UKRAINE

TRADE SUMMARY

The U.S. trade deficit with Ukraine was $452 million in 2004, an increase of $420 million from $32 million in 2003. U.S. goods exports in 2004 were $398 million, up 72.6 percent from the previous year. Corresponding U.S. imports from Ukraine were $850 million, up 223.9 percent. Ukraine is currently the 79th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Ukraine in 2003 was $237 million, up from $198 million in 2002.

IMPORT POLICIES

Ukraine continues to maintain a number of barriers with respect to imports, including fee and certification regimes. Most import tariffs are levied at *ad valorem* rates, ranging from 2 percent to 70 percent and averaging 16.3 percent in 2002. Approximately 16 percent of all tariff line items are subject to either compound, alternative minimum, or specific rates of duty. The value-added tax (VAT), currently 20 percent, and discriminatory excise taxes can also hinder U.S. exports to Ukraine. Import tariffs are particularly high with respect to petroleum products (5-60 EUR/ton) and distilled spirits (7.5 EUR/liter). The import tariff on alcohol is equivalent to an *ad valorem* tariff of 50 percent to 100 percent.

Excise taxes generally range from 5 percent to 100 percent. Excise duty rates are assessed as a percentage of the sum of the declared customs value, customs duties, and fees paid for importing products. Of concern were four categories of imports that were subject to excise taxes in 2004: alcoholic beverages, tobacco, petroleum products, and automobiles. Excise taxes on an array of imported alcoholic beverages range from 2 times to 12 times higher than the duty on domestically manufactured products. The excise duty is 4 times higher on imported unfiltered cigarettes. Excise taxes on imported automobiles range from 0.2 EUR/cc to 3 EUR/cc, while no excise tax is levied on the same product categories if domestically produced. In addition, the excise tax is based on the cubic capacity of the engine, which disproportionately affects automobiles with larger engines.

Import licenses are required for some goods, primarily pesticides, alcohol products, CD production inputs, some industrial chemical products and equipment containing them, official foreign postage stamps, excise marks, officially stamped/headed paper, and checks and securities. The U.S. distilled spirits industry reports particularly burdensome import permit requirements for alcohol products, under which certificates of conformity are issued to importers only after officials of the Ukrainian Government have conducted an exhaustive and costly inspection of the producer's facilities. In some cases, these practices have led exporters to withdraw their products from the Ukrainian market.

Ukrainian barriers to U.S. agricultural goods are estimated to cost U.S. producers between $10 million to $25 million annually. Talk of increasing tariffs and introducing quotas, possibly limiting imports of U.S. poultry into Ukraine's tax-free Free Economic Zones (FEZs), suggests that U.S. exports may be further hampered.

The two-year ban on U.S. poultry products was lifted in 2003 following the renegotiation of a new veterinary certificate. Shipments of U.S. poultry to Ukraine resumed in the fourth quarter of 2003. Currently, U.S. poultry products are regaining market share. The government of Ukraine continues to limit red meat imports from the United States (valued at approximately $13 million in 2004) due to a ban on hormone additives in feed and restrictive veterinary and packaging requirements. U.S pork exports to Ukraine are hampered by regulations that do not appear to be scientifically justified concerning trichinosis.

Non-tariff barriers such as excessive customs fees, discriminatory licensing procedures, and transparency of regulations and rules continue to affect key exports of U.S. non-agricultural goods, including civil aircraft, information technology, and machinery.

While costs related to business registration have been reduced, Ukraine still requires numerous permits to conduct business and engage in foreign trade. A new law requiring registration of legal entities within three working days of a request for a permit entered into force on July 1, 2004. According to the Cabinet of Ministers' Committee on Regulatory Policy and Entrepreneurship, additional aspects of the law have complicated business registration procedures and led to a sharp increase in business complaints over registration requirements.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Foreign investors regard Ukraine's product certification system and licensing procedures as serious obstacles to trade, investment, and ongoing business. The standardization and certification body in Ukraine is the State Committee for Technical Regulation and Consumer Policy (DerzhSpozhyvStandard), the former "DerzhStandard." As of November 2004, DerzhSpozhyvStandard had a network of 107 accredited product certifying bodies and six accredited certifying bodies for quality management systems, as well as 780 testing laboratories throughout Ukraine. Appropriate resources, such as modern analytical equipment and reactants, are not available in most laboratories. DerzhSpozhynStandard's system includes 28 state centers for standardization, systematizing weights and measures, certification and 27 territorial departments for consumer protection.

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) involve complex and lengthy import licensing procedures; (5) impose overly complex and expensive certification requirements; (6) are unevenly enforced; and (7) 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. While Ukrainian law formally stipulates equal treatment of domestic and foreign companies, U.S. businesses report that they often experience arbitrary application of the law and that discrimination against foreign companies is common. Ukraine authorities do not recognize foreign certificates of conformity with Ukrainian product standards unless recognition is mandated through an international treaty signed by Ukraine.

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. DerzhSpozhyvStandard does not properly supervise or enforce pricing rules. 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 U.S. telecommunications 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.

Ukraine applies a range of sanitary and phytosanitary (SPS) measures, many of which do not appear to be consistent with an international, science-based approach to regulation. The certification and approval process is lengthy, duplicative, and expensive, with politics and corruption often behind arbitrary application of regulations. 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 longer than a 4-month shelf life 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 being eventually released. No incidents have been reported since October 2004, but the shelf-life restriction still exists and could be enforced at any time.

The government of Ukraine restricts imports of a number of other U.S. agricultural products. Imports of dried-egg products, with a potential value of $1 million, are restricted due to veterinary requirements demanding U.S. certification of the absence of poultry diseases that could not be transmitted via egg powder. In addition, an unofficial ban on biotechnology products may cost American farmers an estimated $2 million in lost sales of corn products, soybeans and meal.

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 pre-qualification). 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" by the Ministry of the Economy and European Integration. 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. Ukraine is not a signatory to the WTO Agreement on Government Procurement.

EXPORT SUBSIDIES

The Ukrainian government continues to maintain some industrial policies aimed at import substitution and export promotion, although these practices are decreasing. Some Ukrainian enterprises are not required to pay taxes, receive energy at a concessionary price, clear transactions by offsetting mutual debts, and receive below-cost government inputs.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Ukraine was the only country named a Priority Foreign Country in the 2002, 2003 and 2004 Special 301 reviews conducted by USTR. 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 impact a number of Ukrainian products, including metal, footwear, and chemicals, remain in effect based on the repeated failure of the Government of Ukraine to enact and enforce adequate optical disc media licensing legislation in order to fully comply with the June 2000 United States-Ukraine Joint Action Plan to Combat Optical Media Piracy. The Ukrainian Government has drafted amendments to the existing Optical Disc Licensing Law to address the law's inadequacies, but Ukraine's parliament has failed to pass these amendments on several occasions. As a result, Ukraine's law does not have adequate enforcement provisions to prevent unauthorized optical media production and distribution. Ukraine is also a major trans-shipment point and storage location for illegal optical media produced in Russia and elsewhere.

As part of its ongoing efforts to negotiate accession to the WTO, Ukraine has adopted legislation to bring its laws into compliance with the WTO Agreement on Trade- Related Aspects of Intellectual Property Rights (TRIPS). Nevertheless, enforcement remains weak. In addition to optical media piracy, patent and trademark violations are common in Ukraine, and U.S. industries report rampant counterfeiting of pharmaceuticals and consumer products. In addition, the Ukrainian Ministry of Health reportedly does not check the validity of patents when it permits pharmaceutical sales in Ukraine.

In order to increase IPR enforcement, the Ministry of Internal Affairs and the State Customs Service have set up units to deal exclusively with IPR violations. The State Department of Intellectual Property has trained 20 inspectors to enforce Ukraine's CD licensing regime. These under-staffed units cannot, however, adequately deal with the enormous number of IPR infringements. 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. The judicial system does not provide reliable recourse against IPR infringement, because the number of judges trained in IPR law remains low and enterprises generally lack confidence in the Ukrainian judicial system and therefore do not bring private lawsuits. 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 towards this end.

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. Foreign insurance firms and banks are permitted to operate in Ukraine, but they cannot open branches, a prohibition that impedes participation of foreign businesses in Ukraine. Nevertheless, 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. In 2003, Ukraine passed legislation on tax reform, establishing a flat rate on Personal Income Tax of 13 percent and lowering 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 until 2005. The accumulation of VAT refund arrears has also been a serious problem for foreign and domestic exporters in Ukraine.

Rules governing payment of the VAT discriminate against foreign companies and domestic firms with foreign investment. A decision by the State Customs Service requires those companies to pay VAT (20 percent) upon importation of goods, while Ukrainian tax law allows Ukrainian firms to use promissory notes upon importation of goods for re-export, with notes cancelled when re-export occurs. Because the process for obtaining refund of VAT payments can take from six to eighteen months, this interpretation of the law disadvantages foreign companies.

Combined payroll taxes (mainly for pensions) remain high at an average of 37.5 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 two 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.

To attract investment and remove obstacles to trade, Ukraine created eleven Free Economic Zones (FEZs) and nine Priority Development Territories (PDTs), reportedly covering some 10 percent of Ukrainian territory. In August 2002, the Cabinet of Ministers introduced a moratorium on the establishment of FEZs and PDTs until January 1, 2005. There is no single, clear law that regulates the FEZs. Legislative loopholes permit companies to misuse FEZ status, and to avoid taxes and import duties.

Privatization rules generally apply to both foreign and domestic investors, and, in theory, a relatively level playing field exists. In practice, however, the privatization process continues to lack transparency. Clear qualification requirements for investors need to be established, and recognition of procedures and financial information need to be more public, complete, and timely. Each year a list of companies is slated for privatization, but the cash sale of majority shareholdings in several strategic large-scale enterprises has been inconsistent. In the 2004 Presidential election year, the Ukrainian government rushed to privatize large plants including coalmines and steel mills. The privatizations were marked by unclear, non-transparent and changing regulations and by heavy political interference that practically excluded foreign investors from participating in privatization. A particularly egregious case in June 2004 which received wide press coverage was that of Kryvorizhstal, Ukraine's largest steel mill, which was sold to government-backed investors for much less than bids presented by a consortium made up of London-based LNM Corp. and Pittsburgh-based U.S. Steel, as well as other foreign investors.

ELECTRONIC COMMERCE

The Internet and electronic commerce are underdeveloped in Ukraine. 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 the President established the National Council on Communications entrusted with monitoring the telecommunications market. The Council is to begin operating in 2005 with members appointed by the President.

OTHER BARRIERS

As of January 1, 2003, Ukraine imposed an export duty of 30 euros per metric ton on ferrous steel scrap and in the spring of 2004, the government increased by 70 percent railway shipping rates for exported scrap metal, coke and coking coal. 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 assists Ukrainian steel producers by increasing domestic steel scrap supply, providing them with an advantage in Ukraine and in third markets. The government says it will lower the export duty in the course of its WTO accession, but no specific steps have been taken yet. Moreover, the export duty constricts global supplies of a key steel input, which has the effect of raising prices of steel scrap for otherwise competitive producers elsewhere, including those in the United States. Sunflower seeds have been subject to a similar export duty since June 21, 2001, which benefits local sunflower oil producers. Export duties have also been imposed 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 pig skins the duty is 27 percent (but no less than 170 EUR/ton of live weight).