

## UKRAINE

### TRADE SUMMARY

The U.S. trade deficit in 2001 was \$465 million, a \$216 million decrease from 2000. U.S. goods exports to Ukraine were \$205 million, an increase of 7.4 percent from 2000. U.S. imports from Ukraine were \$670 million in 2001, a decrease of \$202 million (23.2 percent) from 2000.

The stock of U.S. foreign direct investment in 2000 was \$76 million, a 46 percent increase over 1999.

Trade relations between the United States and Ukraine are governed by the 1992 U.S.-Ukraine Trade Agreement. Under this agreement, both countries grant each other most-favored-nation (MFN) status. The United States has not granted Ukraine permanent MFN status, however, because Ukraine has not yet "graduated" from provisions of the Jackson-Vanik legislation. Ukraine is not a member of the World Trade Organization (WTO), but it has applied to join.

### IMPORT POLICIES

Generally high import duties and taxes in Ukraine present a major obstacle to trade. For example, import duties range from 5 percent to 200 percent, and excise taxes range from 10 percent to 300 percent. Such levies deter entry into Ukrainian markets of many products and impede domestic commerce. Import duties largely depend on whether a similar item to that being imported is produced in Ukraine. Ukraine has very high import tariffs on a number of products. For example, Ukraine's current tariffs on most distilled spirits imports are equivalent to *ad valorem* rates of 150 percent to 300 percent.

Ukraine has two kinds of tariff rates: general (or full-rate) tariffs and preferential (or partial-rate) tariffs. Preferential tariff rates vary according to the type of products imported. Imports from western countries are generally assessed lower, preferential tariffs. U.S. exports to Ukraine are assessed preferential customs rates if the following three criteria are met: (1) the exporting 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. There are no special registration or other requirements, according to the State Customs Committee.

In October 1999, the import duty on textile goods was reduced to a range between 5 percent and 10 percent from the pre-existing duty rate of 30 percent. On March 29, 2000, the Cabinet of Minister's Resolution "On Making the Decisions of the Cabinet of Ministers of Ukraine compliant with the EU Partnership and Cooperation Agreement" effectively lowered duties for imported automobiles, tobacco products, alcohol (including liquor) and agricultural and light industrial products. In November 2000, import duties on carpets and other floor coverings were lowered from 20 percent to 17 percent. Duties on knitwear, textiles, and clothes were reduced from 15 percent to 13 percent. In 2000, however, duties on rolled metal, bars and plates, ferroalloys and automobile engines were raised.

Five categories of products are subject to excise taxes: alcohol, tobacco, oil products, automobiles, and jewelry. Excise duty rates are assessed as a percentage of the sum of the declared customs value, customs duties, and fees paid for importing products.

Import licenses are required for some goods, primarily pesticides, CD production inputs, some industrial chemical products and equipment containing them, official foreign postage stamps, excise marks, officially stamped/headed paper, checks and securities.

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Ukraine's liquor tax system discriminates against imported products and provides protection for domestic producers. For example, under this system, all imported distilled spirits are taxed at a rate of three Euro per liter.

A value added tax (VAT) of 20 percent is applied uniformly to domestic and imported products and in principle is not a major barrier to trade. The Government of Ukraine, however, has incurred significant debts in the form of VAT refunds owed to importers. Failure by the government to settle these debts fairly and expeditiously would introduce a potentially serious trade barrier, effectively blocking many imports. A limited number of goods, including raw materials, component parts, equipment, machinery, and energy supplies imported by commercial enterprises for "production purposes and their own needs" are exempted from the VAT. Many agricultural enterprises are also exempt from paying VAT.

### **STANDARDS, TESTING, LABELING AND CERTIFICATION**

Ukraine's regulatory environment is chaotic, and foreign investors still regard Ukraine's production certification system and licensing procedures as some of the most serious obstacles to trade, investment, and ongoing business. Although Ukraine has lowered the overall number of licenses from 112 to 42, making the certification process somewhat less difficult to navigate, many still consider this lower number excessive.

U.S. businesses have complained that the standards and certification procedures affecting the consumer goods industry: (1) lack constant, clearly defined standards and regulations; (2) include registration schemes that are not feasible for mass trade; (3) lack procedural flexibility; (4) involve complex and lengthy import license procedures; (5) impose overly complex and expensive certification requirements; (6) are

unevenly enforced; and (7) involve high certification and licensing fees. While the standards process has been significantly streamlined over the past two years, it remains complex and subject to frequent changes. These bureaucratic procedures are a major hindrance to potential investment in Ukraine, significantly raising the cost of doing business in Ukraine, providing opportunities for corruption, and driving substantial amounts of activity into a burgeoning shadow economy. While the law may stipulate formal equality of treatment of both national and foreign companies, U.S. businesses are often left with a very strong impression that the laws are not applied equally and that, in fact, there is discrimination against foreign companies.

Ukraine applies a range of sanitary and phytosanitary measures that are not consistent with a science-based approach to regulation. The certification and approval process is often lengthy, duplicative, and expensive. Moreover, politics and corruption are often behind arbitrary application of regulations. In 2001, for example, Ukraine's Chief Veterinarian banned the importation of U.S. poultry, alleging that several U.S. production practices are not in accordance with a new interpretation of existing Ukraine veterinarian requirements.

The numerous certification bodies around Ukraine 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 Standards Committee does not properly supervise or enforce the pricing rules. Consequently, the agencies do much of the legislative and interpretive work with little or no coordination. In addition, many products require multiple certificates from multiple agencies, with local, regional and municipal authorities often requesting additional documentation beyond that required by central agencies.

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There is a push to certify food additive ingredients, especially for pre-packaged goods and certain products such as chocolate and carbonated beverages. Some companies report having to pay up to \$20,000 to purchase the equipment needed to test ingredients that have been used safely (in some cases) for more than 100 years.

In 1998, Ukraine introduced a requirement for certificates of conformity in order to import distilled spirits. To obtain such certificates a firm must pay Ukrainian officials to conduct exhaustive inspections of the producer's facilities. This expensive and onerous requirement has caused several U.S. distilled spirits exporters to withdraw their products from the Ukrainian market.

According to the U.S. telecommunications industry, access to the Ukrainian market is impeded by numerous and particularly burdensome certification and licensing procedures for telecommunications equipment.

### GOVERNMENT PROCUREMENT

Government procurement is conducted under Ukraine's "Law on Procurement of Goods, Works and Services Using State Funds," which came into force on February 22, 2000. Under this law, all government procurement of goods and services valued above EUR 40,000 must be conducted via tenders (either open, or open with prequalification). Open international tenders must be conducted when procurement is financed by any entity outside Ukraine. Information on government procurement is published in the "State Procurement Bulletin" published by the Ministry of the Economy and European Integration. Among the problems still faced by foreign firms (particularly for smaller procurements) are: (1) absence 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.

### EXPORT SUBSIDIES

There is no reliable estimate of the nature and amount of export subsidies employed by Ukraine, particularly as they relate to Ukraine's export of steel products to the United States. While Ukraine has made significant progress in moving towards a completely market-based economy, hidden subsidies exist and are hard to quantify.

It is known that many Ukrainian enterprises do not pay all or part of their taxes, do not pay for all energy usage, clear transactions by offsetting mutual debts, and receive free or below-cost government inputs. Under pressure from the International Monetary Fund and the World Bank, the Government of Ukraine is introducing more fiscal transparency and accountability. As a result, obligations are increasingly settled with cash payments and opportunities to hide subsidies are decreasing. As improved reporting procedures make them more visible, hidden subsidies tend to be eliminated rather than converted to a cash basis.

### INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

A serious piracy problem, particularly with regard to optical media, undermines Ukraine's efforts to protect intellectual property rights (IPR). Ukraine was designated a Priority Foreign Country in March 2001 and USTR imposed \$75 million in sanctions under Special 301 in January 2002.

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Ukraine has made progress in developing a comprehensive legislative system for the protection of IPR and has joined many of the IPR treaties and conventions. As part of its Bilateral Investment Treaty with the United States, which went into effect in 1996, Ukraine committed itself to protect copyrights in U.S. works. In 2001, Ukraine passed a new copyright law that it believes is WTO compliant, a criminal code that introduced criminal penalties for IPR violations, and civil and customs codes.

Despite enacting critical IPR legislation and becoming a signatory to key conventions, a serious problem of copyright piracy continues in Ukraine. Pirates have established optical media (CD and CD-ROM) production facilities in Ukraine and have been exporting large numbers of unauthorized copies to Europe and beyond. The U.S. recording industry estimates that it lost approximately \$210 million in revenues for 1999. The Motion Picture Association calculates that it lost \$40 million in revenues in 1999 from audio-visual piracy, partly due to the unauthorized broadcast of U.S. audio-visual products by television and cable companies.

Ukraine was placed on the Special 301 Watch List in 1998 and was elevated to the Priority Watch List in 1999. In June 2000, the United States and Ukraine agreed to the U.S.-Ukraine Joint Action Plan to Combat Optical Media Piracy. As a result of Ukraine's failure to enact most of the plan's provisions, USTR designated Ukraine as a Priority Foreign Country in March 2001, launched a Special 301 Investigation of Ukraine's attempts to protect intellectual property rights, and revoked Ukraine's benefits under the Generalized System of Preferences in August 2001. Ukraine's inability to pass legislation establishing a licensing regime for the manufacture of compact disks -- the Joint Action Plan's most important provision -- led USTR to announce trade sanctions in the amount of \$75 million on December 20, 2001. The sanctions, which went into effect on

January 23, 2002, affect metal products, footwear, and chemicals, among other products.

With respect to trademarks, counterfeiting of western products in Ukraine increased dramatically after the 1998 financial crisis, with industry sources estimating that fifty percent of the name brand products on the Ukrainian market may be fake. Unfortunately, the Government of Ukraine has done little to address this problem. When action is taken, it is usually forced by the foreign trademark owners.

Patent protection is also a problem. U.S. pharmaceutical companies claim that Ukrainian and foreign manufacturers blatantly produce and sell on the Ukrainian market generic copies of pharmaceuticals for which the patents are still valid. Ukrainian legislation does not consider IPR infringement to be a justification for removing a counterfeited pharmaceutical from the market. Ukraine's attempts to bring its legislation in line with the WTO would address this problem.

Despite Ukraine's improved legislative base for IPR protection, enforcement is still weak and sporadic. The Ministry of Internal Affairs and the State Customs Service recently set up units to deal exclusively with IPR violations. These understaffed units, however, cannot adequately deal with the enormous number of IPR infringements in Ukraine. In many cases, the rights holder must actively and continually engage with the Ministry of Internal Affairs or the State Customs Service to obtain enforcement of its IP rights. Courts do not provide a reliable means to address copyright infringement because: (1) there are too few judges trained in intellectual property law; and (2) legal reform has not advanced far enough for enterprises to have confidence in seeking a court settlement. Legal experts and government officials have called for the formation of a special patent court in Ukraine to decide all IPR

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cases, but to date there has been no concrete action towards this end.

Ukraine is in the process of negotiating terms of accession to the WTO, and the government claims it has drafted legislation to bring all of Ukraine's laws into compliance with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

### SERVICES BARRIERS

Ukraine has few explicit services restrictions, so foreign professionals are largely permitted to work in Ukraine. However, the lack of transparency and the multiplicity of licensing authorities serves to hinder foreign access to the Ukrainian services market. As Ukraine is interested in becoming a member of the European Union (EU), it is considering establishing a quota on foreign films, following the EU example. There already is a local content provision for radio and television broadcasting, but it has not been stringently enforced. In 2001, limits on foreign ownership of insurers operating in Ukraine were lifted.

Ukrainian legislation distinguishes between two types of legal practitioners: lawyers (those who have obtained a Ukrainian law degree) and attorneys or "advokats" (those who are qualified lawyers admitted to the Bar and practicing law pursuant to the Law of the Ukraine "On Attorneys"). Attorneys must be Ukrainian citizens. If amendments proposed in April 2000 are adopted, virtually any legal services will qualify as services that must be provided by attorneys. Attorneys will have to set up attorneys' associations in the form of attorney bureaus, firms, etc. in contrast to existing law firms in the form of legal entities. As a result, since attorneys may be only Ukrainian nationals, foreign lawyers and law firms will be effectively

prohibited from rendering legal services in the Ukraine.

A 1999 resolution concerning work visas for foreigners created additional burdens for foreign enterprises. Effective January 1, 2000, the resolution changed tax requirements and increased the personal income tax for foreign workers, who are also now required to pay into Ukraine's unemployment fund. In addition, the work visa requirements became more stringent, with more documentation necessary in order to obtain a work visa. This includes the requirement to show an employment contract and a tax certification showing that the foreign worker has paid all taxes at the time of application. In the past, foreign enterprise representative offices were allowed one director who did not need a work visa. Foreign journalists were also exempted.

In 2001, however, Ukraine also adopted changes to immigration rules that significantly reduced the burden on temporary visitors. Business and tourist travelers arriving in Ukraine for short term visits (not for full time work) are no longer required to register their address with the police within three days of arrival or every time they change hotels. The elimination of this requirement saves many business travelers a great deal of time.

### INVESTMENT BARRIERS

An underdeveloped banking system, poor communications networks, a difficult tax and regulatory climate, increasing occurrences of crime and corruption, limited opportunities to participate in privatization, the absence of clear mechanisms to enforce intellectual property rights (thus creating a barrier to technology transfer to Ukraine), poorly defined and overly complex certification procedures, and a poorly-functioning and unstable legal system combine to

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create major obstacles to U.S. investment in Ukraine.

Ukraine's burdensome and frequently changing tax structure remains a major hindrance to foreign investment and business development. Personal income taxes remain high, although pending tax code legislation includes provisions to lower the rates. Combined payroll taxes (mainly for pensions) have been reduced from the previous high of 52 percent to 37.5 percent - still high, but a considerable improvement. Modern VAT and corporate income tax laws have been enacted and implemented, with provisions for normal business deductions. However, numerous amendments and exemptions have created a confusing and possibly inequitable situation. There are frequent changes in other tax laws and regulations as well, such as import duties and excise taxes, often with little advance notice, giving foreign companies little time to adjust to new requirements. Improvements are being made in tax filing and collection procedures, although they still differ from those in western countries in significant ways. Recognizing that this can cause frictions, the Chairman of the State Tax Administration has established an advisory committee on the tax problems of foreign companies that has been functioning for about two years and has already achieved mutually favorable resolutions of some difficult issues brought to it by U.S. and other foreign companies.

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

everyday problems "doing business" and regard the BIT as a tool of last resort.

A council of independent experts, established by Ukraine's President, has arbitrated in a number of investment disputes. Its rulings are not legally binding, but its decisions have generally been upheld. While it is not currently a formal dispute mechanism, the Ukrainian Government would like to elevate it to such.

To attract investments and remove obstacles to trade, Ukraine created five free economic zones (FEZ) in 1997-1998 with favorable investment regimes: Donetsk, Mariupol, Slavutych, Yavoriv, and Transcarpathia. Although special investment zones have also been introduced in other cities and regions, they do not have the same favorable investment conditions, such as independent customs borders, as the FEZs. Since 1999, Ukraine has not created additional FEZs, as part of an IMF loan condition not to grant economic privileges that distort markets.

### ELECTRONIC COMMERCE

Currently, the Internet and electronic commerce are still undeveloped in the Ukraine. To date, the Ukrainian Government has not taken concrete steps to regulate or provide specific protections for this sector. While various entities of the State Security Service (the successor to the KGB) and the National Security and Defense Council both announced plans to license or regulate the Internet in Ukraine, neither body took any concrete steps to implement their announcement. While the announcements were never officially withdrawn, they appear to have been abandoned.