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VIA MESSENGER

The Honorable Donald L. Evans
Secretary of Commerce
Attn: 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. Secretary:

The Ad Hoc Committee of Domestic Nitrogen Producers ("Ad Hoc Committee") hereby submits comments in response to the Department's Notice of Opportunity to Comment on the Status of Ukraine as a Non-Market Economy Country, 67 Fed. Reg. 19394 (April 19, 2002).[1] For the reasons discussed in the attached submission, the Ad Hoc Committee respectfully submits that 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 seven former communist countries – Poland, Slovakia, the Czech Republic, Hungary, Latvia, Kazakhstan, and the Russian Federation.[2] 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.[3] In its determination regarding Kazakhstan's status, however, the policy statements for each of the statutory factors provide a clear foundation for how the Department assesses a country's progress toward market principles.

Based on these standards, it is evident that Ukraine does not yet merit market economy status under the antidumping law. Ukraine has failed to significantly reform its laws and restructure the economy so as to allow market forces to determine wages, prices, and production decisions. This insufficient progress toward market principles has led to the development of an informal economy that constitutes a huge proportion of Ukraine's GDP and has limited foreign direct investment in Ukraine to one of the lowest per capita levels in the region. By any measure, Ukraine has not yet reached the level of transformation to a market economy necessary

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[1] The members of the Ad Hoc Committee are CF Industries, Inc., El Paso Corporation, Mississippi Chemical Corporation, PCS Nitrogen, Inc., and Terra Industries, Inc.

[2] 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).

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

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 19, 2002 notice. Supporting documentation is provided in the attached exhibits, except where a document is readily available on the worldwide web, in which case an electronic address is provided in the citation. The Ad Hoc Committee would, of course, be pleased to provide hard copies upon request. Finally, the Ad Hoc Committee has received only limited permission from Fertecon Ltd. to quote from its proprietary publications and, therefore, only pertinent excerpts are attached in the exhibits.

Respectfully submitted,

Robert C. Liuzzi
President and Chief Operating Officer,
CF Industries, Inc.
Chairman, Ad Hoc Committee
of Domestic Nitrogen Producers

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I. Ukrainian Government Restrictions on the Hryvnia Are Incompatible with Market Economy Status

A. Summary of Comment

The Ukrainian currency, the hryvnia, is not freely convertible because the Ukrainian Government continues to maintain extensive currency controls.

B. Discussion

Under Section 771(18)(B)(i) of the Tariff 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 determination concerning Kazakhstan's NME status, "a particular country's integration into world markets is highly dependent upon the convertibility of its currency."[4] As the Department explained, domestic prices tend to be more market-based if the extent of currency convertibility is greater, since convertibility links domestic prices to world market prices through the introduction of more extensive supply and demand forces in the domestic economy.[5]

In Ukraine, however, the controls that the government maintains on the country's currency, the hryvnia, are not compatible with a market economy, and are more extensive than those maintained by other countries that have recently graduated to market economy status. For example, according to the European Bank for Reconstruction and Development, the hryvnia is not yet fully convertible because 50 percent of hard currency receipts must be converted to hryvnias.[6] In addition, the U.S. Commercial Service reports that currency regulations require that individual licenses must be obtained from the National Bank of Ukraine (NBU) for operations such as use of hard currency in Ukraine as a form of security, opening a bank account abroad by a resident of Ukraine, or obtaining or granting a loan in hard currency above a

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[4] Antidumping Duty Investigation of Silicomanganese from Kazakhstan – Request for Market Economy Status, Department Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 1 (Mar. 25, 2002) (hereinafter "Kazakhstan Memorandum").
[5] See id.
[6] See Ukraine Investment Profile 2001 at 9, available at www.ebrd.org/english/public/index.htm (hereinafter "EBRD Profile").

minimum established by the NBU.[7] These restrictions impede Ukraine's integration into the world economy by limiting access to world markets.

In contrast, the Department noted that in Kazakhstan, the 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.[8] 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.[9] Similarly, the Department found that in Hungary, residents and firms could hold foreign exchange and freely convert the local currency into foreign exchange for both trade and investment purposes.[10]

Unlike those countries that the Department has graduated to market economy status, Ukraine has not yet attained a level of currency convertibility that permits supply and demand forces to ensure that domestic prices are truly market-based. Consequently, the Department should find that the Ukrainian hryvnia is not sufficiently convertible to consider Ukraine to have achieved market economy status.

II. Wage Rates Are Not Determined by Free Bargaining Between Labor and Management

A. Summary of Comment

[7] See Department of Commerce, U.S. Commercial Service, Ukraine Country Commercial Guide FY 2002, at Ch. 8.B, "Foreign Exchange Controls," *available at* www.usatrade.gov/Website/CCG.nsf/CCGurl/CCG-UKRAINE2002-CH--005A5930 (hereinafter "Country Commercial Guide").
[8] See id.
[9] See Antidumping Duty Investigation of Certain Steel Concrete Reinforcing Bars from Latvia – Request for Market Economy Status, Department Memorandum at 6 (Jan. 10, 2001) (hereinafter "Latvia Memorandum").
[10] See Antidumping Administrative Review of Tapered roller Bearings and Parts Thereof, Finished or Unfinished, from Hungary – Market vs. Non-Market Economy ("NME") Analysis Memorandum, Department Memorandum at 6 (Feb. 23, 2000) (hereinafter "Hungary Memorandum").

Workers in Ukraine are not able to fully exercise their rights because of provisions in the law that violate their rights to freedom of association and to organize. The dominance of the successor union to the Soviet-era unions and its strong ties to the government suppress the formation and influence of independent unions. Finally, wage arrearages continue to be a problem, and the vast size of the informal economy leaves workers without any effective protections or ability to bargain for wages.

B. Discussion

As part of its analysis, the Department must consider the extent to which wage rates are determined by free bargaining between labor and management, pursuant to Section 771(18)(B)(ii). The Department stated in its determination regarding Kazakhstan's NME status that "the manner in which wages are set. . . are an important component of producers' costs and prices, and in turn are an important indicator of a country's overall approach to setting costs and prices in the economy."[11] Free bargaining between labor and management is an indicator of 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.[12]

An examination of the labor situation in Ukraine reveals that, even though workers have the legal right to form and join trade unions and to bargain collectively for wages, there are serious impediments to the full exercise of these rights. A glaring example is the 1999 "Law on Trade Unions, Their Rights and Safeguards of Activities," which contains two provisions that the International Labour Organisation has found in violation of ILO Convention 87, "Freedom of

[11] Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 2.
[12] See id.

Association and Protection of the Right to Organize."[13] These provisions require trade unions to register with the Ministry of Justice and to have a certain level of membership and regional representation in order to qualify for national status.[14] In the wake of this law, some unions were unable to obtain registration, lost their tax-exempt status, or were unable to participate in collective bargaining.[15] Further, even though the Ukrainian Constitutional Court found these provisions unconstitutional in October 2000, the Ukrainian parliament failed to enact amendments to conform the law to the ruling, but rather, in December 2001 passed amendments that maintained these requirements.[16] This action makes it clear that the Ukrainian government is not committed to ensuring full and free worker rights.

Another impediment to full worker rights is the status of the Federation of Trade Unions (FPU), which inherited the assets of the official Soviet-era unions and maintains close ties to the government.[17] FPU-affiliated unions control the property and financial holdings, particularly social insurance benefits funds, of the precursor Soviet unions and have denied a share of these holdings to independent unions. This has limited the effectiveness of the independent unions, which also have complained of surveillance by law enforcement agencies as well as efforts by the state to influence union votes and pressure members to report on union activities.[18] In addition, the manner in which the "Law of Collective Bargaining" is applied favors official unions (i.e., those affiliated with the FPU) to the detriment of independent unions.[19]

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[13] See International Confederation of Free Trade Unions, "Ukraine: Annual Survey of Violations of Trade Union Rights (2001)," *available at* www.icftu.org/displaydocument.asp?Index=991213854&Language=EN (hereinafter "ICFTU Survey").
[14] See id.; see also Department of State, Country Reports on Human Rights Practices – 2001 at Sec. 6.a, "Worker Rights" (Mar. 2002), *available at* www.state.gov (hereinafter "State Dept. Report").
[15] See ICFTU Survey.
[16] See State Dept. Report at Sec. 6.a.
[17] See id.
[18] See id.
[19] See id. at Sec. 6.b.

Finally, wage arrears continue to be a problem, and the unofficial economy, which provides no protection to workers, constitutes a significant proportion of the economy. According to a recent report by the International Confederation of Free Trade Unions, the International Labour Organisation conducted a study in Ukraine that found that more than two out of five workers had not been paid for the previous three months, one out of three enterprises had put workers on unpaid or "partially paid" leave, under which workers are given only a token sum, and payment in kind applied to about one quarter of total industrial production.[20] A 1998 report by the Harvard Institute for International Development estimated that the informal economy was in excess of 70 percent of Ukraine's official gross domestic product.[21] The Organization of Economic Cooperation and Development (OECD) estimated that in 2000, the informal economy accounted for 50 to 70 percent of official GDP.[22] These conditions distort the labor market and do not ensure that workers have adequate bargaining rights with management.

In the Kazakhstan determination, although the Department found that wage arrearages were a problem, workers were able to negotiate wages and there was no discussion of an informal economy in Kazakhstan.[23] In addition, in other NME analyses the Department found evidence of a robust labor market in which labor and management participated as equal partners in negotiating wage rates, without any apparent problem with wage arrearages or a significant informal economy.[24] As the discussion above demonstrates, however, wages in Ukraine do not

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[20] See "Ukraine: an economy at rock bottom," (Aug. 10, 2001), *available at* www.icftu.org/displaydocument.asp?Index=991213417&Language=EN.
[21] See Country Commercial Guide at Ch. 7.G, "Labor."
[22] OECD Directorate for Financial, Fiscal and Enterprise Affairs, Ukraine Investment Policy Review, The Legal and Institutional Regime for Investment: Assessment and Policy Recommendations, Executive Summary and Recommendations (Mar. 2001), at 9, *available at* www.oecd.org./oecd/pages/home/displaygeneral/0,3380,EN-document-705-nodirectorate-no-4-4570-30,00.html.
[23] See id.
[24] See, e.g., Hungary Memorandum at 7; Antidumping Investigation of Certain Small Diameter Carbon and Alloy Seamless Standard Line and Pressure Pipe from the Czech Republic: Non-Market Economy ("NME") Country Status, Department Memorandum at 5-6 (Nov. 29, 1999) (hereinafter "Czech Memorandum").

adequately reflect costs and prices in the economy, given that unions are either not fully independent from the government or face discrimination if they are, wage arrearages remain a problem, and the informal economy generates a huge proportion of the country's output. These factors distort the economy such that the Department cannot find that Ukraine has made sufficient progress toward a market economy under this criterion.

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 government to amend its laws and restructure the economy in order to create favorable conditions for investment. The tax system is a serious barrier to foreign investment, as are over-regulation, corruption, and a weak court system. The underdeveloped banking system and capital markets, as well as an accounting system that does not accord with international standards, also act as barriers to foreign investment.

B. Discussion

Pursuant to Section 771(18)(b)(iii) of the Act, the Department must consider the extent to which joint ventures or other investments by firms in other countries are permitted in Ukraine. As the Department noted in its Kazakhstan determination, foreign investment "tends to expose domestic industry to competition from market-based suppliers and their management, production and sales practices. Foreign investors generally demand a certain level of control over their investments, which thereby limits the NME government's control over the market.[25]

It is remarkable that Ukraine, with its well-educated work force, substantial industrial assets, and extremely fertile land, has attracted so little foreign direct investment. Cumulative FDI from 1991 through 2000 totaled only $3.9 billion in a country with a population of nearly 50 million, or $78 per capita. This compares to total FDI for the same period in Poland of approximately $40 billion (population 38.6 million) and over $20 billion in Hungary (population 10.1 million).[26] However, approximately 25 percent of joint ventures involved offshore capital

[25] See Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 3.
[26] See Country Commercial Guide at Ch. 2.A; population figures for Poland and Hungary are from the CIA World Factbook 2001, *available at* www.cia.gov/cia/publications/factbook/index/html.

whose original source was Russian and Ukrainian businesses and, thus, the actual level of FDI from other countries is even lower.[27] As noted by the EBRD, FDI was expected to increase only slightly in 2001, "reflecting the persistently difficult investment climate" in Ukraine.[28]

There are many reasons why foreign investors have avoided doing business in Ukraine, even though the laws nominally provide for equal treatment of foreign-owned enterprises, the right to repatriate profits, and protections for minority shareholders.[29] The Department has described the investment and business climate in Ukraine as "fraught with difficulties," where the rule of law "remains in its infancy," courts are weak and subject to political pressures, and corporate governance is weak so that, in reality, minority shareholders have almost no legal basis for protecting their interests.[30] In addition, corruption is a serious barrier to investment, with Transparency International ranking Ukraine as one of the most corrupt countries in the world and the World Bank ranking Ukraine among the worst Eastern European countries for administrative and state capture corruption (i.e., undue influence of vested interests on government).[31] In addition, the tax regime, both the overall tax burden and its administration, is ranked as the "most serious barrier" to investment according to a survey conducted by the International Finance Corporation.[32] The EBRD stated that most surveys cite, in addition to the tax burden, the extent of regulation, difficulties in enforcing contracts, and corruption as the main obstacles for business in Ukraine.[33]

[27] See "Why Is Foreign Direct Investment in Ukraine Trailing Behind?" World Bank, Transition Newsletter, at 20 (Mar.-Apr. 2002).
[28] EBRD Profile at 5.
[29] See id. at 8-9.
[30] Country Commercial Guide at Ch. 1.
[31] See id.
[32] See id. at Ch. 7.A.
[33] See EBRD Profile at 9.

Perhaps the most damning report regarding the investment climate in Ukraine is the OECD's Ukraine Investment Policy Review.[34] This review was undertaken by the OECD with the cooperation of the Government of Ukraine in order to provide information on the business environment in Ukraine and to enhance cooperation between the OECD and Ukrainian decision-makers on investment issues.[35] The Executive Summary provides ample evidence of the lack of structural reform toward market principles in Ukraine that makes it "among the least advanced transition economies," with a bureaucracy that is "well entrenched and still extensive, and still operates with a mindset reflecting the FSU legacy of control and strict regulation."[36] The Executive Summary chronicles a number of serious problems with the investment climate in Ukraine, such as:

- The collapse of the formal economy led to the expansion of the informal economy to 50-70 percent of official GDP in 2000. The informal economy seriously distorts competition, since informal enterprises do not pay taxes or make social welfare contributions, nor are they effectively subject to government regulations.[37]

- There are limitations on foreign investment in certain sectors, including insurance, television and broadcasting, a prohibition on foreign investors owning land, and very limited participation in privatizations.[38]

- The legal framework for foreign direct investment has been ineffectively implemented, which has been exacerbated by separate laws that regulate different types of business activities and requirements for permits and licenses in certain sectors.[39]

- The absence of a coherent, effective and transparent legal system has created difficulties for compliance and provides only uncertain and inadequate protection for property rights and contracts. The OECD identified three primary reasons for the inadequate legal system in Ukraine. First, Soviet-era laws continue in force unless

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[34] OECD Directorate for Financial, Fiscal and Enterprise Affairs, Ukraine Investment Policy Review, The Legal and Institutional Regime for Investment: Assessment and Policy Recommendations, Executive Summary and Recommendations (Mar. 2001), *available at* www.oecd.org./oecd/pages/home/displaygeneral/0,3380,EN-document-705-nodirectorate-no-4-4570-30,00.html (hereinafter "OECD Investment Review").
[35] See id. at 4.
[36] Id. at 6, 7.
[37] See id. at 9, 25.
[38] See id. at 11.
[39] See id. at 12-13.

they have been specifically repealed or superseded by new laws, which are sometimes no better than the Soviet laws. Second, many laws merely state general principles, and administrative instructions are normally not publicly available. Third, most post-independence legislation has been adopted in response to specific policies, without sufficient attention given to the overall coherence of the legal system.[40]

- The two laws governing business enterprises, the Law on Enterprises and the Law on Companies, do not adequately protect minority shareholders against insider dealing, asset stripping and other abuses, place unnecessary restrictions on corporate finance, and create complexity and confusion.[41]

- The tax regime is a major disincentive to investment because of the high effective tax rate, ambiguity and inconsistency of tax legislation, burdensome compliance requirements, the high number of taxes (over 30 different types), frequent changes in tax laws, and arbitrary and opaque tax administration.[42]

- The banking system and capital market are still in an "embryonic" stage.[43]

- Accounting standards are still not fully developed, which requires enterprises with foreign investments to maintain two accounting systems.[44]

These numerous, systemic problems with the Ukrainian economy and investment climate contrast unfavorably with the investment climates in countries that have graduated to market economy status. In Kazakhstan, for example, the tax code provided certainty for investors and the government had developed a generally consistent policy to improve the investment climate.[45] Latvia implemented policies to encourage foreign direct investment which, along with a stable macroeconomic and favorable business environment, resulted in cumulative per capita FDI for 1989-2000 of $1,027.[46] Foreign direct investment in the Czech Republic was governed by the Czech Commercial Code, under which foreign investors were treated identically to domestic

[40] See id. at 14.
[41] See id. at 16.
[42] See id. at 16-17.
[43] Id. at 19.
[44] See id. at 20.
[45] See Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 3.
[46] See Latvia Memorandum at 8-9; for cumulative per capita FDI figure, see Freedom House, Nations in Transit 2001, Table F, *available at* www.216.119.117.183/research/nattransit/htm.

investors, all economic sectors (with the exception of a few sensitive industries) were open to foreign investors, and foreign investors could own 100 percent of Czech business entities.[47]

In Ukraine, the pervasiveness of the informal economy, the incoherence of the legal and regulatory systems, and the other factors discussed above that have retarded foreign investment all demonstrate that the Ukrainian economy has not sufficiently opened its economy to foreign investment. Ukraine has not, therefore, been exposed to market-based competition to the degree necessary for the Department to revoke its NME status.

[47] See Czech Memorandum at 7.

IV. The Ukrainian Government Maintains Extensive Ownership and Control of the Means of Production

A. Summary of Comment

The Ukrainian government has failed to make steady progress in its privatization efforts. The laws and regulations governing privatization of state-owned assets are weak, which has allowed political interference, corruption, and non-transparent transactions to flourish. Finally, the government maintains substantial ownership interests in many enterprises and sectors, notably the energy sector, and has not sufficiently reformed laws governing land ownership so as to ensure the operation of market principles.

B. Discussion

The Department is required to examine the extent of government ownership or control of the means of production in its analysis of whether to graduate Ukraine to market economy status, according to Section 771(18)(B)(iv). As the Department observed in its Kazakhstan determination, the right to own property is "fundamental" to a market economy.[48] Further, the extent of private sector involvement in the economy is an indicator of the extent to which the economy operates on market principles.[49]

The Ukrainian Government's ownership and control over enterprises and land, however, is far too extensive to permit a market economy to function properly. The lack of sustained progress in Ukraine's privatization efforts is a matter of widespread concern for government and international agencies that monitor Ukraine's efforts to transition to a market economy. For example, the Department noted that "privatization in Ukraine has proceeded unevenly thus far" and "will remain a key variable that will shape Ukraine's success or failure in implementing

[48] Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 4.
[49] See id.

market reforms."[50] Clearly, in the Department's estimation, much more progress in privatization is necessary to transform the economy into one based on market principles, a transformation that is by no means assured. Indeed, according to the Department, more than half of Ukraine's productive assets in terms of employed persons and value of output still remained under government control.[51]

Similarly, the OECD identified privatization as "an important vehicle for foreign investment and economic reform in many countries," but noted that the slow pace of privatization in Ukraine is one of the most pressing structural problems facing the country.[52] The International Monetary Fund found that, while "some progress" had been made on structural reforms, the implementation of the 2001 privatization program "met with delays." The IMF also urged the Ukrainian government to continue structural reforms, noting that "measures to improve the privatization climate and to level the playing field for all investors will be crucial to overcome weaknesses in the business environment."[53] In fact, as the CIA notes in its World Factbook entry on Ukraine, "outside institutions – particularly the IMF – have encouraged Ukraine to quicken the pace and scope of reforms and have threatened to withdraw financial support."[54] The pace of reform and privatization is hampered, however, by the Ukrainian government's decision not to restructure large-scale enterprises before privatizing them, which "forces investors to face the most difficult – and in the end result only politically solvable – questions surrounding the restructuring of Ukraine's Soviet-era industrial infrastructure."[55]

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[50] Country Commercial Guide at Ch. 2.C, "Government Role in the Economy."
[51] See id.
[52] OECD Investment Review at 6-7.
[53] "IMF Concludes 2002 Article IV Consultation with Ukraine," Public Information Notice No. 02/52 at 2-3, 4 (May 8, 2002), *available at* www.imf.org/external/np/sec/pn/2002/pn0252.htm.
[54] The World Factbook – Ukraine, at "Economy," *available at* www.cia.gov/cia/publications/factbook/index.html.
[55] Country Commercial Guide at Ch. 2.C, "Government Role in the Economy."

The privatization process has also been marred by political interference and resistance to change. For example, the Department notes that large-scale privatizations have encountered problems because privatization rules are weak and poorly institutionalized, which permits political interests to exert undue influence on the process. Further, "management and workers resist the prospect of surrendering government ownership to investors interested in an adequate return on capital," and "local and regional governments, who view large state-controlled enterprises within their jurisdictions as an important tool for political influence and patronage, resist surrendering the control that privatization implies."[56] Political interference is still a problem even if an enterprise is nominally privatized. As stated by Freedom House, over 82 percent of industry, accounting for more than 54 percent of GDP in 2000, was former state property that had been turned into shareholding companies, but in which the state still held 25 to 50 percent of the shares. Retaining such substantial ownership permitted the government to "interfere in the decision-making process."[57]

The highly politicized atmosphere surrounding privatization is illustrated by the apparently on-again, off-again sale of shares in the telecommunications monopoly Ukrtelecom. The EBRD reported that the sale of Ukrtelecom had been blocked several times by the Ukrainian parliament, but that the sale of at least 25 percent of shares was scheduled to take place in late 2001, although the government would continue to retain a majority interest.[58] According to the World Bank, however, the sale of a 37 percent stake in Ukrtelecom was one of the "strategically important enterprises still on the list to be privatized in 2002."[59] In addition, in December 2001 the parliament added several strategic enterprises to the list of companies that cannot be

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[56] Country Commercial Guide at Ch. 2.C, "Government Role in the Economy."
[57] Nations in Transit 2001 at 402.
[58] See EBRD Profile at 10, 23.

privatized, including the Zaria plant, which is one of the largest producers of turbines for ships and gas compressor units in the Commonwealth of Independent States.[60] These acts demonstrate that the Ukrainian government has, at best, an ambivalent attitude toward privatization and market reform.

A lack of transparency has also plagued the privatization process in Ukraine. It is astounding that the April 2001 privatization of six electricity distribution companies was the first time a large-scale privatization occurred in Ukraine according to internationally accepted standards.[61] This improvement in the privatization process was overshadowed later in the year, however, by the sale of some assets of a major power generating company for less than their market value, which was carried out in an auction that was not publicly announced until a week after it was held.[62] Although the Ukrainian government subsequently annulled the sale, this incident shows that non-transparent privatization deals are still a problem in Ukraine.

In fact, the energy industry is one of the most problematic sectors of the Ukrainian economy. Of particular concern to the Ad Hoc Committee is the natural gas sector, since natural gas is the primary feedstock for nitrogen fertilizers. Although the government has attempted to restructure and introduce market-based organization methods since the mid-1990s, these efforts have not benefited from clearly defined objectives or a coherent approach.[63] Rather than privatizing the gas industry, however, in 1998 the government consolidated its control by creating Naftohaz Ukrainy, a state-owned holding company that includes enterprises that produce 97 percent of domestic gas, all natural gas transmission, and the major gas trading

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[59] "Why Is Foreign Direct Investment in Ukraine Trailing Behind?" World Bank, Transitions Newsletter at 20 (Mar.-Apr. 2002).
[60] See id.
[61] See Country Commercial Guide at Ch. 2.C, "Government Role in the Economy"; see also EBRD Profile at 19.
[62] See "Ukraine: Energy Sector Privatization," U.S. Energy Information Administration (Sept. 2001), *available at* www.eia.doe.gov/emeu/cabs/ukraine.html.

company in the country.[64] According to the EBRD, the government has plans to eventually privatize Naftohaz, but "reform in the oil and gas production sector has been slow and foreign investment negligible."[65] However, during an April 10, 2002 news conference in Moscow, Ukrainian Prime Minister Kinakh announced that Ukraine will not consider privatizing its major gas pipelines.[66] The government's involvement in the natural gas sector is discussed further in the following section.

Finally, land reforms have not progressed to the point where there is a functioning market in land. This is due to several factors, including the reticence of banks to provide loans for the purchase of land because of problems with ownership registration and the weak legal system that minimizes a creditor's chance to seize property.[67] Indeed, the OECD observed that "adequate legislation and a title registry for mortgages are still unachieved. Thus, mortgage-based lending remains undeveloped and local currency credits in spring 2000 ran at some 50 percent interest and were usually available for short term only (up to one year)."[68] Although the Ukrainian parliament finally passed a new Land Code that came into effect on January 1, 2002, its reforms are still a long way from fruition. For example, the sale of agricultural land and resale of privately-held land is prohibited until 2005.[69] Further, foreigners and non-Ukrainian companies are prohibited from owning agricultural land, and farmland cannot be freely traded until 2010.[70]

The situation in Ukraine is vastly different from that in other countries that have graduated to market economy status. In Hungary, the Czech Republic, and Slovakia, for

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[63] See "An Overview of the Oil and Gas Industry in Ukraine," PriceWaterhouseCoopers (2002), at 1, *available at* www.pwcglobal.com/ua/eng/ins-sol/publ/index/html (hereinafter PriceWaterhouseCoopers Overview").
[64] See id. at 2.
[65] EBRD Profile at 20.
[66] See "Ukrainian Premier Rules Out Privatization of Major Gas Pipelines," BBC Monitoring International Reports (Apr. 10, 2002), attached at Exhibit 1.
[67] See Country Commercial Guide at Ch. 7.B, "Right to Private Ownership and Establishment."
[68] OECD Investment Review at 18-19.
[69] See "FSU Update" Fertecon (Feb. 7, 2002), at 11, excerpt attached at Exhibit 2.

example, the government 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.[71] In Latvia, the Department found that by the end of 1998, virtually all enterprises were privately owned.[72] Notably, in Hungary and Kazakhstan, substantial assets in oil and gas production and distribution were sold to private investors, unlike the situation in Ukraine.[73] 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.[74] 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. 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.[75] This included restitution or sale of the vast majority of land and title rights to land in Slovakia, the Czech Republic, and Hungary. In Latvia, although due to registration delays only about 30 percent of land was legally owned by private holders by the end of 1999, virtually all land was in private hands. In Kazakhstan, there were some restrictions on land ownership, but land use rights were extensive and the land user could sell or mortgage those rights.

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[70] See id.
[71] See Hungary Memorandum at 10-12; Czech Memorandum at 8-11; 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).
[72] See Latvia Memorandum at 12.
[73] See Hungary Memorandum at 12; Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 4.
[74] See Kazakhstan Memorandum at id.
[75] 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 its June 6, 1993 memorandum regarding Poland's market economy status.

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.

V. The Ukrainian Government Exercises Control Over the Allocation of Resources and the Pricing and Output Decisions of Key Enterprises

A. Summary of Comment

The Ukrainian government continues to exert substantial control over the natural gas sector so that prices are not market-determined. The government also continues to direct agricultural production. In addition, the commercial banking sector has not been reformed, which significantly constricts the ability of market forces to direct the allocation of capital.

B. Discussion

Section 771(18)(B)(v) of the Act requires the Department to 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 and firms. As the Department explained in its Kazakhstan Memorandum, "decentralized 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 (most efficient) use."[76] Or, as recently put in a report published by the World Bank outlining the failure of market reform in Ukraine's financial sector, "{m}arkets, and especially financial markets cannot work if the information about relative efficiency is obfuscated by myriad distortions and if the state still plays a significant role in determining how and where resources get allocated."[77]

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[76] Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Facts" at Section 5.
[77] Alan Roe et al., Ukraine: The Financial Sector and the Economy – The New Policy Agenda (Sept. 2001) at para. 2.20, *available at* http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Agenda/$File/Ukr2.pdf (hereinafter "New Policy Agenda").

The Ad Hoc Committee is particularly concerned with the Ukrainian Government's legacy of control over the domestic nitrogen fertilizer industry. Notwithstanding the partial privatization of this industry, it continues to be directed by a web of non-transparent state controls that ensure the continued supply of non-commercially priced natural gas and encourage production for export at unfair prices. We urge the Department to examine carefully this continuing central control, which operates at several levels, including the following:

Control over Natural Gas Prices: As in the Soviet era, natural gas is supplied to Ukraine mainly by Russia. While the Ukrainian Government has attempted to diversify supply, and has recently concluded a supply agreement with Turkmenistan, as of early 2002 around 65 percent of Ukrainian natural gas consumption was of Russian-supplied gas.[78] This supply relationship between the Ukrainian and Russian Governments, which is renegotiated on a regular basis, is characterized by volatility, late payments, barter, and accusations of theft and re-export.[79]

The Ad Hoc Committee is particularly concerned that the Ukrainian Government supplies natural gas to the nitrogen fertilizer industry at prices that are not determined by the market. To begin with, available evidence suggests that the Ukrainian Government pays roughly half the normal export price for Russian natural gas. The U.S. Energy Information Agency recently reported that the normal export price for Russian natural gas is $140 to $150 per 1,000 cubic meters.[80] The Russian and Ukrainian Governments, however, recently agreed that Ukraine would have to pay only $50 per 1,000 cubic meters – <u>one third of the normal export price</u> – at least through July 2002.[81] Moreover, the Ukrainian Government does not pay <u>at all</u> for much of

[78] <u>See</u> PricewaterhouseCoopers Overview at 1.
[79] <u>See</u> Ukraine Country Brief, U.S. Energy Information Administration (Sept. 2001), *available at* www.eia.doe.gov/emeu/cabs/ukraine.html; <u>see</u> <u>also</u> EBRD Profile at 19.
[80] <u>See</u> Russia Country Brief, U.S. Energy Information Administration (April 2002), *available at* www.eia.doe.gov/emeu/cabs/russia.html.
[81] "FSU Update," Fertecon (Feb. 7, 2002), at 21, excerpt attached at Exhibit 2.

the gas it imports from Russia, instead taking the gas in exchange for its agreement to transport Russian gas through Soviet-era export pipelines that run through Ukraine westward to Europe.[82] In short, the government-to-government gas prices are not set by market conditions, but are subject to and vary according to the vagaries of Ukrainian-Russian relations. The result is the provision of massive amounts of natural gas to the Ukrainian Government at very low rates that reflect the distortions of heavy government intervention.

Of particular concern to the Ad Hoc Committee is that the Ukrainian Government apparently provides natural gas to the nitrogen fertilizer industry at even lower rates than it pays for the gas. Indeed, recent evidence suggests that the Ukrainian Government is considering whether to supply gas to nitrogen fertilizer producers at a mere $32 per 1,000 cubic meters. The ostensible purpose of this price reduction would be "to both reduce fertilizer production costs and to supply fertilizer to agriculture at lower prices."[83] The resulting price distortions are strong evidence that Ukraine continues to operate as a non-market economy in large, export-oriented sectors of its economy. This distortion would render use of market economy methodologies inappropriate in assessing the fair value of Ukraine's exports.

Controls over Agricultural Production: The Ukrainian Government has apparently recently mandated Ukrainian farms to increase substantially their consumption of certain nitrogen fertilizers. As explained by Yaroslav Voitko, Chief of Ukraine's Trade and Economic Mission to the United States, at the International Trade Commission's hearing in the final phase investigation in Certain Ammonium Nitrate from Ukraine, the Ukrainian Government has recently implemented a program called Cereals of Ukraine, "which starts in 2001 designed for

[82] Ukraine Country Brief, Energy Information Agency, in "Gas Debts to Russia."
[83] "FSU Update," Fertecon (Feb. 7, 2002), at 21, excerpt attached at Exhibit 2.

four years and which stipulates the increase in Ukrainian AN consumption be 4.3 times."[84] This "four-year plan" spurred Ukrainian AN consumption from 525,000 metric tons in all of calendar year 2000 to 1,035 million metric tons during the first half of 2001.[85] Other recent evidence suggests that Ukraine's Ministry of Industrial Policy is directing nitrogen fertilizer purchasing by domestic agricultural enterprises.[86] Such programs show that the Ukrainian Government has made little progress in shedding centralized planning of agricultural production, and that resources are not allocated on the basis of market signals.

The Department should also consider the lack of progress in the reform of Ukraine's commercial banking sector – a condition of the Ukrainian economy that seriously impedes the extent to which capital can be allocated by market forces. The Department cannot conclude with respect to Ukraine, as it did with respect to Kazakhstan, that its "commercial banks are fundamentally sound."[87] For one, as the World Bank described in a recent study, many of Ukraine's banks are "financially too weak to be trusted with the public's money," and "they are able to mobilise only small volumes of savings and lend even smaller amounts of money to support productive purposes."[88] As of 2001, the capacity of Ukraine's commercial lending sector was so small that, in the five years leading up to 2000, its quantitative contribution as measured in terms of credit as a percentage of GDP averaged only 2.1 percent – as compared to 9.6 percent in Estonia and 7.2 percent in Hungary over a similar period.[89]

In its Kazakhstan Memorandum, the Department concluded that, in that country, (1) allocation decisions rest with the private sector, (2) market-based entrepreneurial activity is

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[84] Transcript of the July 24, 2001 Hearing of the Commission in Certain Ammonium Nitrate from Ukraine, Inv. No. 731-TA-894 (Final), at 112.
[85] Id.
[86] "FSU Update," Fertecon (Feb. 7, 2002), at 21, excerpt attached at Exhibit 2.
[87] Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 5.
[88] New Policy Agenda at para. 2.1. See also OECD Investment Review at 19-20.
[89] New Policy Agenda at para. 2.6.

developing, and (3) the commercial banking sector functions as a financial intermediary.[90] Something quite different – a "part-way reformed socialist," or "hybrid" economy – has developed in Ukraine since independence.[91] The hallmark of this system is control by the state, which exercises its power "not via visible policies but via ubiquitous and mainly non-transparent special arrangements for large numbers of 'deserving' enterprises, farms and banks."[92] The Ad Hoc Committee has witnessed the injurious manifestations of these non-market arrangements first-hand in recent years, in the form of massive quantities of dumped nitrogen fertilizer. Recent reported efforts by the Ukrainian nitrogen fertilizer industry to secure a lower fixed price for state-supplied natural gas are merely one more example of the "special arrangements" that exist between government and industry. So long as these arrangements persist – precluding the allocation of resources and pricing and output decisions by market forces – Ukraine cannot be considered a non-market economy for purposes of the antidumping law.

[90] Kazakhstan Memorandum, "Analysis of Section 771(18)(B) Factors" at Sec. 5.
[91] New Policy Agenda at para. 2.19.
[92] Id.