UKRAINE

TRADE SUMMARY

The U.S. goods trade deficit with Ukraine was $571 million in 2005, an increase of $171 million from $400 million in 2004. U.S. goods exports in 2005 were $532 million, up 33.1 percent from the previous year. Corresponding U.S. imports from Ukraine were $1.1 billion, up 37.9 percent. Ukraine is currently the 78th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Ukraine in 2004 was $256 million, up from $238 million in 2003.

WTO Accession

Ukraine is in the process of negotiating terms of accession to the World Trade Organization (WTO). Negotiations with Working Party Members are active and ongoing. On March 6, 2006, the United States and Ukraine signed a WTO bilateral market access agreement. Other countries with which Ukraine must still conclude a bilateral agreement include: Australia, Colombia, Chinese Taipei, and Kyrgyzstan.

Significant progress towards Ukraine's accession to the WTO was made in 2005. In particular, the passage of key legislation in areas such as intellectual property rights, services, and sanitary and phytosanitary measures helped to bring Ukraine's legislative framework into conformity with WTO requirements and will serve as an important framework going forward for resolving bilateral trade concerns.

IMPORT POLICIES

Ukraine continues to maintain fees and licensing requirements on imports. Ukraine imposes four levies on imported goods: customs tariffs, import duty/fees, value-added-tax (VAT), and excise taxes on alcohol, tobacco, automobiles, and oil products. The current customs tariff schedule comprises approximately 11,000 tariff lines. Most customs tariffs are levied at *ad valorem* rates, but 1,765 tariff line items are subject to specific and combined rates of duty. These specific and combined rates apply to approximately one-third of tariff-lines for agricultural goods, primarily those that are produced in Ukraine. These protected goods include grains, poultry products, sugar, and vegetables such as carrots and potatoes. Between March and July 2005, the Parliament passed three packages of amendments to the Customs Code of Ukraine to decrease tariff rates in an effort to meet WTO accession requirements. The average applied tariff rate for all goods is now 6.5 percent. For agricultural goods, the average applied rate is 13.8 percent (down from 19.7 percent) and for industrial goods the average applied rate is 4.4 percent (down from 8.3 percent). The VAT, currently 20 percent, is levied on top of customs tariffs and excise taxes (when applicable) and can also hinder U.S. exports to Ukraine. Import tariffs were particularly high with respect to petroleum products; they were reduced, however, to zero during a summer 2005 energy crisis and have not been increased again despite a number of proposals in Parliament. Excise taxes on both imported and domestically produced petroleum products remain high, although there have been a number of proposals to reduce these rates.

Most discriminatory excise taxes were eliminated in 2005. However, discriminatory excise taxes still hinder U.S. exports of wine and grape spirits to Ukraine. According to Ukrainian legislation, the excise tax rate on imported wine and grape spirits is 12 and 13 times higher, respectively, than domestically-produced products and will remain at that level until Ukraine accedes to the WTO. Excise tax rates in most cases are fixed and are assessed in hryvnas or Euros. VAT and excise tax exemptions for locally produced vehicles were eliminated on March 29, 2005. Excise taxes on automobiles remain high, ranging from 0.2 EUR/cc to 3 EUR/cc. Also, the excise tax is based on the cubic capacity of the engine, so it disproportionately affects automobiles with larger engines. The import tariff on fully assembled automobiles was raised from 15 percent to 25 percent during 2005 to compensate local producers for the loss of these VAT and excise privileges. This increase has negatively impacted importers of fully assembled automobiles, who are also disadvantaged since the tariff on semi-knocked down (SKD) vehicles is lower.

Import licenses are required for some goods, primarily pesticides, alcohol products, optical media production inputs, some industrial chemical products and equipment containing them, official foreign postage stamps, excise marks, officially stamped/headed paper, checks and securities, and some goods that contain sensitive encryption technologies. Removing unnecessary licensing barriers to trade in mass-market, commercially-traded goods containing encryption is an issue under discussion in Ukraine's WTO accession negotiations. Because product certification is a prerequisite for an import license, those seeking such licenses have two options depending on the value and the frequency of shipments as compared with the cost of certification. The first option entails certification of compliance of a foreign facility to the existing regulations on quality and safety. The U.S. distilled spirits industry reports that this option usually involves a burdensome visit and costly inspection by Ukrainian government officials. The supplier receives a certificate of conformity valid for two to three years, which avoids certification of each shipment. The second option involves certification of each product shipment with mandatory laboratory tests upon arrival in Ukraine.

In terms of customs-related issues affecting trade, imports of U.S. salmon roe (red caviar HS Code 0303 or 0305) were delayed when, early in 2005, the Ukrainian State Customs Service reclassified the products as fish roe substitute (HS Code 1604), which would require payment of a higher customs tariff. Customs requires court decisions to clear the products under the correct category, causing delays and leading to diminished U.S. exports of this highly perishable product.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Foreign investors regard Ukraine's product certification system as a serious obstacle to trade, investment, and ongoing business. U.S. businesses have complained that the standards and certification requirements affecting the consumer goods industry: (1) lack clarity; (2) include registration requirements that are not feasible for mass trade; (3) lack procedural flexibility; (4) impose overly complex and expensive certification requirements; (5) are unevenly enforced; and (6) involve high certification and licensing fees. The process for developing standards has been streamlined over the past few years, however, it remains complex and is subject to frequent changes. At present, Ukrainian authorities do not recognize foreign certificates of conformity with Ukrainian product standards unless recognition is mandated through an international treaty signed by Ukraine. A draft law to harmonize Ukrainian law with the WTO Agreement on Technical Barriers to Trade passed its first reading in Parliament in October 2005.

The standardization and certification body in Ukraine is the State Committee for Technical Regulation and Consumer Policy (DerzhSpozhyvStandard), the former "DerzhStandard." As of November 2005, DerzhSpozhyvStandard had a network of 109 accredited product certifying bodies including 51 accredited certifying bodies for quality management systems, as well as about 780 testing laboratories throughout Ukraine. Appropriate resources, such as modern analytical equipment and reactants, are not available in most laboratories. DerzhSpozhynStandard's system includes 27 territorial departments for consumer protection and 28 state centers for standardization, systematizing weights and measures, and certification.

Numerous certification bodies in Ukraine effectively operate as independent (often monopolistic) entities on a profit-making basis, returning just 20 percent of their fees to the state. Consequently, certification agencies do much of their regulatory work with little or no coordination. Many products require multiple certificates from different agencies, with local, regional and municipal authorities often requesting additional documentation beyond that required by central bodies. According to industry sources, access to the Ukrainian market is impeded by numerous burdensome certification and licensing procedures for equipment. Pharmaceutical and other companies report that they have been required to pay exorbitant additional fees (up to $20,000) to purchase equipment needed to test ingredients that have been used safely for many years.

Sanitary and Phytosanitary (SPS) Measures

Ukraine applies a range of sanitary and phytosanitary (SPS) measures which restrict imports of a number of U.S. agricultural products. Ukrainian barriers to U.S. agricultural goods are estimated to cost U.S. producers between $60 million and $100 million annually. The certification and approval process is lengthy, duplicative, and expensive. Amendments to several laws, including the law "On Quality and Safety of Food Products and Food Raw Materials," intended to bring Ukrainian legislation into compliance with requirements of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Measures), passed in September and November 2005. Further, legislation to bring Ukrainian law into compliance with international norms regarding veterinary medicine, standards, conformity assessment procedures and other sanitary and phytosanitary measures remain at various stages of consideration by Ukraine's Parliament.

The following issues are subjects of discussion between the United States and Ukraine as part of Ukraine's accession to the World Trade Organization:

(1) A two-year ban on U.S. poultry products was lifted in 2003 following the negotiation of a new veterinary certificate. Although not an SPS barrier, high import tariffs and the elimination of Free Economic Zones (FEZs) on March 29, 2005 hampered trade in poultry in 2005. On October 20, 2005, Ukraine's parliament narrowly passed a six-month ban on imports of poultry and poultry products into Ukraine following the discovery of avian influenza in neighboring Russia and Romania. President Yushchenko vetoed this bill, and another similar bill, in November and December 2005;

(2) In the past, Ukraine has blocked the importation of meat and meat products treated with growth promoting hormones. The United States is working with Ukraine to ensure that any measures that Ukraine undertakes are consistent with World Organization for Animal Health (OIE) standards. Ukraine's pending Law of Veterinary Medicine, which is part of the WTO legislative package under consideration, addresses this issue;

(3) U.S pork exports to Ukraine have been hampered by regulations concerning trichinae. The United States is working with Ukraine so that it takes the necessary steps to align Ukrainian standards for trichinae in pork exports with international norms;

(4) Ukraine's biotechnology approval process has been essentially defunct for some time, creating an unofficial ban on biotechnology products. This has resulted in lost sales of corn products, soybeans, and meal. The United States is working with Ukraine to establish procedures regarding biotechnology that are based on modern, science-based risk assessment principles and guidelines, including those of the WTO SPS and Technical Barriers to Trade (TBT) Agreements, the Codex Alimentarius Commission, and the International Plant Protection Convention; and

(5) Beginning in October 2003, the State Department of Veterinary Medicine began detaining large consignments of U.S. salmon, sardines, and roe-citing technical reasons ranging from newly enforced shelf-life regulations to minor certificate errors. In February 2004, a ban on imports of seafood with a shelf-life longer than 4 months was announced. For about a year, seafood shipments from the United States worth a total of $2 million were detained for an average of 2 months until eventually being released. No incidents have been reported since October 2004 and in WTO discussions Ukraine has agreed to eliminate this standard.

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 €40,000 must be conducted via tenders (either open or open with pre-qualification). Open international tenders must be conducted when procurement is financed by any entity outside of Ukraine. The Ministry of the Economy and European Integration publishes information on government procurement in the “State Procurement Bulletin” Among the problems still faced by foreign firms (particularly for smaller procurements) are: (1) the 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. Amendments to the law “On Procurement” introduced in November 2004 and June 2005, attempted to target the problems but raised more concerns. Special requirements for internet sites to publish tender requirements limited competition. The amendments also entrusted the non-government organization (NGO) “Tender Chamber of Ukraine” with the authority to consider claims of tender participants and issue conclusions regarding procurement from a single supplier, leading to discrimination against other NGOs. In order to repair the situation, the Ministry of Economy drafted legislative amendments that are awaiting government and parliamentary approval. Ukraine is not a signatory to the WTO Agreement on Government Procurement. U.S. pharmaceutical companies reported losing government tenders even when they had provided the most competitive offer.

EXPORT SUBSIDIES

Ukraine’s use of industrial policies aimed at import substitution and export promotion is decreasing. The March 2005 budget law either eliminated or initiated the phase-out of tax and customs privileges to favored sectors such as automobiles, shipbuilding, and aerospace as well as on specific companies such as Kyivmiskbud Holding.

The Ukrainian legislation “On State Support of Agriculture” allows the executive branch to establish high minimum prices that could be used for state market interventions. As state-owned grain stocks build up, the Ukrainian government may be tempted to consider the use of export subsidies. The State Reserves Committee of Ukraine was believed to export wheat to Iran and Algeria from July to August 2005 at $125/MT (metric ton), at a time that the purchase price from the farmer was no less than $125/MT. Considering the costs of storage and transportation to the Ukrainian ports, the Committee could not have exported grain without “taking a loss,” i.e. without an export subsidy.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Ukraine was the only country named a Priority Foreign Country in the 2002 to 2005 Special 301 reviews conducted by USTR based on widespread piracy of copyrighted goods such as compact discs (CDs) and digital video discs (DVDs).

The United States withdrew Ukraine's benefits under the Generalized System of Preferences (GSP) program in August 2001 and imposed $75 million worth of sanctions on Ukrainian imports on January 23, 2002. These sanctions, which affected a number of Ukrainian products, including metal, footwear, and chemicals, were lifted on August 30, 2005 after the Ukrainian government secured passage of important amendments to the Laser-Readable Disk Law and other laws, which went into effect on August 2, 2005. The United States concluded a Special 301 Out-of-Cycle Review (OCR) of Ukraine in January 2006. In recognition of the Government of Ukraine's efforts to improve the enforcement and protection of intellectual property rights, the United States reinstated GSP benefits for Ukraine effective January 23, 2006, and lowered Ukraine’s designation under Special 301 from Priority Foreign Country to Priority Watch List. Ukraine agreed to work with the U.S. Government and with the U.S. copyright industry to monitor the progress of future enforcement efforts through an Enforcement Cooperation Group. The United States will continue to monitor developments in the protection of intellectual property rights in Ukraine pursuant to Section 306 of the Trade Act of 1974.

Enforcement of optical media piracy in Ukraine has slowly improved since 2002, when Ukraine was widely viewed as the primary producer and exporter to Europe of pirated copyrighted goods.
A fundamental area of progress is the creation of a regulatory regime for the production, distribution, and export and import of optical media. Many of the deficiencies in Ukraine’s early regulations to stem the commercial-scale pirate production of CDs, CD-ROMs and DVDs were addressed by the amendments to the Laser-Readable disk law that were passed in July 2005 and went into force in August 2005. The new amendments enhanced law enforcement’s role and lowered the threshold for imposing penalties and sanctions. These amendments related to issues such as: (1) establishing a system for monitoring raw materials (optical grade polycarbonate) for optical media production; (2) creating a clear obligation to engrave all manufacturing equipment and molds with SID Codes; (3) expanding non-compliance penalties to include plant closures and deterrent criminal penalties; and (4) stronger enforcement authority to seize infringing machinery and product. The amendments were drafted in close consultation with U.S. industry and the U.S. government.

Implementation and enforcement of these new amendments and other existing intellectual property laws has been ongoing with some positive results. In 2005, the State Department for Intellectual Property (SDIP), which is responsible for the formulation and implementation of Ukraine’s intellectual property laws, as well as the Ministry of Interior conducted 522 inspections of plants and retail establishments resulting in 77 criminal cases and the seizure of 214,882 units of pirated products valued at more than $796,000. Furthermore, the Ministry of Internal Affairs, Ministry of Culture, the General Prosecutors’ office, and the State Security, Tax, and Customs Administration have developed a joint program to coordinate their enforcement efforts. Ukraine remains a major transshipment point, storage location, and market for illegal optical media produced in Russia and elsewhere, however, and needs to significantly improve its customs border enforcement to deal with these continuing problems.

As part of its ongoing efforts to negotiate accession to the WTO, Ukraine has adopted legislation, including a May 2003 Omnibus package, to bring its laws into compliance with the WTO Agreement on Trade- Related Aspects of Intellectual Property Rights (TRIPS). Some issues, however, remain with Ukraine's treatment of foreign geographical indicators. In addition, Ukraine is in the process of strengthening its legal protections for pharmaceutical test data against unfair commercial use. Also, a December 2004 resolution establishing fees for the protection of foreign trademarks and other rights depending on the foreign country's gross domestic product appears not to be in line with international norms.

Patent and trademark violations are common in Ukraine. The Ukrainian Ministry of Health reportedly does not check the validity of patents when it permits pharmaceutical sales in Ukraine. In one case, the Ministry of Health allowed a European company to register the same drug for which a U.S. company held a valid patent. Legal experts and government officials have called for the formation of a special patent court in Ukraine to adjudicate patent cases, but to date there has been no concrete action to establish such a court.

For protection of their trademarks, 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. Trademarked and copyrighted goods must be registered for a fee ($400 for the first good for the first year) in the Customs Authorities' rights holder database in order to be guaranteed protection.

Generally speaking, the number of judges trained in IPR law remains low and companies lack confidence in the Ukrainian judicial system and therefore do not bring private lawsuits. Ukraine has brought a number of criminal cases especially related to trademark violations and retail sale of pirated goods. With lowered thresholds for criminal sanctions in the area of copyright, Ukrainian officials have brought additional cases related to copyright. At the time of writing, however, none of the cases have been completed.

SERVICES BARRIERS

Ukraine has few explicit restrictions on services. Foreign professionals are permitted to work in Ukraine, but the lack of transparency and the multiplicity of licensing authorities hinders foreign access to the Ukrainian services market. A local content requirement exists for radio and television broadcasting, although it has not been stringently enforced. In July 2005, the Parliament adopted legislation that would permit foreign insurance companies to open branches in Ukraine within five years after WTO accession. In July 2005, the Parliament passed the first reading of a draft law that would permit foreign banks to open branches, but it has failed repeatedly in the second reading. Currently, investors can open 100 percent foreign-owned subsidiaries.

INVESTMENT BARRIERS

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. The government is working on streamlining regulations and eliminating duplicative and confusing laws regarding investment and business. In 2003, Ukraine passed legislation on tax reform, establishing a flat tax on personal income of 13 percent and lowering the enterprise profit tax from 27 percent to 25 percent. After the President twice vetoed laws reducing the Value Added Tax (VAT) from 20 percent to 17 percent, Parliament postponed lowering the VAT. The accumulation of VAT refund arrears has also been a serious problem for foreign and domestic exporters in Ukraine, although the GOU has pledged to eliminate VAT arrears and in 2005 improved its repayment record. In 2005, the GOU increased the pace of VAT refunds to 87 percent of the verified claims, up from 65 percent refunded in 2004. However, the process for obtaining a refund of VAT payments can take from three months to eighteen months and remains cumbersome.

Prior to March 2005, only domestic firms were permitted to use promissory notes for the payment of VAT. This discriminatory provision was eliminated by Parliament when the March 2005 budget extended this right to foreign companies.

Combined payroll taxes (mainly for pensions) remain high at an average of 37.5 percent. The 2006 draft budget proposes to lower this tax slightly to 35.5 percent. There are frequent changes in other 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. Improvements are being made in tax filing and collection procedures, although these still differ significantly from those in western countries. The Chairman of the State Tax Administration established an advisory committee on the tax problems of foreign companies, which has been functioning for about three years and has achieved resolution of some difficult issues brought before 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 U.S. investors the better of national and MFN treatment, the right to make financial transfers freely and without delay, international legal standards for expropriation and compensation and access to international arbitration. There are a number of longstanding investment disputes faced by several U.S. companies. These disputes mainly date from the early 1990s and the initial opening of the Ukrainian economy to foreign investors. In most cases, however, there has been little progress toward resolution under subsequent Ukrainian governments.

In early 2005, Ukraine lifted all tax exemptions to investors in Special Economic Zones (SEZ) in order to stop large-scale misuse of the zones. An abrupt and complete cancellation of tax exemptions and lack of compensatory provisions were criticized by investors who suffered from the cancellation, further destabilizing the investment climate. The GOU claims it is currently developing a compensation mechanism for investors. U.S. investors both with planned and existing investment in the SEZs faced substantial losses from the elimination of customs and tax privileges. The Parliament adopted legislation to create technology parks on November 15, 2005, which allows some government financial support, targeted subsidies, and tax privileges for a list of 16 technoparks based on existing scientific and research institutes.

Privatization rules generally apply to both foreign and domestic investors, and, in theory, a relatively level playing field exists. As contrasted with the privatization rush in the 2004 Presidential election year, no major new privatizations were conducted in 2005. Revision of the non-transparent privatization of Ukraine's major steel plant, Krivorizhstal, with a new transparent tender open to international participation allowed the GOU to raise $4.8 billion, as opposed to the $800 million earned from its earlier privatization in 2004. Lack of a clear policy regarding reversals of previous non-transparent privatizations added to the uncertainty of the business climate through most of 2005, resulting in low investment. The GOU made contradictory proposals ranging from revising all suspicious previous privatizations, to relying on private court cases, to seeking amicable agreements with current owners to "pay up" the difference between the purchase and fair market price of the privatized enterprises. The GOU has asserted the need for a law to protect property rights, giving amnesty to current owners after an amicable agreement is reached. Despite these declarations, no such law has been registered in the Parliament yet. The Prime Minister stated publicly in November 2005 that the GOU now plans no further reversals of previous privatizations.

ELECTRONIC COMMERCE

The Internet and electronic commerce are underdeveloped in Ukraine's regions where active Internet users number only a few percent of the population. There is a higher level of usage in Kiev, where 60 percent of city residents are reportedly active Internet users and where Internet commerce, while small in total volume, reportedly increased 50 percent from 2004 to 2005. There are more than 100 Internet retailers in Kiev, 10 of which are large-scale enterprises. The main products sold via the Internet are home appliances and electronics, especially mobile phones. In most cases the Internet retailer operates as a middleman between the wholesaler and the end user. In 2003, the Ukrainian parliament adopted three laws regulating the Internet and setting framework regulations for the telecommunications market. Based on one of those laws ("On Telecommunications"), in 2004, then President Kuchma established the National Council on Communications entrusted with monitoring the telecommunications market. President Yushchenko disbanded that Council and formed a new one, which began operating in April 2005 after President Yushchenko appointed its eight commissioners. It is developing regulations for VoIP (Voice-over Internet Protocol) telephony, but in large part the Internet in Ukraine remains unregulated. A controversial April 2005 Ministry of Transport and Communication regulation that would have forced the registration of Internet websites in Ukraine was cancelled in October 2005, after a public outcry that called the measure an attempt at state-control over the sector and a violation of freedom of speech and expression.

OTHER BARRIERS

Since January 1, 2003, Ukraine has imposed an export duty of 30 euros per metric ton on ferrous steel scrap and a ban on exports of non-ferrous metals. The ferrous scrap export duty contributed to a decline in scrap exports from Ukraine, when global demand and prices for steel scrap were rising. Ukrainian metallurgical producers benefited from lower than world price scrap inputs. This year, in the course of its efforts toward WTO accession, the GOU has repeatedly proposed legislative amendments that would lower the export duty on ferrous scrap to €25 as of January 1, 2006 and to €18 as of January 1, 2007. The GOU also proposed lifting the ban on exports of non-ferrous metal by introducing a 30 percent export duty instead. The Parliament repeatedly defeated these bills during 2005, although a bill to lower ferrous scrap export tariffs passed in the first reading November 15, 2005. Sunflower seeds were subject to a similar export duty since June 21, 2001, which benefited local sunflower oil producers. In July 2005, the export duty on sunflower seeds was lowered to 16 percent of its customs value with further (starting in 2007) one percent annual reductions to reach a final 10 percent. Export duties are also in place on live cattle, sheep, hides, and skins since 1996. For live calves the duty is 75 percent of custom value (but no less than 1500 EUR/ton of live weight); for live cows it is 55 percent (but no less than 540 EUR/ton of live weight); and for live sheep it is 50 percent (but no less than 390 EUR/ton of live weight). For raw hides of cattle the duty is 30 percent (but no less than 400 EUR/ton of live weight); for sheep hides it is 30 percent (but no less than 1 EUR/hide); and for pigskins the duty is 27 percent (but no less than 170 EUR/ton of live weight). On November 15, 2005 the Parliament passed in the first reading a bill to lower the export duty for cattle exports to 30 percent and rawhide exports to 15 percent. Some GOU officials claim these export tariffs are less effective than they appear, as exporters reportedly often circumvent them by transshipping scrap and hides through Moldova, with which Ukraine has a free trade regime.