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COMMISSION STAFF WORKING PAPER

European Neighbourhood Policy

Country Report

Ukraine

{COM(2004)373 final}

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1. INTRODUCTION

1.1. The European Neighbourhood Policy

On 1 May 2004, the enlargement of the European Union took place with the accession of ten new Member States. It has brought changes to the EU's political geography offering new opportunities to deepen existing relations between the Union and its neighbours to the East and to the South. The Union is determined to further develop partnerships with its neighbours to mutual benefit, promoting security as well as stability and prosperity. The EU's external borders will not become new dividing lines but the focus of enhanced co-operation.

The European Neighbourhood Policy sets ambitious objectives for partnership with neighbouring countries based on strong commitments to shared values and political, economic and institutional reforms. Partner countries are invited to enter into closer political, economic and cultural relations with the EU, to enhance cross border co-operation and to share responsibility in conflict prevention and resolution. The Union offers the prospect of a stake in its Internal Market and of further economic integration. The speed and intensity of this process will depend on the will and capability of each partner country to engage in this broad agenda. The policy builds upon and reinforces the existing framework of co-operation.

In this report, the Commission provides an assessment of bilateral relations between the Union and Ukraine. The report reflects progress under the Partnership and Co-operation Agreement, and describes the current situation in selected areas of particular interest for this partnership: the development of political institutions based on the values – democracy, the rule of law, human rights - underlined in the Agreement, regional stability and co-operation in justice and home affairs, and economic and social reforms that will create new opportunities for development and modernisation, for further liberalisation of trade and for gradual participation in the Internal Market. The report provides guidance for the preparation of joint action plans, and may also serve as a basis for assessing future progress in the Union's relations with Ukraine.

1.2. Relations between the European Union and Ukraine - The existing contractual framework under the Partnership Agreement

The **Partnership and Cooperation Agreement** (PCA) was concluded in 1994 and entered into force in March 1998. The PCA forms the legal basis of EU-Ukraine relations, providing for cooperation in a wide range of areas including political dialogue, trade and investment, economic and legislative cooperation, and cultural and scientific cooperation. The parties recall the common values that they share, and state their commitment to promote international peace and security as well as the peaceful settlement of disputes, and agree that respect for democratic principles and human rights as well as for the principles of market economy underpin their internal and external policies and constitute an essential element of partnership and of the Agreement.

The parties accord to one another Most Favoured Nation (MFN) treatment and limit the possibility of imposing restrictions on imports and exports. The agreement also provides that upon further progress of market oriented economic reforms in Ukraine the possibility of beginning negotiations on the establishment of a free trade area will be considered. Specific agreements in trade in textiles, science and technology, and nuclear energy are also in place.

The PCA also foresees a bilateral agreement in trade in steel products (discussions for a renewed agreement currently on their way). A joint report, providing a mid-term **assessment of PCA implementation** was endorsed by the Co-operation Council in March 2003[1].

The various joint institutions and working structures, notably those set up under the PCA, including the Parliamentary Co-operation Committee, have been functioning smoothly.

Article 51 of the PCA recognises the importance of **legislative approximation** for strengthening economic links between Ukraine and the EU and identifies a number of priority areas. Since late 2002 Ukraine, with EU assistance, has sought to reinforce structures, planning and its approach to defining goals and tasks in pursuit of its legislative approximation programme. To this end a draft legislative approximation scoreboard is under preparation in order to assist in prioritisation and measure progress.

The EU is the largest donor to Ukraine. **Total assistance since 1991 amounted to more than €1 billion**. This includes technical assistance through the TACIS programme, macro-financial assistance, and humanitarian assistance. TACIS assistance in the area of nuclear safety alone amounted to almost €260 million over 1991-2003. Assistance also includes the Fuel Gap programme and a major contribution to the Chernobyl Shelter Fund managed by the EBRD.

EC assistance to Ukraine (in € million) has developed as follows since 1998:

	1998	**1999**	**2000**	**2001**	**2002**	**Total**
Tacis National Programme	44	46	48	48	47	**233.0**
Tacis Nuclear Safety	7,7	8.4	5,5	29.4	21,9	**72.9**
*Tacis Cross-border Co-operation**	10.3	5.2	1	5.5	0.5	**22.5**
*Tacis Regional Programme**	4.8	3.7	6	9.1	10,5	**34,1**
Fuel gap	**-**	**-**	25	20	20	**65.0**
ECHO (humanitarian assistance)	1.6	6.3	1.3	0.9	0	**10.1**
Chernobyl Shelter Fund	50	40.5	-	40	20	**150.5**
Macro-financial assistance (loan)	-	58	-		110	**168.0**
Total	***118.4***	***168.1***	***86.8***	***152.9***	***229,9***	***756,1***

* Estimated pro-rata share for Ukraine in regional programmes *European Commission*

The main objectives of the TACIS programme are to reinforce democracy and the rule of law and to promote the transition to a market economy in the partner countries of Eastern Europe and Central Asia. In recent years assistance has been progressively focused on support for institutional, legal and administrative reform; support to the private sector and for economic development; and support to address the social consequences of transition.

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1 http://europa.eu.int/comm/external_relations/ukraine/intro/index.htm

Ukraine participates in the YOUTH programme which promotes people-to-people contacts and co-operation between actors of civil society, such as associations and NGOs in the youth field. Regarding higher education, Ukraine is eligible for participation in the Community programmes Tempus and Erasmus Mundus.

Ukraine is one of some 30 focus countries for the European Initiative for Democracy and Human Rights (EIDHR) in 2002-2004. For this period approximately € 5.3 million were allocated to Ukraine, notably in support of activities to improve access to justice and human rights monitoring..

The current TACIS **cross-border co-operation** (CBC) programme (2004-2006) reflects the objectives of the European Neighbourhood Policy: to allow partners on both sides of the EU's external border to work jointly to address common challenges such as economic and social development of the border areas, environment and communicable diseases, illegal immigration and trafficking, efficient border management and people-to-people contacts.

The Neighbourhood Programmes (2004-2006) are based on the existing funding instruments, Tacis CBC, INTERREG and Phare CBC. Three bilateral/trilateral programmes will be prepared between Ukrainian regions and partner regions in Poland, Hungary, Slovakia, Romania and Belarus, supplemented by one regional/transnational Neighbourhood Programme (CADSES). The indicative allocation of funding for Ukraine amounts to approximately €20 million (2004-2006). For the period beyond 2006, the Commission is examining the possibilities of creating a new Neighbourhood Instrument to act on both sides of the EU's external border.

On 12 July 2002, the EU Council adopted a decision providing for **macro-financial assistance (MFA)** to Ukraine amounting to €110 million and cancelling the non disbursed part (€92 million) of the 1998 loan facility.

In November 2003, the Council decided that - in addition to the €100 million available under the existing **European Investment Bank** Northern Dimension Council Decision 2001/777/EC - an amount of €500 million will be foreseen for EIB lending to Ukraine, Russia, Moldova and Belarus, in areas of EIB comparative advantage (i.e. environment, transport, telecommunications, and energy infrastructure on priority Trans European Network axes with a cross-border aspect for an EU Member State). This extended mandate is subject to certain political and macro-economic conditions.

The Union recently extended until December 2004 the 1999 *Common Strategy* for Ukraine. The Strategy aims at developing a **strategic partnership** between the EU and Ukraine on the basis of the PCA, while acknowledging Ukraine's European aspirations and welcoming the country's European choice.

Ukraine adopted in 1998 a *Strategy for European Integration*. In early 2002, President Kuchma declared EU membership a long-term goal, with Ukraine aiming to fulfil the relevant criteria for lodging an application by 2011.

Through this year's enlargement of the European Union, the Union and Ukraine have become direct neighbours. The EU-Ukraine Summit of October 2003 acknowledged the "broad range of new opportunities" offered by the **European Neighbourhood Policy**, which "should facilitate Ukraine's progressive participation in the EU's internal market and in EU policies and programmes, taking into account Ukraine's strategic goals and priorities". Ukraine noted the EU position that this policy should be seen as distinct from the question of possible EU accession regulated by article 49 of the Treaty on European Union.

2. POLITICAL ISSUES

2.1. Democracy and the rule of law

Ukraine proclaimed its independence in 1991. The country is a **Republic** with a unicameral parliament, the Supreme Council (Verkhovna Rada). The current Constitution, adopted in 1996, establishes a presidential-parliamentary system. The **President**, who is the Head of State and the Chief Executive with wide-ranging powers, is elected by popular vote for a five-year term. The **Prime minister** and deputy prime ministers are appointed by the President and approved by the Verkhovna Rada. The President also appoints all government ministers as well as the heads of local territorial administrations (except municipalities).

Against the background of the political, economic and legislative reform agenda, the division of executive authority between president and prime minister, as well as the role of parliament, have been a source of political tension since independence. Awareness of remaining weaknesses in the overall system of democratic and institutional checks and balances has contributed to the debate on constitutional reform. While initial proposals by President Kuchma meant to rather strengthen the role of the President, constitutional amendments submitted by the current majority in parliament and supported by President Kuchma aimed at a substantial shift of power towards parliament and prime minister. A low level of procedural transparency and public support, together with the fact that major constitutional amendments were launched in the immediate run-up to the October 2004 presidential elections, raised some concerns among domestic and international observers, including the European Union and the Council of Europe's Venice Commission.

Out of the 450 seats in the Verkhovna Rada, 225 are allocated on a proportional basis to those parties that gain 4% or more of the national vote. The other 225 members are elected in single-mandate constituencies. Members of Parliament serve a four-year term. The last parliamentary elections were held on 31 March 2002. The last Presidential elections were held on 31 October and 14 November 1999, the next are scheduled for 31 October 2004.

An International Election Observation Mission (IEOM) concluded that while the parliamentary elections in March 2002 brought Ukraine closer to meeting international commitments and standards for democratic elections, significant flaws persisted. A number of targets, in particular those related to the election campaign and media coverage were missed. The presidential elections in October 2004 will therefore be monitored closely by the international community.

The Constitution and the 2001 law on political parties are the legal basis for the institution, registration and operation of political parties in Ukraine. There are about 125 registered political parties, 27 of which are reported to have branches in all regions (status in January 2003).

Executive powers and administrative structures are characterized by a high level of centralisation at all levels. There are 24 provinces (oblasti), whose governors are appointed and dismissed by the president, plus the Autonomous Republic of Crimea and the cities of

Kiev and Sevastopol, which have a special status. With the exception of the Crimea, which has constitutionally guaranteed autonomy, regional and local self-governing bodies have relatively limited powers.

The Ukrainian Constitution of June 1996 provides for an independent **judiciary**, including the adoption or amendment of relevant legislation and court structures. Since 2001 the Ukrainian unified system of courts consists of a constitutional court, a system of courts - including the Supreme Court - of general jurisdiction, specialized commercial courts, military courts and administrative courts (the latter have not yet been established). The constitutional court consists of 18 members appointed for 9-year terms in equal numbers by the president, the parliament, and the Congress of Judges. The president, at least 45 members of parliament, the Supreme Court, the ombudsman, and the Crimean legislature may request that the constitutional court hear a case. Citizens may apply to the Constitutional Court through the ombudsman, who exercises this right in selected cases.

A set of judicial reform legislation was adopted in 2001 and 2002, aimed at increasing the independence and efficiency of the judiciary in line with the constitution. Together with the revision of court structures, it gave commercial, appellate, and Supreme Court judges the right to nominate and elect their own chairmen. Although local court judges can also nominate their own chairmen, the Ministry of Justice still appoints them. In practice, the judiciary has reportedly not yet achieved a major increase in efficiency and remains vulnerable to political and administrative interference from the executive branch, and to corruption. Further reform, including in particular the broad competences of the General Prosecutor's Office, is one of the main points of concern expressed by the Council of Europe. Systematic training of judges, as well as law-enforcement officials more generally, is an on-going activity implemented within the EC Council of Europe Joint Programme, financed under the European Initiative for Democratic and Human Rights (EIDHR).

A **civil service** law was adopted in 1993, supplemented by subsequent secondary legislation. Progress has been made towards the development of a civil service system, further progress, however, is reported to be necessary in the areas of impartiality and integrity, and professional stability.
The process of ratification of the Council of Europe Civil Law Convention on **Corruption** and Criminal Law Convention on Corruption of 1999 is underway. The Ministry of the Interior has established an interagency group to analyse relevant foreign legislation and draft amendments to existing Ukrainian legislation. The Transparency International Corruption Perceptions Index 2003 ranks Ukraine in place 106 with a score of 2.3 (out of 10). The perceived level of corruption is reported to act as a deterrent for foreign investors and a restraining factor on economic development.

A Presidential Decree of February 2003 instructed the government to adopt a number of measures to strengthen the fight against organised crime and corruption, including a programme of actions to be adopted up to 2010. Particularly relevant in this context are measures on uncovering corrupt conduct by government officials, protecting against criminal attempts to misappropriate state budget funds, and strengthening the protection of court and law enforcement officials. Ukraine has not joined the Council of Europe Group of States against corruption (GRECO). On 10 September 2003 Ukraine signed an OECD regional Anti-Corruption Action Plan along with Armenia, Azerbaijan, Georgia, Russia and Tajikistan.

2.2. Human Rights and Fundamental Freedoms

Ukraine has ratified most of the major international **human rights** instruments. With respect to Ukraine's obligations and commitments as a Member State of the Council of Europe, the Parliamentary Assembly of the Council of Europe concluded in a resolution of 29 September 2003 that, although notable progress has been made since 2001, Ukraine had not yet fulfilled all its obligations and commitments.

Ukraine has ratified the core UN Human Rights Conventions, except the Convention relating to the Status of Refugees and its Protocol.

It has also ratified all ILO fundamental conventions (forced labour, freedom of associations, collective bargaining, child labour and discrimination in employment).

The Constitution and legislation provide for **freedom of assembly**. A 1988 law on public assembly specifies the rules for implementation. The Criminal Code foresees severe punishment for breaching these rules. In practice unauthorised demonstrations are common, and most take place without police interference, fines, or detention.

Media freedom remains one of the crucial issues for political reform in Ukraine. While press freedom is guaranteed by law and the Constitution, the press has come under increasing pressure since 2003. In terms of ownership, the media landscape is characterised by a significant degree of control by national and local authorities, in particular over the electronic media. A number of NGOs have published very critical reports on Ukrainian press freedom in 2003. Privatised or newly established media are concentrated in a few hands, and often inter-linked with government structures. Independent media are often weak in financial terms and reportedly face numerous difficulties in carrying out their work, with persistent interference by state organs and an environment in which laws are often open to interpretations.

The condition of the media in Ukraine has attracted the attention of the Parliamentary Assembly of the Council of Europe (PACE), which in its Recommendation 1589 (2003) on Freedom of expression in the media in Europe noted that "violence continues to be a way of intimidating investigative journalists". The PACE branded as "unacceptable" the lack of progress in the investigation of crimes, such as the murder of journalist Heorhiy Gongadze.

Ukraine has joined the main international instruments on the rights of the child, and in particular the Convention on the Rights of the Child. A 2001 law on child protection was designed to bring the country into conformity with international standards regarding children's safety and quality of life. In 2002, child and family protection laws were amended with the aim of helping to regulate child-refugee protection and address financial assistance for families in need. Nevertheless, deficiencies concerning the implementation and the enforcement of law still exist. The UN Committee on Children's Rights in its Recommendations of September 2002, taking into account the economic situation in Ukraine, stressed the priority that should be given to the best interests of the child and called for the integration of marginalized children.

The Council of Europe Advisory Committee on the Framework Convention for the Protection of National Minorities noted in November 2002 that Ukraine has, since its independence, taken a number of positive measures to protect national minorities. Nevertheless, particularly members of groups such as formerly deported persons (in particular Crimean Tartars), the

Roma community, immigrants with or without legal status, asylum-seekers and refugees are reportedly faced by racism, direct and indirect discrimination, intolerance or disadvantage.

The 1996 Constitution and the 1991 law on Freedom of Conscience provide for freedom of religion and the authorities generally respect these rights in practice; however, a number of minority and non-traditional religions have reportedly experienced difficulties in registration and in buying and leasing property.

Ukraine has ratified both Council of Europe Protocols on the abolition of the **death penalty** and amended the relevant national legislation.

Torture and ill-treatment were among several concerns highlighted in the annual report (2002) of the National Human Rights Ombudsperson on the situation of human rights in Ukraine. According to the report, around 12,000 individuals alleged that they had been subjected to torture and ill-treatment in the previous years, most commonly in the context of interrogation for the purpose of eliciting a forced "confession".

In its review of Ukraine's fourth periodic report in November 2001, the United Nations Committee against Torture noted many ongoing deficiencies in the penal system, including the lack of clarity regarding the time when a detained person may exercise the rights to counsel, medical examination, and contact with a family member.

The 2003 monitoring report for the Council of Europe Parliamentary Assembly shared concerns expressed earlier by the European Committee for the Prevention of Torture (CPT) as regards the conditions of detention in Ukraine, and the lack of progress in numerous areas (especially concerning the ill-treatment of persons deprived of their liberty by law-enforcement agencies, and overcrowding both in militia and penitentiary establishments).

Ukraine has signed, but not ratified the Rome statute for the establishment of an **International Criminal Court**.

Gender discrimination in political, economic, social, and cultural spheres is prohibited under the Ukrainian constitution and domestic laws, and Ukraine is also a signatory to relevant international conventions. However, in practice, Ukrainian women reportedly face obstacles to their full and equal participation in the labour force. In June 2002 the United Nations Committee on Elimination of Discrimination against Women credited Ukraine with adopting a new law on the prevention of domestic violence, but expressed concern about the prevalence of violence against women and the need for improved measures for prosecution and victims' services.

With progressive transition to democracy, Ukraine is beginning to show signs of transformation into a modern, multi-layered society, with respect to the situation of **civil society**. A growing number of non-governmental organisations constitute a balancing factor at national as well as the regional level in the investigation and advocacy of human rights issues, including prison conditions and women's and children's rights. Overall the capacity and sustainability of non-governmental organisations remains however weak and their impact differs greatly from NGO to NGO, depending for example on foreign grant donations.

Ukrainian workers are protected under the International Labour Organisation's Convention on freedom of association and protection of the right to organise. The Law on Collective Bargaining prohibits discrimination against trade unions. According to Ukrainian Law, **trade**

unions and their organisations require official registration in order to be able to pursue their objectives. Standards and criteria for obtaining such registration seem to be unclear. In some cases, the transition from state-controlled unions to independent and efficient unions does not yet seem fully complete.

2.3. Regional and global stability

The EU-Ukraine **political dialogue** has intensified considerably over the past years.. It has yielded practical results and paved the way for further discussions, including on regional issues, conflict prevention and settlement. Ukraine aligns itself unilaterally with a large number of EU declarations in the framework of CFSP and has expressed a firm interest in contributing to future EU operations in the context of ESDP. Ukraine is already participating in the EU Police Mission in Bosnia Herzegovina. In 2002, the Council adopted "Arrangements for consultation and co-operation between the European Union and Ukraine on crisis management". A draft framework agreement setting out the arrangements for the participation of partner countries, including Ukraine, in EU crisis management operations is under preparation.

Ukraine is a member of the United Nations, the Council of Europe and the Organisation for Security and Co-operation in Europe (OSCE), the International Monetary Fund, the World Bank and the European Bank for Reconstruction and Development (EBRD); furthermore, it is member of numerous international and regional bodies, including the Central European Initiative, the Black Sea Economic Co-operation, GUUAM (Georgia, Ukraine, Uzbekistan, Azerbaijan, Moldova) and the Eurasian Economic Community (EAEC). In September 2003, Russia, Ukraine, Belarus and Kazakhstan agreed on the creation of a Single Economic Space.

Dialogue and co-operation between the EU and Ukraine are devoting increasing attention to the need to jointly address global and regional security threats, including the **fight against terrorism, non-proliferation of weapons of mass destruction** and the existence of large stockpiles of old ammunition, in particular anti-personnel land mines. The question of conventional arms sales and in particular their end use has been discussed with Ukraine at several occasions. Ukraine has signed but not ratified the 1997 Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and on their destruction (Ottawa Convention). The number of anti-personnel mines kept in storage by Ukraine amounts to several million. The EU is ready to assist Ukraine in the destruction of these stockpiles in parallel with the ratification process of the Ottawa Convention, and in close collaboration with other donors.

As a direct neighbour of Moldova and a mediator along with the OSCE and the Russian Federation in the five-party mediation process, Ukraine has a major role in the efforts to find a solution to the Transnistria issue in the Republic of Moldova. An estimated 26% of the total population of 740,000 in the Transnistrian region are ethnic Ukrainians. Over the past two years, the EU and Ukraine have intensified exchange of information and dialogue on the Transnistria conflict, including in the OSCE framework.

2.4. Co-operation in Justice and Home Affairs

A specific **EU Action Plan on Justice and Home Affairs** with Ukraine of 10 December 2001 defines the areas for co-operation in this field. The priorities for co-operation are readmission and migration, border management, the fight against money laundering, trafficking in human beings and drugs as well as corruption, preventing and fighting sexual exploitation of children and child pornography. Implementation of the Action Plan is monitored by a detailed Scoreboard, which is updated regularly in co-operation with the Ukrainian authorities. The Scoreboard monitors development made by Ukraine concerning asylum, border management, money laundering and the use of liaison officers.

Ukraine has ratified a number of relevant international conventions (i.a. the 1951 Geneva Convention, 1988 UN Convention on Illicit Traffic of Narcotic Drugs and Psychotropic Substances).

It has adopted a law on Refugees in 2001 and various action programmes, such as an Action Plan for the Integration of Refugees (March 2004) and the Programme for Combating Illegal Migration 2001-2004. A **readmission** agreement with the EU is in the process of being negotiated.

The Criminal Code imposes firm penalties for trafficking in human beings, including for sexual exploitation and pornography. In June 2002, the Government approved a National Action Plan to Counter Trafficking for 2002-2005.

The Ukrainian Border Troops have been legally demilitarised and transferred into the State Border Service, which was established by law in June 2003. A number of measures to strengthen the **fight against organised crime** (e.g. on prevention of trafficking in women and children) and corruption were taken in February 2003. Ukraine has adopted legislation with a view to the ratification of the UN Convention against Transnational Crime and its additional Protocols on smuggling and trafficking on 4 February 2004. Ukraine has, however, not yet deposited the instrument of ratification with the United Nations.

Ukraine is party to a trilateral Agreement with Moldova and Romania on the fight against organised crime in the border regions.

Ukraine is an important transit country for **drug trafficking** and since 2000 has intensified its efforts on enforcement capacity building (e.g. creation of a drugs intelligence data base). The Council of Europe Convention on Laundering, Search, Seizure and Confiscation of Proceeds from Crime has been ratified and a law on preventing and counteracting money laundering was adopted in November 2002, and subsequently amended on the basis of recommendations of the Financial Action Task Force (FATF). A state department of financial Monitoring was created in January 2002. In February 2004 Ukraine was deleted from the FATF “non-cooperation” list.

Ukraine is a member of the Moneyval Committee which groups members of the Council of Europe that are not members of the OECD Financial Action Task Force-FATF.

3. ECONOMIC AND SOCIAL SITUATION

3.1. Macroeconomic and social outlook

3.1.1. Recent economic developments and outlook

After declining markedly during the 1990s, Ukraine’s **real GDP growth** has averaged 6,5% since 2000 (see Table 1). Initially driven by a strong export performance, the competitive level of the hryvnya and exceptionally good harvests, since 2001 the recovery has also been supported by the expansion of domestic demand. Growth slowed in 2002 (to 4.6%) but accelerated significantly again to 9.3%. in 2003 (source: updated report of the Ukrainian State Statistics Committee), exceeding the government's prediction of 5-6%. The major contributing factors were strong industrial growth, domestic demand, and favourable external conditions.

Inflation reached four-digit levels in the years following independence. It remained relatively high until 2000, but declined markedly in 2001-02, reflecting prudent monetary and fiscal policies, the stability of the currency and several years of good harvests. Rapid wage growth, increase in domestic demand and a less favourable harvest has rekindled inflationary pressures moderately in 2003. Annual inflation was 8.2% in 2003, exceeding the government's 6% yearly inflation target.

3.1.2. Fiscal management, monetary and exchange policy

The balance of the consolidated government budget has swung from an average deficit of nearly 4% of GDP in the period 1995-99 to a small surplus in 2002[2]. Supported by stronger than expected economic activity, **fiscal performance** was also very robust in 2003. The consolidated government budget posted a cash deficit amounting to 0.4% of GDP, less than half the level foreseen in the 2003 budget.

The ratio of public debt to GDP, for its part, has been brought down from 56% in 1999 to just below 35% at the end of 2002 and to 29% in 2003. Based on announced policies, and assuming annual GDP growth of 4%, the IMF projects that the debt/GDP ratio will continue to decline in the coming years, reaching 20-25% by the end of the decade.

Ukraine continues to face considerable fiscal challenges. The government sought to address the long-standing issue of VAT refund arrears in 2003, in line with IMF requests. The 2004 budget law envisaged the issuing of five-year domestic bonds to refund accumulated arrears.

The government lowered the profit tax for enterprises from 30% to 25% and introduced a flat 13% tax on personal incomes beginning January 2004. To offset the likely decline on the revenue side, the government raised some mandatory payments (including land use) and eliminated certain tax privileges. The state budget also stipulates an increase of excise rates for petrol and alcohol and establishes a minimum rate of excise duty for tobacco product.

Indirect subsidies remain a sensitive issue for the government. Some VAT exemptions have been removed, but for the current budget year only. Amendments to make some of the exemptions permanent are still under consideration in the Verkhovna Rada. The IMF estimated that the removal of VAT exemptions could save the budget around 4% of GDP.

Ukraine faces medium-term pressures in its public pension system stemming from demographic trends to tackle these problems, two basic pension laws were passed in June 2003 redefining the parameters of the existing, pay-as-you-go public pension system and endorsing a three pillar pension concept. Effective implementation of the new legislation is key to the success of the reforms.

Since January 2000, Ukraine has had a managed floating **exchange rate regime**, with the National Bank of Ukraine (NBU) intervening occasionally in the markets to moderate daily fluctuations. After depreciating sharply during 1999, the hryvnya has shown an impressive

2 Measured on a cash basis and showing privatisation revenues "below-the-line".

degree of stability. Real exchange rate indices have experienced some appreciation since January 2002, but the rate is thought to remain at a relatively competitive level. The NBU has backed up its floating rate regime with a relatively prudent **monetary policy**. Monetary aggregates have shown very high rates of growth in recent years (see Table). This has largely

Table 1. Ukraine - Selected Economic Indicators, 1997-2002

	1997	1998	1999	2000	2001	2002
Real GDP growth (in %)	-3	-1.9	-0.2	5.9	9.2	4.6
Unemployment rate (ILO definition)	n.a.	11.3	11.9	11.7	11.1	10.0
CPI inflation (end of year; in %)	10.1	20.0	19.2	25.8	6.1	-0.6
Average monthly wages (annual average; % change)	n.a.	6.8	16.1	30.2	34.9	20.7
Broad money (end of year; % change)	33.9	25.3	40.4	45.4	42.0	41.7
Consolidated government balance (% of GDP)	-5.6	-2.8	-2.4	-1.3	-1.6	0.5
Current account balance (% of GDP)	-2.7	-3.1	5.2	4.7	3.7	7.7
Official net international reserves (end of year)						
In millions of US dollars	2,375	782	1,090	1,469	3,075	4,400
In months of imports of G&NFS	1.2	0.6	0.7	0.9	1.7	2.3
Public external debt (% of GDP) (end of year)	23.4	26.5	39.4	33.1	26.6	24.6
Debt service (in % of exports of GNFS)	7	11.1	15.8	10.4	6.7	5.4
Exchange rate (hryvnyas/US dollar) (end of year)	1.9	3.4	5.2	5.4	5.3	5.3
Real effective exchange rate (annual change in %) 1/	7.4	-8.5	-17.9	-4.6	5.9	-3.0
Population (million)	50.4	50.0	49.7	49.2	n.a.	n.a.

Sources: IMF and WHO.

1/ A negative sign implies a real depreciation and, therefore, a gain in international competitiveness.

reflected the increase in demand for real money balances related to the ongoing process of remonetisation.

The **independence of the central bank** is not completely ensured as legislation does not restrict the circumstances under which the governor or other members of the council of the NBU can be dismissed. The president has the right to dismiss the governor or the six members of the board he has appointed, and so does the parliament as regards the other board members.

3.1.3. External situation

Ukraine's ***balance of payments*** has moved to a relatively comfortable position in recent years. Since 1999, the current account has been consistently in surplus. This current account surplus has contributed to a significant build-up in the official gross international reserves of the National Bank of Ukraine, which reached about US$ 6.9 billion (roughly 3 months of imports) by the end of 2003. The *debt rescheduling* agreed with private bondholders in April 2000 and by the Paris Club in July 2001 has significantly eased Ukraine's debt service obligations. Debt and debt service ratios have shown a downward trend since 2000, although the country's debt service is expected to rise temporarily in 2003-06. In December 2002, Ukraine regained *access to the international capital markets* (which it had lost in the wake of the Russian financial crisis of 1998) with the issue of a US$ 350 million eurobond. This was followed in June 2003 by the issue of a US$ 800 million, 10-year eurobond, which was oversubscribed and carried an annual interest rate of only 7.65%. Since 2001 the main international rating agencies have upgraded Ukraine several times.

A persistent weakness in Ukraine's balance of payments, however, is the low inflow of FDI. Despite the strengthening of macroeconomic performance, annual net FDI inflows averaged only about 1.8% of GDP in 1999-2002.

3.1.4. Social situation and human development policies

During the 1990s, recession, contraction in real wages, increase in wage differentiation, and the demise of part of the social safety net resulted in an increase in unemployment, poverty and social inequality. Official employment declined by about one third between 1990 and 1999, with reductions of over 40% in agriculture and industry. The overall **unemployment rate**, using the ILO definition, grew to 12% of the labour force in 1999 (declining to 9% in January-September 2003). However, the number of long-term unemployed grew almost tenfold. Using the local definition of **poverty**, about a quarter of the population was below the poverty line in mid-2002. There is also evidence that personal **income inequality** has increased since independence, although it remains low by international standards.

The emergence of a large underground economy has acted as a social buffer. Since growth resumed in 2000, the decline in unemployment and the increase in real wages and pensions (including as a result of the government's decision to eliminate wage and pension arrears) have brought about an improvement in living standards in large **urban areas**. Rural areas, by contrast, continue to show a relatively high (and slightly increasing) incidence of poverty.

Ukraine's **female labour force participation** rate is high (64% compared with 73% for men). Despite similar education levels, women tend to have lower-paid jobs and there are slightly more poor female-headed households than poor male-headed households.

Ukraine's **population** shrank from 51.6 million in 1991 to 47.6 million in 2003, reflecting a dramatic increase in mortality rates, in particular among males, a sharp decline in the birth rate and a significant net migration outflow. The increase in smoke- and alcohol-related **diseases** has been an important factor in the rise in male mortality, together with the resurgence of communicable diseases such as tuberculosis, diphtheria and cholera. The levels of HIV/AIDS have soared, reaching 1% of the adult population, the highest in Europe. Other sexually transmitted diseases, such as syphilis, have also increased dramatically. Sex trafficking, particularly towards Western Europe, continues to involve a significant number of women with no economic alternative. Maternal mortality, while falling since 1992, remains about five times the EU average. Ukraine continues to confront the social legacy of the Chernobyl accident of 1986: 90.000 people have been permanently disabled by the accident and there is evidence of a rising incidence of childhood thyroid cancer and other illnesses in the most affected regions.

In recent years, Ukraine has made significant efforts in developing reform strategies and undertaking reform policies in the human development sector. The country continues to face challenges, however, and in the education sector these translate into unequal access, eroding quality and low efficiency in the use of resources.

A Law on Education (2001) increased compulsory education to twelve years. A Government education reform strategy (the "National Doctrine for Development of Education in Ukraine in the XXIst Century") approved in 2001, included redefined priorities for the sector and improved strategies for service delivery from preschool to tertiary education. Vocational education and training reform is based on a law passed in February 1998 which aims at the decentralisation of a system still heavily oriented towards training specialists in industry and agriculture. Eradicating outdated specialisations and attracting private sector support are among other government aims for Vocational and Educational Training reform.

3.2. Structural reforms and progress towards a functioning and competitive market economy

3.2.1. State involvement in the economy and privatisation

The **private sector** accounted for about 65% of Ukraine's GDP in 2002. Small-scale **privatisation** has been virtually completed. Over 9,500 enterprises were privatised through voucher privatisation launched in early 1995. The number of privatised small enterprises was 11,701 at the end of 2003. However, large-scale privatisation has progressed at a much slower pace. About 30% of the assets of large enterprises have been sold so far. During 2001-02, the government's large-scale privatisation targets were not met, partly reflecting the postponement of the sale of companies in the electricity and telecommunications sectors. Ukraine's privatisation methods have reportedly lacked transparency.

In 2003 there have been signs of reactivation in the privatisation process. The State budget receipts from privatisation made up 2.17bn UAH (€ 361 million) in 2003, according to the State Property Fund of Ukraine (SPF), around 1% of GDP. In mid-2003, the government submitted to parliament an ambitious medium-term Privatisation Programme that proposes a reduction in the number of large-scale enterprises excluded from privatisation for strategic reasons and the completion of the privatisation process by 2008. The Privatisation Programme for 2004-2006 is still being reviewed by the Parliament. For 2004, the government set the target for privatisation receipts at 2.14bn UAH (€ 356 million). The State Property Fund has postponed the offer of enterprises in the energy and metallurgy sectors.

Substantial progress has been made with land privatisation and the reduction of the government's direct intervention in the agricultural sector. The kolkhozes have been dismantled, a new Land Code laying the ground for the development of a private land market entered into force in January 2002 and over 3.92 million land titles have been issued. A package of accompanying laws including laws on land market, the creation of a modern land cadastre and on the creation of a unified property rights registry, necessary to ensure effective implementation of the Land Code are still missing. The passing of a new mortgage law in June 2003 should help the development of a medium and long-term agricultural credit market, while a land leasing market has already emerged. The government's role in the sale of farm inputs and the purchase of farm outputs has been markedly reduced. The significant increase in yields per hectare and total agricultural output observed in recent years partly reflects the implementation of these reforms.

One factor that until recently contributed to a lack of financial discipline was the weakness of bankruptcy enforcement. With the assistance of the World Bank and Tacis, an improved bankruptcy procedure, in line with international practice, and a new bankruptcy law were prepared and adopted in 1999. Under the new law, the number of bankruptcy cases has increased. The recent approval by parliament of two **mortgage laws** will also contribute to strengthen creditor rights. However, weaknesses remain when it comes to the application of the new bankruptcy law to enterprises where the state has a stake of 25% or more.

In 2001, direct support to enterprises amounted to about 2.6% of GDP. Direct subsidies in the form of capital transfers to enterprises have been gradually phased-out. In the 2004 budget, funds were still allocated for the support of such sectors as domestic book printing, coal mining, space industry, agriculture, and aircraft construction. Moreover, loss-making enterprises or sectors are often supported by the government through tax exemptions or other tax privileges, tolerance of tax arrears and, occasionally, the granting of tax amnesties.

Although Ukraine liberalised practically all **prices** in the early 1990s, tariffs for communal services (such as gas, electricity, heating, and rents) are still subject to administrative control and remain in some cases significantly below economic cost recovery levels.

3.2.2. Regulatory framework

The 2001 Law on Protection of Economic **Competition** prohibits anti-competitive concerted actions (authorisation may be granted in certain circumstances) and abuse of a dominant position, and also provides for a system of merger control. The new Economic Code, in force since January 2004, introduces further provisions on competition. Ukraine's legislation does not define, or provide for the control of, **state aids** although the 2001 Law prohibits a number of anti-competitive actions by public authorities. A national competition authority (the Antimonopoly Committee) has been in place since 1993 and operates through a central office in Kyiv as well as a network of regional offices. Appeals against a decision of the Anti-monopoly Committee or its regional offices can be made both at administrative and judicial level.

3.2.3. Financial sector

Banking regulation and supervision have been strengthened considerably since the late 1990s. Regulation and supervision of the sector is carried out by the National Bank of Ukraine, directly responsible to the president and the Verkhovna Rada. Steps taken in recent years include the adoption of a modern Law on Banks and Banking Activities (amended in 2001), the adoption of a law on the deposit guarantee fund in 2001, and the removal of the operating licence of Bank Ukraina (an insolvent state-owned bank) in that same year. In the context of the World Bank's Programmatic Adjustment Loan (PAL), the authorities signed a Memorandum of Understanding in mid-2003 defining a set of transitory measures for restricting the lending activities of the loss-making State Savings Bank and preparing the ground for a comprehensive restructuring of its activities. No significant new bank bail-out operations have taken place in recent years, and banks can set their interest rates freely.

The banking system is now largely in private hands, with state-owned banks accounting for only about 12% of total bank assets. Foreign-owned banks play a sizeable role (the 19 foreign banks existing at end-2003 accounted for 14% of total assets). However, foreign banks are not allowed to open branches. Significant weaknesses remain in the banking system. In particular, non-performing loans (including substandard and doubtful loans) continue to represent a significant share (about one fifth at end-2002) of the loan portfolio. The banking system is also highly concentrated, with the largest eight banks accounting for over 60% of its total assets. Many banks are very small and in some cases act de facto as the financial departments of large enterprises. The initial absence of minimum statutory capital requirements facilitated the multiplication of small banks. The central bank increased minimum statutory requirements, which has led to liquidation of some of the banks not complying with prudential regulations. The number of active banks has declined from 230 in 1995 to 157 in 2003.

The degree of banking intermediation in Ukraine remains low but the banking system has been growing quickly since 2000, with loans increasing by 61% year on year and deposits by 63% in 2003. This rapid growth largely reflects a return of confidence in the banking system in the context of an improved macroeconomic performance.

Domestic **security markets** remain underdeveloped and highly fragmented. Basic market infrastructure exists as does a competent regulator but the legislative basis for capital market operations, as well as many financial instruments need to become operational. The securities market is regulated by the State Commission on Securities and the Stock Exchange. Operations in the market increased last year, both in the capital and equity segments. The inter-bank market and the market for domestic government securities are thin and illiquid. Trading in the licensed stock market has increased in recent years but capitalisation levels remain low and there is a need to consolidate the excessive number of markets, registrars, depositories and brokers. The **non-bank financial sector** is small too. **Insurance** has been expanding quickly but its assets only accounted for 2.5% of GDP at the end of 2002. The combined assets of other financial institutions such as pension funds, credit unions and leasing companies account for less than 1% of GDP. The regulatory and supervisory framework of the non-bank financial sector is being strengthened, including with the creation of an independent Commission for the Regulation of the Financial Services Market in December 2002.

3.2.4. Sustainable Development

Preparation of a strategy on **sustainable development** is under consideration. In 2002 , a National Commission on Sustainable Development was established. This commission has approved a comprehensive programme for the implementation of decisions made at the World Summit on Sustainable Development (Johannesburg, 2002). There are also some sector programmes, such as on agriculture, energy, social sector, regional development which foresee actions for sustainable development.

3.2.5. Relations with the IFIs and other donors

In September 1998, **the IMF** approved an extended arrangement (EFF) for Ukraine in the amount of US$ 2.2 billion, later augmented to US$ 2.6 billion. The EFF ran off-track several times after its inception and expired in September 2002. In December 2003, the IMF agreed with the authorities a draft Letter of Intent and Memorandum of Economic Policies describing an economic programme to be supported by a precautionary stand-by arrangement (SBA). Ukraine has implemented the prior actions requested by the IMF. At the end of March 2004, the IMF Board approved a one year precautionary SBA.

World Bank lending has focused on public sector reform, the agricultural and energy sectors, privatisation and financial sector reform. In this last area, three adjustment operations (the EDAL I and II and the FSAL) have been approved since 1996, totalling US$910 million. The World Bank has also approved two programmatic adjustment loans (PAL) of US$250 million each. The first one was approved in September 2001 and fully disbursed. The second was approved in December 2003 and the first tranche (of US$75 million) disbursed immediately after approval. These PAL operations cover several areas of reform and emphasise financial discipline, the regulatory framework, property rights, fiscal accountability and social and environmental sustainability.

The EBRD's prime effort in the country is to support private companies with direct investments, or through key local banks, or by extensive use of the Turn Around Management Programme. At the same time the Bank pays particular attention to the privatisation and post-privatisation support it can offer to the country.

3.3. Trade, market and regulatory reform

Ukraine is a relatively open economy, with both exports and imports of goods and services exceeding 50% of official GDP. During the 1990s, Ukraine’s exports (and, to a lesser extent, its imports) have experienced a marked reorientation away from its CIS partners towards other countries, in particular the EU. Thus, the share of exports of goods and services directed to the CIS markets fell from more than half in the mid 1990s to less than one quarter in 2002.

Since 1994, Ukraine’s import regime has been largely free of quantitative restrictions, with a few exceptions for health and safety reasons. The trade-weighted average import tariff was about 7% at the end of 2002 and the effective average import duty is even lower reflecting the widespread use of exemptions. Tariff duties show a relatively high degree of dispersion, ranging from 0% to 70%. A few export restrictions remain (on sunflower seeds, live animals, cow hides and skins, and scrap metals).

Ukraine applied for WTO accession in 1994 and negotiations are on-going. By March 2004, Ukraine had completed bilateral negotiations on market access with a total of 23 WTO members, including the EU. The multi-lateral negotiations focus on Ukraine’s future commitments to fully apply the WTO Agreements. In this context, non-tariff issues - e.g. taxation, export restrictions, intellectual property rights, sanitary and phytosanitary measures, technical standards, and, more generally, the implementation of legislation - are also being discussed with a view to removing WTO-inconsistent measures by the time of accession. Ukraine aims to complete accession negotiations by the end of 2004. The EU supports Ukraine's accession to the WTO and has provided technical assistance to this end.

Ukraine benefits from **GSP preferences**, and has requested inclusion in the list of beneficiaries for the GSP social incentive scheme. Ukraine’s preferential imports under the GSP more than doubled between 2000 and 2002 (from €407 million to €872 million in 2002). In 2002, Ukraine ranked 13th amongst the beneficiaries of the EU’s GSP scheme (21st in 2000). The global utilisation rate (eligible imports compared to effective GSP imports) increased from 41% in 2000 to 57% in 2002, which is above average. GSP preferences are particularly important for exports from Ukraine in the mineral product, base metals and textiles and clothing sectors.

Russia remains Ukraine’s main trading partner, with a 35% share (42% for the CIS). The EU is Ukraine's biggest trading partner outside the CIS with close to 20% of its total trade. Ukraine accounts for only a modest part of EU trade: 0.5% in 2002. After enlargement, the EU will account for around 38% of Ukraine’s overall trade flows and will become its main trading partner. On the export side, the major trading partners were EU25 (34% of total goods exports) and the CIS (26%), including Russia (18.7%). On the import side, the CIS dominated (50% of total imports, including 37.6% from Russia), while the EU-25 came second, with 33.4% share. The CIS region is Ukraine's main energy supplier (90% of oil and of the gas consumed in Ukraine come from Russia or Turkmenistan). The other top trading partners were China (4.3% of exports and 2.3% of imports) and Turkey (3.9% and 1.4%), with imports having increased twofold from China and 1.6 times from Turkey over the year.

Ukraine's trade surplus fell from US$ 921 million in 2002 to US$ 59 million in 2003. Both exports and imports registered impressive growth rates, but imports grew faster (36%, as against 29% for exports). The growing revenues of Ukrainian enterprises and expanding consumer budgets resulted last year in increased imports of various investment products, including machinery and equipment, long-term consumer products and electric appliances (+39%) and vehicles (+180%). Imports of metals or metal products increased by 48%, primarily because of shortages of domestic raw materials for the expanding local industry. The industrial demand was also strong for chemicals (+29%) and rubber (+41%). Consumers allocated a part of their rising budgets to imported textile/apparel products and food, making up for the deficit of wheat products due to the poor harvest last summer.

Following a dramatic decline in **trade in goods** between the EU and Ukraine in 1999, two-way trade picked up again between 2000 and 2003: EU exports increased from €3.6 billion in 2000 to €6.2 in 2003 while imports increased from €2.9 billion in 2000, to €3.5 in 2003. The EU has a trade surplus with Ukraine (around €2.8 billion in 2003, above the level of the 1998 peak). All the main EU export products registered increases in 2002: machinery, chemical products, agricultural products and textiles. The same trend is registered in EU imports from Ukraine in machinery, textiles and agricultural products[3].

Trade-related provisions of the PCA with the EU entered into force in February 1996 as part of an Interim Agreement. As a result, trade between the EU and Ukraine is significantly liberalised, except for steel products. The possible establishment of a future Free Trade Area with Ukraine is foreseen in the EU-Ukraine PCA. A **bilateral Agreement on Trade in Textiles** signed in December 2000 led to a reciprocal liberalisation of trade in textiles and clothing from 26 March 2001. The EU has removed all quotas on Ukrainian exports, and for imports from the EU, Ukraine applies MFN tariffs rates.

Since 2001, Ukraine has made progress in implementation of the trade-related PCA commitments. However, a number of contentious issues remain, for example in the field of automobiles, and export duties on scrap metal. More generally, the EU is concerned about frequent changes in regulations affecting foreign trade, lack of transparency, discrimination, and corruption. These points were covered in detail in the joint report on PCA implementation endorsed by the Co-operation Council in March 2003.

Ukraine has also concluded trade and economic MFN agreements with a number of non-EU, countries notably some of the countries covered by the European Neighbourhood Policy. Ukraine has concluded Free Trade Agreements with all of the CIS except Tajikistan.

In September 2003, the presidents of Ukraine, Russia, Kazakhstan and Belarus signed an agreement on the creation of a Single Economic Space (SES). This agreement foresees the creation of a free trade area and, eventually, a customs union, in addition to the coordination of the signatories' energy policies and the stabilisation of their currency exchange rates. The implementation of this agreement remains an open and controversial issue in Ukraine. It was ratified by the Ukrainian parliament in April 2004.

[3] Data in this paragraph from Eurostat. They differ from Ukrainian data which are the source of the rest of the section on trade.

Ukraine's legislative system with respect to **sanitary and phytosanitary issues** is fragmented and insufficiently transparent. Enforcement capacity needs to be strengthened for Ukraine to be able to meet international and EU standards. Food safety, product liability and traceability, and the introduction of HACCP (Hazard analysis and critical control points) would seem to be the priority areas. Ukraine is a member of the International Epizootic Office (O.I.E) and is working towards accession to the Codex Alimentarius and the International Plant Protection Organisation.

A State **Customs** Committee was established in 1991 as the central customs body and the first Customs Code of Ukraine entered into force. A Customs Tariff Council of Ukraine was set up in 1992, and a Law on the Uniform Customs Tariff enacted. Since then, approximation to the internationally applied nomenclature of the Harmonized System (HS) has continued. Ukraine currently applies HS96 and is preparing to switch to HS2002 by 1 January 2005. Ukraine does not yet apply the Combined Nomenclature (CN).

The new Customs Code of Ukraine entered into force on 1.1.2004 and is to increase transparency and predictability of customs legislation and procedures. The Code is a significant step forward in Ukraine's customs law approximation to EU legislation and in the country's plan to enter the WTO. The Code introduced internationally consistent practices and rules on publication of legal acts, relations to operators; as well as on appeals and customs valuation, where some discrepancies still remain. Moreover, it provides uniform simplified customs procedures, and reinforces the powers of the State Customs Service to fight against fraud, counterfeiting and piracy. Secondary legislation is currently scattered across numerous decisions of various executive authorities. Ukraine is reinforcing its administrative and operational capacities in the area of customs.

The Law on Changes to the Law of Ukraine on Taxation System of 1997 contains the main principles of Ukraine's **taxation system** as well as the basic organisational and functioning rules of tax administration. The Ministry of Finance and the State Tax Administration (STA) of Ukraine are the competent bodies in this area.

VAT was introduced in Ukraine in 1992. The 1992 Decree on Excise Duty establishes the legal framework for charging and collecting excise duty on imported and locally produced goods. According to the EU assessment of the implementation of the PCA, Ukraine still applies discriminatory tax measures against imported products, in particular in the area of automobile manufacturing and alcoholic beverages. Administrative capacity, in particular in relation to VAT reimbursement continues to be problematic in Ukraine.

Ukraine has signed double taxation treaties with 64 countries, including 23 EU Member States.

On **technical regulations and standards for industrial products**, Ukraine adopted three laws in May 2001, on conformity confirmation, accreditation and standardisation. Progressive implementation of these laws resulted in the creation of the National Agency of Ukraine on Accreditation and should see a shift towards voluntary (rather than mandatory) standards and the drafting of technical regulations based on the European 'new approach' directives. Steps were taken in 2000 to simplify the certification procedures applicable to certain mass-produced goods (for example electrical appliances and construction materials). Ukraine is also aware of the need to avoid the creation of multiple testing requirements by different public authorities.

In the field of **intellectual and industrial property** rights, legislative initiatives taken include amendments to the law on Copyright and Neighbouring Rights, changes to the Criminal Code to clarify and strengthen the penalties for infringements and a new Customs Code which includes IPR-relevant provisions. IPR requirements have also been included in the Civil and Commercial Codes. The so-called Omnibus Law (in force since June 2003) was the vehicle for many of the changes in IPR legislation, codifying and modifying laws on copyrights, trademarks, rights to inventions and utility models and rights to industrial designs. The Omnibus law strengthened enforcement: courts can now issue preventive measures (which is new in the Ukrainian legal system) including the inspection of business premises or the seizure of property belonging to third parties. Ukraine has also taken a step towards improved judicial protection of intellectual property rights by providing for relevant training for judges from economic courts on IPR matters (specialised IPR courts do not exist). Improving border control is important for effective IPR enforcement.

The 2000 Law on **Procurement** of Goods, Works and Services at the State Expense sets out a decentralised system in which tender committees in the relevant contracting authorities are tasked with choosing between all satisfactory bids the one that best meets the stipulated criteria. National preferences of 10% are provided for, subject to certain criteria and thresholds. The Ministry of Economy and European Integration contains a national Public Procurement Office, responsible for monitoring and enforcement.

On the **right of establishment and provision of services** (other than financial services), the PCA facilitates the establishment of companies in most manufacturing and services sectors in Ukraine and in the EU. EU and Ukrainian companies are free to establish at least on a Most Favoured Nation basis and, once established, are free to operate on a national treatment basis. Despite this, the level of EU investment in Ukraine remains very low, significantly below EU investment levels in neighbouring countries, including Russia.

The Law of 18 January 1991 on Investment Activities is the main legislative act governing investment activities in Ukraine. The Law determines general legal, economic and social conditions, and aims at ensuring the protection of rights, interests and property of investing entities irrespective of types of property ownership or nationality. It sets the same rules for both national and foreign investors. Specific features of the foreign investment regime are however determined by a law of 19 March 1996 on the Regime of Foreign Investment, which foresees that any company with a 10% foreign participation in its statutory capital is a company with foreign investment and forbids investment in certain sectors. Ukraine has concluded agreements on protection of investments with more than 50 countries, including most Member States. The main obstacles to foreign investment include “red tape” (cost and time of business registration and licensing requirements) and corruption.

A Special Task Force on Corporate Governance and Shareholders’ Rights, including representatives from the government and relevant state agencies, private sector associations and the donors’ community, was created in 1998 to help establish an appropriate legal framework to improve corporate governance and promote the use of international accounting and disclosure standards. Reflecting the work of this Task Force, a new Law on Joint-Stock Companies was submitted to parliament in 2001. This new Joint-Stock Company law will improve the definition of the board of directors’ responsibilities, managers and shareholders’ meetings, strengthen disclosure requirements and increase the protection of minority-shareholders’ rights.

3.4. Transport, energy, information society, environment and Research and Innovation

Transport policy aims to develop Ukraine as an important transit country in light of its geographic position. This is reflected in the "Law of Ukraine on the Complex Programme of the Confirmation of the Transit State Status of Ukraine in 2002 – 2010" which aims at the application of market economy principles to the sector in view of an increasing demand for transport services. A reform of the transport sector has started and Ukraine plans to adhere to a number of additional international conventions and technical organisations setting the international standards under which the various transport modes operate. Here the emphasis lies on strengthening of transport safety requirements.

Ukraine plans to further develop the road sector including road safety by setting higher operating standards. In the rail sector, the accent lies on the promotion of multi-modal services and improvements in the interoperability for the further development of rail network connections between Ukraine and countries of Central and Eastern Europe.

In the aviation sector, Ukraine has begun its integration into Pan-European aviation structures. Ukraine is a member of ECAC (European Civil Aviation Conference) and has applied for membership of the JAA (Joint Aviation Authorities). The National Programme of Civil Aviation for Flight Safety adopted in February 2003 aims to develop an independent organisational and legal framework for aviation safety. Ukraine inherited a significant aircraft manufacturing industry (Antonov) from the USSR; support for joint EU-Ukraine projects in the context of enhanced industrial cooperation could be envisaged. Together with the Russian Federation, the EU is the most important aviation partner of Ukraine. Bilateral air services agreements between Ukraine and EU Member States are not in line with Community legislation. As regards maritime transport, the aim of the policy is to improve maritime safety and restructure the state-owned port sector. Concerning infrastructure policy, Ukraine seeks to improve connections and cooperation in the context of the Pan-European corridors network. Missing links and bottlenecks in the international transport and main local networks need to be addressed.

Concerning **energy**, Ukraine is a key strategic country for the transit of (mostly Russian) oil and gas to the EU. It wishes to strengthen this transit position and to enhance its energy network connections with the Union. The EU offers support to the reform of the gas sector, including transit, through the TACIS programme. The recent signature, under the auspices of the EU, of an Agreement with Poland on the development of the Odessa-Brody-Poland oil pipeline and the connection, since July 2002, of the "Burshtyn Island" to Western European interconnected UCTE electricity networks, fit into this policy. Ukraine produces large quantities of coal and some hydrocarbons. Coal mining suffers from a high number of accidents

Ukraine inherited a developed network of **nuclear power** plants (NPP) from the former USSR. The share of nuclear power is approximately 46% of total electricity production. 13 nuclear units are in operation. The main challenge in this area is the follow-up of the conversion of the Chernobyl site into an environmentally safe site, the upgrading of nuclear safety of the operating NPPs and the completion, according to internationally accepted nuclear safety standards, of two units at Rivne and Khmelnitsky NPPs (K2R4), which are under construction. Nuclear safety upgrading of the operating nuclear units and decommissioning are continuing within the framework of the TACIS and IAEA support programmes.

In 2001 Ukraine initiated the drafting of an extensive Energy Strategy until the year 2030, which would address, i.a., the unsustainable (distorted) prices, debts and non-payment issues. The current situation leads to very high inefficiencies in the sector.

The gas sector, suffering from poor maintenance and under-investment, is dominated by the state owned joint-stock company Naftogaz Ukrainy, responsible through its subsidiaries for all gas activities (production, transmission, sales, distribution). Ukraine plans to draft a Gas Law and to reform the sector. In the electricity sector a (limited) measure of market opening took place, i.a., through the privatisation of six distributors in 2001. Privatisation in the sector was put on hold in January 2004, when the President issued a decree on the creation of a vertically integrated electricity company comprising all state-owned assets in the sector (generation, transmission and distribution). Following this decree the State Property Fund decided to take five regional energy distributors (oblenergos) off the 2004 privatisation list.

An electricity law is in force and a regulator, the National Electricity Regulatory Commission, is operational. Ukraine is developing a concept for a wholesale electricity market. The laws on energy efficiency and on alternative energy sources, the State Committee on Energy Efficiency and several programmes (with limited financial resources) constitute the main framework for enhancing energy efficiency and promoting renewable energy sources. Finance is lacking to advance sufficiently in this area.

As regards the **Information Society**, the State Committee on Communications and Informatisation is the regulator of electronic communications services. The Committee reports to the Cabinet of Ministers and in particular the First vice Premier Minister. The Committee adopts sector policy and drafts legislation and regulations on licensing, tariffs, spectrum management and numbering. It is also responsible for managing the government shares in the dominant operator Ukrtelecom and for the relations with international bodies.

The implementation of the National Informatisation Programme is regulated by law. The main objectives are the establishment of legal, economic, institutional, financial and other prerequisites for the introduction of new information technologies as well as the development and support of the market for information products and services to facilitate Ukraine's integration into the global Information Society. Ukraine plans to adopt a new legislative framework, ending the monopoly of Ukrtelecom and establishing an independent national regulatory authority. These and further changes are also needed in order to implement Ukraine’s offer of full opening of the telecommunications market by 2005.

As regards **environment,** Ukraine drafted in 1998 a National Strategy for the Environment for 1998-2008. It was amended in 2003 and has been the basis for developing sectoral programmes on key environment concerns such as on environmental safety (including nuclear energy), drinking water and construction or rehabilitation of water facilities, prevention of deterioration of the Black Sea, sustainable management of natural resources, environmental technologies and protection of biological and landscape diversity.

Ukraine adopted the framework Law on Environmental Protection in 1991, and has since adopted several pieces of legislation to converge with EU requirements. In September 2003, the Ministry of Environment and Natural Resources was split into the Ministry of Protection of Natural Environment of Ukraine and the State Committee for Natural Resources. The former will deal with environmental protection, the latter with rational use of natural resources. Other Ministries, such as the Ministry of Health, are also responsible for environment related matters. Ukraine is a member of the Danube - Black Sea Task Force. An

EU-Ukraine Working Group on Climate Change met for the first time in 2002. Ukraine has ratified relevant international and regional environment conventions, except the Stockholm Convention on Persistent Organic Pollutants (POPs). Ukraine has ratified the Kyoto Protocol.

In October 2003, the Agreement on cooperation in **Science and Technology** between the European Community and Ukraine has been renewed for an additional period of five years. The renewed Agreement aims at upgrading and intensifying co-operation between Ukraine and the European Union, considering the importance of Science and Technology for economic and social development and the mutual wish to extend and strengthen the conduct of co-operative activities in areas of common interest.

Planned cooperation, as also endorsed by the EU-Ukraine Summit in Yalta in October 2003, would concentrate on the enhancement of S&T cooperation between the EU and Ukraine with a view to Ukraine's involvement in the European Research Area and the definition of ways and means to foster cooperation and allow for joint cooperative research opened by the research framework programme and other instruments, including the research partnership INTAS and Science and Technology Centre in Ukraine (STCU).

Special potential is seen in EU-Ukraine cooperation in the space sector.