UKRAINE

TRADE SUMMARY

The United States registered a trade deficit of $687 million with Ukraine in 2000, an increase of $373 million from 1999. Ukraine was the United States' 95th largest export market in 2000. In 2000, U.S. exports to Ukraine were $186 million, an 8.8 percent decrease from 1999. U.S. imports from Ukraine were $873 million in 2000, an increase of $355 million (68.6 percent) from 1999.

The stock of U.S. foreign direct investment in 1999 was $50 million, a 46.2 percent decrease from 1998.

IMPORT POLICIES

Tariffs

Trade relations between the United States and Ukraine are governed by the 1992 U.S.-Ukraine Trade Agreement. In this bilateral agreement, each country granted the other most-favored-nation (MFN) status. In 1993, Ukraine applied for membership in the World Trade Organization (WTO). Since then, Ukraine has indicated its willingness to bring its trade laws and regulations into conformity with WTO requirements and is negotiating market access agreements with the United States and other members of the accession working party that will eventually result in lower tariffs. However, Ukraine still has much left to do in the accession process, including aligning its intellectual property rights laws, customs procedures, subsidies programs, and agricultural policies with WTO rules. Also, it will have to conclude a satisfactory agreement with the United States and other WTO members on tariff reductions and market access for goods and services.

Ukraine employs a two-tiered system of general (full-rate) tariffs and preferential (partial-rate) tariffs. Imports from Western countries are usually assessed preferential tariffs, which vary according to the types of products imported. Import duties largely depend on whether a similar item to that being imported is produced in Ukraine, and if so, the rate tends to be higher. For example, Ukraine imposes tariff rates with an *ad valorem* equivalent of 100-300 percent on most imported distilled spirits. U.S. exports to Ukraine usually receive preferential customs rates if the following three criteria are met: (1) the company is registered in the United States; (2) the goods have a certificate to prove U.S. origin; and (3) the goods are imported directly from the United States. In 2000, exemptions from import duties, as well as the VAT, were created for certain import contracts for shipyard equipment through January 1, 2005, under a law giving state support to the shipbuilding sector. Effective February 19, 2001, duties on used foreign cars doubled for cars under five years old and tripled for cars more than five years old; duties on new cars remained the same.

Non-tariff Barriers

In 2000, the number of excisable goods was reduced from 20 to 5 categories: alcohol, tobacco, oil products, automobiles, and jewelry. The excise tax for jewelry rose to 55 percent from 35 percent. Excise duty rates range from 10 to 300 percent of the declared customs value. This often results in duties and fees amounting to over 100 percent of the declared value of the item. In January 2001, excise duty rates were differentiated for cigarettes with and without filters and increased on certain wines, vermouth, and cognac. On some wines (champagne, sparkling wine) rates were lowered. Ukraine intends to increase excise rates for beer in April 2001. Excise rate increases are expected on petroleum products and have already risen for automobiles.

The value added tax (VAT) is levied on the customs value of an invoice and is generally payable at the time of customs clearance. Firms complain that the VAT system is poorly administered and some firms have reported that their VAT refund claims were not honored. Exempt goods include raw materials, component parts, equipment, machinery, and energy for production purposes and enterprise's own needs. Zero VAT rates were also established for the following: sale of certain agricultural products by farmers until 2002; import of materials and equipment used for the development of the domestic shipbuilding until 2005; imports of materials and equipment and exports of domestically produced space and equipment until 2009; import of materials and equipment used for the development of special chemical and ammunition production industry (excluding excisable products) until 2010; imports of goods used for the development of the domestic car construction industry and exports of domestically produced or assembled cars and compartments (under the condition of making at least a $150 million investment) until 2008; sale of recreation services in the Crimea resorts until 2005; and business development and work places creation in Slavutich until 2004.

In January 2000, border checkpoints began collecting a new uniform customs duty, combining seven import fees - customs clearance, sanitary, veterinary, phytosanitary, radiation, ecological control, as well as fees charged for the passage of vehicles on the motor roads of Ukraine - into a single tax.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Imported products/goods are subject to sanitary, veterinary, radiological and ecological control. Ukraine’s regulatory environment is chaotic and foreign firms regard the production certification system and licensing procedures as extremely problematic and burdensome to trade and investment. U.S. businesses identify the following as the leading problems: (1) lack of constant, clearly defined standards and regulations; (2) registration schemes unfeasible for mass trade; (3) lack of procedural flexibility; (4) complex and lengthy import license procedures; (5) overly complex and expensive certification requirements; (6) uneven enforcement of requirements; and (7) high certification and licensing fees. Ukraine’s numerous certification bodies effectively operate as independent (often monopolistic) entities on a private profit basis, returning only 20 percent of the proceeds derived from certification fees to the state. The State Standardization Committee (SSC) does not effectively regulate or enforce what investors consider vague pricing rules and other agencies undertake legislative and interpretive work with little or no coordination. Many products require multiple certificates from multiple agencies at local and regional levels, requiring investors to provide additional documentation beyond that required by central agencies. The numerous and burdensome certification and licensing procedures have posed a major barrier for the U.S. telecommunications equipment industry.

Product testing and certification generally relate to technical, safety, and environmental standards, as well as efficacy standards with regard to pharmaceutical and veterinary products. Such testing often requires official inspection of the company's production facility at company expense and is often done in sub-standard facilities on a unit-by-unit basis rather than "type" testing. Where Ukrainian standards are not established, country of origin standards may prevail. Ukraine applies a range of sanitary and phytosanitary measures that are not consistent with a science-based approach to regulation and the certification and approval process is often lengthy, duplicative, and expensive.

In 1998, Ukraine required certificates of conformity in order to import distilled spirits. Firms were obligated to obtain such certificates at their own expense after exhaustive inspections by Ukrainian officials of the producers facilities (at the producer’s expense), causing several U.S. distilled spirits exporters to withdraw their products from the market. Furthermore, licenses for production of ethyl, cognac, and fruit alcohol and alcoholic beverages, cigarettes and tobacco are higher than the base level for licenses for the wholesale trade of these goods. In January 2001, a law was passed exempting domestic cooperatives in rural areas from the payment of license fees for the production and trade of ethyl, cognac and fruit alcohol, spirits, and tobacco. There has been a push to certify all food additive ingredients, especially chocolate and carbonated beverages and pre-packaged goods, for which all ingredients must be certified.

Pending legislation may provide relief. A draft law, "On Standardization," would introduce voluntary standards and require standards be set by legislative or government acts. A draft law, "On Assurance of Conformity," would replace mandatory certification for many types of products and permit gradual correspondence of conformity assessment procedures to international standards and the "New Approach" directives of the European Union, including the principle of "presumption of conformity to standards.” A draft law, "On Accreditation of Conformity Assessment Bodies," would establish a national accreditation body, separate regulation of accreditation and certification, and ensure use of practice, standards, and procedures that apply for membership in the European Cooperation for Accreditation (ECA).

GOVERNMENT PROCUREMENT

A government procurement law passed in March 2000 requires that priority be given to Ukrainian bidders when the government solicits bids for the purchase of goods and services and gives ten percent preferential allowance to domestic bidders. Among the problems faced by foreign firms are: (1) a lack of public notice of tender rules; (2) the failure to state tender requirements; (3) covert preferences in tender awards; (4) awards made subject to conditions that were not part of the original tender; and (5) the lack of an effective avenue for firms to air grievances over contract awards or an effective means to resolve disputes. Ukraine is not a signatory of the WTO Agreement on Government Procurement. Purchasing practices in Ukraine vary, ranging from open to closed tenders. In order to avoid abuses in strongly monopolized areas of industry, the Ukrainian government prefers open tenders as the main procurement method. However, in a country with an underdeveloped business infrastructure, personal contacts and politics still play a very important role in the procurement process.

EXPORT SUBSIDIES

Due to budget constraints, Ukraine has significantly reduced the amount of direct, budgeted subsidies it provides to state owned industry over the last several years. Even in heavily subsidized sectors such as agriculture and coal, change is underway. Nevertheless, the government still uses subsidies as an instrument of economic policy. Where such subsidies are used, however, they do not appear to be specifically designed to provide direct or indirect support for exports, but rather to maintain full employment and production during the transition to a market-based economy. Many Ukrainian enterprises do not pay taxes, do not pay market prices for energy, and receive free or below-cost production inputs from the government. Because subsidies in Ukraine are in many cases the result of *ad hoc* administrative actions and decisions, they are difficult to identify.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

Ukraine has very serious problems with protecting intellectual property rights (IPR) stemming from rampant piracy and inadequate legislation. As a result, Ukraine was identified in March 2001 as a Priority Foreign Country under U.S. trade laws. Such an identification could result in severe trade penalties. The International Intellectual Property Alliance announced in February 2001 that Ukraine tops a list of 58 countries considered to have inadequate standards of IPR protection.

Copyright and trademark piracy are rampant in Ukraine. Enforcement of IPR laws has been very weak and piecemeal enforcement agencies are burdened by lack of experience and corruption. Pirate CD manufacturers, in particular, have exploited loopholes in copyright and holograms law to produce and export large quantities of unauthorized music and software CDs. The international recording industry now believes that Ukraine is the largest exporter of pirated optical media products in Europe. According to the recording industry, losses to legitimate right-holders exceed $200 million annually. The Motion Picture Association calculates that it loses $40 million in revenues annually from pirated videocassettes and unauthorized broadcast of U.S. audio-visual products by television and cable companies. Recently, leading cable TV operators in Ukraine announced that they will not broadcast unauthorized movies through their networks. In 2000, Ukraine adopted a law requiring all music CDs as well as audio- and videocassettes sold in the country to carry hologram stickers issued by the government. Distributors are required to prove their rights to reproduction in order to receive the stickers. The law is woefully deficient for several reasons: it exonerates manufacturers from all criminal and administrative penalties, provides no solid basis for confirming rights claims, and exempts exports from the hologram regime.

Enforcement of trademark laws has also been weak. Counterfeiting of Western products in Ukraine increased dramatically after the Fall 1998 financial crisis, with industry sources estimating that 50 percent of name brand products on the market could be counterfeit. While selling counterfeit products is illegal, their production is not. As a result, many legally licensed factories, including state-owned factories, are producers of counterfeit goods. Unfortunately, little has been done to close this loophole.

Ukraine has made some progress in developing a comprehensive legislative system for the protection of IPR. Ukraine has joined many of the IPR treaties and conventions, either by default as a successor state to the former Soviet Union, or since its independence. In 2000, Ukraine became a party to the Geneva Phonograms Convention. In addition, Ukraine has laws on the Protection of Rights in Inventions and Utility Models (1993), the Protection of Rights in Industrial Designs (1993), the Protection of Rights in Marks for Goods and Services (1993), and the Protection of Plant Variety Rights (1993). As part of its Bilateral Investment Treaty with the United States, which went into effect in 1996, Ukraine committed itself to provide protection for U.S. patents, trademarks and copyrights.

The IPR legislative framework still has major failings. Most importantly, Ukraine fails to provide national protection for foreign right-holders and does not afford copyright protection for pre-2000 foreign sound recordings. Protection for pre-existing sound recordings is called for in both the 1996 Bilateral Investment Treaty between the United States and Ukraine and by the WTO TRIPS Agreement. The legal basis for successful court action against copyright infringement remains incomplete, and prosecutors and judges lack experience. Administrative and criminal penalties for copyright and trademark infringement lack deterrent value. Ukraine will need to improve its IPR regime - both with respect to legislation and to enforcement - in order to meet the requirements of the WTO TRIPS Agreement, which the United States and other WTO members insist upon as one of the preconditions for Ukraine to join the WTO.

Against this backdrop, Ukraine was placed on the Special 301 Watch List in 1998 and was elevated to the Priority Watch List in 1999, where it remained in 2000. In the Spring of 2000, the U.S. Trade Representative delayed a decision to identify Ukraine as a "Priority Foreign Country" until December after Ukraine promised to solve the CD piracy problem. At a summit in June 2000, President Kuchma and President Clinton endorsed a U.S.-Ukrainian Joint Action Plan to combat optical media piracy. As part of the plan, Ukraine agreed to suspend production at pirate facilities, close legal loopholes exploited by pirates, and enact legislation to provide law enforcement agencies and the court system with adequate methods to monitor CD production and distribution. Progress has been slow, however. Only at the close of 2000 did Ukraine begin to clamp down on CD manufacturers engaged in piracy and enact legislation foreseen in the Action Plan. Joint U.S./Ukrainian plant inspections, foreseen in the Action Plan, revealed productive capacity far in excess of Ukraine's annual demand for CDs and manufacturers' active ploys to circumvent Ukraine's weak copyright laws. In light of the last minute progress, the U.S. Trade Representative deferred until March 2001 whether to identify Ukraine as a "Priority Foreign Country." However, such progress was not sustained. Therefore, on March 12, the U.S. Trade Representative made this identification, which could lead to the imposition of trade sanctions and the withdrawal of U.S. trade preferences.

SERVICES BARRIERS

Ukraine has few explicit services restrictions but, in practice, corruption and lack of transparency in licensing and administrative approval processes constitute significant barriers. Ukraine also lacks a reliable payments system, credit and financing are limited, and there is limited recourse for collecting on unpaid services. Nevertheless, some sectors offer potential for growth: banking, advertising, public relations, legal, audit, and accounting services, tourism, and telecommunications.

The banking sector remains underdeveloped and has failed to play a meaningful role for savers or as a source of financing for business. In October 2000, 156 banks were operational (mostly joint-stock companies), 29 partially backed by foreign capital, and 7 fully backed by foreign capital. The National Bank of Ukraine (NBU) regulates monetary circulation and banking activity. A new law simplified bank licensing requirements and granted NBU wider authority to liquidate problem banks and set international standards for bank supervision, disclosure, and fiduciary requirements. It authorized banks to track large, "dubious" transactions and extend foreign currency loans to resident legal entities and individual entrepreneurs. It also addressed loan receipts from non-residents, interest-free credits in foreign currency, applications of sanctions for currency violations, and liberalizes lending and costs of financing. Most international instruments are used in Ukraine. The irrevocable letter of credit is used for receiving payments for exports. The state security service and interior ministry must approve foreign currency transaction licenses. Regional branches must provide these agencies with information on license applications. Effective February 2001, NBU can require banks to oversee export-import and leasing transactions on the basis of freight customs declaration registers. NBU and SSC share a data exchange system to improve currency control in the foreign trade sphere and prevent fraudulent customs declarations to purchase currency and transfer it abroad.

The non-banking financial subsector, especially private pension funds and insurance, is developing within a weak policy framework. Ukraine has had a 49 percent foreign-equity limitation on insurance services, but has showed interest in lifting this barrier. International accounting and auditing statements and independent financial assessments were implemented in early 2000. Meanwhile, foreign lawyers, accountants, and consultants are watching the development of a proposed law, "On Advocatura," which they claim may restrict professional activity if it is not amended. As of June 2000, Ukraine had 300 advertising agencies. Tourism has growth potential, but is underdeveloped. Service and facilities fall short of Western expectations.

Ukraine has made limited progress in liberalizing the telecommunications market. As part of the WTO accession process, the United States continues to encourage Ukraine to liberalize this relatively undeveloped sector and undertake commitments pursuant to the WTO Agreement on Basic Telecommunications Services and the WTO Information Technology Agreement. The state-owned Ukrtelecom and mostly state-owned Utel dominate national and long distance networks and others make up only a small fraction of the market. Nonetheless, wireless communication accounts for nearly 70 percent of the telecom market. Currently, five operators offer wireless services using several local loop networks, which have the potential to go mobile. While mobile services are not subject to artificially low state-set telecommunication rates, they are subject to other forms of government intervention.

Employing foreign workers has become more burdensome than in previous years. Work visa requirements are more stringent and require more documentation, including employment contracts and certification of taxes payments. A 1999 resolution increased the personal income tax for foreign workers, the proceeds from which are paid into Ukraine's unemployment fund.

INVESTMENT BARRIERS

Despite some progress in deregulation, the investment climate remains hampered by poor banking, corporate governance, communications networks, tax regimes, privatization efforts, rule of law, and enforcement of contractual and property rights. The regulatory regime lacks independence and transparency and there are numerous and burdensome licensing, registration, certification, and inspection requirements. Investment disputes frequently involve corporate ownership, shareholder and voting rights, and disclosure issues. Bureaucratic obstacles significantly raise the cost of doing business in Ukraine, provide opportunities for corruption, and drive business activity into the burgeoning shadow economy. While laws stipulate equal treatment for foreign companies, unequal treatment continues to hinder investment.

The tax system presents a major obstacle to trade and investment in Ukraine. Numerous amendments to tax laws combine to create a confusing and possibly inequitable situation.

Investors were dismayed when Ukraine withdrew a promised five-year tax holiday and exemptions of customs duties and taxes. Tax filing and collection procedures continue to fall short of expectations. The State Tax Administration (STA) established an advisory committee to resolve tax disputes brought by foreign companies. However, some investors report that STA conducts arbitrary inspections and freezes bank accounts on the pretext that it believes companies are delinquent. To simplify and rationalize the tax system, a new tax code is being considered.

Positive developments include the implementation of IAS and independent financial assessments and legislative reforms efforts involving joint stock companies, stock market development, and the judiciary. A draft civil code under consideration in 2001 would enhance enforcement of contractual and property rights and provide a framework for economic, criminal, stock market, and tax laws. A new bankruptcy law provided for debtor-led reorganization and a moratorium on payment and collection of pre-existing debt and tax forgiveness provisions. A resolution provided new procedures for adoption of regulatory acts relating to entrepreneurial activity, including cost-benefit analysis, notice and comment periods, and tighter deadlines for appealing administrative decisions. A cabinet resolution was passed July 2000 which provided new guidelines for the State Committee for Regulatory Policy and Entrepreneurial Activity for approving draft regulations relating to entrepreneurial activity. The resolution provides for cost-benefit analysis, notice and comment periods for adoption of regulations and tighter deadlines for appealing regulatory decisions, all of which significantly influence the market environment.

The United States has a Bilateral Investment Treaty (BIT) with Ukraine, which took effect on November 16, 1996. The BIT guarantees U.S. investors the better of national or MFN treatment, the right to make financial transfers freely and without delay, international law standards for expropriation and compensation, and access to international arbitration.

A chamber of independent experts, established by Ukraine's President, has arbitrated a number of investment disputes. Its rulings are not legally binding, but its decisions have generally been accepted and applied by the parties. It is not a formal dispute mechanism, but Ukraine would like to elevate it to such.

Foreign ownership in privatized entities is limited to 49 percent or less in the charter capital of enterprises in certain sectors such as telecommunications and insurance and certain privatized "strategic" enterprises; foreign shares of TV and radio broadcasting and publishing companies may not exceed 30 percent.

ANTI-COMPETITIVE ACTIVITY

Ukraine's Antimonopoly Committee supervises observance of antimonopoly legislation, protection of consumers and business interests resulting from violations, abuse of monopoly position, and unfair competition. Nearly all equity investments, joint ventures with multiple partners, and share acquisitions require the committee's approval. In January 2001, a law "On Economic Competition Protection," was passed that established a new framework for the support of economic competition and regulation of monopolies arising from entrepreneurial activities.

A more transparent privatization law was passed covering the period 2000-2002, which provided for the cash sale of majority shareholdings in a number of strategic enterprises, an increase in the transparency of bidding procedures, and the use of financial advisers to assist the Ukraine's

State Property Fund (SPF) in ensuring transparency in the privatization process. The SPF converted privatization from certificate to cash, accelerated share sales via stock exchange, and adopted new tender regulations to sell controlling shares to strategic investors. However, the SPF has only recently adopted these more transparent procedures and no major stake in an attractive company was sold in 2000 to a non-CIS country investor. For 2001, a list of enterprises was submitted, including seven energy distribution companies and a substantial minority stake in the telecom monopoly Ukrtelecom. Ukraine's attempt to privatize 20 of the country's 27 regional electricity distributors, if successful, could be the first transparent, large-scale privatization using international standards since independence. Tenders for the Zaprorizhya aluminum plant and Crimean sodium plant caused some controversy and demonstrated the need for further reforms.

A 1999 production sharing agreement (PSA) law provided a mechanism for foreign investment in natural resources (notably oil and gas) by guaranteeing that the terms of contracts between foreign investors and Ukraine will not be unilaterally changed once investment takes place.

ELECTRONIC COMMERCE

Recognizing the need for foreign investment to provide financing and technology, Ukraine enacted legislation enabling foreign companies to operate in the telecom market. In July 2000, a Presidential Decree prioritized development of Internet and e-commerce with improved IPR, copyright protection, and use of electronic documentation and digital signatures. One barrier to increased e-commerce is the relatively poor state of the telecommunications infrastructure in Ukraine.

The Internet service providers (ISPs) sector is growing, but remains limited by the business climate, low income of potential users, dependency on local loop access, poor computer infrastructure, and the lack of basic legislative and regulatory framework. Cancellation of mandatory licensing in 1998 stimulated proliferation of ISPs and customers doubled. Ukrtelecom reported in February 2001 that its Internet usage grew four times over the second half of 2000 and that within Ukraine there are approximately 500 Internet providers, 800,000 users, 32,000 hosts, 6,000 web servers, and 11,000 domains registered. With only 500,000 bankcard users, however, fewer international credit card holders, and customs and mail restrictions, e-commerce remains unattractive. Cable/ ISP and cable/telephone combinations and prepaid access cards have been attempted, but investors face high costs for billing software, limited customer base and returns, and low capacity of international channels. Internet telephony is restricted by reliance on access to the local loop resulting in companies being forced from the market.

OTHER SIGNIFICANT BARRIERS

During 2000, Ukraine was rated the third most corrupt nation by Transparency International. A joint World Bank / EBRD study of selected countries concluded that Ukraine ranked near the top of the study group both in terms of "administrative corruption" (the taking of bribes, etc.) and "state capture corruption" (the ability of well-connected individuals to usurp areas of government activity or even sectors of the economy for their own benefit). Corruption is ubiquitous and permeates the civil service. Regulatory bodies lack independence and transparency, and officials often appear to act with conflicts of interest. "State capture" corruption has a pervasive influence on large parts of the economy and is a major deterrent to investment. Ukraine has not developed a credible consistent anti-corruption strategy and has been urged to open dialogue with the public regarding corruption.

In November 2000, Ukraine ranked 133rd in the 2001 *Index of Economic Freedom* produced by the U. S. Heritage Foundation and the Wall Street Journal. This figure was down 17 from Ukraine's previous rating. Foundation experts said the decline was due to ineffective trade policy, an increase in taxation, and misguided government intervention in economy. Ukraine's trade policy score was three points (moderate level of protectionism), down one point due to tariff rates ranging from 1 to 20 percent, an average weighted tariff of 7.5 percent, and non-tariff barriers in the form of non-transparent standards and import licenses. The fiscal burden of government score was 4.5, a half-point drop, due to high income and corporate tax rates, slow privatization efforts, and heavy GDP generation and consumption in the public sector.