU Delegation to Ukraine. <http://www.delukr.ec.europa.eu/page36090.html>

<sup>90</sup> The Everything But Arms regime grants duty-free access to imports of all products from least developed countries, except arms and ammunitions, without any quantitative restrictions (with the exception of bananas, sugar and rice for a limited period). - <http://ec.europa.eu/trade/wider-agenda/development/generalised-system-of-preferences/everything-but-arms/>

<sup>91</sup> Movchan, Guicci and Kutsenko (2010)

<sup>92</sup> MEU (2010)

considered a further eight sections, in particular the parties exchanged their proposals on agreements on services that had not yet been discussed in the negotiations.

However, discussions are still on-going in such areas as sanitary and phytosanitary standards, technical barriers in trade, energy-related issues (transit, transportation, pricing), trade and sustainable development. To date no mutually acceptable solutions have been found.

In addition, the issue of mutual access to markets for certain commodity items remains open and extremely difficult. As expected, the parties are not ready for the full liberalisation of trade in agricultural goods, and the search for a compromise, which is likely to include the application of tariff quotas and long transition periods, continues. Negotiations are also continuing on the issue of geographical indications.

#### **Negotiations on free trade with third countries and groups**

Ukraine is also in the process of negotiations on trade liberalisation and hopes to conclude appropriate agreements with Singapore and Turkey. Ukraine is also considering the possible introduction of free trade regimes with Canada, Serbia, Syria, Israel, Mexico, Algeria, the Gulf states and some other African and Asian countries.

The free trade negotiations between Ukraine and Turkey<sup>93</sup> deal with such matters as tariffs, non-tariff barriers, technical barriers to trade, trade safeguard instruments, sanitary and phytosanitary measures, services, investments, capital movements, rules of origin, government procurement, intellectual property rights and the settlement of disputes.

A trade agreement between Ukraine and Singapore is also expected to be broad in scope. The agreement envisages that Singapore will completely cancel import tariffs for all goods of Ukrainian origin whereas Ukraine will cancel import tariffs for all goods of Singaporean origin except for HS commodity groups 1701 and 1702, once the agreement enters into force. Special attention will be paid to competition, sanitary and phytosanitary requirements, intellectual property protection and to the origin of goods.

Contemporary draft free trade agreements are wider in terms of their coverage and they will promote diversification of Ukraine's exports and protection of exporters' rights.

<sup>93</sup> A Customs Union has existed between Turkey and the EU since 31 December 1995. However, this agreement does not cover all economic sectors and is rather limited. The Customs Union provides for the introduction of a unified external tariff for some products and the adoption by Turkey of European legislation in some important areas related to the common internal market. Despite the existence of the Customs Union with the EU, Turkey enters into, and negotiates on, free trade agreements with other countries (EFTA, Israel, Macedonia, Croatia, Bosnia and Herzegovina, Tunisia, Morocco, Palestine, Syria, Egypt, Georgia and Albania).

<sup>94</sup> Institutional map, as the rest of the Report, is based on the data as of the end of October 2010. In December 2010 Ukraine initiated an administrative reform, which significantly alters the government's organizational system. Taking into account time constraints and the incompleteness of the reforms enactment, these changes aren't analysed in the Report

## **2.3 INSTITUTIONAL MAP<sup>94</sup>**

Development and regulation of foreign trade policy in Ukraine at the legislative level is the responsibility of the Parliament of Ukraine as the highest body for the state regulation of foreign economic activities.

Subordinated to the Parliament is the Anti-Monopoly Committee of Ukraine that takes part in the drafting of laws and other regulatory legal acts concerned with the development of competition policy and de-monopolisation of the economy. The Committee also interacts with other public authorities including local governments and other institutions and organisations on matters related to advancing economic competition and the de-monopolisation of the economy.

Implementation of Ukraine's foreign economic policy, based on the laws approved by the Parliament of Ukraine, falls within the powers of the Cabinet of Ministers of Ukraine as the highest executive authority in Ukraine. Thus, a leading role in realising the goals of foreign trade policy is assigned to ministries, state committees and other central executive authorities as well as state enterprises and agencies subordinated thereto.

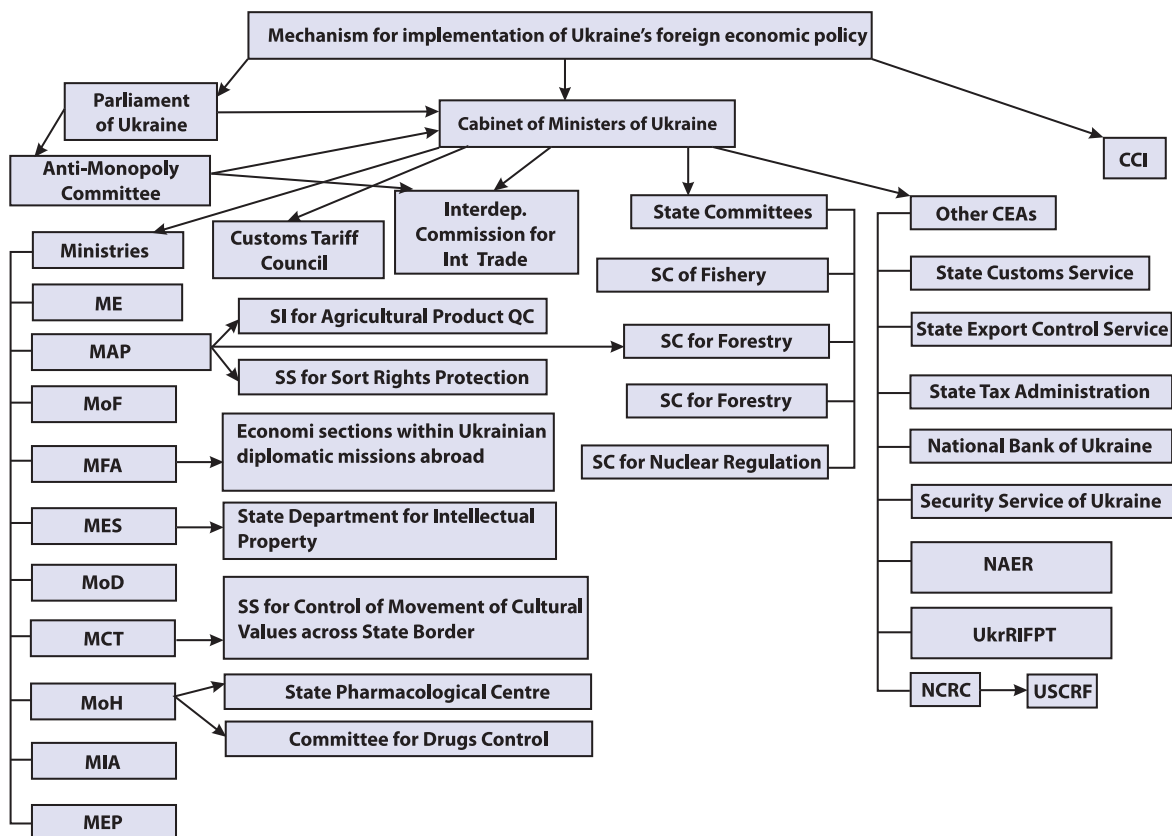
Implementation of Ukraine's foreign economic policy involves collective bodies of the Cabinet of Ministers of Ukraine including the Interdepartmental Commission for International Trade and the Customs and Tariff Council of Ukraine. Both bodies are chaired by the Minister of Economy of Ukraine and include representatives of ministries, state committees and other central executive authorities.

As far as the practical realisation of Ukraine's foreign trade policy is concerned, documents giving authority for the exercise of customs control and customs clearance of goods and vehicles are issued by some central executive authorities, which are described in detail below. In addition, in cases specified by laws, such documents are also issued by the Chamber of Commerce and Industries of Ukraine, a nongovernmental, non-profit, self-managed organisation that includes Ukrainian legal persons and individuals registered as entrepreneurs, as well as associations thereof.

A matrix of the mutual relationships among the various authorities engaged in the elaboration and implementation of foreign economic policy in Ukraine is presented in Figure 2.5.

The powers of the Parliament of Ukraine in the field of development and regulation of Ukraine's foreign economic policy include the following functions:





**Figure 2.5. Institutional framework for the implementation of Ukraine's foreign trade policy**

Source: Ukrainian legislation, IER analysis

MEU – Ministry of Economy, MAP – Ministry of Agrarian Policy, MoF – Ministry of Finance, MFA – Ministry of Foreign Affairs, MES – Ministry of Education and Science, MoD – Ministry of Defence, MCT – Ministry of Culture and Tourism, MoH – Ministry of Health, MIA – Ministry of Internal Affairs, MEP – Ministry of Environment Protection, CEAs – central executive authorities, CCI – Chamber of Commerce and Industries, SI – State Inspectorate, SS – State Service, SC – State Committee, NAER – National Agency on Ensuring Efficient Use of Energy Resources, UkrRIFPT – Ukrainian Research Institute for Forecasting and Testing of Equipment and Technology for Agricultural Production, NCRC – National Commission for Regulation of Communications, USCRF – Ukrainian State Centre of Radiofrequencies, QC – quality control

- passing, amending and cancelling laws related to foreign economic activities;
- approving key directions of Ukraine's foreign economic policy;
- considering, approving and changing the structure of the bodies of state regulation of foreign economic activities;
- concluding Ukraine's international treaties and bringing current Ukrainian legislation into conformity with the rules established thereby;
- approving the lists of goods, the import and export of which are prohibited by current Ukrainian legislation.

The Anti-Monopoly Committee of Ukraine, accountable to the Parliament of Ukraine, exercises control over the observance by economic entities engaged in foreign trade of legislation on the protection of economic competition. The main task of the Committee is to take part in the formulation and implementation of Ukraine's competition policy, which is done in the following areas:

- exercising state control over the observance of legislation on the protection of economic competition including preventing, detecting

and stopping breaches of legislation on the protection of economic competition;

- participating in the drafting and submission, in due course, of proposals concerning laws and other regulatory legal acts that regulate the development of competition, competition policy and the de-monopolisation of the economy;
- supervising the regulation of prices (tariffs) of goods produced (sold) by natural monopoly entities;
- promoting the development of fair competition by means of interaction with public authorities, local governments, administrative economic management and control bodies, enterprises, institutions and organisations concerning the development, support and protection of economic competition and de-monopolisation of the economy.

The Cabinet of Ministers of Ukraine takes measures to implement foreign trade policy according to the legislative framework approved by the Parliament and performs the following functions:

- coordinates the work of ministries, state committees and agencies of Ukraine for the regulation of foreign economic activities;

- coordinates the work of Ukrainian trade representations in foreign states;
  - adopts regulatory management acts on foreign economic activities in cases provided for by Ukrainian laws;
  - negotiates and concludes Ukraine's intergovernmental treaties on foreign economic activities in cases provided for by Ukrainian laws on Ukraine's international treaties; ensures the implementation of Ukraine's international treaties on foreign economic activities by all public management bodies subordinated to the Cabinet of Ministers; involves other foreign economic activity entities in the implementation of these treaties on a contractual basis;
  - submits proposals for consideration, as per its competence, to the Parliament of Ukraine, on a system of ministries, state committees and agencies which are responsible for the operation of state regulation of foreign economic activity, the powers of which may not be higher than those granted to the Cabinet of Ministers under Ukrainian law;
  - sets the rates for license issuance fees, taking into consideration the actual costs related to the application of licensing procedures;
  - approves decisions on the application of a licensing regime for export (import) of goods, including the establishment of quotas (quantitative or other restrictions) as represented by a central executive authority for economic policy (Ministry of Economy), including the specification of a list of goods the export (import) of which is subject to licensing, the period for which the license is valid, and quantitative or other restrictions concerning each commodity;
  - ensures the compilation of the balance of payments and a consolidated currency plan for Ukraine;
  - takes measures to ensure the rational use of the means of the State Monetary Fund of Ukraine;
  - ensures compliance with the UN Security Council's resolutions on foreign economic activities.
- The National Bank of Ukraine has the following powers in the regulation of foreign economic activities:
- regulates the rate of Ukraine's national currency to the monetary units of other states;
  - carries out accounting and settlements on state credits and loans granted and received, conducts transactions with centralised currency resources allocated from the State Monetary Fund of Ukraine to the National Bank of Ukraine;
  - acts as a guarantor for credits granted to economic entities by foreign banks, financial and other international organisation] against the security of the State Monetary Fund and other state property of Ukraine;
  - represents the interests of Ukraine in relations with central banks of other states, international banks and other financial and credit institutions, and enters into appropriate interbank agreements.
- The Ministry of Economy of Ukraine, as a central executive authority for economic policy, the activities of which are directed and coordinated by the Cabinet of Ministers of Ukraine, performs the following functions:
- securing the implementation of a uniform foreign economic policy in respect of economic entities' access to foreign markets, and coordination of their foreign economic activities, taking into account Ukraine's international treaties;
  - supervising the observance of existing Ukrainian laws and provisions of Ukraine's international treaties by all economic entities engaged in foreign trade;
  - carrying out antidumping, anti-subsidy and special investigations according to a procedure specified by Ukrainian laws;
  - licensing foreign economic transactions by providing authorisations for the export (import) of goods by an economic entity engaged in foreign trade; informing the State Customs Service of Ukraine on a monthly basis about the licenses issued for the export (import) of goods which are subject to licensing;
  - continuously monitoring the development of foreign economic relations, analysing the efficiency of the export and import of goods (works, services), developing and securing the implementation of measures to develop and improve the structure of the export and import of goods (works, services), preparing recommendations for relevant economic sectors considering changes of conditions in world markets;
  - participating in the preparation of the balance of foreign trade and of the balance of payments;
  - preparing proposals to secure the operation of the system of nontariff regulation of foreign economic activities, accounting (registration) of some types of foreign economic agreements (contracts) concluded by Ukrainian entities engaged in foreign trade of all ownership forms, and taking appropriate measures;
  - ensuring realisation of a uniform customs and tariff policy, preparing proposals to improve the regulatory legal framework for customs and tariff regulation;
  - performing, on a statutory basis, regulatory, registration and permissive functions in the field of the export and import of goods (works, services), licensing for the export and import of goods (works, services) and undertaking some economic activities according to the laws, determining a level of indicative prices and publishing their list, etc.

The Ministry of Foreign Affairs of Ukraine manages the work of economic sections within Ukrainian diplomatic missions abroad.

The responsibility for trade representation at Ukrainian embassies in foreign countries was transferred from the Ministry of Economy to the Ministry of Foreign Affairs according to a presidential decree<sup>95</sup> in 2010. The decree instructs the Ministry of Foreign Affairs to organise economic sections within the Ukrainian foreign diplomatic missions and, in this connection, to close trade and economic missions within the Ukrainian foreign diplomatic institutions. The change was made in order to: secure the integrity and concerted implementation of Ukraine's foreign political interests, improve the mechanism of protecting the country's interests in the economic field abroad, continue the development of economic relations with foreign states and international organisations.

The Interdepartmental Commission for International Trade includes the Minister of Economy and representatives of the Ministries of Economy, Industrial Policy, Environmental Protection, Health, Finance, Internal Affairs, Foreign Affairs, Fuel and Energy, Regional Development and Construction, Justice, Agrarian Policy, Transport and Communications, representatives of state committees and other central executive authorities and a representative of the Anti-Monopoly Committee. The Commission performs the following functions:

- ensuring the operation of state regulation of foreign trade activity in Ukraine according to Ukrainian laws;
- making decisions to initiate and carry out anti-dumping, anti-subsidy or special investigations and to apply anti-dumping, countervailing or special measures accordingly;
- making decisions on the introduction of a licensing regime in cases where protective measures can be applied to protect a domestic commodity producer, according to laws.

The Customs and Tariff Council of Ukraine is a collective body under the Cabinet of Ministers. Its activities are aimed at pursuing a uniform customs and tariff policy taking into account the interests of the country and economic entities engaged in foreign trade, protect the domestic market, restrict monopolies, prevent unfair competition in export and import transactions, counteract discriminatory measures of other states and their associations. The Council includes the Minister of Economy and representatives of the Ministries of Economy, Industrial Policy, Culture and Tourism, finance, Foreign Affairs, Fuel and Energy, Transport and Communications, Agrarian Policy, representatives of the State Customs Service and other central executive authorities. The Council has the following tasks:

- develop proposals on key areas and means of implementation of Ukraine's customs tariff policy;

- draft Ukrainian legislative acts and Ukraine's international treaties concerning the regulation of customs tariffs;
- prepare proposals on setting, cancelling or changing the rates of import and export duty ;
- prepare and consider proposals on amending the Ukrainian classification of foreign economic activity goods;
- develop the rules of determining the customs value of goods and their countries of origin;
- develop and consider proposals on the provision of tariff privileges and preferences as well as measures aimed to protect the domestic market.

The Customs Service of Ukraine exercises customs control in Ukraine according to the customs policy defined by the Parliament of Ukraine, given the Ukrainian laws in force. In particular, customs regulation of foreign economic activities is provided in accordance with the Law on Foreign Economic Activities, the Customs Code of Ukraine, the laws of Ukraine on customs regulation, the Uniform Customs Tariff of Ukraine, and Ukraine's international treaties. The laws of Ukraine on customs regulation establish Ukrainian customs rules that should include a procedure of declaration of goods, payment of duties and customs dues, provision of customs preferences, and other conditions of customs control.

The State Customs Service submits information to the Ministry of Economy on the volumes of exports (imports) of goods according to licenses issued on a monthly basis. Only one type of license may be established for each type of goods.

As far as the practical realisation of Ukraine's foreign trade policy is concerned, the documents giving authority for the exercise of customs control and customs clearance of goods and vehicles moving across the Ukrainian customs border are issued by the following central executive authorities:

The Cabinet of Ministers of Ukraine issues a special permit for selling outside Ukraine donor blood components and preparations made of donor blood and its components, which is issued on behalf of the Cabinet of Ministers of Ukraine by a Vice Prime Minister of Ukraine.

The Ministry of Economy issues licenses for the export and import of goods including:

- a license for the right of export (import) of ethyl alcohol, cognac and fruit spirit, alcoholic beverages and tobacco products;
- a license for export (import) of disks for laser reading systems, matrices;
- a special license for import of goods to which special measures are applied according to a decision of the Interdepartmental Commission for International Trade;
- a one-time (individual) license for a foreign economic transaction;

<sup>95</sup> Decree by the President of Ukraine, No. 522/2010 as of 8 April 2010.

- an individual license for making property investments by residents outside Ukraine;
- a permit for the re-export of goods, lists of which are published by the Ministry of Economy of Ukraine;
- cards for the registration and accounting of a foreign economic agreement (contract).

The Ministry of Finance issues an official letter permitting exportation of precious metals, precious stones, their scrap and waste as give-and-take materials from the Ukrainian customs territory as well as a Kimberley process certificate.

The Ministry of Health issues:

- an opinion of the state sanitary and epidemiological expertise;
- a registration certificate for a medicine or a certificate of state registration of a medical immunobiological drug;
- an authorisation for the one-time importation of unregistered medicines as well as medical supplies;
- an original certificate of state registration of a medical article or a notarised copy;
- a confirmation of state registration of medical supplies;
- a certificate of state registration of a disinfectant;
- an original sanitary certificate for the freight of food products destined for export.

In addition, the State Pharmacological Centre of the Ministry of Health issues a letter for importation of unregistered medicines to Ukraine for preclinical research, clinical trials and state registration.

The Committee for Drugs Control under the Ministry of Health issues a permit for the right to import narcotic drugs, psychotropic substances and precursors to the territory of Ukraine, exporting them from the territory of Ukraine, or transiting them across Ukraine.

The Ministry of Agrarian Policy issues:

- an international veterinary health certificate;
- a veterinary certificate;
- a phytosanitary certificate;
- a phytosanitary certificate for re-export;
- an import (transit) quarantine permit;
- a documentary confirmation for seeds and planting materials of plant sorts imported for state testing, imported and not being intellectual property entities, or exported by permission of the plant breeder's rights owner;
- a certificate of registration (document proving registration of an exchange agreement (contract) on grain export).

The State Service for Plant Breeder's Rights Protection under the Ministry of Agrarian Policy issues a certificate of state registration of plant varieties and a one-time permit for the importation of seeds and planting materials of plant varieties, which are not registered in Ukraine.

The State Committee of Fishery (activities of which are directed and coordinated by the Cabinet

of Ministers through the Minister of Agrarian Policy) issues a form for the registration of Patagonian and Antarctic toothfish catches / a form of re-export of toothfish species.

The State Inspectorate for Agricultural Product Quality Control and Monitoring of Its Market under the Ministry of Agrarian Policy issues a grain quality certificate.

The Ministry of Environment Protection issues:

- a notice on transboundary waste transportation;
- an opinion that the Green List waste is not subject to items 6-33 of the Regulations on control over cross-boundary transportation of dangerous waste and their utilisation/disposal;
- a permit for the transportation of poisonous substances, including biotechnology products and other biological agents;
- a certificate of state registration of pesticides and agricultural chemicals;
- a permit for the importation and use of unregistered pesticides and agricultural chemicals for state testing and scientific research, as well as of seed (planting) materials processed with them;
- a consent for the importation of metal scrap;
- an environmental control certificate.

In addition, a permit or certificate for importation/exportation of flora and fauna objects (which are regulation objects under the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)) is issued by: the Ministry of Environment Protection - for all samples except sturgeons and products made thereof, and the State Committee of Fishery - for sturgeons and products made thereof.

The State Committee for Forestry issues a certificate of origin of wood products and sawn timber made thereof for export transactions.

The Ministry of Education and Science issues a permit for the importation of unregistered genetically modified organisms destined for scientific research purposes or for state approval (testing).

The State Department for Intellectual Property under the Ministry of Education and Science issues an excerpt from the MES register on the recognition of SID codes on disks as well as an excerpt from the MES register on the recognition of SID codes on matrices.

The Ministry of Defence issues an opinion on the compliance of military measurement equipment with requirements of the Law of Ukraine on Metrology and Metrological Activities. It also issues an opinion for the importation of special-purpose radio-electronic equipment and emitting devices.

The State Service for the Control of the Movement of Cultural Values across the State Border of Ukraine under the Ministry of Culture and Tourism issues a certificate for the right of exportation (temporary exportation) of cultural values from the territory of Ukraine.

The Ministry of Internal Affairs issues a permit for transportation of specified articles, materials and substances covered by the permissive system.

The Nation Bank of Ukraine provides:

- a special NBU permit for importation of Ukrainian currency to Ukraine;
- a special NBU permit for exportation of Ukrainian currency from Ukraine;
- a written NBU permit for opening of correspondent accounts with banks (non-residents) in foreign currency and for carrying out transactions on them;
- a written NBU permit for carrying out transactions with bank metals in international markets;
- a written NBU permit for transactions with bank metals in the Ukrainian currency market and/or transactions with bank metals in international markets;
- a written NBU permit for transactions with currency values;
- a special NBU permit for importation of bank metals to Ukraine.

Together with the State Tax Administration, the NBU issues a certificate of declaration of currency values, income and property belonging to a Ukrainian resident and situated outside Ukraine.

The territorial NBU directorates also issue individual licenses for the exportation of bank metals from Ukraine.

The State Tax Administration issues applications with calculation for the purchase of excise marks (second copy).

The State Committee of Ukraine for Technical Regulation and Consumer Policy (or an authorised certification body) issues a certificate of conformity and a confirmation of conformity recognition.

A territorial body of the above-mentioned State Committee issues its opinion on the compliance of

measurement equipment with requirements of the Law of Ukraine on Metrology and Metrological Activities; a territorial certification body issues a production certificate that is usually issued to economic entities reprocessing fishing products.

The State Committee for Nuclear Regulation issues a permit for the transportation of radioactive materials in the territory of Ukraine as well as a license for use of ionising radiation sources.

The Security Service of Ukraine issues a license for importation/exportation of holographic protective elements.

The State Export Control Service issues a permit (opinion) for the right to carry out international transfers of goods.

The National Agency of Ukraine on Ensuring Efficient Use of Energy Resources issues an opinion of state expertise on energy saving.

The Leonid Pohorilyi Ukrainian Research Institute for Forecasting and Testing of Equipment and Technologies for Agricultural Production issues a registration certificate for the technical means of application of pesticides and agricultural chemicals, as well as a permit for the importation of unregistered technical means of application of pesticides and agricultural chemicals.

The Ukrainian State Centre of Radiofrequencies under the National Commission for Regulation of Communications issues a permit for the importation of radio-electronic equipment and radio emitting devices.

The Chamber of Commerce and Industries of Ukraine issues a certificate of origin of a commodity for its exportation from the Ukrainian customs territory in cases where a certificate is required and is mentioned in the national regulations of a country of importation or envisaged under international treaties.



# SECTION 3

## TRADE FACILITATION



## SECTION 3. TRADE FACILITATION

## 3

### 3.1 INTERNAL TRADE RESTRICTIONS

#### 3.1.1 Customs and other procedures related to trade

Issues related to the efficiency of customs procedures and control are of a great importance in trade facilitation programmes. They can have a direct impact on the volumes of exports and imports of goods and can often become a substantial non-tariff barrier.

Negotiations on trade facilitation in the WTO framework mainly deal with GATT VIII (Fees and Formalities connected with Importation and Exportation). The improvement of international trade procedures is of fundamental importance to trade facilitation programmes.

A general feature of the work of customs services around the world is that the workload is extremely large, but there is insufficient capacity to undertake the task. On the one hand, customs services are pressed by their own governments and international organisations to simplify customs clearance procedures for law-abiding passengers and freight but on the other hand, they are responsible for identifying possible crimes and acts of terrorism. Therefore, it is not always possible to achieve a desired balance between simplifying procedures and carrying out controlling actions. In addition, the proceeds of customs procedures often make a considerable contribution to state budget revenues, adding pressure on the work of the customs services from the state financial authorities.

In Ukraine, the customs service is an independent authority. Its work is coordinated by the Minister of Finance who nominates a candidate for the post of Chair of the Customs Service for appointment by the Cabinet of Ministers.

The Customs Service provides a considerable revenue inflow to the country. The revenue from

all customs duties accounted for 33.9% of the total revenues of the state budget of Ukraine in 2009 and 53.8% of tax receipts (Table 3.1). As a result of the global financial crisis, the number of officially registered import transactions in 2009 fell by 36% year-on-year while the volume of “grey” imports to the country increased.<sup>96</sup>

A key task of customs control is to ensure the passage of goods across the state border of Ukraine at all motor, water, railway and air crossing points. There are now 218 border-crossing points in Ukraine as well as numerous internal points of customs clearance. However, securing a necessary volume of customs receipts often becomes a goal of customs control.<sup>97</sup>

The Customs Code of Ukraine is the main document defining Ukraine’s customs policy.<sup>98</sup> According to the Code, all goods and vehicles moving across Ukraine’s borders are subject to customs control (except in cases provided for by legislation in force). Customs control is exercised directly by officials of the Ukrainian Customs Service by means of examining documents and data necessary for customs purposes, carrying out inspections of goods and vehicles, questioning individuals and officials. It also covers accounting for goods and vehicles, inspecting the location and premises of temporary storage warehouses, customs license warehouses, free customs zones, duty-free shops where goods and vehicles subject to customs control can be situated or where activities subject to control by Ukrainian customs bodies are carried out. Ukrainian law-enforcement bodies, financial institutions, taxation and other controlling bodies inform the customs bodies, in response to the latter’s requests or upon their own initiative according to Ukrainian laws, on data which is available to them and is required for customs control.

Depending on the direction of movement of goods, there is a distinction between the customs

**Table 3.1. Share of revenue from Customs procedures in total tax receipts in Ukraine, 2005-2010**

	2005	2006	2007	2008	2009	2010*
Tax receipts ( billion UAH)	74.5	94.8	116.7	167.9	148.9	201.6
Revenue from Customs procedures (billion UAH) **	29.8	39.3	51.7	93.3	80.1	93.3
Share of revenue customs procedure tax receipts (%)	39.9	41.4	44.3	55.6	53.8	46.3

Source: Reports of the State Treasury of Ukraine

Note: \* Plan for 2010; \*\* Customs procedure income include taxes on international trade and external transactions and value-added tax on goods (works, services) imported into Ukraine.

<sup>96</sup> American Chamber of Commerce in Ukraine (2009)

<sup>97</sup> World Bank (2010)

<sup>98</sup> Customs Code of Ukraine No. 92-IV of 11.07.2002



control of imports (goods brought into the territory of Ukraine) and of exports (goods brought from abroad to the territory of Ukraine), and transit (goods moved across the territory of Ukraine).

Customs control is divided into the examination of documents for goods and vehicles and the inspection and re-inspection of goods, vehicles. Examination is a form of documentary control whereas inspection and re-inspection is a form of actual control (verification of quantities, quality control of energy carriers).

The current provisions of the Customs Code of Ukraine require considerable improvement as far as the simplification of customs procedures is concerned. In this connection, a new draft Customs Code is under preparation. The draft is consistent with EU requirements, the new wording of the Kyoto Convention and largely with the WTO regulations.<sup>99</sup> The new Customs Code will be adapted to the EU customs rules and will allow for the implementation of a “one-stop shop” for the clearance of cargos. Other bodies, particularly the Security Service of Ukraine and the State Tax Administration, will no longer have the possibility to examine containers.<sup>100</sup>

From the trade facilitation perspective, the World Customs Organisation's<sup>101</sup> Convention on Simplification and Harmonisation of Customs Procedures, as revised and supplemented in June 1999 with a Protocol (known as the Kyoto Convention), is recognised as the fundamental international instrument for trade facilitation. Ukraine acceded to the Kyoto Convention in 2006.<sup>102</sup>

The Kyoto Convention, on the one hand, aims to encourage foreign economic activities by means of simplifying and expediting procedures of customs clearance and customs control. On the other hand, it seeks to prevent such implementation and simplification from causing damage to the interests of the State and society, especially as regards state budget revenues and domestic market protection. According to the Convention, one of the directions in which customs administration should move under contemporary conditions is towards customs control methods based on post-audit and risk management.

However, inconsistency between the Ukrainian legislation and international rules does exist. It mainly concerns cooperation between the Customs Service and customs brokers, the determination of value and classification of goods and the introduction of customs clearance at any place chosen by importers.

In addition, it is necessary to pass a separate law that would regulate the Customs Service's activities and specify its powers. The Customs Service is currently a centralised structure with branches in the regions. However, the intermediate regional level has a purely functional importance and often is just an intermediate link in communication between local directorates and the central body instead of taking an active role in supporting local experts and in promoting flexible resource management. The remit and role of border control bodies – customs bodies and border guards – also need further refinement.

In terms of the World Bank's Logistics Performance Index<sup>103</sup>, Ukraine ranks 135<sup>th</sup> among 155 countries in the efficiency of the customs clearance process, the same level as a number of African countries.<sup>104</sup> This indicator was determined based on the speed, simplicity and predictability of customs procedures in the country. According to the Global Competitiveness Report by the World Economic Forum, Ukraine ranks 115<sup>th</sup> among 133 countries in terms of the indicator 6.13 “Burden of customs procedures”.<sup>105</sup>

The key reasons for the inefficiency of the work of the Customs Service and the existence of burdensome customs procedures in Ukraine include the need for the Service to carry out the fiscal functions assigned to it. An unreasonably large number of customs procedures, long queues and the high workload of Customs Service officials are all major shortcomings (see Figure 3.1).

As far as corruption is concerned, the major cases of corruption in customs procedures take place during document examination and border crossing (see Figure 3.2).

The inefficient work of the customs is mainly related to imperfect legislation. Firstly, importers are bound in Ukraine to specific regional customs departments. Secondly, determining the value of a good for customs purposes often becomes a problem in the import and export of goods. It is done not on the basis of commercial value but with the aid of a pricelist and other reference methods of determining value, which is not provided for by the WTO. Other problem areas of the Customs Service's work include the classification of goods where a customs house often chooses tariff items, which have the highest rate of duty, and over the origin of goods because the certificates of origin are often returned to the issuing countries for verification, which further extends the verification process.

<sup>99</sup> World Bank (2010)

<sup>100</sup> Tshipko: a draft new Customs Code of Ukraine may be presented in 1.5 months". <http://news.finance.ua/ua/~1/0/all/2010/10/13/213001>

<sup>101</sup> Ukraine has been a member of the World Customs Organisation since 1992.

<sup>102</sup> Law of Ukraine on the Accession of Ukraine to the Protocol on Amending the International Convention on Simplification and Harmonization of Customs Procedures, No. 227-V as of 5.10.2006.

<sup>103</sup> Logistics Performance Index (LPI) includes performance indicators in six areas: 1) efficiency of the customs clearance process; 2) quality of trade and transport-related infrastructure; 3) ease of arranging competitively priced shipments; 4) competence and quality of logistics services; 5) ability to track and trace consignments; 6) frequency with which shipments reach consignee within scheduled or expected time.

<sup>104</sup> Logistics Performance Index <http://info.worldbank.org/etools/tradesurvey/mode1b.asp?cgroup=0&order=q10rank>

<sup>105</sup> WEF (2009a), <http://www.weforum.org/documents/GCR09/index.html>

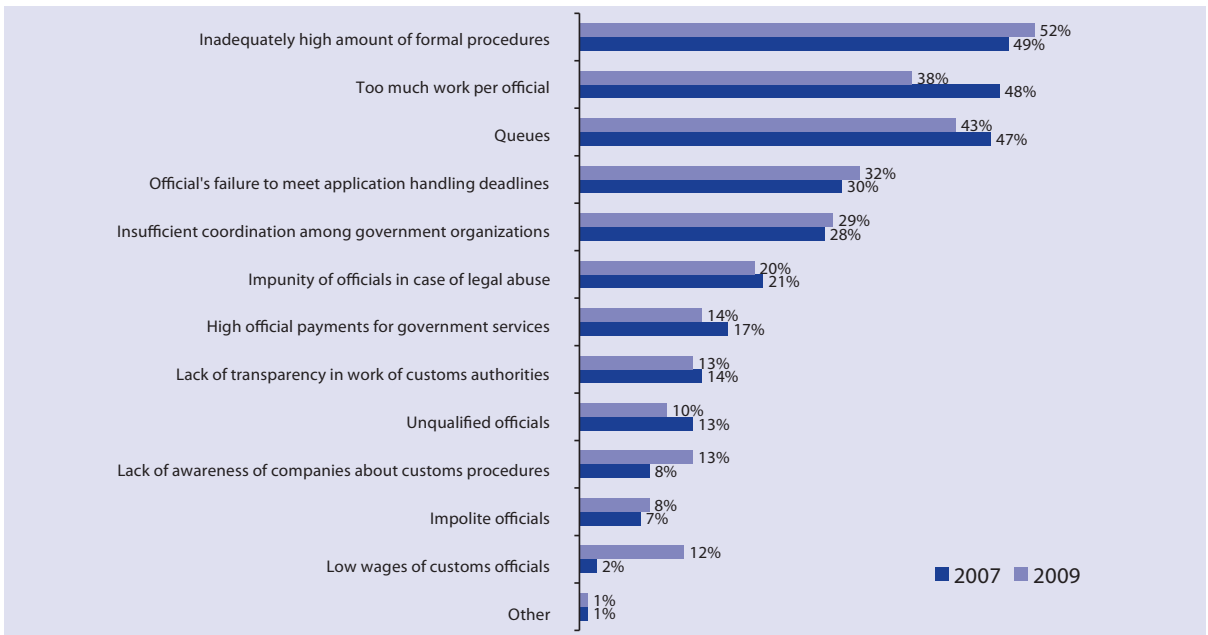


Figure 3.1. Main shortcomings in the work of the customs bodies

Source: MSI (2008)

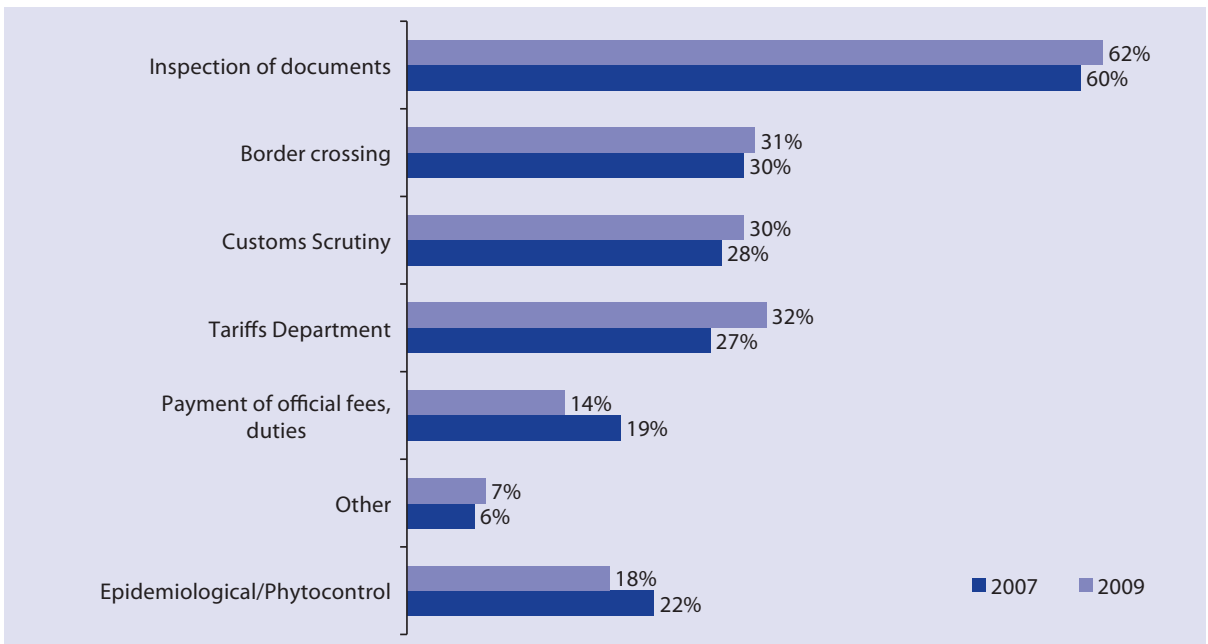


Figure 3.2. Corruption in customs procedures

Source: MSI (2008)

It is worth noting, however, that half of all participants of a survey related to the Logistics Performance Index said that customs clearance procedures had improved since 2005. A review of general performance indicators of the Customs Service shows an improvement in the situation in recent years from the perspective of labour productivity, profitability and cost-effectiveness.

The functioning of the 'one-stop shop' also needs improvement. At present, it differs from the international standards established by the UN Centre for Trade Facilitation and Electronic Business (UN-CEFACT). It just consists of one office at border stations where most agencies are situated in one room. In addition, documentary processes for entering Ukraine need to be simpler.

Despite considerable problems and the relatively low efficiency of customs procedures and of the Customs Service's work, Ukraine is making steps towards reform in this area.

The new EU-Ukraine Association Agenda highlights trade facilitation and customs issues in a separate section. For example, the parties agreed to elaborate a comprehensive plan with EU support for customs reform for 2010, including reform of the Customs Service itself, including procedures, resources, IT support and an implementation plan. The EU Modernised Customs Blueprints may be used as a benchmark. The parties also plan to assess the feasibility of the establishment of mechanisms for the exchange of data, inter alia on goods and vehicles,

in line with relevant data protection standards and regulations.<sup>106</sup> At present, the Customs Service of Ukraine takes part in information exchange programmes with the EU on the establishment of an integrated information system on cross-border transportation within the ICITAP project (adapting the State Customs Service's Uniform Computer-Aided System to the NCTS system) and in the development of the Electronic Customs project. It also cooperates with Eurostat on a methodology of maintaining foreign trade statistics and operating the Eurostate COMEXT trade database.<sup>107</sup>

A programme of reform of the Customs Service structure has been under review for some time in Ukraine. In order to build an efficient management system, the creation of a vertical organisational management structure "State Customs Service – regional customs departments – customs departments" is envisaged. A system of regional customs departments must be established according to the territorial principle, whereby the central office would delegate control and management functions to the regional level. A Regional Information Customs is to be created during the first stage of the reform; one of its key tasks would be to establish a so-called "electronic customs" that would allow the quality of customs regulation to be improved.<sup>108</sup>

Several measures taken by the State to improve customs procedures and streamline the work of customs services should be highlighted. For example, on 20 February 2009, the Parliament adopted at the first reading the draft Law of Ukraine on Amending Some Legislative Acts of Ukraine concerning Preliminary Documentary Control at Customs Border Crossing Points.<sup>109</sup> The law is intended to reduce the time required for vehicles transporting cargos to cross the customs border. The Cabinet of Ministers has authorised<sup>110</sup> the Customs Service to specify the companies that may undergo customs clearance using simplified customs procedures without preliminary permits from the Ministry of Economy and the State Tax Administration.

In 2010, the State Customs Service began to streamline its own structure by reducing the number of customs houses due to "joining", i.e. changing the status of some customs houses. The administrative staff of the customs house will be reduced and their management functions are to be transferred to other

customs house. This measure is expected to lower the administrative costs of customs houses. As of early October 2010, such reorganisation has taken place or is taking place in customs houses in several oblasts in the country including Donetsk, Kyiv, Zakarpattia, Chernihiv, Vinnytsia, Luhansk and Sumy.<sup>111</sup>

Other areas of work include addressing such issues as customs value, classification and origin of goods, implementation of the 'white list', customs post audit and appeals, declaration of goods at a customs house, modernisation of customs regimes, customs payments, and authorised economic operators.

To summarize, it should be said that improvement of customs procedures in Ukraine requires a comprehensive approach and in-depth reform of the existing system.

### 3.1.2 Transport and logistics services

Ukraine is situated at the intersection of many international transport corridors (ITC)<sup>112</sup> connecting it to other countries and is, therefore, an important link between them. Such geography implies important role of transport in the country's economy. Besides, economic growth in 2000-2008 resulted in a greater demand for transport services. Accordingly, freight flows across the Ukrainian border were growing (Figure 3.3) and revenues from transport services were increasing.

Overall, 556 million tonnes of freight was transported across Ukraine's borders in 2008<sup>113</sup> - 50% more than in 2000. However, the economic crisis caused a sharp decline in freight transportation volumes. In 2009, freight traffic across Ukraine's border dropped to 400.4 million tonnes, mainly due to a reduction in the volumes of transit freight (Figure 3.3).

Due to significant volume of energy resources transit to Europe the most used mode of transport by volume for trade in goods is pipeline transport that is accounted for 43.9% of total freight traffic in 2009. If this mode of transportation is excluded, the freight flows structure would be somewhat different. As in the previous years, most of freight in 2009 was exported (60%) whereas imports of freight made up only 18% with transit accounting for the rest (22%).<sup>114</sup>

Rail and road transport account for a substantial share by volume in foreign trade in goods (Figure

<sup>106</sup> List of the EU-Ukraine Association Agenda Priorities for 2010 [http://ec.europa.eu/external\\_relations/ukraine/index\\_en.htm](http://ec.europa.eu/external_relations/ukraine/index_en.htm)

<sup>107</sup> State Customs Service of Ukraine. Progress in performing the Ukraine-EU Association Agenda. Information as of 30 June 2010. [http://www.customs.gov.ua/dmsu/control/uk/publish/article?art\\_id=2015502&cat\\_id=296951](http://www.customs.gov.ua/dmsu/control/uk/publish/article?art_id=2015502&cat_id=296951)

<sup>108</sup> Mission of Ukraine to European Communities. Ukraine takes new important steps to modernize its customs services. 12 October 2006 <http://www.ukraine-eu.mfa.gov.ua/eu/ua/news/detail/2759.htm>

<sup>109</sup> [http://gska2.rada.gov.ua/pls/zweb\\_n/webproc4\\_1?id=&pf3511=33043](http://gska2.rada.gov.ua/pls/zweb_n/webproc4_1?id=&pf3511=33043)

<sup>110</sup> Resolution of the Cabinet of Ministers of Ukraine No. 455 of 6 May 2009

<sup>111</sup> Orders of the State Customs Service of Ukraine Nos. 1148 of 5.10.2010, 751 of 13.07.2010, 548 of 28.05.2010, and 647 of 17.06.2010.

<sup>112</sup> III, V, VII and IX Pan-European (Crete) ITCs, and such ITCs as Europe-Asia, the Baltic Sea – the Black Sea, and TRACECA (Europe-Caucasus-Asia) run across Ukraine's territory.

<sup>113</sup> Of which 261 million tonnes (47%) was delivered by pipeline transport.

<sup>114</sup> Without freight transported by pipelines.

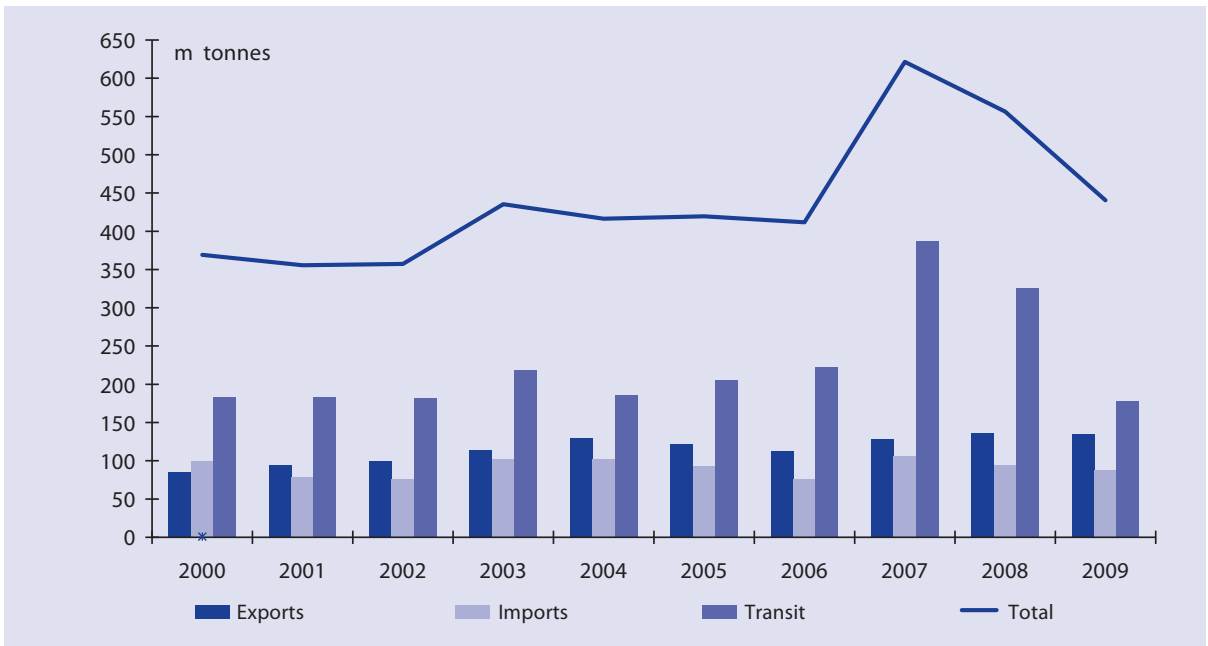


Figure 3.3. Freight traffic through Ukraine's borders, 2000-2009

Source: State Statistics Committee of Ukraine

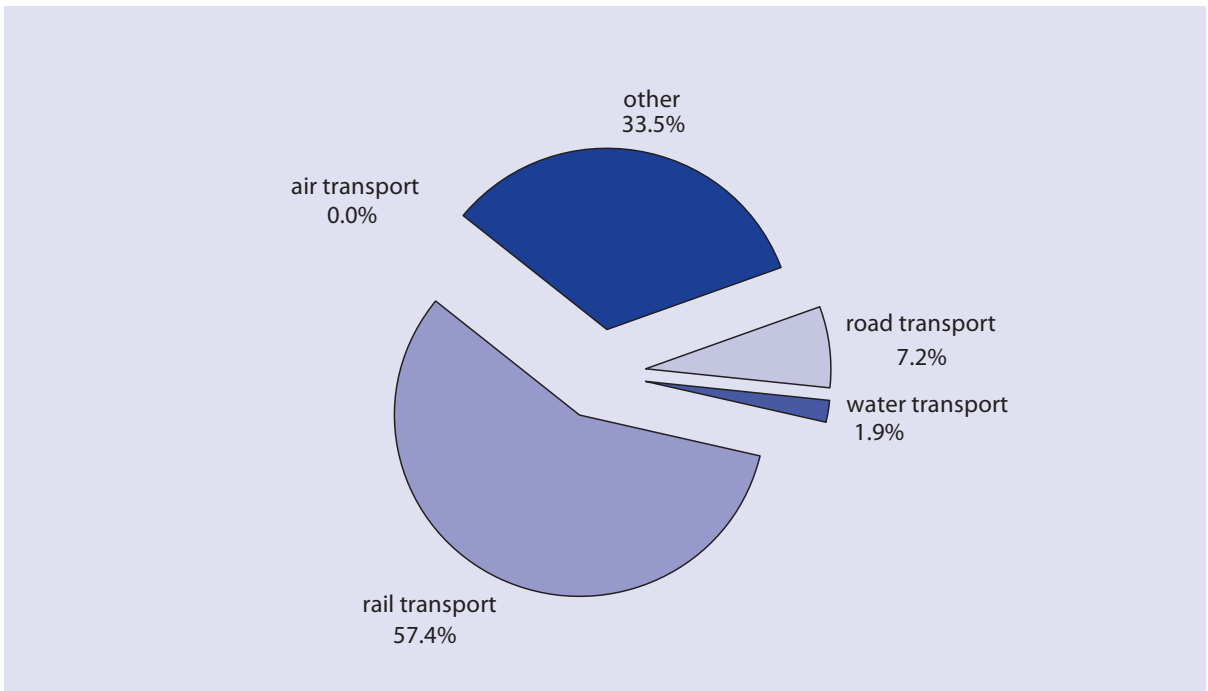


Figure 3.4. Structure of foreign economic freight traffic through Ukraine's borders by main modes of transport, 2009 \*

Source: State Statistics Committee of Ukraine

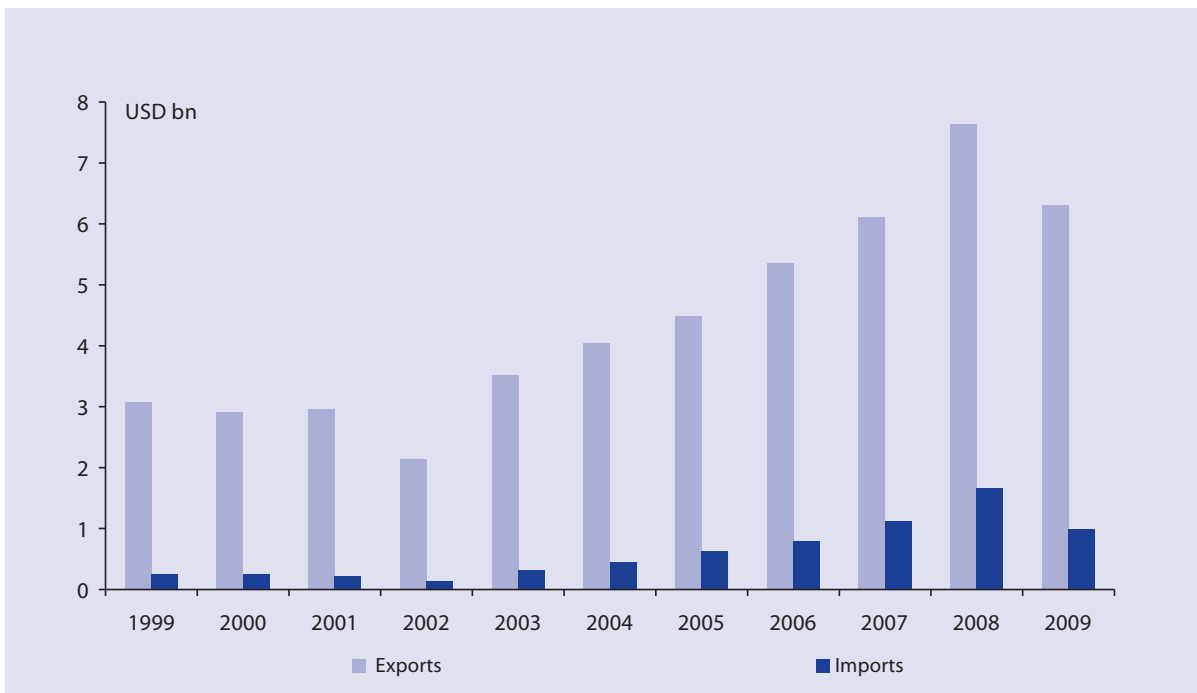
Note: \* data provided without freight transported by pipelines

3.4)<sup>115</sup>, whereas the role of other modes of transport remains extremely low. However, although sea transport is not very developed in Ukraine, the ports are a very important element of global supply chains: the ports handled 167 million tonnes of foreign economic cargo in 2008 (the figure in 2009 was 152 million tonnes).

Transport services play the most significant role in trade in services, accounting for 49.3% of foreign

trade in services in 2009. Due to the growth in the volumes of transported cargos, revenues from transport services also increased. Ukraine normally records a large surplus in its trade in transport services, although it fell from USD 5.3 billion in 2008 to USD 4.4 billion in 2009 mostly because of the crisis and thus resulting decrease in trade volumes ( Figure 3.5). The most important role is traditionally played by services of pipeline transportation which accounted for 29.1%

<sup>115</sup> The 'other' category includes: road vehicle in a railway car; railway car on a sea vessel; unaccompanied trailer or semi-trailer on a sea vessel; post; river vessel on a sea vessel; self-propelled road transport; 'hand luggage'; unknown mode of transport.



**Figure 3.5. Trade in transport services, 1999-2009**

Source: State Statistics Committee of Ukraine

in the foreign trade in transport services in 2009. As to other modes of transport, rail transport accounts for 22.6%, air transport 19.7%, sea transport 19.3% and other modes of transport 9.3%.

**Rail transport.** Ukrzaliznytsia (UZ), the State Administration of Rail Transport, is the monopolistic operator of the railways in Ukraine, managing all the railroads in the country. The main drawbacks of the railway infrastructure usage include the fact that the width of the track gauge (1520 mm) is wider than the European standard (1435 mm), there are non-optimal loads on various segments<sup>116</sup>, the tracks have a multifunctional purpose<sup>117</sup> and there is limited access of private users to the infrastructure<sup>118</sup>.

UZ faces an important challenge with the need to upgrade its rolling stock, which is 75-80% outdated. The UZ investment needs are only partially met – only 25-30%<sup>119</sup> in the past 10 years – because UZ subsidised passenger transportation for a long time at the expense of freight transportation and some industrial consumers<sup>120</sup>, and also acted as a ‘cash cow’ for the budget. An acute shortage of resources made the Ministry of Transport and Communications of Ukraine allow UZ to raise credit funds and sharply

increase tariffs for all types of railway transportation. However, the intervals between tariff changes were uneven and were not sufficient to enable consumers to adapt to the new conditions, so that some shifted to road transport, while the service quality remained low. UZ does provide a number of modern transport practices in a very limited form (e.g. con trailer traffic). Generally, however, the actual costs of railway transportation depend on the type of freight and distance; transportation costs per km decline as distance increases.

The current situation is that the railway sector is inefficiently operated both by the state and commercial management, hence it requires urgent and in-depth reform, but this process is has proved to be very slow.

**Road transport.** The length of Ukraine’s network of motor roads is 169.5 thousand km of which 77.9% is suitable for heavy loads.<sup>121</sup> However, 60% of roads require overhaul<sup>122</sup>, and only 280 km of roads meet the standards of the Trans-European Transport System.<sup>123</sup> The governance and commercial functions in this sector, as in the railways, are assigned to the state - the State Road Service (Ukravtodor) - that also

<sup>116</sup> The existing infrastructure is only used at one half of its capacity. At the same time, about 30% of railroads are completely overloaded.

<sup>117</sup> The same tracks are used for both passenger and freight transport.

<sup>118</sup> A shortage of rolling stock forced UZ to allow shippers to use their own cars. However, as the crisis began in 2008 and the volume of trade (transportation) dropped, UZ started to refuse them that right. Meanwhile, the UZ car booking system is characterised by a wide range of shortcomings: including the considerable time lags between an application for cars and notification of their availability, the lack of flexibility in the booking process and difficult access to information, etc.

<sup>119</sup> World Bank (2010)

<sup>120</sup> E.g., metal and chemical industry enterprises enjoyed discounted tariffs during the crisis as compared with other users.

<sup>121</sup> Defined as roads of cement concrete, asphalt concrete, and bituminous macadam.

<sup>122</sup> 60% roads in Ukraine need overhaul. Press conference by Head of Ukravtodor Vadym Hurzhos // [http://www.rbc.ua/ukr/top/show/v\\_ukraine\\_60\\_dorog\\_trebuyut\\_kapitalnogo\\_remonta11032010](http://www.rbc.ua/ukr/top/show/v_ukraine_60_dorog_trebuyut_kapitalnogo_remonta11032010)

<sup>123</sup> World Bank (2010)

failed to obtain financial resources to develop and maintain the network of roads. Hence, the sector needs reform.

In the market of services related to passenger and freight deliveries by road transport, about 80 thousand economic entities are operating and have obtained licences according to the law; about half of them are engaged in freight transportation.<sup>124</sup> Between 80% and 90% of the firms providing road transportation services possess fewer than 10 trucks each.<sup>125</sup> The vehicle fleet has grown by 5% in recent years whereas the volume of road transportation has increased by 20% annually. The fleet of trucks involved in international transportation was about 23,300 vehicles in 2007. As estimated by Association of International Motor Carriers of Ukraine, about half of the all the trucks undertaking international transportation to the CIS countries belong to Euro-I class and Euro-II class. The other half (50%, or 10-11 thousand vehicles) consists of Euro-III-V class vehicles. The number of class IV and V trucks that are most suitable for transportation to the EU is not more than 2,000.

A typical feature of the road transport sector is the high level of capital expenditure and high interest rates. Although the costs of transportation per freight unit in Ukraine are lower than, for example, in Poland, the price advantage is offset by delays in the issuance of visas, transport licences, etc.<sup>126</sup> The transportation of imported goods costs on average 2-3 times more than that of freight exports. A considerable share of the costs consists of informal payments caused mainly by bureaucratic procedures in customs clearance. In Ukraine, at least two working days are required to load goods and organise the necessary customs clearance. This reflects the low throughput capacity of border-crossing points on the Ukrainian side, the lack of joint control and the large number of controlling services.

However, competition in the transportation market has forced road hauliers to introduce various innovative solutions to promote their services, such as freight consolidation, regular freight transportation between the largest cities, services for delivery of small freight shipments, freight transportation on difficult and risky routes. Due to their greater flexibility and comparable prices, there has been a partial reorientation of transport flows towards roads at the expense of the railways in recent years. This has, however, entailed higher transport costs, greater energy consumption and emissions, and more accidents.

*Water transport.* Ukraine's water transport sector has a complicated institutional structure and is

overburdened with duplicating public authorities. Ukraine has almost 20 seaports on the Black Sea and the Sea of Azov as well as some river ports on the Dnipro and the Danube. Most ports are engaged in transportation of bulk freight, but only three Great Odessa ports have a large volume of container operations. The seaports, as well as most infrastructural facilities in their territory, are owned by the State. The tariffs for port services are set by the Cabinet of Ministers of Ukraine and the MTCU. However, the ports have undergone little reform and there is still no sector legislation, which would enable reform to proceed. Accordingly, the state-owned ports have experienced an acute shortage of financial resources for investment and have to cope with this problem by themselves. They have done this mainly by cooperating with private stevedoring companies or through raising credit funds.

At present, liner freight and passenger shipping are carried out on the Black Sea by roll on/roll off ships (ro-ro type) and by ferries. Regular lines have been organised to neighbouring countries and transoceanic hubs on the Mediterranean Sea as well as to other European and Asian ports. This has enabled Ukrainian ports to receive vessels with a capacity of between 500 20-foot equivalent units (TEUs) and 1500 TEUs as well as container ships from the world's major shipping companies.<sup>127</sup>

About 90% of pre- and on-carriage of containers from a port to consumers is performed by road transport, mainly due to its flexibility. A trip from a port to a destination in Ukraine can take up to ten days due to delays in document execution and freight release at the port (a relatively long time). Informal payments are systematic and occur at various stages of freight servicing. The costs of handling containers in Ukrainian ports are higher than international tariffs, even if informal payments are not counted. The key reason is the inefficient work of the public authorities and of the port administrations.

*Air transport.* Ukraine has about 30 airports although only a few play a key role.<sup>128</sup> At present, most of Ukraine's airports are municipal property. The State owns airports in Boryspil, Dnipropetrovsk, Zaporizhia and Lviv.

The international air transportation sector has developed rapidly in recent years. The Ukrainian fleet of large cargo aircraft is mainly used to perform international air transport operations, e.g. for provision of humanitarian aid or peacekeeping missions. The sector of regular passenger transportation has developed swiftly due to the expansion of the services network and of operators range, but airports' throughput is not yet a serious issue. Freight transport by air

<sup>124</sup> MTCU press service // <http://www.mtu.gov.ua/uk/news/7087.html>

<sup>125</sup> World Bank (2010)

<sup>126</sup> Tariffs for freight transportation in inland traffic in Ukraine in 2008 were 0.025-0.03 USD/t-km; the comparable tariff in the EU states is three or even four times higher // World Bank (2010)

<sup>127</sup> Maersk (Safmarine), CMA/CGM, COSCO, MSC and Hapag-Lloyd

<sup>128</sup> Boryspil, Dnipropetrovsk, Donetsk, Kyiv (Zhuliany), Lviv, Odesa, Simferopol, Kharkiv and Zaporizhia.

from Ukraine may be done at similar prices to those in European airports. Customs clearance of air freight is performed more quickly than for freight carried by road. However, the sector is affected by a lack of local budget funds, a lack of airport coordination, insufficient throughput of terminals and adjacent facilities at major airports while the high costs of refuelling complicate the provision of high-quality aviation services.

**Warehouse services.** The storage/warehousing services provided by foreign companies are used less often in Ukraine than in the EU countries, and many Ukrainian firms have their own warehouses. The markets for warehousing and related logistics services provided by third parties are not developed, and the major users are generally large international firms, particularly in retail trade. An acute shortage of warehouse capacities was felt in the country before the crisis, which led to rapid increase in prices with no adequate improvement in quality.

**Forwarding services.** There are numerous small forwarders in the Ukrainian market that execute the transportation of small shipments of imported freight. Their basic task consists of implementing the complicated process of customs clearance for freight. This market segment is not targeted on the provision of multimodal services since the number of customers is quite limited. About 2100 forwarding companies are registered in Ukraine, but only 10% of them are members of national associations.<sup>129</sup> Another segment includes international forwarding firms and joint ventures that have an extensive network of representative offices in many countries of the world.

The expected total logistics costs in trade amounted to USD 23 billion in 2008 (15.1% of trade turnover and 12.1% of GDP), as estimated by the World Bank.<sup>130</sup> This is a high figure, but not that high for other large countries with the same level of development. However, Ukraine's rank in the Logistics Performance Index (LPI) 2010 has worsened considerably: it ranked 102<sup>nd</sup> among 155 countries (Table 3.2)<sup>131</sup> Although Ukraine's score in LPI 2010 (2.57) was almost the same as in 2007 (2.55), its ranking declined from 73<sup>rd</sup> to 102<sup>nd</sup>, what reflects the growing efficiency of logistics procedures and transport in other countries.

Thus, despite an extremely advantageous geographical position and the heritage of a developed transport infrastructure, Ukraine has not managed

to ensure its adequate maintenance or growth to support economic development. The quality of transport and logistics services remains low and the prices for such services remain relatively high.

**Table 3.2. Logistics Performance Index (LPI) for selected countries, 2010**

Country	Position	Score	% of the highest score
Ukraine	102	2.57	50.6
Poland	30	3.44	78.2
Romania	59	2.84	59.1
Russia	94	2.61	51.6
Turkey	39	3.22	71.4

Source: Arvis et al (2010)

### 3.1.3 The system of technical regulation

Reform of the technical regulation system in Ukraine has been underway for a long period of time. A legislative framework, which meets international requirements to some extent, has been developed during the recent decade.

Ukraine's framework instruments on standardization and certification include the Law of Ukraine on Standardization (2001)<sup>132</sup>, the Law of Ukraine on Confirmation of Conformity (2001)<sup>133</sup>, the Law of Ukraine on Accreditation of Conformity Assessment Bodies (2001)<sup>134</sup>, the Law of Ukraine on Standards, Technical Regulations and Conformity Assessment Procedures (2005)<sup>135</sup>, the Decree of the Cabinet of Ministers of Ukraine on Standardization and Certification<sup>136</sup>, the Concept of Developing the System of Technical Regulation and Consumer Policy for 2006-2010<sup>137</sup>, and the State Program of Standardization for 2006-2010.<sup>138</sup> The State Committee of Ukraine for Technical Regulation and Consumer Policy (Derzhspozhyvstandart) is the central executive authority on standardization.

However, some contradictions between the 'new' legislation adopted since 2001 and the 'old' norms on technical regulation, protection of consumer rights, etc. still exist. Most importantly, implementation of the 'new' legislative framework in the technical regulation system is proceeding quite slowly<sup>139</sup> despite the fact that commitments on reform are

<sup>129</sup> World Bank (2010)

<sup>130</sup> *Ibid.*

<sup>131</sup> Arvis et al (2010)

<sup>132</sup> Law of Ukraine No. 2408 of 17 May 2001 <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2408-14>

<sup>133</sup> Law of Ukraine No. 2406 of 17 May 2001 <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2406-14>

<sup>134</sup> Law of Ukraine No. 2407 of 17 May 2001 <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2407-14>

<sup>135</sup> Law of Ukraine No. 3164 of 1 December 2005 <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=3164-15>

<sup>136</sup> CMU Decree No. 46-93 of 10 May 1993 <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=46-93>

<sup>137</sup> CMU Executive Order No. 267-p of 11 May 2006 <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=267-2006-%F0>

<sup>138</sup> CMU Resolution No. 229 of 1 March 2006 <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=229-2006-%EF>

<sup>139</sup> Kutsenko, Kuziakiv (2009)

included in the Report of the Working Party on the Accession of Ukraine to the WTO.<sup>140</sup>

According to *Derzhspozhyvstandarty*, 5,790 national standards harmonised with international and European standards were valid in Ukraine as of 10 September 2009.<sup>141</sup> This meant that slightly more than a quarter of the total number of standards in Ukraine have been harmonised whereas EU membership would require at least 80% harmonisation.<sup>142</sup>

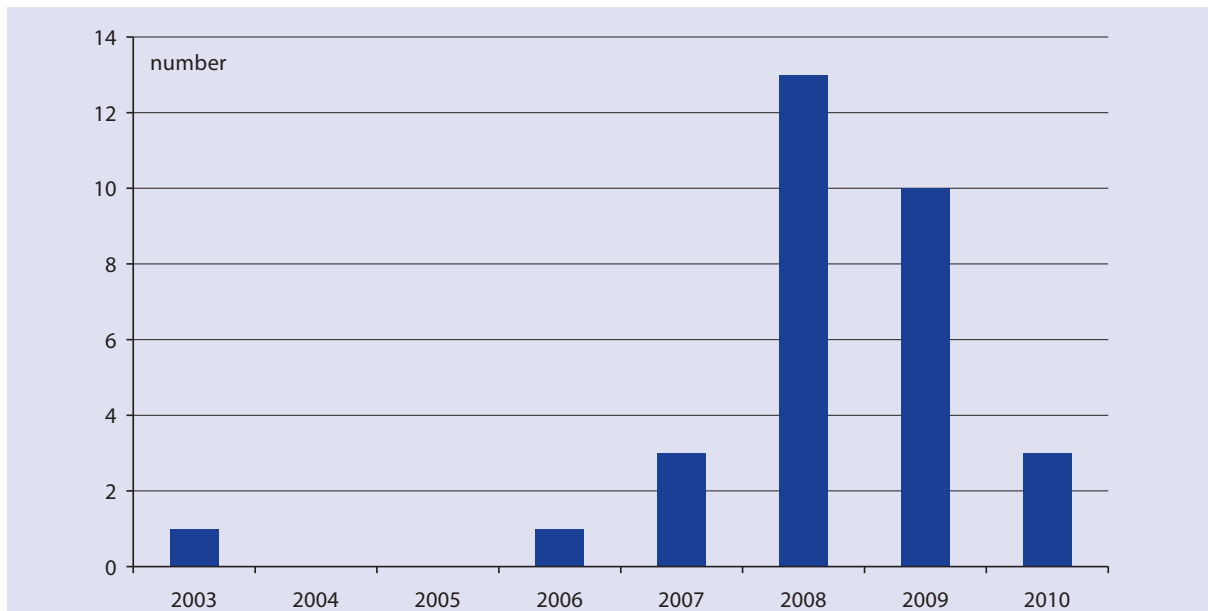
Implementation of technical regulations is a key element for the transition from compulsory product certification to product conformity assessment, as per international and European practices. As of October 2010, 31 technical regulations were adopted in Ukraine that were grounded in relevant EU Directives.<sup>143</sup> The overwhelming majority of the regulations were adopted in 2008-2009 (Figure 3.6).

The speed with which technical regulations were adopted decreased in 2010 compared to previous years. According to the National Programme of Development of Technical Regulations, 23 regulations were due to be adopted in Ukraine during 2010.<sup>144</sup> However, the Cabinet of Ministers of Ukraine has approved only three regulations since the beginning of 2010; five drafts have been submitted for consideration and are now under elaboration in the Cabinet of Ministers; ten draft technical regulations are being agreed upon with the central executive authorities concerned; the initial versions of five more technical regulations are under preparation in the central executive authorities on technical regulation.

Most regulations are voluntary for producers and suppliers for a few years after they take effect from a Cabinet of Ministers' resolution approving the regulation. During that period of time, work is carried out to appoint organisations responsible for the application of a technical regulation by enterprises, establish advisory and methodological centres, revise and publish national standards that are a proof of conformity with a regulation in case of voluntary application. It is only after completion of all the preparatory procedures that the technical regulation in question becomes binding.

The following measures have been taken, *inter alia*, to realise the programme of implementation of technical regulations:<sup>145</sup>

- infrastructure has been created consisting of 26 appointed bodies for conformity assessment of the products covered by the requirements of the technical regulations scheduled for implementation in 2009-2012;
- joint action plans have been approved for the implementation of technical regulations that were passed by the Cabinet of Ministers of Ukraine without such plans;
- advisory and methodological centres are being established for the implementation of those technical regulations which have been adopted;
- lists of national standards, the voluntary application of which is a proof of product conformity with the requirements of these technical regulations, have been approved and they are periodically updated;



**Figure 3.6. The number of technical regulations adopted in Ukraine as of October 2010**

Sources: Ukrainian legislation, calculations by the authors

<sup>140</sup> WTO (2008)

<sup>141</sup> *Derzhspozhyvstandart* (2009a)

<sup>142</sup> *Derzhspozhyvstandart* (2009b)

<sup>143</sup> *Movchan* (2010b)

<sup>144</sup> *Derzhspozhyvstandart* (2010a)

<sup>145</sup> *Derzhspozhyvstandart* (2009c)



- the Procedure of Maintaining a Register of Technical Regulations has been approved<sup>146</sup>;
- maintenance of an online Register of Approved Technical Regulations, containing information on each technical regulation, has been organised;
- to popularise implementation of technical regulations, Derzhspozhyvstandart, the Ministry of Industrial Policy and Derzhhirpromnahliad hold meetings and seminars involving product manufacturers, conformity assessment bodies, testing laboratories, and representatives of other interested parties.

Nine technical regulations must be implemented in Ukraine by the end of 2010,<sup>147</sup> almost a third of the regulations already approved. An overwhelming majority of existing regulations (28) must become binding by late 2012 to comply with CMU executive order on adoption and implementation of technical regulations as part of the adaptation of the Ukrainian economy to the WTO requirements.<sup>148</sup>

The development of a system of technical regulations is accompanied by an extremely important process of transition from conformity certification, carried out by authorised conformity assessment bodies, to a declaration of conformity presented by a manufacturer, an authorised representative thereof in Ukraine or, if certain regulations specify, a supplier.<sup>149</sup>

In particular, according to the Derzhspozhyvstandart letter addressed to the State Customs Service and conformity assessment bodies,<sup>150</sup> the following rules are in force:

- When products (goods) subject to conformity assessment according to technical regulations are undergoing customs clearance, they must be accompanied with a declaration of conformity.
- At the same time, a certificate of conformity (conformity recognition certifying document) is a basis for customs clearance of products included in the *List of products subject to compulsory certification in Ukraine* approved by Derzhspozhyvstandart Order No. 28 of 1 February 1.
- Taking the above into account, a declaration of conformity or a certificate of conformity (conformity recognition certifying document) is sufficient for the purposes of customs clearance

of products (goods) that are the subject of certain technical regulations and at the same time are included in the List.

Hence, goods covered by technical regulations in force may be accompanied by a declaration of conformity, which makes conformity assessment procedures less expensive and simpler.

The situation is not unambiguous, however. In particular, according to a Derzhspozhyvstandart letter<sup>151</sup>, any product, which is the subject of the Technical Regulation on Maximum Permitted Power Consumption by Refrigerating Devices and the Technical Regulation on Labelling of Lamps for Residential Use for Power Consumption Efficiency, must be supported simultaneously by a declaration of conformity or a certificate of conformity (conformity recognition certifying document).

The introduction of the declarative principle in conformity assessment will not promote greater efficiency of the technical regulation system unless a key requirement of such a system is secured, namely the protection of the health and safety of consumers, and of the environment. To achieve that, implementation of declarations of conformity must be supported by the establishment of a modern system of market surveillance. A draft law on market surveillance is now under consideration in the Parliament.

The Cabinet of Ministers issued an executive order in May 2010, which is intended to expedite reform in the area of technical regulation.<sup>152</sup> Several areas of reform were specified:

- **establishing a system of supervision over product safety (market surveillance).** In particular, it is envisaged that draft laws related to state market surveillance, general product safety, liability for defected products, etc will be developed and submitted to the Cabinet of Ministers. At present, some draft laws related to this subject are already under consideration by the Parliament;
- **conducting the reorganization of Derzhspozhyvstandart.** This is expected to take place after the adoption of laws shaping a system of market surveillance. A key issue is to divide the functions of standardisation, conformity control and market supervision

<sup>146</sup> Derzhspozhyvstandart Order No. 66 of 12 February 2009.

<sup>147</sup> Derzhspozhyvstandart (2010b)

<sup>148</sup> CMU Executive Order No. 1381-p of 30 October 2008.

<sup>149</sup> Introduction of the principle of declaration of product conformity with requirements of a technical regulation should not be confused with conformity declarations of the products not covered by existing technical regulations. The President's Decree No. 1105 of 13 July 2005 provides for the implementation of conformity declaration for products having a low degree of risk for consumer life and health. In pursuance of the Decree, Derzhspozhyvstandart issued Order No. 342 of 1 December 2005 on the Temporary procedure of declaring conformity of products having a low degree of risk for consumer life and health, and Order No. 6 of 29 January 2007 that introduced the List of products conformity of which may be confirmed with a conformity declaration. These goods were excluded from the List of products subject to compulsory certification.

<sup>150</sup> Derzhspozhyvstandart letter No. 1128-1-4/17 of 12 February 2010.

<http://www.qdpro.com.ua/qdw/php/common/disarchieve/getdoc.php?isnvalue=43559>

<sup>151</sup> Derzhspozhyvstandart letter No. 1904-1-4/17 of 4 March 2010.

<sup>152</sup> CMU Executive Order No. 1070-p of 19 May 2010.

among various bodies to avoid any conflict of interests;

- **cancelling the conformity declarations registration** as it is not in compliance with Ukraine's commitments to the WTO. The registration of declarations is currently envisaged by Article 32 of the Law of Ukraine on Standards, Technical Regulation, and Conformity Assessment.<sup>153</sup> A relevant draft law has been registered with the Parliament in pursuance of this measure;
- **improving the procedure of appointment of the bodies for the assessment of conformity** of products, processes and services with requirements of technical regulations. The procedures must comply with European practices and standards;
- **adopting technical regulations** based on the European Directives on the New and Global Approaches as well as other EU Directives;
- **shortening the list of products subject to compulsory certification** by means of excluding any product assessed for conformity based on technical regulations as well as low-risk products;
- **revising standards in force** to cancel outdated ones and harmonise the rest with international and European standards;
- **continuing with the modernisation of laboratories** to improve the quality of their assessments thereby strengthening consumer protection in Ukraine and securing recognition of those assessments in other countries.

The steps suggested are undoubtedly important and necessary for successful reform of the system of technical regulation in the country. However, implementation of these measures is slow. In particular, only one technical regulation was approved during the period after the issuance of the above-mentioned CMU executive order; products assessed for conformity based on technical regulations were not excluded from the list of products subject to compulsory certification. Meanwhile, these measures could have been taken by the executive authorities without any legislative amendments.

Establishment of a modern efficient system of market supervision remains a priority. A series of laws need to be passed, particularly on market surveillance, on general product safety and on liability for defected products. This would allow amendments to the Cabinet of Ministers' Decree on Standardisation and Certification<sup>154</sup> to be made to cancel the requirement on compulsory observance of state and other standards.<sup>155</sup>

<sup>153</sup> Law of Ukraine No. 3164 of 1 December 2005.

<sup>154</sup> Decree of the Cabinet of Ministers of Ukraine No. 46-93 of 10 May 1993.

<sup>155</sup> Derzhspozhyvstandart (2009a)

<sup>156</sup> CMU Executive Order No. 498-p of 26 October 2001.

<sup>157</sup> NCRE Resolution No. 57 of 29 January 2009

<sup>158</sup> CMU Resolution No. 925 of 14 October 2008

## 3.2 EXPORT PROMOTION POLICY

The basic principles of the current export promotion policy in Ukraine are set out in the Programme of Product Export Promotion.<sup>156</sup> The Programme aims at developing and implementing mechanisms to promote the growth of production of competitive products, providing conditions for an increase in exports and improvements in the export efficiency of domestic products including hi-tech products. In practice, all the measures to promote exports in Ukraine can be schematically divided into a few categories. Firstly, there is zero-rate taxation of exports of goods and related services and indirect subsidies to some economic sectors. Secondly, credits are provided by the state-owned Ukreximbank for export transactions using funds provided by international and governmental sources. Thirdly, there is a range of administrative measures, partly to protect the interests of national manufacturers abroad.

Importantly, the exports of goods and related exports services are charged with zero-rate value-added tax (VAT); this is actually one of the main export promotion mechanisms. Since Ukraine is a WTO member, direct subsidies to economic sectors are prohibited, therefore zero-rate VAT is almost the only fiscal measure of export support involving the State. However, the so-called "anti-crisis measures" should also be mentioned among the measures of indirect export stimulation. In particular, a preferential gas price was established for metal and chemical industry enterprises, particularly for fertiliser manufacturers, which use natural gas as a raw material.<sup>157</sup>

In November 2008, the CMU and representatives of mining and metal enterprises signed a memorandum of understanding, which included the introduction of a moratorium on increases in tariffs for railway freight transportation for mining, metal and chemical enterprises. There was also a suggestion that increases in electricity prices should be stopped.<sup>158</sup> Such measures distort market structure, conserve cross-subsidies of economic sectors and discourage improvements in economic efficiency.

Indirect support for exports involving the State is provided through Ukreximbank that is 100% owned by the State. Its key objectives, according to its statute, include the financing of trade (by means of providing loans and letters of credit) and guaranteeing export and import transactions. The bank is not engaged in insurance of foreign economic transactions, an activity that was delegated to commercial banks. Ukreximbank grants credits to corporate business for up to 18 months to replenish current assets and for

**Table 3.3. List of investigations carried out against Ukrainian-made products as of October 2010**

Country	Investigation	Goods	Date of initiating the investigation
Belarus	Antidumping	Starch syrup	February 2010
	Antidumping	Malt beer	April 2010
Indonesia	Antidumping	Hot-rolled stock in rolls	March 2010
Kazakhstan	Special	Confectionery	December 2008
	Special	Preserve cans and bottles	June 2009
Moldova	Special	Confectionery	March 2010
Russian Federation	Antidumping	Steel forged mill rolls	July 2009
	Special	Machine-building fixtures	May 2009
	Special	Activated charcoal	November 2009
	Special	Caramel products	March 2010
Pakistan	Antidumping	Hot-rolled stock in rolls	September 2009

Source: Ministry of Economy of Ukraine

up to five years for investment projects. Credits are provided in US dollars or Euros. The main institutions providing funds to the bank include the IBRD and the EBRD as well as their consortiums with foreign banks. At present, there is about USD 1.8 billion in the country's economy granted by Ukreximbank.<sup>159</sup>

The Ukrainian Chamber of Commerce and Industries is an important actor in the export promotion process, its key function being to provide various advisory services as well as confirm country of origin by means of issuing certificates of origin. The Chamber also maintains a register of enterprises that foreign companies may use when making their investment-related decisions. In particular, the Chamber organises business forums, conducts research, implements international cooperation programmes on the export of Ukrainian-made products to the EU, organises Ukrainian representatives' visits to foreign exhibitions and fairs, etc.

Among other export promotion measures are the trade and economic missions within Ukraine's diplomatic missions abroad.<sup>160</sup> They protect and represent the interests of Ukrainian manufacturers abroad; in particular, they prepare opinions on the prospects of exporting goods and services or of raising a loan from a receiving state, based on the prices, tariffs, interest rates, etc., offered by the receiving state.

The protection of national manufacturer interests abroad is ensured, inter alia, by the state involvement

in antidumping and special investigations now going on against Ukrainian manufacturers. The state actions are specified in relevant Cabinet of Ministers' Resolution that contains *the Procedure of protecting domestic commodity manufacturers' interests in the process of antidumping, special protective or countervailing investigations against import of Ukrainian-origin goods pursued by foreign states, their economic or customs associations*.<sup>161</sup>

As of October 2010, five antidumping and six special investigations are being conducted against goods of Ukrainian origin (Table 3.3); thirty antidumping measures are in force, of which four are under review.<sup>162</sup>

The key intentions of the existing government on export stimulation include:

- passing the draft Law of Ukraine on Special Free Economic Zones to simplify customs procedures for attracting and efficiently using investments in the implementation of export-oriented investment projects, intensifying economic activities aimed at increasing exports of goods, implementing novel technologies, developing modern production and market infrastructure;
- considering the draft Law of Ukraine on Prospective Development Territories that provides for the establishment of a legal regime of economic activities under which stimulation of investments in the output of export-

<sup>159</sup> <http://www.eximb.com/ukr/personal/>

<sup>160</sup> Pursuant to the President's Decree No. 522 of 8 April 2010, trade and economic missions were replaced with economic sections subordinated to the Ministry of Foreign Affairs of Ukraine.

<sup>161</sup> CMU Resolution No. 801 of 7 June 2006.

<sup>162</sup> Information of the Ministry of Economy of Ukraine.

[http://www.me.gov.ua/control/uk/publish/category/main?cat\\_id=48272](http://www.me.gov.ua/control/uk/publish/category/main?cat_id=48272)

- oriented products will be ensured;
- developing a draft Law of Ukraine on Export Insurance and Crediting that assumes the possible use of budget funds to insure export operations and secure their protection mechanisms through governmental or banking counter-guarantees for compliance of foreign consumers of Ukrainian-made goods with their obligations.<sup>163</sup>

A separate point in the list of export stimulation measures is the issue of Ukraine's participation in world trade organisations and accession to trade unions. For example, Ukraine signed a free trade agreement with EFTA in June 2010; negotiations are underway to sign a deep FTA agreement with the EU as well as a free trade agreement with Canada. Signature of such agreements facilitates trade relations with other countries and will result in better discipline of national production and customs procedures in the future, which will have a positive impact on the competitiveness of Ukrainian exports.

### 3.3 ENTREPRENEURS' ASSESSMENTS OF TRADE RESTRICTIONS

An analysis of trade barriers as evaluated by entrepreneurs was conducted on the basis of results of a special survey among manufacturing industry entrepreneurs as part of a Quarterly Enterprises Survey conducted by the IER within the framework of the Business Surveys project. A description of a sample and the methodology of the index calculation are presented in Annex 1.

The analysis presented below was conducted on the basis of two surveys among a panel of enterprises carried out in January 2004 and July 2010. Each exporter or importer included in the survey was asked to assess the complexity of the procedures they had faced in their foreign economic operations according to a five-grade scale. In addition, the enterprises were asked about the procedures that were most expensive in terms of costs and time.

The key trade barriers, the assessment of which the survey respondents were asked for their views included fiscal (tax and customs) barriers, logistical restrictions, and non tariff measures of trade regulation, particularly:

- paying customs fees;
- confirming origin of goods;
- confirming customs value;
- confirming registration of goods/contracts;
- licensing;
- obtaining permits / endorsement letters from public authorities;
- undergoing sanitary-epidemiological and phytosanitary control;

- undergoing veterinary control;
- undergoing environmental and radiological control;
- obtaining a certificate of conformity;
- storing goods in a customs warehouse.

From the importers' viewpoint, logistical problems were the main ones in 2010 (storing goods in customs warehouses was mentioned as posing substantial restrictions in trade<sup>164</sup> by 65.8% of importers who responded to this question). The procedures for paying customs fees were also problematic for importers. This kind of trade restriction was indicated as substantial by 57.6% of importers who responded to this question. Importers' estimates of logistical and financial restrictions worsened dramatically in 2010 compared to 2004, when relatively few entrepreneurs regarded these restrictions as substantial (Figure 3.7).

Compared to 2004, estimates of the problems caused by many non-tariff import regulation measures increased in 2010. For example, such measures as veterinary control, sanitary and phytosanitary control, obtaining permits and confirming customs value became more problematic.

The gradual reform of technical regulations and the reduction of the list of goods subject to compulsory certification resulted in a substantial decrease in the difficulty of obtaining a certificate of conformity by importers, compared to 2004. Whereas this kind of restriction was the most substantial one affecting imports, identified by 40% of respondents in 2004, the importance of this indicator had fallen sharply by 2010. It is worth pointing out, however, that verification of conformity by other means (obtaining a certification on recognition of conformity or submitting a declaration of conformity) goes not always easy as well: 23.7% importers pointed out substantial problems in these procedures in 2010.

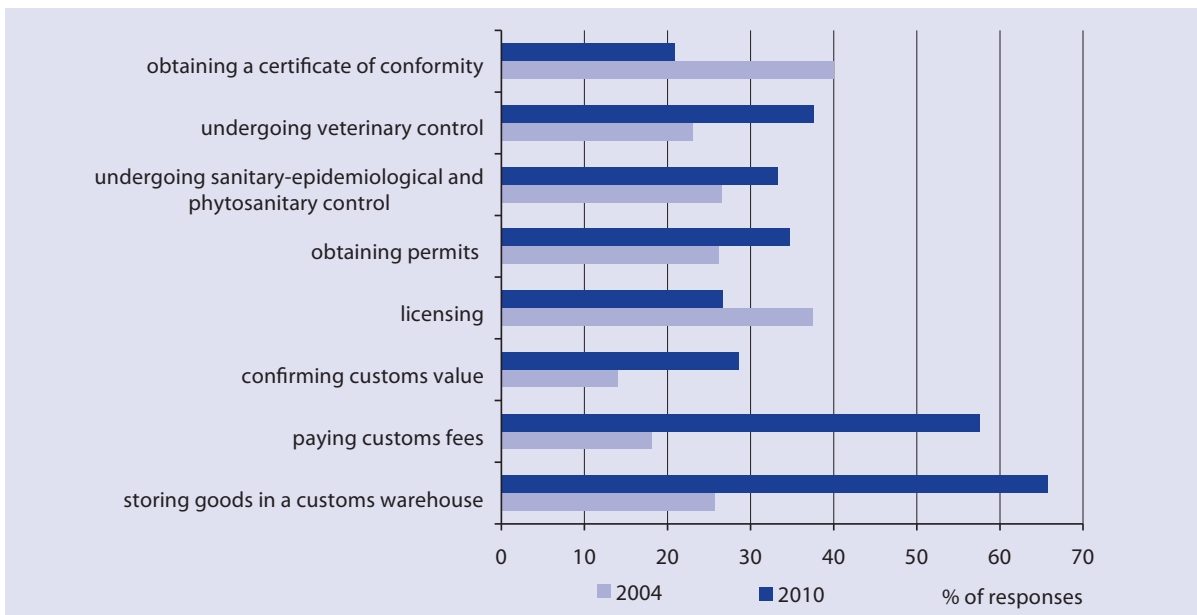
In addition, the reduction in the problem level of import licensing procedures during the period 2004-2010 was an important achievement of trade liberalisation.

The main barrier in exports, from the entrepreneurs' point of view, remains the issue of VAT refunds. Moreover, the situation has deteriorated dramatically compared to 2004. Whereas 42.2% of exporters mentioned VAT refunds as a substantial problem in 2004, which was comparable to the problem level of licensing, problems of VAT refunds in 2010 are the major issue among trade restrictions faced by exporters. In 2010, 75.2% of respondents specified this procedure as causing substantial problems, while 73.8% said the problem is the most substantial.

As with importers, the survey results from exporters indicated there had been an improvement in licensing and obtaining certificates of conformity, although the improvement is not so substantial as for imports. At the same time, there has been little change

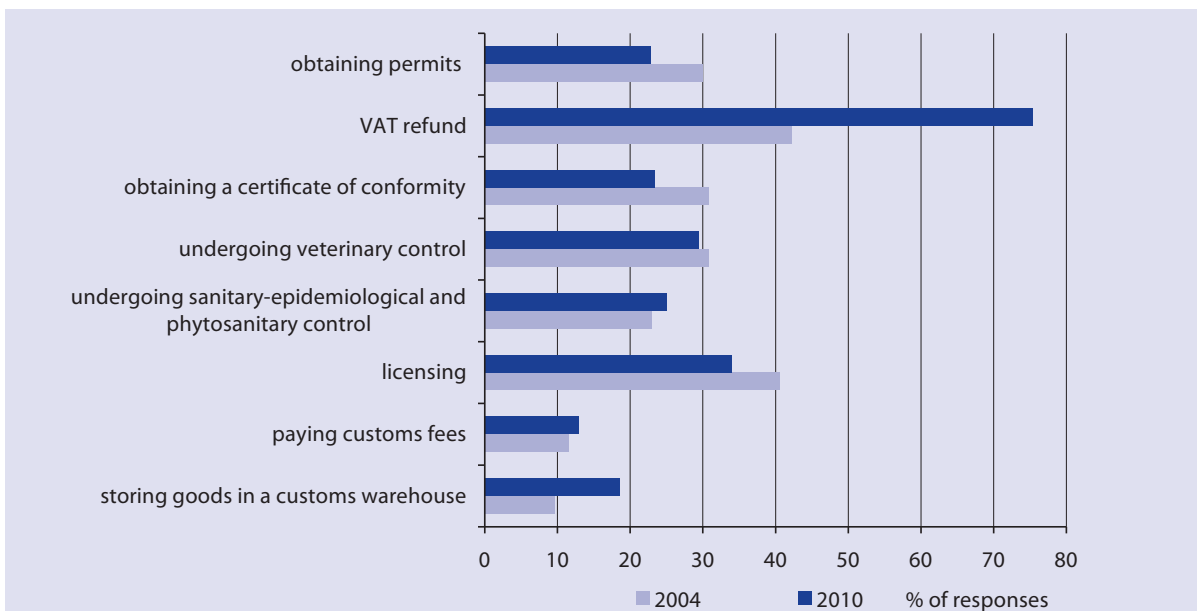
<sup>163</sup> Ministry of Economy of Ukraine. <http://me.kmu.gov.ua/file/link/148800/file/Zvit.doc>

<sup>164</sup> In this section, problems are considered as substantial if they were rated 4 or 5 according to a five-grade scale, unless specified otherwise.



**Figure 3.7. Trade restrictions causing substantial problems for importers: estimates by entrepreneurs in 2004 and 2010**

Source: Business Surveys project, [www.ier.kiev.ua](http://www.ier.kiev.ua)



**Figure 3.8. Trade restrictions causing substantial problems for exporters: estimates by entrepreneurs in 2004 and 2010**

Source: Business Surveys project, [www.ier.kiev.ua](http://www.ier.kiev.ua)

in exporters' estimates of problem levels of such non-tariff trade regulation measures as veterinary control, sanitary and phytosanitary control.

Unlike importers, exporters are not very concerned by financial and logistical barriers although the respondents pointed out certain improvements in the situation with storing goods in customs warehouses.

In 2010, procedures related to foreign economic activities cost 9.0% and 11.4% on average of the value of export and import consignments, respectively. The cost of procedures has decreased compared to 2004 when it was 10.4% and 13.5%, respectively. Large exporting enterprises (more than 1,000 staff)

spend more funds on all the procedures (13.6% of the consignment value on average). Among importers, small enterprises pay most of all (Table 3.4).

Fiscal barriers (VAT, customs fees, etc.) were the most expensive item for both exporters and importers in 2010. As far as other restrictions are concerned, exporters pointed out the high costs of confirmation of origin, obtaining permits and licensing, and these problems have remained important since the first survey in 2004. As regards importers, in addition to the costs of permits and confirmation of origin, the respondents identified the high costs of undergoing sanitary and

**Table 3.4. Cost of undergoing procedures related to foreign trade: estimates by entrepreneurs in 2010 % of one commodity consignment value on average**

Operation	Total	Less than 100 staff	101-500 staff	501-1000 staff	Over 1,000 staff
Import	11.4	16.4	9.4	9.7	13.7
Export	9.0	8.6	8.6	8.6	13.6

Source: Business Surveys project, [www.ier.kiev.ua](http://www.ier.kiev.ua)

phytosanitary control as well as of confirmation of customs value.

Compared to 2004, both exporters and importers indicate there has been a considerable decrease in the costs of obtaining a certificate of conformity, which indicates that some progress has been made in the reform of technical regulations.

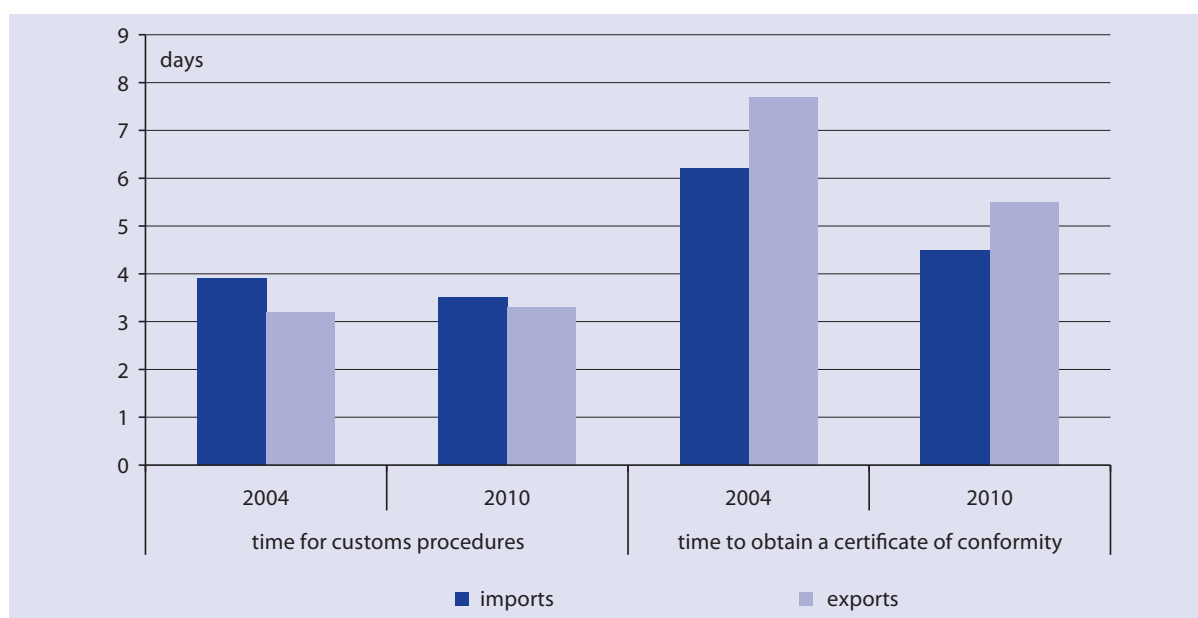
Apart from cash expenses, entrepreneurs also mentioned the time required to deal with the procedures. Obtaining certificates of conformity takes the longest period. This was true for both years of the survey, although the situation has gradually improved (Figure 3.9). Compared to 2004, both importers and exporters stated they spent less time on the procedures of obtaining certificates of conformity.

The average time required for customs clearance of one consignment in Ukraine is 3.2 days for exports and 3.5 days for imports. It should be noted that the time taken by customs procedures for importers has decreased by 0.3 days on average while no change has occurred for exporters.

Hence, in the opinion of entrepreneurs themselves, fiscal and logistical restrictions and non-tariff trade regulations pose substantial barriers for foreign economic operations. Fiscal restrictions – and logistical restrictions for importers are the most problematic. Among non-tariff restrictions, substantial barriers are created by sanitary and phytosanitary control, veterinary control, obtaining licensing and permits.

It is worth noting that gradual the reform of the technical regulation system has resulted in a reduction in the extent of the problem level of obtaining a certificate of conformity as a restriction of foreign trade both for exporters and importers.

Compared to 2004, trade restrictions are a substantial problem for a larger number of enterprises. However, the procedures are now less expensive to undergo and take less time compared with six years ago.



**Figure 3.9. Time required for certain procedures related to foreign economic activities: estimates by entrepreneurs in 2004 and 2010**

Source: Business Surveys project, [www.ier.kiev.ua](http://www.ier.kiev.ua)

# SECTION 4

## ANALYSIS OF HUMAN DEVELOPMENT IN SENSITIVE ECONOMIC SECTORS

## SECTION 4.

## ANALYSIS OF HUMAN DEVELOPMENT IN SENSITIVE ECONOMIC SECTORS

## 4

## 4.1 IMPORTANCE OF TRADE FOR HUMAN DEVELOPMENT

Trade liberalisation and openness in the contemporary world are usually regarded as important components of macroeconomic policy aimed to facilitate economic growth and the general welfare of people.<sup>165</sup> Another question is how liberalisation policy affects human development that concerns not only income, but also levels of education, life expectancy, equal opportunities of human self-realisation and human participation in the life of society.<sup>166</sup>

Trade liberalisation can affect welfare, including the **welfare of poor groups of population**, through:

- changing prices of goods subject to trade and expanding the range of goods;
- changing relative wages and capital costs thereby affecting employment opportunities for the poor;
- affecting fiscal revenues from foreign trade and, accordingly, government's ability to fund social programmes;
- changing incentives for investments and innovations that affect economic growth;
- affecting economic sensitivity to negative external shocks.<sup>167</sup>

*Prices and range of goods.* Trade liberalisation usually decreases the prices of imported goods and limits the growth of prices of goods which compete with imports, which increases people's real income, including those of the poorest. If the poorest group of the population is employed in export-oriented economic sectors, they can benefit from the lifting or reduction in export barriers because that encourages general production and export and fosters higher employment in these branches.

Trade liberalisation also promotes the growth of import of equipment and technologies, including technologies that improve the quality of life and contribute to human development. They include new medications, new technologies of food packaging and storage, etc.

*Wages and employment.* A few factors exist that determine the impact of foreign trade liberalisation on wages and employment of the poorest groups of the population. Firstly, they include the level of wage flexibility and labour mobility. Changes in the relative prices in the domestic market after trade liberalisation means that certain sectors will boost production

whereas some other sectors will experience a fall, provoking similar changes in the demand for resources, including labour. These changes will affect either wages or employment depending on which is more flexible in any given economy.

Secondly, they include the initial level of sector protection and the sectoral structure of employment of the poorest. Obviously, if those that are poor work in sectors that were the most protected, then trade liberalisation, growing competition and price reductions will have a negative impact on earnings and well-being. Accordingly, state support aimed at overcoming these consequences would be necessary.

*Fiscal revenues and social programmes.* The impact of trade liberalisation on fiscal revenues and, hence, on government's ability to finance various social programmes depends largely on the structure of trade protection and the structure of economy prior to liberalisation. In particular, the initial structure of trade protection determines how many prohibitive restrictions or unproductive expenses there were, the removal of which would substantially encourage imports and allow the reductions in import duties to be offset by growing trade volumes. The structure of economy, namely the ratio between export-oriented and domestic-market-oriented branches, will indicate what impact liberalisation can have on overall production, hence on the State's revenue from domestic taxes and dues.

*Investments and innovations.* An important prerequisite for securing continuous poverty reduction consists of ensuring sustainable economic growth that involves the poorest groups of population. Increased exports and greater efficiency in resource allocation provide an important but short-term incentive for economic growth. More important is the access to new technologies as well as the need to encourage investment that would allow sustained and stable growth provided there are necessary institutions, supported by an adequate macroeconomic and exchange rate policy.

*Sensitivity to external shocks.* Foreign trade liberalisation makes the economy more open and deepens its integration with the rest of the world. That provides opportunities for economic development, but also increases the sensitivity of the economy to external shocks.

<sup>165</sup> Winters L.A. (2000)

<sup>166</sup> The human development concept is discussed in detail on the UN webpage, particularly <http://hdr.undp.org/en/humandev/>

<sup>167</sup> Bannister G.J., Thugge K. (2001) "International Trade and Poverty Alleviation" Finance and Development, December 2001, Volume 38, Number 4



In addition to the impact on people's welfare, trade expansion has other channels of influence on human development. In particular, the trade impact on **improving the quality of public health care** is essential since it is only trade that allows the rapid distribution of new medicines, vaccines and medical instruments.

Important factors to secure healthy lifestyles consist of access to fresh fruit and vegetables throughout the year, the spread of new (safer) household chemical goods and new types of domestic appliances that improve the quality of product processing and allow more nutrients to be preserved. Access to such goods is also provided by a more liberal trade regime.

Trade in hi-tech goods and a country's involvement in production chains contributes to knowledge enhancement and encourages **people's training**, hence it increases demand for high-quality, lifelong education that is reflected in changes in the country's education programmes. New technologies also allow for improvements in **environmental protection** and increases in energy saving. This is also an important component of human development.

At the Millennium Summit 2000 in New York, the heads of state and government of 189 UN member states approved a programme of improving people's living standards by 2015. Signing the Millennium Declaration, Ukraine undertook to reach seven goals and fifteen specific targets within the framework of achieving the Millennium Development Goals by 2015.<sup>168</sup> The targets include poverty reduction, improvements in the quality of education, stabilisation of air pollution from stationary sources, reduction of mortality and morbidity of children and mothers, among others.

Aid for trade is an important driver for the country to meet its commitments successfully and secure a higher level of human development in Ukraine.

## 4.2 AGRICULTURE AND FOOD INDUSTRY

### 4.2.1 The role of agriculture and the food industry in Ukraine's economy

Agricultural production and the food industry play an important role in Ukraine's economy. Agricultural production accounts for about 8% of Ukrainian GDP, with about 7-8% provided by the food industry. If supportive links – agricultural machine-building, production of mineral fertilizers, chemicals and fodders – that constitute the agro-industrial complex are added, then the agro-industrial complex share in Ukraine's GDP goes up to 25%. In 2008, 10% of all employed worked in agricultural production and the food industry, and almost 32% of the country's population lived in rural areas.

It is widely known that agriculture's share in production and employment decreases in the course of a country's economic development as the shares of industry and services go up. According to Table A2-1 (Annex 2) Ukraine follows a similar trend. For example, the share of the population employed in agriculture decreased from 20.4% in 2002 to 15.5% in 2009 whereas the share of agriculture in GDP has declined from 13.0% to 7.2% over the same period.

However, in case of Ukraine, this trend does not result from the impact of long-term factors in a full-employment economy described in economic textbooks. There are many applied studies demonstrating that the entire Ukrainian economy, including agriculture, works below the production possibility curve. For example, Tiffin<sup>169</sup> in an econometric study on production efficiency found that in 2000 Ukraine's output was only 22% of its possible maximum volume of production whereas in the 1990's the figure was 49%. It means that structural changes in Ukraine's economy since independence have occurred mainly due to the depth of the transition crisis in some sectors. Therefore, the share of agricultural production in GDP may remain unchanged or even grow in the medium-term, given the fast pace of reform and restructuring in the sector. However, it might slow, but unlikely to change the decline in the share of employment in agriculture.

The food industry in Ukraine is now of a similar size to the primary agricultural sector. Whereas the share of agriculture in Ukraine's GDP was almost twice as large as that of the food industry in 2000, production in both the food industry and primary agricultural "have kept apace" with each other since 2006. However, unlike agriculture, the food industry's share in Ukrainian GDP has not decreased so quickly, but has even grown and is now about 8%.

Agricultural production in Ukraine is concentrated in household farms and agricultural enterprises. As of 2009, agricultural enterprises owned 50% of the 41.7 million ha of agricultural land and accounted for about 45% of the entire gross output. Household farms owned about 38% of Ukraine's agricultural land and produced about 55% of gross output. Households also dominate in terms of the sector breakdown of agricultural production. For instance, the share of households is about 54% in the gross output of plant products and about 57% in that of animal products.

By products, households still dominate the entire range of livestock products (Figure 4.1). However, their share has been decreasing every year due to the growth of output in agricultural enterprises dictated by tougher market requirements and higher prices of raw materials. This is a positive trend because agricultural enterprises are able to ensure more competitive production and provide the country with higher-quality products which meet European quality

<sup>168</sup> MEU (2010a)

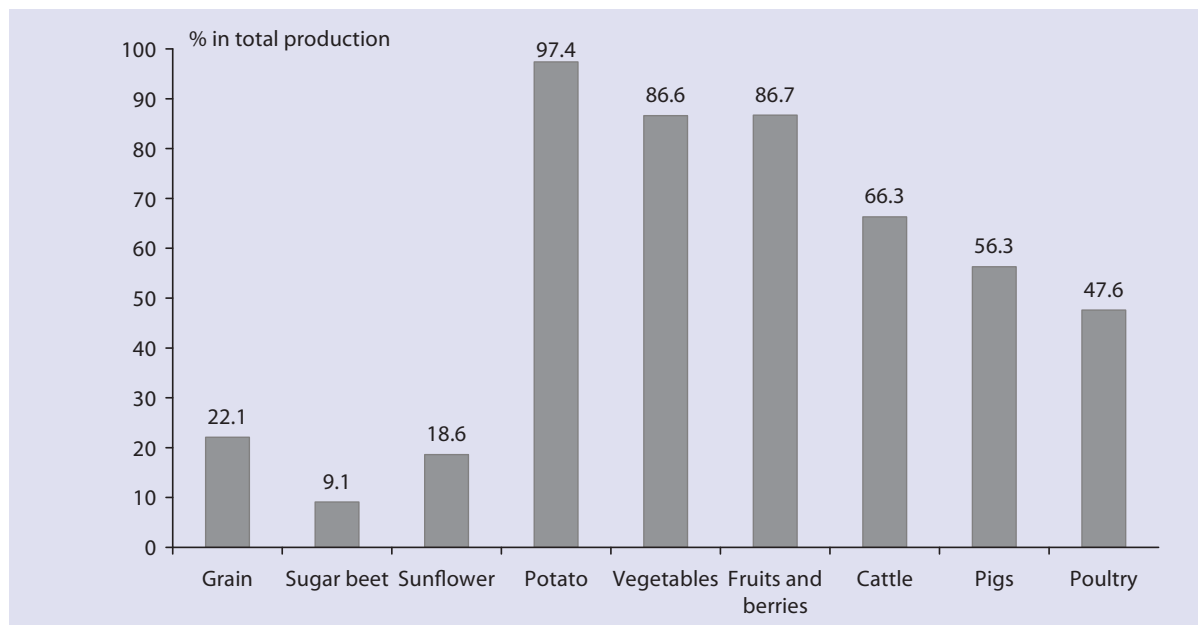
<sup>169</sup> Tiffin (2006)

standards and enhance Ukraine's opportunities to organize the export of animal products to the EU market.

In crops, households prevail in the production of potatoes, vegetables and fruit whereas agricultural enterprises play the leading role in cultivation of mainly export-oriented crops (Figure 4.1). Ukraine

requiring a higher degree of processing, where requirements are stricter. Ukraine managed to penetrate the EU cereals and oil-bearing crops market, but the core sales market for dairy products (one of the few food industry sectors where Ukraine is a net exporter) consists of the CIS countries where standards and certification requirements meet Ukrainian norms. Some

4



**Figure 4.1. Household share in output of some agricultural products**

Source: Author's calculations based on data of the State Statistics Committee of Ukraine

produced more than 52 million tonnes of cereals in the 2008/2009 marketing year, a record for the entire independence period.

Agricultural production and the food industry play an important role in Ukraine's foreign trade. For example, the share of agricultural production and the food industry in Ukrainian exports in 2006 was 6.8% and 7.1% respectively, about 14% in total. In addition, the export dynamics have a positive trend. The export-to-import ratios in Table A2-1 suggest that agriculture and the food industry are among the export-oriented branches in Ukraine's economy.

The traditional export markets for agricultural produce include the countries of the CIS, the EU and Northern Africa as well as the Middle East. The CIS states, particularly Russia, remain major importers of dairy industry products, whereas cereals and oil-bearing crops were mainly exported to Africa, Asia and the EU.

Ukraine's key competitive advantages in the short-term in these sales markets consist of a relatively low cost of producing products which only require a fairly low degree of processing, especially cereals, oil-bearing seeds, oil cakes, and vegetable oils. While product quality requirements in international markets have been toughened (partly due to the need for regulation of genetically modified products), it is easier for Ukrainian suppliers to compete in such markets than in those for animal products and other products re-

quiring a higher degree of processing, where requirements are stricter. Ukraine managed to penetrate the EU and US markets (particularly poultry producers) by means of individual implementation of the necessary quality control systems, but these markets are hardly accessible to the sector as a whole.

As mentioned above, output from the entire Ukrainian economy, including agriculture and the food industry, is below the production possibility frontier. The findings of a series of studies empirically applying efficiency analysis techniques to data of agricultural enterprises of Ukraine and other ex-USSR countries demonstrate the considerable heterogeneity of enterprise efficiency. A large number of enterprises carry out their operations considerably below the production possibility frontier. This is confirmed by reviewing of such a simple (partial) productivity indicators as agricultural crop yields. The yields in Ukraine are generally half the yields in the EU or the USA, and in some cases the yields can be three-times lower (Table 4.2).

Partial productivity indicators like yields, however, can be misleading because they only take one of the resources used into account while farms use several inputs simultaneously to produce a number of outputs. The efficiency with which farms convert all inputs into outputs is important for competitiveness. One measure is the total factor productivity (TFP), a measure of the ratio between the aggregate use of inputs and aggregate output. The development

**Table 4.1. Net exports of main agricultural product categories, 2000-2010, thousand tonnes**

Products	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Barley	987	2708	2621	1384	4305	3898	5089	995	6367	6221
Maize	371	345	788	1238	2320	2452	1003	2050	5485	4990
Oats	34	47	6	7	17	0	-5	20	6	5
Rye	-16	292	142	-90	104	69	2	0	6	56
Wheat	-608	5394	5759	-3299	4369	6393	3287	901	12963	9309
Sunflower oil	550	308	910	978	640	1514	1867	1324	2098	2645
Sunflower seeds	1019	94	330	926	6	215	330	67	761	347
Sugar	-392	-160	-1110	-255	-43	-43	-10	-75	-41	-475
Beef and veal	156	94	183	206	106	36	-6	37	-3	15
Pork	9	0	0	7	-48	-51	-59	-80	-238	-186
Dairy products	94	162	98	135	214	211	142	127	148	82

Source: Author's calculations based on USDA data

**Table 4.2. Yields of main cereal crops in Ukraine and in the World, 2007-2011**

	2007/2008	2008/2009	2009/2010	2010/2011*
<b>Barley</b>				
Yield in Ukraine, t/ha	1.46	3.04	2.36	2
Average yield in the EU-27, t/ha	4.17	4.52	4.44	4.29
Average yield in the US, t/ha	3.23	3.42	3.93	3.96
<b>Maize</b>				
Yield in Ukraine, t/ha	3.89	4.75	5	4.42
Average yield in the EU-27, t/ha	5.63	7.09	6.8	6.83
Average yield in the US, t/ha	9.46	9.66	10.34	9.78
<b>Wheat</b>				
Yield in Ukraine, t/ha	2.34	3.67	3.1	2.64
Average yield in the EU-27, t/ha	4.86	5.6	5.36	5.29
Average yield in the US, t/ha	2.7	3.02	2.99	3.14

Source: Author's calculations based on USDA data (\* according to preliminary USDA data)

in this measure for Ukraine and other countries and regions of the world is shown in Table 4.3. The average annual TFP growth in Ukraine's agriculture has amounted to 4.1% since 1992. This is a good result and is even higher than the average world figure (about 3%) over the same period. However, Table 4.3 shows also that TFP growth has slowed down slightly since 2000; the average annual TFP growth rate was 5.5% between 1992 and 2000 but only 2.5% between 2001 and 2007. Although this is higher than the average of the global indicator, it is less than half the level for Russia and Belarus. Such a trend is of concern in view of the need to increase the competitiveness of Ukraine's agriculture.

Foreign direct investment in Ukraine's agriculture amounts to about 3% of total FDI in Ukraine,

which is relatively large compared to the global average. According to the global report on investments<sup>170</sup>, FDI in agriculture in developed countries is less than 1% of the total global FDI volume and the average figure for developing countries, South-east Europe and CIS is also about 1% (according to 2006-2008 data). This proves that Ukraine is one of the leaders in attracting foreign investment to agriculture.

At the same time, a larger part of the investment in Ukraine's agriculture is fixed capital investment. This is because agrarian enterprises invest a considerable amount in their development by themselves. The existence of such a tendency is confirmed by the fact that between 20% and 85% of total output of basic cereals and oil-bearing crops, as well as meat and

<sup>170</sup>UNCTAD (2010)

**Table 4.3. Annual indicators of Combined Factor Productivity growth in Ukraine and other countries and regions of the World, 1993 - 2007**

	Africa	Latin America and Caribbean	North America	China	Western Europe	Central and Eastern Europe	India	Russia	Ukraine	Belarus	World
1993	1.6	-4	-11	15.2	-1	12.2	2.7	2.6	15.3	4.6	3
1994	0.5	2.8	23.4	5.8	1.4	-1.6	2.8	-3	-12.3	-6.8	5.1
1995	2.1	6	-12.1	4.3	2.6	8.3	2.2	-0.1	9.3	-3.3	1.5
1996	7.8	-1.5	11.6	5.8	7.8	1.4	3.7	2.7	6	5.3	5.5
1997	1.9	3.4	5.4	10.5	2.6	3.1	2	11.4	12.8	0.9	4.7
1998	2.6	3.7	0.8	1.6	3.8	3.3	4	-8.1	-7.5	3.2	2.5
1999	2.8	5.9	2.1	-0.1	5	-0.7	4.3	7.5	2.6	-4.5	2.8
2000	1.7	7.1	3.1	0.1	3.3	-1.8	0	9.8	22.1	5.1	3.3
2001	1	4.1	-2.7	1.1	-2.5	11.7	2.5	11.2	19.3	6.2	1.7
2002	2.5	4.5	-4.5	1.9	3.7	-0.5	-6.8	3.8	-3	2.7	0.7
2003	3.1	5.1	10.1	1.2	-4	-3.1	7.3	0.8	-14.8	3.1	3.6
2004	4.1	1.2	13.3	3	9	11.5	1.9	8.7	44	13.5	4.8
2005	6.1	3.7	-0.8	1.1	-1.9	-4.6	4.8	8	-1.6	5.3	2.3
2006	3.5	1.8	-3.6	0	2	-0.4	5.3	6.2	-1.2	5.6	1
2007	-3.1	5.2	8.7	1.6	0.5	-0.9	5.6	0.8	-13.9	3.9	2.1
1992-2007	2.5	3.2	2.5	3.5	2.1	2.4	2.8	4	4.1	2.9	3
1992-2000	2.6	2.9	2.3	5.3	3.2	2.9	2.7	2.7	5.5	0.5	3.5
2001-2007	2.4	3.6	2.7	1.4	0.9	1.8	2.9	5.6	2.5	5.7	2.3

Source: Nivievskiy, O., S. von Cramon-Taubadel, and B. Brümmer (2010)

**Table 4.4. Investments in Ukraine's agriculture, 2004-2009**

million USD	2004	2005	2006	2007	2008	2009
FDI in Ukraine's agriculture	224.0	310.0	404.3	557.3	803.2	871.4
Total FDI in Ukraine's economy	6794.4	9047.0	16890.0	21607.3	29542.7	35616.4
<i>FDI in agriculture as percentage of total</i>	3%	3%	2%	3%	3%	2%
Fixed capital investments in Ukraine's agriculture	634.0	980.0	1447.3	1849.1	3378.0	1180.1
Total capital investments in Ukraine's economy	14232.0	18182.8	24802.8	37324.0	44060.7	19458.6
<i>Fixed capital investments in agriculture as percentage of total</i>	4%	5%	6%	5%	8%	6%

Source Author's calculations based on data of UCAB, the State Statistics Committee, and the National Bank of Ukraine

milk, is concentrated in 150 of the largest Ukrainian agrarian companies (see details in the next section).

#### 4.2.2 Specificity and problems of Ukraine's agriculture and food industry

The factors hindering the realization of the potential of Ukraine's agriculture and food industry relate to the long-term transition from the conservative

Soviet system of agrarian practices to a modern one, which impedes integration into international markets by producing competitive products. Conservative practices permit less efficient agrarian enterprises to remain in the market while the current status of the system of education, science and research in agriculture also remains uncompetitive. The latter adds to low and inadequate qualifications of agricultural personnel. The insufficient and slow exchange of ex-

expertise with the international community, as well as distortions due to non-transparent state regulation and the slow rate of infrastructure development result in very slow improvements to the organization of agrarian business, hindering the progress towards improving the competitiveness.

Changing conditions of economic management, particularly to the forms of land ownership and growing openness, hence more intense competition in international markets, have led to changes in the organizational structure of agrarian production. The sharing of collective farms' property has resulted in the formation of small farms (personal peasant plots, farm enterprises). However, small enterprises were not able to provide sufficient capital intensity of production, and resources have gradually accumulated in large organizational structures. That has resulted in the rapid development of large agrarian businesses – agricultural holdings that are able to ensure more competitive production due to their large scale of production, investments in technology and vertical integration. The access of small and medium-size businesses (farm enterprises) to external funding resources is more difficult and given high interest rates, they are not able to compete with large agricultural holdings in traditional markets (cereals, oilseeds). Thus the smaller farms tend to focus on narrower niches (vegetable growing, viticulture).

In 2010, agricultural holdings farmed more than 4 million ha of land in Ukraine (13% of the total area) whereas about 150 of largest Ukrainian agrarian companies produced 40% of the total output of wheat, 60% of maize, 55% of sunflower, 85% of sunflower oil, 80% of rape, 80% of poultry meat, 40% of meat of all types and 20% of milk production.<sup>171</sup> At the same time, most meat production (except for poultry meat) and milk production comes from household farms. According to UCAB's research, the difference in technical efficiency between small and large agrarian enterprises is 30.8%, especially in animal husbandry where the difference rises to 43.8% in favor of large agrarian enterprises.<sup>172</sup> The higher efficiency levels of large enterprises enables them to compete in global markets<sup>173</sup>, but the existence of lower productive agrarian enterprises as a whole mean that the average indicators of Ukrainian agricultural development remain lower than average global figures (such as cereals yield, milk yield, etc.).

Small and medium-size farms, having the opportunity to occupy market niches, perform a social function of maintaining farming culture and preserving cultural and welfare traditions of rural development. They often use more conservative technologies and rarely consider improvements or diversification opportunities. Such enterprises find it harder to follow trends in market demand without investing in new areas of development.<sup>174</sup>

One of the key problems in agriculture is the inefficiency of the state support system and the unpredictability of interventions in production and trade. Important issues for reform of this system include the need to reduce the unequal distribution of production subsidies, replacing them with growth-stimulating state investments such as investments in applied science and practical education, in the creation of market information systems, in support to farmer advisory services, and, most importantly, in rural infrastructure (roads, energy and water supply, health care, schools).

Distortions in the agrarian produce market are also caused by the taxation system, particularly the VAT refund mechanism. Arrears on VAT refunds to exporters have occurred in Ukraine for many years. This issue is of great concern not only inside the country but in the international arena as well. Every misunderstanding on this occasion, especially with international companies, damages Ukraine's reputation in the international community.

As far as other aspects of state regulation are concerned, Ukraine ranks 145<sup>th</sup> among 181 countries in the World Bank 2009 ranking on the ease of doing business.<sup>175</sup> Ukraine has a complicated system of import regulation (particularly for agricultural equipment and fertilizers) and complicated customs procedures, difficult conditions for starting and closing a business, weak protection of investors, etc. The most important point is that legislative documents are not always complied with by public authorities, and many actions of the latter only exist de facto.

A specific example concerns the recent export restrictions that emerged in Ukraine's grain market before and after the official introduction of quotas.<sup>176</sup> Quotas for grain export in Ukraine were introduced for the second time during the last five years. The previous quota system that was established in 2006–2008 turned out to be unjustified because internal grain

<sup>171</sup> Data by the Ukrainian Agribusiness Club (UCAB): <http://www.agribusiness.kiev.ua>

<sup>172</sup> Based on a sample of 7800 agricultural enterprises in Ukraine (UCAB survey).

<sup>173</sup> Demyanenko S.I. (2008)

<sup>174</sup> For example, following current developments of alternative energy in Ukraine, the demand for biomass (such as straw) is growing. The estimated biomass potential in Ukraine is large, but finding suppliers remains difficult. The more traditionally minded farmers prefer burying more-than-recommended quantities of straw in the ground or burning it in the fields instead of gathering, baling and selling it.

<sup>175</sup> <http://www.doingbusiness.org/rankings>

<sup>176</sup> Resolution No. 938 as of 4 October 2010 on introduction of grain export quotas took effect on 19 October. According to the Resolution, quotas are set at 500 thousand tonnes for wheat, wheat-rye mix (meslin) and einkorn; 2 million tonnes for maize; 200 thousand tonnes for barley; 1 thousand tonnes for rye; and 1 thousand tonnes for buckwheat. Exports were informally blocked until the quotas were officially established. Upon the introduction of the quotas, rapid licensing blocked grain exports for a second time in 2010. For more details see news on <http://www.apk-inform.com>

supplies were quite sufficient to cover all domestic needs as well as to export more than had been estimated by the government. The consequences of the 2006–2008 restrictions had negative impacts of grain export quotas and licensing on the national economy.<sup>177</sup> The total welfare loss in Ukraine amounted to about USD 8 million from the introduction of a wheat export quota in 2006 alone when the quota was set at 400 thousand tonnes (now 500 thousand).<sup>178</sup>

There is a wide range of other examples of the government's inefficient policy on support for agriculture.<sup>179</sup> They include fiscal policy (there is a need to correct a tax bias in favour of agricultural holdings and urbanized areas for securing a sufficient tax inflow to rural community budgets), the uneven distribution of support among various products and enterprises, support arrangements, price regulation (setting floor and ceiling prices for socially significant products), distribution of education and research expenses, ensuring systems for food quality and safety control.

Important rural problems include lack of motivation to work, poverty, labour migration, unemployment, degradation of the social infrastructure, decline of demographic reproductive and labour potential of rural areas, and the disappearance of villages. As mentioned in the previous section, average wages in agriculture are the lowest among all economic sectors in Ukraine. To overcome these and other problems of Ukrainian rural areas, the government has developed many programs and concepts. However, a specific feature of the Ukrainian government is to draft a multitude of written programs and then not to take any action to implement and improve them. This problem is also aggravated by frequent changes of governments in Ukraine, each of which begins to put forward its own legislative initiatives and rewrite existing programs, instead of implementing the existing ones.

The moratorium on the purchase and sale of agricultural land is an acute problem for agriculture development in Ukraine. The moratorium was initially formally imposed by the existing Land Code of Ukraine in 2001 until 1 January 2005, but has been extended many times. The government's justification for the annual extension reflects the lack of the Law on Land Market and the Law on Land Cadastre that are always planned to be drafted and adopted within each extension year of the moratorium's validity. The present government plans to lift the moratorium before 1 January 2012.

The moratorium on the purchase and sale of agricultural land is grounded in political rather than economic reasons. The moratorium is rather harmful from the economic point of view. It does not curb

agricultural land purchase transactions, but has given rise to a shadow market (a few schemes for evasion of the moratorium now exist in Ukraine). The parties that lose out include: land owner peasants who receive a much lower price for their land compared to an open market price or who rent out land and receive a relatively low rent for the land; the government in the form of local governments and local budgets, because of the non-payment of taxes for agricultural land transactions; agricultural producers and agrarian production as a whole since it is not possible to involve land for human activity and obtain mortgage loans.<sup>180</sup>

Hence, the key problem for development of Ukrainian agriculture remains the need to address those aspects of state policy and state regulation that create barriers to improve the competitiveness of the agro-food sector on the whole.

### 4.2.3 Prospects and barriers for increasing exports

Favourable agro-climatic conditions mean that Ukraine has considerable potential or alternatively, international competitiveness in agricultural production. Over 40 million ha of agricultural land, including about 33 million ha of arable land, provide an excellent base for the production of crops, which can be grown in a temperate climate, and animal products. More than a half of Ukrainian arable land consists of black earth which is ideal for agricultural crops; Ukraine possesses about one-third of the world's stock of black earth.

Due to its relatively low population density,<sup>181</sup> Ukraine's considerable production potential implies a considerable export potential. In other words, an increase in agricultural exports depends directly on the international competitiveness of Ukrainian production. In addition, Ukraine's industrial and export potential is also dictated by its considerable geographical advantages. The country's Black Sea ports do not freeze up and provide year-round, direct access to world markets. Moreover, Ukraine is situated close to important import markets of agricultural products in the Middle East, the former USSR, North Africa and the EU.

However, the importance of these natural advantages in the current context is reduced by the transformation which occurs to products throughout the value chain, i.e. from the field to supermarket counters. As already described in detail in the previous section, the competitive advantages of agricultural production in Ukraine (considerable agro-climatic potential and convenient geographical

<sup>177</sup> Von Cramon S., Raiser M. (2006).

<sup>178</sup> Kuznetsova G. (2010).

<sup>179</sup> World Bank (2008)

<sup>180</sup> Demyanenko S.I. (2008).

<sup>181</sup> Ukraine's population density is 77 per sq. km. For example: average global density – 48, India – 346, China – 137, the US – 31; Argentina – 14; Russia – 8.4 (Wikipedia, 2006). If agricultural land alone is considered, Ukraine's population density (1.17 per agricultural hectare) is less than the global average (1.28) (FAO, 2006).

position) are limited by a whole range of factors such as insufficient human capital, generally inefficient and costly marketing infrastructure, ineffective and counterproductive state policy and regulation in agriculture.

Change in an enterprise's international competitiveness depends on: i) productivity and ii) prices<sup>182</sup> Increasing productivity and producer prices result in growing competitiveness whereas higher input prices lower the competitiveness of an enterprise. Taking these factors into account, in what way can competitiveness of agriculture and, hence, exports be raised?

With respect to prices, what trend will prices follow in the future, will they improve the competitiveness of Ukrainian agriculture, can these trends be changed by state policy? The future development of agricultural product prices has been the subject of debate for many years. The real prices of agricultural products have tended to fall since the middle of the XIX century (with short-term fluctuations) because of technical progress in agriculture and transport as well as an increase in the agricultural areas of the world which has allowed supply to exceed demand. Many experts are sure that the above-mentioned trend has ended and that a variety of factors, such as strong growth of population and income, climate change, and limited growth of yields and of agricultural areas, will result in increases in agricultural product prices during the next decades (again, with short-term fluctuations).

Perhaps, such developments will increase the competitiveness of Ukraine's agricultural production, but one should not forget the following factors. Firstly, price growth is also expected for many products which are basic inputs for other agricultural production (for example, grain for livestock production). Besides, the demand and supply factors that will cause higher agricultural product prices will also result in higher input prices, for example for mineral fertilizers and fuels. All these factors will weaken the positive impact of the growth of agricultural product prices on the competitiveness of agricultural enterprises.

Secondly, as already mentioned, the ineffective and counterproductive state policy and regulation in agriculture lead to distortions in product and input prices. For example, export restrictions result in worse ratios between output prices and inputs for agricultural enterprises. Costly marketing infrastructure also adversely affects this ratio. Hence, even given long-term positive conditions in world markets, Ukrainian agricultural producers might fail to benefit because of the State's counterproductive steps.

With respect to productivity, in conditions where there is likely to be uncertainty over future price trends, maintaining and strengthening the growth of productivity, especially of TFP is the most efficient

and sustainable way to increase competitiveness of Ukraine's agriculture and hence of exports. The growth of TFP in agriculture can be secured by i) investing in fundamental and applied agricultural research to encourage the development of new technologies and the adoption of technologies developed in other countries to Ukrainian conditions; ii) investing in training, education and advisory services to improve the efficiency of enterprises and speed up the introduction of new technologies; iii) making policy changes that would allow for in-depth restructuring and less interference of the state in pricing.

#### 4.2.4 Impact of international trade agreements on human development

Upon accession to the World Trade Organization in 2008, Ukraine considerably liberalized access to its domestic agricultural product market by reducing import duties. However, the level of protection of agricultural goods remains higher than for industrial products (average weighted tariff for agriculture and industry is 10.7% and 4.5%, respectively). Ukraine committed to establish a quota for sugar imports to Ukraine at 260 thousand tonnes with a 2% duty (the rate over and above the quota is 50%) and reduce an export duty rate for oilseed crops from 16% to 10% within six years as well as limit direct state support to the sector to UAH 3.04 billion.

As calculated by the IER,<sup>183</sup> there is likely to be a decrease in aggregate output of agricultural products by 6.1% in the medium term and by 3% in the long term due to accession to the WTO. This can be explained mainly by the reduction of import duties and stronger competition from imported goods. It is expected at the same time that exports will grow by 9.4% due to better access to external markets. The fall in aggregate output will result in a decline in the agricultural labour force. In the medium term, the demand for skilled and unskilled workers is expected to fall by 6.9% and 6.8%, respectively.

After accession to the WTO, Ukraine can choose from several further scenarios of regional trade integration. Intense negotiations have started since 2008 on an agreement on a deeper and comprehensive free trade area between the EU and Ukraine. The key points of such an arrangement might include the mutual cancellation of import duties and a reduction of non-tariff restrictions. It is expected that the establishment of a free trade area with the EU will facilitate an increase in aggregate agricultural product output by 3.2% in the medium term and by 9% in the long term.<sup>184</sup> Agricultural exports are expected to grow by 3.8% in the medium term and by 19.8% in the long term. A similar tendency is expected in the food industry: a 3.4% increase in aggregate

<sup>182</sup> For a more detailed description of mathematical calculations see Nivjevskyi, O., S. von Cramon-Taubadel and B. Brümmer (2010b)

<sup>183</sup> Burakovskiy I.V. and Movchan V. (2008)

<sup>184</sup> The Institute for Economic Research and Policy Consulting (2010): *Ukraine's trade policy options: pros and cons of various scenarios. An unpublished report.*

**Table 4.5. SWOT analysis of agriculture and the food industry**

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>- favorable natural climatic conditions;</li> <li>- advantageous position relative to sales markets: Europe and CIS;</li> <li>- growing inflow of investments to the sector;</li> <li>- high natural soil fertility;</li> <li>- availability of port capacities to handle large vessels.</li> </ul>	<ul style="list-style-type: none"> <li>- low efficiency of the sector, high share of households in production;</li> <li>- great number of conservatively disposed agrarians;</li> <li>- lack of staff (especially highly skilled);</li> <li>- unsatisfactory quality and safety of food products;</li> <li>- shortage of elevator capacities; undeveloped marketing infrastructure in rural areas;</li> <li>- high dependence on agro-climate conditions, inefficient system of insurance of agricultural risks;</li> <li>- high administrative and transactional costs.</li> </ul>
Opportunities:	Threats:
<ul style="list-style-type: none"> <li>- global climate change and soil fertility changes in the world;</li> <li>- growing world population and increasing demand for food products;</li> <li>- increasing demand for alternative energy – market for agricultural raw materials.</li> </ul>	<ul style="list-style-type: none"> <li>- decreasing content of nutrients in soils, erosion, worn-out melioration systems;</li> <li>- imperfect system of budget support, delays in VAT refund to exporters;</li> <li>- inadequacy of the expert training system, low level of integration into the international scientific community;</li> <li>- low predictability of state policy, quantitative restrictions of foreign trade;</li> <li>- depopulation and urbanization of rural population;</li> <li>- decreasing production output in related branches (insufficient provision with means of production).</li> </ul>

Source: IER

product output is expected in the medium term and a 7.7% increase is expected in the long term. Exports are expected to grow by 36.2% in the medium term and by 46.8% in the long term.

A customs union with Russia, Belarus and Kazakhstan might become another regional integration option for Ukraine. However, the possible benefits for agriculture are quite limited and losses can appear in some cases. Therefore, based on the preliminary calculations, the advantages of a free trade area with the EU over a customs union with Russia, Belarus and Kazakhstan can be clearly seen.

It should also be noted that the free trade area with the EU is expected to facilitate a growing demand for skilled and unskilled workers both in agriculture and in the food industry by between 4.7% and 11.7% in the medium term that could promote the human development in the sector. The main reason for such positive expectations from the creation of a FTA with the EU is that Ukrainian exporters would have better access to a very large and capacious market. At the same time, Ukrainian companies would be able to import highly productive capital at relatively low prices, thereby improving their competitiveness.

<sup>185</sup> Where the sector's share in total output is between 25 and 45%.

<sup>186</sup> Its share in total output was 32.9% in 1990. During the period of economic transformation, the country's machine-building complex experienced a long destructive crisis that was accompanied by a more than twofold decrease in its share in Ukraine's industrial output, considerable losses of industrial and human resources potential, and a decline in innovation and investment. However, in the 2000s the sector has gradually adapted to the new economic conditions and expanded to new industrial markets.

<sup>187</sup> According to the Input-Output table.

<sup>188</sup> According to the State Statistics Committee of Ukraine.

## 4.3 MACHINE-BUILDING

### 4.3.1 Review of the Ukrainian machine-building sector

The degree of development of the machine-building sector's in the country is traditionally one of the criteria for assessing the country's material and technical base as well as technological progress without which it is impossible to secure a high level of human development. Although the importance of this sector in Ukraine is currently less when compared to developed countries<sup>185</sup> and to the early 1990s,<sup>186</sup> machine-building has been a major sector in Ukraine's economy and remains one of the leading branches (Table 4.6).

The multi-branch machine-building complex today is a powerful sector in Ukrainian industry that comprises more than 11,000 enterprises. It ranks fourth among 38 economic sectors<sup>187</sup> in terms of output after the food production, metal production and trade. A fifth of all the workers employed in the industrial sector work in machine-building, and more than 15% of fixed assets are concentrated there.<sup>188</sup>



**Table 4.6. Key indicators of Ukraine's machine-building sector, 2005-2008\***

Category	Indicator	2005	2006	2007	2008
Output	Value, million UAH	82004	103892	149628	195667
	Share in total output, %	7.2	7.5	8.2	8.0
	Share in total industrial output, %	13.5	14.4	15.9	15.6
Value added	Share in GDP, %	4.7	5.1	5.9	5.0
	Share in sectoral output, %	25.5	26.6	28.4	24.1
Exports	Value, million UAH	28368	33190	48190	63993
	Share in exports, %	12.5	13.1	14.9	14.4
	Share of exports in total sectoral output, %	34.6	31.9	32.2	32.7
Imports	Value, million UAH	53963	70882	101769	138373
	Share in imports, %	24.1	26.3	27.9	26.6
	Share of imports in total sectoral output, %	65.8	68.2	68.0	70.7
Export-to-import	Index	0.5	0.5	0.5	0.5

Source: State Statistics Committee of Ukraine (Input-Output table for 2005-2008 in consumer prices), IER calculations

Note: \* As data used in this table are released by the State Statistic Committee of Ukraine with 1.5-year lag, data for 2009-2010 are not available

During 2000-2007 (prior to the 2008 crisis), the growth rate of machine-building sector's production was higher than corresponding indicator for industry as a whole (Table 4.7). Such growth resulted from favourable conditions in domestic and foreign markets and, accordingly, from increasing demand for new machinery and equipment. That was ensured by the investment activities of domestic and foreign enterprises (mostly from the CIS countries) aimed at upgrading fixed assets (in particular in transport, construction and extractive industries). In addition, people's incomes were growing and credits to the real sector were increasing.

industry (Table 4.7), which is a positive sign of the sector's development.

However, a shortage of modern equipment has hindered development of the sector. The average rate of depreciation of fixed assets in the sector is 68.4%, according to the State Statistics Committee, in spite of some recovery of investment activity (Table 4.8). Problems related to renewal of the sector's production potential, to deeper changes in the structure of commodity production, to development of knowledge-intensive machine building and to competitiveness of end products are being resolved quite slowly.

**Table 4.7. Growth rates of production and labour productivity in machine-building, 2001-2009**

Period	Production growth rate, % yoy		Labour productivity growth rate, % yoy	
	Industry	Machine-building	Industry	Machine-building
2001	14.2	18.8	18.6	28.4
2002	7.0	11.3	n/a	n/a
2003	15.8	35.8	19.8	43.6
2004	12.5	28	12.3	29.7
2005	3.1	7.1	4.0	10.9
2006	6.2	11.8	9.5	17.9
2007	10.2	28.6	14.3	34.9
2007	7.6	19.0	14.3	34.9
2008	-5.2	0.3	n/a	n/a
2009	-21.9	-44.9	n/a	n/a

Source: State Statistics Committee of Ukraine

The growth in production in the sector was accompanied by a reduction in employment and an increase in wages, although wages were and remain lower than the average for industry as a whole (Table 4.8). Accordingly, the growth of labour productivity in the sector was higher than that in

All the segments of Ukraine's machine-building complex are sufficiently developed, but Ukraine's focus on the production of mechanical equipment, electrical machinery and means of transport, particularly railway rolling stock, is a reflection of the country's Soviet heritage (Table 4.9).

**Table 4.8. Employment and investment in machine-building, 2005-2009**

Category	Indicator	2005	2006	2007	2008	2009
Employment / labour remuneration	Employment, thousand persons	773	733	719	645	569
	Share in average annual number of employees in industry, %	22.6	21.7	21.6	20.9	20.3
	Average monthly wage, UAH	821	1060	1389	1789	1709
	Percentage of industry average wage, %	84.9	87.5	89.4	88.7	80.7
Investments	Fixed capital investments, million UAH	2251	3653	5340	6189	3564
	Share in total volume of investments in industry, %	6.4	8.1	8.3	8.1	6.2
	FDI as of the year beginning, million USD	n/a	759	966	1050	1094
	Share in total volume of investments in industry, %	n/a	14.7	15.8	12.9	12.1

Source: State Statistics Committee of Ukraine

**Table 4.9. Structure of sales in Ukraine's machine-building sector\***

Sector	% of total
<b>Machine-building</b>	100
<b>Machinery and equipment</b>	30.6
Including	
mechanical equipment	6.3
machinery and equipment for agriculture and forestry	2.9
machine-tools	1.3
other machinery and special-purpose equipment	10.6
domestic appliances	2.2
<b>Electric, electronic and optical equipment</b>	21.6
Including	
office equipment and computers	1.3
electric machines and equipment	14.4
equipment for radio, TV and communications	2.5
medical equipment, measuring devices, optical devices and equipment, watches	3.4
<b>Means of transport and transport equipment</b>	47.8
Including	
motor vehicles, trailers, semitrailers	26.1
other means of transport	21.8
of them	
railway rolling stock	16.3

Source: State Statistics Committee of Ukraine

Note: Table relies on 2007 data as the latest available. As structure of production changes slowly, these data are treated as good approximation of current structure.

After a sharp fall in output in 2009 (almost twofold), the machine-building complex has begun to recover. Machine building has demonstrated positive development dynamics in 2010. Output of the sector rose by 30.1% in the first half of 2010 (compared to the first half of 2009), with higher output from all the key segments of machine building. The main factor behind the recovery was an increase in investment activity among major importers of Ukrainian-made machine-building products (CIS countries).<sup>189</sup>

Ukraine's machine building is very reliant on international trade. In 2008, the share of exports in

total output of machine-building products was 32.7% while that of imports was 70.7% (Table 4.6). Hence, the export-to-import ratio of the sector has tended to decline since imports have grown faster than exports. This occurs mainly because of the growth in investment demand of Ukrainian enterprises, a need to import components because of the specific production cycle inherited from Soviet times and stronger consumer demand by households.

The CIS countries accounted for 18% of total machine-building imports in 2009 (Figure 4.2). Russia, accounting for 15% of total imports of machinery

<sup>189</sup> MEU (2010c)

and equipment, remains a major supplier. However, machines designed to meet households needs (various kinds of domestic appliances and motor vehicles) prevail in the total structure of imports (Figure 4.2 and Table 4.10). They are imported mainly from the EU and Asia.

have considerably increased their demand for finished machine-building product categories during the years of economic growth.

The market for Ukrainian-made products in developed countries is quite limited (see Figure 4.2) although Ukraine has managed to increase its share of

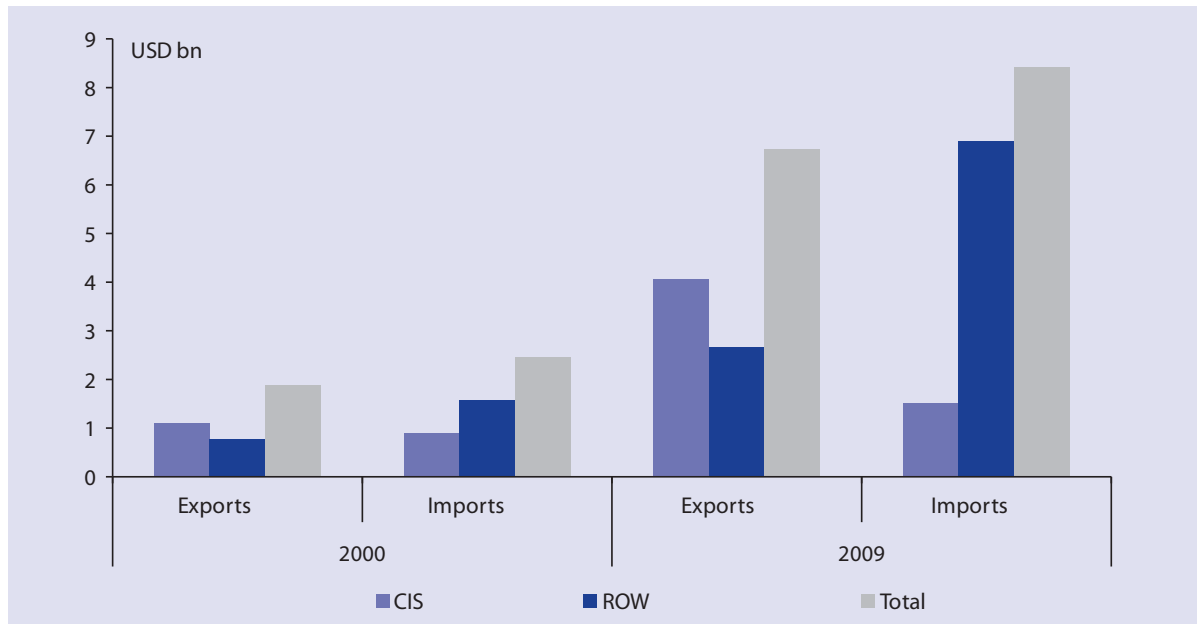


Figure 4.2. Foreign trade in machine-building products, geographical structure, 2000-2009

Source: UN Comtrade, IER calculations

Table 4.10. Structure of foreign trade in machine-building products, 2009 (%)

Goods	Exports	Imports
Power generating machinery and equipment	14.2	10.4
Machinery specially designed for specific industries	8.4	14.2
Machinery for metal working	3.9	2.0
Non-special machinery and equipment for industry and machinery parts not specified elsewhere	17.5	18.0
Office machinery and equipment for automatic data processing	0.6	1.5
Devices and equipment for telecommunications, sound recording and reproduction	5.8	8.3
Electric machines, apparatuses and devices and their electric parts not specified elsewhere	26.2	21.0
Motor vehicles	5.5	22.2
Other transport equipment	18.0	2.4
<b>Total, %</b>	<b>100.0</b>	<b>100.0</b>

Source: UN Comtrade, IER calculations

Regards exports of machine-building products, their share in total Ukrainian exports has grown (Table 4.6). The export range is dominated by mechanical equipment, including transport equipment and electrical machinery (Table 4.10). The traditional export markets still consist of the CIS countries whose share in 2009 amounted to 60% of total machine-building exports (Figure 4.2), as well as countries that are developing rapidly in industrial terms (China, India, Iran). These countries, particularly Russia (which accounted for 42% of machine-building exports),

exports of higher-VAT products to European countries in recent years. For example, Ukraine exports equipment with electric audio or video signal to Cyprus, Slovakia, Austria and the UK; parts, accessories for audio and video recording equipment to Hungary and Austria; vessels, boats and other floating facilities (to the Netherlands and Cyprus).

Thus, Ukraine's machine-building complex plays a significant role in the country's economy. Development of the manufacture of machine-building products with high value added could contribute to

faster and higher-quality growth and to enhanced trade with the world. However, at present this sector features an old production and technical base and a focus on the markets of the CIS countries and developing states. This does not provide favourable prospects for the sustainable development of the sector in the future. The economic crisis has proved that demonstratively.

#### 4.3.2 Specific issues and problems of Ukraine's machine-building sector

After the collapse of the USSR, very few machine-building enterprises had the possibility of continuing their work and selling their products without encountering obstacles.<sup>190</sup> As an integrated part of the production chains formed in the Soviet Union, machine-building enterprises had no option but to maintain their traditional distribution channels and contacts with enterprises in the CIS countries. A very small number of enterprises that manufactured finished products and enjoyed a good reputation in international markets has retained their exporting capability in the transition period. The rest accrued considerable arrears on taxes and wages, used barter schemes and stopped any investment activities.

The recovery of economic growth in Ukraine and the CIS countries resulted in a renewal, and then growth of machine-building production in the 2000s. However, the ability of the sector to compete in global markets was weakened, although the previous technology achievements and the stock of human capital in some branches (e.g. aircraft building) have enabled Ukraine to continue to occupy niches in certain world market segments.

Since metals and energy resources are the main material components of the costs in machine building, Ukraine enjoyed a long period of strong competitive advantage in machine-building production related to developed metallurgical sector and access to cheap energy. However, as market relations in transition economies developed, Ukraine lost its advantage. This was partly because the prices of energy sources supplied mainly by Russia rose swiftly in the second half of the 2000s, and partly because of higher prices for metals that were actively exported. Besides, production of great number of products needed components produced in the former USSR countries that also experienced an economic downturn in the 1990s, so they often could not retain product lines and technologies.

Hence, Ukrainian enterprises have had to adapt to the new environment and to search for new suppliers that are not always technologically suitable

for Ukrainian-made products, whereas funds for mass technology upgrades are not available in the necessary amounts. At the same time, the fact that human resources have not been completely lost and that some innovations are being developed and introduced, are positive factors. However, the shortage of financial resources adversely affects the possibility of Ukrainian experts to access new R&D.

A worldwide trend in the development of the machine-building sector now is a decrease in the share of traditional machine-building segments (so-called low-tech products) with a simultaneous growth of exports of electrical and electronic machine-building products. This trend, however, is not typical for Ukraine for the reasons mentioned above. In particular, according to UNCTAD/WTO<sup>191</sup>, Ukraine's share of world exports of such goods was only 0.15% in 2008. Unfortunately, Ukraine's respective shares of other machine-building segments are also minor, except for such groups as railway and tramway locomotives, rolling stock and equipment, where Ukraine accounted for 7.2% of global exports. Ukraine is one of the top five exporters of these products, behind China, Germany and the US, which points to its strong competitive position in this sub-sector.

Generally, developed countries' markets for machine-building products are characterised by tough competition where, apart from quality and price, a considerable role is also played by political factors, particularly long-term established relationships with a partner and the reputation of a manufacturer. That makes it considerably difficult for Ukrainian products' to entry into this segment of the world market. The main opportunities for the exports of machine-building products to developed countries' markets arise if the products are highly specialised or if the manufacture of such products in a given country is not economically reasonable.

Some products made by the Ukrainian machine-building sector are in demand, not only in the traditional markets of the CIS countries, but also in such competitive markets as the UK, the US and Germany.<sup>192</sup> Ukrainian-made products have gained access in some narrow segments of the market, such as aircraft building and shipbuilding products, space equipment, military equipment and arms, which are manufactured to world quality levels. One of the most hi-tech machine-building segments is the defence industry that traditionally occupies a special place in machine-building and is competitive in the international market. In particular, according to SIPRI data<sup>193</sup>, Ukraine ranks 16<sup>th</sup> among arms exporting countries<sup>194</sup>. However, the share of the defence industry in the sector's output has fallen in recent years and it now enjoys considerably

<sup>190</sup> This mainly refers to enterprises of defence industries.

<sup>191</sup> UNCTAD/WTO International Trade Centre. <http://www.intracen.org/>

<sup>192</sup> UNCTAD/WTO International Trade Centre. <http://www.intracen.org/>

<sup>193</sup> Stockholm International Peace Research Institute

<sup>194</sup> Since no official data is available, the segment's role may only be estimated by expertise (as estimated by IER, the share of defence industry products in total output is not higher than 10%).

less influence on the industry's development due to the uncertainties of state policy and non-transparent agreements. Thus, its export potential remains insufficiently used.

Although there are possibilities for boosting output of the machine-building sector, there are also certain problems in Ukraine related to the regulatory environment. State regulation in the machine-building sector currently focuses mainly on customs regulation and the provision of tax privileges, with a tendency towards decreasing the level of support. In May 2010, for example, the Cabinet of Ministers of Ukraine cancelled its Resolution on Introducing a Provisional 13 Percent Surcharge on the Existing Import Duty Rate that had been adopted in March 2009. The resolution provided for a temporary 13% surcharge to the existing import duty tariff for motor vehicles and had an anti-crisis protectionist nature. However, the introduction of the surcharge was not an effective measure. The prices of imported motor cars in Ukraine did not increase in 2009 and the introduction of the surcharge in 2009 resulted in a budget loss (instead of an expected rise of budget revenues) due to a dramatic drop in imports of motor cars. Furthermore, if the surcharge had been retained, some countermeasures might have been taken against Ukraine by other WTO members.

Considering state policy on taxation of the machine-building sector, it should be noted that the overwhelming majority of tax privileges for the sector were cancelled in 2005, whereas the privileges valid during the crisis period were provisional. However, some tax privileges introduced as part of the anti-crisis measures in late 2008 and early 2009 are still in force today (Annex 2). This refers particularly to the temporary (until 1 January 2019) exemption from value-added tax for the import of machinery, equipment and devices used in the development of renewable energy sources. In addition, import duty is not charged on equipment and parts used to manufacture equipment for non-conventional and renewable energy sources, producing alternative fuels as well as for energy-saving equipment and products (provided that identical goods with similar qualitative features are not manufactured in Ukraine).

In addition, a series of privileges for the aircraft building and space industries, which are valid until 2015-2016, were established by the Law on the State Budget 2010. Key privileges include exemption from VAT and import duty for some specified goods as well as exemption from land fees.

Meanwhile, all enterprises face difficulties related to export VAT refunds as well as to taxation procedures. Machine-building products often have a long production cycle during which an enterprise earns no profit but instead only incurs expenses and, accordingly, shows a loss. Some enterprises, especially those situated in large cities and occupying large areas,

bear the burden of larger land fees. Many problems arise due to product certification procedures and compliance with international standards and rules.

The machine-building enterprises remaining in state ownership have to overcome a great number of barriers to doing business. The barriers are predominantly related to restrictions in operations and investment decision-making, bureaucratic control and reporting procedures and a lack of managerial motivation, etc.

However, the major problem is that the State has no strategic view on the development of the economy and particularly of the role of the machine building sector. Most programme measures on the part of the State are currently too general and cannot be implemented due to the low quality of public administration and the lack of public finance. In particular, there is acute shortage of working capital to finance investment projects in aircraft building, defence and machine building.<sup>195</sup>

Hence, the Ukrainian machine-building sector is still in the stage of transformation with the break-up of its operating structures and arrangements inherited from the USSR. The State retains an appreciable influence on the machine-building sector, and this is largely negative considering the quality and efficiency of public administration.

#### 4.3.3 Prospects and barriers for exports expansion

Although some of Ukrainian machine-building products have competitive advantages in world markets and, therefore, can be actively exported, the sector's net exports are negative, a trend that has grown continuously since the economic downturn of the 1990s. The reasons of this situation are mainly internal such as the relatively backward state of technology compared with world standards, administrative export barriers, obsolescence of production facilities, gradual loss of human capital, shortages of working capital, excessive reliance on the import of products of the same sector, persistent presence of the State in some of the more promising areas (e.g. aircraft building), the small share of high-value-added products, the lack of venture capital and beneficial programmes for financing operational activities.

According to market players, the greatest barriers exist in the field of state policy, hence enterprises themselves have no possibility either to affect or overcome them. The most critical barriers include: the state-regulated wage rates and prices of products manufactured by state-owned enterprises; tax and dividend policy, which is often unpredictable and burdensome, in particular in hard times; absent fundamental R&D; too bureaucratic procedures of customs control and regulation of the export of machine-building products (in particular those relating

<sup>195</sup> Major programmes include the State Programme of Machine-Building Development for 2006-2011, the State Programme of Reforms and Development of the Defence Industries until 2013, etc.

to the defence complex); inefficient governance of the State's corporate rights; unpredictable investment climate inside Ukraine.

Hence, many problems exist in Ukraine's machine-building sector, and they cannot be settled without intervention on the part of the State which itself is ineffective. However, certain opportunities for product improvement and export expansion still exist (Table 4.11).

by the specific features of development inside a country. Estimates of the impact of trade agreements, particularly FTA with the EU, for Ukraine show that they can be expected to have a positive influence on machine building<sup>196</sup>. That is, production in the sector would most likely grow after the elimination of trade barriers by countries, which are Ukraine's key trading partners – the EU and Russia.

**Table 4.11. SWOT analysis of the machine-building sector**

<b>Strengths:</b>	<b>Weaknesses:</b>
<ul style="list-style-type: none"> <li>- highly qualified staff;</li> <li>- relatively low product price;</li> <li>- existence of well-established bilateral relations in international trade and technological cooperation on machine-building with the CIS countries;</li> <li>- patent on some unique machine-building technologies;</li> <li>- availability of a raw material base;</li> <li>- a rather diverse range of products;</li> <li>- proximity to capacious markets in Europe and Russia;</li> <li>- considerable size of Ukraine's domestic market.</li> </ul>	<ul style="list-style-type: none"> <li>- outdated production technologies;</li> <li>- high rate of depreciation of fixed assets;</li> <li>- low production efficiency;</li> <li>- low consumer features of Ukrainian-made products;</li> <li>- high technological reliance on other parts of the production chain territorially situated outside Ukraine, particularly in the CIS (Russia);</li> <li>- a long production cycle resulting in working capital shortages;</li> <li>- an inadequate regulatory regime;</li> <li>- considerable presence of the State in the sector as an owner having no strategic vision;</li> <li>- weak marketing at all levels (corporate, public).</li> </ul>
<b>Opportunities:</b>	<b>Threats:</b>
<ul style="list-style-type: none"> <li>- the sector's potential in terms of implementation of new technologies;</li> <li>- joining the sectoral potential of Ukraine and Russia, e.g. in aircraft building, would provide an opportunity to become a serious player in the international market for these products (due to lower transaction costs, technology exchange, etc.);</li> <li>- increasing the number of space launches;</li> <li>- growth of transport flows that need new means of transport, which would provide an opportunity for higher rates of capacity utilization at transport machine-building enterprises (e.g. Luhanskteplovoz);</li> <li>- increasing income in developing countries (Africa and Asia);</li> <li>- preparing for EURO 2012;</li> <li>- development of venture capital;</li> <li>- using capabilities of technological parks and major universities.</li> </ul>	<ul style="list-style-type: none"> <li>- declining external demand for domestic machine-building products due to change in global market conditions;</li> <li>- increasing prices of raw materials and energy resources;</li> <li>- technology changes in Russia or other CIS countries;</li> <li>- decreasing transport flows;</li> <li>- development of machine-building sectors in developing countries;</li> <li>- losing the sector's human capital;</li> <li>- lack of a comprehensive approach on the part of the State to promoting products in the international market;</li> <li>- negative changes in the regulatory regime (e.g. tax rate increase);</li> <li>- complicated access to financing;</li> <li>- problems of intellectual property rights protection that hinder inventions and patenting.</li> </ul>

Source: IER

Hence, Ukraine's machine-building sector undoubtedly possesses certain advantages and opportunities to develop exports, but there are also risks related to its reliance on imports, the loss of technologies and human potential as well as the fact that the State has no reasonable policy on the development of the sector.

#### **4.3.4 Impact of international trade agreements on human development**

The impact of international trade agreements on human development is determined by the specific terms and conditions of these agreements and

The growth of production due to trade expansion should in its turn have positive effects on human development. For example, an increase in output and sales means that the sector increases its income and enterprises are able to generate more investment resources. There are two ways of using them in machine building: renovating fixed assets and investing in human capital. The former means better technologies that should result in increases in labour productivity, but at the same time releases some of the labour force, although overall production increases. The latter means an improvement in staff skills and the employment of additional workers.

<sup>196</sup> ECORYS (2007)

Thus, trade expansion will positively affect the demand for skilled labour force in machine building, which means higher requirements for educational level as well as an increase in employment in the long run.

The enhancement of employment opportunities in machine building will provide wider employment alternatives for the poorest, in particular rural residents, and result in higher households' incomes.

As far as the gender dimension is concerned, the share of women in the labour force is now 40% whereas their wages are, on average, 26% lower than men's. The latter is directly connected with job characteristics and much less with discrimination against women. Nevertheless, upgrading production and technology can promote the enhancement of employment opportunities for women, which is a positive aspect.

Growing households' income in the areas where machine-building enterprises are located reduces the need for budget support to regional development in such areas, hence promotes the partial elimination of regional disparities.

Most international trade agreements contain provisions on the improvement of national standards concerning production technologies, health care, working conditions and occupational safety. Modernisation of the sector would also have a positive impact on occupational safety. In the machine-building sector, about 20% of staff works in conditions that do not meet current standards of hygiene and sanitation. It is expected that the proportion of such workers would decrease substantially.

The health and education of the sector's staff will improve for two more reasons. One of them is related to personal income growth. Higher incomes enhance

people's ability to improve their living conditions, which would positively affect their state of health, education expenses and their opportunities to participate fully in the development of society. The second reason is connected with increases in the sector's budget contributions, which can indirectly mean higher public expenditures for healthcare and education.

Thus, the impact of international trade agreements on the machine-building sector and human development is estimated as positive because it means an expansion of production and modernisation, hence technologically and environmentally safer working conditions, higher requirements for education, an all-round improvement of the sector staff's living conditions and the mitigation of regional problems.

## 4.4 MANUFACTURE OF METALS AND METAL PRODUCTS

### 4.4.1 Overview of the sector of metallurgical production and the manufacture of finished metal products in Ukraine

Ukraine is one of the world's largest manufacturers of metals and metal products. In particular, it was ranked 8<sup>th</sup> in the global ranking in terms of steel output.<sup>197</sup> Large-scale production, combined with access to raw materials in the domestic market, brought about development of this sector in Ukraine. In 2005-2008, it accounted for 10% of total output and 32-34% of exports, while metallurgy's value added amounted to 5% of GDP (Table 4.12). However, the sector suffered greatly during the economic crisis from a drop in world demand caused by a record-breaking decline in construction, a decrease in steel products

**Table 4.12. Key indicators of metallurgical production and the manufacture of finished metal products in Ukraine, 2005-2008\***

Category	Indicator	2005	2006	2007	2008
Output	Value, million UAH	117449	143122	191501	249738
	Share in total output, %	10.2	10.4	10.5	10.2
	Share in total industrial output, %	19.3	19.8	20.4	19.9
Value added	Share in GDP, %	5.1	5.9	5.8	4.9
	Share in sectoral output, %	19.2	22.3	21.9	18.4
Exports	Value, million UAH	74058	86269	108540	145816
	Share in exports, %	32.6	34.0	33.6	32.8
	Share of exports in total sectoral output, %	63.1	60.3	56.7	58.4
Imports	Value, million UAH	15383	19266	27931	41130
	Share in imports, %	6.9	7.2	7.7	7.9
	Share of imports in total sectoral output, %	13.1	13.5	14.6	16.5
Export-to-import	Index	4.8	4.5	3.9	3.5

Source: State Statistics Committee of Ukraine (Input-Output table for 2005-2008 in consumer prices), IER calculations

<sup>197</sup> According to the International Iron and Steel Institute (IISI, now the World Steel Association), Ukraine was ranked 8<sup>th</sup> in the world among the leading steel producing countries in 2008, with 37.3 million tonnes of metal output (2.8% of the world total steel output). <http://www.worldsteel.org/?action=stats&type=steel&period=latest&month=13&year=2008>

consumption by machine-building industries in most countries of the world, and cutbacks of state financing for infrastructure projects.

Despite the importance of the metallurgy sector in Ukraine's economy, the sector is not a leader in terms of productivity indicators. For example, the growth of production during the period of 2000-2009 was lower than the same indicator for the industry as a whole (see Table 4.13). The same could be mentioned about labour productivity indicators where Ukraine lags behind the US considerably, as well as China and Russia, in many product categories, mainly because the sector continues to rely on outdated equipment. During the years when the world market environment was favourable for exports of the sector, the majority of enterprises preferred profit maximisation in the short term instead of implementing large-scale investment programmes.

sector's product structure shows its low level of technological development.

This situation could be remedied by implementing large-scale investment programmes. Capital investments in the sector grew constantly during the years of the first decade of the century up until the crisis that began in 2008 (Figure 4.3). However, a high rate of depreciation of fixed assets and the lack of conformity of the Ukrainian metal production's technical level with world levels are systemic problems. Almost 45.2% of steel in Ukraine is smelted in open-hearth furnaces, 51% in converters, and only 3.8% in electric steel-melting furnaces. Elsewhere in the world, the open-hearth process remains only significant in Russia (accounting for 23% of steel production)<sup>199</sup>. The use of continuous casting in Ukraine is only 33% whereas Russia has almost 66% and Germany has 98%. In addition, 54% of coke-

**Table 4.13. Growth rates of production and labour productivity in the manufacture of metals and metal products, 2001-2009**

Period	Production growth rate, % yoy		Labour productivity growth rate, % yoy	
	Industry	Metallurgy	Industry	Metallurgy
2001	14.2	4.9	18.6	4.1
2002	7.0	3.9	n/a	n/a
2003	15.8	14.3	19.8	15.2
2004	12.5	12	12.3	10.1
2005	3.1	-1.5	4	-3
2006	6.2	8.9	9.5	10.1
2007	10.2	8.3	14.3	12.7
2007	7.6	7.0	14.3	12.7
2008	-5.2	-12.3	n/a	n/a
2009	-21.9	-26.7	n/a	n/a

Source: State Statistics Committee of Ukraine

Between 2005 and 2009 output growth was occurring simultaneously with a decline in employment in the sector, though the sector's share of employment in industrial employment remained stable at little under 13% (Table 4.14). Meanwhile, wages were increasing and exceeded the average for the industrial sector as a whole by 20-30% in 2005-2009. However, labour remuneration expenses accounted for only 4% of total production costs on average whereas this figure in Europe is about 9%.<sup>198</sup>

The main product types include iron-ore concentrate, agglomerate and pellets, coke, firebricks, iron, steel, ferrous metal rolled stock, pipes, and ferroalloys. The lion's share in the sector's product structure belongs to the manufacture of iron, steel and ferroalloys – 72.6% (Table 4.15) whereas the manufacture of finished metal products with high value added only accounts for 9.7%. Hence, the metallurgy

oven batteries, 89% of blast furnaces, 87% of open-hearth furnaces, 26% of converters and almost 90% of all rolling mills in Ukraine have been in operation for longer than their specified service life, which contributes to the high energy intensity of production. All the factors mentioned above adversely affect the sector's prospects and has especially weakened it during the economic crisis.

The economic crisis adversely affected the sector's development. Production dropped sharply late in 2008 due to a dramatic decline in steel prices. For example, slab price FOB Black Sea fell from 1,055 USD per tonne in June 2008 to 425 USD per tonne in November 2008.<sup>200</sup> The slump in production continued in 2009 as the sector's annual output dropped by 27% compared to 2008. The situation hit all the metallurgical enterprises that had accumulated considerable debts prior to the crisis and had not

<sup>198</sup> Foundation for Effective Governance (2009)

<sup>199</sup> Mining and smelting sector: <http://novynar.com.ua/business/43104>

<sup>200</sup> Foundation for Effective Governance (2009)



**Table 4.14. Employment and investment in metallurgical production and in the manufacture of fabricated metal products, 2005-2009**

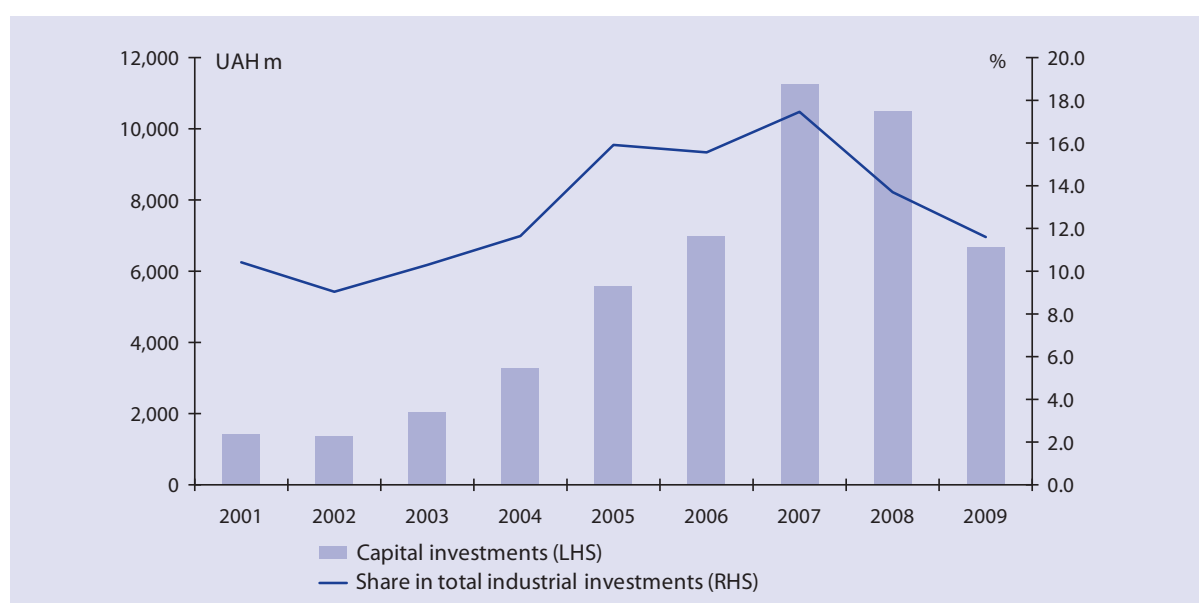
Category	Indicator	2005	2006	2007	2008	2009
Employment / labour remuneration	Employment, thousand persons	425	433	422	390	347
	Share in average annual number of employees in industry, %	12.4	12.8	12.7	12.6	12.5
	Average monthly wage, UAH	1287	1560	2003	2418	2429
	Percentage of industry average wage, %	133.1	128.7	128.9	119.9	114.7
Investments	Fixed capital investments, million UAH	5575	6971	11234	10503	6683
	Share in total volume of investments in industry, %	15.9	15.5	17.5	13.7	11.6
	FDI as of the year beginning, million USD	n/a	1246	1441	1686	1401
	Share in total volume of investments in industry, %	n/a	24.1	23.6	20.7	15.5

Source: State Statistics Committee of Ukraine

**Table 4.15. Structure of sales of metals and fabricated metal products\***

Sector	% of total
<b>Metallurgical production and manufacture of finished metal products</b>	100
<b>Metallurgical production</b>	90.9
including	
manufacture of iron, steel and ferroalloys	72.6
manufacture of pipes	9.3
other forms of primary steel processing	2.3
manufacture of non-ferrous metals	5.7
metal casting	1.1
<b>Manufacture of finished metal products</b>	9.7

Source: State Statistics Committee of Ukraine Note: Table relies on 2007 data as the latest available. As structure of production changes slowly, these data are treated as good approximation of current structure.

**Figure 4.3. Capital investment in the sector of metallurgical production and in the manufacture of finished metal products, 2001-2009**

Source: State Statistics Committee of Ukraine

completed their investment projects to upgrade their production facilities. The slow recovery of the world economy has now resulted in a growth in the demand for steel as well as an increase in global metal prices. As a result, in 2010 the sector's output increased by 12.7% during the first 9 months (yoy).

Perhaps the most important feature of the metallurgy sector is that it is clearly export-oriented. Foreign trade volumes went up steadily during the period of economic growth (Figure 4.4) and up to 65% of the sector's output is exported (Table 4.12). The sector's exports account for one-third of Ukraine's total volume of exports of goods. At the same time, imports of metallurgy products have also increased in recent years (Table 4.12) – representing up to 16.5% of output in 2008 and up to 8% of Ukraine's total imports of goods.

for the development of the entire Ukrainian economy. However, the sector's existing structure is too outdated and inefficient so there are also many risks to further development. The sector is also too dependent on export markets, therefore any external shocks immediately affect the development of the rest of Ukraine's economy.

#### 4.4.2 Specific issues of the sector of metallurgical production and manufacture of fabricated metal products

There are about 4,000 industrial enterprises in the metallurgy sector in Ukraine.<sup>201</sup> Enterprises of the Ukrainian mining and metallurgical complex (MMC) are mainly concentrated in Donbas and Prydniprovya:

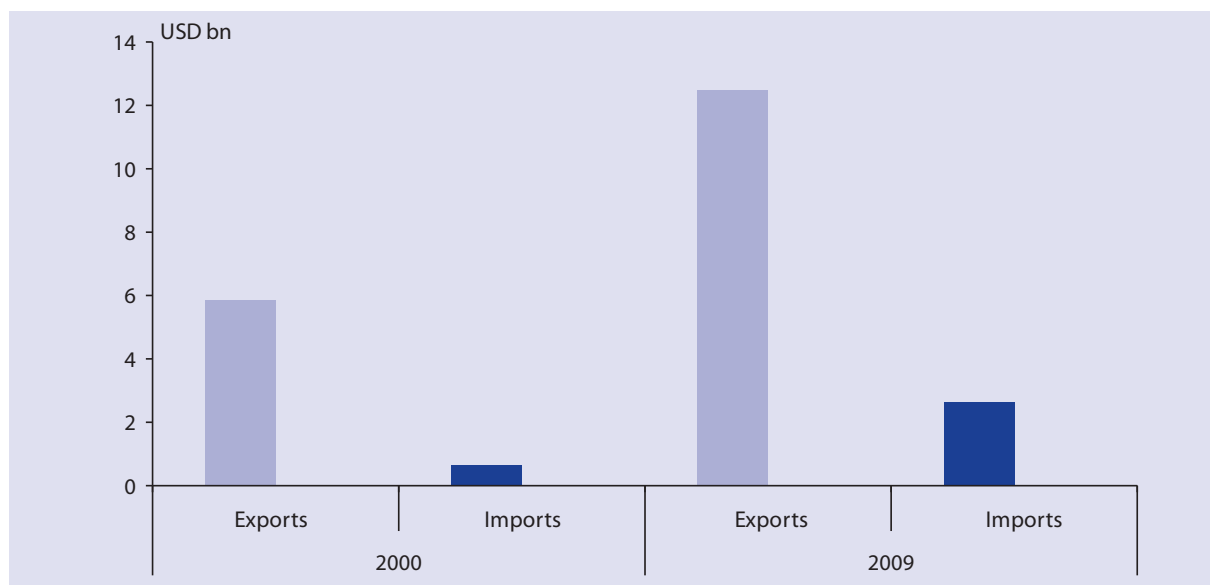


Figure 4.4. Foreign trade in metals and finished metal products, 2000-2009

Source: UN Comtrade, IER calculations

Iron and steel dominate the structure of foreign trade in metallurgical products, accounting for 92% of the sector's exports and 47% of imports (Figure 4.5). In other words, much of Ukraine exports have a low value added (Table 4.12) and, therefore, are not of the highest profitability.

Ukraine's major partners accounting for about a half of Ukrainian metallurgical exports (Table 4.16) include countries such as Russia, Turkey, China, Italy, Kazakhstan, India, Egypt, UAE and the US. As regards imports, the largest share of imports of metallurgical products is of Russian origin, mainly iron and steel (58%).

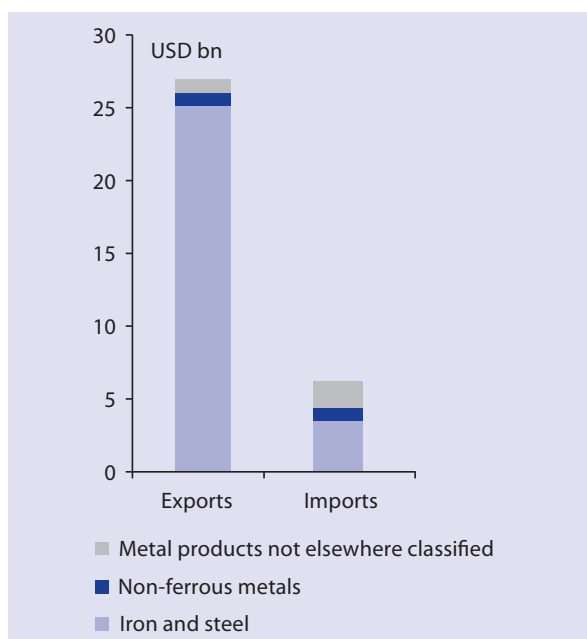
Hence, upon reviewing the sector of metallurgical production and manufacture of fabricated metal products, there is no doubt the sector is important

all metallurgical plants, most ore mining and processing plants (MPP), most coking and refractory plants, ferroalloy plants, and non-ferrous metallurgy enterprises are situated there. At the same time, the Ukrainian market as such is divided between a few financial industrial groups.<sup>202</sup>

The level of costs varies greatly between enterprises due to their different levels of vertical integration. Companies, which are vertically integrated and have access to their own raw materials (iron ore, coke) and which have managed to upgrade their production facilities, have lower cost structures and are more competitive. They include Azovstal and Yenakievo Metal Works (SCM), Makiivka MW, and Dnipropetrovsk MW named after Petrovskiy. At the same time, some Ukrainian manufacturers have no their own raw

<sup>201</sup> According to the State Statistics Committee of Ukraine.

<sup>202</sup> The largest metallurgical enterprises are as follows: ArcelorMittal Kryvyi Rih, Ilyich Iron and Steel Works of Mariupol, Azovstal, Zaporizhstal, Donetskstal, Alchevsk Metal Works, Dniprovskiy Metal Works named after Dzerzhynskiy, Yenakievo Metal Works, Makiivka Metal Works, and Dnipropetrovsk Metal Works named Petrovskiy.



**Figure 4.5. Structure of Ukraine's foreign trade in metals and metal products**

Source: UN Comtrade, IER calculations

material base (Ilyich Iron and Steel Works of Mariupol, Dniprovskiyi MW named after Dzerzhynskiyi, Alchevsk MW, Zaporizhstal, Donetskstal). Their position is the most unfavourable since their costs are higher than that of their competitors.

advantage of access to raw materials, markets are not always open to them. Upon accession to the WTO, Ukraine did not manage to dismantle promptly most of the trade barriers its metal products face in other countries' markets. In addition, a new wave of protectionism creates the threat of market closedown. Countries can resort to trade barriers in the form of quotas, import duties, countervailing, antidumping and other duties. At present, over 30 measures of such kind are in force against Ukrainian-made metallurgical products.<sup>203</sup>

For instance, protective duties on imports of some products to the U.S. are as follows: wire rods – 116.37%, reinforcement bars – 41.49-41.69%, plate steel – 81.43-237.91%, hot-rolled flat stock – 62.5%. A rather difficult situation exists in other countries of North America. Mexico and Canada retain a number of import duties on Ukrainian products (mainly sheet products). However, their quantity has decreased greatly when the validity periods of trade barriers set for long-length rolled metal products expired in 2007-2008.

The EU closed its market to Ukrainian-made rolled products as far back as 1997 by establishing a supply quota regime. It was only in the middle of 2008, upon accession to the WTO, when Ukraine obtained access to European markets, but it was unable to use this opportunity due to the crisis.<sup>204</sup>

**Table 4.16. Ukraine's main partners in trade in metals and metal products, 2009**

Partner	Exports, m USD	Share in the sector's aggregate exports, %	Imports, m USD	Share in the sector's aggregate imports, %
Russia	1567.6	12.6	840.1	32.0
Turkey	1105.0	8.9	63.6	2.4
China	643.3	5.2	255.8	9.8
Italy	602.1	4.8	87.2	3.3
Kazakhstan	509.3	4.1	95.9	3.7
India	381.0	3.1	38.8	1.5
Egypt	379.6	3.0	2.3	0.1
UAE	223.6	1.8	2.2	0.1
US	79.0	0.6	35.7	1.4
Other countries	6977.7	56.0	1200.9	45.8
<b>Total</b>	<b>12468.2</b>	<b>100.0</b>	<b>2622.4</b>	<b>100.0</b>

Source: UN Comtrade, IER calculations

The decline in demand has naturally aggravated competition in the world market. Metal companies from Russia, Turkey and Asia (particularly China) are the main competitors to Ukrainian manufacturers. Although Ukrainian enterprises generally enjoy an

A wave of antidumping investigations in Asia, North Africa and Russian Federation, all of which are now key sales markets for Ukrainian metallurgical enterprises, is especially dangerous to the latter.<sup>205</sup> However, many countries, particularly Vietnam, Iran,

<sup>203</sup> NISS (2009)

<sup>204</sup> In October 2008, the European Commission initiated an antidumping investigation against the import of pipes originated from Ukraine, Belarus and Turkey. In December 2008, the European Commission stated that it intended to retain an anti-dumping duty on welded iron pipes and unalloyed-steel pipes imported from Ukraine at 44.1%. However, it would lower the duty for Interpipe company to 10.7%.

<sup>205</sup> For example, in December 2008 India's authorities began a large-scale antidumping investigation on the import of hot-rolled steel stock used in both construction and in the automotive industry. Objects of the investigation include rolls, sheets, plates, strips and other flat articles of hot-rolled steel imported from fifteen countries including Ukraine.

Israel, Pakistan, UAE, Qatar and others, cancelled import duties on all steel products almost completely in 2007-2008 due to a substantial excess of demand over domestic supply. Most infrastructure projects are still underway in these countries; therefore, demand for metal products is decreasing at a slower pace than in other parts of the world. In addition, re-rolling metallurgy in developed countries consumes semi-finished products, hence most types of the latter are not subject to restrictions, thus Ukrainian metal enterprises can export them freely. It is semi-finished products of Ukrainian metallurgy are competitive.

There is also the threat of Russian market's closure. At present, a considerable fraction of the Ukrainian-made range of rolled products is subject to various forms of restrictions in Russia including voluntary limitation of supplies, quotas, customs and political prohibitions. Russian metal-makers actively lobby additional restrictions on imports, mainly from China and Ukraine, in the Federal government. Russia introduced a 15% duty on imported steel in January 2009.<sup>206</sup>

As far as sector regulation is concerned, direct state regulation of metallurgy remains limited. At the same time, metallurgy receives state support from time to time in the form of lower tariffs for some services. The sector has also benefited for many years from lower natural gas prices compared with those paid by its competitors. Nevertheless, natural gas prices have gradually increased to the European level, thereby adversely affecting the sector's financial conditions.

For instance, late in 2008 when metallurgy faced major problems due to a fall in demand and a decrease in world metal prices, the government introduced anti-crisis measures to support the sector. Relevant measures were provided by a Memorandum of Understanding signed by the Government and the MMC representatives. In particular, it offered lower tariffs for electricity, natural gas and rail transportation. Although the lower tariffs were initially valid for one calendar quarter, in practice they remained in force until April 2010. In return, enterprises of the sector promised to avoid mass lay-offs of staff, which could be an obstacle to enterprise restructuring.

The Memorandum also provided for an extension of the period for the return of currency proceeds from energy-saving projects up to 360 days and for VAT refunds to be made within five days. However, VAT refund arrears to MMC enterprises grew considerably during the crisis and amounted to UAH 7.1 billion as of 1 March 2010. Hence, problems with VAT refunds to exporting enterprises erode their working assets, which in turn create problems for both their operations and their investment activities.

Thus, state regulation of the sector during the crisis was aimed at supporting the sector by decreasing its production costs. However, the sector would rather benefit from infrastructure improvement. In particular, the State could stimulate MMC development by

means of financing large infrastructural projects. In addition, instead of preventing employers from releasing staff, the government should focus on providing social protection for workers released due to restructuring, by implementing efficient and active measures of employment promotion. Improvement of the country's investment climate will foster job creation in other sectors.

Hence, the sector of metallurgical production and manufacture of finished metal products in Ukraine do not constitute a developed market. Market development, enterprise restructuring, technological modernisation and overcoming trade barriers are all issues that have yet to be fully addressed.

#### 4.4.3 Prospects and barriers for increase of exports

Ukraine is now a serious player in the global metal market. However, its dependence on world market conditions as well as low technological level of exported products create serious problems for the development of the sector and hence for the growth of exports in the long run. Apart from external shocks, the most critical internal problems include the high material and energy intensity of production due to outdated technologies and the age of fixed assets. Ukrainian manufacturers generally spend twice as much energy as their competitors, and the domestic metallurgy industry consumes 6 or 7 billion cubic metres of gas annually. By contrast, most international manufacturers have abandoned use of natural gas and have installed technologies based on pulverised coal fuel. The consumption of coke per tonne of iron produced in Ukraine is 500-550 kg whereas the world average rate is 270-300 kg.<sup>207</sup> Furthermore, monopolistic elements in Ukraine's raw-material markets (particularly in the markets of iron ore, coking coal, and coal) result in higher costs of raw materials and lower quality. Thus, despite having a surplus of iron ore, Ukrainian metallurgical enterprises, which are not vertically integrated with manufacturers of raw materials, have to import the ore from Brazil.

Hence, to protect its share in the world market, the sector should continue financing investments to upgrade equipment and production processes. It would also be better for Ukrainian enterprises to be geared more to the manufacture of end-products and their sale both in external and domestic markets. However, it would be difficult to achieve that during the crisis, given the restrictions on obtaining access to longer-term sources of finance. Nevertheless, the sector also has some opportunities that, if they were realised, could promote the rapid upgrading and restructuring of metallurgy (Table 4.17).

In conclusion, despite all the competitive advantages of the sector in the form of its raw-material

<sup>206</sup> NISS (2009)

<sup>207</sup> NISS (2009)

and production base, these advantages cannot be realised in world markets in the medium and long run without upgrading the manufacturing technologies. Hence, the development of infrastructure and modernisation of production facilities provide the only possible prospect for Ukrainian metallurgy.

#### 4.4.4 Impact of international trade agreements on human development

Estimates of the impact of trade agreements, particularly the FTA with the EU, on Ukraine's economy show that metallurgical production and the manufacture of finished metal products can be expected to grow.<sup>208</sup> The development of metallurgical production in terms of its impact on human development will mostly have positive consequences. For example, growing output and sales mean growing revenues of the sector so that enterprises generate investment resources, which is very important from the viewpoint of the acute need for large-scale modernisation of the sector. More investments mean better technologies allowing

labour productivity to be increased. However, the introduction of more advanced technologies in metallurgy is likely to mean a decrease in employment in the sector, especially in the medium run. Nevertheless, the quality of the remaining labour force will increase because working with new technologies requires more qualified staff.

Hence, trade expansion will positively affect the dynamics of demand for skilled labour in metallurgy, which means stricter requirements for educational level. At the same time, those employees who will be released are also likely to create additional demand for education since they will need to compete in the labour market, an increasingly difficult task if people do not have higher qualifications.

As far as the gender dimension is concerned, the share of women among workers is quite high at 35%. However, their wages are, on average, 28% lower than men's, which is most likely explained by the nature of the work performed by women. It is possible that upgrading of production and modernising technology will promote wider employment opportunities for women. However, the probability of that is not high,

**Table 4.17. SWOT analysis of the sector of metallurgical production and manufacture of finished metal products**

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>- large production capacities;</li> <li>- high production concentration;</li> <li>- relatively cheap labour force;</li> <li>- convenient position of the country;</li> <li>- availability of own raw materials (including rare, rare-earth, and precious metals);</li> <li>- patented technologies in metallurgy;</li> <li>- rail and sea transport infrastructure;</li> <li>- provision of own electric power.</li> </ul>	<ul style="list-style-type: none"> <li>- low product diversification;</li> <li>- low technological level of products;</li> <li>- relatively low quality, considerable percentage of semi-finished materials;</li> <li>- obsolescence of fixed assets;</li> <li>- old production technologies;</li> <li>- lack of investment resources;</li> <li>- absence, in some cases, of certification according to international standards;</li> <li>- state regulation of prices of energy and transport services;</li> <li>- high reliance on external market conditions;</li> <li>- unsatisfactory conditions of infrastructure;</li> <li>- low quality of Ukrainian iron ore.</li> </ul>
Opportunities:	Threats:
<ul style="list-style-type: none"> <li>- tax reduction;</li> <li>- expansion of the product range in favour of exclusive products that would be in demand under any market conditions (electrical steel, automobile body sheets);</li> <li>- increase of domestic demand for Ukrainian-made metallurgical products;</li> <li>- geographical expansion of exports, distribution all around the world (through joint ventures);</li> <li>- infrastructure projects in developing countries;</li> <li>- higher oil prices that result in higher demand in Arab countries;</li> <li>- growing output of motor vehicles;</li> <li>- transition to a more modern technological level.</li> </ul>	<ul style="list-style-type: none"> <li>- falling product prices in international markets;</li> <li>- non-refund of VAT;</li> <li>- restricted access to imported coking coal;</li> <li>- low infrastructure investments;</li> <li>- second wave of the global crisis;</li> <li>- lack of stable internal demand;</li> <li>- protectionism in other countries;</li> <li>- stricter environmental requirements;</li> <li>- growing imports of similar products;</li> <li>- further increases of prices of electricity, transport services, etc., by the State</li> <li>- strong rise in wages</li> <li>- growing prices of energy sources;</li> <li>- development of similar production in Asian states (China);</li> <li>- unstable exchange rates.</li> </ul>

Source: IER

<sup>208</sup> ECORYS (2007)

given that employment is expected to decrease in the sector.

Growing household revenues in the areas where metallurgical enterprises are situated will cause a multiplier effect, given their weight in economy of the country and individual regions. Economic development will result in a reduced need for budget support to regional development.

The terms of modern international trade agreements provide for raising national standards of healthcare, occupational safety and working conditions. At present, about 52% of staff in metallurgy work in conditions that fail to meet sanitary and hygienic standards. This is a high level and therefore a decrease would surely have a positive impact on the quality of human development in the areas where metallurgical enterprises are situated. Health will also be positively affected by the increase in individual incomes, which will improve the access of staff working in the metallurgical sector to high-quality medical services and will allow nutrition to be improved.

Changes related to the improvement of environment protection will go the same way. The sector of metallurgical production and manufacture

of finished metal products is currently the second largest source of atmospheric air pollution after the production and distribution of electricity, gas and water.<sup>209</sup> Accordingly, compliance with high international environmental standards will promote a cleaner environment in polluted industrial regions of the country, which would have a positive impact on the health of not only the sector staff, but of the entire population.

Since the metallurgical sector is one of the largest sources of budget revenues, increases in its contributions to the budget would permit greater state spending on social programmes, in particular on healthcare and education.

Thus, the impact of international trade agreements on the sector of metallurgical production and manufacture of finished metal products is mainly assessed as positive because it means an expansion of production and upgrading, hence an all-round improvement in the staff's living conditions and a mitigation of regional problems. However, restructuring of the sector would result in a reduction of employment in the sector, which could mean a temporary worsening of the quality of life in the medium term for those who are unemployed.

<sup>209</sup>According to the State Statistics Committee, metallurgical production and manufacture of finished metal products accounted for 23.5% of the total volume of hazardous substance emissions into the air in 2009.

# SECTION 5

## CONCLUSIONS AND RECOMMENDATIONS

## SECTION 5.

# CONCLUSIONS AND RECOMMENDATIONS

### 5.1 CONCLUSIONS

International trade plays an important role in Ukraine's economy and in improving its population's living standards. Considering the country's openness, export-oriented sectors are one of the significant sources of people's income whereas imports provide better access to new technologies, new medications, new food products, etc.

A rather liberal trade regime has been established in the country at present in terms of the level of import duties. Moreover, Ukraine has either already established free trade areas with key trade partners or is negotiating on the establishment of such areas with others, which increases the potential for duty-free trade.

Therefore, moving to the forefront of the policy agenda now are the issues of aid for trade aimed at addressing the more complicated tasks of internal reform and a reduction of non-tariff barriers.

Ukraine's trade policy should aim at ensuring efficient involvement in the international trade system based on the rules that now exist in the world, and at using, as efficiently as possible, the opportunities offered by free movement of resource in the globalisation era.

Trade policy efficiency depends on specific conditions of the macroeconomic, social and political environment. Respectively, environment changes in turn call for changes in the trade policy and strategy configuration. The most important prerequisites for trade policy shaping, and at the same time challenges for Ukraine, are as follows:

- ensuring a stable macroeconomic environment;
- providing a favourable environment for business;
- developing and upgrading human capital and physical infrastructure;
- improving the operation of market institutions;
- building the capacity to participate and affect changes in the functioning of the mechanism of the world trade system;

- increasing the private sector's ability to make competitive goods and services. The observance of relevant standards and requirements must be viewed as an important tool to strengthen the position of Ukrainian enterprises in traditional markets and to access new ones;
- strengthening competition policy;
- developing education and science;
- addressing trade-related issues of the labour market and environment protection;
- using information and communication technologies in both business and public administration;
- participating in regional economic cooperation;
- assessing the impact of globalisation on internal socioeconomic processes, etc.

Trade policy shaping should become an efficient process consisting of four components – situation analysis aimed at identifying shortcomings and opportunities; formulation of a strategy and identification of its implementation tools; practical realisation of the decisions made; monitoring and evaluation that should be conducted on the regular basis. In the long run, efficiency is determined both by each component's efficiency and by quality of linkage among them. These considerations are assumed as a basis of relevant proposals concerning trade policy.

It should be noted that many measures, the need for which is stipulated by Ukraine's international commitments ensuing from its WTO membership, agreements and arrangements with the European Union, etc., completely meet the logic and content of the Aid for Trade concept. Besides, a number of technical assistance projects in trade and trade policy and related sectors have already been implemented, or are under implementation, in Ukraine. Therefore, the suggested matrix contains only the most important proposals on promoting trade and increasing trade policy efficiency that supplement or clarify respective intentions and plans.



## 5.2 ACTION MATRIX

No.	Action recommended	Target indicator and result	Timeframe	Agencies involved	Necessary resources	Necessary donor assistance
<b>1. Trade policy</b>						
1.1.	Designing and implementing a national development strategy (economic agenda) in accordance with international and regional commitments, and maximising economic effect of participation in regional and international economic structures	<p>Giving priority status to trade problems is implemented on three levels, namely:</p> <ol style="list-style-type: none"> <li>1) political level: trade will be integrated in national and sectoral development strategies;</li> <li>2) institutional level: creating relevant opportunities and structures that promote trade dialogue and trade integration in other economic policy areas;</li> <li>3) cooperation with donors: trade-related issues will become a priority area of a government-donor dialogue. Making appropriate amendments to the draft Law of Ukraine on State Strategic Planning and to regulatory documents that govern activities of the Cabinet of Ministers, ministries, and other executive authorities.</li> </ol>	2011 - 2014	Cabinet of Ministers, Ministry of Economy	State budget funds, donor funds, advisory assistance	<ol style="list-style-type: none"> <li>1. Advisory assistance on trade integration in the system of strategic planning of economic development.</li> <li>2. Advisory and expert assistance in preparation of a series of forecast analytical materials on topical issues of international trade and trade policy</li> <li>3. Advisory and expert assistance in development of a state integrated programme of support to trade</li> </ol>
1.2.	Assigning trade and trade policy issues a priority status in activities of key ministries and agencies	Identifying problems in activities of ministries and agencies related to trade and trade policy, and developing ways to improve coordination among key ministries and agencies in this field	1st half of 2011	Ministry of Economy, Ministry of Foreign Affairs, Secretariat of the Cabinet of Ministers	State budget funds, donor funds, advisory assistance	Advisory assistance in the preparation of an Independent Diagnostic Report concerning the status of elaboration and implementation of trade policy in Ukraine that would contain recommendations on improving interagency coordination in the respective field
1.3.	Improving quality of the trade policy making process	Strengthening Ukraine's positions in foreign markets	2011-2013	Ministry of Economy, Ministry of Foreign Affairs, Secretariat of the Cabinet of Ministers	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in commencement of a regular Diagnostic Trade Integration Study to identify problems that restrict the country's competitiveness and efficient realization of export potential of some economic sectors, and in commencement of training of such study participants

№	Action recommended	Target indicator and result	Timeframe	Agencies involved	Necessary resources	Necessary donor assistance
1.4.	Building analytical capacity for operational analytical support to government decision-making on international trade and trade policy	Improving quality of government decisions on international trade and trade policy	Permanently	Ministry of Economy, Secretariat of the Cabinet of Ministers, Ministry of Foreign Affairs, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Providing advisory assistance to the Government of Ukrainian on trade policy making, trade negotiations and trade policy implementation on the ad hoc basis, with a consultative and advisory centre involving Ukraine and donors (according to the Ukrainian-European Policy and Legal Advice Centre model) as a possible organisational form
1.5.	Establishing a modern, business-enabling system of state regulation of production and commercial activities	Forming a modern system of electronic commerce regulation	2011–2013	Ministry of Economy, Ministry of Justice, National Bank, Ministry of Finance, State Tax Administration of Ukraine	State budget funds, donor funds, advisory assistance	Analytical and advisory assistance in the establishment of a system of electronic commerce that would be based on relevant international principles and best practices
<b>2. Building institutional capacity and analytical support for the trade policy making and implementation process</b>						
2.1.	Ensuring integrity of the trade policy development and implementation process	Ensuring clear division of powers in trade policy development and implementation in the executive authorities system	2011–2013	Committee for Economic Reforms, Cabinet of Ministers, Ministry of Economy	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in the design and realisation of an administrative reform concept that would contain clearly formulated tasks and steps to strengthen institutional capacity in every stage of the trade policy development process: situation analysis, strategy formulation and definition of its implementation tools, practical realisation of decisions made, monitoring and evaluation
2.2.	Counteracting unfair trade practices	Improving efficiency of measures to combat unfair trade practices according to international standards and Ukraine's commitments	Permanently	Ministry of Economy, Anti-Monopoly Committee of Ukraine, State Customs Services, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in building national institutions' capacity for taking measures aimed to combat unfair trade practices, including by means of diagnostics of needs and organisational capabilities as the first step in this direction

No.	Action recommended	Target indicator and result	Timeframe	Agencies involved	Necessary resources	Necessary donor assistance
2.3.	Building institutional capacity in international trade and trade policy	Developing a research network in international trade and trade policy			State budget funds, donor funds, advisory assistance	Advisory and expert assistance in establishing a Centre for Analysis of Trade and Trade Policy Problems as an analytical and archiving institution that would perform the following functions: preparation of analytical materials, depositary of relevant documents and reports in technical assistance projects on international trade and trade policy
2.4.	Improving the capacity of civil servants in the field of international trade, trade policy and international trade negotiations on central and regional level	Establishing a special component on Trade and Trade Policy in the system of advanced training for civil servants Organization of trainings for local and regional administrations on their role in providing export oriented information for small business	2011-2012	Ministry of Economy, Chief Directorate of Civil Service of Ukraine Local and regional administrations	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in developing a specialised programme of civil servants' advanced training in the field of international trade and trade policy for two target groups - civil servants directly engaged in trade issues, and civil servants engaged in other economic policy issues, and in providing necessary training and methodological materials; organization of trainings for local and regional administrations on their role in providing export oriented information for small business
2.5.	Developing potential of economic analysis of trade and trade policy (trade negotiations) problems	Developing the system for economic assessment of government decisions	Permanently	Ministry of Economy, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in development of economic assessment and decision analysis in the trade policy field (positions on trade negotiations) using modern methods of economic analysis (CGE, etc.)
2.6.	Raising civil servants' awareness on international trade and trade policy	Improving skills of civil servants, and increasing quality of state decisions on trade policy	2011-2012	Ministry of Economy, Chief Directorate of Civil Service of Ukraine	State budget funds, donor funds, advisory assistance	<ol style="list-style-type: none"> <li>1. Advisory and expert assistance in institutional capacity building and development of a methodological basis for the system of analysis of government decisions' impact on trade and trade policy (developing institutional basics and analytical capabilities)</li> <li>2. Advisory and expert assistance in development of training programmes and provision of trainings to civil servants on assessment of governmental policy's economic consequences for trade</li> <li>3. Advisory and expert assistance in development and organisation of a series of training activities (courses, round-tables, seminars, etc.), courses on trade promotion with account of Ukraine's specific features</li> </ol>

No.	Action recommended	Target indicator and result	Timeframe	Agencies involved	Necessary resources	Necessary donor assistance
2.7.	Developing public-private partnership to promote trade development and improve trade policy efficiency	Forming new mechanisms of cooperation between the State and private business in international trade development	2011	Ministry of Economy, State Customs Service of Ukraine, business associations	State budget funds, donor funds, private funds of enterprises concerned, advisory assistance	Advisory and expert assistance in a study on possible forms of partnership between the State and business in promoting development of export potential
2.8.	Improving efficiency of the use of international technical assistance resources in trade development and trade policy reform	Identifying needs for technical assistance, and clarifying areas of its use	2011	Ministry of Economy, State Customs Service of Ukraine, Chief Directorate of Civil Service of Ukraine, other public authorities	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in analysing efficiency of technical assistance projects related to international trade, trade policy, and international trade negotiations
<b>3. Business awareness-raising on international trade and trade policy, and development of dialogue between business and government</b>						
3.1.	Raising awareness on international trade and trade policy	Increasing transparency in trade policy making, and improving understanding of external factors that determine the operating environment for national enterprises	Permanently	Ministry of Economy, other ministries and agencies concerned, business associations	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in development of a system for immediate notification of business on topical issues of international trade and trade policy by means of providing introduction trainings for representatives of business associations, disseminating appropriate information and analytical materials, etc.
3.2.	Developing support infrastructure in international trade	Forming a network of support to national manufacturers, mainly SMEs, in international trade	2011-2012	Ministry of Economy, business associations	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in assessment of reasonability and possible format of establishment of regional export promotion centres in Ukraine (that would provide advisory services to local producers, disseminate information on relevant markets and quality requirements to products and services, and help search for potential partners, etc.)

No.	Action recommended	Target indicator and result	Timeframe	Agencies involved	Necessary resources	Necessary donor assistance
3.3.	Integrating Ukrainian enterprises in international network cooperation structures as a competitiveness improving tool	Entry of Ukrainian enterprises into international business networks and innovation networks	2011-2013	Ministry of Economy, Ministry of Foreign Affairs, business associations	State budget funds, donor funds, advisory assistance, private funds	Promoting the entry of Ukrainian enterprises into the Enterprise Europe Network (EEN) in order to integrate into European business and innovation networks
3.4	Creating an effective mechanism of public consultations on trade policy to let the public have adequate access to information concerning current trade negotiations and international trade problems, and ensuring transparency of such consultations with representatives of all community groups	Introducing annual publication of white papers on Ukraine's trade policy, certain international trade problems, etc.	Regularly	Cabinet of Ministers, Ministry of Economy, Ministry of Foreign Affairs, State Statistics Committee	State budget funds, donor funds, advisory assistance	Advisory and expert assistance on preparation (format, content, procedures, etc.) of white papers and other conceptual documents on international trade and trade policy
3.5.	Raising awareness of national exporters on standards and technical requirements related to both traditional Ukrainian export products and new goods that can be supplied by Ukrainian manufacturers	Developing and improving the trade and market information systems	Permanently	Ministries, other central authorities, business associations	State budget funds, donor funds, advisory assistance, private funds	Financial and expert assistance
<b>4. Creating a favourable business environment</b>						
4.1.	Developing a system of support to national manufacturers in international trade	Creating a system of financial support to national manufacturers in international trade	2011-2013	Ministry of Economy, Ministry of Finance, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in development of trade finance

No.	Action recommended	Target indicator and result	Timeframe	Agencies involved	Necessary resources	Necessary donor assistance
4.2.	Bringing state support mechanisms and government procurement mechanisms into conformity with internationally recognised principles and Ukraine's international obligations	Developing necessary legal acts that regulate government procurement and state support	2011 - 2013	Cabinet of Ministers, Ministry of Economy, Ministry of Finance, Ministry of Justice, Ministry of Foreign Affairs, Anti-Monopoly Committee of Ukraine	State budget funds, donor funds, advisory assistance	<p>1. Advisory and expert assistance in development of a special law that would clearly specify principles, mechanisms and format of state support. Such a law must be based on internationally recognized principles of state support and reflect Ukraine's international obligations.</p> <p>2. Advisory and expert assistance in negotiations on Ukraine's accession to the WTO Agreement on Government Procurement.</p>
4.3.	Developing a system of agricultural extension services	Developing information networks of support to national manufacturers of agricultural products, including in international trade	Permanently	Cabinet of Ministers, Ministry of Agrarian Policy, Ministry of Economy, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in development of several model centres of agricultural extension services to gain practical experience in this area
<b>5. Transport, customs, statistics</b>						
5.1.	Modernising the transport sphere	Completing discussion and adoption of a comprehensive national transport strategy of Ukraine	2011-2012	Cabinet of Ministers, Ministry of Transport, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in development of a national transport strategy of Ukraine
5.2.	Improving the procedures related to movement of goods across the border	Reducing time and costs related to movement of goods across the border	Permanently	Ministry of Economy, Ministry of Transport, State Customs Service, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in development of a system for periodic analysis of regulatory measures affecting movement of goods across the Ukrainian customs border

No.	Action recommended	Target indicator and result	Timeframe	Agencies involved	Necessary resources	Necessary donor assistance
5.3.	Reforming the customs service	Establishing a modern and efficient customs service Clear division of functional responsibilities among all structures that control goods crossing the border Creating a uniform electronic customs database in the SCSU system, which will allow customs procedures to be performed where it is convenient to a customs applicant	2011-2013	State Customs Service of Ukraine	State budget funds, donor funds, advisory assistance	1. Advisory and expert assistance in completion of a strategy of reforming the customs service of Ukraine. 2. Advisory and expert assistance in creation of the Electronic Customs system as a component of electronic government
5.3.	Developing a system of national statistics	Improving trade statistics quality	2010-2011	State Statistics Committee of Ukraine	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in development of the service trade statistics system
<b>6. Standards, technical requirements, etc.</b>						
6.1.	Raising awareness of national exporters on standards and technical requirements related both to traditional Ukrainian export products and new goods that can be supplied by Ukrainian manufacturers	Developing and improving trade and market information systems Strengthening competitiveness of Ukrainian manufacturers in international markets	Permanently	Ministries, other central authorities, business associations	State budget funds, donor funds, private funds	Advisory and expert assistance in the development of a national system to inform manufacturers on standards, technical requirements, etc., in respective international markets
6.2.	Developing a national system of standards, technical requirements, etc.	Strengthening competitiveness of Ukrainian manufacturers in international markets	Permanently	Ministry of Economy, Ministry of Agrarian Policy, State Committee of Ukraine for Technical Regulation and Consumer Policy, State Committee of Veterinary Medicine of Ukraine, State Inspectorate for Medications Quality Control, other ministries and agencies concerned	State budget funds, donor funds, advisory assistance	Advisory and expert assistance in the development of a national system of standards, technical requirements, etc., in order to select adequate national policy options concerning the Voluntary Standards Systems, etc.

### 5.3 DATABASE OF DONORS ENGAGED IN AID FOR TRADE

No	Title	Sector	Donor	Amount of funding	Timeframe	Status
1.	Business Investments and Loans	Development of enterprise	U.S. Government through the U.S. Agency for International Development (USAID)	150 million USD (together with Moldova)	21.09.1994-26.08.2011	Under implementation
2.	Programme of assistance to farms and cooperative associations of farmers (phase II)	Agriculture	U.S. Department of Agriculture	3.6 million USD	10.08.1998-31.12.2010	Under implementation
3.	Capital markets project	Finance	U.S. Government through the U.S. Agency for International Development (USAID)	14.2 million USD	19.09.2005-30.09.2010	Under implementation
4.	Municipal finance strengthening initiative in Ukraine	Finance	U.S. Government through the U.S. Agency for International Development (USAID)	Information not available	01.10.2008-30.09.2011	Under implementation
5.	Commercial law	Law	U.S. Government through the U.S. Agency for International Development (USAID)	Information not available	16.07.2008-15.07.2011	Under implementation
6.	Initiative for proliferation prevention (IPP-WMD): strengthening border management on the Ukrainian-Moldovan state border	Border management	U.S. Government (through the U.S. Department of Defence / Defence Threat Reduction Agency)	Information not available	16.08.2004-22.04.2010	Implemented
7.	Non-proliferation of weapons of mass destruction and dual-use goods	Export control	U.S. Government through the U.S. Agency for International Development (USAID)	Information not available	19.09.2005-30.09.2010	Under implementation
8.	Technical aid to strengthen the system of Ukraine's export control and counteraction to the proliferation of weapons of mass destruction	Export control	U.S. Department of State's Bureau of International Security and Non-proliferation	3.1 million USD	11.06.2007-12.06.2010	Implemented
9.	Improving law-enforcement training programmes and opportunities of providing basic training in professional training centres of the State Border Guard Service of Ukraine	Border management	U.S. Government (U.S. Department of State)	Information not available	08.06.2009-30.09.2010	Under implementation
10.	Local investment and national competitiveness	Competition	U.S. Government	Information not available	16.03.2009-01.03.2012	Under implementation
11.	Ukraine credit union strengthening project	Lending	Government of Canada	909 thousand CAD	29.03.2004-31.03.2010	Implemented



No	Title	Sector	Donor	Amount of funding	Timeframe	Status
12.	Regional governance and development	Regional development	Government of Canada	Information not available	30.03.2005-30.04.2010	Implemented
13.	Horticulture development	Agriculture	Canadian International Development Agency	8.15 million CAD	31.10.2008-30.06.2013	Under implementation
14.	Promoting Ukraine's global integration (PROGINT)	International integration	Canadian International Development Agency	Information not available	11.08.2006-31.07.2010	Under implementation
15.	German-Ukrainian policy dialogue in agriculture	Agriculture	Federal Republic of Germany; Federal Ministry for Economic Cooperation and Development (BMZ)	387 thousand EUR	01.01.2010-31.12.2011	Under implementation
16.	Promoting bilateral financial cooperation with Ukraine	Finance	Federal Republic of Germany; Federal Ministry for Economic Cooperation and Development (BMZ)	Information not available	15.08.2007-15.08.2010	Under implementation
17.	Municipal infrastructure development project	Municipal development	Swedish International Development Cooperation Agency	5.6 million USD	22.10.2008-30.06.2012	Under implementation
18.	Facility for agricultural reform and modernisation	Agriculture	Government of Canada	1.12 million CAD	01.03.2003 - 30.06.2010	Implemented
19.	Grain quality, rural agricultural credit – phase II	Agriculture	Government of Canada	4 million CAD	30.10.2009 – 31.07.2010	Implemented
20.	Improving the competitiveness of the dairy sector	Agriculture	Canadian International Development Agency	7 million CAD	31.03.2008-30.06.2013	Under implementation
21.	Programme of promoting economic development and employment	Economy	Federal Republic of Germany; Federal Ministry for Economic Cooperation and Development (BMZ)	Information not available	01.01.2009-31.12.2011	Under implementation
22.	Certification in organic farming	Agriculture	State Secretariat for Economic Affairs (SECO) of the Swiss Confederation's Ministry of Foreign Affairs	1.84 million CHF	20.12.2005-31.12.2010	Under implementation

No	Title	Sector	Donor	Amount of funding	Timeframe	Status
23.	Sustainable development of agrarian production in Ukraine - EcoFinLan	Agriculture	Swiss Confederation's Ministry of Foreign Affairs	1.57 million CHF	01.01.08-31.12.2010	Under implementation
24.	Strengthening cross-border cooperation in provision of business services and facilitation of access to them (Ukraine-Poland-Belarus neighbourhood programme)	Transborder cooperation	European Union	186.2 million EUR (total budget for three countries)	22.04.2008-21.04.2010	Implemented
25.	Strengthening activities of the National Accreditation Agency of Ukraine	Technical regulation	European Union	1.4 million EUR	31.01.2008-30.04.2010	Implemented
26.	BOMUK-3 – Border management improvement: equipment supply to the State Border Guard Service of Ukraine. Lot 2: surveillance equipment	Border management	European Union	Information not available	01.08.2007-31.03.2011 (incl. guarantee period)	Under implementation
27.	BOMUK-4 – Border management improvement: equipment supply to the border guard services of Ukraine. Lot 1: devices for document inspection with a biometric control function	Border management	European Union	Information not available	01.08.2008-31.05.2011	Under implementation
28.	BOMUK-4 – Border management improvement: equipment supply to the border guard services of Ukraine. Lot 2: border surveillance equipment – vehicle-based IR imaging equipment	Border management	European Union	Information not available	01.08.2008-31.07.2011	Under implementation
29.	Supply of mobile inspection equipment and X-ray scanning systems to customs services of Belarus, Ukraine and Moldova	Customs control	European Union	Information not available	17.07.2008-16.07.2010	Implemented
30.	Supply of equipment for metrology and testing services	Certification	European Union	3.33 million EUR	20.04.2009-19.04.2011	Under implementation
31.	Support for the Ukrainian veterinary services in enhancing the legal and technical aspects of food safety control system	Food safety	European Union	1.26 million EUR	01.09.2009 – 31.08.2011	Under implementation

No	Title	Sector	Donor	Amount of funding	Timeframe	Status
32.	Support to sustainable regional development	Regional development	European Union	8.7 million EUR	02.07.2008-01.12.2011	Under implementation
33.	Sustainable regional development	Regional development	European Union	4.98 million EUR (total project cost)	23.10.2006-22.10.2010	Under implementation
34.	Sustainable regional development – equipment supply (Lot 9)	Regional development	European Union	See No. 33	30.07.2008-22.04.2010	Implemented
35.	Sustainable regional development – equipment supply (Lot 4, Lot 12)	Regional development	European Union	See No. 33	04.08.2008-10.08.2010 (incl. one year guarantee period)	Under implementation
36.	Sustainable local development – equipment supply (Lot 3, Lot 5, Lot 8, Lot 11, Lot 13)	Regional development	European Union	See No. 33	04.08.2008-04.05.2010 (incl. one year guarantee period)	Implemented
37.	Sustainable local development – equipment supply (Lot 2)	Regional development	European Union	See No. 33	09.08.2008-04.07.2010	Implemented
38.	Legislation, certification and commercialization of the Eastern European Regional Gas Metrology Centre in Boyarka, Ukraine	Certification	European Union	Information not available	30.07.2008-29.01.2010	Implemented
39.	Feasibility studies for expanding the Boyarka Gas Metrology Centre to include oil, oil products, liquefied gas metrology, satellite monitoring for optimization and control	Certification	European Union	Information not available	20.07.2009-19.07.2011	Under implementation
40.	Supply of equipment for the Eastern European Regional Gas Metrology Centre in Boyarka	Certification	European Union	Information not available	31.07.2009-30.07.2010	Under implementation
41.	Bukovyna Innovation Centre (Neighbourhood Programme Ukraine-Romania)	Innovation development	European Union	820 thousand EUR	05.08.2008-04.08.2010	Under implementation
42.	Enhance innovation strategies, policies and regulation in Ukraine	Innovation development	European Union	2.78 million EUR	29.07.2009-28.10.2011	Under implementation

No	Title	Sector	Donor	Amount of funding	Timeframe	Status
43.	Development of financial schemes and infrastructure to support innovations in Ukraine	Innovation development	European Union	2.31 million EUR	15.07.2009 - 14.09.2011	Under implementation
44.	Support to knowledge based and innovative enterprises and technology transfer to business in Ukraine	Innovation development	European Union	2.47 million EUR	30.06.2009 - 29.08.2011	Under implementation
45.	Support to strengthening road freight and passenger transport safety in Ukraine	Transport	European Union	1 million EUR	24.07.2008-23.04.2010	Implemented
46.	International logistics centres for Western NIS and Caucasus 09.08.2008-04.07.2010: Azerbaijan, Armenia, Georgia, Moldova, Ukraine	Transport	European Union	3.44 million EUR	22.12.2008-21.12.2010	Under implementation
47.	Support to transport policy design and implementation in Ukraine	Transport	European Union	1 million EUR	05.01.2009 – 04.01.2011	Under implementation
48.	Ukraine port development feasibility study	Transport	European Union	1.71 million EUR	04.08.2008-03.08.2010	Under implementation
49.	Integration of Ukraine in the trans-European transport network TENT	Transport	European Union	5.85 million EUR	01.08.2008-01.01.2011	Under implementation
50.	Integration of trans-European transport network and border crossing points, Ukraine-Belarus	Transport	European Union	Information not available	15.01.2009-14.12.2010	Under implementation
51.	Development of Common Security Management System and Cooperation in the Area of Maritime Safety and Ship Pollution Prevention for the Black Sea and the Caspian Sea	Transport	European Union	3.5 thousand EUR	31.07.2009-30.07.2011	Under implementation
52.	Implementation of Ukraine's commitments under WTO and ENP frameworks in the rural sector (sector wide approach)	Trade policy	European Union	4.74 million EUR	16.10.2008-15.04.2012	Under implementation
53.	Harmonisation of competition and public procurement systems in Ukraine with EU standards	Competition/ public procurement	European Union	4.39 million EUR	20.01.2009-19.07.2011	Under implementation
54.	Maritime routes in the Black and Caspian Seas	Transport	European Union	2.44 million EUR	02.12.2008-01.12.2010	Under implementation

No	Title	Sector	Donor	Amount of funding	Timeframe	Status
55.	Supply of equipment for veterinary laboratories in support of implementation of AP 2006 project "Implementation of Ukraine's commitments under WTO and ENP frameworks in the rural sector (sector wide approach)" – Lot 1	Trade policy	European Union	1.92 million EUR	29.07.2009-28.03.2010	Implemented
56.	Strengthening of Ukrainian financial services sector	Finance	European Union	3.71 million EUR	04.08.2008-03.12.2010	Under implementation
57.	Enhancing performance of InvestUkraine: the Ukrainian Centre for Foreign Investment Promotion in line with the best European practices	Investment promotion	European Union	Information not available	30.10.2009-29.10.2011	Under implementation
58.	Supporting economic reforms in Ukraine through the UNDP Blue Ribbon Analytical and Advisory Centre	Economy	European Union, UNDP	4.5 million USD	07.2005-12.2011	Under implementation
59.	Technical assistance to Ukrainian quality infrastructure	Quality control	European Union	3.09 million EUR	23.06.2008-22.12.2010	Under implementation
60.	Grant from the Netherlands Government for support to the 2nd financial sector reform programme	Finance	International Bank for Reconstruction and Development	1.5 million EUR	22.08.05-01.10.2010	Under implementation
61	Sector Policy Support Programme 'Promoting mutual trade by removing technical barriers to trade between Ukraine and the EU'	Trade policy (removing technical barriers to trade)	European Union	45 million EUR	21 December 2009 - 21 December 2013	Under implementation

Sources: Ministry of Economy of Ukraine, <http://www.me.gov.ua/file/link/145741/file/Perelik01-03-2010.doc>; EU Delegation to Ukraine, [http://ec.europa.eu/delegations/ukraine/projects/list\\_of\\_projects/projects\\_en.htm](http://ec.europa.eu/delegations/ukraine/projects/list_of_projects/projects_en.htm); Database of international technical aid projects in Ukraine's agro-industrial complex, <http://www.taprojects.org.ua/?locale=uk>; USAID in Ukraine, [http://ukraine.usaid.gov/ukraine\\_economic.shtml](http://ukraine.usaid.gov/ukraine_economic.shtml); UN Development Programme, <http://europeandcis.undp.org/poverty/show/C148D3BF-F203-1EE9-B6242983E3518BFA>; Canadian International Development Agency, [http://www.acdi-cida.gc.ca/INET/IMAGES/NSF/vLImages/stats/\\$file/STATISTICAL-REPORT-2008-2009\\_ENG.pdf](http://www.acdi-cida.gc.ca/INET/IMAGES/NSF/vLImages/stats/$file/STATISTICAL-REPORT-2008-2009_ENG.pdf)

## REFERENCES

- AmCham (2009): ACC (2009) Співробітництво з метою покращення конкурентоспроможності економіки України. Звіт Американської торговельної палати України, 2009. - [www.chamber.ua](http://www.chamber.ua).
- Arvis J.-F., Mustra M., Ojala L., Shepherd B., and Saslavsky D. (2010) Connecting to Compete 2010. Trade Logistics in the Global Economy. The Logistics Performance Index and Its Indicators. World Bank [http://siteresources.worldbank.org/INTTLF/Resources/LPI2010\\_for\\_web.pdf](http://siteresources.worldbank.org/INTTLF/Resources/LPI2010_for_web.pdf)
- Aslund (2002): Ослунд А. (2002) Чому в Україні відновилось економічне зростання? Наукові матеріали ІЕД. – [http://www.ier.com.ua/ua/publications/working\\_paper/archive\\_2002/?pid=1661](http://www.ier.com.ua/ua/publications/working_paper/archive_2002/?pid=1661)
- BE (2010) Заборгованість з відшкодування ПДВ в Україні: аналіз та рекомендації щодо вирішення проблеми, з приділенням особливої уваги сільському господарству. Консультативна робота Berlin Economics
- Betliy (2010): Бетлій О. (2010) «Стійкість Державного боргу під питанням» // Місячний економічний моніторинг України №10 (120), жовтень 2010р. – [www.ier.com.ua](http://www.ier.com.ua)
- Burakovsky I. (2003) Economic Integration and Security in the Post-Soviet Space // Swords and Sustenance: The Economics of Security in Belarus and Ukraine. Edited by Robert Legvold and Celeste A. Wallander. – 2003
- Burakovsky et al. (2009) Coping with the Effects of International Financial Crisis. Searching for Proper Policy Response. // Problems of Economic Transition, vol. 51, no. 10, February 2009, pp. 78-99
- Burakovsky, I. (2001) Ukraine's Foreign Trade Regime: In Search of the Proper Place for the State. OECD Round Table on "Ten Years of Trade Liberalisation in Transition Economies", Paris, July 10-11
- Burakovsky, Movchan (2008): Бураковський І.В. та В. Мовчан (2008): Аналіз економічних наслідків вступу України до СОТ. Оновлена оцінка. Інститут економічних досліджень та політичних консультацій.
- Dem'yanenko (2006): Дем'яненко С. (2006) Ринок сільськогосподарської землі в Україні: дозволити чи заборонити? Консультативна робота ІЕД № AgPP 8, листопад
- Dem'yanenko (2008): Дем'яненко С.І. (2008) Агрохолдинги в Україні: добре чи погано? Консультативна робота ІЕД № AgPP 21, серпень 2008 року.
- Derzhspozhyvstandart (2009a): Держспоживстандарт (2009a) Інформація щодо першої річниці членства України в СОТ. [http://www.dssu.gov.ua/control/uk/publish/article/main?art\\_id=134600&cat\\_id=87101](http://www.dssu.gov.ua/control/uk/publish/article/main?art_id=134600&cat_id=87101)
- Derzhspozhyvstandart (2009b): Держспоживстандарт (2009b) Розроблення стратегії у сфері подолання технічних бар'єрів у торгівлі: стандартизація та оцінка відповідності.
- Derzhspozhyvstandart (2009c): Держспоживстандарт (2009c) Інформація про розширене засідання Колегії Держспоживстандарту України від 29 вересня 2009 року. [http://www.dssu.gov.ua/control/uk/publish/printable\\_article?art\\_id=134670](http://www.dssu.gov.ua/control/uk/publish/printable_article?art_id=134670)
- Derzhspozhyvstandart (2010a): Держспоживстандарт (2010a) Держспоживстандарт активізує розробку технічних регламентів [http://www.dssu.gov.ua/control/uk/publish/article/system?art\\_id=143164](http://www.dssu.gov.ua/control/uk/publish/article/system?art_id=143164)
- Derzhspozhyvstandart (2010b): Держспоживстандарт (2010b) На ДП «Харківстандартметрологія» відбудеться всеукраїнський семінар щодо переходу від обов'язкової сертифікації до оцінки відповідності продукції. [http://www.dssu.gov.ua/control/uk/publish/article/system?art\\_id=140484](http://www.dssu.gov.ua/control/uk/publish/article/system?art_id=140484)
- EBRD (2010) «Дослідження умов для бізнесу та ефективності підприємств 2008 - 2009 років», Європейський банк реконструкції та розвитку, квітень 2010. <http://www.ebrd.org/pages/research/analysis/surveys/beeps.shtml>
- EBRD-WB (2005) *Business Environment and Enterprise Performance Survey*
- ECORYS (2007) Аналіз перспектив торговельних відносин між Україною та ЄС у контексті переговорів щодо розширеної угоди. Підготовлений ECORYS та CASE. Роттердам, 13 грудня 2007 р.
- Effective Governance Fund (2009): Фонд «Эффективное управление» (2009) Вплив кризи на українську металургію та пропоновані заходи для підтримки й реструктуризації галузі. <http://www.feg.org.ua>
- EU (2009) Women in European Politics – Time for Action. Report. - <http://ec.europa.eu/social/BlobServlet?docId=2052&langId=en>
- Freinkman, L. Polyakov E., REVENCO C. (2004). "Trade Performance and Regional Integration of the CIS Countries." Policy Research Working Paper 38. Washington, DC: World Bank
- Guicci, Kirchner, Kravchuk (2010): Джуччі Р., Кірхнер Р., Кравчук В. (2010) «Криза кредитування в Україні: факти, причини та шляхи відновлення» Консультативна робота Інституту економічних досліджень та політичних консультацій PP 03, червень 2010 року.
- Handrich, Betliy (2008): Хандріх Л., Бетлій О. (2008) Принципи і способи функціонування адресної соціальної допомоги: рекомендації для України, Консультативна робота PP 07, жовтень 2008 року

- IER (2008): ІЕД (2008) Членство України в СОТ: Огляд зобов'язань та коментарі до них. Проект здійснено ІЕД на замовлення USAID / TIBA. – Київ, 2008. – ISBN 996-347-049-6
- IER (2009): ІЕД (2009) Як подолати вплив міжнародної фінансової кризи: пошуки адекватної економічної політики. / Аналітична доповідь. За ред. І. Бурковського та В. Мовчан. – Харків: Права Людини, 2009.
- IFC (2009a) «Інвестиційний клімат в Україні: Яким його бачить бізнес?», Міжнародна фінансова корпорація. [http://www.ifc.org/ifcext/eca.nsf/AttachmentsByTitle/Ukraine\\_IC\\_report\\_2009/\\$FILE/Ukraine\\_IC\\_report\\_2009\\_ukr.pdf](http://www.ifc.org/ifcext/eca.nsf/AttachmentsByTitle/Ukraine_IC_report_2009/$FILE/Ukraine_IC_report_2009_ukr.pdf)
- IFC (2009b) Doing Business 2010 Ukraine. IBRD/WB. - <http://www.doingbusiness.org/Documents/CountryProfiles/UKR.pdf>
- IFC (2009c) The Costs of Tax Compliance in Ukraine. // Investment Climate Advisory Service. The World Bank Group. – Kyiv.
- IFC/PriceWaterhouseCoopers (2010) Paying Taxes 2010. A global picture. - <http://www.doingbusiness.org/documents/FullReport/2010/Paying-Taxes-2010.pdf>
- IMF (2008) Ukraine: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, October 31, 2008. <http://www.imf.org/external/np/loi/2008/ukr/103108.pdf>
- IMF (2009a) Ukraine: Letter of Intent and Technical Memorandum of Understanding, July 23, 2009. <http://www.imf.org/external/np/loi/2009/ukr/072309.pdf>
- IMF (2009b) IMF Mission Statement on Ukraine. Press Release No. 09/366, October 25, 2009. <http://www.imf.org/external/np/sec/pr/2009/pr09366.htm>
- IMF (2010) IMF Executive Board Approves US\$15.15 Billion Stand-By Arrangement for Ukraine. Press Release No. 10/305. July 28, 2010. <http://www.imf.org/external/np/sec/pr/2010/pr10305.htm>
- Kutsnko, Kuziakiv (2009): Куценко К., Кузяків О. (2009) «Технічне регулювання в Україні після набуття країною членства у Світовій організації торгівлі»
- Kuziakiv, Dvorak (2010): Кузяків О., Дворак Я. (2010) Квартальне опитування підприємств №3 (33), вересень 2010 р. ІЕД. – [www.ier.kiev.ua](http://www.ier.kiev.ua)
- Kuznetsova G. (2010) The welfare effect of export restrictions: the case of Ukrainian market for wheat. LAMBERT Academic Publishing, 2010 (ISBN: 978-3-8433-5444-8).
- Lammersen F., Hallaert J.-J., Roberts M. (2010) "Aid for Trade: Is It Working?" – [www.wto.org](http://www.wto.org)
- MEU (2010a): MEU (2010a) «Цілі розвитку тисячоліття: Україна - 2010», Національна доповідь, Міністерство економіки України, Київ 2010
- MEU (2010b): MEU (2010b) Поточний стан переговорного процесу між Україною та ЄС щодо створення зони вільної торгівлі. Інформаційна довідка. – Київ, 2010
- MEU (2010c): MEU (2010c) «Промислове виробництво: підсумки I півріччя 2010 року». Звіт Міністерства економіки України. <http://www.me.gov.ua>
- Movchan (2002): Мовчан В. (2002) Економічне відновлення України: короткий коментар щодо змін ВВП. // Тенденції української економіки. Українсько-європейський консультативний центр (UEPLAC). Березень 2002 р.
- Movchan (2009): Мовчан В. (2009) «Україна в міжнародному економічному співробітництві» // Зовнішня політика України 2008. Стратегічні оцінки, прогнози та пріоритети. Щорічник. Під ред. Г.М.Перепелиці. – Київ, 2009
- Movchan (2010): Мовчан В. (2010) «Україна в міжнародному економічному співробітництві» // Зовнішня політика України 2009. Стратегічні оцінки, прогнози та пріоритети. Щорічник. Під ред. Г.М.Перепелиці. – Київ, 2010.
- Movchan (2010b): Мовчан В. (2010b) Реформа системи технічного регулювання в Україні: що зроблено і що треба зробити. Матеріали до Круглого столу «Проблеми регулювання якості і безпеки продукції та підтвердження відповідності», Верховна Рада України, Комітет з питань промислової і регуляторної політики та підприємництва. Київ
- Movchan, Guicci, Kutsenko (2010): Мовчан В., Джуччі Р., Куценко К (2010) «Торговельна політика України: Стратегічні аспекти та наступні кроки, які треба здійснити» Консультативна робота PP/02/2010
- MSI (2008) «Корупція та регулювання підприємницької діяльності в Україні: митні процедури та транспортування товарів», Звіт Менеджмент Системс Інтернешнл (MSI) у співробітництві з Інститутом маркетингу InMind, м. Київ, 2008
- NISS (2009): НІСД (2009) Металургійний комплекс України в умовах кризи: причини падіння та напрямки покращення ситуації. – <http://www.niss.gov.ua/Monitor/September09/3.htm>

Nivievskiy, O., S. von Cramon-Taubadel, and B. Brümmer (2010). International Agricultural Productivity Growth: is there a consistent pattern across the methods? Working paper, Department for Agricultural Economics and Rural Development, University of Göttingen

Nivievskiy, O., S. von Cramon-Taubadel and B. Brümmer (2010b) A Note on Technical Efficiency, Productivity Growth and Competitiveness. Paper presented at the Agricultural and Applied Economics Association Meetings in Denver, Colorado, July 25-27, 2010

OECD (2009) Aid for Trade at a Glance 2009. Maintaining Momentum – Ukraine. <http://www.oecd.org/dataoecd/3/17/43196457.pdf>

OECD/WTO (2009) Aid for Trade at a Glance 2009. Maintaining Momentum. ISBN WTO 978-92-87-03525-7

Tiffin, A. (2006). Ukraine: The Cost of Weak Institutions. International Monetary Fund (IMF) Working Paper WP/06/167. Washington D.C.

UNCTAD (2010) World Investment Report 2010, Annex Tables: <http://www.unctad.org/Templates/Page.asp?intltemID=5545&lang=1>

UNDP (2009) Overcoming Barriers: Human Mobility and Development. Human Development Report 2009. - [http://hdr.undp.org/en/media/hdr\\_2009\\_en\\_complete.pdf](http://hdr.undp.org/en/media/hdr_2009_en_complete.pdf)

UNDP (2009): ПРООН (2009) «Торговля и человеческое развитие. Как проводить оценку потребностей развития торговли в странах с переходной экономикой». ISBN: 978-92-9504-284-1

UNDP (2009b): ПРООН (2009b) Рекомендации относительно экономических и институциональных реформ 2009. – Аналитическо-консультационный центр «Голубой ленты» ПРООН, Киев, 2009. - <http://brc.undp.org.ua/ua/publications/books>

UNDP (2010) - Human Development Report 2010 — 20th Anniversary Edition. United Nations Development Programme// <http://hdr.undp.org/en/reports/global/hdr2010/>

UNDP (2010): ПРООН (2010) Україна. Пояснення змін у значеннях і рейтингах Індексу людського розвитку у Звіті про людський розвиток за 2010 рік.

Von Cramon, Raiser (2006): фон Крамон, С., Райзер М. (2006) «Квоти не експорт зерна в Україні: недіючі, неефективні та непрозорі», Консультативна робота №10, ІЕД, листопад 2006 року

WB (2008) „Ukraine– Agricultural Competitiveness“, Report No. 44843-UA, World Bank, Washington DC, June

WB (2009) «Трагедія, якої можна уникнути: Подолання в Україні кризи здоров'я людини». <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/UKRAINEEXTN/0,,contentMDK:22234568~pagePK:1497618~piPK:217854~theSitePK:328533,00.html>

WEF (2007) The Global Competitiveness Report 2007/2008. - <http://www3.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/PastReports/index.htm>

WEF (2008) The Global Competitiveness Report 2008/2009. - <http://www.scribd.com/doc/7471885/The-Global-Competitiveness-Report-20082009>

WEF (2009a) The Global Competitiveness Report 2009/2010. - <http://www.weforum.org/pdf/GCR09/GCR20092010fullreport.pdf>

WEF (2009b) The Global Gender Gap Report 2009. <http://www.weforum.org/pdf/gendergap/report2009.pdf>

WEF (2010a) The Global Competitiveness Report 2010/2011. - [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2010-11.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf)

WEF (2010b) The Global Gender Gap Report 2010. - <http://www.weforum.org/pdf/gendergap/report2010.pdf>

World Bank (2004): Світовий банк (2004). Торговельна політика України: Перспективи і пріоритети інтеграції. – Київ, 2004. ISBN: 966-514-056-6

World Bank (2010): Світовий банк (2010) Україна: Дослідження щодо сприяння торгівлі і транзиту. Світовий банк. Київ, 2010. <http://siteresources.worldbank.org/UKRAINEEXTN/Resources/TTF-Executive-Summary-e.pdf>

WTO (2008) Report of the Working Party on the Accession of Ukraine to the World Trade Organization. WT/ACC/UKR/152, 25 January 2008



# ANNEXES

## ANNEXES

### ANNEX 1. METHODOLOGY OF THE QUARTERLY SURVEY OF ENTERPRISES

The Business Survey project has existed since 1996. Studies within the project framework have been conducted since June 2002 by the Institute for Economic Research and Policy Consulting. The regular surveys, which are carried out every three months, use the *business tendency surveys* method. The method was designed by IFO, a Munich-based institute.

A panel sample consists of 300 manufacturing-industry enterprises. The sample represents enterprises of all sizes, industry branches, and forms of ownership. The average response rate is 94.0%. The sample structure reflects the panel structure.

The main sample construction criterion consists of the number of workers in every sector of industry. The construction used data from the State Statistics Committee of Ukraine and available information from the Fenix database.

The enterprises are grouped by size according to their staff count. The following enterprises were distinguished: small (less than 50 staff), average (51-250 staff), large medium-size (251-500 staff), large (501-1000 staff), and the largest (over 1000 staff). Sometimes, when there is no substantial intergroup difference, three latter groups are combined into the large enterprises groups (Table A1-1).

**Table A1-1. Sample structure by staff count**

Staff count	%
Less than 50	39.1
51 – 250	37.5
251 – 500	9.0
501 – 1000	8.0
Over 1000	6.4

Source: Kuziakiv, Dvorak (2010)

The sample included enterprises from four regions of Ukraine: western, southern, eastern, and central ('metropolitan'). The regional sample structure as of July 2010 is presented in Table A1-2.

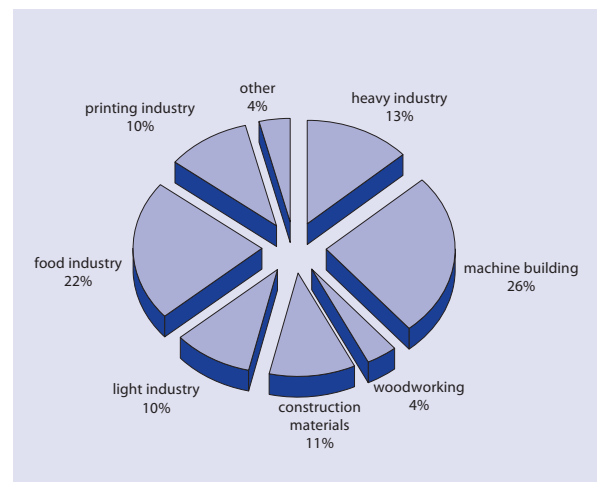
The sectoral structure of enterprises in the sample (not weighted by output) is presented in Figure A1-1.

All indices are calculated according to a uniform methodology. Responses are counted as +1 when an enterprise replies that an indicator has increased, 0 if the indicator has not changed, and -1 if it has decreased. For example, if 20 out of 100 respondents indicated production growth, 50 mentioned a fall and 30 reported no change, the index will be equal to -0.30. A positive (negative) index value means that

**Table A1-2. Regional sample structure**

City	Region	%
Lviv	Western	13.7
Kyiv	Central	31.8
Kharkiv	Eastern	32.1
Khmelnysky	Western	7.0
Sumy	Eastern	8.7
Odesa	Southern	6.7

Source: Kuziakiv, Dvorak (2010)



**Figure A1-1. Sectoral sample structure**

Source: Kuziakiv, Dvorak (2010)

the share of enterprises where production has grown is greater (smaller) than the number of those where production has decreased. Every index higher than +0.09 or lower than -0.09 is statistically significant and differs from zero with 5% error probability.

The aggregate indicator of industry prospects (*industrial confidence indicator*) is calculated as an arithmetic average of indices of expected production changes, estimated volume of new orders, and estimated stock of finished products (the latter one with a '-' sign).

The general *unfavourable regulatory climate* indicator consists of three components: (1) high regulatory pressure, (2) frequent changes in legislation, and (3) corruption, and reflects the share of respondents who chose at least one of the above-mentioned factors.

## ANNEX 2. Some development indicators for agriculture and the food industry

Table A2-1. Performance indicators of Ukraine's agriculture and food industry

		2002	2003	2004	2005	2006	2007	2008	2009
<b>Agriculture*</b>									
Gross output	billion UAH	66.4	66.1	85.7	94.8	98.4	113.1	156.0	157.9
	% aggregate output	13.2	11.0	10.6	9.5	9.6	7.2	7.5	7.6
Gross value added	% GDP	13.0	10.9	10.8	9.2	7.5	6.6	6.9	7.2
Value added / gross output	%	44.3	43.9	43.5	42.8	41.7	41.9	41.7	41.7
Value added structure:									
	Employees labour remuneration	% value added	17.4	16.8	16.2	17.0	20.6	25.0	22.0
	Profit, mixed income	% value added	81.8	83.6	85.6	85.1	83.6	80.1	82.5
	Net taxes on production and import	% value added	0.8	-0.4	-1.8	-2.1	-4.2	-5.1	-4.5
Employment**	thousand persons	4107	4079	3975	3986	3634	3468	3300	3131
	% total employment	20.4	20.2	19.6	19.3	17.5	16.6	15.7	15.5
Average wage	UAH/month	178	210	295	415	553	733	1 076	1220
Exports	billion UAH	7.36	4.55	8.26	9.44	10.49	9.34	30.2	
	% total exports	5.9	2.9	3.9	4.1	4.1	2.9	6.8	
	% output	11.0	6.9	9.6	10.0	10.7	8.3	19.4	
Imports	billion UAH	0.8	5.06	3.34	3.80	4.41	5.45	8.9	
	% total imports	0.7	3.4	1.8	1.7	1.6	1.5	1.7	
	% output	1.2	7.7	3.9	4.0	4.5	4.8	5.7	
Exports/imports	Index	9.2	0.9	2.5	2.5	2.4	1.7	3.4	
<b>Food industry***</b>									
Gross output	billion UAH	68.9	84.5	103.2	133.2	153.1	197.46	261.59	
	% aggregate output	12.0	12.3	11.3	11.6	11.1	10.8	10.6	
Gross value added	% GDP	7.9	8.2	4.2	7.8	8.3	7.5	7.3	
Value added / gross output	%	25.8	25.8	24.1	26.0	29.4	27.4	26.6	
Value added structure:									
	Employees labour remuneration	% aggregate output	24.7	25.5	34.1	39.5	32.9	28.1	27.1
	Profit, mixed income	% aggregate output	27.6	28.6	15.5	17.7	19.9	25.8	29.6
	Net taxes on production and import	% aggregate output	47.6	45.9	50.3	42.8	47.2	46.1	43.3
Employment	thousand persons	464	445	452	462	461	452		
	% total employment	3.8	3.8	4	4	4	3.9	3.9	
Average wage	UAH/month	423	496	597	780	986	1223		
Exports	billion UAH	8.96	12.25	16.73	16.13	16.27	25.92	31.4	
	% total exports	7.2	7.9	7.9	7.1	6.4	8.0	7.1	
	% output	13.0	14.5	16.2	12.1	10.6	13.1	12.0	
Imports	billion UAH	4.9	6.70	6.65	9.70	10.87	15.64	24.7	
	% total imports	4.3	4.5	3.6	4.3	4.0	4.3	4.7	
	% output	7.1	7.9	6.4	7.3	7.1	7.9	9.4	
Exports/imports	Index	1.83	1.83	2.52	1.66	1.50	1.66	1.28	

Source: own calculations based on data of the State Statistics Committee of Ukraine

Notes:

\*Agriculture, hunting, forestry and fishing, total output in actual prices

\*\* Including private households

\*\*\* In consumer prices

**Table A2-2. Output of main agricultural crops in Ukraine, 1990-2009**

million tons	1990-92	1995	1997	1999	2001	2002	2003	2004	2005	2006	2007	2008	2009
Cereals	42.7	33.9	35.5	24.6	39.7	38.8	20.2	41.8	38	34.3	29.3	53.2	46.0
Wheat	23.7	16.3	18.4	13.6	21.3	20.6	3.6	17.5	17.9	14	13.9	25.9	20.9
Maize	4.1	3.4	5.3	1.7	3.6	4.2	6.9	8.9	6.6	6.4	7.4	11.4	10.5
Rye	1.2	1.2	1.3	0.9	1.8	1.5	0.6	1.6	1.3	0.6	0.6	1.05	0.95
Oats	1.1	1.1	1.1	0.8	1.1	0.9	0.9	1	0.8	0.7	0.5	0.9	0.7
Barley	9.1	9.6	7.4	6.4	10.2	10.4	6.8	11.1	8.8	11.4	6	12.6	11.8
Sugar beet	36.4	29.7	17.7	14.1	15.6	14.5	13.4	16.6	15.6	22.4	16.9	13.4	10.1
Sunflower	2.3	2.9	2.3	2.8	2.3	3.3	4.3	3.1	4.3	5.3	4.1	6.5	6.4
Potatoes	17.5	14.7	16.7	12.7	17.3	16.6	18.5	20.8	19.5	19.5	19.1	19.5	19.7
Vegetables	6	5.9	5.2	5.3	5.9	5.8	6.5	7	7.3	8.1	6.8	8.0	8.3
Fruit and berries	2.2	1.9	2.8	0.8	1.1	1.2	1.7	1.6	1.7	1.1	1.5	1.5	1.6
Meat	3.9	2.3	1.9	1.7	1.5	1.6	1.7	1.6	1.7	1.7	1.9	19.7	11.6
Beef and veal	1.4	0.9	0.8	0.6	0.6	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.5
Pork	1.1	0.7	0.6	0.5	0.6	0.6	0.6	0.6	0.5	0.5	0.6	0.6	0.5
Poultry	0.6	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.5	0.7	0.8	0.9
Milk	22	17.3	13.8	13.4	13.4	14.1	13.7	13.8	13.8	13.4	12.3	11.8	11.6

Source: Authors' calculations based on data of the State Statistics Committee of Ukraine

### ANNEX 3. List of concessions on taxes and dues (compulsory payments)

*with calculation of the consolidated budget revenue losses caused by their provision in 2009 and expected losses for 2010*

Tax (due) / concession type	Estimated budget losses in 2009, ths UAH	Expected budget losses in 2010, ths UAH	Article/ paragraph of Law
<b>LAND FEE</b>			
during the validity period of the provisions of Ukraine's international treaties (agreements) ratified by the Parliament of Ukraine on space activities concerning creation of space equipment (including units, systems and parts for space complexes, carrier rockets, spacecraft, and ground segments of space systems), but no later than <b>1 January 2015</b> , resident space activity entities that received a license for such activities and take part in implementation of such treaties (agreements) – for production-purpose land plots according to a list to be approved by the Cabinet of Ministers of Ukraine (takes effect on 1 July 2009)	-	60 000.0	Article 12, part 1, para. 26
<b>until 1 January 2016</b> , land plots of aircraft-building entities subject to provisions of Article 2, Law of Ukraine on Development of Aircraft Industry, directly used for manufacture of end products, namely: aircraft, their bodies, engines including their storage sites (warehouses, hangars, parking places), landing strips, and places where fuelling (refuelling) and flight control points for motor aircraft are situated - 52 000.0 Article 12, part 1, para. 27	-	52 000,0	Article 12, part 1, para. 27
<b>Total</b>	0.0	112 000.0	
<b>VALUE-ADDED TAX</b>			
supplies of goods (raw and other materials, equipment and hardware), except for excisable goods and goods in groups 1-24 HS, that are procured at the expense of international technical aid funds and the State Budget of Ukraine, within the framework of preparation for withdrawal and of withdrawal of the Chernobyl NPP from service and of conversion of the Coverage facility into an environmentally safe system according to the Framework Agreement between Ukraine and the EBRD	2 892.2	3 355.0	11.23 para. 3
provisionally, <b>until 1 January 2016</b> , aircraft-building entities subject to provisions of Article 2, Law of Ukraine on Development of Aircraft Industry, for operations on: bringing (transferring) to Ukraine's customs territory under the customs regime of import (re-import) of goods, except for excisable goods, used for the aircraft-building industry's needs, if such goods are exempted from import duty according to paragraph "p", Article 19, Law of Ukraine on the Uniform Customs Tariff; supplies to Ukraine's customs territory of results of research and development works conducted for the aircraft-building industry's needs	-	140 000.0	11.34
operations on supply under the customs regime of import of goods specified in paragraph «я», first part, Article 19, Law of Ukraine on the Uniform Customs Tariff, within the limits set by the Cabinet of Ministers of Ukraine, provided that such goods are specifically used in the manufacture of space equipment (including units, systems and parts for space complexes, carrier rockets, spacecraft, and ground segments of space systems) by resident space activity entities that received a license for such activities and take part in realisation of such treaties (agreements) - during the validity period of the provisions of Ukraine's international treaties (agreements) ratified by the Parliament of Ukraine on space activities concerning creation of space equipment (including units, systems and parts for space complexes, carrier rockets, spacecraft, and ground segments of space systems), but no later than <b>1 January 2015</b>	-	43 000.0	11.47

Tax (due) / concession type	Estimated budget losses in 2009, ths UAH	Expected budget losses in 2010, ths UAH	Article/ paragraph of Law
operations: on import of goods specified by para. «я», «я1», first part, Article 19, Law of Ukraine on the Uniform Customs Tariff; on supply of equipment, machinery and hardware specified by Article 7, Law of Ukraine on Alternative Fuels, in the territory of Ukraine, from 1 January 2010, provisionally <b>until 1 January 2019</b>	-	1 333 000,0	5.18.4.
<b>Total</b>	<b>2 892.2</b>	<b>1 519 355.0</b>	
<b>EXCISE</b>			
<i>special-purpose motor cars for disabled persons, the cost of which is paid for by social security authorities, as well as special-purpose motor cars (ambulance and for the needs of the MoE units), the cost of which is paid for at the expense of state and local budgets (Law of Ukraine No. 2505 of 25.03.05)</i> <i>(!) before 31.03.05, the list was specified by the Cabinet of Ministers of Ukraine and covered also special-purpose motor cars for militia, Law of Ukraine No. 2505 of 25.03.05</i>	276.2	280.0	Article 5, part 4, CMU Decree 18-92
<b>Total</b>	<b>276.2</b>	<b>280.0</b>	
<b>IMPORT DUTY</b>			
goods (except excisable goods) imported into Ukraine's customs territory according to the Agreement between the Cabinet of Ministers of Ukraine and the Russian Federation Government on movement of goods in the framework of cooperation in space exploration, creation and operation of space rockets and rocket equipment	4588.9	5 323.1	Agreement between CMU and RF Government
<i>goods for technological parks' needs</i> <i>(!) cancelled on 31.03.05, Law of Ukraine No. 2505 of 25.03.05</i> <i>(!!) renewed since 3.02.06, Law of Ukraine No. 3333 of 12.01.06</i>	3070.1	3 561.3	Article 19, para. "к"
Materials, equipment and parts used to manufacture equipment working on unconventional and renewable energy sources that produces alternative fuels; energy-saving equipment and materials; articles operation of which provides saving and sustainable use of fuel and energy resources; means to measure, control and supervise consumption of fuel and energy resources; if identical goods with similar qualitative parameters are not manufactured in Ukraine.	55452.7	64 325.1	Article 19, para. «ч», «щ»
<b>until 1 January 2015</b> - goods that, within the framework of Ukraine's international treaties (agreements) ratified by the Parliament of Ukraine on space activities concerning creation of space equipment (including units, systems and parts for space complexes, carrier rockets, spacecraft, and ground segments of space systems) are imported by resident space activity entities to Ukraine and are categorised by HS codes	-	12 000.0	Article 19, para."я"
from <b>1 January 2010 to 1 January 2019</b> – equipment, machinery and hardware used to reconstruct existing enterprises and build new enterprises for production of biofuels and for manufacture and reconstruction of technical and transport means in order to consume biofuels categorised by HS codes specified in Article 7, Law of Ukraine on Alternative Fuels unless such goods are produced or have analogs in Ukraine.	-	190 000.0	Article 19 para.»я»
until 1 January 2016 – goods imported under the customs regime of import (re-import) by aircraft-building entities subject to Article 2, Law of Ukraine on Development of the Aircraft-Building Industry, by HS	-	47 000.0	Article 19 para. «р»
<b>Total</b>	<b>63 111.7</b>	<b>322 209.6</b>	
<b>TOTAL LOSS</b>	<b>66 280</b>	<b>1 953 845</b>	

Source: based on data of the Ministry of Finance (as estimated on the basis of the STAU reporting data on privileged taxation volumes (9 months of 2009) and of the SMSU reporting data on the amounts of conditionally charged customs payments (2009))

The **Blue Ribbon Analytical and Advisory Centre (BRAAC)** is a project funded by European Union, co-funded and implemented by UNDP. The Centre is an independent institution that adheres in its activities to the principles of free and democratic market economy. It combines in-house expertise with that of leading national and international experts, and think-tanks. The Centre strengthens the national capacity in policy formulation and implementation by working with government officials and coordinates its activities with other donor organizations to ensure efficient use of resources. The Centre facilitates the emergence of public-private partnerships in the development of key policy measures, thereby providing a voice for civil society in the decision-making process. For more information on Centre's activity please visit Centre's website <http://brc.undp.org.ua> or call **+380 44 253 58 66**



**United Nations Development Programme**

Regional Centre for Europe and the CIS

Grosslingova 35

811 09 Bratislava

Slovak Republic

Tel: +421 2 5933 7111

Fax: +421 2 5933 7450

<http://europeandcis.undp.org>