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#21

New economic legislation: 2002–2003

This issue features an evaluation of changes in economic legislation during the period December 2002–December 2003 and their impact on business activity in Ukraine. During this period, a number of key documents were adopted which should ensure legal reforms in Ukraine with respect to current needs. First of these are the Civil and Commercial Codes. Significant steps were taken in reforming tax legislation, in the area of pension security, and in the regulation of financial services. However, given the confrontation between various business and political groups, legislation has become the instrument of political horse-trading. It is approved without the development of a well-coordinated state policy and clearly defined priorities, goals and means

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International Centre for Policy Studies:
vul. Pymonenka 13A, Kyiv, Ukraine 04050
Phones: (380-44) 236-1292. Fax: (380-44) 236-4668.
E-mail: office@icps.kiev.ua. Web: www.icps.kiev.ua

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Overview

This issue of policy studies features an evaluation of changes in economic legislation that occurred during December 2002–December 2003 and their impact on the business climate in Ukraine. During this period, a number of key documents were adopted which should ensure legal reforms with respect to the current needs. First of these are the Civil and Commercial Codes. Significant steps were taken in reforming tax legislation, in the area of pension security, and in the regulation of financial services. However, given the confrontation between various business and political groups the adopted legislation has been a result of the compromises reached and not of a clear and consistent state policy. Thus, on the one hand, the new economic legislation will certainly contribute to the acceleration of economic growth, but, on the other hand, the general conditions for doing business are growing more complicated because of deterioration in the quality, transparency and consistency of the regulation

As before, the barriers to adopting effective laws in Ukraine are the lack of common ground among competing interests and the lack of a solid basis for legislative changes. Laws are viewed as a means of satisfying the interests of particular influential groups, and not as a tool for implementing state policy. However, the critical mass of gaps in Ukraine's laws makes it impossible to delay the adoption of necessary legislation. Thus, during December 2002–December 2003, a number of key laws were passed. At the same time, laws have become the subject of political horse-trading in Ukraine. Quite often they are adopted without any detailed analysis of issues and without the development of a well-coordinated state policy, which ought to include clearly defined priorities, goals and the means for achieving them—and take into account the interests of all stakeholders. The result has been a growing number of contradictions among different pieces of legislation.

The new Civil and Commercial Codes serve as good examples. Adopted on the same day, these fundamental legislative acts include a great number of absolutely incompatible measures for regulating one and the same issue (see **Ownership and privatization**). Still, it is possible to see a gradual approach of ownership regulation to market standards. The strengthening of property rights in the Civil Code has somewhat reduced the risks of doing business in Ukraine.

Unfortunately, this period saw no systemic changes in area of corporate governance legislation. So far, the Verkhovna Rada has been unable to pass a new Law on joint stock companies. In our opinion, adopting this bill does not suit the interests of Ukraine's financial-industrial groups, since it deprives them of a slew of tools for re-distributing property.

For similar reasons, reforms to legislation on state property management and privatization have been delayed (see **Ownership and privatization**). During 2003, the legislature failed to adopt the Law on managing state property and the State Privatization Program for 2003–2008. Given this and the new requirements regarding state property management stipulated in the new Civil Code, the utiliza-

tion of state property could get totally out of control in 2004.

2003 was the year when tax reform finally came to life (see **Tax policy**). Having understood the futility of further work on the Tax Code given that there was no real cooperation between the executive and the legislature, lawmakers turned their efforts to reforming separate areas of tax legislation. They adopted the Law on personal incomes tax and substantially reformed profit tax—specifically by reducing the tax rate to 25% starting in 2004. Improvements to the tax administration system were also tackled. In addition, reforms to pension legislation expanded the base of Pension Fund contributors to include enterprises that are eligible to pay a flat tax. In 2003, the Government clearly indicated its intentions to eliminate flat taxes or at least substantially restrict eligibility. In particular, amendments to the 2003 State Budget Law eliminated special licenses. Thanks to enormous lobbying efforts, small business managed to hang on to its position for 2004. Mostly likely all the fine points will be resolved in 2004, when, in our opinion, a special law on the system of simplified taxes is adopted.

On the whole, these active reforms in tax legislation were positive, as they considerably improve the business environment in Ukraine. Still, the Government's efforts to preserve the current level of social payments will make it impossible to maximize the benefits of tax reform.

Amendments to financial sector regulation were also intended to improve the business environment. In 2003, this sector was given new means to stimulate credit and stock market development (see **Financial sector**). In addition, a State Financial Services Regulatory Commission was set up. At the end of 2003, this body went into action, which had an immediately positive impact on this market. In particular, with the passing of a provision on their registration, the development of credit unions should speed up.

Another positive step was the adoption of Laws on electronic documents and e-document flow and on electronic signatures (see **Financial sector**). The introduction of new forms of commerce should have a positive impact on business development in Ukraine and help it integrate into the global economy.

To speed up this process, the Government acted to reform legislation related to WTO accession and to harmonize national legislation to EU norms. Active efforts to bring Ukrainian legislation into conformity with WTO requirements (see **Open economy**) has made it possible to sign 20 bilateral agreements on access to goods and services. At the same time, EU harmonization is barely progressing.

The new Commercial and Customs Codes that effect foreign commerce have not introduced any revolutionary innovations. Thus, there are unlikely to be any substantial changes in terms of open trade in 2004. The situation with movement of capital has actually changed for the worse, caused, in particular, by actions of the National Bank of Ukraine aimed at improving the process of importing and exporting capital. Still, these moves actually did reduce capital flight.

Throughout 2003, Government and Verkhovna Rada efforts to regulate business activity were distinguished by the lack of a systematic approach (see **Business regulation**). Passing the Law on the registration of legal entities and private entrepreneurs was a key event. This law eliminated a number of gaps in the process of registering and closing businesses. Still, it did not resolve the problem of lowering barriers to entry in the market. Setting up a "one-stop shop" registration system will be impossible without introducing a slew of changes to other laws. And the Government showed little intention of initiating such changes.

The principles of state policy in licensing continue to lose credibility. Changes to the list of activities subject to licensing continue to happen unsystematically and, in our opinion, without careful thought. Expanding the use of holographic protection has led to increased unproductive business expenses (see **Business regulation**).

Amendments to legislation aimed at preserving competition mostly increased the role of the Anti-Monopoly Committee (see **Preserving competition**). In our opinion, one of the consequences of this approach will be to strengthen administrative pressure on business.

Unfortunately, at the same time as the role of executive bodies was expanded during December 2002—December 2003, the role of the judiciary was not. Judicial reform is progressing at a snail's pace (see **Judiciary reform**). The system for supporting judicial activity remains flawed. After the President signed a provision on the state judicial administration in 2003, the body responsible for the operation of the courts launched into activity, but this changed very little. For one thing, the amount of Budget funding allocated to the judiciary remains wretched. Moreover, the Judicial Administration remains dependent on both the Cabinet of Ministers and the President.

Changes to the Commercial Procedural Code extended the situations under which businesses can appeal decisions of the High Commercial Court of Ukraine (see **Judiciary reform**). On the whole, however, reforms to procedural legislation have been very slow. The Administrative Procedural Code is still at the preparatory stage. Delays in adopting it could soon have a negative impact on the effective operation of the country's newly-created administrative courts.

The ineffectiveness of laws as tools of state policy is one of the main problems in Ukrainian legislation. The Law on the basis for business regulatory policy could provide some help (see **Regulatory policy**). This law establishes certain obligations for those bodies responsible for developing and adopting regulations: planning the setting of norms and standards, analyzing regulatory impact, tracking the results of applied regulations, and reviewing/canceling those that are ineffective. Unless state bodies treat the requirements of this law as nominal, the level of predictability, consistency and effectiveness of Ukrainian legislation should improve.

Table 1. Summary of changes in commercial legislation, December 2002–December 2003

Business-friendly changes	Business-unfriendly changes
– Reducing the corporate tax burden by adopting: – the Law on personal income tax; – the Law amending the Law on corporate profit tax, which reduced the tax rate and increased depreciation rates	– Failing to solve the problems of accumulated VAT refund debts and deciding to effect obligatory repayment via issuing domestic treasury bills
– Eliminating flaws in tax administration	– Destroying the simplified tax system by eliminating special licenses, by trying to raise single and fixed tax rates, and by extending mandatory Pension Fund contributions to payers of the flat tax
– Adopting a new edition of the Civil Code that more effectively protects property rights	– Moving further away from the stated policy principles for licensing, and introducing ill-considered changes to the list of activities subject to licensing
– Adopting the Law on the basis for business regulatory policy, which should ensure improvements in Ukraine's regulatory environment	– Delaying judiciary reforms, which makes it impossible for businesses to protect their rights effectively
– Expanding stock market instruments by adopting the Laws on mortgage and on non-state pension funds	– Delaying adoption of the Law on joint stock companies
– Introducing new forms of lending by adopting the Law on mortgage lending, transactions with consolidated mortgages, and mortgage certificates	– Failing to present the State Privatization Program, and delaying adoption of the Law on state property management, which makes state property utilization and management untransparent
– Adopting laws regulating electronic document flow	– Failing to coordinate key provisions of the new Civil and Commercial Codes

This report was prepared by:

Serhiy Seheda
Tetiana Shcherbakova
Oleksandr Tatarevskiy
International Centre for Policy Studies

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Business regulation

2003 will be remembered as the year new rules were set for registering business entities. Still, in other areas of business regulation, the actions of the Government and the Verkhovna Rada were not distinguished by a systematic approach to the solution of long-standing problems. This year did not see the expected breakthrough in simplifying procedures for issuing all the permits necessary to launch business operations or in protecting the rights and interests of businesses against state control and supervision. Tackling these issues was moved to 2004

Registering a business

The Law on the state registration of legal entities and private entrepreneurs[1] was adopted 15 May 2003 for the purpose of expanding provisions in the new Civil Code and it considerably changes the current procedure for state registration of legal entities and private entrepreneurs.[2]

Above all, the Law sets a unified approach to state registration of all legal entities. Although the Law envisages that specific laws may establish the details of state registration for specific legal entities,[3] all of them will nevertheless gain the status of a legal entity only upon registering with the state according to the procedure set forth by the Law on the state registration of legal entities and private entrepreneurs. In our opinion, these specifics are unlikely to be so radical as to spoil the new procedure for state registration.

The Law also calls for setting up a Single Register of Legal Entities and Private Entrepreneurs, which should obviously be based on the Register of Subjects of Business Activity, which currently provides an uncoordinated informational system. One positive feature of the new register is detailed regulation of conditions for access by legal entities and private individuals to Registry data. This should create a better informational environment for business. Still, if a Unified State Register of Legal Entities and Private Entrepreneurs comes into being, what is the point of Ukraine's Unified State Register of Enterprises and Organizations (USREO)?

Among the positive points of the Law on the state registration of legal entities and private entrepreneurs," several are worth a mention:

- the differentiation of registration activities based on their purpose, including those arising from court decisions;
- details describing each step in the registration process;
- the elimination of many gaps in the regulation of procedure for state registration. Until now, these were typically eliminated through the publication of interpretations by the Licensing Office, which has been eliminated, and the State

[1] This law comes into effect on 1 July 2004.

[2] Private entrepreneurs are physical entities (individuals) who are registered and act as a business.

[3] Civic and community associations, charitable organizations, political parties, state bodies and bodies of local government, banks, chambers of commerce and industry, financial institutions, exchanges.

Committee for Entrepreneurship. Given that this kind of approach was not actually legal, the actions undertaken by the Licensing Office and the State Committee for Entrepreneurship had little enough effect.

As soon as this Law comes into effect, we expect that, in some cases, the registration processes will become more complicated.

Still, once it does come into effect, it is unlikely that Ukraine will introduce "one-stop shop" registration procedures. Although this concept is presented in the Law, the latter does not provide any actual mechanisms for combining state registration procedures with post-registration procedures, such as registration with the State Tax Inspection as a taxpayer, entering an entity into the USREO, registering an entity with the Pension and Social Security Funds. As now, businesses will have to continue to deal directly with other registration and oversight bodies.

To solve this issue, all legislation and regulation related to state registration needs to be brought in line with the Law on the state registration of legal entities and private entrepreneurs before 1 July 2004. This would make it possible to actually introduce "one-stop shop" registration procedures.

Incidentally, registration procedures for subjects of business activity changed as of 1 January 2004, even before the Law on the state registration of legal entities and private entrepreneurs comes into effect. With the Commercial Code gaining force, the Law on entrepreneurship—except for Article 4—becomes void. Article 8 of this Law determined the legal procedure for registration. Thus, for six months, from 1 January—1 July 2004, state registration will be subject competing legal norms in the Civil and Commercial Codes.

It is our opinion that the current Provision on the state registration of subjects of business activity, approved by a Cabinet Resolution dated 25 May 1998,[4] will actually apply during this period.

However, there is also a risk that the state registration of businesses will be blocked altogether during this period. The Civil Code allows the regulation of such state registration only at the legislative level. Moreover, there are sometimes substantial differences between the state registration procedures established by the Codes and the current Provision on state registration of subjects of business activity. For example, the Commercial Code no longer allows the district administrations in the cities of Kyiv and Sevastopol to carry out state registration. The Code also defines reasons for refusing a state registration: until now, the only legitimate reason for such a refusal was if a list of mandatory papers was missing in the statutory documents of a business association. Some negative consequences can also be expected from the lack of conformity between norms of the Civil Code and said Provision.

As a result of inactivity on the part of the Government in eliminating discrepancies among various pieces of legislation that regulate this critically important sphere, it should be expected that legal and organizational problems with business registration procedures will arise during the first half of 2004.

Business licenses

During the period of this study, legislation governing the licensing of business activity was affected by contradictory tendencies, some of which clearly point to the need

[4] According to the Commercial Code, the Government is supposed to adopt the provision on state registration procedures for businesses.

for reform in the current system of licensing.

On one hand, the legislature established a precedent by curtailing the list of business activities subject to licensing. The Law on electronic signatures dated 22 May 2003 cancelled the requirement for a license to provide services related to electronic signatures as of 1 January 2004. These are now a component of services providing cryptographic protection of information, which require licensing.

On the other, the list of business activities subject to licensing has been growing although the purpose for introducing a license has not always been justified. This list, determined by the Law on licensing certain types of business activity, was extended to include:

- wholesale seed trade;[5]

- production, storage and sale of breeding (genetic) materials; genetic assessment of an animal's lineage and anomalies.[6]

It is not clear why it was necessary to introduce licensing in these business activities, since it certainly is not needed to protect human health or the environment.

In our opinion, decisions by the Verkhovna Rada such as these to amend the list of licensed business activities reflect the lack of a unified systematic approach to licensing. Indeed, they demonstrate clear lack of understanding of the purpose of such tools as licensing to regulate a market.

Certainly the introduction of licenses for certain kinds of business activity has not followed any system. For instance, the Law on social services dated 19 June 2000, subjected professional provision of social services to licensing, yet the Cabinet of Ministers is supposed to specify the conditions and procedures for such licensing. What is more, this type of activity was not entered into the list of activities subject to licensing included in the Law on licensing certain types of business activity. At the same time, there is no provision saying that licensing this particular area is in compliance with any specific law.

Similarly, pursuant to the procedure set forth in the Law on land management, this activity is legally subject to licensing. However, related amendments have not been introduced to the Law on licensing certain types of business activity.

During the period of this study, the list of business activities in the areas subjected to licensing under specific laws was also expanded:

- The Law on non-state pension funds, dated 9 July 2003, introduced licensing for the administration of pension funds and stipulates that the State Financial Services Regulatory Commission will handle such licensing.

- The Law amending certain legislative acts on technical-vocational education, dated 11 September 2003, introduced licensing for on-the-job training at manufacturing plants for all enterprises, organizations and institutions, regardless of form of ownership and subordination.

Meanwhile, all kinds of exceptions to the general licensing procedure set forth by the licensing Law kept cropping up. Specifically, the Laws on mortgage lending, consolidated mortgage debt and mortgage certificates, and on crediting mechanisms and property

[5] See the Law on seed and planting stock dated 26 December 2002.

[6] See the Law amending certain Laws related to the introduction of licensing for certain types of business activity in cattle breeding, dated 20 February 2003.

management in residential construction and real estate transactions state that establishing registers of such mortgage owners and such deed owners in the Property Transactions Fund (PTF) shall be done independently by the issuer, without special license and regardless of the number of such deed owners. Yet, a PTF mortgage deed is a type of security and these laws overlook the fact that the keeping of registers of securities owners by issuers is, in fact, subject to licensing.

As another example, the Law amending the scrap metal Law, dated 25 December 2002, brings the list of transactions with scrap metal subject to licensing in line with the licensing Law. But it also:

- grants local administrations the right to delegate to relevant village, settlement and local councils the power to inspect specialized enterprises or metalworks as to their conformity with the requirements of this Law. Such a review is actually a condition for issuing a license;

- establishes that only one business entity can use an equipped piece of land of the stipulated area to handle scrap metal;

- grants specialized enterprises and metalworks the right, provided they are licensed, to store their own scrap metal on the territories of ports and railway stations solely for the purpose of loading it;

- states that, if information is repeatedly submitted to the state statistics offices late, said license will be cancelled.

A particularly notable case reflecting all the current negative tendencies in the licensing system is the licensing of the dissemination of sexual or erotic products, introduced by the Law on protecting public morals, dated 20 November 2003. This Law implemented "innovations" that, so far, have had no precedents in legislative practice:

- establishing a list of individuals who cannot obtain such a license;

- stipulating that licenses for review and assessment of erotic or sexual products and spectaculars shall be issued exclusively to state bodies. Yet, both the licensing Law and common sense say that a state body cannot be a license holder.

Meantime, some isolated steps were made to simplify licensing procedures. Cabinet Resolutions dated 16 November 2002 and 4 June 2003, both amending the list of documents attached to an application for a license for specific business activities, simplified requirements for such documents for licenses to manufacture, wholesale and retail medical products and to engage in activities related to the distribution of narcotic or psychotropic substances and their precursors.[7]

Violations of the general licensing procedures established by the licensing Law have reached such a level, that it is no longer enough to speak simply about reducing the number of activities subject to licensing and licensing the majority of activities strictly according to the procedure set in this Law, with a few specific exceptions. Ukraine's clear and unified licensing system exists largely on paper and the corruption of this system cannot be explained away as involving a few departments alone. It is quite evident that licensing rules for cargo and pas-

[7] A report that was required from the State Medical and Medicinal Products Quality, Safety and Manufacture Control Department or other authorized body on the state of the company's technological base, the presence of mandatory standard and legal documents, and the qualifications of company employees has been replaced by the same information on a form set by the Ministry of Health and signed by the applicant for the license. This means that the required documents will not be confirmed at the stage of obtaining a license-a clear sign of the declarative nature of the issuance of such licenses.

sengers in taxis and in space shuttles needs to be different. For instance, the requirement to pay 20 minimum monthly incomes (mmi) up front to get a license is not the least thing to hamper the legalization of taxicab activity. For this reason, it's important to start a debate on the expediency of a licensing policy principle such as establishing a unified procedure for licensing business activities on the territory of Ukraine.

Technical regulation

Confirming conformity

The Cabinet of Ministers issued a resolution in October 2003 approving the first technical rules for acknowledging conformity: "Technical Regulation of Modes of Evaluating Conformity and Requirements for Marking the National Sign of Approval That is Applied in Technical Regulations on the Confirmation of Conformity." In compliance with a decision of the Council of Europe dated 22 July 1993, this Technical Regulation introduces nine modes of conformity—sets of unified procedures for evaluating conformity. This considerably expands the possibility of confirming conformity against a relatively small list of certification requirements that existed before this confirmation system was reformed.

This Technical Regulation is the basis for developing other technical regulations for confirming conformity which, it is recommended, should be elaborated in line with European directives. The TR also defines the principles for applying modes for evaluating conformity, including:

- writing into the Regulations the broadest possible choice of modes for the manufacturer that are compatible with ensuring product conformity to the established requirements;

- rejecting the application of modes that are too complicated in view of the goal of ensuring product conformity;

- allowing authorized certification bodies that operate within established regulations to apply these modes without setting up excessive complications for business.

However, applying these and other progressive innovations will depend on the progress of central bodies in developing other technical regulations for the evaluation of conformity.

During 2003, conformity confirmation regulations also showed a tendency towards eliminating duplication of functions and procedures:

- The 20 February 2003 Law amending certain legislative acts stipulated that the results of tests performed in accredited testing laboratories or centers for the purpose of mandatory certification will not require further confirmation by other accredited testing laboratories or centers, except for cases, when the results of tests prove to be doubtful under the law. In addition, this Law separates the areas of oversight over safety measures for raw food materials and foodstuffs of animal origin;

- Commodities and products imported into Ukraine as research samples[8] are exempted from mandatory certification. Soon this exemption were extended to commodities (products) that belong to Group 1–24 of the Ukrainian Classification of Commodities for

[8] See Cabinet Resolution on amending Clause 2 of the procedure for customs clearance of imported commodities (products) subject to mandatory certification in Ukraine, dated 24 February 2003.

Foreign Economic Activity (UCCFEA) when they are imported as research samples for the purpose of carrying out research or testing with documentary confirmation from the State Committee for Consumer Standards.[9] This measure should simplify the procedure for importing new products into Ukraine for the purpose of testing and to ultimately speed up their entrance into Ukrainian markets.

The list of products subject to mandatory certification in Ukraine[10] has not grown over the period of this study. However, there is a possibility that it will be expanded in 2004: on 18 November 2003, the Verkhovna Rada adopted the Law amending the Law on tourism, according to which a list of tourist services subject to mandatory certification with respect to safety and health, as well as the protection of property and the environment, shall be determined by the Cabinet of Ministers, in compliance with the Law on confirming conformity. Given such a broad definition of the goals of mandatory certification, it can be expected that an even larger list of tourist services will be subject to certification as of 1 January 2004, when the new edition of the Law on tourism comes into effect.

Accreditation to evaluate conformity

Legislation covering the accreditation of organizations to evaluate conformity has not undergone any substantial changes. Although the new edition of the Provision on the Accreditation Council of the national accreditation body adopted by a Ministry of Economy Decree, dated 6 February 2003 establishes some positive norms aimed at strengthening work discipline among the members of the Council, it also considerably strengthened the administrative and informational dependence of this advisory-supervisory body on the National Accreditation Agency of Ukraine (NAAU) and limited the rights of the Council itself.

Notably, the informational dependence of the Council is negatively influenced by the loss of the right:

- to submit decisions to the Cabinet of Ministers for adoption in appropriate acts of legislation;
- to submit proposals to the president, the Verkhovna Rada, the Cabinet of Ministers, the State Committee for Consumer Standards and other central and local executive bodies;
- to obtain information from central and local executive bodies and businesses on issues that fall under its authority. From now on, such information can only be obtained from the NAAU.

The Council's administrative dependence on NAAU is aggravated by the fact that the Council's secretary, who performs important functions in the Council's operation, will now be appointed by the head of NAAU from among NAAU personnel and cannot be a member of the Council. Until this time, the secretary was appointed by the Council from among its members. Worse, the periodicity of the Council's meetings has been curtailed: it used to have to convene at least once a quarter; now, it only needs to convene once every six months.

Understandably, under such conditions, certainly the supervisory function of the Council cannot be carried out effectively—

[9] See Cabinet Resolution on amending Clause 2 of the Procedure for customs clearance of imported commodities or products subject to mandatory certification in Ukraine, dated 27 August 2003.

[10] This list was approved on 3 August 2002 by a Decree of the Derzhstandart.

and this cannot lead to positive results in the process of accrediting bodies that evaluate conformity.

State supervision of compliance

Two opposing tendencies can be seen with normative regulation of state supervision over compliance with standards, norms and rules.

On one hand, as in the area of confirming conformity, the legislature and the executive have managed to eliminate duplication of functions and procedures. The 20 February 2003 Law amending certain legislative acts established that state supervision over adherence to veterinary health standards will be the province of state veterinary bodies alone, and not the State Consumer Standards Committee and its local arms. According to another legislative act, the 20 February 2003 Law amending the Cabinet Decree on state oversight of compliance and responsibility for violations, certified manufacturers are removed from the list of enterprises subject to state compliance oversight, while inspections for compliance with health and sanitation norms are removed from the competence of the State Committee for Consumer Standards and its local arms. The Law also establishes that state supervision applies, not to all export production, but to that paid for with government funds.

On the other, the Law amending the Cabinet Decree on state oversight of compliance has introduced provisions aimed at expanding the application of this kind of state supervision:

- the grounds for the Consumer Standards Committee and its local arms to carry out random inspections during state supervision have been expanded. These are to be done at the request of executive bodies, local executive bodies, or offices of the prosecutor. Until now, the only grounds were appeals by ordinary citizens;

- wholesale traders are now subject state supervision;

- state inspectors now have the right, in situations where businesses set up hurdles to state supervision, to turn to enforcement agencies to eliminate those barriers;

- compliance with proper procedure has now been made obligatory through the introduction of a provision that, should a violator fail to comply with proper procedures as established by law, a fine will be charged.

In our opinion, these new elements are more likely to provide opportunities for further administrative pressure over business by those bodies that performed this kind of oversight.

Unresolved issues

A key problem in the development of a technical regulation system in Ukraine is the lack of progress in:

- preparing and adopting technical regulations, basic technical conformity regulations, and technical regulations affecting specific kinds of commodities;

- harmonizing domestic standards to the equivalent international norms—above all, European standards.

The lack of resolution in these critical areas threatens Ukraine's accession to the WTO, as well as its European integration, especially as EU requirements for standardization and conformity are about to be extended to the countries that are becoming its new members.

Holographic security

Steps were taken to introduce holographic protection on specific documents that were entered into the list of documents subject to holographic security and relevant state customers.[11] This kind of holographic security has been extended to:

- excise stamps for alcoholic beverages and tobacco products. On 23 April 2003, the Cabinet issued a Resolution introducing excise stamps of a new pattern with holographic security elements to mark alcoholic beverages and tobacco products.[12] According to a Government decision of 1 July 2003, Ukraine introduced new excise stamps with holographic security elements (HSE) to mark alcoholic beverages and tobacco products. The cost of excise stamps was also raised: excise stamps for alcoholic beverages rose from UAH 0.02588 to UAH 0.037, while those for tobacco products went from UAH 0.00912 to UAH 0.022;[13]

- copies of certificates of conformity and certificates of approval. The 15 October 2003 Cabinet Resolution amending the procedure for trading activities and the rules for trading with the public established that, as of 1 December 2003, copies of certificates of conformity or certificates of approval that accompany goods during the selling process must be produced on letterheads protected with HSE. However, neither the State Consumer Standards Committee, which did not have enough time to procure such letterheads, nor businesses were prepared to introduce "secure" letterheads. Thus, on the initiative of the State Committee for Entrepreneurship, the Government decided to reschedule the effective date of this Resolution to 1 February 2004. Thus, unproductive business expenditures connected to the sale of goods can be expected to rise as of February 2004.

On the whole, we consider the tendency to expand the application of holographic security negative. Practice shows that:

- in some cases, the effectiveness of HSE is not enough to justify their use;

- the costs of introducing HSE often exceed the benefits of such step.

The State Committee for Entrepreneurship took the initiative to resolve this problem by proposing that the lists of documents and groups of goods subject to holographic security be reviewed with the idea of shortening it and the cost of HSE-protected letterheads reduced. This proposal merits support.

In addition, the Government should also focus its attention on:

- simplifying the procedure for obtaining protected letterheads and applying HSE to documents;

- calculating the economic impact from using HSE and their effectiveness in achieving the purpose of holographic security.

[11] This list was approved by the 5 July 2002 Cabinet Resolution approving lists of documents and groups of commodities subject to holographic security.

[12] This Resolution was issued to implement instructions in a Presidential Decree on measures to introduce state supervision over the production and distribution of alcohol, alcoholic beverages and tobacco products, dated 27 December 2002.

[13] See the 20 June 2003 Cabinet Resolution on excise stamp rates for alcoholic beverages and tobacco products.

Regulatory policy

On 11 September 2003, the Verkhovna Rada adopted a Law on the basis for state regulatory policy in business. Thus, the legislature established the principles of regulatory policy and specific procedures for preparing and adopting regulations. This Law should replace earlier legislation on regulatory policy: Presidential Decrees eliminating restrictions on business development, dated 3 February 1998, and introducing a unified business regulatory policy, dated 22 January 2000, as well as a number of Cabinet resolutions. This Law embodies regulatory reform experience in Ukraine starting in 1998 along with new ideas aimed at resolving key problems in carrying out regulatory policy principles. Still, substantial risks remain in the process of implementing the new Law

Problems

A number of obstacles in the way of the regulatory reform launched back in 1998 include:

- lack of a clear vision of the purpose and tasks of regulatory policy;
- limited spheres for applying the principles of regulatory policy;
- lack of effective mechanisms for introducing regulatory policy, oversight and responsibility for violations of state regulatory policy principles.

Key provisions

The Law on the basis for state regulatory policy in business is an attempt to solve these problems. According to this Law, the main elements of regulatory policy are:

- planning the drafting of regulations;
- preparing analysis of regulatory impact;
- publishing draft regulations to get feedback and alternative proposals;
- following up the effectiveness of regulations;
- revising regulations.

The new Law expands and clarifies the term "regulatory act." Firstly, instructional letters (directives) that interpret the rules of business activity cannot be considered regulatory acts. Secondly, the Law establishes that a document that has all the necessary juridical signs of a normative, legal act can be deemed a regulatory act even if such document is not considered a legal act under any special law. Specifically, standards and other norm-setting documents, as well as letters from state bodies that include legal norms, are deemed such documents if they establish mandatory requirements for businesses.

The passing of the Law on the basis for state regulatory policy in business can be seen as an attempt to extend the range of application of regulatory policy principles:

- Firstly, regulatory policy principles now apply to regulating the norms of business relations and to administrative relations among regulatory bodies and other state bodies, on the one hand, and businesses on the other. Until now, these principles applied only to the regulation of business activity.

- Secondly, the duty to adhere to regulatory policy principles now applies to the Verkhovna Rada, the President, the Cabinet of Ministers, the Crimean Rada, the National Bank of Ukraine, the National Radio and Television Council, and other state bodies, local government bodies and officials, arms of central executive bodies, specialized state institutions and organizations, mandatory social security funds, and any other officials of these bodies, if they are authorized under law to personally adopt regulatory acts. The latter include such persons as heads of health departments.

New emphasis

A less obvious advantage in the Law on the basis for state regulatory policy in business is the attempt to solve the issue of improving regulatory acts on an ongoing basis and the issue of ensuring that the policies are actually capable of being carried out [implementable].

Thus, this Law moves the emphasis from the drafting phase of regulations to the follow-up phase, when the effectiveness of adopted regulations is studied and the regulations are revised based on feedback. The purpose of tracking the effectiveness of regulations is to determine the actual level of implementation of regulatory provisions and the extent to which a given regulation achieves its intended goals.

Presented in a special report, the results of studying the effectiveness of a regulation should be analyzed by the body that adopted the regulation—in exceptional cases this may be a different body—and, if necessary, become the basis for:

- the revision of the regulation by the body that issued it;

- a decision to cancel the given regulation by a state body authorized to do so.

In addition, to provide public oversight, both individual citizens and legal entities have been granted the right to independently analyze regulatory influence for the preparation of regulations and tracking their effectiveness. Results obtained in this way can be used in discussions with the authors of these regulations and during public hearings.

The Law also introduces large-scale publication of all documents prepared during the regulatory process, including: schedules for the drafting of regulations, draft regulations, impact analysis of regulations, and follow-up reports on their effectiveness. Like the effort to engage the non-government sector in the implementation of regulatory policy, this proposal should also facilitate the implementation of this Law, thanks to continuous public pressure.

Risks

There are a number of risks that might may negatively affect the implementation of the Law on the basis for state regulatory policy in business:

- insufficient funding for 2004;[14]
- lack of experience among state bodies and their officials in analyzing of regulatory impact or in tracking the effectiveness of regulations. This risk may be partly compensated by organizing training for civil servants and local government officials;
- underdeveloped sociological services in state bodies and local governments, which will make it difficult to carry out follow-up studies of regulatory effectiveness using data from opinion polls;
- lack of accountability for ignoring requirements in regulatory policy legislation;
- the cavalier attitude of public servants and local officials towards fulfilling the requirements of regulatory policy legislation. This risk may partly be compensated by increasing opportunities for the public to participate in regulatory activity and disseminating information about it more widely.

[14] The 2004 State Budget Law does not allocate any funds for implementing state regulatory policy. That leaves only the funds allocated in local budgets and those allocated for activities under the National Program for the Promotion and Development of Small Business.

Tax policy

In 2003, the Verkhovna Rada finally buried the notion that a new Tax Code would be adopted any time soon. While they busied themselves solving more pressing political problems, members of the Government and the legislature were unable to find the necessary time to familiarize themselves with the fine points of this document, which, if truth be told, was several hundred pages long. Given the importance of the document for business, attempts to adopt the Tax Code in bits and pieces, without a thorough analysis of what was written in it, failed–to the good fortune of the country's entrepreneurs. Moreover, this draft largely replicated most of the current system of taxation. Still, rejecting the Tax Code did not mean rejecting tax reform altogether. From December 2002 through December 2003, lawmakers continued to pass legislations with the precise purpose of reforming separate areas of tax legislation

The trouble is that tax reform is being undertaken in Ukraine without a clear and consistent state policy in this sphere. As a consequence, the laws that emerge are not doing much to solve critical flaws in the tax system, which include:

- excessive tax pressure, which leads to sluggish business development and low investment appeal;
- complicated tax procedures, which result in high indirect, that is, unproductive, business costs;
- lack of transparency in tax legislation. On one hand, discrepancies in tax legislation provide well-connected enterprises and FIGs with opportunities to minimize their tax liabilities, which seriously reduces tax revenues to the Budget. On the other, SMEs, who do not have the same kinds of resources to defend their interests, suffer the pressure of a variety of "enforcements." This actually aggravates the conflict between the Government and business and lowers the appeal of investing in a business in Ukraine because of the high level of risk involved;
- unstable tax legislation, which complicates business planning and hampers long-term investment into the domestic economy;
- lack of a clear policy on tax breaks, which results in an uneven distribution of the tax burden among businesses and Budget shortfalls. The need to compensate these shortfalls at the expense of other businesses gets in the way of lowering of tax rates, that is tax pressure on business.

Most of these problems will remain unresolved in 2004. Tax reform will be further hampered due to:

- lack of a unified strategy in tax reform, which means that tax pressure will not only remain high but will be redistributed to various sectors–and tax legislation will become even more complicated;
- the Government's intention to maintain the level of social spending in an election year, which means rejecting serious tax cuts and easing of tax procedures;

- strong lobbies among pro-administration groups, who will adopt legislation that protects their own interests and defend their own tax breaks, which will further reduce the Government's options for lowering tax rates.

Personal income tax

The growth of Ukraine's economy should also ensure the growth of individual incomes. However, the personal income tax system that was in force until 2004 actually hampered this process because:

- high progressive tax rates were a disincentive to raise wages, which in turn limited purchasing power among consumers, the main "investor" in the domestic economy;

- high tax rates encourage businesses to use all legal and illegal means of reducing tax burdens connected with payroll, which only reduces Budget revenues.

As a result of such situation, the practice of paying out a significant part of wages "under the table"—and hence untaxed—is extremely widespread. In addition, there is a growing number of private entrepreneurs and enterprises are switching from traditional labor relations with their employees to civil contracts: this is one the most popular ways of cutting personal income taxes.

To resolve the personal income tax problem, the Verkhovna Rada adopted a Law on personal income tax on 22 May 2003. Except for a number of provisions that will gain force on 1 January 2005, this Law came into effect on 1 January 2004.

The Law radically changed the existing personal income tax system by introducing:

- A 15% fixed rate of personal income tax (this rate will be further reduced to 13% in 2004–2006) to replace the old progressive tax scale, according to which personal incomes were taxed at 10–40%. The new rate will be applied to most incomes. In separate instances, other tax rates will apply. For example, interest income, income from the sale of property, inheritances, and so on, will be taxed at a 5% rate starting in 2005.

- A major expansion of the tax base. Starting in 2004, personal income tax will be levied on insurance settlements, on the value of property granted into use rent-free, on utilization through an authorization agreement, as well as on discounts, interest income, and even on such "exotic" incomes as bribes. The expansion of the tax base is expected to compensate any Budget losses due to the reduction in tax rates.

- The concept of tax credits—expenditures which reduce taxable income. Under certain circumstances, tax credits may include interest for mortgages, payments for education, medical treatment, and so on. This step should provide an opportunity to lower tax pressure and at the same time stimulate the consumption of goods and services whose cost will reduce the taxable income.

- Tax deductions, social tax breaks will be introduced in stages by 2007, at the level of the minimum monthly wage.

- A special procedure for taxing incomes from the business activity and incomes of self-employed individuals. The application of this procedure could result in a substantial growth of business expenses, especially for those to whom the flat tax applies.

According to ICPS legal specialists, the Law on personal income tax only partly fulfills its

proper tasks. The reduction of tax pressure will certainly contribute to the growth of personal incomes. However, the Law does not do enough to legitimize shadow wages. This process is hampered by the considerable pressure on payroll budgets placed by mandatory contributions to the Pension Fund and other government social insurance funds.

In addition, the Law on personal incomes tax does not promote simplified tax procedures nor transparency and stability in tax legislation—one of the key tasks of tax policy. On the contrary, tax procedures are getting even more complicated. Firstly, the Law expands the base of tax agents, those responsible for calculating, levying and remitting taxes to the State Budget. These will now include gaming institutions, notaries, banks and other financial institutions. Secondly, the Law complicates the procedure for determining annual taxable income. This is tied into the introduction of different taxation procedures for different forms of income: interest from the sale of property, performance of commercial activity, and so on.

In order to regulate the procedure for paying and administering personal income taxes, in December 2003 the Cabinet of Ministers and the State Tax Administration adopted nearly 10 different regulatory and legislative acts. This only testifies to the complexity of the tax administration system.

In the opinion of ICPS specialists, the tax base is being expanded without proper consideration. For instance, the Law introduces the taxation of insurance settlements, which is not economically sound and could cause considerable losses for the insurance services market.

The Law on personal income tax remains flawed in terms of legal approach, transparency and accessibility. Its text includes numerous inconsistencies and it was not brought in line with many other pieces of legislation in Ukraine. The most significant are discrepancies in the provisions dealing with taxing business activity. Interpreting these norms fiscally, it is possible to speak about the effective cancellation of the flat tax system for those entrepreneurs who provide services and perform tasks. Given the untransparent nature of legislative regulation, the least that might result from this is growing business risk in Ukraine. In addition, the shortcomings of this Law could actually push a significant number of entrepreneurs to move into the shadow sector in 2004.

This Law will likely be amended fairly soon—yet another proof of its instability. Evaluating the Law as a whole, it is possible to conclude that lowering tax rates for personal incomes will lead to a reduction of employers' labor costs. This could become an incentive for some employers who have so far worked in the shadow economy to legitimize their workers' wages. This will increase revenues to the Budget and contributions to the Pension Fund. In addition, this will contribute to the growth of household savings and consumption, which, in turn, will stimulate economic growth.[15] However, this kind of "legitimization" is unlikely to become widely popular until payroll tax pressure is reduced. This means primarily pension and social contributions paid by employers. The solution to this problem is to implement social security reforms. A logical step would be to adopt a law on a single social insurance fee or contribution.

Meanwhile, unproductive business costs will related to tax procedures will continue to rise as the number of private entrepreneurs declines, some of whom will resort to being paid "under the table."

Minimizing these losses will require two main tasks to be fulfilled:

[15] See ***quarterly predictions*** for Q3'03.

- simplifying tax procedures;
- entrenching transparency and stability in tax legislation.

This can be achieved by introducing the necessary amendments to the Law on personal income tax. At the same time, because the Law contains numerous contradictory provisions, a positive step would be to introduce a provision in the Law stipulating that all questions related to the norms laid down in the Law shall be interpreted in favor of the taxpayer.

Value-added tax

The value-added tax (VAT) remains the most burdensome tax for businesses. The problems that accumulated in recent years only grew more aggravated during 2003, in particular:

- VAT refund arrears and lack of transparency in the refunding procedure;
- lack of stability and transparency in procedures for remitting the VAT;
- the persistence of baseless tax breaks.

Government actions aimed at solving these problems in 2003 did not yield positive results and were unsystematic. Of a total of 130 items in the Preliminary Plan for legislative activity approved by a 20 January 2003 Cabinet Resolution, only three were dedicated to the VAT. And all three were aimed at establishing tax breaks in specific areas. The Government specifically intended to fulfill two main tasks:

- determining the legal grounds for writing off and selling outdated or excess production capacities at domestic enterprises manufacturing machinery and equipment for the agro-industrial complex;
- setting up favorable conditions for the stable development of agricultural production and the growth of production volumes in the farm and food processing industries.

In the light of such a narrow spectrum of tasks last year, no essential amendments were introduced into the Law on the VAT. Most amendments were aimed at introducing or cancelling VAT exemptions. These exemptions continue to have the interests of various business groups at their core, and not the implementation of state policy goals. In particular, exemptions were granted to fuel and energy complex companies and to agricultural producers. Meanwhile, with a view to expanding the tax base, VAT exemptions were eleminated on the sale of domestic periodicals and books, medications—except those included on a list compiled by the Cabinet of Ministers—, and healthcare services.

During 2003, the Government tried to find a way to get rid of its VAT refund debt burden. It succeeded in these attempts at the end of the year. The 27 November 2003 Law on the 2004 State Budget anticipates the repayment of VAT arrears that accumulated by 1 November 2003 and not refunded by 1 January 2004, by restructuring them in the form of domestic government bonds (OVDP) with a 5-year maturity period.

These domestic bonds will be paid out annually in equal installments, together with interest calculated at 120% of the NBU's discount rate. Yet, the Law did not specify a term within which these VAT arrears should be rearranged as OVDP. Most likely, the Cabinet will determine this point, since it is authorized to regulate such issues.

This refusal to immediately compensate VAT arrears in cash could also negatively affect Ukraine's investment image. However, it is unlikely to further do serious damage to busi-

nesses, since VAT arrears have rarely been compensated in recent years.

Still, those exporters who have been counting on their VAT being refunded are suffering substantial losses. If they are deprived of the right to compensation, their businesses could become unprofitable, forcing them to re-orient on the domestic market. As a result, hard currency inflows to Ukraine can be expected to decline.

In addition, the 2004 State Budget Law includes a number of provisions aimed at preventing the future accumulation of VAT arrears. The main tool for preventing this is to simply remove the VAT exemption enjoyed by exporters. However, adopting this decision did not solve the problem of refunding the VAT, since the legislative shortcomings that led to the accumulation of arrears have not been removed.

Almost simultaneously with adoption of these regulations, the Verkhovna Rada registered bills aimed at cancelling them. The strong position of exporters in the pro-Administration coalition means that some of these bills will likely be adopted shortly.

The Verkhovna Rada is also considering a number of bills aimed at improving the procedure for settling and preventing Budget debts for VAT refunds. These draft laws propose:

- extending the deadline for compensation to 100 days, transferring the function of compensation to the Treasury, and automating the compensation process almost entirely;
- permitting compensation in the form of credits against other tax liabilities, such as corporate profit tax.

This should provide an opportunity to solve current problems with VAT refunds. However, these measures will not eliminate the primary causes behind the emergence of VAT arrears in the first place.

During the year, there were also attempts to reduce tax pressure on businesses. For instance, the bill on amending certain legislative acts proposed:

- increasing from UAH 61,200 to UAH 300,000 the threshold at which a business is subject to mandatory registration as a VAT payer;
- compensating the VAT by reducing tax liabilities in subsequent tax periods;
- establishing a VAT rate of 17% of the tax base as of 1 January 2004 and at 15% as of 1 January 2006.

The president has vetoed this particular Law twice. However, his criticisms were never aimed at the suggested tax rates, so the VAT rate is most likely to be lowered starting in 2005.

To solve problems related to the VAT in 2004, ICPS specialists say it is urgent to:

- adopt a law introducing an effective mechanism for compensating current Budget VAT debts;
- reduce tax pressure by lowering VAT rates;
- develop a clear state policy on the granting of VAT exemptions and review existing exemptions.

Corporate profit tax

Corporate profit tax legislation has all the general shortcomings inherent in the Ukrainian tax system such as high rates, complicated procedures and unstable legislation. An additional urgent problem in this area is low depreciation rates that hamper investment in the renewal of capital assets and upgrading production.

Key changes in the corporate profit tax were introduced on 24 December 2002, when the Verkhovna Rada adopted the Law amending the Law on corporate profit tax:

- The main purpose behind this Law was to expand the tax base. In particular, the application of the concept of "regular" prices was substantially expanded. This "innovation" is fairly negative, since it allows tax officials to increase administrative pressure on taxpayers. In addition, the complicated procedure for determining "regular" prices will result in more disputes over the profit tax rate.

- The Law permitted the taxation of repayable financial aid, excise duty paid by buyers of excisable goods in favor of the duty payer, and so on.

- The Law clarified a number of definitions, eliminating a number of misunderstandings and making terminology more transparent.

- The Law introduced quarterly tax installments, which should have a positive impact on the financial state of private entrepreneurs.

- The Law introduced Group IV fixed assets and increased depreciation rates, in an attempt to provide incentives to enterprises to renovate and upgrade outdated equipment. This could result in increased business productivity.

- To reduce tax pressure, the Law stipulated that, as of 2004, the corporate profit tax rate would be a flat 25%. This means that the basic conditions for doing business in Ukraine have been improved as of 2004.

But this was the sum total of profit tax reforms. During 2003, the Government expended minimal efforts in this area. Almost all changes were aimed at providing exemptions, such as:

- the 16 January 2003 Law extending exemptions for sale of publications;

- the 19 June 2003 Law exempting from taxes the business profits of newly-created farmsteads for three years, and for five years in settlements with labor shortages;

- the 10 July 2003 Law exempting certain types of incomes of non-profit organizations from taxation.

At the end of 2003, there was a clear withdrawal from corporate profit tax reform. Violating the Budget Code yet again, the Government included into the 2004 State Budget Law passed on 27 November 2003 tax rules that postponed the 2004 increase in depreciation rates for fixed assets acquired prior to 2004.[16]

These kinds of Cabinet actions are not governed by the tasks of state policy, but by the immediate need to ensure Budget revenues in 2004. To do so, the Government cancelled a number of tax breaks in 2004, namely:

[16] See ***quarterly predictions*** Q3'03, p. 17.

- gross expenditures cannot include expenditures related to the purchase or completion of an unfinished construction object and its introduction into exploitation;

- the incomes of consignment companies from the sale of specific types of by-products such as scrap and other secondary materials shall be subject to taxation;

- corporate profit tax shall not apply to car, bus and component manufacturers operating under the Law on stimulating vehicle production in Ukraine, except for enterprises that already have investment programs approved by the Cabinet of Ministers;

- tax breaks will no longer apply to companies under the Bronetekhnika [Armored Technology] Ukrainy concern, with the exception of those who have already concluded contracts, provided that the advance payment transferred is over 20% of the contract value.

Cutting down on the number of tax exemptions is a positive step that will make it possible not only to increase Budget revenues, but also to distribute the tax burden more evenly among various spheres of business in Ukraine.

The 2004 State Budget Law also disallowed the inclusion of balance losses registered prior to 1 January 2002 and not repaid prior to 1 January 2004 for the purpose of reducing corporate profit taxes. In this way, the Government confirmed its intention to fight unprofitable businesses.

Overall, tax pressure related to corporate profit taxes appears to be gradually abating. But should there arise a problem with filling the 2004 State Budget, it should be expected that the tax base will be further expanded. Such steps could well reduce the positive effects of tax reforms launched in 2002. In the opinion of ICPS specialists, Budget losses need to be primarily compensated by revising existing exemptions.

Simplified taxation

The main flaw in Ukraine's simplified tax systems is that they splinter businesses into smaller "simplified tax" businesses and encourage the switch from labor relations between employers and employees to civil contracts in order to reduce tax pressure. There are two main consequences of this:

- fewer tax revenues for the Budget, the Pension Fund and social security;

- the loss of certain social security guarantees for workers.

Given this and the reduced rates for personal income tax and corporate profit tax, the Government is now directing its efforts at restricting the application of flat tax systems and at increasing tax revenues from payers of flat taxes.

Flat tax systems are practically the only area where the Government is consistently sticking to a certain policy:

- applying fixed single tax rates to self-employed persons only, provided that their incomes do not exceed UAH 300,000 per year;

- increasing the tax rates for simplified tax payers;

- revising the upper limits for gross annual income, below which legal entities may pay a flat tax and establishing a new

rate and mandatory VAT payment for legal entities who pay a flat tax;

- establishing that flat tax payers also contribute to the Pension Fund and social security funds;

- restricting the conditions for applying civil contracts in relations between employers and employees.

The 22 May 2003 Law on personal income tax and the 9 July 2003 Law on mandatory state pension insurance are both aimed at implementating these policy principles.

The first Law allows civil contracts to be equal to labor relations in the provision of services and performance of work. This means incomes obtained within such relations are to be taxed in the same way as wages: at the 13% rate. The second Law obliges all entrepreneurs, including flat tax payers, to contribute to the Pension Fund as of 2004.

These provisions increase tax pressure on small businesses and reduce the appeal of flat tax systems.

On 22 May 2003, the Verkhovna Rada adopted a Law amending the 2003 State Budget Law and other legislative acts. This Law dropped the special retail trade license. As of 1 October 2003, this flat tax system no longer applies in Ukraine.

In addition, in late 2003, during debates over the 2004 State Budget Law, the Government proposed increasing fixed and single tax rates:

- fixed tax: from UAH 20–100 to UAH 100–300;

- single tax: from UAH 20–200 to UAH 200–600.

Although these proposals were rejected, it can be expected that attempts to increase tax revenues from flat tax payers will continue in 2004.

At the same time as they introduced a stricter policy regarding most payers of flat taxes, lawmakers adopted a Law amending certain Laws regulating activity in the agricultural sector on 19 June 2003. This Law extended the fixed agricultural tax (FAT) until 2010. According to this Law, only those enterprises whose share of revenue from agricultural activity amounts to 75%—not just 50% as was prior to this—are eligible to pay the FAT. Moreover, under the new Law, this tax will apply only to agricultural activity. Other activities will be taxed as normal business activities.

The implementation of the current policy, which is effectively aimed at eliminating of flat tax systems, may have negative consequences. Despite definite shortcomings, this kind of tax system has a number of positive features. First of all, it encourages the legalization of business. The share of tax revenues from flat tax payers in local budgets is growing steadily and is now over 8%. According to preliminary data, flat tax payers remitted about UAH 1.9bn to various budgets in 2003.[17] In addition, the development of flat tax systems is providing more jobs. The number of single tax payers in 2003 was over 550,000 individuals.[18] The majority of these individuals are creating new jobs. The number of persons working for flat tax payers has grown from about 50,000 in 1999 to more than 400,000 last year.

If the Government continues to fight against flat tax systems, their use will become less attractive. As a result, the number of entrepreneurs applying flat tax will likely decline as some of them begin to operate in the shadow economy.

[17] State Committee for Entrepreneurship data.

[18] State Tax Administration data.

Given the amendments to legislation, it is quite likely that the tax costs for running small businesses under the flat tax system will grow in 2004, as will the cost of tax procedures. This will impede the development of small business, whose share in Ukraine's economy is already lower than in the economies of developed countries.

Some of the problems of flat tax systems can be resolved by adopting a special law to deal with this issue. Before doing so, however, it is necessary to gain consensus among small businesses and the Government as to the future of flat taxes. Since small businesses do not have substantial influence on the Government and the Verkhovna Rada, this process could be delayed. On the other hand, representatives of small businesses could use the upcoming presidential election as an opportunity to push for some clear benefits for themselves.

Mandatory basic pension and social insurance

Contributions to social funds and the Pension Fund have been placed outside the country's tax system. However, by their nature these fees, like tax payments, create additional pressures on business. Thus they are discussed here as a part of Ukraine's tax policy.

In pension and social security, Government policy has been aimed at raising the level of social protection. The burden of such an improvement is being carried mainly by business.

The main event during December 2002–December 2003 was the 9 July 2003 adoption of the Law on mandatory basic state pension insurance. Entering into effect on 1 January 2004, the Law provides for:

- extending the application of pension legislation, particularly mandatory contributions to the Pension Fund, to flat tax payers;

- the annual setting of insurance rates by the Verkhovna Rada. Suggestions for insurance rates will be introduced to the legislature by the Cabinet, together with the draft State Budget for the following year. This kind of system makes it almost impossible to plan out business activities for subsequent years. Business owners will have to get used to the fact that the rules of the game change only at the turn a new year—or even after it has already begun.

At the same time, there were some attempts in 2003 to adopt the Law on the mandatory basic state social medical insurance. This bill was prepared for third reading in late 2003 and its final adoption should happen very soon. Such expectations are substantiated by the fact that fees for medical insurance were already included in the Law on personal income tax adopted in 2003.

Thus, businesses can expect that a new fund for mandatory basic state social insurance to be set up in 2004. The insurance rate paid into this fund will be annually approved by the Verkhovna Rada. It should amount to about 5% of payroll.

In the opinion of ICPS specialists, the current system of social insurance is far too burdensome and hampers economic development. The huge administrative costs of these funds reduce their efficiency while at the same time increasing unproductive business expenditures.

The solution to this problem lies in the adoption of the Law on a consolidated social fee. This bill was registered with the Verkhovna Rada on 26 June 2003. The draft envisaged introduction a consolidated insurance fee, which would include all social fees currently levied on taxpayers. The shortcoming of this

bill was that it did not eliminate the existing social funds, which means that, to a certain extent, unproductive costs will continue to plague businesses.

Tax procedures

On 20 February 2003, the Verkhovna Rada adopted the Law amending the Law on the procedure for paying taxpayer liabilities to budgets and special state funds. The aim of the Law was to correct flaws in the tax administration system that emerged because of inconsistencies and contradictions among different pieces of legislation.

In order to achieve this goal:

- the Law on the procedure for paying taxpayer liabilities to budgets and special state funds has been expanded to apply to contributions to mandatory state pension insurance and basic state social insurance. Thus, the procedural system for taxes and contributions has been reduced a common denominator;

- the procedure for submitting tax declarations has been regulated. In particular, the law obliged the relevant body to accept tax returns without prior review and provided taxpayers with the option of delivering such tax returns by registered mail. This should help curtail abuses during the delivery of tax returns. Specifically, tax bodies lose the right to refuse tax returns that reflect a loss;

- the Law clarified the procedure for applying penalties, increasing, at the same time, threshold rates for certain penalties;

- the Law determined that the decisions of fee-collecting bodies, including tax offices, will constitute mandatory orders. Thus, tax bodies can now seize taxpayer assets without a court order;

- the concept of "conflict of interests," which shall be interpreted in favor of the taxpayer where it can be interpreted several ways under current legislation, has been extended to all legal relations in taxation.[19]

On the whole, the changes introduced during 2003 have made the tax administration system more transparent and efficient. Still, the risk remains that "indirect methods" of determining tax liabilities will continue to be applied.

In conclusion, Ukraine's tax reforms demonstrate the lack of a unified approach, and the cancellation of tax breaks has turned out much more complicated than just lowering of tax rates.

Improving the effectiveness of reform will be hampered, first of all, by lack of incentives for legalizing the shadow economy. Tax pressure on the economy will not be significantly reduced. According to ICPS, the share of redistribution through the 2003 State Budget reached 28% of GDP. ICPS forecasts are for this share to slip to 27% of GDP in 2004, then rise slightly to 27.5% of GDP in 2005.[20]

[19] So far, this concept has applied only to the settlement of appeals, which made it of little use to businesses.

[20] See ***quarterly predictions*** for Q4'03, p. 16.

Opening up the economy

During December 2002–December 2003, no significant steps were taken to bring Ukrainian legislation into line with WTO and EU requirements. The key unresolved issues remain: reimbursing exporters for the VAT, the operation of special economic zones (SEZ) and priority development areas (PDA), the protection of intellectual property rights, the adaptation of health and sanitary norms, and the removal of technical barriers to trade. Accelerating the adaptation of Ukrainian laws to international standards is a necessary condition for foreign trade to develop in the next few years

Openness in trade

Legislative reforms to accede to the WTO

Ukraine's progress in acceding to the WTO showed perceptible progress during December 2002—December 2003. The country signed bilateral agreements on access to markets of goods and services with a number of countries, particularly with the European Union.[21] The European Union and the US are the most influential members of the WTO, so the fact that Ukraine signed such agreements with the EU serves as a signal that the accession process is being accelerated. Key issues remaining unsolved in negotiations with the US are taxation issues, the operation of SEZs, intellectual property rights, health and sanitary norms, and technical barriers in trade.

The ban on chicken imports from the US, which so far was the most prickly, has been settled: Ukraine introduced veterinary certification for each shipment of chicken from the US.[22] Ukraine also introduced a special moratorium on setting up new and expanding existing SEZs, technological parks and special investment regimes on new territories during 2004.[23] According to the 2004 State Budget Law, outstanding VAT arrears as of 1 November 2003 and not compensated prior 1 January 2004 will be settled in the form of domestic government bonds with a five-year maturity. However, so far no measures have been taken to ensure that such arrears do not continue to accumulate in the future. In addition, an oversight system needs to be developed to help stem illegal compensation of VAT at the least possible cost to the business environment.

At the end of October, Ukraine agreed to limit subsidies to the agricultural sector to US $1.376bn. However, the issue of protecting the farm sector is not been completely resolved yet, since some items related to specific commodities—however minor they may be—still need to be negotiated at the bilateral level.

One positive moment in the harmonization of national legislation was the fact that the

[21] As of 1 January 2004, Ukraine had signed 20 bilateral agreements on access to goods and services markets.

[22] See the 30 April 2003 State Customs Service Directive "On chicken imports from the US to Ukraine."

[23] The 2004 State Budget Law dated 27 November 2003.

President signed decrees aimed at accelerating accession to the WTO. Specifically, the Government was given 60 days to develop and submit to the Verkhovna Rada a bill cancelling the Law on stimulating automobile production in Ukraine and other legislation related to the state support of the car-making industry in Ukraine, which do not conform with GATT/WTO[24] standards and principles. The President also ordered that the issue of mechanisms of state support to different branches and the approval of business investment programs based on tax, customs and other exemptions according to procedures that do not comply with WTO agreements[25] be held off until a legislative solution was found. In addition, the Government developed a bill on development the car industry in Ukraine, which set as a goal bringing national legislation in line with GATT/WTO requirements and with the Partnership and Cooperation Agreement between Ukraine and the European Union. The draft includes raising import duty and simultaneous elimination of the breaks granted to the car industry by the Law on stimulating automobile production in Ukraine. However, the bill introduces new breaks, particularly on the clearance of import duty.

In addition, the bill removed a restriction that said individuals who were held criminally or civilly responsibility could be represented only by a lawyer who was a Ukrainian citizen. As a result, access to legal services markets in Ukraine should satisfy WTO member-countries.

Adoption of the 20 November 2003 Law amending Art. 16 of the Law on foreign economic activity determined the procedure for automatic and non-automatic licensing and specified the conditions for applying licensing to foreign trade transactions in accordance with WTO requirements.

Despite some positive steps, from December 2002 to December 2003, Ukrainian legislation was being brought to conformity with WTO norms at an extremely slow pace. To accede to the WTO Ukraine still needs to:

- ensure the VAT refund process for exporters and in particular prevent future accumulations of unrefunded VAT;
- ensure a national program for car-making and SEZs;
- cancel discriminatory protectionism in the steel industry;
- conform technical barriers such as standardization rules, certification, and health and sanitary inspections with WTO requirements;
- liberalize the financial services market.

The inability of the Verkhovna Rada and the Government to quickly adopt the necessary legislation will likely mean that Ukraine not be able to accede to the WTO before 2005.

Adapting to EU norms

After EU expansion in 2004, gaining market economy from the EU will become particularly urgent because it will help Ukraine to more effectively protect itself

[24] The Presidential Decree invalidating the 17 September 2003 Cabinet Resolution #1473 was caused by the Cabinet's adoption of this Resolution, which approved the Investment Program for production of trucks and buses by VAT Lutsk Automobile Plant [LuAZ]. According to this Program, VAT LuAZ is granted exemptions that run contrary to the WTO requirements. The adoption of such a resolution once again reveals the lack of consistency in Government actions ostensibly aimed at bringing Ukrainian legislation in line with WTO requirements.

[25] The 18 November 2003 Presidential Decree on measures related to Ukraine's accession to the World Trade Organization.

in trade disputes.[26] But gaining market economy status means the country's legislation must conform to EU requirements.

On 27 November 2003, the Verkhovna Rada passed second reading of a bill on an All-state program to adapt Ukrainian legislation to European Union legislation. The Law is based on the Concept of the All-State Program for Adapting Ukrainian Legis-lation to European Union Legislation.[27] The Bill determines stages for adaptng the legislation and defines aim and tasks for the first stage of the Program. In addition, it sets out priority areas for adapting legislation according to Art. 51 of the Partnership and Cooperation Agreement between Ukraine and the European Union, and determines the sequence in which legislation should be adapted in these spheres. The Program includes a fairly well-developed mechanism for adapting national legislation and calls for elaborating and approving, jointly with the EU, a mechanism for putting together of an adaptation timetable and for monitoring its carrying out. However, the Bill lacks provisions for monitoring the Program's implementation.

In 2003, the Government set up an Interagency Commission to monitor the implementation of the requirements of EU directives in Ukraine and the harmonization of standards and health, sanitary, environmental, veterinary norms with international and European requirements regarding farm products and goods.[28] The Commission is a consultative body under the Cabinet of Ministers, set up for the period while these issues are regulated by law. However, the Commission did not issue a single memorandum regarding any decisions during 2003.

The level of Government financing also remains insufficient for programs involving the adaptation of legislative. In other words, declarations of intent as to moving towards the harmonization of the Ukrainian legal system to that of the European Union do not much match the real steps the country is taking in this direction.

A number of urgent issues remain unresolved:

- the actions being taken by different executive bodies in adapting legislation do not match;
- there is no mechanism for the Verkhovna Rada to ensure conformity to WTO rules and standards in Ukrainian legislation and draft laws that are being presented to the legislature for consideration;
- an ineffective mechanism for avoiding decisions that conflict with WTO requirements and the provisions of EU legislation.

Protection of intellectual property rights

One of the problems impeding Ukraine's closer integration into the world economy,

[26] For more on the implications of EU enlargement for the Ukrainian economy, see ***quarterly predictions*** for Q4'03, p. 32–34.

[27] Approved by the 21 November 2002 Law on a Concept for an All-state program for adapting of Ukrainian legislation to European Union legislation.

[28] The 26 April 2003 Cabinet Resolution establishing an Interagency Commission to monitoring the implementation of the requirements of the European Union directives and harmonizing standards and sanitary, ecological, veterinary, health norms to international and European standards for agricultural products and goods.

according to the opinion of experts at international organizations, is the insufficient protection of intellectual property rights (IPR). Given this, the Verkhovna Rada continues to adopt laws directed at combatting violations of IPR.

The 22 May 2003 Law amending certain legislative acts regarding the protection of IPR resulted in a number of changes:

- articles on preventive measures were added the Civil and Commercial Procedural Codes;

- the Criminal Code now includes stronger penalties for violations of copyright and related rights, rights to inventions, applications, industrial models, the schemes of integrated circuits, plant varieties, and labor-saving innovations, and for the illegal use of goods and services trademarks, brand names and authorized origin of goods marks. Specifically, the size of the fine has been increased and sentencing to prison been introduced as a form of punishment;

- provisions of the Criminal Procedural Code and the Law on the protection of rights to goods and services trademarks and others have been made more clear. Particular attention has been paid to the verification of applications for certificates of rights to the ownership of goods and services trademarks, the right to register schemes of integrated circuits, and for the patent to an invention.

Customs procedures

With a few exceptions,[29] the Customs Code came into effect on 1 January 2004. The Code no longer contains some articles in the 17 May 2001 editions. However, a number of articles, including one on the procedure for collecting customs duties, will be eliminated on 1 January 2005. This is connected mainly to the risk of reduced Budget revenues due to tax reform in 2004.

An insignificant number of by-laws to the Customs Code, adopted during December 2002—December 2003, reveals ineffectiveness of the way the Customs Code is being introduced in Ukraine. A large number of customs procedures still lacks proper regulation, making it evident that little has been accomplished in terms of establishing a more open economy.

The Commercial Code

The Foreign Economic Activity section of the Commercial Code is based on the principles laid out in the Customs Code, the Laws on foreign economic activity, on a unified customs tariff, on a foreign investment regime and other laws and international agreements. This particular section will not have much of an impact on the level of openness of the Ukrainian economy, since it contains nothing that contradicts these laws.

Still, it should be noted that the Special Business Regimes Section of the Commercial Code provides the opportunity for setting up new special/free economic zones that:

- fails to meet the requirement to cancel privileged tax regimes, particularly within the framework of accession to the WTO;

- contradicts the ban on setting up SEZ in 2004 that was written into the 2004 State Budget Law.

[29] See Art. 82 of the 2004 State Budget Law of 27 November 2003.

Free movement of capital

The National Bank of Ukraine has banned the purchase of foreign currency on the interbank currency market by both banks and non-banking financial institutions under agreements or contracts between residents and non-residents for the purchase-sale of securities from the Ukrainian issuers without an individual license issued by the NBU.[30] This step was taken for three reasons:

- to improve the import and export of capital;
- to reflect a 20 December 2002 decision of the Financial Action Task Force (FATF), an international body for combatting worldwide money-laundering, that led to some countries introducing sanctions against Ukraine by partly restricting payment settlements;
- to include the appropriate requirements of banks of FATF members regarding the transparency of transactions performed by Ukrainian banks.

This NBU resolution made it possible to stop capital flight concealed under reverse buyouts. Still, this kind of restriction on the free movement of capital conflicts, among others, with WTO requirements. These restrictions will likely be removed during negotiations on accession to the WTO.

[30] See the 29 January 2003 Resolution of the NBU Board on transactions with securities from Ukrainian issuers.

Judiciary reform

Over the period of this study, reforms in Ukraine's judiciary witnessed no substantial activity. The lesser reform launched in 2001 failed to give the necessary push to across-the-board changes to the judiciary system that might bring Ukrainian court procedures to the level of Council of Europe standards

The problems judiciary reform must tackle

In recent years, public trust in Ukraine's judiciary has grown considerably. This is confirmed by rapid growth in the number of cases currently under review in courts with a broad jurisdiction, up from 1.5mn in 2000 to more than 4mn cases in 2002. Yet, the growing workload in the country's courts is aggravating old legal proceedings problems and stimulating new ones in Ukraine. Among them are:

- **The low level of independence and impartiality in the judiciary**. The causes behind this situation are the lack of an effective mechanism to avoid administrative pressure over courts, insufficient financing and support, and the ineffective and opaque approaches to the appointment of judges.

- **The poor quality of the operation of the court system**. At this time, nearly one case in five comes to court in violation of procedural deadlines. The effectiveness of of the courts is hampered by understaffed courts, on one hand, and by outdated and ambiguous procedural rules that do not contribute to the quick settlement of cases, on the other.

- **Many issues related to the operation of the court system and the protection of individual rights in the courts remain unregulated**. Specifically, the Verkhovna Rada has failed to regulate the issue of free legal aid to individuals, the operation and use of the institute of jurors and sworn witnesses, and issues of civil proceedings.

The Government is busy putting out economic and political fires and paid little attention to resolving these issues in 2003. Those events that did take place were ripples of the lesser judicial reform.

Changes in the judicial system

During the study period, the court system continued to take shape. Presidential decrees established a number of new commercial courts of appeal. On 11 December 2003 the Verkhovna Rada adopted a Resolution on the appointment of judges to the High Civil Court. This step indicates that there has been some progress in administrative court reforms.

At the same time, the court system has suffered certain losses. On 16 December 2003, the Constitutional Court published a decision that setting up a court of appeal in the system of courts of general jurisdiction was in violation of the Constitution. The different branches of power and government and non-government organizations saw this decision of the Constitutional Court differently, which reveals the extent to which there is a lack of clear vision as to the development of the judiciary in Ukraine. Since the Constitutional Court made this decision, the right of citi-

zens to appeal will continue to be handled only by the higher specialized courts and the Supreme Court.

The courts are now busy hiring personnel. Although the President issued about 30 decrees dedicated to appointing judges, the process is still moving forward at a sluggish pace. In Q1'03, nearly 21% of judges' postings remained vacant. As a result, a huge workload has fallen upon available judges—about 100 cases a month—, which is having a terrible impact on the timeliness and quality of court proceedings.

On the one hand, the current regime seems to want to reject lifetime appointments of judges. Some proposals are to elect judges a maximum of ten years. In the opinion of ICPS specialists, such a step will reduce the independence of judges, since any Administration will have the opportunity to influence them through the selection process.

In September 2003, the Verkhovna Rada registered a bill amending the Law on the High Council of Justice. This Law is needed for two main reasons:

- inconsistencies between the Law on the High Council of Justice and the text of the Law on the judicial system that was amended during the lesser judicial reform;
- the recognition by the Constitutional Court that a number of provisions of the Law on the High Council of Justice violate the Constitution, such as provisions that allow a Deputy and the Verkhovna Rada's Commissioner for Human Rights to turn to the Highest Council of Justice with a proposal to accept a motion to dismiss judges.

In addition, the bill also calls for the organization of legal inspections under the Higher Council of Justice to examine complaints about judges who violate their oath of office and to improve the approach to dismissing judges.

The dependence of judges on the Administration remains a serious problem. Of the 20 members of the Higher Council of Justice, which has the power to set in motion the dismissal of a judge, only four are representatives of the judiciary. The rest are from the two other branches of power and the public, although most European countries give the advantage to representatives of the judiciary. The bill amending the Law on the Higher Council of Justice that was submitted to the Verkhovna Rada makes no effort to address this problem.

Ensuring the operation of the court system

On 3 March 2003, the President issued a decree that approved a Provision on the State Judiciary Administration that determines the powers and duties of this institution, as well as its rights and its organization. At this point, the Ministry of Justice completely withdrew from the organization of court activities. Now the State Judiciary Administration handles these issues.

One positive feature in the activity of this institution is the fact that it does not combine regulatory and administrative functions. Thus, the Decree has eliminated possible conflicts of interest.

One negative point is that, according to the Provision, activity of the State Judicial Administration is guided and coordinated by the Cabinet of Ministers. This kind of subordination creates opportunities for administrative pressure over this institution, which is ultimately likely to affect the independence of Ukrainian courts. In addition, Ukrainian legislation does not clearly specify mechanisms for the State Judicial

Administration to operate, report and be held accountable. This affects the transparency of the judiciary and, thus, overall trust in it.

On 16 June 2003, the Cabinet of Ministers issued a resolution approving the State Program for organizing court activity in 2003–2005. In this Program, the Government declared carrying out judicial reform that includes entrenching an independent judicial branch of power a strategic task of state-building in Ukraine.

In addition, the Program states that the Constitution shall provide the key state policy guidelines in carrying out this reform. However, references to the Constitution, which only establishes basic principles of functioning for the entire judiciary, underscores the fact that the current Government is unable to clearly define its policy with respect to judicial reform in Ukraine.

Among its main tasks for 2003–2005, the Government established:

- setting up the proper organizational, financial, physical conditions for the activity of the courts, judges and judicial bodies;
- establishing an integrated system for staffing the judicial system, training highly qualified court personnel and reserves;
- ensuring the necessary informational, normative, legal, and research support systems for the operation of the court system, keeping in mind the eventual introduction of international legal provisions;
- forming and entrenching the civil court system, whose main function will be protecting individuals' rights, against violations through the action or inaction of officials in state and local government bodies.

A large number of actions are scheduled for the implementation of the Program, including the development of numberless instructions, methodical recommendations and procedures. Yet, only a small number of activities in the Program address one of the most urgent problems: how to support court activity logistically. In other words, there is little hope of improvement in the matter of financing the judicial branch next year.

Changes in procedural legislation

Just as before, the Government has not been paying enough attention to inadequate procedural legislation, though according to the Presidium of the Supreme Court, the flawed order for submitting and considering appeals and reversals provided for by current legislation, causes problems with the administration of justice. Yet, the State Program for the organization of court activity in 2003–2005 does not include a requirement to develop amendments to legislative acts that would improve the appeal and reversal process. It only anticipates developing technical and practical recommendations for the organization of appeal and cassation proceedings.

Given this, it is no wonder that during this year only a few laws were aimed at regulation of these issues. In particular, the 15 May 2003 Law introduced amendments to the Commercial Code allowing cassation appeals to go to the Supreme Court. In addition, it:

- allows rulings of the High Commercial Court to be appealed, so businesses will be able to exercise the right to appeal in cases when the High Commercial Court

refuses to consider cassation applications;

- stipulates that the question of whether to launch proceedings involving the Supreme Court and the revision of resolutions or rulings by the High Commercial Court should be solved favorably with the consent of at least one judge. Given that, until now, initiating such proceedings required the consent of five judges, the chances that business cases will be heard in the Supreme Court have grown considerably.

The 5 June 2003 Law presents Section 31-A of the Civil Procedural Code, which is dedicated to appeals of decisions, actions or inactions on the part of state bodies, local governments, officials and civil servants, in a new edition. These amendments are aiming at making a more effective and transparent mechanism for considering civil cases. However, this Law resolves with only one insignificant part of the problems related to the administrative side of the delivery of justice. The problem of adopting the Civil Procedural Code, the key document for the use of civil courts set up during the minor judicial reform, has become very urgent.

Changes in executive enforcement

Understanding that confidence in the judiciary is impossible when court decisions are not carried out, the Government has tried to improve the effectiveness of the enforcement process. On 10 July 2003, the Verkhovna Rada adopted the Law on amending the Laws on the state execution service and on the enforcement of execution, which had been prepared by the Cabinet.

The Law extended the rights of state enforcers, clarified the procedure for implementing separate procedures during the enforcement of execution, and so on. All these measures should improve the effectiveness of mechanism for enforcing court decisions.

However, no attention has been paid to the enforcement of court decisions involving the sale of the assets of state-owned enterprises. In 2001, the Verkhovna Rada introduced a moratorium on the forced sale of assets of state-owned enterprises and business associations in whose statutory funds the state has at least a 25% stake. Having set up this obstacle for "shadow" privatization, lawmakers did not bother to set up the mechanism for enforcing court decisions involving state enterprises. So these decisions often remain unenforceable, and this undermines the authority of Ukraine's judicial branch.

Unresolved problems and possible solutions

The majority of problems within Ukraine's judicial system remain unresolved. Still lacking are:

- a mechanism for ensuring the independence of courts;
- bringing procedural legislation in line with contemporary needs.

One effective way of solving these issues could be the adoption of a Major Judicial Code to:

- determine a system for the selection and appointment of judges;
- regulate organizational aspects of court activities;
- consolidate the process of administering justice during civil, commercial and administrative cases;
- establish instruments to ensure the competitiveness and equality of the sides, the right to fair consideration of disputes within reasonable time limits, and so on.

Preserving competition

The legislation to protect commercial competition has not seen any substantial changes, other than ongoing work to complete it. New legislation strengthens the administrative power of the Anti-Monopoly Committee (AMC) and its bodies through oversight of business activities. Greater hazards in regulation to protect commercial competition have now appeared because of discrepancies that have been created between norms in the Commercial Code, which came into effect on 1 January 2004, and special laws to protect commercial competition

Strengthening the Anti-Monopoly Committee

Having adopted the Law amending some laws related to the protection of commercial competition on 20 November 2003, the Verkhovna Rada finally brought the powers and the organization of the activities of Anti-Monopoly Committee bodies in line with the 11 January 2001 Law on protecting commercial competition.

At the same time, the adoption of this Law is more proof of the tendency to strengthen the role and influence of the AMC and its agencies in the regulation of business activity. In particular, the AMC has obtained the right to apply to the Ministry of Economy and European Integration to impose special sanctions on subjects of foreign economic activity and the right to request that banks provide information that includes bank secrets. In addition, the rights of authorized officials and heads of the territorial departments of the AMC, especially the right to inspect business entities, their premises and vehicles, the right to unencumbered access to premises while carrying out inspections, and the right to request that businesses provide restricted information and the right to prepare a charge-sheet of civil violations have been extended to officials of the AMC itself and its territorial offices.

Confirming this tendency to reinforce the role of the AMC role, on 26 August 2003 the Committee issued Instruction amending a 25 December 2001 AMC Instruction #182-r. This ruling extends the list of reasons for carrying out random inspections regarding compliance with the Law protecting commercial competition. This now includes situations where there is documentary evidence of monopolization on a commodity market or anti-competitive collusion, provided that this information was obtained by the Committee's agents while carrying out their duties in accordance with the law. The appearance of this new basis for random inspections in addition to the many existing reasons can only reinforce the administrative influence of the AMC on business.

Permitting control or consolidation

During the period of this study, the procedure for the Cabinet to provide permission to control or concentrate business activities was normalized when the Anti-Monopoly Committee and MEEI jointly approved a procedure for the establishment and operation of a Commission to evaluate the positive and negative impact of actions to control and concentrate business activities and a procedure for overseeing the enactment of Cabinet decisions regarding the provision of permission for coordinating or con-

centrating the activities of business entities.[31]

The Commission to evaluate the positive and negative impact of actions to control and concentrate business activities is an interim agency, set up by MEEI with a number of independent experts on an ad hoc basis when a joint application from the participants of such control or concentration for the relevant permission comes to the Cabinet of Ministers. The task of the Commission is to prepare estimations of the impact of such coordinated or concentrated activity and to determine whether or not the Cabinet should grant or deny permission on the basis of these conclusions. The Commission is set up on a competitive basis using clearly-defined core and other criteria. However, there are some risks that could affect the effectiveness of the Commission's activity:

- firstly, the deadline from the date an application is received until the date the Commission convenes is too long: 43 days with the possibility of an extension;

- secondly, there are no guarantees that the Commission's activity will produce results or that delays can be avoided. Instead it is stated that, should the Commission fail to make any decision to approve or deny the application during the course of six months (the final term for action), a decision shall be made to dismiss this Commission and set up a new one, which can only result in further delays in the process of issuing permission.

The procedure for overseeing the implementation of the Cabinet decisions to provide permission for the control or concentration of business activities[32] introduces several forms of oversight: observing the situation on commodity markets and the activity of business entities who have been given such permission; scheduled and random field inspection; and requesting large volumes of information and reports from those business entities granted permission. On the one hand, this should contribute to getting objective information on the impact of issuing permission by the Cabinet. On the other hand, this could lead to the duplication of a variety of forms of oversight and information-gathering.

Impact of the Commercial Code on commercial competition

The Commercial Code, adopted on 16 January 2003, came into effect 1 January 2004. Chapter 3 of Sect. I of the Code The Restriction of Monopolies and the Protection of Business Entities and Consumers from Unfair Competition" is mainly oriented towards the norms established in the 18 February 1992 Law restricting monopolies and preventing unfair competition in entrepreneurial activity, which is no longer valid, rather than those in the Law that replaced it on 11 January 2001, on protecting commercial competition. In particular:

- the definition of the basic anti-monopolist concept of abuse of monopoly position on the market that is in the Code is outdated;

- the Commercial Code uses the concept discrimination against business entities by state bodies and unlawful agree-

[31] A 24 April 2003 MEEI Decree, a 11 February 2003 AMC Instruction on approving the a Commission to evaluate the positive and negative impact of actions to control and concentrate business activities, a 29 August 2003 AMC Instruction, a 16 September 2003 MEEI Decree approving the procedure for overseeing the implementation of Cabinet decisions related to regarding the provision of permission for coordinating or concentrating the activities of business entities.

[32] Approved by the 29 August 2003 AMC Instruction and the 16 September 2003 MEEI Instruction.

ments, although, for example, the concept unlawful agreements and its definition had already been replaced with the concept anti-competitive coordinated activities already in March 1998!

- Chapter 3 of Sec. I of the Commercial Code excludes from regulation relations among participants the results of whose activities are only evident outside Ukraine, unless otherwise anticipated by ratified international agreements, although current anti-monopoly and competition legislation does not include this restriction.

In addition, the Commercial Code violates the principle of equality of approach and permits the legislation of exceptions in implementing anti-monopoly and competition policy in the state and communal sectors. On the whole, the provisions of the Commercial Code regarding the protection of commercial competition are a step backward in the regulation of competitive policy. They should be brought in line with current legislation on protection of competition.[33]

Meanwhile, it can be hoped that in 2004 work on the draft Competition Procedural Code will speed up, as the concept was approved by Cabinet resolution back on 18 March 2002. The draft of this Code is supposed to be submitted to the Cabinet by 1 January 2005. Based on its concept and the principles for procedural legislation, the Code must include detailed descriptions of the proper order of legal proceedings in applications for and determinations of the granting of permission to control and concentrate business activities and involving the violation of legal requirements to maintain competition. Presumably, the draft Competition Procedural Code, like current legislation to protect competition, should correct the already perceptible imbalance between rights and obligations of AMC bodies and business entities.

[33] On 27 November 2003, the Cabinet submitted to the Verkhovna Rada a bill amending the Commercial Code, which proposes removing the majority of the provisions that are specifically related to protecting competition and protecting against unfair competition.

Financial sector

Between December 2002 and December 2003, the Government continued to actively combat money-laundering. Nearly half of the by-laws in the financial sector dealt with this issue. At the same time, with the adoption of the Laws on mortgage, on mortgage lending, consolidated mortgage debt and mortgage certificates, on non-state pension security, the stock market gained a large number of new tools. Thus, the next few years could mark a milestone, with the Ukrainian stock market developing at a rapid pace. In 2003, the Verkhovna Rada finally established the legislative basis for electronic document flow, which provides the foundation for intensive development of e-commerce, particularly in the financial sector

Regulations

Changes in banking activity

During the research period, the legislation to regulate banking activity did not change much. The new Civil and Commercial Codes include separate sections dedicated to operation of the banking sector. However, the provisions of these Codes are effectively simply repeating provisions of the effective laws. Therefore, the coming into effect of these two Codes in January 2004 will not lead to any significant changes in the activity of Ukraine's commercial banks.

More significant changes were instituted in by-laws that set norms and regulate banking activity.

To ensure the conditions for long-term lending (refinancing) of domestic banks, the National Bank passed an Interim Provision on the procedure for NBU lending to (re-financing) banks that provide such loans.[34] This Provision allows for banks to obtain loans for re-financing for a period of up to three years at the NBU discount rate.[35]

The new refinancing mechanism so far is not working to full capacity. By the end of Q3, refinancing of investment projects amounted to only about UAH 600mn, out of a total of UAH 6.5bn over January–July.[36]

The new regulation shows that mechanisms for refinancing banks are being activated, creating conditions for financially replenishing Ukraine's growing economy with cash. However, there are risks that these mechanisms will be applied to provide sector-specific refinancing, based on mostly political decisions.

To prevent the growth of inflation and the greater de-dollarization of the economy, the NBU managed to toughen requirements for reserves. In particular, this was the objective of an 18 June 2003 NBU Board Resolution.

[34] See the 12 February 2003 NBU Board Resolution approving the Interim Provision on the procedure for long-term re-financing (support of liquidity) of banks by the Bank.

[35] 7% pa at the end of 2003.

[36] See ***quarterly predictions*** for Q3'03.

Changes to non-banking financial acivity

In June 2003, substantial changes were made to the procedure for issuing licenses to non-banking institutions for specific banking transactions.[37] Among the mandatory conditions for obtaining such licenses are:

- regulatory capital in the amount of at least EUR 1mn, appropriate premises and working conditions;
- no fines from the State Commission for Regulating Financial Services Markets for at leasts six month prior to the date of filing the application for this license;
- unimpeachable reputation and appropriate qualifications on the part of managers of a non-banking financial institution.

The State Commission for Regulating Financial Services Markets

On 4 April 2003, the President issued a Decree approving the Provision on the State Commission for Regulating Financial Services Markets (SCRFSM), which finally made it possible for this institution to work full-bore. Yet the issuing of licenses began only in July 2003. As was predicted, the launch of operations in this Commission took more than six months.[38] During this period, a noticeable slowdown in the operations of non-banking financial institutions could be seen.

The Commission's efforts were largely aimed at regulating procedural issues related to the activity of financial institutions and also at issuing licenses:

- on 17 September 2003, the Commission issued a Decree approving a Provision on the levers of influence of the SCRFSM. These measures are to be applied to financial institutions and other business entities who have the right under law to provide financial services but whose actions or inactions are in violation of the law;
- the Commission approved rules for inspections by the Commission;[39]
- a number of steps were taken to regulate the activity of credit unions. In November 2003, the Provision on the registration of credit unions[40] was finally approved. Hopefully, the development of credit unions will pick up speed in 2004.

In addition, the Commission has become actively involved in combating money-laundering.

The stock market

In order to protect the rights of securities owners, the Verkhovna Rada adopted amendments to the Law on the National Depository System and the features of electronic circulation of securities on 22 May 2003. These amendments:

[37] See the 18 June 2003 NBU Board Resolution approving amendments to the Provision on the procedure for issuing licenses to non-banking institutions for specific banking transactions.

[38] See ***policy studies*** #19.

[39] The 28 October 2003 Resolution of the State Commission for Regulating Financial Services Markets.

[40] The 11 November 2003 Resolution of the State Commission for Regulating Financial Services Markets.

- establish a prohibition for a registrar and its participants to directly or indirectly own shares of an issuer whose register of ownership is with them;

- stipulate a prohibition for issuers to directly or indirectly be founders or participants of a registrar in charge of the register of ownership of their securities.

These amendments as clearly positive. In the opinion of ICPS specialists, they will help strengthen the independence of securities registrars from issuers of securities.

During the research period, there was increased oversight over participants on the stock exchange:

- in April 2003, the State Commission for Securities and the Stock Market approved a Procedure for overseeing adherence to the licensing conditions for professional activity on the stock market;[41]

- to prevent money-laundering, the Commission approved rules for inspecting the activity of joint investment institutes, stock exchanges and other professional participants in the securities market in terms of adherence to requirements of current legislation on the prevention and counteraction of money-laundering and the financing of terrorism.

Through amendments, the Commission defined a mechanism for reorganizing investment funds and investment companies into investment funds.[42]

New tools of the stock market

Ukraine's stock market continues to be very much underdeveloped. However, during the period of study, legislation in this area saw substantial changes that could have a positive impact on the development of related legislation.

The Law on mortgage lending, transactions with consolidated mortgage debt and mortgage certificates adopted on 19 June 2003 came into effect on 1 January 2004. This law aims to regulate:

- mortgage lending;

- the release and circulation of mortgage certificates as a new type of security.

On 19 June 2003, the Law on lending mechanisms and property management in residential construction and real estate transactions was also adopted and also came into effect on 1 January 2004.

After these Laws came into effect, the securities market saw a new paper, the encumbrance, born. Encumbrances ensure the free circulation of mortgage liabilities on the stock market. The use of this tool also permits a mortgagee to refinance activities by selling encumbrances to a third party with an obligation to reverse purchase by issuing mortgage securities: mortgage bonds and mortgage certificates. Such mortgage securities should become very important for the domestic stock market, since they are secured by the most liquid asset, real estate. On the whole, mortgages and their new financial tools will contribute to the growth of business activity and the development of the financial services markets.

In 2003, factoring, a tool widely used in international practice, was instituted in the Codes. Factoring is considered a commercial instrument, which allows for not only providing the seller credit on the factor, but also concommitant services. Despite some

[41] The 17 April 2003 Decision of the State Commission for Securities and Stock Market.

[42] The 8 July 2003 Decision of the State Commission for Securities and Stock Market.

minor discrepancies between the Codes with respect to the regulation of factoring,[43] the expansion of this instrument will provide an opportunity to substantially reduce the risks exporters experience with the full and timely return of hard currency proceeds from export operations in Ukraine. Indeed, factoring offers the opportunity to carry out an export sale with 100% coverage of the risks.

During the past year, there was a revival of market interest in securities such as bonds. This was caused in part by improvements to norms and regulations on the issue and circulation of bonds. In particular, on 17 July 2003 the State Commission for Securities and Stock Market approved a Provision on the procedure for issuing corporate bonds.

This issue is also raised in the bill on securities and the stock exchange. However, the chances of its being adopted are very slim.

In addition, with the adoption of the Law on investment funds (share and corporate investment funds), the Commission approved a Provision on the procedure for allocating, circulating and buying-out the securities of joint investment institutes.[44] This, again, expands the agglomeration of instruments on the stock market.

Electronic document flow

On 22 May 2003, the Verkhovna Rada simultaneously adopted two laws aimed at setting up the legal basis for e-document flow: the Laws on electronic documents and electronic document flow and on electronic digital signatures.[45]

According to this legislation, state regulation of e-document flow is intended to:

- implement a unified state policy in electronic document flow;
- ensure the rights and legal interests of subjects of e-document flow;
- provide norms and regulations for the technology of processing, generating, transferring, receiving, saving, using, and destroying electronic documents.

Thus, since January 2004, when these Laws came into effect, business entities can register mutual legal relations in electronic form. With some minor exceptions, e-documents will have the same legal power as their hard copy equivalents.

Digital signatures will be introduced to identify the signer and confirm the integrity of e-documents. Digital signatures will be a mandatory requisite for any e-document. To implement the requirements set by the Law on electronic digital signatures, e-signatures shall be equal to the real signature or seal in terms of legal status.

The positive effect here is the fact that the use of e-documents does not entail applying a special procedure for the conclusion of agreements. Such documents will apply

[43] According to the Commercial Code, the factor can only be a bank, while under the new Civil Code, the factor can be a bank, other financial institutions and even an individual who is a private entrepreneur.

[44] See the 9 January 2003 Decision of the State Commission for Securities and Stock Market.

[45] These Laws came into effect in January 2004.

the procedure for signing agreements and other documents, as established in law for exercising authority in writing.

In the opinion of ICPS specialists, the introduction of e-document flow is an important step forward in terms of implementing cutting-edge innovation technologies in business practice, and this will make it possible to:

- establish and widely use various payment systems in Ukraine;
- introduce e-commerce, e-securities;
- simplify and accelerate document flow between businesses.

Combating money laundering

During the period under review, active efforts were taken to develop effective mechanisms for combating the laundering—legalization—of dirty money. To this end, on 6 February 2003, the Verkhovna Rada adopted the Law amending some Laws to prevent the use of banks and other financial institutions for to legalize money gotten through illegal means:

- banks are prohibited from opening and maintaining anonymous accounts. To ensure that all commercial banks carry out this requirement, they have been instructed to close all anonymous and coded accounts of private individuals in both foreign and national currency by 11 July 2003;[46]
- banks shall identify clients who are opening accounts;
- bank shall identify clients who are performing cash transactions worth over UAH 50,000 without opening an account;
- at least once a year, the NBU shall review all banks for their adherence to money-laundering legislation;
- the threshold for transactions that are subject to financial monitoring has been lowered from UAH 300,000 to UAH 80,000;
- norms are introduced to ensure the independence of the authorized body.

To harmonize Ukrainian legislation with the requirements of the Law on preventing and counteracting the legalization (laundering) of illegally gained money, a number of the NBU regulations have been changed:

- on 12 November 2003, a NBU Board Resolution introduced a new version of its Instruction for opening, operating and closing accounts in both the national and foreign currencies, which alters the requirements for documents that must be submitted to banking institutions on opening an account; determines the requirements for banks to identify clients; prohibits opening anonymous accounts, and so on;
- the NBU changed its Provision on the registration and submission of payment orders in foreign currency, of applications for the purchase or sale of foreign

[46] See the 4 June 2003 NBU Board Resolution on the procedure for closing anonymous currency accounts and coded accounts of private individuals (residents and non-residents) in foreign and domestic currency.

currency to authorized banks and other financial institutions, and the procedure for carrying them out.[47] According to the new procedure, if a client does not provide all the necessary documents or does not provide a full set of documents, or if the transaction is subject to financial monitoring, the bank shall return payment orders in foreign currency without execution.

Amendments have also been introduced to the Provision on the procedure for issuing payment cards and performing transactions using them[48] and the Instruction on non-cash settlements in the national currency.[49] All these changes are aimed at solving one main task: to prevent money-laundering.

As of 12 July 2003, legal entities are expected to provide the State Financial Monitoring Department with information in specially approved forms.[50]

Meanwhile, in September 2003, a court ruling declared null and void a 29 May 2002 Cabinet Resolution that set out the criteria for classifying financial transactions as suspect and irregular. To implement this ruling, the Cabinet cancelled its Resolution on 15 October 2003.

In the absence of such criteria, it will be impossible to develop an effective system for financial monitoring, it can be expected that new criteria for classifying financial transactions as suspect or irregular will be developed and approved.

[47] See the 4 June 2003 NBU Board Resolution approving amendments to the Provision on the registration and submission of payment orders in foreign currency, of applications for the purchase or sale of foreign currency to authorized banks and other financial institutions, and the procedure for carrying them out.

[48] See the 4 June 2003 NBU Board Resolution approving amendments to the Provision on the procedure for issuing payment cards and performing transactions using them.

[49] See the 4 June 2003 NBU Board Resolution approving amendments to the Instruction on non-cash settlements in Ukraine in the national currency.

[50] A 13 May 2003 Decree of the State Financial Monitoring Department under the Ministry of Finance.

Ownership and privatization

The big event in the regulation of ownership in 2003 was the adoption of the Civil and the Commercial Codes. The adoption process was politically biased, which has affected the quality of both documents. In 2004, the country was faced with radically reformed civil and commercial legislation that contained fundamental discrepancies in a number of key areas. Moreover, reforming the country's corporate governance and privatization legislation remains a major problem. The Verkhovna Rada failed to adopt the Law on joint stock companies. The absence of this piece of legislation and internal contradictions between the Civil and the Commercial Codes may put under question the further activity of many joint stock companies (ATs). Privatization has become more active than in previous years, despite the fact that the State Privatization Program for 2003–2008 was never adopted. If the legislature does not approve this document soon, privatization could come to a total standstill in 2004

Corporate governance

National legislation so far has not allowed enterprises to take advantage of the corporate form of running a business. The current Law on companies does not meet modern requirements and its shortcomings are leading to considerable litigation with respect to violation of the shareholder rights, including the Govern-ment's. As a result, business development and foreign investment are being hampered.[51]

All in all, little real attention was paid to legislative solutions to corporate governance issues in 2003—just like the previous year. Hardly any changes were made to the 19 September 1991 Law on companies or the 27 March 1991 Law on enterprises in Ukraine.[52]

The situation could well deteriorate in 2004, which started with the of the new Civil and Commercial Codes coming into effect. They actually require the adoption of a separate law to regulate corporate relations but, after some consideration, the Verkhovna Rada rejected both the Government's and the legislature's bills on joint stock companies. According to ICPS specialists, the reasons for this rejection were:

- lack of conformity between the norms of the Civil and the Commercial Codes. For example, the Civil Code envisages only open joint stock companies (VAT), while the Commercial Code allows also closed ones (ZAT). In this situation, any law that was adopted would conflict with legisla-

[51] As noted in the Principles of Corporate Governance approved by the State Commission for Securities and Stock Market, if measures of effective corporate governance are not instituted, such as proper protection of investors' rights, an effective system of governance and oversight, and open and transparent business operations, there is little basis to anticipate investor confidence and inflows of external financing.

[52] This Law became null and void as of 1 January 2004, with the adoption of the Commercial Code.

tion that takes precedence, which would make its practical application impossible;

- resistance from certain FIGs. Lack of openness and transparency in corporate governance legislation suits them as it makes the process of "redistributing" state amd other property easier.[53]

Hopefully, in 2004 reforms to corporate governance legislation will revive. Undoubtedly, Ukraine's FIGs will put considerable effort into protect their property from risks related to the upcoming presidential election. As a result, the Verkhovna Rada will likely end up adopting legislation that reflect special and not state policy on corporate governance.

The preparation of by-laws and regulations went on at a much more active pace during this same period. On 18 January 2003, the Cabinet issued a Decree approving measures on implementing priority directions in the development of corporate governance ATs. The Government determined as priority tasks:

- facilitating the VR's adoption of the Law on joint stock companies;
- facilitating its adoption of the Law on the management of state property;
- improving the system of disclosure of information on activities of ATs;
- developing and approving sectoral and regional programs for the development of corporate governance in ATs.

By the end of 2003, it became absolutely clear that the Government had failed to accomplish the first two tasks and the remaining two are going very slowly. Specifically, in March 2003, the Ministry for Education and Science approved the Program for the Development of Corporate Governance in Education and Science ATs for 2003–2008.[54] Putting this Program into action should ensure the conditions for effective governance and oversight of ATs in education and science and provide an opportunity to unite the interests of shareholders and stakeholders alike.

In early June 2003, the SCSSM approved draft Principles of Corporate Governance,[55] developed to fulfill the 21 March 2002 Presidential Decree on measures for developing corporate governance in ATs. This document establishes that:

1. Raising the competitiveness and efficiency of ATs by ensuring:

- paying proper attention to shareholder interests;
- providing equal influence and balance of interests of participants in corporate relations;
- improving financial transparency;
- introducing rules for rational management and proper oversight.

2. Corporate governance is an important issue for the country because of its impact on the social and economic development of the country through:

- facilitating the development of investment processes, ensuring confidence and improving the trust of investors;

[53] These kinds of processes visibly picked up steam in Ukraine in 2003.

[54] See the 28 March 2003 Decree of the Ministry of Education and Science approving the Program for Corporate Governance Development in ATs in education and science for 2003–2008.

[55] After debate in late 2003, the Principles of Corporate Governance were at the end of 2003.

- improving the efficiency of the use of capital and activities of ATs;

- taking into account the interests of a broad circle of stakeholders, which ensures that ATs will perform to the benefit of the society as a whole and the growth of the national wealth.

These Principles should encourage the institution of new approaches and standards in corporate governance that are closer to world norms. This should, in turn make it possible for foreign investors to have a clearer and deeper understanding of the processes taking place around the assets of ATs.

State property

State property management

As of 1 January 2004—from the moment when the new Civil Code came into effect, Ukraine has actually eliminated such forms of corporate property management as economic jurisdiction, operational management and operational use.[56] That means the country is finally getting rid of key tools support the management of state and communal assets.

This situation might have been rescued by the Law on the management of state property, which the Verkhovna Rada adopted in September 2003. However, it, too, has numerous shortcomings and does not offer any new instruments for state property management. It was little wonder, then, that the President vetoed this Law. At this point, the chances for overturning the presidential veto are almost non-existent. The relevant VR committee agreed with his suggestions and critiques and drafted a resolution to cancel the decision of the Verkhovna Rada to adopt the Law on managing state property.

Thus, in 2004, the management of state property will totally lack in transparency and proper oversight.

Nor can this situation be improved by adopting by-laws. The effectiveness of state property management and use will depend entirely on the political will of the Government and on its desire to ensure openness and transparency in this area. Certain measures are gradually being developed. On 29 October 2003, the approved a Provision on the State Corporate Rights Register.[57] The Provision set out certain goals:

- bringing order to information on state stocks, shares, and stakes in the statutory funds of businesses and other commercial entities;

- ensuring current accounting of such shares, portions, stocks;

- ensuring the proper application of state corporate rights, as well as the openness and transparency of information on state property.

However, there is a risk that the Register's information will be used for a further "shadow" redistribution of state assets.

Privatization

Due to the growing influence of FIGs over the national privatization process, there is a pressing need to develop new approaches to privatization. However, no major steps were

[56] In fact, these forms remain in the Commercial Code but the Civil Code has more supporters and there is little doubt that the provisions of the Civil Code will have precedence over those in the Commercial Code.

[57] See the 29 October 2003 Cabinet Resolution.

taken in privatization legislation during 2003. Minor editorial changes were introduced to the Law on the privatization of state property and the list of objects not subject to privatization was extended by four items.

During the period of this study, a good deal of attention was paid to the effectiveness of state oversight and management of privatization rather than the effectiveness of state regulation. The State Property Fund (SPF) regularly inspected state property buyers in terms of fulfilling the conditions of finalized agreements. In Q3'03 alone, the SPF checked up on the fulfillment of conditions of 1,476 agreements, only 28% of the total number subject to oversight during the year. These inspections revealed that in 196 cases or 13.3%, the conditions were not properly fulfilled. The SPF also focused on applying penalties on buyers who violated the conditions of their purchase and sale contracts, on cancelling such agreements and returning privatization objects into state ownership. As of 1 October 2003, the state had taken back 108 privatized objects and its specialists are working on terminating another 171 purchase and sale agreements and returning those objects into state ownership.

Since 1995, the amount of money invested into Ukrainian enterprises in fulfillment of the conditions of purchase and sale agreements has gone up to UAH 3.6bn, US $499.3mn, DM 2.5mn and EUR 10.8mn. When these amounts are converted to the hryvnia, the total investment amounts to UAH 5.1bn, which is well above the volume anticipated by the conditions written into agreements for this period.

Despite these improvements in SPF activity, there is a serious negative, in that this activity is not being carried out under the State Privatization Program, but on an ad hoc basis.[58] Ukraine's lawmakers returned the Cabinet's State Privatization Program for 2003–2008 for further work in June 2003. The reworked edition was debated in September, but was still not adopted. The draft Program has new privatization priorities, including:

- Provision for the innovational upgrading of enterprises. Under this principle, buyers who promise to invest in renovating and upgrading of outdated capital assets are given the advantage. This has to facilitate increased productivity and the competitiveness of the goods being made.

- Concentration on individual privatizations. The State Privatization Program shows that the Government intends to reject the concept of selling exclusively to industrial investors and exclusively for cash.[59] Instituting these principles of individual privatization could lead the way to the more effective sale of state property. At the same time, there are huge risks that such privatizations will be neither transparent nor open. This can easily be concluded given that the conditions of sale and the content of the purchase and sale agreement in an individual privatization are determined through negotiations with concrete buyers, and not subject to a transparent tender or other competitive mechanism.

- Broadest possible application of the sale of shares of VATs on formal securities markets. This will contribute to the development of the stock market. At the same time, the Program calls for the speediest possible mechanisms for selling residual stakes in VATs. This is risky, again, since it could lead the selling of state shares at depressed prices.

[58] The State Privatization Program for 2000-2002 expired in 2003.

[59] Privatization for cash still remains a Government responsibility.

- Optimization of the structure of state property in manufacturing and maximization of privatization. These principles are needed to reduce the current considerable share of the state sector in the domestic economy to 8–10% within the next decade. On the whole, this aspiration is a positive step in the estimation of ICPS specialists. Reducing the state share in the economy will help speed up the development of market-oriented regulatory instruments.

- Maximum transparency and openness of all privatization procedures. This principle remains entirely declarative. The lack of transparency in the process of individual privatization, the application of qualifying requirements to buyers, and so on, are major obstacles to its actual implementation.

The failure to adopt the State Privatization Program for 2003–2008 is a real risk that could threaten the privatization process in 2004. The Commercial Code states clearly that the privatization of state-owned or communal enterprises is to take place solely within the framework of the State Privatization Program.

In addition, both the Commercial Code and the new Civil Code emphasize that the privatization of state/communal enterprises should be done in accordance with the procedure set forth by law. However, the current Law on the privatization of state property does not specify the procedure for privatizing property that belongs to communities, that is, communal property. Thus, privatization could well be blocked at the local level in 2004.

The new Codes and ownership

On 16 January 2003, the Verkhovna Rada adopted two new Codes: the Civil Code and the Commercial Code, both of which came into effect on 1 January 2004. The Codes regulate major categories of legal relations involved in business activity, including property relations.

The Civil Code

Developed on the basis of market principles of regulating ownership, the Civil Code introduces significant changes to the regulation of legal ownership, contractual relations, and so on. In particular, it introduces:

- new instruments for regulating ownership: legal practice and legal analogy.[60] This will substantially expand opportunities for business and prevent the emergence of legal loopholes in the regulation of new market instruments;

- the principle of freedom of agreement, according to which the parties have the right to freely deviate from the provisions of civil legislation in their contracts and regulate their relations at their own discretion, while adhering to certain restrictions.[61] This means that the Civil Code does not strictly regulate relations, but simply restricts the parties to such relations within certain limitations. This principle should provide owners with greater freedom in terms of managing and using their property;

[60] Legal practice is the rule of behavior that is not established by civil legislation, but is common in a certain area of civil relations. Legal analogy is applied when specific relations are not regulated by legislation, so norms regulating similar relations are applied.

[61] Parties to agreements cannot deviate from the provisions of civil legislation, if these acts so specify, or if the binding power of the provisions of the civil legislation rises from their nature or the nature of the relations between the parties.

- measures to ensure stability in civil legislation. To do so, the Code clearly defines the regulatory power of legislation. From the moment the Civil Code comes into effect, it becomes impossible to adopt legislation regulating civil relations differently from the Civil Code without actually changing the Code. Thus, the Code is intended to solve one of the key headaches of doing business in Ukraine: constant changes to the rules of the game.

Above all, this new regulation of ownership aims to protect the interests of owners, whether they be legal entities, private individuals, the government, the nation, or communities:

- ownership rights are considered legally acquired, unless other conclusions arise from the law or the acquisition of ownership is ruled illegal by a court of law. Ownership can be acquired by any means not expressly prohibited by the law. This is a much more liberal approach than the current one;

- ownership rights are inviolable. Nobody can be deprived of these rights or be restricted in their application. Forced alienation of the right to ownership of an object (expropriation) may be applied only in exceptional cases, for reasons of the public need on the basis of and according to a procedure set forth in the law and on condition of a prior and full compensation of the object's value;

- ownership of property is considered legal, unless another conclusion arises from the law or is established by a court ruling.

The Civil Code expands and regulates in detail the ways of applying ownership rights. In particular, the Code describes the means for exercising rights to the property of others, such as: the right to own, the right to use (exploitation), the right to use land parcels for agricultural purposes (emphyteusis), and the right to develop land parcels (superficies).

At the same time, the Code has eliminated such anachronisms as collective ownership, but also types of property exploitation like the right of jurisdiction and the right of operational management and operational use. In the opinion of ICPS experts, eliminating of these last seems not to have addressed all the risks. This is effectively the elimination of the main forms of managing state property, which could result in considerable "greying" and even criminalization in this area.

The Commercial Code

The new Commercial Code is one of the few legislative acts that directly defines key guidelines of state policy and aims to institute of this policy. In particular, the Code states that state policy in commerce is divided into long-term (strategic) and current (tactical) and is aimed at fulfilling and optimally agreeing the interests of commercial entities and consumers, different social groups, and the general population.

To implement economic policy, the Government needs to apply a number of commercial regulation methods and mechanisms:

- state procurements, state assignments;
- licenses, permits and quotas;
- certification and standardization;
- application of standards and limits;
- regulation of prices and tariffs;
- taxes and investment, tax and other breaks;
- subsidization, compensation, targeted innovations and subsidies;
- state oversight and supervision.

The Commercial Code has determined the right to property as the key material right in commercial actvity. A business entity that is engaged in a commercial activity on the basis rights of ownership, may own, use and dispose of property belonging to them at their own discretion, individually or jointly with other entities.

A separate section of the Code is dedicated to issues of regulating corporate rights. Corporate rights are viewed as the rights of an entity having a definite share in the statutory fund or assets of a commercial organization. These rights include the power of an entity that has contributed to the statutory fund (assets) of a commercial organization, inlcuding: the right to participate in the management of the organization, to obtain a share of the organization's profits (dividends), the right to a share of its assets in case the company is closed down according to the law, and other powers under law and the organization's statutory documents.

The Commercial Code suggests an approach to ownership regulation that is different from that envisaged by the Civil Code. The legality of ownership of property that is the basis of an entity's commercial activity, includes:

- property/ownership rights;
- the right to commercial jurisdiction;
- the right to operational management;
- the right to operational use.

Commercial activity can also be carried out on the basis of other material rights, such as the right to own, use, and so on, which are envisaged by the Civil Code. On the other hand, the Civil Code does not provide the possibility to use certain material rights mentioned in the Commercial Code. In other words, the simultaneous introduction of the Civil Code and the Commercial Code has considerably increased business risks. There are substantial discrepancies between the two documents and the regulation of the same areas and activities is underpinned with different principles and approaches:

- the terminology in the two Codes differs;
- varying classifications of legal entities. The Civil Code introduces a new one concept: it states that legal entities can be set up in the form of associations, institutions and other forms allowed by law, while the Commercial Code keeps the current classifications;
- the Codes establish different mechanisms for registering legal entities;
- different legal status for enterprises. The Civil Code states that a commercial enterprise is subject to civil rights, while the Commercial Code states that an enterprise is subject to legal rights;
- different approaches to the legal status of property in state-owned enterprises. The Civil Code states that property is assigned to state-owned enterprises under the right of ownership, while the Commercial Code preserves the older concepts of the rights of jurisdiction, operational management, and operational use of property in state-owned enterprises.

Thus, in 2004 companies will face a choice of which Code to given priority to. In many cases, fulfilling provisions of one Code will automatically result in violations of requirements of the other one.

In addition, the Codes are not direct laws. Each of them includes some 1,000 provisions that refer to norms of other current legislation. Worse, the Ministry of Justice and the Cabinet of Ministers did not ensure a timely harmonization of current legislation with requirements of the new

Codes. At the end of 2003, the Ministry of Justice drafted a bill amending current legislation because of the adoption of the Civil Code. However, it is unlikely that the Verkhovna Rada will debate this draft any time soon. As for the Commercial Code, the bill on adjusting current legislation to this Code has not even been submitted to the Verkhovna Rada.

Mortgage

On 5 June 2003, the Verkhovna Rada adopted the Law on mortgages.[62] The Law replaces the outdated provisions of Section II of the Law on pledges, which regulated mortgage relations. The Law should facilitate the solution of a number of issues:

- the flaws in the existing legal base for mortgage regulation and lack of conformity with the international standards;
- lack of transparent and effective instruments that might help revive the real estate market by substantially increasing of lending volumes and terms;
- ill-defined legal regulation of mortgage relations with respect to unfinished construction projects, which actually hampers lending for housing.

These problems are being regulated through systemic changes in mortgage relations:

- the content and subject of mortgages are expanded. Specifically, mortgages can be applied not only to real property, but also the right to lease/use real estate, unfinished construction, and so on;
- the rules for mortgaging parcels of farmland are defined. When transferring land plots under mortgage, the mortgage is applied to any immovable property located on such land parcels and vice versa, the land parcel on which the mortgaged immovables are located shall be part of any mortgage on the property and will also be transferred;
- the concept of encumbrance has been introduced. A debt instrument, the encumbrance is issued in favor of the creditor.

There's no doubt that the adoption of the Law on mortgages is a positive step. As soon as the Law came into effect, it:

- established a transparent mechanism for the application of mortgages as a special means to ensure the fulfillment of liabilities involving real estate;
- introduced new instruments that should promote lending in Ukraine;
- reduced credit risks, which should help cut the costs of borrowing and revive investment activity.

[62] This Law came into effect on 1 January 2004.

Problems

In 2004, the Government will have to solve many outstanding problems in the regulation of property rights:

- there is an urgent need to bring in line provisions of the Civil and the Commercial Codes. One or the other of them needs to be re-done. According to ICPS, this should be the Commercial Code, since it is less progressive than the Civil Code;
- it is necessary to ensure that existing legislation is adapted to the new Codes;
- it is critical to develop a clear state policy on corporate governance and privatization, and to produce the relevant instrument for carrying out this policy.

Sectoral legislation

Land regulation

In 2003, the Verkhovna Rada and the Government actively worked on the regulation of land. They managed to adopt a number of important laws aimed at improving access of commercial entities to land resources. However, as always, in view of the large-scale reforms in land legislation, they did not manage to eliminate contradictions and loopholes. Thus, in 2004 first of all those laws that have been adopted and the Land Code need to be corrected, and some additional laws need to be adopted, without whom the land market will not be able to develop to full capacity

Allocating parcels for sale and permanent use

Having adopted the 11 July 2003 Law amending the Land Code, lawmakers made an attempt to simplify the procedure for allocating land for transfer/buyout in order to place immovable property on it and to reduce the time this process takes. They also aimed at protecting the rights of legal entities that take parcels of land into permanent use. As a result:

- The Law introduces the principle of a "one-stop shop" to approve building sites. From now on, villages, settlements, municipal councils and local administrations have the obligation of submitting requests for site approvals together with the necessary documents that have been filed by a legal entity for consideration by other state bodies. Prior to this, an applicant had to obtain all consents and permits separately.

- The Law has substantially cut the time period for the procedure for approving a building site. The term for preliminary consideration of an application by local councils or administrations has been reduced from 30 days to 5. In addition, the Law establishes time limits for other stages of the process for approving a building site: 14 days for approving the site by authorized bodies and 10 days for the local council or local administration to accept or refuse the building permit.

Using the "one-stop shop" principle should considerably reduce the time applicants spend and simplify the procedure for jurisdiction over a piece of land. Still, the deadlines that have been set did not take into account the nature of the operations of local government bodies. According to the Law on local government, questions involving land regulation are settled exclusively at the regular sessions of these councils, while the convening of a session needs to be announced to deputies and to the general population at least 10 days prior to the session. Only in very exceptional cases can it be done 24 hours prior to the session. It is obvious that such sessions cannot be convened within 5 days of the date of a request being registered. With this in mind, it makes sense to allocate 14 days for authorized bodies to approve a building site.

In addition, the Law amending the Land Code says that executive bodies or local government agencies need to provide legal entities interested in building permits with information about other options for build-

ing their project, compliance with the town's adopted planning documents and land management documents. This new point should raise the level of information provided to land developers about available parcels of land. Of course, it is the job of the Cabinet to determine the procedure for providing this information, as well as the procedure for selecting land for building purposes.

Some amendments were introduced to the procedure for allocating pieces of land for permanent use. Specifically, the Law stipulates that agreements on the development of projects for allocating land should meet the requirements of a standard contract whose has been approved by the Cabinet of Ministers. This could be seen as Government interference in civil and legal relations. The Law also establishes that the decision to refusal the allocation of a parcel of land into permanent use must contain an explanation of the reasons with references to specific provisions of the law, town planning documents, and land management documents. This particular measure should help protect the rights and interests of applicants, should they chose to appeal a rejection of their application for the permanent use of a piece of land.

The changes implemented by the Law amending the Land Code, despite their positive aims, are unbalanced and in practice could actually lead to complications and delays in the relevant processes.

Acquiring rights to land parcels

After the 10 July 2003 adoption of the Law amending Article 82 of the Land Code, joint ventures set up with participation of foreign entities and private individuals gained the right to acquire rights to non-farm land in the same instances as legal entities founded by Ukrainian citizens or legal entities. However they have to apply the procedure established for foreign legal entities.

Since foreign legal entities are substantially limited in the basis for acquiring rights to land, it can be assumed that they will be spurred to set up joint ventures with Ukrainian partners. In addition, the expansion of opportunities for joint ventures to acquire land rights will increase sales revenues to state and local coffers and will stimulate greater competition on the land market. However, the fairly complicated procedure for selling land to foreign legal entities has now been extended to apply to joint ventures. Moreover, joint ventures cannot gain full ownership rights to non-agricultural land, since there is a ban on foreign legal entities gaining ownership rights to farmland. This measure clearly places joint ventures in unequal conditions compared to enterprises set up solely by Ukrainian citizens or legal entities.

On 18 November 2003, the Verkhovna Rada adopted a Cabinet bill amending the Land Code in relation to rights of ownership and rights of use of land. This bill proposed canceling existing restrictions on the acquisition of land parcels by legal entities set up by Ukrainian citizens and legal entities, when the purpose of acquiring ownership rights to land is for business operations. The elimination of this limitation should intensify the acquisition of land by legal entities.

Registration of land rights

The debate on the expediency of consolidating the systems for registering rights to land and to the real property located on them, rights which are closely related, has come to an end. A 17 February 2003 Presidential Decree on measures to establish a unified system for state registration of land, real property and the rights thereto in the State Land Title Registry places responsibility for this registration process on the State Land Resources Committee. The new register will be called the State Land and Property Title Registry.

Thus, the judicial system has lost the function of handling registration of rights to real property. There was clearly a certain inconsistency in defining which body was to perform this function. When the 19 August 2002 Presidential Decree on improving the system for state management of land resources and oversight over their use and protection came into effect, the handling of registration of immovables located on land in the State Land Title Register was given to the State Land Resources Committee at the same time as the handling of the registration of rights to such property was left to the judiciary.

To implement this Decree, the Cabinet approved a Resolution 15 May 2003, on measures to set up a unified system for the state registration of land, real property and title to them within the State Land Title Registry. Accordingly, the State Land Resources Committee has been defined as the keeper of the State Land and Property Title Register, which contains the State Land Title and the State Real Property Title databases. The administrator of the Land Title database is now the State Land Title Registry Center under the State Land Resources Committee, while the administrator of Property Title database is the Information Center, a state enterprise under the Ministry of Justice.

According to the 17 July 2003 Cabinet Resolution on setting up a unified system for state registration of land, real property and title to them within the State Land Registry, this scheme should last until a State Registry of Land and Property Title is set up, which is supposed to be done by 1 January 2005. After this State Registry is set up, the State Land Title Registry Center under the State Land Resources Committee will be the only body handling state registration of land, real property and title to them.

Regulation of land leases

On 2 October 2003, the Verkhovna Rada adopted the Law amending the Law on land leases, which presents a new edition of the latter that complies with the norms of the new Land Code.

This Law introduces a number of progressive innovations aimed at eliminating restrictions that impeded acquiring land under lease and its subsequent use. The Law also strengthens the mutual obligations of parties to a land lease agreement:

- by expanding the base of lessors and lessees. From now on, land belonging to individuals and legal entities may be leased out not only by their actual owners, but also by those authorized by them. Land parcels may also be leased by regional and oblast councils and by the Crimean Rada or legislature;

- by cancelling the requirement that decisions to lease land parcels that are in state ownership can be made only after preliminary agreement at a session of the relevant council;

- by eliminating the restriction according to which those who are leasing farmland for agricultural production can be only legal entities whose statutory documents include this type of activity or private individuals with relevant qualifications or work experience in the agri-business;

- by dropping the restriction on transferring farmland into sub-lease. So far this kind of land could be transferred into sub-lease only when the lessees themselves were unable to use them;

- by regulating the insurance of leased property, the risk of accidental destruction or damage to the leased property, and compensation of losses due to changes in the condition of leased property;

- by mitigating requirements for notarizing land lease agreements. Previously, lease agreements for more than five

years had to be officially notarized, while agreements concluded for less than five years were notarized only when at the request of one of the parties. Currently, lease agreements are notarized only at the request of one of the parties, regardless of their term. Requirements for notarizing land sub-lease agreements were further eased: now such agreements are notarized upon consent of both parties, rather than on the request of one of the parties.

The Law also provides a detailed description of the relations between lessee and lessor, including the requirements for concluding lease agreements.

Assessing these substantial changes to norms regarding rental payments for land is not straightforward:

- the maximum annual rental rate for land is 10% of its standard monetary valuation,[63] while earlier there was only a minimum rate, equal to the land tax. Where lessees are selected on a competitive basis, rental payment can be set at a higher rate. However, since the standard monetary valuation does not reflect the market value of a piece land, this value may not be reflected in the rental rate. From the lessor's point of view, this could result in the ineffective use of land resources. On the other hand, the lack of a minimum rate could have a negative impact on the rights of lessors who are rural residents forced to lease their land due to a shortage of money;

- the VR has established that rental levels for sub-leases on land in state or communal ownership cannot exceed the levels of the original lease. This effectively eliminates the attractiveness of leasing land for the sole purpose of profiting on a sub-lease;

- the calculation of the land rental payments shall include inflation indices, unless the lease agreement states otherwise;

- the restriction on automatically extending rental payments for no more than a one-year term has also been dropped;

- rental payment in forms other than in cash, in kind or in labor is forbidden;

- the Law established a triennial review of rental payments for land in state or communal ownership that has been leased for agricultural purposes. This review should follow the procedure set forth by the Law or by the actual lease agreement. This will somewhat reduce the predictability for operation costs for lessees who are agricultural producers.

At the same time, some of the innovations restrict the circulation of land under lease or otherwise burden the lessee:

- there is now a prohibition for transferring land into sub-lease, if integrated building complexes belonging to state-owned or communal enterprises, organizations and institutions are located on them and if they are on property that belongs to Crimea. This will limit opportunities for state and communal enterprises to take in rental revenues;

- the lessee's obligations now include the provision of a copy of the lease agreement to the appropriate tax authority within 5-day period after state registration of a lease agreement for land in state or communal ownership. This requirement serves no purpose, since all land lease agreements are subject to state registration. Moreover, the obligation to remit land tax and other payments related to land leases is with the lessor, not the lessee.

[63] For details on valuations of land, see ***quarterly predictions*** for Q1'04, p. 55–57.

In addition, the law introduced some ambiguities in to the regulation of leasing. First of all, the procedure for state registration of land lease agreements should be stipulated not by the Cabinet, but by a law—which so far has not been adopted. This makes the conclusion of land lease agreements a more complicated since, according to the currently-established procedure—until a law on state registration of land lease agreements comes into effect—registration puts into question the legitimacy of these agreements. Secondly, there is uncertainty as to the procedure for acquiring the right to lease land parcels in state or communal ownership on a competitive basis. So far, this procedure has been determined solely by lessors, but once the new law comes into effect, this procedure needs to be specified by legislation, which will allow various interpretations of the level of this legislation.

To further develop the land market and also eliminate gaps that impede the proper and full regulation of land, first of all, it is necessary to adopt of all the laws that have been developed according to Clause 4 of the Concluding Provisions of the Land Code:

- the Law on the State Land Title Registry, which should stipulate that the State Land Title Registry holds registration of all titles to land and real property located on it and should specify the procedure for state registration of land agreements. A bill was adopted the basis for this Law on 9 July 2003;

- the Law on differentiating lands in state and communal ownership, the lack of which currently is leading to uncertainty as to the legitimacy of state bodies and local government bodies disposing of land, and a certain temporariness in the normative regulation of the disposal of land. The President vetoed this Law on 4 August 2003;

- the Law on the land market, which should, among others, establish the procedure for holding land tenders, a form of competitive sale of state-owned and communal land parcels to business for building purposes that is allowed in the Land Code. Delays in the adoption of this Law has resulted, among others, in hampering the sale of land for development and, in some Ukrainian towns, the practice of hold land tenders according to temporary procedures and provisions adopted by local councils. As a result of this kind of illegitimate procedure for transferring land rights, the outcomes of such sales are under serious question;

- the Law on state and land-titling surveys, which is a necessary part of the establishment of title to land and for the building of immovables on it. A draft of this Law failed to pass first on 19 June 2003.

In addition, continuing work is needed on provisions of the Land Code on allocating non-agricultural land for sale are a step backwards comparable presidential decrees.

Regulation of telecommunications

Domestic telecommunications legislation is still undergoing radical reforms. Attempts to bring telecoms regulation into conformity with European standards finally reaulted in the Law on telecommunication, which, according to ICPS experts, reflects compromises reached with various competing interest groups, and not a consistent, transparent state policy

From December 2002 through December 2003, there were substantial changes in the regulation of the domestic telecommunications branch. The Government's key tasks were to establish:

- an effective mechanism to ensure universal access to communications services to replace the outdated scheme for cross-subsidies;
- a system of impartial regulation of the telecommunication branch, which should be handled by a national regulatory body.

Worthy of mention are two top events effecting telecoms during this year:

- making incoming mobile calls free-of-charge;
- adopting the Law on telecommunications.

Amendments canceling charges for incoming calls were added to the Law on communication in November 2002. However, they came into effect only on 19 September 2003. During this period, private operators, together with the national operator VAT UkrTelecom, developed and introduced mechanisms to compensate for losses arising due to dropping charges for incoming calls. The mechanism is similar to those applied in European countries and involves collecting charges from the caller.

In the opinion of ICPS specialists, these amendments to the Law on communication could stimulate the development of telecoms services in Ukraine, particularly cellular services. Steadly dropping rates are making this type of communication very attractive for the average citizen.

On 18 November 2003, lawmakers finally adopted the Law on telecommunications. Other than a few articles, this Law came into effect the date of its publication and radically changed the rules of the game in telecommunications.

Differentiation of state management and regulation

The function of regulation such as licensing, registration, distribution of numbers, and rate regulation, is now to be handled by the National Commission for Development of Communication. To ensure an impartial regulatory body, the Law introduces a number of restrictions: a prohibition on dismissing Commission members for reasons other than those directly specified by the law, a prohibition on Commission members to have commercial ties to telecoms operators, and so on.

However, in the opinion of ICPS experts, it is still premature to say that Ukraine's telecoms regulation system has come closer to European standards. This is hampered by several factors:

- lack of clear and transparent mechanisms for the functioning of the Commission and mechanisms for adopting regulatory decisions and their appeal;

- lack of accountability among Commission members for the decisions that they make;

- lack of clear distinctions between rights and obligations of the state telecoms management body and the Commission;

- the Commission's financial and political dependence upon the Government. As a state body, the Commission is controlled by and subordinate to the president, and its financing is determined by the Cabinet of Ministers while the State Budget is being drafted.

New rules of access to the telecoms market

Telecommunications operators can operate on the domestic market on condition that they have provided written notification to the Commission and obtained all necessary licenses. The area of licensing has been expanded to include mobile communication. In the opinion of ICPS specialists, since the underdeveloped mobile communications market affects only a small portion of the population, licensing has an exclusively fiscal purpose. Moreover, the licensing fees, which are established by the Cabinet,[64] are not restricted in any way.

In addition, there is a risk that the proposed licensing system will be used to restrict competition. This risk is aggravated by:

- the right of the Commission to introduce into telecoms licenses special conditions for individual operators and providers, although the Law does even hint at such a possibility;

- the right of the Commission to limit the number of licenses although, again, there are no clearly defined grounds for such a decision.

Another risk to the development of this market is the lack of regulation for the removal of licenses from telecoms operators. The social commitments of operators who enjoy a monopoly or dominant position on the market,[65] actually make it impossible to make any decisions to withdraw their licenses. In the absence of other sanctions in the Law, monopolist operators can afford to ignore the requirements to adhere to licensing conditions. This points out to the fact that such operators have a substantial competitive advantage.

New approaches to tariff regulation

The Law also brings rate regulation closer to market standards:

- the state can only regulate rates for public services and the allocation of telecoms channels to monopoly operators;

- rate calculations will be based on the production cost of the different services plus a profit margin;

- rates will be established on the principle of avoiding the cross-subsidization of one service at the expense of other services.

Above all, these new approaches will benefit operators who provide fixed line telephony—local, long distance and international services.[66] Before the adoption of the Law on

[64] By setting the cost of access to the market, the Cabinet of Ministers performs a regulatory function. This ICPS specialists see as a risk to the development of a system of impartial communications regulation.

[65] In the first place, this means public access to telecommunication services.

[66] These services are considered public services.

telecommunications, rates were determined for political reasons and not based on actual of service delivery. In the opinion of ICPS specialists, the profitability of local telephone providers could go up, which might give spur the rapid growth of this segment of the telecoms market.

Universal access to telecoms services

Guaranteed consumer access to public telecommunications services that are necessary to satisfy consumer needs is a fundamental principle of activity in the telecoms sector.

The new principles of rate regulation make impossible use of the current system of providing universal access by cross-subsidizing telecoms services. However, the Law does not provide for any effective alternative. Thus, the Cabinet of Ministers will determine the mechanism for compensating operator losses resulting from providing universal service. The Concluding Provisions of the Law indicate that this mechanism will go into operation no sooner than January 2005.

Under these conditions, the state is left with only one option for providing universal access in 2004: administratively. The ICPS forecasts that the introduction of new principles of rate regulation will be impossible until the issue of ensuring universal access to services is resolved.

During 2004 telecoms operators will have to work without any clear rules of the game. The investment appeal of this market will depend largely on the behavior of its main player, the state.

Interconnectedness of telecoms networks

The Law also pays attention to regulating horizontal relations on the telecoms market, that is, relations between operators in the process of interconnecting networks. The proposed mechanism should prevent the establishment of discriminatory conditions by monopolist operators for the purpose of limiting competition. Pre-trial procedures for disputes among telecoms operators should make it possible to speed up the settlement of such disputes.

Problems

On the whole, the evaluation of the new Law on telecommunications reveals that it fails resolve key problems in the telecommunications sector:

- determining a mechanism for financing services in unprofitable segments of the market;
- differentiating between the commercial and social functions of VAT UkrTelecom, that is, eliminating the key reason for the distortion of competition on this market;
- establishing a clear and transparent system for impartial regulation in this sector.

The Law introduces a number of instruments aimed at solving these problems, but given the absence of clear operating rules, their effectiveness will largely depend on administrative and political factors.

List of evaluated legislation

Document	Title	Adoption	No.
Business regulation			
Law	Amending the Law on scrap metal	25.12.2002	No. 359-IV
Law	On seeds and planting stock	26.12.2002	No. 411-IV
Law	Amending some legislative acts	20.02.2003	No. 540-IV
Law	Amending the Cabinet Decree on state supervision over adherence to standards, norms and rules and responsibility for their violation	20.02.2003	No. 544-IV
Law	Amending some laws related to introduction of licensing for certain types of business activity in cattle breeding	20.02.2003	No. 546-IV
Law	On state registration of legal entities and private entrepreneurs	15.05.2003	No. 755-IV
Law	On social services	19.06.2003	No. 966-IV
Law	Amending some legislative acts related to vocational-technical education	11.09.2003	No. 1158-IV
Law	Amending the Law on tourism	18.11.2003	No. 1282-IV
Law	On protecting public morals	20.11.2003	No. 1296-IV
Cabinet of Ministers Resolution	Amending Clause 2 of the Procedure for customs clearance of imported commodities (goods) subject to mandatory certification	24.02.2003	No. 191
Cabinet of Ministers Resolution	On introducing new excise stamps with holographic security elements for marking alcoholic beverages and tobacco products	23.04.2003	No. 567
Cabinet of Ministers Resolution	Amending the list of documents enclosed to the application for a license for certain types of business activity	04.06.2003	No. 846
Cabinet of Ministers Resolution	On rates of payment for excise stamps for alcoholic beverages and tobacco products	20.06.2003	No. 926
Cabinet of Ministers Resolution	Amending Clause 2 of the Procedure for customs clearance of imported commodities (goods) subject to mandatory certification	27.08.2003	No. 1361
Cabinet of Ministers Resolution	Approving the Technical Regulations of modules for determining conformity and requirements for marking with the national sign of approval applied in technical regulations on the confirmation of conformity	07.10.2003	No. 1585
Cabinet of Ministers Resolution	Amending the Procedure for retail activity and rules of retail servicing of the general public	15.10.2003	No. 1611
Cabinet of Ministers Resolution	Amending the list of documents enclosed to the application for a license for certain types of business activity	16.11.2002	No. 1762

Order of the Ministry of Economy and European Integration	Amending the Provision on the Accreditation Council of the National Accreditation Body	06.02.2003	No. 24
Regulatory policy			
Law	On the basis of state regulatory policy in business activity	11.09.2003	No. 1160-IV
Tax policy			
Law	Amending the Law on corporate profit tax	24.12.2002	No. 349-IV
Law	Amending some laws related to taxation	16.01.2003	No. 440-IV
Law	Amending the Law on the value-added tax	16.01.2003	No. 469-IV
Law	Amending the Law on the procedure for repayment of taxpayers' liabilities to budgets and special state funds	20.02.2003	No. 550-IV
Law	Amending the Law on the 2003 State Budget and some other legislative acts	22.05.2003	No. 849-IV
Law	Amending the Law on value-added tax	22.05.2003	No. 857-IV
Law	On personal income tax	22.05.2003	No. 889-IV
Law	Amending some laws related to the regulation of activity in the farm sector	19.06.2003	No. 974-IV
Law	On mandatory universal state pension insurance	09.07.2003	No. 1058-IV
Law	Amending some legislative acts related to the activity of trade unions	10.07.2003	No. 1096-IV
Law	Amending Art. 18 of the Law on the procedure for repayment of taxpayers' liabilities to budgets and special state funds	11.07.2003	No. 1127-IV
Law	Amending some laws related to taxation of grain crops	23.10.2003	No. 1240-IV
Law	On the 2004 State Budget	27.11.2003	No. 1344-IV
Cabinet of Ministers Resolution	On the Preliminary plan for law-drafting activity in 2003	20.01.2003	No. 100
Opening the economy			
Law	Amending some legislative acts on the legal protection of intellectual property	22.05.2003	No. 850-IV
Law	Amending Art. 16 of the Law on foreign economic activity	20.11.2003	No. 1315-IV
Presidential Decree	Cancelling Cabinet Resolution No.1473 dated 17 September 2003	01.10.2003	No. 1132/ 2003
Presidential Decree	On measures aimed at accelerating accession to the World Trade Organization	18.11.2003	No. 1313/ 2003
Cabinet of Ministers Resolution	On creating the Interdepartmental Commission to implement requirements of the European Union directives in Ukraine and harmonizing standards and sanitary, ecological, veterinary, and health norms to match international and European requirements for raw materials and agricultural commodities	26.04.2003	No. 620

NBU Board Resolution	On transactions with securities of Ukrainian issuers	29.01.2003	No. 36
Letter from the State Customs Service	On chicken imports from the US to Ukraine	30.04.2003	No. 11/5-10-6753-EP
Judiciary reform			
Decision of the Constitutional Court	On case No. 1-38/2003 on the Court of Cassation	11.12.2003	No. 20-rp/2003
Law	Amending the Commercial Procedural Code	15.05.2003	No. 761-IV
Law	Amending the Civil Procedural Code	05.06.2003	No. 917-IV
Law	Amending the Laws on the state execution service and on enforcement of execution	10.07.2003	No. 1095-IV
Verkhovna Rada Resolution	On the election of judges to the Higher Civil Court	11.12.2003	No. 1393-IV
Presidential Decree	On the Provision on the State Judiciary Administration	03.03.2003	No. 182/2003
Presidential Decree	On creating the Kyiv Inter-oblast and Luhansk Commercial Courts of Appeal	25.06.2003	No. 552/2003
Cabinet of Ministers Resolution	Approving the State Program for Organizational Provision of Court Activity in 2003–2005	18.06.2003	No. 907
Preserving competition			
Law	Amending some Laws on protecting competition	20.11.2003	No. 1294-IV
Anti-Monopoly Committee Instruction	Amending the Instruction of the Anti-Monopoly Committee No. 182-r dated 25 December 2001	26.08.2003	No. 272-r
Order of the Ministry of Economy and European Integration	Approving the Provision on the Commission for evaluating the positive and negative impacts of the control and concentration of business activities	24.04.2003	No. 106
Anti-Monopoly Committee Instruction		11.02.2003	No. 41-r
Order of the Ministry of Economy and European Integration	Approving the Procedure for overseeing implementation of the Cabinet of Ministers Decision on granting permission to control and concentrate business activity	16.09.2003	No. 256
Anti-Monopoly Committee Instruction		29.08.2003	No. 283-r

Financial sector			
Law	Amending some laws related to preventing use of banks and other financial institutions for the legalization (laundering) of illegal gains	06.02.2003	No. 485-IV
Law	On electronic documents and electronic document flow	22.05.2003	No. 851-IV
Law	On electronic digital signatures	22.05.2003	No. 852-IV
Law	Amending Art. 12 of the Law on the National Depository System and features of electronic circulation of securities in Ukraine	22.05.2003	No. 853-IV
Law	On lending mechanisms and property management in residential construction and transactions with real estate	19.06.2003	No. 978-IV
Law	On mortgage lending, transactions with consolidated mortgage debt and mortgage certificates	19.06.2003	No. 979-IV
Law	On non-state pension security	09.07.2003	No. 1057-IV
Presidential Decree	On the Provision on the State Commission for Regulating Financial Services Markets	04.04.2003	No. 292/ 2003
NBU Board Resolution	On approving the Interim Provision on the procedure for long-term refinancing (support of liquidity) of banks by the National Bank	12.02.2003	No. 51
NBU Board Resolution	Approving amendments to the Provision on registration and remittance of payment orders in foreign currency, on applications for the purchase or sale of foreign currency to authorized banks and other financial institutions and the procedure for carrying them out	04.06.2003	No. 225
NBU Board Resolution	Approving amendments to the Provision on the procedure for issuing payment cards and transactions using them	04.06.2003	No. 226
NBU Board Resolution	Approving amendments to the Instruction on non-cash settlements in Ukraine in the national currency	04.06.2003	No. 227
NBU Board Resolution	On the procedure for closing anonymous currency accounts and coded accounts of private individuals (residents and non-residents) in foreign and national currency	04.06.2003	No. 231
NBU Board Resolution	Approving amendments to the Provision on the procedure for issuing licenses to non-banking intuitions for specific banking transactions	18.06.2003	No. 249
NBU Board Resolution	Amending the NBU Board Resolution No. 447 dated 25 November 2002 and the Provision on the procedure for forming mandatory reserves for banks	18.06.2003	No. 266
NBU Board Resolution	Approving the Instruction on the procedure for opening, using and closing accounts in the national and foreign currency	12.11.2003	No. 492

Instruction of the State Commission for Regulation of Financial Services Market (SCRFSM)	Approving the Provision on levers of influence of the State Commission for Regulating Financial Services Markets	17.09.2003	No. 42
Instruction of the SCRFSM	Approving the Rules for inspections by the State Commission for Regulating Financial Services Markets	28.10.2003	No. 96
Instruction of the SCRFSM	Approving the Provision on the registration of credit unions	11.11.2003	No. 115
Decision of the State Comission on Securities and Stock Market (SCSSM)	Approving the Provision for allocating, circulating and buying-out securities of joint investment institutes	09.01.2003	No. 3
Decision of the SCSSM	Approving the Procedure for overseeing adherence to the licensing conditions for professional activity on the securities market	17.04.2003	No. 162
Decision of the SCSSM	Approving the Provision on the procedure for reorganizating investment funds and investment companies in joint investment institutes established according to the Presidential Decree No. 55 on investment funds and investment companies dated 19 February 1994	08.07.2003	No. 304
Ownership and privatization			
Code	The Civil Code	16.01.2003	No. 435-IV
Code	The Commercial Code	16.01.2003	No. 436-IV
Law	On mortgages	05.06.2003	No. 898-IV
Cabinet of Ministers Resolution	On forming and maintaining the State Corporate Rights Register	29.10.2003	No. 1679
Cabinet of Ministers Resolution	Approving measures on implementing priority directions in developing corporate governance in joint stock companies (ATs)	18.01.2003	No. 25-r
Order of the Ministry of Education and Science	Approving the Program for developing corporate governance in ATs in education and science in 2003–2008	28.03.2003	No. 188
Sectoral legislation			
Law	On land management	22.05.2003	No. 858-IV
Law	On farm management	19.06.2003	No. 973-IV
Law	Amending Art. 82 of the Land Code	10.07.2003	No. 1103-IV
Law	Amending the Land Code	11.07.2003	No. 1119-IV

Law	Amending the Law on land lease	02.10.2003	No. 1211-IV
Law	On telecommunications	18.11.2003	No. 1280-IV
Presidential Decree	On measures related to establishing a unified system for state registration of land, real property and rights thereto with the State Land Cadaster	17.02.2003	No. 134/ 2003
Cabinet of Ministers Resolution	On measures to establishing a unified system for state registration of land, real property and rights thereto with the State Land Cadastre	15.05.2003	No. 689
Cabinet of Ministers Resolution	On setting up a unified system for state registration of land, real property and rights thereto with the State Land Cadastre	17.07.2003	No. 1088

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