American Iron and Steel Institute

July 11, 2005

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Joseph A. Spetrini
Acting Assistant Secretary for Import Administration
Attention: Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Re: Inquiry into the Status of Ukraine as a Non-Market Economy Country for Purposes of the Antidumping Law

Dear Acting Assistant Secretary Spetrini:

On behalf of the American Iron and Steel Institute and pursuant to the Department's notice of initiation and request for comments in the above-referenced inquiry,[1] we hereby submit comments on whether Ukraine should continue to be treated as a non-market economy country for purposes of the antidumping law.

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[1] Initiation of a Changed Circumstances Review of the Antidumping Duty Order on Carbon and Certain Alloy Steel Wire Rod from Ukraine, 70 Fed. Reg. 21396 (Dep't Commerce Apr. 26, 2005) (initiation and request for comments); Changed Circumstances Review of the Antidumping Duty Order on Carbon and Certain Alloy Steel Wire Rod from Ukraine, 70 Fed. Reg. 34744 (Dep't Commerce June 15, 2005) (extension of comment period).

Thank you for your attention to this matter.

Respectfully submitted,

____

cc: Lawrence Norton
Shauna Lee-Alaia

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BEFORE THE
UNITED STATES DEPARTMENT OF COMMERCE
INTERNATIONAL TRADE ADMINISTRATION

COMMENTS REGARDING THE NON-MARKET ECONOMY STATUS OF UKRAINE

July 11, 2005

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20 Law of Ukraine of 03.12.1990 on Prices and Pricing, No. 507-XII (1990)

21 “Govt Drafting Concept of Coal Mining Industry’s Development Throughout 2030,” Web Portal of Ukrainian Government (May 12, 2005), available at http://www.kmu.gov.ua/control/publish/article?art_id=16592161

22 “IMF Survey,” International Monetary Fund (Apr. 4, 2005), Vol. 34, No. 6

23 “Ukraine: Building Foundations for Sustainable Growth,” World Bank (Aug. 2004)

24 "U.S. Presses Scrap Export Tax Complaints in WTO Accession Talks," Inside U.S. Trade (Oct. 8, 2004), available at http://www.insidetrade.com/secure/dsply_docnum_txt.asp?f=wto2001.ask&dn=INSIDETRADE-22-41-12

25 "2004 National Trade Estimate Report on Foreign Trade Barriers – Ukraine," Office of the U.S. Trade Representative (Mar. 31, 2005)

I. INTRODUCTION

The American Iron and Steel Institute ("AISI"), on behalf of its U.S. member companies, hereby makes this submission in response to the Department's request for comments on the issue of whether Ukraine should continue to be treated as a non-market economy country ("NME") for purposes of the U.S. antidumping laws.[1] In 1997, the Department concluded that Ukraine should continue to be treated as an NME country.[2] In so doing, the Department found that evidence bearing upon each of the six statutory factors that the Department is required to consider in its NME analysis showed that Ukraine is not a market economy country. While certain changes in the economic and political environments have occurred since that time, they do not warrant a different conclusion now.

Section 771(18)(B) of the Tariff Act of 1930, as amended (the "Act"), provides that, in determining whether a country is an NME, the Department shall take into account:

> (i) the extent to which the currency of the foreign country is convertible into the currency of other countries;

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[1] Initiation of a Changed Circumstances Review of the Antidumping Duty Order on Carbon and Certain Alloy Steel Wire Rod from Ukraine, 70 Fed. Reg. 21396 (Dep't Commerce Apr. 26, 2005) (initiation and request for comments); Changed Circumstances Review of the Antidumping Duty Order on Carbon and Certain Alloy Steel Wire Rod from Ukraine, 70 Fed. Reg. 34744 (Dep't Commerce June 15, 2005) (extension of comment period).

[2] Certain Cut-to-Length Carbon Steel Plate From Ukraine, 62 Fed. Reg. 61754 (Dept. Commerce Nov. 19, 1997) (final determ.) ("1997 Determination").

(ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management;

(iii) the extent to which joint ventures or other investments by firms of other countries are permitted in the foreign country;

(iv) the extent of government ownership or control of the means of production;

(v) the extent of government control over the allocation of resources and over the price and output decisions of such enterprises; and

(vi) such other factors as . . . {the Department} considers appropriate.[3]

Whether these criteria are considered individually or collectively, the evidence clearly demonstrates that Ukraine continues to be an NME.

In particular, as established below, the evidence relating to the statutory criteria shows as follows:

- There continue to be major limitations on the convertibility of the Ukrainian currency, the hryvnya;

- Wage rates in Ukraine are largely determined by government fiat, not by free bargaining between labor and management;

- Foreign direct investment in Ukraine remains low by any standard;

- The state still has overwhelming control over the means of production;

- Both directly and indirectly, the Government of Ukraine controls the allocation of resources and the price and output decisions of enterprises; and

3 19 U.S.C. § 1677(18)(B) (2000).

- Ukraine lacks the judicial and legal infrastructure necessary for a market economy to properly function, and reports indicate that corruption in Ukraine remains a serious concern.

Indeed, there is a general consensus among authoritative, independent observers that Ukraine has not yet developed a market economy. In particular, the "2005 Index of Economic Freedom" report on Ukraine shows that the country's overall index remains in the report's "mostly unfree" classification.[4] Additionally, the Freedom House's 2004 ratings on various measures of democratic development in Ukraine show that the country either has made no progress or has regressed in the level of democratization for all of the categories covered.[5]

Furthermore, trade officials from the European Union ("EU") recently raised serious concerns about treating Ukraine as a market economy country. According to Anatoliy Kinakh, Ukraine's First Vice Prime Minister, the EU expressed concerns that the methods of manual economic management employed by the government and the government's control over prices have actually strengthened in Ukraine as of late.[6] In other words, the EU has expressed to Ukrainian officials its concern not only that Ukraine has failed to make sufficient progress to graduate to market

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4 "2005 Index of Economic Freedom – Ukraine", Heritage Foundation, available at http://www.heritage.org/research/features/index/country.cfm?id= Ukraine (last visited May 24, 2005) ("2005 Index of Economic Freedom – Ukraine"), at 383, attached as Exhibit 1.

5 Nations in Transit 2004: Ukraine, Freedom House, at 1, attached as Exhibit 2.

6 "Kyiv Must Build Investors' Trust in Ukraine's Pricing Policy, EU Says," First News (May 18, 2005), available at http://www.firstnews.com.ua/ en/article.html?id=51240, attached as Exhibit 3.

economy status, but that its movement toward a market economy has reversed course. Clearly, Ukraine may not be deemed a market economy country under such conditions.

To the contrary, significant changes must be made in the Ukrainian economy before it may be considered a market economy. This is clear from a consideration of each of the six statutory criteria set forth in Section 771(18)(B) of the Act.

II. THERE ARE MAJOR LIMITATIONS ON THE CONVERTIBILITY OF UKRAINE'S CURRENCY

Summary of Comment

Although Ukraine has made some progress toward making its currency, the hryvnya, convertible, it still is not convertible outside the Newly Independent States. In addition, the Government of Ukraine has engaged in frequent interventions in the foreign exchange market in order to maintain a *de facto* peg of the hryvnya against the U.S. dollar, thereby showing that Ukraine's currency is not reflective of market forces and is not fully convertible.

Discussion

In determining whether a country is an NME, the Department is directed to consider the extent to which the currency of the foreign country is convertible into the currency of other countries.[7] As the Department has recognized,

> {a} particular country's integration into world markets is highly dependent upon the convertibility of its currency. The greater the extent of currency convertibility, for both trade and investment purposes, the greater are the supply and demand forces linking domestic market prices in the NME country to world market prices. The greater this linkage, the more market-based domestic prices tend to be.[8]

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7 19 U.S.C. § 1677(18)(B)(i).

8 Memorandum from Albert Hsu, et al. to Faryar Shirzad, Assistant Secretary for Import Administration, Regarding Inquiry into the Status of the Russian Federation as a Non-Market Economy Country Under the U.S. Antidumping Law (June 6, 2002) ("Russia NME Memo") at Analysis of Section 771(18)(B) Factors (Public Document).

In its 1997 determination to continue to treat Ukraine as an NME, the Department determined that there are major limitations on the convertibility of the hryvnya. Specifically, the Department found that, while the hryvnya is convertible within the Newly Independent States, it is not yet convertible elsewhere.[9] There has been no indication that this lack of convertibility of the hryvnya has been remedied since the Department's 1997 determination.

The Department also observed in its 1997 determination that the Ukrainian government "retains control over the influx of foreign currency into its domestic economy by requiring that 50% of foreign export earnings be converted to hryvnyas through an Interbank Currency Exchange set up by the {government} for this purpose."[10] According to a recent report, this requirement was cancelled in April 2005.[11] While this could be a positive step, it is too early to determine if this is a permanent move on the part of the government.

Finally, the Government of Ukraine has maintained a *de facto* peg of the hryvnya against the U.S. dollar and is expected to continue its frequent interventions in the foreign exchange market in order to support that peg.[12] Although the

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9 1997 Determination, 62 Fed. Reg. at 61755.

10 Id.

11 "Country Report – Ukraine," Economist Intelligence Unit (Apr. 2005) ("Country Report – Ukraine"), at 23, attached as Exhibit 4.

12 See "IMF Executive Board Concludes 2004 Article IV Consultation with Ukraine," International Monetary Fund (Jan. 24, 2005), at 3-4, attached as Exhibit 5.

International Monetary Fund (the "IMF") has concluded that "a move toward a more flexible exchange rate regime {would be} more beneficial to Ukraine," no such move has been forthcoming.[13] Accordingly, the value of Ukraine's currency still is not set by the free flow of currency and goods between countries. Indeed, the Ukrainian government's intervention in the market in pegging exchange rates for the hryvnya demonstrates that Ukraine's currency is not reflective of market forces and is not fully convertible.

[13] Id. at 3.

III. WAGE RATES IN UKRAINE ARE NOT DETERMINED BY FREE BARGAINING BETWEEN LABOR AND MANAGEMENT

Summary of Comment

Wage rates in Ukraine still are not determined on the basis of free bargaining between labor and management. The Government of Ukraine is heavily involved in setting wage rates through the so-called "Tariff Rate System," and workers continue to be paid extensively from non-wage sources, when they are paid at all. Moreover, the Ukrainian government continues to significantly restrict labor unions and workers' rights, including the freedom of movement.

Discussion

To determine whether a country remains an NME, the Department must also consider "the extent to which wage rates in the foreign country are determined by free bargaining between labor and management."[14] The Department has determined that "{t}he reference to 'free bargaining between labor and management' reflects concerns about the extent to which wages are market based, i.e., about the existence of a market for labor in which workers and employers are free to bargain over the terms and conditions of employment."[15] Because wages are an important component

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14 19 U.S.C. § 1677(18)(B)(ii).

15 Memorandum from Lawrence Norton et al. to Joseph A. Spetrini, Acting Assistant Secretary for Import Administration, Regarding the 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) ("Romania NME Memo")

of producer costs and prices, the manner in which they are set is "an important indicator of a country's overall approach to setting prices and costs in the economy."[16]

As the Department found in its 1997 decision to continue to treat Ukraine as an NME, the Government of Ukraine is "heavily involved" in setting wage rates and in other employment-related issues.[17] Specifically, the Department found, *inter alia*, that the government has a so-called "Tariff Rate System," under which all jobs are graded and salaries are set based upon the level of complexity of the job and workers' qualifications.[18] All state-owned enterprises must base their wage and hiring decisions on this system, and all non-state-owned enterprises must compile their own job classification and wage rates to reflect the standards established by the system.[19] The law establishing this system – the Law on Remuneration of Labor – remains in effect and has not been amended in any material respect since 1997. Thus, the "Tariff Rate System" and the concomitant government control over wage rates and other employment-related issues in Ukraine remain in effect.

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at 8 (Public Document); see also Russia NME Memo at Analysis of Section 771(18)(B) Factors (Public Document) (same).

16 Romania NME Memo at 8 (Public Document); see also Russia NME Memo at Analysis of Section 771(18)(B) Factors (Public Document) (same).

17 1997 Determination, 62 Fed. Reg. at 61755.

18 Id.; see also Law of Ukraine of 24.03.1995 on Remuneration of Labor, No. 108/95-BP (1995) ("Law on Remuneration of Labor"), attached as Exhibit 6.

19 1997 Determination, 62 Fed. Reg. at 61755.

In addition, Ukrainian workers' freedom of movement within the country is severely restricted. This is true notwithstanding the fact that the residence permit system (i.e., the propiska system) that was instituted when Ukraine was part of the Soviet Union has been abolished to comply with the European Convention on Human Rights. Workers still must register their residence. But even more significantly, movement within Ukraine is restricted by the possibility of economic loss due to a change of locations. Indeed, Ukraine has reportedly tied all social benefits to a person's place of residence, "meaning that a person can lose all these benefits upon moving."[20] Clearly, individuals are not likely to feel free to move about the country in the face of such consequences.

Wage arrears also continue to be a significant problem in Ukraine. In fact, unpaid wages resulted in several strikes by miners in 2003. In some instances, the miners involved had not been paid for as long as seven months.[21] The miners' problems have not been resolved by the new government that recently took office in Ukraine, as protests continued in May 2005 over unpaid wages.[22]

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20 "Encyclopedia: Propiska," Nationmaster, available at http://www.nationmaster.com/encyclopedia/Propiska (last visited May 21, 2005), attached as Exhibit 7.

21 "Ukraine: Annual Survey of Violations of Trade Union Rights (2004)," International Labor Organization ("Annual Survey of Trade Union Right Violations"), at 4, attached as Exhibit 8.

22 "Luhansk Miners March to Kyiv Over Unpaid Wages and Working Conditions," First News (May 16, 2005), available at http://www.firstnews.com.ua/ en/article.html?id=49884, attached as Exhibit 9.

In addition to massive wage arrears, a significant portion of income continues to be paid from non-wage sources. Indeed, upwards of 50% of household income is currently from non-wage sources.[23] This amazingly high figure is not at all surprising given the explicit provision for the payment of income from non-wage sources in Ukraine's Law on Remuneration of Labor. Specifically, the law provides that

> {s}alary shall be paid to the employees in banknotes that are legal tender within the territory of Ukraine. Payment of salary in the form of promissory notes, receipts or any other different form shall be prohibited. At the same time, as an exception collective agreement may provide for partial payment of salary in form in kind (for the prices not exceeding prime cost) in amount that does not exceed 50% of a monthly salary. The list of goods which shall not be provided instead of salary shall be set by the Cabinet of Ministers of Ukraine.[24]

In this manner, the Ukrainian government has clearly and explicitly provided for and fostered the payment of income from non-wage sources in Ukraine. This results in Ukrainian workers receiving a distorted form of payment that is not reflective of the market value of their services.

Ukrainian workers have the right to form and join labor unions.[25] However, these rights are not always respected in practice. Specifically, the Government of Ukraine has used a registration requirement to delay and, in fact, deny the formation

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23 "The Economy: Ukraine's Economy," EIU Country Profile (Feb. 4, 2005), at 2, attached as Exhibit 10.

24 Law on Remuneration of Labor, attached as Exhibit 6 (emphasis added).

25 Annual Survey of Trade Union Right Violations at 1, attached as Exhibit 8.

of unions in that country.[26] Moreover, there continue to be pervasive complaints of harassment of workers based on the exercise of their labor union rights.[27] According to the International Labor Organization ("ILO"),

> {t}rade union members are often subject to discrimination. They are often intimidated, put under pressure to leave trade unions, suffer wage arrears or are transferred to positions that do not correspond to their skills. Trade union leaders are often threatened and are given assignments where working conditions are dangerous. Government agencies participate in the intimidation of trade unions.[28]

In fact, even where workers form and join unions, the ILO has found that "{e}mployers often refuse to enter into collective bargaining with independent unions that have not obtained registration."[29] This only further interferes with the ability of Ukrainian workers to organize and bargain collectively, thereby preventing them from being able to present and defend their interests with management. In turn, this strongly impedes the establishment of market-based wages in Ukraine.

Despite laws prohibiting forced or compulsory labor, such practices continue in Ukraine.[30] In particular, human rights groups have described the widespread use of army conscripts for refurbishing and building private houses for army and govern-

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26 See "Ukraine: Country Reports on Human Rights Practices – 2004," Bureau of Democracy, Human Rights, and Labor, U.S. Dep't of State (Feb. 28, 2005) ("State Dept. Report on Human Rights"), at 24-25, attached as Exhibit 11.

27 Id. at 25; Annual Survey of Trade Union Right Violations at 2, attached as Exhibit 8.

28 Annual Survey of Trade Union Right Violations at 2, attached as Exhibit 8.

29 Id.

30 State Dept. Report on Human Rights at 26, attached as Exhibit 11.

ment officials "as compulsory labor."[31] Furthermore, the U.S. State Department has found that child labor continues in Ukraine and that the trafficking of children for the purpose of forced labor is a problem.[32]

In sum, wage rates and labor conditions in Ukraine are poor and certainly are not the product of free bargaining between labor and management. Based on this factor, either on its own or together with the other factors discussed herein, Ukraine clearly is not entitled to market economy status.

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31 Id.

32 Id.

IV. FOREIGN DIRECT INVESTMENT REMAINS LOW

Summary of Comment

Foreign direct investment in Ukraine remains low, both when considered on its own and when compared to that in other similarly situated countries. The low level of foreign direct investment in Ukraine is directly attributable to the extensive formal and informal barriers to such investment in the country. Chief among these barriers are the weak and unpredictable legal system, prohibitions or restrictions on foreign participation in certain sectors of the economy, restrictions on converting and transferring funds, restrictions on landholding by foreigners, and the lack of protection of property rights.

Discussion

In assessing whether a foreign country has moved to a market economy, the Department must examine the "extent to which joint ventures and other investments by firms of other foreign countries are permitted."[33] As the Department has recognized,

> {o}pening an economy to foreign investment tends to expose domestic industry to competition from market-based suppliers and the management, production and sales practices that they bring. It also tends to limit the scope and extent of government control over the

[33] 19 U.S.C. § 1677(18)(B)(iii).

> market, since foreign investors, as a general rule, demand a certain degree of autonomous control over their investments.[34]

In evaluating this factor, the Department does not simply analyze whether the formal legal framework for foreign direct investment appears to be hospitable.[35] The Department must also evaluate "developments in the economy" to determine whether the country in question is truly open to foreign direct investment.[36]

In analyzing this factor in 1997, the Department highlighted Ukraine's "burdensome and unpredictable arbitration and enforcement system" and the prohibition on foreigners owning land.[37] These problems remain, and actual foreign direct investment in Ukraine, while growing, remains low relative to its neighbors. As of January 2004, cumulative foreign direct investment in Ukraine was $6.66 billion or $140 per capita, one of the lowest values in the Commonwealth of Independent States.[38] In fact, the level of foreign direct investment in Poland was nearly ten times

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34 See Russia NME Memo at Analysis of Section 771(18)(B) Factors (Public Document); see also Romania NME Memo at 11 (Public Document) (same).

35 Memorandum from George Smolik to Faryar Shirzad, Assistant Secretary for Import Administration, Regarding Antidumping Duty Investigation of Silicomanganese from Kazakhstan – Request for Market Economy Status (Mar. 25, 2002) at Analysis of Section 771(18)(B) Factors (Public Document).

36 Id.

37 1997 Determination, 62 Fed. Reg. at 61756.

38 "Doing Business in Ukraine: A Country Commercial Guide for U.S. Companies," U.S. & Foreign Commercial Service and U.S. Department of State (2004) ("Ukraine Country Commercial Guide"), at Chapter 6: Investment Climate – Foreign Direct Investment Statistics, p. 6-15, attached as Exhibit 12.

as high.[39] Foreign direct investment rose to $8.4 billion, or $175 per capita, as of January 2005.[40] However, the total amount of such investment "is still disappointing in comparison with most other countries in the region, and is still well below Ukraine's potential."[41] Moreover, the per capita amount remains "one of the lowest levels . . . in the transition region."[42]

The low level of foreign direct investment in Ukraine is due to the barriers to such investment in the country. Indeed, in the 2005 Index of Economic Freedom, Ukraine received an overall score of 4.0 (out of 5.0) for "capital flows and foreign investment," which indicates a high level of barriers to foreign direct investment.[43]

There are extensive formal and informal barriers to foreign direct investment in Ukraine. As set forth below, these barriers include:

- a lack of confidence in the Ukrainian legal system;
- prohibitions or restrictions on foreign participation in certain sectors of the Ukrainian economy;
- restrictions on converting and transferring funds;
- restrictions on landholding by foreigners; and
- the lack of protection of property rights.

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39 Id.

40 Country Report – Ukraine at 35, attached as Exhibit 4.

41 Id.

42 Id.

43 2005 Index of Economic Freedom – Ukraine at 384, attached as Exhibit 1.

As the U.S. government itself recently found, Ukraine's legal system continues to suffer from burdensome procedures, unpredictability, political interference, corruption, and inefficiency.[44] The rule of law is poorly developed in Ukraine, and dispute settlement remains weak.[45] Even where a favorable judicial or arbitration decision is obtained, it is difficult, if not impossible, to enforce it.[46] Indeed, the U.S. government found in a recent report that "{f}oreign investors express little confidence in the Ukrainian court system. Ukrainian courts tend to strike down or ignore contractual provisions for international arbitration or that assign legal responsibility for dispute resolution to a foreign court."[47]

Additionally, in a recent review of Ukraine's legal environment, a roundtable conducted under the auspices of the Organization for Economic Cooperation and Development (the "OECD") identified a number of inconsistencies and conflicts between the Civil and Commercial Codes in Ukraine and the problems that have developed in trying to implement the two conflicting laws.[48] Significantly, the OECD-sponsored roundtable also found that "the Commercial Code embodies

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44 Ukraine Country Commercial Guide at Chapter 6: Investment Climate – Dispute Settlement, pp. 6-4 to 6-5, attached as Exhibit 12.

45 See id.

46 See id.

47 Id. at Chapter 6: Investment Climate – Openness to Foreign Investment, p. 6-1.

48 "Legal Issues with Regard to Business Operations and Investment in Ukraine," OECD (Oct. 2004) ("Legal Issues with Regard to Business Operations and Investment"), at 9, attached as Exhibit 13; see also Ukraine Country Commercial Guide at Chapter 6: Investment Climate – Openness to Foreign Investment, p. 6-2, attached as Exhibit 12 (same).

concepts that simply do not work within a market economy."[49] In fact, it recommended the abolition of the Commercial Code because of its "decided tendency towards re-establishing a command economy, for example, its empowerment of the government to dictate the actions of companies and to deprive companies of various benefits and privileges when they do not comply with government demands."[50] Clearly, the current Ukrainian legal environment is not conducive to foreign direct investment.

Another barrier to foreign direct investment in Ukraine is that foreign investors are not allowed full access to all sectors of the economy. Specifically, foreigners are simply prohibited from participating in the manufacture of alcohol or weapons.[51] Moreover, Ukraine's privatization program strictly limits the ability of foreign parties to invest in the "strategic" sectors of radio, television, energy, and insurance. Foreign ownership of companies in the radio, television, and publishing sectors may not exceed 30%.[52]

Furthermore, any foreign investment in Ukraine is made more burdensome and costly by the fact that it must be conducted in the local currency. A November

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49 Legal Issues with Regard to Business Operations and Investment at 9, attached as Exhibit 13 (emphasis added).

50 Id. (emphasis added).

51 Ukraine Country Commercial Guide at Chapter 6: Investment Climate – Openness to Foreign Investment, p. 6-2, attached as Exhibit 12.

52 Id.

2004 resolution of the National Bank of Ukraine stipulates that "foreign investment funds may only be brought into Ukraine via special commercial bank accounts, which must convert the hard currency into Hryvnia."[53] Further complicating the process, the resolution in question also requires that "all payments to foreign investors must be made in Hryvnia to the investors' bank accounts in Ukraine."[54] While the banks may then convert the hryvnia into hard currency for repatriation, this process adds an additional level of cost and complexity to the process.

Yet another reason for the low level of foreign direct investment in Ukraine is the severe restrictions on landholding by foreigners. Although private ownership of land is provided for under the Constitution of Ukraine, legislation passed in October 2001 imposed a 20-year moratorium on agricultural land sales to foreigners.[55] Plainly, these and other restrictions on the sale and purchase of land by foreign parties impose a severe burden on foreign direct investment.

Finally, the Ukrainian government has shown a consistent inability to protect overall property rights. One recent report states that "{o}rganised crime and domestic vested interests pose a significant threat to foreign investors who become involved in those areas of the local economy that are considered to be protected."[56] In

53 Id. at Chapter 6: Investment Climate – Conversion and Transfer Policies, p. 6-3.

54 Id.

55 See id. at Chapter 6: Investment Climate – Protection of Property Rights, p. 6-7; 2005 Index of Economic Freedom – Ukraine at 384, attached as Exhibit 1.

56 2005 Index of Economic Freedom – Ukraine at 384, attached as Exhibit 1.

addition, Ukraine's protection of intellectual property rights has been and continues to be a major problem. In its Special 301 Report issued in May 2005, the Office of the United States Trade Representative ("USTR") continued to be harshly critical of Ukraine for failing to provide adequate and effective protection of intellectual property rights.[57] Indeed, USTR found that Ukraine's failure to protect intellectual property rights "undermines its ability to attract trade and investment."[58]

Ukraine's difficulty in attracting foreign investors is borne out by the fact that the number of enterprises with 100% foreign ownership represents a minuscule proportion of all enterprises in Ukraine.[59] In fact, from 2001 to 2004, the number of enterprises with 100% foreign ownership actually declined, from 2,400 to 2,300, while the total number of establishments rose.[60]

For all of the foregoing reasons, the legal and business environments in Ukraine continue to place significant limitations on foreign direct investment. On this basis as well, Ukraine should continue to be treated as an NME.

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57 "Special 301 Report," Office of the U.S. Trade Representative (2005), at Executive Summary and Priority Foreign Country, attached as Exhibit 14.

58 Id. at Executive Summary.

59 "Ukraine 2003," State Statistics Committee of Ukraine, available at www.ukrstat.gov.ua (last visited May 22, 2005) ("Ukraine 2003"), at 56, attached as Exhibit 15.

60 Id.

V. THE MEANS OF PRODUCTION REMAIN SUBSTANTIALLY IN THE CONTROL OF THE GOVERNMENT OF UKRAINE

Summary of Comment

While the Government of Ukraine has conducted numerous privatizations of state-owned companies, the means of production remain substantially in the control of the government. In fact, the privatizations that have occurred in Ukraine have had little or no effect in returning economic activity in the country to the private sector. Moreover, recent events indicate that the government's privatization efforts may actually be regressing, rather than progressing.

Discussion

In its NME analysis, the Department must examine "the extent of government ownership or control of the means of production."[61] As demonstrated below, the government continues to control much of the means of production in Ukraine.

The Department found in its 1997 NME determination for Ukraine that privatization has proceeded unevenly and that "much of the economy remains in the hands of government."[62] At the time of that determination, the Department observed

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61 19 U.S.C. § 1677(18)(B)(iv).

62 1997 Determination, 62 Fed. Reg. at 61756.

that "strategic" enterprises were ineligible for privatization.[63] These were the largest companies and "those with the greatest export potential."[64] Although in the 1997 proceeding Ukraine stated that 44% of state-owned enterprises were privatized, the Department expressed concern that these enterprises were not fully privatized.[65] The concerns raised by the Department in 1997 continue to exist.

While, on their face, the efforts to privatize public enterprises in Ukraine may appear to have been successful, the facts tell a different story. Indeed, despite numerous privatizations, the influence of the government in the economy remains significant. As noted in a report by Pricewaterhouse Coopers on the privatizations, the Government of Ukraine simply has given up "majority ownership" in 90% of the enterprises privatized since 1991.[66] In other words, it has not relinquished full control of those enterprises. Moreover, Ukrainian government authorities "continue to exert informal influence over roughly 10,000 medium and large enterprises privatised since 1992" due to the fact that "in most cases the directors and managers of privatised enterprises are those from the Soviet era" who are only "gradually being replaced."[67]

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63 Id.

64 Id.

65 Id.

66 See "Privatisation," Pricewaterhouse Coopers, available at http://www.pwcglobal.com (last visited May 22, 2005), at 2, attached as Exhibit 16.

67 Id. at 2.

In fact, the privatizations that have occurred in Ukraine have had little or no impact in returning economic activity to the private sector. The State Statistics Committee of Ukraine reports that, as of January 1, 2004, the number of economic entities by type of ownership is 4% state, 8% municipal, 57% collective, 30% private, and 1% international organizations and legal entities of other countries.[68] Thus, a total of 69% of the country's economic entities are either directly or indirectly controlled by the government.

The pervasiveness of government control of the means of production is also reflected in the distribution of employment by sector. In a January 2005 report, the International Monetary Fund (the "IMF") found that employment in the state, collective, and cooperative sectors accounted for 66.2% of total employment in Ukraine in 2000, the last year for which full data were available.[69] The state sector alone accounted for 34.2% of total employment.[70]

Recent events indicate that the Government of Ukraine's privatization efforts may actually be regressing, rather than progressing. Questions about the legality of up to 40 privatizations that occurred in 2004 have raised serious concerns regarding the possible re-nationalization of the companies involved. While the government has stated it has no plans for a mass nationalization of companies or industries,

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68 "Ukraine 2003" at 56, attached as Exhibit 15.

69 "Ukraine: Statistical Appendix, IMF Country Report No. 05/21," International Monetary Fund (Jan. 2005), at 17 (Table 12), attached as Exhibit 18.

70 Id.

Ukrainian President Viktor Yushchenko has sent a disturbing signal regarding his priorities for the country's privatization program. As reported in the Financial Times, President Yushchenko appointed a critic of privatization, Ms. Valentina Semenyuk, to head the State Property Fund, the agency directly charged with administering the program.[71] Ms. Semenyuk's background and views reflect adversely on the Ukraine government's commitment to privatization. According to the Financial Times,

> Ms. Semenyuk, a member of the Socialist party, advocates using the privatisation review to return property to state hands, and argues that the state should seek to earn profits from its enterprises and sell only loss-makers.[72]

A process of privatizing only loss-makers is unlikely to reduce the level of government influence over these enterprises or over the economy generally. The very fact that these enterprises have been loss-makers indicates that government support to the enterprises in the form of substantial subsidies or re-nationalization is likely to be necessary to keep them afloat. To the extent that government support is provided to the loss-makers, the operations of such enterprises will undoubtedly be heavily influenced by the state. Alternatively, if these enterprises are unable to survive on their own and are allowed to go out of business, this would only further consolidate economic resources in the hands of the state.

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71 "Ukrainian Politics: Investors Remain Cautious," Financial Times (May 13, 2005), available at http://www.firstnews.com.ua/en/industry/ industry.html?id=49824, at 2, attached as Exhibit 19.

72 Id.

Based on the foregoing, the evidence shows that, just as in 1997, the means of production remain substantially in the control of the Government of Ukraine.

VI. THE GOVERNMENT OF UKRAINE EXERTS SIGNIFICANT CONTROL OVER THE ALLOCATION OF RESOURCES AND PRICE AND OUTPUT DECISIONS OF ENTERPRISES

Summary of Comment

The Government of Ukraine continues to have the authority to set prices on goods and services that affect the entire economy, and it has exercised this authority to set the prices on crucial products such as sugar, grain, gas, and oil as well as services such as electricity, telecommunications, transportation, and utilities. Additionally, the government continues to have significant ownership interests in and/or control over industries that are of critical importance to the country. Thus, the government's control over the allocation of resources and price and output decisions of enterprises remains significant in Ukraine.

Discussion

As yet another factor in its NME analysis, the Department must consider "the extent of government control over the allocation of resources and over the price and output decisions of enterprises."[73] As the Department has recognized, "{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

[73] 19 U.S.C. § 1677(18)(B)(v).

resources are allocated to their best (most efficient) use."[74] As shown below, the Ukrainian government continues to exert significant control over the allocation of resources and price and output decisions of enterprises through a variety of direct and indirect means.

In the 1997 determination on Ukraine's NME status, the Department concluded that the Government of Ukraine "continues to set domestic prices in some areas of the economy."[75] The Department noted that under Ukraine's law "On Prices and Pricing," the Ukrainian government "has authority to set prices on products which affect the entire economy, to set domestic prices of monopolies, and to render to the government any monopoly profits deemed excessive."[76] The facts bearing on this issue have not changed.

Under the law "On Prices and Pricing," the Cabinet Ministers of Ukraine have the authority to determine the list of goods and services to be subject to fixed and administered prices and the prices at which such goods and services will be sold.[77] Persons found to be violating the state price mechanism may be held criminally or administratively liable.[78] According to the U.S. State Department, the

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[74] Romania NME Memo at 17 (Public Document).

[75] 1997 Determination, 62 Fed. Reg. at 61756.

[76] Id.

[77] Law of Ukraine of 03.12.1990 on Prices and Pricing, No. 507-XII (1990), attached as Exhibit 20.

[78] Id. at Art. 14.

Cabinet Ministers of Ukraine have exercised this authority by setting prices and tariffs with respect to "products, goods, and services in certain sectors. These lists include basic tariffs (e.g. electricity, telecommunications, transportation, utilities), and some crucial products such as sugar, grain, gas, oil, etc. Government regulated prices and tariffs may change as a result of changes in production and sale conditions."[79]

Ukraine also subsidizes its domestic steel producers by imposing taxes and restrictions on the export of steel scrap. In fact, the Ukrainian government imposes substantial taxes and restrictions on exports of steel scrap, maintaining a 30 euro per ton tax on exports of ferrous scrap and a complete ban on the export of non-ferrous metal scrap.[80] As a result, this increases the domestic supply and lowers the price of steel scrap in Ukraine. In turn, Ukrainian steel producers benefit from scrap prices that are substantially below global market prices. According to USTR,

> {t}his 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 provides an artificial advantage to Ukrainian steel producers by increasing domestic steel scrap supply, providing producers with an unfair advantage in Ukraine and in third markets.[81]

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79 Ukraine Country Commercial Guide at Chapter 3: Selling U.S. Products and Services – Pricing, p. 3-12, attached as Exhibit 12.

80 "U.S. Presses Scrap Export Tax Complaints in WTO Accession Talks," Inside U.S. Trade (Oct. 8, 2004), available at http://www.insidetrade.com/secure/dsply_docnum_txt.asp?f=wto2001.ask&dn=INSIDETRADE-22-41-12, attached as Exhibit 24.

81 "2004 National Trade Estimate Report on Foreign Trade Barriers – Ukraine," Office of the U.S. Trade Representative (Mar. 31, 2005) at 476, 480, attached as Exhibit 25.

The United States has pressed Ukraine to eliminate its scrap export tax as a precondition to the country's accession to the World Trade Organization, but to date the Ukrainian government has resisted all requests to reduce or eliminate the tax.

Additionally, the Ukrainian government continues to have significant ownership interests in and/or control over industries that are of critical importance to the country. For example, the government continues to have huge ownership interests in and control over the coal industry. Indeed, of the 167 existing coal companies in Ukraine, 122 of them are state owned.[82] On the other hand, only 10 companies are privately owned.[83] This is significant as coal represents 95.4 percent of Ukraine's fuel deposits and a substantial proportion of its fuel consumption.[84]

Clearly, the scope of the Ukrainian government's control over the allocation of resources and pricing and output decisions is considerable.

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82 "Govt Drafting Concept of Coal Mining Industry's Development Throughout 2030," Web Portal of Ukrainian Government (May 12, 2005), available at http://www.kmu.gov.ua/control/publish/ article?art_id=16592161, attached as Exhibit 21.

83 Id.

84 Id.

VII. THE DEPARTMENT SHOULD CONSIDER OTHER FACTORS INDICATING THAT UKRAINE REMAINS AN NME

Summary of Comment

The continuing concerns regarding corruption and the absence of the effective rule of law in Ukraine are other factors indicating that the country remains an NME.

Discussion

As a final matter, in making NME determinations, the Department is authorized to take into account "such other factors as . . . {it} considers appropriate."[85] Here, the Department should consider the continuing concerns, based on public reports, regarding corruption and the poorly developed rule of law in Ukraine as other factors weighing against a finding that the country has a market economy.

While the Government of Ukraine has taken steps to combat corruption, the effect of such efforts is uncertain and corruption remains a serious concern in Ukraine. As the IMF recently observed, "{b}y all indications, corruption and rent seeking remain endemic. Ukraine ranks 122 out of 146 countries in the corruption index compiled by Transparency International, and its privatization efforts have been

85 19 U.S.C. § 1677(18)(B)(vi).

notorious for allegedly brazen insider deals."[86] Similarly, the U.S. State Department has found that

> {c}orruption pervades all levels of society and government and all spheres of economic activity in Ukraine. . . . Corruption stems from rampant conflicts of interest, a lack of institutional traditions of transparent decision-making and societal understanding of the importance of corporate governance and transparency. [87]

According to public sources, the unpredictability and ineffectiveness of the legal system and the poorly developed rule of law in Ukraine also create problems for those doing business in the country.[88] The U.S. State Department has reported that the Ukrainian legal system is so "weak," "unpredictable," and subject to "political interference" that foreign investors try to avoid that system altogether.[89]

According to the World Bank, an "insider economy" has developed in Ukraine based on the concentration of economic activity in large financial-industrial groups – raising concerns that concentrated economic resources allow such groups greater influence and power over government institutions and regulators as well as the courts.[90] The World Bank has reported that this "insider economy" nature of

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86 "IMF Survey," International Monetary Fund (Apr. 4, 2005), Vol. 34, No. 6, at 90, attached as Exhibit 22.

87 Ukraine Country Commercial Guide at Chapter 6: Investment Climate – Corruption, pp. 6-11 to 6-12, attached as Exhibit 12.

88 See id. at Chapter 6: Investment Climate – Openness to Foreign Investment, p. 6-1; id. at Chapter 6: Investment Climate – Dispute Settlement, pp. 6-4 to 6-5.

89 See id. at Chapter 6: Investment Climate – Dispute Settlement, p. 6-5.

90 See "Ukraine: Building Foundations for Sustainable Growth," World Bank (Aug. 2004), at

Ukraine "hinders fair competition, encourages low transparency and corruption, discourages foreign investment, restricts the adaptability of the economy to changing market conditions, limits the realization of genuine comparative advantage, and complicates processes associated with access to foreign markets and world economic integration."[91] Such an environment constitutes another factor weighing against treating Ukraine as a market economy.

vi, attached as Exhibit 23.

91 Id. at vi-vii.

VIII. CONCLUSION

As demonstrated above, the overwhelming weight of the evidence shows that Ukraine does not satisfy the conditions necessary to be treated as a market economy. To find otherwise would be to ignore the studied conclusions of all parties who have analyzed the situation, including the U.S. Government itself. Accordingly, the Department should determine that Ukraine must make significant changes and developments before it may graduate to market economy status.

Respectfully submitted,

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Vice President, Trade and Economic Policy