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July 11, 2005

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Case No. A-823-812

PUBLIC DOCUMENT

BY HAND DELIVERY

Joseph A. Spetrini
Acting Assistant Secretary for Import Administration
U.S. Department of Commerce
Central Records Unit
Room 1870
Pennsylvania Avenue and 14th Street, NW
Washington, DC 20230

Re: Comment on the Status of Ukraine as a Non-Market Economy Under the Antidumping and Countervailing Duty Laws

Dear Mr. Spetrini:

On behalf of the Rebar Trade Action Coalition ("RTAC"), and its individual members, we submit these comments in opposition to possible revocation by the Department of Commerce ("the Department") of the Non-Market Economy ("NME") status of Ukraine. Application of the six-factor test, as stated in 19 U.S.C. § 1677 (18)(B), conclusively demonstrates that Ukraine continues to merit NME treatment. Accordingly, the Department should not alter Ukraine's designation as a nonmarket economy at this time.

Please find attached an original and six copies of our comments. Additionally and as per the Department's request, we hereby submit an electronic copy of the text of our comments on a CD-ROM.

Please contact the undersigned if you have any questions regarding this submission.

Respectfully submitted,

Alan H. Price
Timothy C. Brightbill

Counsel to the Rebar Trade
Action Coalition

WRFMAIN 12354068.1

CERTIFICATE OF SERVICE

PUBLIC

Carbon And Certain Alloy Steel Wire Rod from Ukraine
Changed Circumstances Review, A-823-812

I certify that a copy of this document was served on the following parties, via hand delivery service, on July 11, 2005.

On behalf of the Embassy of Ukraine:

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BEFORE THE
UNITED STATES INTERNATIONAL TRADE COMMISSION

Inquiry Into the Status of Ukraine as a Non-Market Economy Country Under the Antidumping and Contervailing Duty Laws	Inv. No. 823-812 Total Pages: 37 Investigation Contains No Business Proprietary Information **PUBLIC DOCUMENT**

COMMENTS OF THE REBAR TRADE ACTION COALITION

Alan H. Price
Timothy C. Brightbill

On Behalf of the Rebar Trade Action Coalition and its individual members

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July 11, 2005

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I. EXECUTIVE SUMMARY AND PRIORITY ISSUES

On behalf of the Rebar Trade Action Coalition[1] and pursuant to the Department's notice of initiation and request for comments,[2] we hereby submit comments on whether Ukraine should continue to be treated as a non-market economy for purposes of the antidumping law.

This is an extremely important inquiry for RTAC. In response to petitions filed by the Coalition, the Commerce Department and the International Trade Commission found Ukrainian rebar to be dumped in the United States, and found material injury to the domestic industry as a result of those (and other) dumped imports. Currently, Ukrainian rebar is subject to antidumping duties of 41.69 percent. These antidumping orders have played an important role in the domestic industry's recovery, although other factors (such as global overcapacity and subsidies) continue to threaten the domestic rebar industry. The Ukrainian dumping margin, which is not excessive or prohibitive, was calculated using the Department's non-market economy methodology.

As set forth in detail below, Ukraine's non-market economy status should not be revoked at this time. Although Ukraine is no longer a centrally planned, communist-styled economy, it is neither a free market system. We provide additional comments pursuant to the Department's revocation criteria below. In addition, RTAC also concurs in full with the separate comments filed by the American Iron and Steel Institute.

Unfortunately, it appears as if the Department has already made its decision in this matter, prior to its usual review of the required revocation criteria. In two April 6, 2005, news articles, one carried by the BBC and one in the "Ukraine Business Report," Secretary Gutierrez

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1 RTAC includes the following domestic producers of rebar: Nucor Corp., Gerdau Ameristeel, CMC Steel Group, and TAMCO.

2 *Carbon and Alloy Steel Wire Rod from the Ukraine,* 70 Fed. Reg. 21396 (Apr. 26, 2005); 70 Fed. Reg. 34744 (June 15, 2005).

"has expressed confidence that the US government will recognize Ukraine as a market economy."[3] Indeed, the Ukraine Business Report article is titled: "US Secretary of Commerce Says His Country is Sure to Grant Market Economy Status to Ukraine."[4]

While we certainly recognize the historic nature of the Orange Revolution, and the remarkable, historic events that ushered in President Yushchenko, these events should not unduly influence the Department's analysis of Ukraine's market status, nor should they preclude the Department's typical analysis.

Of all the issues and factors that the Department must consider, the Coalition believes that three are of paramount importance. We respectfully submit that these issues must be addressed prior to revoking Ukraine's non-market economy status, and prior to its accession to the World Trade Organization.

First, the government continues to grant subsidies to or maintain price controls over many industries, including key segments of Ukraine's manufacturing sector. As the U.S. Agency for International Development pointed out this year, "the extensive network of direct government subsidies and implicit taxes, continue to distort the efficient allocation of resources."[5] According to Commission of European Communities, in the 2004 budget, the following industries were allocated government subsidies: domestic book printing, coal mining, space industry, agriculture, and aircraft construction. Moreover, loss-making enterprises or sectors are often "supported by the government through tax exemptions or other tax privileges,

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3 "U.S. Trade Secretary Backs Market Economy Status for Ukraine," BBC Monitoring International Reports (Apr. 6, 2005).

4 "U.S. Secretary of Commerce Says His Country Is Sure to Grant Market Economy Status to Ukraine," Ukraine Business Report (Apr. 6, 2005).

5 *See* http://www.usaid.gov/policy/budget/cbj2005/ee/ua.html

tolerance of tax arrears and, occasionally, the granting of tax amnesties."[6] Among these industries, the coal-mining sector, which consists of "a large number of unprofitable mines," is "heavily subsidi{z}ed by the government."[7]

Price control still occurs in many sectors of Ukraine's economy, most notably in several strategic sectors and communal services. Tariffs for communal services (such as gas, electricity, heating, and rents) are still subject to "administrative control and remain in some cases significantly below economic cost recovery levels."[8] In the energy sector, the government "fixes the price of nuclear and hydro generation supply."[9] Energy subsidies plainly benefit all of Ukraine's manufacturing economy, artificially reducing the production costs of every producer.

Price control has also been used as a macroeconomic tool by the central government to curb inflation. Tymoshenko, the newly appointed prime minister, is a strong advocate of a strong state role in key markets and has herself used temporary price caps on petrol to keep down inflation.[10] For example, Russian oil companies TNK-BP, Lukoil and Alliance Group had to face price caps on petrol in April to May.[11] In an emergency conference in Kiev attended by government representatives from both Ukraine and Russia on May 19, 2005, Yushchenko

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6 Commission Staff Working Paper of Commission of the European Communities, European Neighbourhood Policy, Country Report: Ukraine at 16 (May 12, 2004).

7 *Id.*

8 Commission Staff Working Paper of Commission of the European Communities, European Neighbourhood Policy, Country Report: Ukraine, at 16 (May 12, 2004).

9 Ukraine Country Analysis Brief at www.eia.doe.gov/emeu/cabs/ukraine.html.

10 Tom Warner, "Investors remain cautious UKRAINIAN POLITICS: Tom Warner on the deflation of expectations in Kiev," Financial Times, (May 16, 2005).

11 Stefan Wagstyl and Tom Warner, "Kiev struggles to draw in foreign investors: Uncertainty over economic policy has unsettled business sentiment," Financial Times, (June 15, 2005).

himself criticized Tymoshenko for "resorting to 'administrative, non-market' methods, such as price controls and anti-cartel investigations, to deal with the price escalation by Russian companies" in the oil industry.[12] Although Yushchenko announced the cancellation of government-imposed price ceilings during the conference, both governments agreed to "regulate prices temporarily, at levels substantially lower than those ceilings."[13] Prices per liter on the Ukrainian market were set at 3.2 hryvnias and 3 hryvnias, respectively, for two types of high-octane gasoline, and 2.85 hryvnias for diesel fuel. Price fluctuations are to be allowed within a 3% corridor.[14]

We strongly urge that the U.S. Government continue to emphasize that WTO membership and revocation of non-market economy status will not occur until after Ukraine has committed to a comprehensive plan for elimination of these market-distorting subsidies, particularly in the energy sector.

Second, Ukraine also subsidizes its domestic steel manufacturers by imposing duties on the export of steel scrap. The Ukrainian government levies substantial taxes on exports of steel scrap, maintaining a 30-euro per ton tax on ferrous scrap and a complete ban on the export of non-ferrous metal scrap.[15] As a result, Ukrainian steel producers are currently enjoying scrap prices that are substantially below global market prices. In addition, these barriers restrict the

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12 Vladimir Socor, "RUSSIAN-UKRAINIAN OIL SUMMIT: AN UNEASY, FLEETING COMPROMISE," at http://www.jamestown.org/edm/article.php?article_id=2369784.

13 *Id.*

14 *Id.*

15 "U.S. Presses Scrap Export Tax Complaints in WTO Accession Talks," Inside U.S. Trade (Oct. 8, 2004), *available at* http://www.insidetrade.com/secure/dsply_nl_txt.asp?f=wto2001.ask&dh=161352302&q=scrap.

flow of steel scrap out of Ukraine, driving up the level of scrap exports and the price of scrap in other countries – such as the United States. According to USTR:

> This export duty has contributed to a decline in scrap exports from Ukraine, at a time when global demand and prices for steel scrap are rising. The export tax provides an artificial advantage to Ukrainian steel producers by increasing domestic steel scrap supply, providing producers with an unfair advantage in Ukraine and in third markets.[16]

The United States has pressed Ukraine on multiple occasions to eliminate its scrap export tax as a precondition to the country's accession to the World Trade Organization. We greatly appreciate the U.S. Government's willingness to pursue this issue aggressively. <u>However, to date the Ukrainian government has stonewalled all requests to reduce or eliminate the scrap export tax.</u> In fact, on July 6, AMM reported that the Ukrainian parliament has removed from its agenda draft legislation to lower the scrap export duty, allegedly because "the ferrous scrap export tariff has been dropped from the requirements that Ukraine must meet before it can join the World Trade Organization."[17] We understand that the Office of the U.S. Trade Representative strongly disagrees with this claim and is continuing to pursue complete elimination of the duty. We strongly urge that the U.S. Government continue to emphasize that WTO membership and revocation of non-market economy status will not occur until after the total elimination of scrap and other raw material export duties. This should be an absolute requirement; if the United States gives ground to Ukraine on this issue, it will simply undermine its own position (and that of the European Union) in the WTO non-agricultural market access negotiations, where the United States and the EU are seeking to eliminate all raw material export taxes.

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16 United States Trade Representative, 2004 Nat'l Trade Estimate Report on Foreign Trade Barriers – Ukraine at 476, 480 (Apr. 1, 2004).

17 "Ukraine delays action on reducing export duty," AMM, July 6, 2005.

Third, Ukraine's privatization process has failed to affect many of Ukraine's business sectors, and privatization efforts have been tainted by scandals, corruption, and non-market forces, as demonstrated by the infamous "fire sale" of Kryvorizhstal, the country's largest steel mill, to former government officials, despite much higher bids from commercial investors. President Yushchenko, after taking office, accused steel owners of having exploited "personal ties to the former government to acquire assets from the state worth billions at knock down prices."[18] Kryvorizhstal has since been re-nationalized, typifying the government's questionable commitment to privatization going forward. So long as state ownership of the means of production remains the norm, Ukraine simply cannot be considered a market economy.

[18] Tom Warner, "Vital industry faces up to trying times METALS: Metallurgy sector troubles could affect the entire economy, says Tom Warner," Financial Times, (June 1, 2005).

II. INTRODUCTION AND BACKGROUND

Under U.S. law, the term non-market economy refers to any country determined not to operate on market principles of cost or pricing structures, so that sales of merchandise in such a country do not reflect the fair value of merchandise.[19] Extensive direct and indirect government involvement in production, price, and output decisions; state control of the means of production; governmental restriction on the convertibility of currency; the lack of legitimate free bargaining between labor and management; and the limited amount of foreign capital through joint ventures or direct investments demonstrate conclusively that Ukrainian prices do not represent fair value. Accordingly, the Department of Commerce should reject Ukraine's request for revocation of its non-market economy status.

Ukraine recently experienced a dramatic political transformation in what is commonly referred to as the "Orange Revolution." While the political events that ushered in President Yushchenko are remarkable, they should not unduly influence the Department's analysis of Ukraine's market status. Analyzing Ukraine's NME status must follow the six factors provided in the statute. While Ukraine's steps toward democracy are laudable, it is apparent that once the six required factors are analyzed, either individually or collectively, Ukraine should retain its non-market economy status.

Although Ukraine is no longer a centrally planned, communist-styled economy, it is neither a free market system. As concluded by a State Department report:

> Much remains to be done to achieve full economic liberalization. Ukraine's economy is still shackled by corruption, poorly developed rule of law, over-

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[19] 19 U.S.C. § 1677(18)(A).

regulation and excessive government interference in what should be private business decisions.[20]

This sentiment was echoed in the 2005 Index of Economic Freedom survey, which concluded that Ukraine was economically "mostly unfree."[21] Additional rankings underscore the conclusion that Ukraine is not a fully functioning market or democracy. For example, Ukraine ranks 129 out of 150 in the World Democracy Audit and is tied with Syria, Angola and China.[22] Ukraine is also 112 out of 149 in press freedom and behind countries such as Yemen, Lebanon, and Angola.[23]

Corruption is also a major concern in contemporary Ukraine because it is a pervasive fact of life that impacts "ninety-nine percent of Ukrainian citizens".[24] Corruption is of primary concern because of its ability to stifle market reforms and hinder privatization campaigns.[25] According to Transparency International's 2004 ranking of corrupt nations, Ukraine ranks 128 out of 146, right between Sudan and Cameroon.[26] Corruption has disrupted Ukrainian economic life in a way that impacts every aspect of the economy evaluated by the Department in this inquiry and must be considered a major problem.

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20 Ukraine: 2005 Investment Climate Statement, U.S. Department of State, see Restrictions on Converting/Transferring Funds (last visited July 6, 2005), http://www.state.gov/e/eb/ifd/2005/43044.htm.

21 Heritage Foundation, available at http://www.heritage.org/research/features/index/country.cfm?id=Ukraine, (last visited July 6, 2005).

22 http://www.worldaudit.org/democracy.htm (last visited July 6, 2005).

23 http://www.worldaudit.org/press.htm (last visited July 9, 2005).

24 "Yushchenko Pledges to Fight Corruption," Associated Press, (Jan. 2, 2005).

25 Kjetil Bjorvatn and Tina Soreide, "Corruption and Market Reform," http://www.nhh.no/sam/res&publ/2003/06.pdf, (May 6, 2003).

26 *Id.*

In determining whether a country merits NME treatment, the Department considers the following factors: (i) the extent to which the currency of the foreign country is convertible into the currency of other countries; (ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management; (iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country; (iv) the extent of government ownership or control of the means of production; (v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises; and (vi) such other factors as the administering authority considers appropriate. No single factor is dispositive and the Department may use discretion in its analysis based upon the unique facts of each case.[27]

As discussed more thoroughly below, Ukraine maintains restrictions on its currency, resists the rights of its workers to organize, limits the amount for foreign investments in various ways, controls the means of production, and significantly interferes in price and production decisions. Thus, an objective consideration of the factors listed above demonstrates that Ukraine is not yet a market economy.

Additionally, we note that Ukraine has requested market economy status prior to its WTO accession. But the process should proceed in the opposite order. China's accession is a useful model – China acceded to the WTO in 2001, but continues to be considered an NME in light of its current status and economic development. China's continuing NME status remains an important means of encouraging compliance with the WTO accession commitments it has already made. Ukraine should be treated in a similar manner.

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[27] *See, e.g.*, Antidumping Duty Investigation of Certain Steel Concrete Reinforcing Bars From Latvia, *Memorandum from Holly A. Kruga to Troy H. Cribb: Non-market Economy Status Revocation* (Jan. 12, 2001).

III. UKRAINE RESTRICTS CONVERTIBILITY OF ITS CURRENCY

Summary of Comment

The extent of convertibility for Ukraine's currency, the hryvnia, does not warrant changing its non-market status. While the currency has been stable because it essentially is fixed to the U.S. dollar,[28] Ukraine has overly burdensome administrative requirements and actively manipulates its currency markets. Additionally, Ukraine has significantly restricted conversion in the recent past and is likely to do so again during a future economic crisis.[29]

Discussion

In evaluating "the extent to which the currency of a foreign country is convertible into the currency of another,"[30] the Commerce Department has focused on currency conversion for investment as well as trade purposes.[31] Such a focus is relevant because integration into world markets is highly dependent on linking domestic market prices to world market prices.[32] Therefore, in considering this factor, it is important to consider how Ukraine's conversion laws apply to foreign investors.

Ukraine has recently passed regulations that complicate currency conversions for foreign investors. In April 1996, the "Foreign Investment Law" went into effect and guaranteed the

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28 Ralf Wiegert, "Ukraine Considering Hryvnia Float," World Markets Research Centre, (Mar. 15, 2005).

29 "Ukraine risk: Foreign Trade and Payments Risk," Economist Intelligence Unit RiskWire, (Mar. 3, 2004).

30 19 U.S.C.S. §1677(18)(B) (2005), §771(18)(B) of the Tariff Act of 1930.

31 Issues and Decisions Memorandum for Faryar Shirzad, "Inquiry into the Status of the Russian Federation as a Non-Market Economy Country Under the U.S. Antidumping Law" at Analysis of Section 771(18)(B) Factors (June 6, 2002).

32 *Id.*

"unhindered transfer" of profits, revenues and other proceeds in foreign currency.[33] However, the notion of "unhindered transfer" was recently limited under the National Bank of Ukraine's (NBU) Resolution 482 effective November 12, 2004. That resolution required hard currency brought into the country from foreign investment funds to be converted into hrynvia via special commercial bank accounts.[34] The result of this resolution was to require all foreign investment to be conducted in hrynvia.[35] This resolution also stipulated that all payments to foreign investors be made in hryvnia to the investor's account in Ukraine.[36] While the banks can then convert the hryvnia into another currency for repatriation, this new regulation has limited currency conversion by increasing the difficultly and cost for investors. The result is a troubling example of how Ukraine has recently taken steps to limit conversion by increasing its difficulty.

Ukraine has other administrative roadblocks whose effect is to impact currency conversion. The NBU requires review of any transaction that sends more than $50,000 in hard currency out of the country.[37] Regulations also require that to purchase hard currency, companies must: 1) provide their bank with a copy of the foreign trade contract, and, 2) for contracts exceeding $10,000, obtain a permit from the State Tax Administration.[38] If the contract exceeds $500,000, the bank must announce the client's intention to sell on the Ukrainian

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33 Ukraine: 2005 Investment Climate Statement, U.S. Department of State, see Restrictions on Converting/Transferring Funds (last visited July 6, 2005), http://www.state.gov/e/eb/ifd/2005/43044.htm.

34 *Id.*

35 *Id.*

36 *Id.*

37 *Id.*

38 *Id.*

Interbank Currency Exchange (UICEX).[39] Such requirements add to the difficulty and complexity of converting currency in Ukraine.

The government also limits currency conversion by setting exchange rates and then only permitting a 2 percent deviation from that official rate on the UICEX.[40] The market is also limited by a government rule that restricts the range of purchase and sale exchange rates to 10 percent.[41] Setting exchange rates and restricting trading ranges enables currency markets to be manipulated and allows Ukraine to limit the extent to which its currency is convertible.

Since the hryvnia was issued in 1996, Ukraine has imposed various restrictions on its convertibility, many of which were introduced following the Russian financial crises of 1998.[42] One major and long-standing restriction was a 50% foreign export earnings conversion requirement.[43] This requirement allowed Ukraine to limit the influx of foreign currency into its domestic market and was a significant impediment to converting currency.[44] While this requirement was reportedly rescinded in April 2005,[45] it demonstrates the extent to which Ukraine will control currency conversion. Ukraine's long history of limiting currency conversion should give the Commerce Department pause when reviewing the extent to which

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39 *Id.*

40 As of October 2004. Ukraine: 2005 Investment Climate Statement, U.S. Department of State, see Restrictions on Converting/Transferring Funds (Last viewed on July 6, 2005), http://www.state.gov/e/eb/ifd/2005/43044.htm.

41 *Id.*

42 "Ukraine risk: Foreign Trade and Payments Risk," Economist Intelligence Unit RiskWire, (Mar. 3, 2004).

43 *Id.*

44 *Certain Cut-to-Length Carbon Steel Plate From Ukraine*, 62 Fed. Reg. 61754, 61755, (Nov. 19, 1997) (final).

45 "Ukraine: Currency Forecast," Economist Intelligence Unit ViewsWire, (Apr. 15, 2005).

Ukraine's currency is convertible because, based on its past actions, Ukraine is likely to impose significant restrictions should a future economic issue develop. Moreover, it is not yet clear whether the rescission of the 50% foreign export earnings conversion requirement has led to any practical change in terms of currency convertibility or the investment climate in Ukraine. The Commerce Department should determine the status of an economy based not only on its current structure, but also with consideration for how it might change, especially in cases where restrictions have only recently been lifted. While Ukraine has taken steps towards a market-based economy, one must question whether these steps are permanent and consider the likelihood such restrictions will reappear.

In conclusion, foreign investors face increased administrative hurdles to complete currency conversion transactions. While progress has been exhibited, current regulations and the track record dictate that Ukraine should retain its non-market status.

IV. UKRAINIAN WAGE RATES ARE NOT DETERMINED BY FREE BARGAINING BETWEEN LABOR AND MANAGEMENT

Summary of Comment

Worker wages in Ukraine are not determined by free bargaining between labor and management. Ukraine's hostility towards unions, and its ongoing problems with nonpayment of wages indicate that Ukraine remains a non-market economy. According to a recent report by the Department of State, "Ukraine's economy is still shackled by corruption, poorly developed rule of law, over-regulation and excessive government interference in what should be private business decisions."[46]

Discussion

Ukraine's heavy involvement in the setting of wage rates, and its resistance to organized and independent labor, have prevented market forces from freely establishing wage rates. The Department of Commerce reaffirmed Ukraine's status as a non-market economy as recently as 1997. At that time, the Department considered the extent to which wage rates in Ukraine are determined without excessive involvement by the government and concluded, "the government continues to be heavily involved."[47] The Ukrainian government was found to be heavily involved because it mandated the use of a Tariff Rate System that set wage levels for jobs according to the complexity of the job and the qualifications of the workers.[48] Even non-state

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46 2005 Investment Climate Statement-Ukraine, U.S. Department of State, (last visited July 6, 2005) at http://www.state.gov/e/eb/ifd/2005/43044.htm.

47 *Certain Cut-to-Length Carbon Steel Plate From Ukraine*, 62 Fed. Reg. 61,754, 61,755 (Nov. 19, 1997) (final).

48 *Id.*

owned enterprises had to conform to this system.[49] Furthermore, the government regulated both the form and the place of payment of wages.[50] These laws are still in effect.[51] The Ukrainian government still utilizes the Tariff Rate System, and the government continues to regulate the form and place of payment. There has been no change since 1997 that justifies an outcome contrary to the 1997 decision with respect to the level of government involvement in the regulation of wages.

Consistent with the heavy involvement by the Ukrainian government in wage rates is the determination made by the World Bank that Ukraine's employment structure is significantly more rigid than the average system in the region.[52] Ukraine scored worse than average in the region on the Difficulty of Hiring Index, the Rigidity of Hours Index, and the Difficulty of Firing Index, to produce an overall low score on the Rigidity of Employment Index. In fact, Ukraine is ranked by the World Bank as having one of the twenty-five most rigid employment systems in the world.[53] This rigidity precludes a finding that the Ukraine allows for the free establishment of wage rates.

In addition to direct involvement in establishing rates, Ukraine continues to oppose organized labor. While the right to create and join trade unions is guaranteed by law, trade

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49 *Id.*

50 *Id.*

51 Law of Ukraine, On Remuneration of Labor, No. 108/95-BP (1995).

52 Snapshot of Business Environment – Ukraine, World Bank, available at http://rru.worldbank.org/DoingBusiness/ExploreEconomies/BusinessClimateSnapshot.aspx?economyid=194. The Rigidity of Employment Index is an average of three indices, the Difficulty of Hiring Index, Rigidity of Hours Index, and the Difficulty of Firing Index. These, respectively, measure how difficult it is to hire a new worker, how rigid the regulations are on working hours, and how difficult it is to dismiss a redundant worker. Each index assigns values between 0 and 100, with higher values representing more rigid regulations. This methodology is based on that found in originally developed in "The Regulation of Labor" by Juan Botero, Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, Quarterly Journal of Economics, November 2004.

53 *Id.*

unions are nevertheless discriminated against in practice.[54] The hostility extends both towards labor unions as a group and individual members. Under Ukraine's Civil Code, all trade unions are required to register with the Minister of Justice, who may deny registration.[55] Even prior to the new Code, when approval was mandatory, many groups claimed that the Minister of Justice used extensive document requests to delay and harass.[56] In some areas, the lack of new unions prevents workers from using collective bargaining at all.[57]

Leaders of independent trade unions have recently noted increased hostility and harassment as well.[58] The International Labor Organization found that individual members of trade unions were "intimidated, put under pressure to leave trade unions, suffer wage arrears, or {were} transferred to positions that do not correspond with their skills."[59] The government is also involved in this intimidation. The Independent Trade Union of Miners in Ukraine (ITUMU) reported that law enforcement officials destroyed trade union offices throughout the country.[60] On the other hand, unions associated with the Federation of Trade Unions (FPU), which maintains strong ties with the government and works closely with management, are favored.[61]

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54 2004 Ukraine Annual Survey of Violations of Trade Unions Rights, International Labor Organization, available at http://www.icftu.org/displaydocument.asp?Index=991219470&Language=EN.

55 State Dept. Report on Human Rights (Feb. 28, 2005).

56 *Id.*

57 *Id.* (noting that approximately 90,000 people work in the eleven export processing zones but do not have access to unions).

58 *Id.*

59 2004 Annual Survey of Violations of Trade Union Rights.

60 *Id.*

61 *Id.*

Collective bargaining is prejudiced in favor of FPU as opposed to independent unions.[62] These factors prevent labor from freely bargaining with management to determine market-based wages.

Significant wage arrears also continue to plague Ukraine. Even though 2004 saw more improvement in this area than ever before, through May 2005 wage arrears had increased by 16 percent.[63] The problem was particularly acute for coal miners, who threatened to strike in May 2005 due to massive arrears. Their wage arrears had exceeded UAH 300 million by May 5.[64] Because workers are not even receiving wages they are entitled to, it cannot be said that they are freely negotiated. The threats of strike also reveal that the state of affairs in Ukraine is not yet sufficiently stable to warrant a finding that wage rates are freely negotiated between labor and management.

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62 *Id.*

63 "Papiev Points to High Rate of Paying Back Wage Arrears in 2004," Ukraine Business Report, (Dec. 2004); "Wage Arrears Growth Slows to 1%," Ukraine Business Report, (May 10, 2005).

64 "Coal Miners' Union Ready for Strike", Ukraine Business Report, (May 7, 2005).

V. UKRAINE MAINTAINS SERIOUS INSTITUTIONAL BIASES AGAINST FOREIGN INVESTMENT

Summary of Comment

In Ukraine, foreign investors must deal with written or unwritten rules that discriminate against foreign investment, and must operate in a system that lacks process, predictability, transparency and integrity. Moreover, the Government of Ukraine often changes the foreign investment rules in a capricious manner, often without notice or even acting contrary to prior commitments. In a country where seeking legal recourse is extremely difficult, foreign investors have traditionally shunned from, and still hesitate about investing in Ukraine.

Discussion

Foreign investors continue to face serious barriers while investing in Ukraine. The U.S. Trade Representative has found that "an underdeveloped banking system, poor communications networks, a difficult and frequently changing tax and regulatory climate, crime and corruption, and a weak legal system create major obstacles to U.S. investment in Ukraine."[65] Under such an environment, it is not surprising that Ukraine still lags far behind in foreign direct investment levels as compared to its neighbors, with only 7 to 8 billion U.S. dollars of total cumulative foreign investment since its independence, which is the equivalent amount of *annual* foreign investment in Poland.[66] The small amount of foreign investment in Ukraine does not come from

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65 United States Trade Representative 2005 National Trade Estimate Report on Foreign Trade Barriers at http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/2005_NTE_Report/asset_upload_file558_7504.pdf, page 631.

66 Jorge E. Intriago, "Ukraine – Investment Potential," PricewaterhouseCoopers, there has been the long perception that "foreign investors were not playing in a level-playing field" at http://www.pwcglobal.com/extweb/pwcpublications.nsf/docid/8E86DAD9C16992608025 7007004F8468 (last visited July 11, 2005).

varied sources: 55% of the total is Russian capital coming in via other countries.[67] According to *Financial Times*, foreign investments have not increased even after Ukraine's Orange Revolution, with people only "coming to Kiev to investigate the potential," but few willing to "put down hard cash."[68] Even Oleksander Zinchenko, Ukraine's newly appointed state secretary, could not hide his disappointment with the recent development in foreign investment, "It is slower that we hoped."[69]

In its most recent analysis of foreign investment barriers, the U.S. Trade Representative has commented on Ukraine's strong institutional bias toward supporting domestic industries and discriminating against foreign companies.[70] The foremost instance concerns rules governing payment of the Value Added Tax (VAT). The accumulation of VAT refund arrears has affected some foreign investors in Ukraine, and the rules concerning VAT also discriminate against foreign companies and domestic firms with foreign investment.[71] Whereas Ukrainian firms may use promissory notes upon importation of goods for re-export as a form of payment (with notes cancelled upon re-exportation), foreign firms have to wait from six to eighteen months to obtain refund of VAT payments.[72] More importantly, Ukraine, under the newly elected government,

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67 Elena Zvereva, "Yushchenko's Problems," Moskovskii Komsomolets, No. 55, (Mar. 16, 2005).

68 Kiev struggles to draw in foreign investors: Uncertainty over economic policy has unsettled business sentiment, by Stefan Wagstyl and Tom Warner, Financial Times, June 15, 2005.

69 *Id.*

70 *See also*, PricewaterhouseCoopers, "Ukraine – Investment Potential."

71 United States Trade Representative 2005 National Trade Estimate Report on Foreign Trade Barriers at 631.

72 *Id.*

adopted a budget law in March that "broadened the application of value-added tax and applied the changes retroactively."[73]

The process of foreign investment in Ukraine continues to lack clear procedures, although the rules give an appearance of a "relatively level playing field."[74] In the eyes of the U.S. government, "clear qualification requirements for investors need to be established, and recognition of procedures and financial information need to be more public, complete, and timely."[75] Although companies are frequently slated for privatization, the process is hampered by "unclear, non-transparent and changing regulations" and "heavy political interference that practically excluded foreign investors from participating in privatization."[76] This is evident in the privatization of Ukraine's largest steel mill in June 2004, where it was sold to government-backed investors for much less than bids presented by a group of foreign investors.[77] It is also unrealistic to expect that the macroeconomic environment for foreign investment in Ukraine will improve with the recent change of government. According to Jorge Zukoski, president of Kiev's American Chamber of Commerce, in spite of Mr Yushchenko's strong statements on foreign investment, his government had made many contradictory decisions that had baffled people about his administration's commitment.[78] Francis O'Donnnell, UN Resident Coordinator in

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[73] Stefan Wagstyl and Tom Warner, "Kiev struggles to draw in foreign investors: Uncertainty over economic policy has unsettled business sentiment," Financial Times, (June 15, 2005).

[74] United States Trade Representative 2005 National Trade Estimate Report on Foreign Trade Barriers at 632.

[75] *Id.*

[76] *Id.*

[77] *Id.*

[78] Stefan Wagstyl and Tom Warner, "Kiev struggles to draw in foreign investors: Uncertainty over economic policy has unsettled business sentiment," Financial Times, (June 15, 2005).

Ukraine, recently commented on the lack of transparency of the new government, stating "Sometimes it seems that there is less information than it could be with the former government."[79] Based on the results of a three-day forum attended by foreign experts on the issue of reforms in Ukraine, O'Donnell also noted that macroeconomic forecasts of the Ukrainian government are too optimistic and the privatization process is still so uncertain as to impede inflows of foreign investment in Ukraine.[80]

As stated, one key factor preventing foreign investor confidence in Ukraine is the unstable legal system. As the U.S. government has noted, there are "frequent changes in tax laws and regulations, such as import duties and excise taxes, often with little advance notice, giving companies little time to adjust to new requirements."[81] Furthermore, tax filing and collection procedures still vary significantly from those in western countries.[82] As PricewaterhouseCoopers has noted, all these changes in laws and regulations were totally unexpected because they were not discussed or consulted with the private sector.[83] Under such a system, investors "naturally feel uncertain as to whether the assumptions made at the beginning of an investment project will hold true for the life of the project, and thus whether all other things being equal, the expected results of the project will be accomplished."[84] The same applies to the transparency of the legal process. As PricewaterhouseCoopers has remarked, the country still

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79 Macroeconomic Forecasts of Ukrainian Government for 2005 Too Optimistic, Experts Say. Ukraine Business Report April 27, 2005.

80 *Id.*

81 United States Trade Representative 2005 National Trade Estimate Report on Foreign Trade Barriers at 632.

82 *Id.*

83 PricewaterhouseCoopers, "Ukraine – Investment Potential."

84 *Id.*

needs to build an independent and powerful judiciary to improve the level of enforceability and transparency of the legal system.[85] Another commentator summarized the effect of this unstable system on foreign investment recently:

> The legal process is not independent and the judiciary is easily cowed by vested interests. Contracts are difficult to enforce and regulation is neither impartial nor clear. Although it is possible for foreign firms to win court cases, particularly at the higher levels, the judicial process remains slow and inefficient. Powerful local players who have successfully excluded foreign capital dominate Ukraine. The risk that foreign investors' assets will de facto be expropriated is low, but recent examples of this exist. The outgoing government's record on promoting competition and restraining unfair competitive practices was poor. Although the new government is much more committed to a level playing field, reforming the old system will take a while. Private property are still not well protected. Local accounting standards are well below accepted levels in the EU and the U.S.[86]

PricewaterhouseCoopers has noted a recent *deterioration* in the Ukrainian government's ability to honor its commitments, such as earlier tax benefits promised with the aim of attracting foreign investors.[87] For example, the tax holidays granted in the Free Economic Zones were even cancelled before the expiration of their term.[88] Verkhovna Rada Chairman Volodymyr Lytvyn commented that such abandonment of prior commitments entail "changing the rules of the game" and "will not improve the investment climate." He further noted that the current situation with foreign investment in Ukraine is "simply catastrophic."[89]

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85 PricewaterhouseCoopers, "Ukraine – Investment Potential."

86 Executive Briefing Ukraine: Market Profile and Industry Forecasts, 11/04 (3/05), Business Information Service for the Newly Independent States at http://www.bisnis.doc.gov/bisnis/bisdoc/Executive%20BriefingUkraine.htm (last visited July 11, 2005).

87 PricewaterhouseCoopers, "Ukraine – Investment Potential."

88 *Id.*

89 "Cancellation of Tax Breaks and Liquidation of Free Economic Zones to Multiply Appeals, Says Lytvyn," Ukraine Business Report, (Mar. 25, 2005).

Foreign investors also face barriers in certain sectors in Ukraine. The U.S. government has noted that Ukraine places explicit restrictions on the service sector. Specifically, "the lack of transparency and the multiplicity of licensing authorities hinders foreign access to the Ukrainian services market."[90] Foreign insurance firms and banks may operate in Ukraine, but they cannot open branches, a prohibition that "impedes participation of foreign businesses in Ukraine."[91] There is also not a level playing field in the banking sector in Ukraine, where Russian banks have an advantage over Western banks, who consider the business "too high-risk for them" in Ukraine.[92] Foreign investors are also more hesitant in moving into certain sectors of Ukraine's economy, such as natural resources, because they have "learned some lessons from bitter experience."[93]

Another problem plaguing foreign investors in Ukraine is, not surprisingly, corruption. According to a recent report by *Financial Times*, foreign investors in Ukraine having to pay bribes to local officials is a prominent feature of foreign investment in the country.[94] The practice is so deeply entrenched that one consultant even advised foreign companies to come up with "alibis" while paying the bribes, in order to avoid potential legal problems at home.[95] This adviser also suggested "when making the decision to turn to a powerful person for help, one

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90 United States Trade Representative 2005 National Trade Estimate Report on Foreign Trade Barriers at 631.

91 *Id.*

92 Elena Zvereva, "Yushchenko's Problems," Moskovskii Komsomolets, No. 55, (Mar. 16, 2005).

93 *Id.*

94 "Coping with Corruption Foreign Companies: Tom Warner Looks at Ukraine as Example of Operating in a Tricky Environment", Financial Times, (June 27, 2005).

95 *Id.*

should be aware that one will usually later receive 'some kind of bill.'"[96] At the World Economic Forum's business conference in Kiev in June 2005, one investor attending a panel on corruption remarked, "I don't pay bribes but my wife's family's company does."[97] Although the recently elected government has made promises to curb corruption, a PwC senior partner believes that such a task is difficult to achieve "once {corruption} is in the nature of society."[98]

96 *Id.*

97 *Id.*

98 *Id.*

VI. THE GOVERNMENT OF UKRAINE EXCESSIVELY CONTROLS THE MEANS OF PRODUCTION

Summary of Comment

Despite recent attempts by the Ukrainian government to privatize the country's economy, the process of privatization has failed to affect many of Ukraine's traditional strategic sectors. The recent privatization efforts on the part of the Ukrainian government have been tainted by scandals, corruption, and non-market forces. Furthermore, it is unclear whether the new government of Ukraine is as committed to privatization as the public would like to believe.

Discussion

As The Economist commented on the role of state ownership in the Ukrainian economy, "although sectors with the least government interference (such as food-processing) have recorded strong growth, the weight of these industries in the economy is still less important than the more traditional sectors."[99] As The Economist also noted, privatization has proceeded "more slowly in Ukraine than in former communist countries in central Europe, such as Poland and Hungary."[100] This is evident in some of the country's key sectors. As of 2004, only 30 percent of the assets of large enterprises had been sold.[101]

According to the Energy Information Administration, Ukraine's coal industry, consisting of less than 200 mines and employing about 500,000 people, is managed by "a hierarchy of state

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99 Country Briefings: Ukraine, at www.economist.com/countries/Ukraine/PrinterFriendly.cfm?Story_ID=2570448 (last visited July 11, 2005).

100 *Id.*

101 Commission Staff Working Paper of Commission of the European Communities, European Neighbourhood Policy, Country Report: Ukraine, at 15 (May 12, 2004).

organizations." Although the government made plans to privatize the industry by handing it over to 21 open joint-stock companies in December 2002, privatization still proceeded slowly afterward.[102] Although President Kuchma announced that all of Ukraine's 27 regional electricity distribution companies should be privatized in 2003-2004, only six of them have begun the process of privatization as of yet, and the government has been reluctant to give investors "more than a minority stake in the companies."[103] Around half of Ukraine's power supply comes from its "four outmoded thermal plants, all controlled by the state-owned company, Energoatom."[104] As a result of "insufficient privatization," both the coal and power sectors in Ukraine are "suffering," and successive governments have been "unwilling to close loss-making coal mines."[105] In the oil and gas sector, Naftogaz Ukraine, the state-owned oil and gas company, still "dominates oil extraction" and "accounts for over 95% of total domestic natural gas production."[106]

Although the State Property Fund of Ukraine had planned to put up for sale a number of controlling stakes in large and nationally strategic enterprises in 2004, the Parliament earlier this year rejected this proposed program.[107] The planned privatization of a 42% stake in Ukrtelecom, the state-owned former telecommunications monopoly, has also been delayed from year to

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102 Ukraine Country Analysis Brief at www.eia.doe.gov/emeu/cabs/ukraine.html (last visited July 11, 2005).

103 *Id.*

104 Executive Briefing Ukraine: Market Profile and Industry Forecasts, 11/04 (3/05), Business Information Service for the Newly Independent States at http://www.bisnis.doc.gov/bisnis/bisdoc/Executive%20BriefingUkraine.htm (last visited July 11, 2005).

105 *Id.*

106 *Id.*

107 "Privatization Programme for 2004-2006: What to expect in the coming years?," PricewaterhouseCoopers at http://www.pwcglobal.com/extweb/pwcpublications.nsf/docid/B854A29C76A0D72080256F6D004CB0E0 (last visited July 11, 2005).

year.[108] This insufficient progress and undue delay calls the government's commitment into serious question. Indeed, the newly elected Ukrainian government spoke proudly of the prominent role of the state in its economy during the first quarter of 2005:

> We obtained for 2004 965 million UAH as dividends from state economy work. And we own 6,5 thousand state enterprises or enterprises with a state part . . . It is the first time the Government approved financial plans for monopolies. And we foresee in 2005 to get 6 billion 415 million from state monopolies or even more. It is six times more than in the last year . . . We need to preserve these enterprises in state ownership as all countries in the world do – nearly 20% - 35% of the total sector of economy subjects belong to state ownership.[109]

On the other hand, the Ukrainian government's completed privatization endeavors in the recent years are anything but a success story. Instead of transferring the means of production from the hands of the government to the private sector through privatization, privatization in Ukraine has too often been a vehicle for the government to transfer valuable assets to big businesses with political connections. Under former president Leonid Kuchma, "big business developed as a preserve of the politically connected with privati{z}ation often used to nurture a loyal group of oligarchs."[110] Therefore, it is not surprising that Yushchenko, after taking office, accuses steel owners of having exploited "personal ties to the former government to acquire assets from the state worth billions at knock down prices."[111]

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108 Executive Briefing Ukraine: Market Profile and Industry Forecasts, 11/04 (3/05), Business Information Service for the Newly Independent States.

109 "Government summed up social and economic development of Ukraine for the 1st quarter of 2005," Press Service of the Cabinet of Ministers of Ukraine, (May 5, 2005), available at http://usb.com.ua/en/investing/investment_climate/2005/05/1/ (last visited July 11, 2005).

110 Jan Cienski and Tom Warner, "New Leaders start to shape the great leap forward Foreign companies are watching the country's transformation since the Orange revolution and wondering where they can fit in," Financial Times (June 1, 2005).

111 Tom Warner, "Vital industry faces up to trying times METALS: Metallurgy sector troubles could affect the entire economy, says Tom Warner," Financial Times, (June 1, 2005).

Yushchenko now intends to revise up to "29 privati{z}ation sales carried out by the former government, by holding new auctions with new bidders {and} then giving current owners the chance to match the highest bid."[112] Despite the political nature of this move by Yushchenko, this revision strategy highlights the failure of Ukraine's privatization process in recent years. As Yushchenko himself put it, the former authorities simply gave away particular properties, including last year's infamous sale of Kryvorizhstal, the country's largest steel mill. The current revaluation process is only the beginning of a normal process.[113] It has also recently been reported that Lukoil, tire maker Amtel and aluminum companies Rusal and Sual "are also being threatened with revision of the privati{z}ation deals."[114] However, it is doubtful whether Yushchenko's plan of this "normal process" will succeed. According to *Financial Times*, Yushchenko faces severe difficulty in passing the law authorizing the revaluation, as he does not have a parliamentary majority.[115] Yushchenko could also be forced to seek an alliance with the Communist party, who simply favors the nationalization of these companies.[116] Tymoshenko, the new prime minister, is also vehemently opposed to Yushchenko's plan.[117]

It is also unclear whether the new government's revision strategy and its privatization plans in the coming years will simply serve as a political tool. According to Stanislav

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112 Tom Warner, "Investors fear assets could be resold at auction to new buyers," Financial Times, (June 1, 2005).

113 *Id.*

114 Stefan Wagstyl and Tom Warner, "Kiev struggles to draw in foreign investors: Uncertainty over economic policy has unsettled business sentiment," Financial Times, (June 15, 2005).

115 Tom Warner, "Investors fear assets could be resold at auction to new buyers," Financial Times, (June 1, 2005).

116 *Id.*

117 *Id.*

Belkovsky, President of the National Strategy Institute, bitter political bickering will be a prominent feature of Yushchenko's revision strategy and the "simple revenge factor will play an important role."[118] He will have a "big grudge against certain Kuchma-era business leaders," believing that they played a role in attempting to discredit him during the presidential campaign.[119] According to Konstantin Zatulin, director of the CIS Countries Institute, the new authorities of Ukraine want to take away the economic assets of the new opposition, the members of which have themselves been beneficiaries of privatization in recent years.[120] This is evident from the list of enterprises that the new government is targeting: the focus has been on those companies (including Kryvorizhstal) that mostly belong to the relatives or political allies of the former government. Yushchenko's inner circles, many of whom had bought assets at ridiculously low prices through privatization, have largely escaped from the hit-lists.[121] As a result, the new government's revision plan, including its June decision to resell Kryvorizhstal, has created uncertainty instead of confidence among investors. As the World Economic Forum said on June 17, 2005 in a statement summing up the conference: "The current uncertainty deters domestic and foreign investment. The government must make a clear, binding and coherent statement about the handling of past privati{z}ation."[122]

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118 Elena Zvereva, "Yushchenko's Problems," Moskovskii Komsomolets, No. 55, (Mar. 16, 2005).

119 *Id.*

120 *Id.*

121 *Id.* Among such allies are Zaliv Shipyard, Ukraine's newly appointed Emergencies Minister, and Poroshenko.

122 Stefan Wagstyl and Tom Warner, "Ukrainian steel mill to go back on sale after appeal court decision," Financial Times (June 20, 2005).

Another sign of Ukraine's failed attempts to privatize its economy is the flood of lawsuits challenging the integrity or the legality of the privatization sales. For example, in recent years, Ukrainian courts have revised deals such as the sale of the Zaporizhya Aluminum Plant to a Russian company and the privatization of the Nikopol Ferroalloy Plant.[123] Although there is nothing to stop private parties from challenging privatization sales in courts, and nothing to stop judges to reverse the sale, if they find the deal to be illegal or corrupt,[124] such a mechanism does not solve the pressing problems plaguing privatization in Ukraine, as the integrity of the judicial branch and the enforceability of its decisions are themselves an area of concern.

Putting aside political factors, the commitment of the new government on privatization is also highly doubtful. For example, Yulia Tymoshenko, Ukraine's new prime minister, recently "charted a broadly leftist economic course including plans to beef up the state's involvement in business."[125] Ironically, Yushchenko appointed a critic of privatization, Valentina Semenyuk, as head of the privatization agency, the State Property Fund, the very agency responsible for implementing court orders on privatization sales.[126] Semenyuk even goes so far as to advocate "using the privati{z}ation review to return property to state hands" and argue that the state should "seek to earn profits from its enterprises and sell only loss-makers."[127]

123 Tom Warner, "Investors fear assets could be resold at auction to new buyers," Financial Times (June 1, 2005).

124 *Id.*

125 Jan Cienski and Tom Warner, "New Leaders start to shape the great leap forward Foreign companies are watching the country's transformation since the Orange revolution and wondering where they can fit in," Financial Times (June 1, 2005).

126 Tom Warner, "Investors remain cautious UKRAINIAN POLITICS: Tom Warner on the deflation of expectations in Kiev," Financial Times, (May 16, 2005).

127 *Id.*

VII. THE GOVERNMENT OF UKRAINE EXCESSIVELY CONTROLS THE ALLOCATION OF RESOURCES AND PRICE AND OUTPUT DECISIONS OF ENTERPRISES

Summary of Comment

The government of Ukraine still plays a key role in allocating resources and setting price, output decisions for enterprises in some of the country's key sectors, such as automobile, energy, agriculture and communal services. The government also maintains an extensive network of subsidies available to industries that it wants to promote, such as steel and coal mining. Price control has also been a favorite macroeconomic tool of the newly appointed government to curb inflation, suggesting that the mere change in government will not necessarily bring about a true market economy.

Discussion

According to *The Economist*, Ukraine's transition to a market economy has been hampered by "vested bureaucratic and economic interests eager to preserve elements of the centrally planned system, and by consensus among political and business leaders over the desirability of market reforms."[128] Even up until this date, ruling elites lack interest in "relinquishing their tight control over economic and bureaucratic powers," which has "slowed economic restructuring, and ensured a far higher degree of over-regulation and state interference than in the more advanced transition economies in the region."[129]

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[128] Country Briefings: Ukraine, at www.economist.com/countries/Ukraine/PrinterFriendly.cfm?Story_ID=2570448.

[129] *Id.*

With such an outlook, it is not surprising that the government of Ukraine still plays a key role in allocating resources and making price and output decisions for enterprises, including those in some of the key strategic sectors.

In order to raise domestic output of automobile production, the government has provided numerous monetary incentives to promote domestic automotive manufacturers and imposed protective measures.[130] For example, Ukraine raised duties on imported cars from "2-3% to 15-20% (depending on engine size) in May 2004," thereby "forcing up the retail price of imported cars."[131] Furthermore, the government places high duties on imports of used cars and even bans imports of certain categories of cars.[132] For imports of Russian cars, traditionally the largest provider, the government also places quotas on top of duties. As of April 2004, the quota for new Russian passenger cars was only 20,800 per year, while annual imports from Russia had already reached 25,000 in 2002.[133] This is more significant given that Ukraine's domestic production of cars had drastically increased in the recent years.[134] The government also introduced a series of incentives in March 2005 to boost domestic production, including a new law exempting domestic motor vehicle producers from VAT payments and from paying duties on imports of machinery and components.[135]

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130 Executive Briefing Ukraine: Market Profile and Industry Forecasts, 11/04 (3/05), Business Information Service for the Newly Independent States.

131 *Id.*

132 *Id.*

133 *Id.*

134 *Id.*

135 *Id.*

The government's prominent role in price and output decisions is also evident in the prevalence of subsidies granted to many industries. As the U.S. Agency for International Development pointed out this year, "the extensive network of direct government subsidies and implicit taxes, continue to distort the efficient allocation of resources."[136] According to Commission of European Communities, in the 2004 budget, the following industries were allocated government subsidies: domestic book printing, coal mining, space industry, agriculture, and aircraft construction. Moreover, loss-making enterprises or sectors are often "supported by the government through tax exemptions or other tax privileges, tolerance of tax arrears and, occasionally, the granting of tax amnesties."[137] Among these industries, the coal-mining sector, which consists of "a large number of unprofitable mines," is "heavily subsidi{z}ed by the government."[138]

Ukraine also subsidizes its domestic steel manufacturers by imposing duties on the export of steel scrap. The Ukrainian government levies substantial taxes on exports of steel scrap, maintaining a 30-euro per ton tax on ferrous scrap and a complete ban on the export of non-ferrous metal scrap.[139] As a result, Ukrainian steel producers are currently enjoying scrap prices that are substantially below global market prices. In addition, these barriers restrict the flow of steel scrap out of Ukraine, driving up the level of scrap exports and the price of scrap in other countries – such as the United States. According to USTR:

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136 *See* http://www.usaid.gov/policy/budget/cbj2005/ee/ua.html

137 Commission Staff Working Paper of Commission of the European Communities, European Neighbourhood Policy, Country Report: Ukraine at 16 (May 12, 2004).

138 *Id.*

139 "U.S. Presses Scrap Export Tax Complaints in WTO Accession Talks," Inside U.S. Trade (Oct. 8, 2004), *available at* http://www.insidetrade.com/secure/dsply_nl_txt.asp?f=wto2001.ask&dh=161352302&q=scrap.

> This export duty has contributed to a decline in scrap exports from Ukraine, at a time when global demand and prices for steel scrap are rising. The export tax provides an artificial advantage to Ukrainian steel producers by increasing domestic steel scrap supply, providing producers with an unfair advantage in Ukraine and in third markets.[140]

The United States has pressed Ukraine to eliminate its scrap export tax as a precondition to the country's accession to the World Trade Organization, but to date the Ukrainian government has stonewalled all requests to reduce or eliminate the scrap export tax.

Price control still occurs in many sectors of Ukraine's economy, most notably in several strategic sectors and communal services. Tariffs for communal services (such as gas, electricity, heating, and rents) are still subject to "administrative control and remain in some cases significantly below economic cost recovery levels."[141] In the energy sector, the government "fixes the price of nuclear and hydro generation supply."[142] The government also routinely imposes price control measures on agricultural products, which has often caused an interruption in imports and brought about prices below market levels. Between 2003 and 2004, agricultural officials did not let the market determine the internal prices in the domestic grain market and imposed price controls that adversely affected farmers, consumers, and traders alike.[143] In 2003, some local farmers were forced to sell milling quality wheat after the harvest at $130-140 per

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140 United States Trade Representative, 2004 Nat'l Trade Estimate Report on Foreign Trade Barriers – Ukraine at 476, 480 (Apr. 1, 2004).

141 Commission Staff Working Paper of Commission of the European Communities, European Neighbourhood Policy, Country Report: Ukraine, at 16 (May 12, 2004).

142 Ukraine Country Analysis Brief at www.eia.doe.gov/emeu/cabs/ukraine.html.

143 "Ukraine: Grain and Feed Wheat Import Update 2003" at 2, www.fas.usda.gov/gainfiles/200312/146085355.pdf (last visited July 11, 2005).

ton, well below the $180 per ton market price.[144] Local administrators also set maximum profit margins for bakeries, leading to a significant price differential between flour and bread.[145]

Price control has also been used as a macroeconomic tool by the central government to curb inflation. Tymoshenko, the newly appointed prime minister, is a strong advocate of a strong state role in key markets and has herself used temporary price caps on petrol to keep down inflation.[146] For example, Russian oil companies TNK-BP, Lukoil and Alliance Group had to face price caps on petrol in April to May.[147] In an emergency conference in Kiev attended by government representatives from both Ukraine and Russia on May 19, 2005, Yushchenko himself criticized Tymoshenko for "resorting to 'administrative, non-market' methods, such as price controls and anti-cartel investigations, to deal with the price escalation by Russian companies" in the oil industry.[148] Although Yushchenko announced the cancellation of government-imposed price ceilings during the conference, both governments agreed to "regulate prices temporarily, at levels substantially lower than those ceilings."[149] Prices per liter on the Ukrainian market were set at 3.2 hryvnias and 3 hryvnias, respectively, for two types of high-

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144 *Id.*

145 *Id.*

146 Tom Warner, "Investors remain cautious UKRAINIAN POLITICS: Tom Warner on the deflation of expectations in Kiev," Financial Times, (May 16, 2005).

147 Stefan Wagstyl and Tom Warner, "Kiev struggles to draw in foreign investors: Uncertainty over economic policy has unsettled business sentiment," Financial Times, (June 15, 2005).

148 Vladimir Socor, "RUSSIAN-UKRAINIAN OIL SUMMIT: AN UNEASY, FLEETING COMPROMISE," at http://www.jamestown.org/edm/article.php?article_id=2369784.

149 *Id.*

octane gasoline, and 2.85 hryvnias for diesel fuel. Price fluctuations are to be allowed within a 3% corridor.[150]

150 *Id.*

VIII. CONCLUSION

In conclusion, an examination of the statutory factors clearly demonstrates that the Department should continue to treat Ukraine as a non-market economy. The Ukrainian government's restrictions on its currency, the denial of fundamental worker rights, limitations on foreign investment, and the control of the means of production, prices, output and resources – all contrary to free market principles -- clearly indicate that Ukraine is still an NME. Although the recent political changes in Ukraine are encouraging, it is premature to conclude that Ukraine has become a market economy in the matter of a few months. Before the Department determines that Ukraine may be treated as a market economy, it needs to observe the developments in the country over a much longer period. Accordingly, the Department should not alter Ukraine's designation as a non-market economy at this time.

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