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OF
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VIA MESSENGER

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Acting Assistant Secretary for Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th Street & Constitution Avenue, NW
Washington, DC 20230

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

Dear Mr. Assistant Secretary:

The Ad Hoc Committee of Domestic Nitrogen Producers ("Ad Hoc Committee")[1] hereby submits comments in response to the Department's Notice of Initiation of a Changed Circumstances Review of the Antidumping Duty Order on Carbon and Certain Alloy Steel Wire Rod from Ukraine and Request for Comments, 70 Fed. Reg. 21396 (April 26, 2005).[2] For the reasons discussed in the attached submission, the Ad Hoc Committee respectfully submits that

[1] The members of the Ad Hoc Committee are CF Industries, Inc., PCS Nitrogen Fertilizer, L.P., and Terra Industries, Inc.

[2] These comments are timely filed pursuant to the Department's Notice of Extension of Comment Period, 70 Fed. Reg. 34744 (June 15, 2005).

Ukraine has not made sufficient strides in transitioning its economy to a market orientation to permit the Department to revoke Ukraine's non-market economy ("NME") status pursuant to Section 771(18) of the Tariff Act of 1930, as amended.

To date, the Department has revoked the non-market economy status of ten former communist countries – Poland, Slovakia, the Czech Republic, Hungary, Latvia, Kazakhstan, the Russian Federation, Estonia, Lithuania, and Romania.[3] As the Department has recognized in these earlier cases, the statute does not provide a bright-line test with which to measure a country's progress in reforming its economy.[4] However, in prior determinations, the Department has fleshed out the requirements for each of the statutory factors and the clear foundation they provide for how the Department will assess a country's progress toward market principles.

While the recent election in Ukraine is a very positive development, it is evident that, based on the statutory standards, Ukraine cannot properly be graduated to market economy status under U.S. antidumping law. Ukraine has to date failed to sufficiently reform its laws and restructure its economy so as to allow market forces to determine wages, prices, and production decisions. Limited progress toward market economics has resulted in foreign direct investment in Ukraine being one of the lowest in the region. Further, privatization

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[3] See Respondent's Request for Revocation of Poland's NME Status, Department Memorandum (June 21, 1993); Antidumping Duty Determinations on Cold-Rolled Carbon-Quality Steel Products from the Slovak Republic – Market vs. Non-Market Economy Analysis, Department Memorandum (Oct. 13, 1999); Antidumping Investigation of Certain Small Diameter Carbon and Alloy Seamless Standard Line and Pressure Pipe from the Czech Republic: Non-Market Economy Country Status, Department Memorandum (Nov. 29, 1999); Antidumping Administrative Review of Tapered Roller Bearings and Parts Thereof, Finished or Unfinished, from Hungary – Market vs. Non-Market Economy Analysis Memorandum, Department Memorandum (Feb. 23, 2000); Antidumping Duty Investigation of Certain Steel Concrete Reinforcing Bars from Latvia – Request for Market Economy Status Department Memorandum (Jan. 10, 2001); Antidumping Duty Investigation of Silicomanganese from Kazakhstan – Request for Market Economy Status, Department Memorandum (Mar. 25, 2002); Inquiry into the Status of the Russian Federation as a Non-Market Economy Country Under U.S. Antidumping Law, Department Memorandum (June 6, 2002); Decision Memorandum Regarding Estonia's Status as a Non-Market Economy Country (Feb. 28, 2003); Decision Memorandum Regarding Lithuania's Status as a Non-Market Economy Country (Feb. 28, 2003); Antidumping Duty Administrative Review of Certain Small Diameter Carbon and Alloy Seamless Standard, Line and Pressure Pipe from Romania – Non-Market Economy Status Review (Mar. 10, 2003).

of state-owned enterprises has been slow and marred by lack of transparency. Finally, the Government of Ukraine continues to play a significant role in allocation and pricing decisions, particularly in the energy sector. By any measure, Ukraine has not yet reached the level of transformation to a market economy necessary to revoke its NME status, or to permit U.S. antidumping laws to operate meaningfully using market economy methodologies.

The comments provided below are organized according to the instructions set forth in the Department's April 26, 2005 notice. Electronic addresses for supporting documentation are provided in the citations. The Ad Hoc Committee would, of course, be pleased to provide hard copies upon request.

Respectfully submitted,

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[4] See, e.g., Latvia Memorandum at 20.

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The Ukrainian currency, the hryvnia, is not freely convertible because the Government of Ukraine ("GOU") continues to maintain extensive currency controls.

B. Discussion

Under Section 771(18)(B)(i) of the Tariff Act of 1930, as amended ("Act"), the Department must consider the extent to which the currency of a country being considered for market economy status is convertible. As the Department stated in its 2002 determination graduating Russia from non-market economy ("NME") status, "a country's integration into world markets is highly dependent upon the convertibility of its currency."[1] In its 1997 review of Ukraine's status, the Department examined this issue and found that the hryvnia "is not convertible" outside of the Newly Independent States and that the {GOU} "retains control over the influx of foreign currency into its domestic economy by requiring that 50 percent of foreign export earnings be converted to hryvnias . . . ."[2]

The situation has not changed significantly since the Department's decision in 1997, and the GOU continues to retain significant control over foreign currency. Indeed, the International Monetary Fund "has for some time now recommended that Ukraine allow more exchange rate flexibility."[3] Moreover, as the Department of Commerce has recently recognized, the GOU

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[1] Inquiry into the Status of the Russian Federation as a Non-Market Economy Country Under the U.S. Antidumping Law, Department Memorandum, "Analysis of Section 771(8)(B) Factors" (Jun. 6, 2002) ("Russian Memorandum").

[2] Certain Cut-to-Length Carbon Steel Plate from Ukraine, 62 Fed. Reg. 61754, 61755 (Nov. 19, 1997)(final determination of sales at less than fair value) (hereinafter cited as "1997 Determination") (the Department determined that the economic conditions in Ukraine did not warrant the revocation of its non-market economy ("NME") status).

[3] International Monetary Fund, "IMF Survey," Vol. 34, No. 6., at 90 (Apr. 4, 2005) ("IMF Survey"), available at http://www.imf.org/external/pubs/ft/survey/surveyx.htm.

requires that foreign funds can "only be brought into Ukraine via special commercial bank accounts," which must convert hard currency into hryvnia and, therefore, "{f}oreign investments may only be conducted in hryvnia."[4] In addition, "for hard currency sent out of Ukraine, each transaction valued over $50,000 has to be approved by the {National Bank of Ukraine, which} charges a fee to review the transaction,"[5] and "investors must convert half of their foreign currency revenues to the national currency."[6] These restrictions are "burdensome and costly for investors,"[7] and have the effect of stifling foreign competition and preventing market-based activity.

In contrast, when it graduated Russia, the Department noted that the ruble was fully convertible and domestic and foreign companies and individuals were free to repatriate capital and remit profits.[8] Similarly, when Kazakhstan was graduated, its currency was fully convertible for current account purposes, exchange rates were market driven, and the National Bank of Kazakhstan limited its influence on the value of the currency to interventions designed to control inflation.[9] In graduating Latvia, the Department found that Latvia did not restrict the transfer or use of foreign exchange for domestic business transactions or international trade purposes, nor were there any foreign exchange surrender requirements.[10] Likewise, the Department found that

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[4] Department of Commerce and Department of State, Doing Business in Ukraine: A Country Commercial Guide for U.S. Companies, (2004) at Ch. 6, "Investment Climate," Section on "Restrictions on Converting/Transferring Funds," available at http://buyusainfo.net/docs/x_6979181.pdf ("Country Commercial Guide").

[5] Id.

[6] Id.

[7] Id.

[8] See Russian Memorandum at "Analysis of Section 771(8)(B) Factors."

[9] See Antidumping Duty Investigation of Silicomanganese from Kazakhstan – Request for Market Economy Status, Department Memorandum, at "Analysis of Section 771(8)(B) Factors" (Mar. 25, 2002) ("Kazakhstan Memorandum").

[10] See Antidumping Duty Investigation of Certain Steel Concrete Reinforcing Bars from Latvia – Request for Market Economy Status, Department Memorandum at 6 (Jan. 10, 2001) ("Latvia Memorandum").

in Hungary, residents and firms could hold foreign exchange and freely convert the local currency into foreign exchange for both trade and investment purposes.[11]

Unlike these countries that the Department has graduated to market economy status, Ukraine has failed to date to attain a level of currency convertibility that permits the operation of the supply and demand forces that are necessary to ensure that domestic prices are truly market-based. Consequently, the Department must find that, at this time, the Ukrainian hryvnia is not sufficiently convertible for Ukraine to have achieved market economy status.

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[11] See Antidumping Administrative Review of Tapered Roller Bearings and Parts Thereof, Finished or Unfinished, from Hungary – Market vs. Non-Market Economy Analysis Memorandum, Department Memorandum at 6 (Feb. 23, 2000) ("Hungary Memorandum").

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

A. Summary of Comment

Workers in Ukraine are restrained by legal provisions that limit their freedom to associate and to organize. The continuing dominance of the union that succeeded the Soviet-era unions and its strong ties to the Ukrainian government suppress the formation and influence of independent unions, and prohibits wage rates from being set by the market.

B. Discussion

Under Section 771(18)(B)(ii) of the Act, the Department must consider the extent to which wage rates are determined by free bargaining between labor and management. The Department stated in its Russian graduation decision that "the manner in which wages are set. . . {is} an important component of producers' costs and prices, and in turn are an important indicator of a country's overall approach to setting cost and prices in the economy."[12] Free bargaining between labor and management indicates the extent to which there is a market for labor in the country and, thus, the extent to which wages are determined by the market.[13] The Department previously examined this issue with respect to Ukraine and found that, although Ukrainian law allows for collective bargaining, the GOU still appears to be "heavily involved."[14] This situation has not changed significantly since the Department's 1997 Determination, and the Department should continue to find that wages are not determined by free bargaining between labor and management.

Despite legal provisions that might suggest otherwise, the GOU continues to exert significant direct and indirect control over the activities of trade unions. The U.S. Department of

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[12] Russian Memorandum, "Analysis of Section 771(18)(B)."

[13] See id.

[14] 1997 Determination, 62 Fed. Reg. at 61755.

State has recently found that, although Ukrainian law allows for trade unions to participate in collective bargaining, these "rights are not always respected."[15] Specifically, "overlapping spheres of responsibility frequently impeded the collective bargaining process, and the manner in which the collective bargaining law was applied prejudiced the bargaining process against independent unions and favored the official unions."[16] These official unions (or Federation of Trade Unions) "maintained strong ties to the {GOU}. . .{and}. . .often coordinated its activities with the {GOU}. . . ."[17] In many cases, independent unions were denied recognition by employers and, as a result, the unions were also denied other rights, such as the right to bargain collectively.[18]

Independent trade unions have had a difficult time in even becoming established in Ukraine. In 2003, amendments to the Law on Trade Unions granted unions the status of "legal entities" that need only provide notification of registration, rather than having to obtain approval from the Ministry of Justice ("MOJ").[19] However, "union representatives claim that the MOJ has used repeated requests for additional documents as a delaying tactic."[20] Independent trade unions have also complained of state representatives trying "to influence union votes and pressure members to report on union activities," as well as "harassment by security forces and tax authorities."[21] Many of the gains resulting from the 2003 amendments were "undone by the

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[15] Department of State, Country Reports on Human Rights Practices – 2004 at Sec. 6.b., "Worker Rights" (Feb. 28, 2005), available at www.state.gov ("State Department Report").

[16] Id.

[17] Id. at Sec. 6.a.

[18] See International Confederation of Free Trade Unions, "Ukraine: Annual Survey of Violations of Trade Union Rights (2004)," available at www.icftu.org/displaydocument.asp?Index=991219470&Language=EN ("ICFTU Survey").

[19] State Department Report at Sec. 6.a.

[20] Id.

[21] Id.

{subsequent} entry into force of the new Civil Code, {which}. . . reinstated the requirement that all legal entities, including trade unions, must register."[22]

Activities by workers are also restricted. In a 2004 survey, the International Confederation of Free Trade Unions reported that "{m}any restrictions on the freedom of association and on the right to strike remained on the books. . . {and that} corruption {among employers} remained a major problem."[23] Further, "{t}rade union members {are} often the subject of harassment {and are}intimidated, put under pressure to leave trade unions, suffer wage arrears or are transferred to positions that do not correspond to their skills."[24] Moreover, even though the Ukrainian Constitution permits workers to join trade unions, some workers are not permitted to do so.[25]

While the GOU has enacted new laws that appear favorable towards labor and the idea of free bargaining, in practice the GOU continues to interfere in labor and management issues. Under these conditions, wages in Ukraine do not adequately reflect costs and prices in the economy, given that unions are either not independent of the government or, if they are, face discrimination. These factors distort the economy such that the Department cannot find that Ukraine has made sufficient progress toward a market economy under this criterion.

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[22] Id. Emphasis added.

[23] ICFTU Survey.

[24] Id.

[25] State Department Report, at Sec. 6.a.

III. THE UKRAINIAN GOVERNMENT HAS NOT ESTABLISHED A FAVORABLE CLIMATE FOR JOINT VENTURES AND FOREIGN INVESTMENT

A. Summary of Comment

Ukraine has one of the lowest per capita levels of foreign direct investment in the region due to the failure of the Ukrainian government to create favorable conditions for investment. The Ukrainian political system, tax system, legal system, and widespread corruption are all serious impediments to foreign investment.

B. Discussion

Under Section 771(18)(B)(iii) of the Act, the Department must consider the extent to which joint ventures or other investments by foreign investors are permitted. As the Department noted in its Russian graduation decision, foreign investment "tends to expose domestic industry to competition from market-based suppliers and their management, production and sales practices . . . ."[26] Foreign investors generally demand a certain level of control over their investments, which thereby limits the NME government's control over the market.[27] In its 1997 Determination, the Department found that, while Ukraine was open to foreign investment, "areas of concern remain for foreign investors, in particular the reportedly burdensome and unpredictable arbitration and enforcement systems."[28] The situation has not changed significantly since 1997, and the Department should continue to find that Ukraine is insufficiently open to foreign investment to permit graduation to market economy status.

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[26] Russian Memorandum, "Analysis of Section 771(18)(B)."

[27] See id.

[28] 1997 Determination, 62 Fed. Reg. at 61756.

The Department's own very recent assessment of Ukraine paints a bleak picture of the Ukrainian economy for foreign investors, finding unequivocally that "operating risk in Ukraine is high."[29] The Department noted numerous areas of concern, including that:

- the political system is unpredictable and ineffective;
- vested interests distort the commercial and administrative system;
- red tape remains pervasive;
- discrimination against foreign businesses is common;
- the commitment to a liberal market is weak; and
- the tax system is unclear and unpredictable.[30]

Exacerbating an already uninviting investment environment is the fact that "corruption is widespread and reaches the highest levels of government,"[31] and the GOU interferes excessively in "what should be private business decisions."[32] Indeed, Ukraine ranks just "122 out of 146 countries in the corruption index compiled by Transparency International . . . ."[33] Furthermore, the Department noted that the previous government had a poor record of "promoting competition and restraining unfair competitive practices {and} although the new government is much more committed to a level playing field, reforming the old system will take a while."[34] The Department of State noted that the Ukrainian economy "remains burdened by a lack of transparency, with the shadow economy accounting for a significant proportion of real

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[29] U.S. Department of Commerce, Executive Briefing Ukraine: Market Profile and Industry Forecasts, (Mar. 2005), at Section on "Overall Assessment" ("Ukraine Executive Briefing").

[30] Id. Regarding the tax system, see also Country Commercial Guide, at Ch. 6, Section on "Tax Policies" ("There has been discrimination against foreign companies in the use of promissory notes to cover VAT for temporary imports. In addition to confusing regulations and a heavy tax burden, investors complain of harassment by tax officials, discriminatory application, and disproportionate penalties.")

[31] Id at "Government Effectiveness Risk."

[32] Country Commercial Guide, at Ch. 6, "Government's Attitude Towards Foreign Investment."

[33] IMF Survey at 90.

[34] Ukraine Executive Briefing, at Section on "Legal and Regulatory Risk."

income."[35] Such significant, persistent, and deep-rooted problems have created a very unfavorable climate for joint ventures and foreign investment.

Moreover, the Organization for Economic Cooperation and Development ("OECD") noted in a recent report that:

> For all the progress that Ukraine has made in the decade since it became independent, much work remains to be done. While it is disappointing to point out, it is nonetheless a fact that the explosion of new legislation that has issued from Ukraine's Parliament over the past several years has resulted in many new codes and laws that are riddled with ambiguities, internal conflicts and conflicts with other pieces of legislation . . . . Both foreign and domestic businesses are consequently forced to fight through a sea of red tape on a daily basis . . . .[36]

Specifically, the OECD Report noted significant conflicts between Ukraine's new Civil Code and Commercial Code that create ambiguities for foreign and domestic businesses, noting that "{d}espite their different names, both the Civil Code and Commercial Code regulate some of the same business matters."[37] Importantly, the two codes take different approaches to regulating business, with the Civil Code aiming to "support a market economy, with freedom of contract, fair competition, and protection of businesses' rights, {while} the Commercial Code seems to be trying to impose a planned economy on the nation."[38] The OECD Report also found that "the main problem with the Commercial Code is that it permits the State and its functionaries to engage in business to the detriment of private enterprise development in Ukraine . . . . {T}he Commercial Code permit{s} and facilitat{es} the State's interference in the economy."[39] Clearly, the GOU seeks to continue to interfere in private commercial affairs. In

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[35] State Department Report, at Introduction.

[36] Organization for Economic Cooperation and Development, Legal Issues with Regard to Business Operations and Investment in Ukraine, (Oct. 2004) at 15 ("OECD Report"), available at http://www.oecd.org/dataoecd/57/59/34514482.pdf.

[37] Id. at 18.

[38] Id.

[39] Id. at 22.

addition, laws on creditors' rights and insolvency are weak, as is the legal and regulatory framework for corporate governance. Finally, Ukraine's accounting and auditing standards do not conform to international standards, which makes it difficult to properly assess the financial condition and creditworthiness of enterprises.[40] These shortcomings clearly demonstrate that the GOU has not yet created a favorable climate for foreign investment.

Even if foreign investors were to risk ventures in Ukraine despite the challenges discussed above, the country's legal system provides little comfort that ensuing disputes will be handled fairly or efficiently. The Department noted very recently that in Ukraine, "the judicial process remains slow and inefficient . . . {and } the legal process is not independent, {with} a judiciary{that is}. . .easily cowed by vested interests."[41] Foreign investors have "little confidence in the Ukrainian court system."[42] Furthermore, should foreign companies enter into joint ventures, "contracts are difficult to enforce and regulation is neither impartial nor clear,{and} private property rights are still not well protected."[43] Even when favorable court decisions are received, "investors claim they are often not enforced."[44]

An analysis of the statistical data on foreign investment bears out the conclusion that, due to the significant problems described above, foreign investors have shown little enthusiasm for investing in Ukraine. In its March 2005 assessment, the Department reported that "{d}espite Ukraine's strategic location, rich natural resources, and its relatively cheap and skilled labor force, which make it a potentially attractive investment location, inflows of foreign direct

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[40] See International Monetary Fund, "Ukraine: Selected Issues" at 22 (January 2005) ("Selected Issues").

[41] Ukraine Executive Briefing, at Section on "Legal & Regulatory Risk."

[42] Country Commercial Guide, at Ch. 6, "Investment Climate," section on "Restrictions on Converting/Transferring Funds."

[43] Ukraine Executive Briefing, at "Legal & Regulatory Risk."

[44] Country Commercial Guide, at Ch. 6, "Enforcement of Rights."

investment ("FDI") have been comparatively low."[45] Total FDI in Ukraine in 2002 was only $4.75 billion, which was only a fraction of the $40 billion that "government officials estimate is required to complete the country's transition to a market economy."[46] Furthermore, per capita FDI was only $100, "one of the lowest figures in the transition region."[47] By 2004, per capita FDI had risen to only $140, and was still "one of the lowest . . . in the CIS."[48] Foreign investment is clearly not a priority for Ukraine, where "considerable problems still remain. . . {and which is} a long way behind most countries in the region in implementing long-delayed structural reforms."[49]

As the discussion above demonstrates, significant areas of concern remain. The uncertainty over application of the law, rampant corruption, and continued discrimination against foreign businesses contribute heavily to Ukraine being ranked among the lowest of the countries in the region in foreign direct investment. Ukraine has not sufficiently opened its economy to foreign investment and has not, therefore, been exposed to market-based competition to the degree necessary for the Department to graduate Ukraine to market economy status.

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[45] Ukraine Executive Briefing, at "Foreign Investment."

[46] Id.

[47] Id.

[48] Country Commercial Guide, at Ch. 6, "Foreign Direct Investment."

[49] Ukraine Executive Briefing, at "Foreign Investment."

IV. THE UKRAINIAN GOVERNMENT MAINTAINS EXTENSIVE OWNERSHIP AND CONTROL OF THE MEANS OF PRODUCTION

A. Summary of Comment

Privatization of state-owned enterprises has been slow and marred by a lack of transparency. The new government does not appear to be fully committed to further privatization and market economy principles. The GOU also continues to exert substantial control over the energy sector, and has made no progress toward privatizing the natural gas sector.

B. Discussion

Under Section 771(18)(B)(iv) of the Act, the Department must examine the extent of government ownership or control of the means of production. As the Department noted in its decision to graduate Russia to market economy status, the right to own property is "fundamental" to a market economy.[50] Further, the extent of private sector involvement in the economy is an indicator of the extent to which the economy operates on market principles.[51]

In assessing the extent to which a government owns or controls the means of production, the Department has generally examined (1) the privatization of industrial enterprises; and (2) land reforms.[52] In its 1997 Determination, the Department examined this issue and found that, while Ukraine had made significant progress in privatizing state-owned businesses, "privatization has proceeded unevenly. . . and much of the economy remains in the hands of the government."[53] Although the GOU has made further progress in privatizing the economy since 1997, the level of government ownership remains far too extensive to permit a functioning market economy.

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[50] Russian Memorandum, "Analysis of Section 771(18)(B)," at Sec. 4.

[51] Id.

[52] See, e.g., Russian Memorandum, "Analysis of Section 771(18)(B)," at Sec. 4.

[53] 1997 Determination, 62 Fed. Reg. at 61756.

The lack of sustained progress in Ukraine's privatization efforts is a matter of widespread concern for government and international institutions that monitor the status of Ukraine's transition to a market economy. For example, the European Bank for Reconstruction and Development noted very recently that "privatization has been carried out on an ad-hoc and non transparent basis" and "{o}verall, the pace of privatization has been slow."[54] Moreover, despite reforms to date, the "{GOU} still retains a significant share of fixed assets in a number of major sectors including energy transport and distribution, mining, fishing and transport."[55] According to the International Monetary Fund, approximately 2,600 enterprises remain under state control, fully a third of which were unprofitable.[56] The EBRD also expressed concern about the non-transparent nature of many privatizations, noting that their terms frequently favored the "financial industrial groups" ("FIGs") purchasing state assets in transactions that cast serious doubts on whether the government received full value.[57] In fact, the EBRD cited "integrity" as the biggest challenge it faces in Ukraine, since the FIGs that purchased many state assets were created in part by privatizations marked by a lack of transparency and other questionable activities, thereby making it difficult for the EBRD to work with them.[58]

Further, the International Monetary Fund this year expressed "regret" that privatization procedures "remain non-transparent" and urged the GOU to "ensure that future privatizations are in line with best international practices."[59] It also noted that "recent privatizations to well-

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[54] European Bank for Reconstruction and Development, "Strategy for Ukraine – 2005-2007," at 22 (May 17, 2005) ("EBRD Report"), available at http://www.ebrd.com/about/strategy/country/ukraine/strategy.pdf.

[55] Id. at 20.

[56] See Selected Issues at 56.

[57] Id. at 22.

[58] Id. at 15.

[59] International Monetary Fund, "Ukraine: 2004 Article IV Consultation – Staff Report," at 29 (January 2005) ("IMF Staff Report"), available at http://www.imf.org/external/pubs/ft/scr/2005/cr0515.pdf.

connected members of the establishment, in which proceeds have totaled more than $1 billion, were not conducive to greater foreign investment."[60] Clearly, the IMF believes that the Ukrainian privatization process to date is seriously flawed and has not been conducted according to market principles.

The World Bank noted that "the business environment still suffers from high uncertainty, unequal economic conditions and selectivity in the application of laws and regulations" and that "the lack of a level playing field for business in Ukraine is a mirror reflection of the insider economy itself."[61] The Department has also noted that privatizations in Ukraine only "in theory" level the playing field between foreign and domestic investors.[62] The recent privatization of Ukraine's largest steel company, Krivorizhstal, is a prime example of the seemingly arbitrary and non-transparent Ukrainian privatization process that led to extremely valuable assets being sold to "well connected oligarchs for bargain prices."[63] In that case, the steel plant was sold to a Ukrainian group for $800 million, "despite offers of $1.2 billion by the Russian steel giant Severstal and $1.5 billion from the British-US consortium of LNM Group and United States Steel Corp."[64] Following allegations of fraud, the courts determined that the privatization was illegal, but that decision is being challenged at the Ukrainian Supreme Court.[65]

It is not altogether apparent, moreover, that the new government is truly committed to transparent and market-based privatization of the Ukrainian economy. One knowledgeable

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[60] Id. at 26.

[61] World Bank, "Ukraine: Building Foundations for Sustainable Growth" at 79 (August 2004) ("Building Foundations"), available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/UKRAINEEXTN/0,,menuPK:328539~pagePK:141159~piPK:141110~theSitePK:328533,00.html.

[62] Country Commercial Guide, at Ch. 6, at "Privatization."

[63] "Ukraine to Review Privatization of Firms," Deutsche Welle (Feb. 26, 2005), available at http://www.dw-world.de/dw/article/0,1564,1502214,00.html.

[64] Id.

[65] See id.

observer recently lamented that "the biggest blow to the {Ukrainian} economy has been the new government's foggy plans for re-privatization."[66] Government officials have indicated that the GOU may contest the legality of as many as 3,000 privatization deals,[67] but it is not at all clear that the government would not re-nationalize the most valuable properties. For example, the government has already moved to re-nationalize the Zaporoshye aluminum smelting plant, and other enterprises have been targeted.[68] In addition, in reaction to the fuel crisis in Spring 2005 caused by government-imposed price controls, President Yushchenko instructed his cabinet to introduce legislation to consolidate state ownership interests in oil refineries in the state-owned enterprise Ukrnafta as part of a longer-term effort to create a vertically-integrated state-owned company that will supply 40-50 percent of the domestic fuel market.[69]

Notably, Prime Minister Tymoshenko and the head of the State Property Fund both appear to be in favor of such renationalizations. Both have suggested that Krivorizhstal should be renationalized,[70] and Prime Minister Tymoshenko stated in a recent interview that "{t}he biggest enterprises, which can easily be efficiently managed, must not be privatized, and they can give the state as an owner wonderful profits."[71] She has also stated that "{i}f an enterprise brings profits to the country, it is not necessary to sell it into private ownership."[72] Statements such as these indicate that, rather than selling remaining state-owned enterprises and directing

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[66] Anders Aslund, "Betraying a Revolution," Washington Post (May 18, 2005) at A17.

[67] See id.

[68] See "Another day, another scandal – the Ukrainian "orange" revolution marks its first 100 days," Pravda (May 4, 2005), available at http://english.pravda.ru.

[69] See "Kyiv Takes Emergency Steps to Cope with Fuel Crisis," Eurasia Daily Monitor (May 19, 2005), obtained from Ukrainian Center for Independent Political Research, www.ucipr.kiev.ua

[70] See Taras Kuzio, "Kyiv Divided on How Far to Go with Re-Privatization," Eurasia Daily Monitor (May 11, 2005), obtained from Ukrainian Center for Independent Political Research, www.ucipr.kiev.ua.

[71] "Betraying a Revolution."

[72] Taras Kuzio, "Kyiv Divided on How Far to Go with Re-Privatization," Eurasia Daily Monitor (May 11, 2005), obtained from Ukrainian Center for Independent Political Research, www.ucipr.kiev.ua.

the economy toward market principles, the GOU is more likely to increase its ownership role and strengthen its control of production and resources.

Of particular concern to the Ad Hoc Committee is the natural gas sector, since natural gas is the primary feedstock for nitrogen fertilizers, and the support for continued government ownership of major economic assets expressed by high-ranking government officials, noted above, strongly indicates that the government is likely to retain its substantial involvement in the energy sector for the foreseeable future. Ukraine's largest company in the energy sector is Naftohaz Ukrayiny, which the government formed in 1998 by consolidating under its control various enterprises involved in the production, transmission, exploration, and trading of natural gas.[73] Naftohaz Ukrayiny currently accounts for 15 percent of Ukraine's GDP and almost 20 percent of government revenues[74] and still remains under government ownership. According to the World Bank, Naftohaz Ukrayiny has "steadily consolidated its hold on the gas sector"[75] and, to the best of the Ad Hoc Committee's knowledge, the GOU has not taken any steps to privatize any of Naftohaz Ukrayiny's holdings, nor are there indications that it intends to do so.

Also troubling is the government's lax oversight of Naftohaz Ukrayiny; according to the World Bank, effective regulation of the company will not be possible unless the government requires "more open and detailed financial audits, comprehensive (unbundled) accounting of gas production, transmission, storage, and distribution, and the divesture of un-related assets."[76] As the World Bank observed, "allowing state-owned firms with soft budget constraints to interact in

[73] See World Bank, "Ukraine: Challenges Facing the Gas Sector," at 3 (September 2003) ("Challenges Facing the Gas Sector), available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/UKRAINEEXTN/0,,menuPK:328539~pagePK:141159~piPK:141110~theSitePK:328533,00.html.

[74] See Zeyno Baran, "Energy Reform in Ukraine: Issues and Recommendations," The Nixon Center (March 2005) at 9 ("Energy Reform in Ukraine"), available at http://www.nixoncenter.org/ukraine-energy.pdf.

[75] Challenges Facing the Gas Sector at 3.

[76] "Building Foundations" at 83-84.

markets also invites the theft of state resources through various schemes. In the interest of fair competition and the protection of state assets, efforts should be made to place most state-owned enterprises under the same market and payment discipline as their private counterparts."[77] As discussed further in the following section, however, the GOU has not operated Naftohaz Ukrayiny under market principles.

Finally, land reforms in Ukraine have not progressed to the point where there is a functioning market in land. Although the GOU has reformed its previously restrictive Land Code, significant problems remain. Importantly, the GOU still restricts land ownership by foreign nationals. Specifically, foreign ownership of agricultural land is still not permitted, as is non-agricultural land outside of city limits.[78] Moreover, agricultural land inherited by a foreign national must be sold within one year of inheritance.[79] While foreigners are allowed to participate in the privatization of land, such sales "must be carried out by the Cabinet of Ministers and agreed to by the Parliament,"[80] an overly-burdensome requirement.

The situation in Ukraine is vastly different from that which characterized other countries when they were graduated to market economy status. In Hungary, the Czech Republic, and Slovakia, for example, the governments quickly embraced privatization after the fall of communism, restoring property to previous owners or selling the vast majority of government holdings by the mid-1990s.[81] In Latvia, the Department found that by the end of 1998 virtually

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[77] Id. at 84.

[78] See "Ukrainian Legal Developments: New Land Code," BISNIS Bulletin (Apr. 2002), available at www.bisnis.doc.gov/BISNIS/BULLETIN/apr02bull4.htm.

[79] See id.

[80] Id.

[81] See Hungary Memorandum at 10-12; Czech Memorandum at 8-10; Antidumping Duty Determination on Cold-Rolled Carbon-Quality Steel Products from the Slovak Republic – Market vs. Non-Market Economy Analysis, Department Memorandum at 8-11 (Oct. 13, 1999) ("Slovak Memorandum").

all enterprises were privately owned.[82] Notably, in Hungary and Kazakhstan, substantial assets in oil and gas production and distribution were sold to private investors, unlike the situation in Ukraine.[83] It is also instructive that the Department found that in Kazakhstan, the remaining state-owned enterprises were in sectors in which there was significant competition from foreign and domestic private enterprises.[84]

In Ukraine, however, as noted in Section III above, the level of foreign investment is so abysmally low that it cannot be said that state-owned enterprises operate in an environment of significant market competition, nor is there much interest shown by outside investors in acquiring remaining state-owned enterprises. In the case of the energy sector, Western investors have shown little interest in investing in projects or state assets given the lack of regulatory transparency, low regulated prices for gas, substantial debt, and the need for substantial restructuring of state-owned enterprises.[85] As for Naftohaz Ukrayiny and its subsidiaries, only Russian companies have indicated any interest in purchasing these assets,[86] although as noted previously, the GOU has not indicated its intention to sell any of them. In addition, the significant shareholdings of Pryvatbank, a subsidiary of the Pryvat Group, in some Naftohaz Ukrayiny subsidiaries will make restructuring the company more difficult. The Pryvat Group has significant holdings in the energy sector, and the former government gave Pryvatbank free rein in directing Ukrnafta, which is involved in oil and gas exploration and development.[87] Further, as is the case with many oligarchic business interests in Ukraine, the Pryvat Group

[82] See Latvia Memorandum at 12.

[83] See Hungary Memorandum at 12; Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 4.

[84] See Kazakhstan Memorandum at id.

[85] See EBRD Report at 39.

[86] See "Energy Reform in Ukraine" at 10.

[87] "Energy Reform in Ukraine" at 10.

maintains significant political influence and its corporate structure and operations are not transparent, which may complicate efforts to restructure the energy sector.[88]

Finally, land reform was substantially more advanced in all of the countries that have graduated to market economy status at the time the Department made its determinations than is the case in Ukraine.[89] In sum, Ukraine has not yet made sufficient strides in relinquishing ownership and control over the means of production. Therefore, the Department cannot find that the Ukrainian economy operates on market principles.

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88 "Energy Reform in Ukraine" at 11.

89 See Kazakhstan Memorandum at id.; Latvia Memorandum at 13-14; Hungary Memorandum at 13; Czech Memorandum at 12; Slovak Memorandum at 11. The Department did not specifically discuss land privatization in it June 6, 1993 memorandum regarding Poland's market economy status.

V. THE UKRAINIAN GOVERNMENT EXERCISES CONTROL OVER THE ALLOCATIONS OF RESOURCES AND THE PRICING AND OUTPUT DECISION OF KEY ENTERPRISES.

A. Summary of Comment

The GOU continues to set the price of natural gas at below-cost levels, thereby intensifying existing serious distortions in the Ukrainian economy. Development of Ukraine's domestic energy resources has been neglected in favor of below-market priced imports in transactions that involve barter arrangements. Finally, the Ukrainian banking sector is non-transparent and characterized by a significant level of related-party lending.

B. Discussion

Under Section 771(18)(B)(v) of the Act, the Department must consider the extent of government control over the allocation of resources and over the price and output decisions of enterprises. Otherwise stated, under this factor the Department considers whether a transitioning non-market country subjugates economic decision making to centralized planning or relinquishes it to private individuals or firms. As the Department explained in its Russia graduation determination, "{d}ecentralized economic decision-making is a hallmark of market economies, where the independent investment, input-sourcing, output and pricing actions of individuals and firms in pursuit of private gain collectively ensure that economic resources are allocated to their best (and most efficient) use."[90] In its 1997 Determination, the Department found that, "{e}ven with the process of privatization continuing, the {GOU} still retains significant control over the means of production and in allocating resources regarding all state-owned business enterprises. .

[90] Russian Memorandum, "Analysis of Section 771(18)(B)."

. ."[91] Moreover, the Department found that the GOU "continues to set domestic prices in some areas of the economy."[92]

Although Ukraine has made some progress in reforming its economy since 1997, the GOU continues to be heavily involved in allocation and pricing decisions in key economic sectors. For example, in April 2005 the government introduced fixed prices for petroleum products in the wake of rapidly rising prices, thereby creating a supply crisis. In order to resolve the situation, the government made some concessions to the largely Russian energy companies that supply Ukraine and, in return, the Russian companies agreed to continue selling fixed volumes of "socially oriented" fuel at low prices.[93] Continuing GOU involvement in setting prices is an issue of general concern in the international community; for example, the IMF recently noted that the European Commission had announced that, in order to be granted market economy status, Ukraine had to make further progress implementing the legal framework for bankruptcy and in eliminating state influence on prices.[94] Notably, the European Commission has specifically cited the metal and fertilizer sectors as examples of areas where state interference in pricing needs to be eliminated before market economy status can be granted.[95]

The Ad Hoc Committee is especially concerned that the Ukrainian Government continues to exert substantial control over the energy sector, particularly natural gas. As discussed above, the state-owned oil and gas holding company Naftohaz Ukrayiny is involved in all facets of the energy sector and plays a substantial role in the overall Ukrainian economy as well. However,

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[91] 1997 Determination, 62 Fed. Reg. at 61756.

[92] Id.

[93] See "Victor Yushchenko Resolved a Conflict Between Russian Oil Companies and Ukrainian Authorities," Russian Oil and Gas Report (May 23, 2005), available on LexisNexis.

[94] See IMF Staff Report at 11.

[95] See "The EU's Relations with Ukraine," available at http://europa.eu.int/comm/external_relations/ukraine/intro/ (last updated March 2005)...

due to below-market pricing for gas, in 2003 Naftohaz Ukrayiny was providing implicit subsidies to the economy equivalent to approximately 2.5 percent of GDP and was the largest tax debtor in the country, with debts in excess of $850 million, according to the World Bank.[96] Although Naftohaz Ukrayiny has recently improved its collection of payments and has reduced its tax debt, its revenues are still limited due to prices set by the government that are below cost-recovery levels, including long-term investment costs.[97]

Further, the National Electricity Regulation Commission ("NERC"), the GOU agency responsible for regulating the price of natural gas, sets the price of gas below its true economic value.[98] The World Bank noted in its 2003 report that Naftohaz Ukrayiny had de facto monopoly control of gas supplies, thus making regulatory oversight of prices and ensuring adequate incentives to promote operating efficiency especially important.[99] However, the NERC's pricing methodology "does not take account of market or other economic values attributable to this gas," thereby forcing Naftohaz Ukrayiny to forego potential profits. Further, the NERC's methodology "runs directly counter to normal international practice and is inconsistent with the EU Gas Directive."[100]

The World Bank further noted that this tariff structure, which does not permit recovery of the full economic value of the gas, created distortions in the Ukrainian economy that the GOU should address as a high priority.[101] Indeed, energy prices "are tailored more to the ability of

[96] See "Challenges Facing the Gas Sector," at 4.
[97] See "Building Foundations" at 78.
[98] See "Challenges Facing the Gas Sector" at 4.
[99] See id. at 21.
[100] Id.at 14.
[101] Id. at 18.

consumers to pay than to cost and value of services provided."[102] The World Bank estimated that these distorted prices, along with payment arrearages and non-technical losses, created a large quasi-fiscal deficit equivalent to approximately 7 percent of GDP in 2003.[103] In another report, the World Bank indicated that energy continues to be priced at below-cost levels and that Ukraine needs to establish an "effective, fair, and stable regulatory framework" for the energy sector that "should involve explicit and clear methodologies for linking utility prices to cost information in a manner that leaves little room for discretionary interference by the government."[104] In addition, the EBRD listed as key transition goals for the energy sector the introduction of market pricing, achieving cost recovery, strengthening the independence of NERC, and introducing competition through appropriate market models.[105]

As a result of below-cost gas prices and payment arrearages, total energy sector debt in Ukraine continues to grow.[106] In addition, exploration and production of Ukraine's significant gas reserves have been neglected and, therefore, domestic energy demand must be satisfied through imports.[107] Historically, Russia has supplied the majority of Ukraine's natural gas in arrangements that have been marked by below-market pricing, corruption, lack of transparency, and late payments.

Notably, Russia has paid Ukraine to transport natural gas through Ukraine's pipeline system to export markets in Europe largely through a barter arrangement. Specifically, Russia has supplied Ukraine with approximately 25 bcm of gas annually as an in-kind payment for the

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[102] World Bank, "Project Information Document – Energy Sector Reform," at 2 (March 2005), available at www.worldbank.org/infoshop ("Energy Sector Reform").

[103] See id.

[104] "Building Foundations" at 77.

[105] EBRD Report at 34-35.

[106] See Energy Sector Reform at 2.

[107] See, e.g., EBRD Report at 39.

transit of Russian gas through Ukraine.[108] According to the World Bank, the volumes of gas supplied to cover transit fees are calculated using a "deemed" value of imported gas, not an actual market price. The value of this barter arrangement is significant, for example, in 2002 the "deemed" value of the tariff payment was $1.5 billion.[109] However, this barter arrangement results in a loss of revenue for Ukraine because Naftohaz Ukrayiny charges below-market prices for gas in the domestic market. In other words, not only does Ukraine supply natural gas transport services to Russia on non-market determined terms, it also does not receive full value for the gas it has received in the barter arrangement when that gas is subsequently sold in the domestic market.[110]

Turkmenistan has recently become a significant supplier of natural gas to Ukraine, but those sales are also characterized by below-market pricing and in-kind payments. During 2004, Turkmenistan sold natural gas to Ukraine for only $44 per 1,000 cubic meters, with only half paid in cash and half paid in kind.[111] Although Turkmenistan raised the price to $58 per 1,000 cubic meters in January 2005, it does not appear to have altered the barter arrangement with Ukraine. Further, despite reportedly reaching an agreement with Ukraine to supply a significant portion of Ukraine's natural gas requirements, Turkmenistan also reached a deal with Russia's energy giant Gazprom in April 2005, under which it appears that most of Turkmenistan's exports will be sold to Gazprom beginning in January 2007.[112] As a consequence, Ukraine is likely to become more dependent on Russia, and specifically Gazprom, for its natural gas imports. In

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[108] See Challenges Facing the Gas Sector at 51; Energy Reform in Ukraine at 19.

[109] See Challenges Facing the Gas Sector at 51.

[110] See id.

[111] See id. at 20.

[112] See "Ukraine, Turkmenistan Probe Gas Deal," available at Eurasianet.org. (Apr. 5, 2005); "Ukraine, Russia Spar Over Turkmen Gas," Radio Free Europe Energy Bulletin (Apr. 20, 2005), available at http://www.energybulletin.net/news.php?cat=29.

turn, Gazprom relies on Ukraine's pipeline system to transport natural gas to the European market, suggesting that there will be no decline in the gas supply obtained as barter for pipeline access.

Under these circumstances, it is unlikely that Ukraine will undertake the critical structural reform of the natural gas sector necessary for it to operate on market principles. Thus, it is likely that the Ukrainian government will continue to be heavily involved in the allocation and pricing of natural gas to domestic consumers, including the nitrogen fertilizer industry. Given the significance of energy to the Ukrainian economy and the fact that many of its most important export-oriented industries, such as fertilizer, are energy-intensive, the GOU's failure to restructure the energy sector will continue to cause serious trade distortions and injury to U.S. industries.

Finally, Ukraine's banking sector has not yet made the transition to market principles. In particular, the banking sector is characterized by links between banks and politicians, questions about the integrity of bank owners, and the use of non-transparent business practices.[113] In addition, many banks are part of larger industrial groups and engage in a substantial amount of related-party lending,[114] thus further undermining the transition to a market-based system. The IMF recently noted that the "widespread practice" of related-party lending has created a particular risk to the Ukrainian economy, since "the true state of credit quality and of bank financial conditions remains opaque."[115] In addition, "the continuing difficulty in identifying the banks' ultimate owners has exacerbated" the weaknesses of the banking system.[116]

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[113] See EBRD Report at 30.

[114] See id.

[115] IMF Survey at 90.

[116] IMF Staff Report at 25.

The continued significant involvement of the GOU in allocation and pricing decisions is a key structural problem of the Ukrainian economy that cannot be solved in the short term. In particular, the natural gas sector requires significant and sustained restructuring before it can operate on market principles, but the GOU has to date shown little inclination to undertake this complex task. Therefore, the Department cannot find that Ukraine meets the requirements for revocation of non-market economy status under this criterion.

VI. CONCLUSION

For all of the reasons discussed above, the Ad Hoc Committee respectfully submits that Ukraine has not yet made sufficient progress in transitioning to a market economy to warrant a determination by the Department to revoke Ukraine's non-market economy status under U.S. trade law.