

**PUBLIC REGULATORY POLICY:  
INTERACTION OF BUSINESS AND POWER**

**Public Regulatory Policy in the Business Sphere**

**Influence of Entrepreneurs and Business Associations on  
Elaboration of Regulations**

**Advantages and Drawbacks of Public Regulatory Policy:  
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## *The Uniform Public Regulatory Policy in the Business Sphere*

*By Serhiy Sheheda, member of the Secretariat of the Business Associations' Board at the Government Committee for Economic Development*

Success of any society on the way to stable development strongly depends on relationship between the power and the public and the role of public opinion in elaboration of legal acts influencing social interests. Only those state officials guided by public opinion can have support and serve their country.

Ukraine inherited non-transparent system of public regulation, where people held aloof from discussion of draft regulations and economic analysis of regulatory impact of legal documents to be adopted and efficiency of previously enacted regulations was absent. Such a system did not offer an opportunity for open dialogue and cooperation with general public but was designed to dictate political will of state officials.

The above entailed negative attitude of population to both the state and public regulation and made it impossible to meet some requirements of political decisions.

Spheres and methods of public policy regulating entrepreneurship have been heatedly debated for many years. Though, no straight answer was given. It was agreed that the state had to interfere with social and business affairs but principles of public regulation were not clearly identified. The matter in question is neither principles of public regulation in specific sphere, such as licensing, certification or taxation, nor those relating to definite type of business. The only question is why, how, when, and what regulatory measures should be instituted.

On January 22, 2000, the President of Ukraine signed the decree "On Introduction of the Uniform Public Regulatory Policy in the Business Sphere" that finalized the above discussion.

Under the above decree, the uniform public regulatory policy in the business sphere is viewed as activity of the state ensuring efficient public regulation of entrepreneurship and removing legal, economic and administrative barriers to business. Its major objectives are to improve the regulatory process, enhance effectiveness of legal acts regulating business issues and involve general public in discussion of regulatory drafts. Hence, public regulatory policy in the business sphere should be based on principles preventing adoption of ineffective and economically inefficient regulatory documents and encouraging enactment of regulations geared toward social and economic development.

To implement those objectives, executive authorities must adhere to the following principles so that:

- Expediency of legal regulation, its compliance with market requirements
- Positive social and economic effect of regulatory documents
- Systemic, coherent and well-coordinated elaboration, adoption and enforcement of regulations
- Publicity of elaboration of major regulatory documents influencing business environment, rights and interests of businessmen
- Mandatory, regular and timely provision of economic entities with information on passed regulations

To put the above principles into effect, the President of Ukraine and the Cabinet of Ministers of Ukraine resolved to institute some measures focused on improvement of functions of executive bodies relating to elaboration, adoption and enforcement of legal acts regulating business issues.

Regulatory impact analysis and approval of drafts by the State Committee for Regulatory Policy and Entrepreneurship should ensure adherence to such principles as expediency, adequacy, compliance with market requirements and efficiency providing for positive social and economic effect.

Compliance with the principle of publicity of elaboration of major regulatory documents influencing business environment, rights and interests of businessmen can be ensured by means of public discussion of their drafts.

To adhere to the principle of systemic, coherent and well-coordinated elaboration, adoption and enforcement of regulations executive authorities are ordered to plan in advance regulatory measures and estimate efficiency and impact of enacted legal document dealing with business issues.

The State Committee for Regulatory Policy and Entrepreneurship is charged with coordination of functions of executive bodies relating to elaboration, adoption and enforcement of regulations.

Another direction of the uniform public regulatory policy in the business sphere is deregulation viewed as broad-based measures for removal of barriers to business development and reduction of state interference with entrepreneurship.

In Ukraine, the issue of deregulation was first raised in 1997. At that time, deregulation was interpreted as decrease in the number of regulatory requirements to businessmen and reorientation of the state from regulatory activities towards rendering services to businesses. In any advanced economy, the mission of government is to create conditions favorable for development of business and private initiative. Any state should also render services to its citizens. For the above reasons, in the process of Ukraine's administrative reform, it is often stated that officials should act as public servants and that businessmen represent the most important constituency, as they are major taxpayers and actually maintain state officials.

The February 3, 1998 presidential decree No. 79/98 "On Removal of Barriers Impeding Business Development" laid legal foundations for deregulation. The decree provided for the following deregulatory measures

and organizational hindrances to business development:

- Simplify procedure for establishment, registration and liquidation of economic entities
- Abate the list of business activities requiring licenses, patents, certificates or other permissive documents
- Restrict revision and control of activity of economic entities
- Simplify procedure for customs clearance of imported/exported commodities
- Ensure consistent and stable legal basis of business

Under the above presidential decree, the Cabinet of Ministers of Ukraine, ministries and other national executive authorities were ordered to ensure maximum reduction of business expenditures relating to enforcement of regulations. Proceeding from the above, any legal document regulating business issues could be regarded as “deregulation article”. The State Committee for Regulatory Policy and Entrepreneurship (SCRPE) was empowered to implement deregulatory measures.

Procedure for deregulation looks as follows. The SCRPE is to reconsider and analyze regulations passed by national executive authorities and regional state administrations for the purpose of reducing and preventing excessive state interference with the business sphere. Such analysis is carried out mostly on the basis of complaints filed by businessmen and public organizations. For this reason, representatives of business community can and should lodge their complaints with the SCRPE in the event they believe that a definite regulatory document hinders their activity.

In the event the analysis proves that a regulation runs counter to valid legislation or some of its sections impede business activity, the SCRPE will have to eliminate those discrepancies, if necessary. Respective resolution of the SCRPE is sent to an executive body responsible for adoption of the regulation. As such a resolution is mandatory, the executive body is given one month to change the regulatory document or reject the resolution in conformity with the established procedure. Should the executive body fail to take any of the above steps within a month following adoption of the resolution, the regulation will be considered invalid until discrepancies indicated in the resolution of the SCRPE are eliminated. The SCRPE informs the public about suspension of such regulations in the mass media, such as the *Uriadoviy Kurrier*, the *Bizness weekly* and the *Ukraina-Business*, and in some legal databases, such as the *Liga*.

We would like to pay attention to the following positive examples of deregulatory measures taken by the State Committee for Regulatory Policy and Entrepreneurship in cooperation with business associations.

- At the level of national executive authorities:

Under Paragraph 3.6 of the April 21, 1999 decree of the Special State Monopoly Department of Ukraine No. 67 “On Procedure for Revision of Economic Entities apropos of Their Compliance with Licensing Requirements to Wholesale Trade in Spirits and Tobacco Goods”, all applicants for a license to carry on wholesale trade in alcoholic beverages were required to be insured with an authorized insurance against liabilities for third party damages arising out of sale of such goods. At the same time, early re-registration of granted licenses was announced. Companies could not reregister their licenses to carry on wholesale trade in spirits without an insurance policy despite the fact that by virtue of the law of Ukraine “On Insurance” such type of insurance was voluntary. Besides, they had to conclude such contracts with one of just two insurance companies authorized by the state.

There was absolutely no reasonable explanation, why wholesalers and not retailers had to conclude insurance contracts. Moreover, minimum cost of insurance policy constituted a considerable amount of 5 000 UAH and insurance payments could not be included in production expenditures thereby sufficiently lowering traders’ profits.

Companies and entrepreneurs carrying on wholesale trade in spirits filed a number of complaints with the State Committee for Regulatory Policy and Entrepreneurship. As soon as the first claim had been submitted, the SCRPE initiated review of the above decree No. 67. Analysis proved that complaints were justified, since one of the decree’s rules ran counter to valid legislation and hampered business development.

On June 17, 1999, the SCRPE passed the resolution No. 17-93/6 recommending the Special State Monopoly Department of Ukraine to abolish Paragraph 3.6 of the decree No. 67. On July 14, 1999, the Special State Monopoly adopted the resolution No. 111 on abolition of Paragraph 3.6.

Later on, the State Committee for Regulatory Policy and Entrepreneurship conducted a poll among businessmen carrying on wholesale trade in spirits. Polling results confirmed negative impact of obligatory insurance and proved that wholesale trading companies suffered losses in the amount of UAH 5 million.

- At the level of local executive bodies:

In February 1999, businessmen of Ternopil region presented the State Committee for Regulatory Policy and Entrepreneurship with several complaints about the December 20, 1998 instruction of the head of regional state administration No. 573 “On Approval of Procedure for Transfer or Purchase of Lands in Ternopil Region”. Businessmen stated that the above procedure was too expensive. Besides, it took them almost a year to obtain land shares. Furthermore, list of documents required to obtain a land share and identify its location did not comply with the Land Code of Ukraine.

The State Committee for Regulatory Policy and Entrepreneurship considered those complaints and passed the February 8, 1999 resolution No. 17-13/02 recommending the Ternopil regional administration that the above instruction should be postponed and brought into line with valid legislation and that a draft on changes and amendments to the instruction No. 573 should be approved by the SCRPE.

recognition of the instruction No. 573 invalid.

Program of deregulatory measures carried out within 1998-2001 on the ground of complaints made by economic entities and designed to remove legal barriers to development of entrepreneurship allowed the State Committee for Regulatory Policy and Entrepreneurship to review over 150 regulations of national and local executive authorities and eliminate numerous discrepancies entailing dozens of million hryvnias of additional expenses incurred by Ukrainian entrepreneurs. Hence, businessmen should resort to the afore-mentioned deregulatory mechanism, for the SCRPE as the national executive authority having special status, was founded for the purpose of solving problems of entrepreneurs and protecting their interests.

In conclusion, it is possible to assert that regulatory and deregulatory activities of executive power are two major integral parts of the uniform public regulatory policy in the sphere of entrepreneurship. Elaboration and adoption of regulations on the principles of the uniform public regulatory policy in the business sphere should prevent enactment of economically inefficient legal documents, while deregulation is targeted toward systemic review of those regulations and their abolition or improvement, if necessary.

Deregulation implies assessment of efficiency of adopted regulations and regulatory impact analysis. Such analysis is designed to present well-founded substantiation of economic efficiency of regulatory documents and make a decision on introduction of necessary changes or abolition of ineffective regulations.

Introduction of the uniform public regulatory policy in the business sphere serves as a basis for the regulatory reform, i.e. the reform of the decision-making process. The regulatory reform was launched almost simultaneously with the administrative reform focused not only on altering functions and organizational structure of executive authorities but also on effecting radical changes in governance and decision-making technologies.

## ***Public Regulatory Policy in Business Sphere***

*By Ludmyla Khomenko, head of the regulatory policy methodology department at the State Committee for Regulatory Policy and Entrepreneurship*

### ***Tasks and Role of Public Regulatory Policy in Business Sphere at the Present Stage of Reforming Ukraine's Economy***

One of major factors determining economic stabilization and growth is comprehensive solution to problems of market reforms.

Decade of formation of Ukraine's legislation system, adoption of a number of laws regulating relations of the state with economic entities, elaboration of numerous rules of the law entailed the situation that started scotching development of entrepreneurship. At the present stage of economic transformation, such a situation requires removal of some legal, administrative and economic barriers to business development.

The February 3, 1998 presidential decree No. 79 "On Removal of Barriers Impeding Business Development" was targeted toward limitation of state interference with entrepreneurship and introduction of new approaches to public regulation of business so that to ensure economic growth. The decree marked the initial stage of the regulatory reform in Ukraine.

This stage is characterized by realization of measures for restricting excessive state interference with entrepreneurship through abolition of inefficient legal acts in force.

At the same time, deregulatory measures carried out within 1998-1999 related only to legal documents in force at that period and did not deal with elaboration and adoption of new ones. In the opinion of independent experts, some positive results facilitating improvement of business climate in definite spheres were not sufficient. It was vitally important to work out new and more efficient approaches to elaboration of acts regulating entrepreneurship, more perfect methods of assessing existent regulations and rules of activity of economic entities and mechanisms for review of those documents and their abolishment, if necessary.

The January 22, 2000 presidential decree No. 89 "On Introduction of the Uniform Public Regulatory Policy in the Business Sphere" and declaration of the regulatory reform initiated the second stage of public regulatory policy in the field of entrepreneurship. Under the decree, effective realization of the uniform public regulatory policy in the business sector was one of the top priorities of economic reforming.

Regulatory reform must be focused on formation of effective regulation of entrepreneurship that would remove legal, economic and administrative barriers to business activities.

The above decree serves as an evidence of European approach to transparency of decision-making process. Improvement of legal basis for activity of economic entities is one of the key requirements of all programs of the World Bank and the International Monetary Fund. It should be mentioned that Ukraine successfully fulfills the above requirement.

According to principles formulated in the decree No. 89, rules and regulations related to entrepreneurship should comply with requirements of market relations, be expedient and sufficient to carry on business; introduction of those rules and regulations should be effective and must ensure positive economic and social results; measures for elaboration and enactment of regulatory acts should be systemic and consistent; elaboration and enactment of regulatory documents should meet the publicity principle.

*Efficiency of the regulatory reform in the field of entrepreneurship depends on adherence to the following interrelated principles of public regulation:*

Expediency of adoption of each regulatory draft should be thoroughly analyzed and well-founded in the process its elaboration

Efficiency of each regulatory act in force should be regularly reconsidered so that to make a decision on introduction of necessary changes or abolition of such document in the event of its ineffectiveness

All draft regulatory documents that essentially influence market environment, rights and interests of business community should be subject to public discussion.

Legal basis for implementation of public regulatory policy in the business sphere in 2000 was actually formed: a new system of elaboration, publication and enactment of regulatory documents was developed; standardized methodology of substantiating draft regulatory acts was worked out; conditions for the open dialogue between the state and the public were created. Those steps paved the way for gradual transition from public regulation of entrepreneurship to principles of social partnership.

Enactment of the law of Ukraine "On Principles of Public Regulatory Policy in the Business Sphere" establishing new approaches to public regulatory policy should mark complete formation of its legal basis.

The above law will initiate a key stage of implementation of public regulatory policy in the business sphere, whose positive impact would ensure economic development of Ukraine.

Formation or improvement of a certain economic sector in compliance with ideology of the regulatory policy must be based on coherent, predictable and effectively instituted measures. New requirements to a procedure for elaboration of regulatory documents are as follows:

apropos of compliance with principles of legal regulation and approved by the State Committee for Regulatory Policy and Entrepreneurship

Each draft regulation that essentially influence market environment should be discussed with general public and economic entities

Each draft regulation should be approved by the Government Committee for Economic Development

The so-called filters set at the coordination stage prevent approval and introduction of economically inefficient regulatory acts and foster consistent public regulatory policy. Identification of regulations that may adversely affect the national economy or conflict with general state policy prior to their adoption contributes to enhancement of responsibility of executive authorities. For instance, within 2000-2001, the State Committee for Regulatory Policy and Entrepreneurship considered over 700 draft regulatory acts and approved only 60% of them.

Such a procedure offers an opportunity to enhance transparency and efficiency of and responsibility for decision-making in national executive bodies dealing with elaboration of new regulatory documents, makes them present sufficient and detailed evidence of the need for adoption of a certain regulation. This presentation calls for reorientation of work of national and local executive bodies toward carrying out regular analysis of efficiency of regulations enacted, introduction of new regulatory procedures and publicity.

Except for institution of deregulatory measures, national executive bodies also perform the following functions at the national, regional and non-governmental levels: reconsider regulations in force passed by other executive authorities and review them apropos of compliance with principles of legal regulation; coordinate work of executive bodies responsible for elaboration and publication of regulations and control over realization of regulatory acts; render methodological assistance to the State Committee for Regulatory Policy and Entrepreneurship.

At the national level, public regulatory policy is coordinated by the State Committee for Regulatory Policy and Entrepreneurship (SCRPE), ministries and administrations, at the regional level – by territorial departments of the SCRPE and local executive authorities, and at the non-governmental level – through involvement of businessmen and public organizations advocating protection of entrepreneurship.

The opportunity to implement public regulatory policy at the regional level is an important feature of comprehensive improvement of the legal basis. Working out regulations, local executive authorities should obtain approval of those documents by regional departments of the SCRPE in conformity with formulated requirements. Such an approach contributes to accelerated consideration and approval of new draft regulations. Moreover, all new regulations to be realized should be necessarily grounded at the regional level. Procedure for approval of decisions made by local executive authorities should be recommendatory so that to make it possible to estimate advantages and drawbacks of those new documents and compare alternative regulations. Therefore, successful development of business in regions strongly depends on understanding of public regulatory policy and efficient implementation of its requirements by local executive officials.

Public organizations established to protect entrepreneurship also play an important role in legal regulation. Those structures consider increasing number of complaints about inefficient legal acts hampering business development.

In 2000-2001, the State Committee for Regulatory Policy and Entrepreneurship worked out methodological approaches ensuring effective elaboration of draft regulations. Within that period, the SCRPE held 18 training seminars for representatives of national executive authorities, regional state administrations, regional departments of the SCRPE and public organizations. In November 2000, the SCRPE initiated special regional field advisory sessions for representatives of regional state administrations and local self-government bodies. Active work of the State Committee for Regulatory Policy and Entrepreneurship promoted better understanding of the regulatory policy ideology by executive officials, who gained practical experience of elaboration of regulatory documents in compliance with valid national legislation.

### ***Problems and Barriers***

In 2000, valid legal acts of executive authorities were revised apropos of their compliance with market requirements. As a result, 50 regulatory documents were changed or abolished. Such a number of abolished regulations and numerous complaints of entrepreneurs made the government order ministries and regional state administrations to proceed with review of regulations in 2001. At present, over 200 inefficient documents were identified, of which over 90 regulations have already been abolished or partially changed.

Analysis of the above revision indicates that some executive authorities did not make it properly. Despite the fact that some ministries and administrations report that no regulations are to be improved, only in 2001, the State Committee for Regulatory Policy and Entrepreneurship passed 4 resolutions on the need for elimination of ineffective provisions in regulatory acts of national executive authorities.

The same is true for local executive bodies. In 2001, the SCRPE adopted two deregulatory resolutions. Cooperation of territorial departments of the SCRPE with regional administrations of justice encouraged revelation of regulations passed by local executive bodies without preliminary approval of the SCRPE. As a result of such cooperation, just in one Ukrainian region, 37 regulations were identified as those passed by local executive bodies without preliminary approval of the territorial department of the SCRPE. Program of measures carried out within 1998-2001 on the ground of complaints made by economic entities and designed to remove legal barriers to

abolished or radically changed.

In 2001, the State Committee for Regulatory Policy and Entrepreneurship passed 14 deregulatory resolutions, of which eight documents dealt with regulations of executive authorities elaborated in 2000, i.e. subsequent to introduction of mandatory coordination of draft regulations.

One of the key directions of comprehensive and systemic deregulation of entrepreneurship is elaboration and adoption of regulations designed to improve business activity and enhance its efficiency in such priority sectors as transportation services, land relations, construction, pharmaceuticals, hotel and tourism services, foreign economic relations, domestic trade, technical regulation and intellectual property protection.

On the basis of analytical surveys studying problems of definite business sectors, the State Committee for Regulatory Policy and Entrepreneurship formulated recommendations and presented the Cabinet of Ministers of Ukraine and Committees of the Verkhovna Rada with respective proposals.

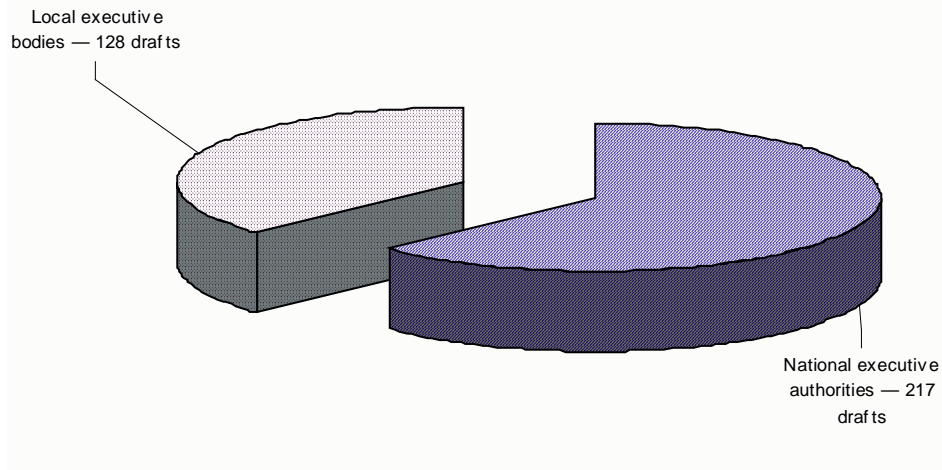
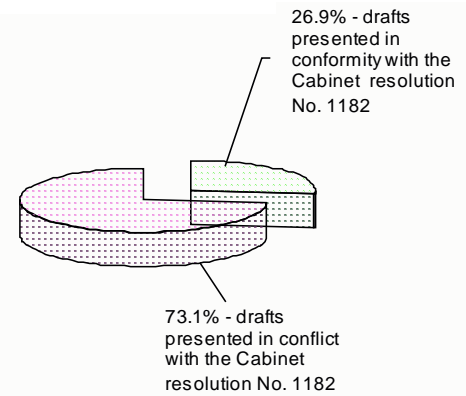
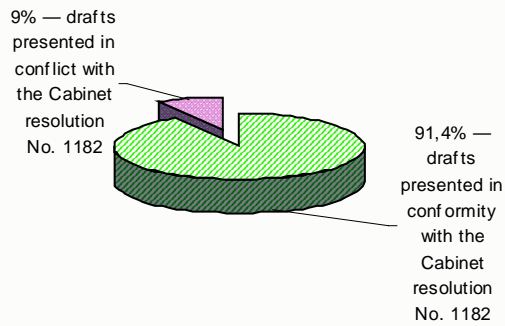
At present, comprehensive and systemic regulatory policy in some economic sectors is the major precondition for formation of favorable business climate and development of entrepreneurship.

In 2000-2001, over 700 draft regulations of executive authorities were submitted to the SCRPE and its regional departments for approval. Last year, just 19.3% of the overall number of draft regulatory documents presented for approval by national executive authorities indicated expediency of their adoption. Within initial six months of 2001, executive bodies submitted 344 draft regulations to the SCRPE and its regional departments for approval. Positive decisions were made on 216 documents. Substantiation of state interference in a certain business sphere, forecasts of social and economic outcomes of proposed measures made on the basis of statistical data and comparative analyses of alternative solutions were enclosed to 175 draft regulations or 62.7% of their overall number. The above can serve as evidence that the situation relating to adherence of executive authorities to the procedure for substantiating draft regulations considerably improved. In the first quarter of 2001, the share of presented draft regulations, whose expediency was substantiated, amounted to 42.5%.

It is necessary to mention that at present, local executive bodies more thoroughly approach requirements to elaboration of draft regulations. 91.4% of the overall number of draft regulations worked out and presented for approval by local executive bodies complied with the above requirements, whereas only 26.9% of such acts proposed by national executive authorities were developed duly (see diagram 1).

At the same time, figures indicating compliance with requirements to elaboration of regulatory documents are not sufficient, since it is impossible to estimate efficiency of new regulations after their adoption due to the absence of preliminary analysis of their impact. For this purpose, it is recommended to involve experts and train them in new governance technologies.

Experience proves that regulatory impact analysis and assessment of efficiency of adopted regulatory documents are the most complex stages. Regulatory impact analysis is an integral part of elaboration process and is viewed as substantiation of expediency of state interference with respective business sphere and its expected efficiency. Such analysis is designed to present well-founded economic substantiation of the need for state interference in a certain business sphere and calculate public and economic expenses for state interference.

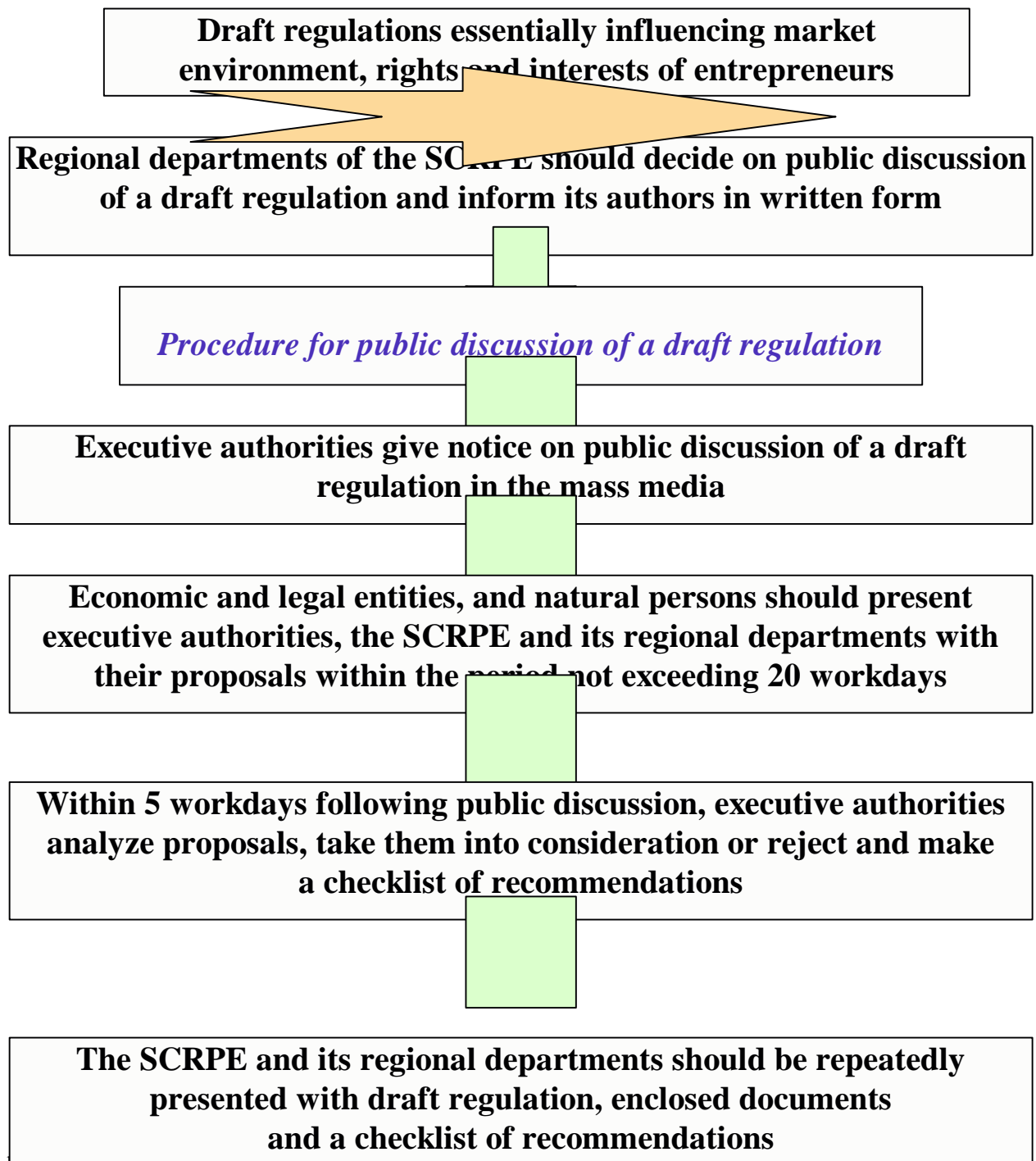


To make a sound decision on adoption of a new regulation, it is necessary to clearly identify the problem, describe regulatory mechanisms and consider alternative methods (see table 1). According to requirements of public regulatory policy, executive authorities are to analyze effectiveness of a draft regulation, make relevant assessments and further modify it, if necessary.

Within the last year, instead of making the above analysis, executive authorities applied outdated methods, indicating no alternative regulation, improperly and superficially calculating expenditures and expediency, estimating anticipated social and economic outcomes in purely declarative way. In 2001, the situation changes for the better. This is especially true for some ministries. New approach urged those organs to fundamentally and rapidly revise their methods of work. As a result, quality of substantiation of expediency of draft regulations increased by far.

To ensure adequate organization of public regulatory policy, the majority of executive authorities, on instructions of the Ukrainian government, formulated measures for implementation of the uniform public regulatory policy in the sphere of entrepreneurship. The above measures provide for the following: complete review, abolition or improvement of valid regulatory documents that run counter to principles of public regulation; draw up plans of elaboration and adoption of regulations in compliance with requirements established; thoroughly analyze efficiency of regulations in force; hold seminars on introduction of the uniform public regulatory policy in the business sphere; provide the mass media with information on measures for realization of public regulatory policy etc. However, most of those measures incorporate a number of the following serious drawbacks: they were formulated without indicating the period and officials responsible for their realization; some executive authorities recommended measures that are beyond the public

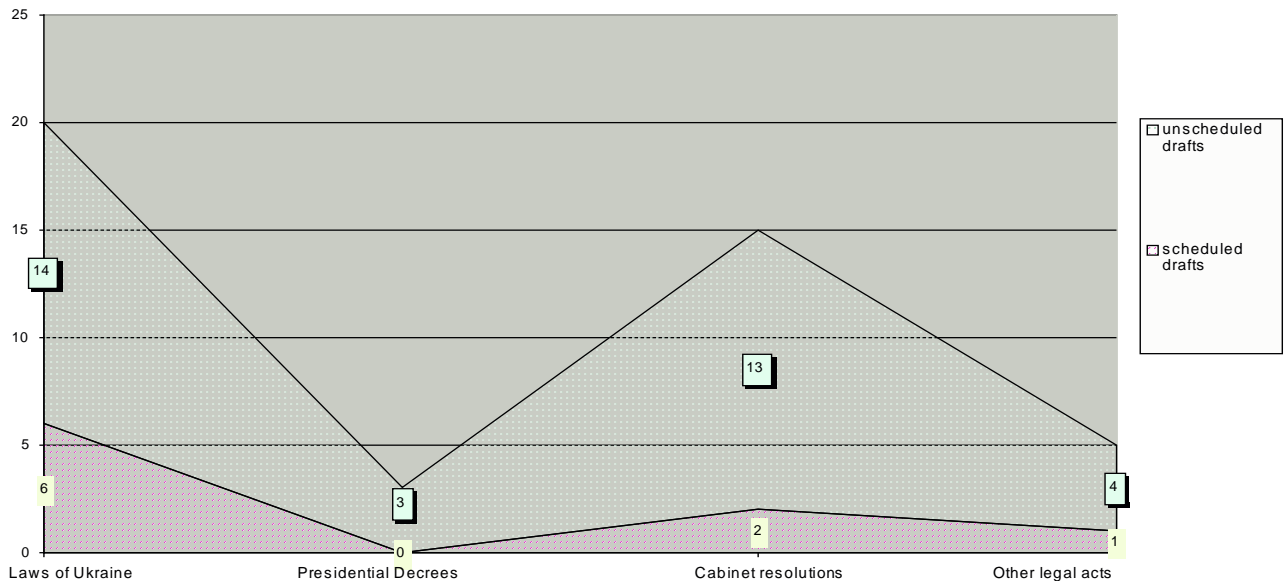




Most reports on those measures are akin to information on elaboration of draft regulations within initial six months of 2001. No regulatory document worked out in 2000 was substantiated with analysis of its effectiveness; the mass media furnished no information on realization of those regulations; there was no cooperation with NGOs and business community in the process of their elaboration.

This year, ministries and administrations plan to work out 31 draft laws, 7 draft presidential decrees, 4 draft resolutions of the Cabinet of Ministers of Ukraine and 86 draft regulations of national executive authorities. At the local level, it is expected to pass 165 resolutions and instructions regulating entrepreneurship.

The majority of draft regulations elaborated by national executive authorities and submitted to the State Committee for Regulatory Policy and Entrepreneurship for approval were not planned at all (see diagram 2). Such a situation indicates that state officials misunderstand compliance with consistency and predictability principles so important for formation of favorable business environment.



### ***Influence of Entrepreneurs on Elaboration of Regulatory Documents***

Public discussion of draft regulations that significantly influence market environment, rights and interests of businessmen should be organized by the State Committee for Regulatory Policy and Entrepreneurship or its regional department at the stage of its approval. Public discussion of pending draft regulations involving business associations is part and parcel of public regulatory policy. It encourages the state to make sound decisions on approval and enactment of such documents (see table 2).

Should a decision on public discussion of a draft regulation be taken, its authors are given 20 workdays to publish information on the forthcoming discussion in the mass media, indicating their postal and e-mail addresses as well as those of the State Committee for Regulatory Policy and Entrepreneurship or its regional department and newspaper or journal where this draft regulation is to be published. Within five workdays following the end of public discussion, authors are to analyze proposals, modify a draft regulation, draw up a checklist and substantiate reasons that led to rejection of some proposals, if any. In the event of disagreement of authors with comments and recommendations of the public they initiate formation of a coordinating committee (task force) for holding consultations so that to eliminate discrepancies. Consultations (sessions of the task force) should be held within ten workdays.

The above procedure offers great opportunities. By its ideology, it must accumulate social potential in the process of elaboration of new regulations. Business associations can invite legal, economic and other experts to take part and advocate their own and thereby national interests. Making necessary calculations and analysis and studying proposals of general public and businessmen will indirectly help lower burden on state officials. Such activity of public organizations and business associations will not be vain, as elaborating regulatory documents, national authorities must pay close attention to all proposals made during public discussion, take them into consideration or present reasoned substantiation of their inexpediency.

Mechanism for public discussion of draft regulatory documents that essentially influence market environment, rights and interests of economic entities came into force in early 2000. Last year, the State Committee for Regulatory Policy and Entrepreneurship decided to submit 12 draft regulations for public discussion. In 2001, the SCRPE resolved to initiate public discussion of seven draft regulations, of which national executive authorities elaborated three documents and local bodies worked out four drafts. The above indicates that power exerts efforts to initiate dialogue with the public in regions.

At the same time, activity of executive authorities geared toward involvement of public organizations in elaboration of draft regulations is not efficient enough. For the time being, only numerous complaints of entrepreneurs about regulatory deficiency serve as assessment of regulatory documents in force. The above indicates that state officials still uphold their personal interests and that general public offers weak resistance to such a situation.

### ***Measures Facilitating Public Regulatory Policy***

Market reforms undermined ingrained traditions of work of executive authorities. By coincidence, the second stage of the regulatory reform was launched simultaneously with the administrative reform in national executive authorities. Those two reforms are targeted toward radical changes in the work of government agencies. They imply establishment of close relationship of regulatory and administrative reforms and development of social and business spheres.

efficiency of regulations in force takes place at the time, when ministries and administrations experience drastic organizational and structural changes. Though, branch public governance is transforming into functional one very slowly. Ministries and other government agencies still elaborate draft regulations on the basis of branch approach. Hence, each new draft regulatory act is worked out by different expert group, which impedes elaboration of such documents in conformity with standardized rules and requirements.

Comparative analysis of administrative and regulatory reforms is sufficient to allow conclusion that they are based on the following common principles:

- Minimization of interference of executive bodies acting on behalf of the state with activity of economic entities
- Expediency and adequacy of public regulation, its compliance with market requirements
- Positive economic and social effect

The administrative reform is focused on formation of an effective system of public governance, while the regulatory one provides for efficient public regulation of entrepreneurship.

To better organize elaboration of legal regulatory acts, monitor efficiency of those in force and introduce an effective mechanism for administrative responsibility, it is recommended to revise functions of central and local executive authorities and order their heads to appoint officials in charge of implementation of public regulatory policy.

The year 2001 should be decisive for the regulatory reform in the business sphere. Settlement of numerous business issues at the local level depends upon effective work of national executive bodies. It should encourage close cooperation of executive power with business associations and public organizations so that to ensure realization of public regulatory policy in the future. Such cooperation can positively influence stability and consistency of Ukraine's legislation in general and regulatory policy in particular.

Public regulatory policy is one of the key directions of the regulatory reform declared in the message of the President of Ukraine to the Verkhovna Rada "Ukraine in the XXI Century: Economic and Social Strategy for 2000-2004". This policy should be of a long-term nature (for instance, it took 18 years to effect the regulatory reform in Canada) providing for stabilization and development of the national economy.

Efficient public regulatory policy should ease regulatory pressure on economic entities due to simplified procedures for public regulation of economy and reduction of financial and business expenditures. The above will result in growing number of economic entities and new jobs, thereby promoting employment of the able-bodied population and increasing gross domestic product of Ukraine.



Table 2. Procedure for Approval of Draft Regulations by the State Committee for Regulatory Policy and Entrepreneurship

**Draft regulation and enclosed documents are submitted for approval to the State Committee for Regulatory Policy and Entrepreneurship or its regional department**



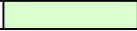
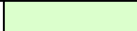
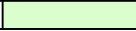
*The State Committee for Regulatory Policy and Entrepreneurship considers draft regulation and makes a decision*



**on approval**  
*within 7 workdays following registration of a draft by the SCRPE or its regional department*

**on public discussion**  
*within 3 workdays following registration of a draft by the SCRPE or its regional department*

**on reasonable rejection**  
*within 7 workdays following registration of a draft by the SCRPE or its regional department*

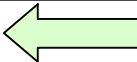


A draft is approved in conformity with the established procedure

A draft is given to executive authorities for public discussion

Conclusion of the SCRPE or its regional department is sent to executive bodies for improvement with regard to comments and proposals made

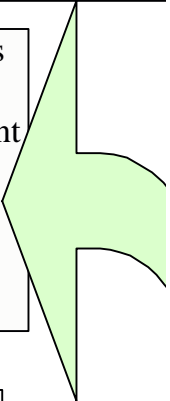
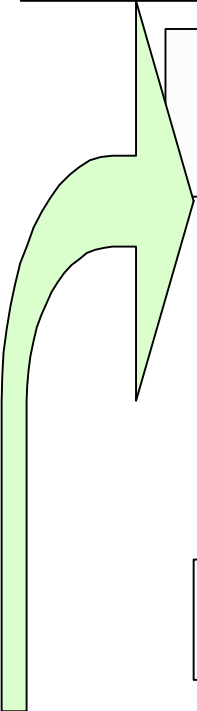
*Procedure for public discussion*



Draft regulation, enclosed documents and checklist of recommendations are submitted to the SCRPE or its regional department for approval



The state Committee for Regulatory Policy or its regional department considers a draft regulation and makes a decision



## **Impact of Business Community on Elaboration of Regulatory Documents**

*By Ksenia Lyapina, project coordinator at the Institute for Competitive Society*

One way or the other, business community always had an impact on elaboration of legal acts. As a rule, this process was not transparent. That non-transparency was proportionate to non-transparency of governance. In such a situation, entrepreneurs rather protected interests of small political groups and frequently gave their support to decisions impeding business development. As soon as the regulatory reform was launched in Ukraine, the situation started to change for the better.

As for formation of mechanisms for the civilized influence of business community on elaboration of regulations, the year 2000 was the most progressive.

On the one hand, the January 22, 2000 presidential decree “On Introduction of the Uniform Public Regulatory Policy in the Business Sphere” prioritized realization of the uniform public regulatory policy in the business sphere by executive authorities. Its goal was formulated as “intolerance against any infringement of the right of citizens to carry on business”. In compliance with the presidential decree, one of the key principles of the uniform public regulatory policy was public discussion of all draft regulatory documents essentially influencing market environment, rights and interests of business community. Hence, the document paved the way for a new style of dialogue between the power and the business community, i.e. public discussion of draft regulations.

On the other hand, two essential legal acts that established clear procedures for implementation of public regulatory policy were adopted in 2000. The May 6, 2000 Cabinet resolution No. 767 “On Approval of Procedural Recommendations for Substantiation of Draft Regulations” was targeted toward introduction of the uniform approach to substantiation of regulatory drafts and prevention of adoption of economically ineffective documents. By virtue of this resolution, national and local executive authorities should apply indicated procedures in the elaboration process. Under this document, the State Committee for Regulatory Policy and Entrepreneurship should necessarily approve each draft regulation presented to the President or the Cabinet of Ministers of Ukraine for consideration. Regulatory impact analysis should be enclosed to every draft.

The July 31, 2000 Cabinet resolution No. 1182 “On Approval of Procedure for Elaboration of Regulations” established procedures for elaboration of regulatory drafts by national and local executive authorities and the Council of Ministers of the Autonomous Republic of Crimea, approval of draft regulations by the State Committee for Regulatory Policy and Entrepreneurship (SCRPE) and appellate mechanisms to be applied in the event the SCRPE’s rejection.

The procedure clearly indicated in the above two legal acts incorporates an important provision that offers business community an opportunity to influence the process of approval of regulations with the SCRPE. As a matter of fact, national and local executive authorities are to present the SCRPE with required substantiations of regulatory drafts, inclusive of regulatory impact analysis and analysis of alternative documents based on quantitative parameters used to estimate their efficiency in the future.

### ***What Should Business Community Do To Have Strong Impact on Elaboration of Regulatory Drafts***

First of all, they should gather information on elaboration schedules of ministries and administrations to be planned annually and necessarily submitted to the State Committee for Regulatory Policy and Entrepreneurship. Secondly, business community should get into and maintain close contacts with officials in ministries and administration responsible for elaboration of regulatory drafts. Though, it is very difficult to reach success at this stage, for a responsible authority may intend to adopt some regulation in its own interests and be reluctant to lend an ear to arguments of businessmen. Therefore, it is extremely important to cooperate with the State Committee for Regulatory Policy and Entrepreneurship. As the SCRPE does not have any bureaucratic interests and is responsible for business development, it will pay close attention to all proposals and recommendations made by the business community. However, the SCRPE does not have enough time to thoroughly analyze numerous applications apropos of various regulatory drafts. For the above reason, it would be expedient to present the SCRPE with proposals made by business associations, for they consider not individual interests but interest of business community on the whole. Business organizations should put forward their proposals or recommendations in the form identical to substantiation of regulatory drafts of executive authorities. The best plan to be followed is to present the SCRPE with proposals made on the basis of regulatory impact and alternative analyses. The SCRPE will really pay close attention to such proposals and most likely take them into account. As a matter of fact, the above work of business associations requires substantial resources, for it must be done competently.

Development of such cooperation with the SCRPE calls for special institutional mechanisms. The State Committee for Regulatory Policy and Entrepreneurship formed those mechanisms at various levels. The Public Council of the SCRPE was founded at the national level for the purpose of involving general public in discussion and implementation of public regulatory policy in the sphere of business development. The mission of the Public Council is to work out proposals relating to various issues of formulation and realization of the uniform public regulatory policy in the business sphere, especially licensing of business activities and registration of enterprises.

The Public Council is formed of representatives of national business associations and regional public councils established to support business. Regional public councils have been working on establishment of close cooperation of

various business associations and trade unions so that to work more effectively.

The July 15, 2000 presidential decree “On Measures Ensuring Support for and Further Development of Entrepreneurship” provided for establishment of business development advisory boards at the offices of local executive bodies. Those boards should be founded on a parity basis and consist of representatives of business organizations, public councils for protection of businessmen, the State Taxation Administration, the Ministry of Internal Affairs and local executive bodies. The advisory boards should take an active part in settlement of regional business and regulatory issues and produce strong influence on elaboration of regulations at the local level.

Government committees serve for the afore-mentioned purpose at the governmental level. In compliance with the Cabinet Temporary Procedure, prior to presentation of the Cabinet of Ministers of Ukraine with regulatory drafts, they should be considered at sessions of special government committees. There is yet another institutional tool providing for a dialogue with the State Committee for Economic Development. The May 18, 2000 Cabinet resolution “On Formation of the Council of Business Associations at the State Committee for Economic Development” established a standing consulting commission at the State Committee for Economic Development. The commission was founded for the purpose of attracting business associations to elaboration and improvement of drafts regulating business issues, ensuring transparency of the decision-making process in the economic sphere and establishing a feedback between economic entities and executive authorities on the basis of publicity and regulatory impact analysis. The commission consists of representatives of 33 national and local business organizations of Ukraine and ensures participation of businessmen in the decision-making process.

Analysis of work of advisory boards proves that they do have impact on the decision-making process. For instance, the Council of Business Associations at the State Committee for Economic Development (SCED) regularly presents the Committee with expert recommendations. Incidentally, 60% of decisions taken by the SCED do coincide with those recommendations and proposals.

The afore-mentioned system of institutional mechanisms allows a conclusion that business community is offered a lot of opportunities to legally influence adoption of regulatory documents at various levels. Unfortunately, such system is not that effective at present.

Its major drawback is functioning of business organizations in a “fire-extinguishing” manner. Both detailed provisional information on elaboration schedules and impact analysis of regulations in force are absent. Besides, business associations constantly complain that regional advisory boards do not function at all.

Deficiency of the system is engendered by ineffective activity of the power and business community.

Business community is characterized by the following drawbacks:

- Inability to make a regulatory impact analysis and present convincing arguments
- Inability to consolidate efforts of various business associations due to internal conflicts impeding a consensus
- Insufficient strength of business organizations that frequently force them to respond to regulations only subsequent to their enactment

Reluctance of the power to get into contact with business community is caused by the following reasons:

- Public discussion of draft regulations is perceived as interference with public governance secrets
- Bureaucratic approach to substantiation of regulatory drafts and, as a result, poor quality of a regulatory impact analysis and total inability to search for alternatives

Hence, the primary objective of business organizations is to strengthen their impact on elaboration of regulatory drafts. It is possible to achieve the above goal by the following means:

- Upgrade quality of analytical work
- Offer more opportunities for regular and step-wise control over elaboration of regulatory drafts
- Constantly monitor regulatory impact
- Learn to influence the power

As a matter of fact, business associations should acquire necessary skills and knowledge and share positive experience with each other so that to implement all the afore-mentioned objectives.

## *There is a Way out*

### **Interview with Andriy Palyanytsya, independent expert**

*ERT: How do you estimate the role of public regulatory policy in the business sphere? Does it meet social needs?*

Mr. Palyanytsya: Public regulatory policy as it is formulated and declared can actually meet daily needs, since it is based on the principle of responsibility of state authorities and Ukrainian government for their social and economic functions. State officials must understand that any regulation they enact will have certain consequences. Therefore, they should make an in-depth analysis of regulatory impact of each document so that to pursue sound and clear policy.

Public regulatory policy is a key pillar that should serve as a basis for public governance. As for its implementation and efficiency, those issues are rather ambiguous. In general, implications of public regulatory policy are positive but some of its fundamentals are realized only partially. As a matter of fact, there are numerous problems. Though, I would like to emphasize that regulatory policy is well-designed from the viewpoint of systemic approach.

At present, the most formidable challenges are those pertaining to other spheres but indirectly related to public regulation, such as problems of public governance engendered by the unfinished administrative reform, incentives of state officials to implementation of regulatory policy, absence of responsibility of judges for wrong or inefficient decisions and failure to comply with regulatory policy rules. Hence, despite the fact that the above problems do not directly pertain to regulatory policy domain, they indirectly affect its outcomes reducing forecasted positive implications.

*ERT: How can business community benefit from introduction of both public regulatory policy in the business sphere and deregulatory mechanisms?*

Mr. Palyanytsya: As far as entrepreneurs are concerned, public regulatory policy means not only protection but also prevention of violation of their interests. Judicial system advocates interests of business community in courts of arbitration in view of the fact of their violation. As for public regulatory policy, everything is different. The rules are more complicated on the one hand but much more beneficial for businessmen on the other. Businessmen, who take an active part in the process of elaboration and adoption of regulations and analysis of regulatory drafts, are offered an opportunity to become acquainted with elaboration schedule of government agencies, identify and prove inexpediency of documents impeding business activities. The above can prevent unscheduled inspections and abuse of power on the part of state officials. In other words, this procedure serves as the system of preventive measures.

*ERT: What are necessary preconditions for introduction of efficient public regulatory policy?*

Mr. Palyanytsya: This question is very important. It is possible to say that political will of the higher leadership, first and foremost, the President of Ukraine and the Cabinet of Ministers of Ukraine, is the major and necessary prerequisite for introduction of effective public regulatory policy. Furthermore, I would like to formulate it as follows: given political will of the higher leadership, life will be easier even without regulatory policy. Ukraine took the difficult way of formulating really perfect public regulatory policy because it always experienced problems relating to political will. It is not absence of various declarations that matters. The only question is that in reality, decisions made by the power often ran counter to those declarations and were not coherent. So, political will of Ukraine's leadership is the key factor.

There are yet two aspects having profound impact on efficiency of public regulatory policy. The first one is the administrative discipline. It means that administrative responsibility of state officials for their decisions, especially at lower and medium levels, must be clearly identified. State officials should accurately comply with decisions of their superiors.

The other equally essential aspect is influence of business associations, NGOs etc. The point is that Ukrainian government seems to be interested to carry out regulatory policy and theoretically has necessary motivation. However, in our country, theory is one thing and practice is quite another. From time to time, either political elite or business associations or public organizations should consolidate public efforts and initiate necessary changes. Though, given underdeveloped democracy, the role of the public is minor. So, as far as I can judge, it is political will that serves as determinant.

*ERT: What is the role of entrepreneurs, business associations and NGOs in realization of public regulation and deregulation? What mechanisms can ensure their involvement in such activity?*



first one is that they have to review regulatory drafts at the elaboration stage and put forward their own proposals and recommendations. They should not rule out a possibility of adoption of an alternative regulatory document. For this reason, entrepreneurs and business associations should critically review drafts elaborated by government agencies of various levels.

The second aspect is the way business community responds to enactment of deficient regulations. This mechanism is much more complex. It requires establishment of priorities, identification of most topical issues and consolidation of efforts to improve the situation by means of lobbying. Secret of success is mobilization of politically active constituency and involvement of general public in the lobbying process.

I would also like to mention that except for special regulations, all legal drafts are open to the public. Those documents should necessarily be available on Ukraine's government web-site or published in the mass media. Moreover, public discussion of a regulatory draft should take a specified period of time. So, entrepreneurs and business associations can present their proposals and recommendations within this period. Proposals and recommendations made by business community must be enclosed to documents of a ministry responsible for elaboration of a certain regulation to be submitted to the State Committee for Regulatory Policy and Entrepreneurship. By the way, the Committee provides businessmen with timetable of work on a definite regulation, i.e. terms of initial and final stages of its elaboration, public discussion etc.

The Council of Business Associations at the State Committee for Economic Development is yet another mechanism that proved to be effective under the previous government. The Council is to analyze and monitor all draft regulations, except for special or secret ones, worked out by the State Committee for Economic Development (SCED) and make its own expert conclusions. Entrepreneurs anxious about any regulatory draft impeding business could lodge their claims with the Council. The latter regularly presented the SCED with almost all recommendations made by businessmen. Incidentally, 60% of decisions met those recommendations and proposals. The above fact serves as evidence of effective cooperation between the previous government and entrepreneurs. Though, the remaining 40% of regulations ran counter to the interests of business community. Anyway, it is the issue of political will.

I am not confident that under the new government functioning of the Council will be as efficient as it used to be. However, the July 15, 2000 presidential decree "On Measures Ensuring Support for and Further Development of Entrepreneurship" provided for establishment of business development advisory boards at the State Committee for Regulatory Policy and Entrepreneurship and the offices of local executive bodies. Those boards also include representatives of business organizations. Be it as it may, entrepreneurs should protect their interests through business organizations. The most important thing they have to learn is to clearly formulate their problems.

*ERT: What should government agencies and entrepreneurs do so that to make public regulatory policy and deregulatory mechanisms more effective?*

Mr. Palyanytsya: Entrepreneurs should join in business associations so that to be able to represent and advocate their interests. Alone, they will have to spend a lot of time and money but all their efforts will be in vain. Business associations are founded to protect interests of their members. As a matter of fact, Ukrainian business organizations should advocate rights of their members more vigorously and demonstrate the power that their position does matter and must be regarded. Unfortunately, Ukrainian state officials are not accountable to the public. As a rule, such a situation is engendered by inertness of business associations. So, the latter must propose alternative drafts and play more active role in the regulatory process.

As for government agencies, especially local ones, their employees lack incentives to meet regulatory policy requirements. In my opinion, as soon as the budget reform is launched in Ukraine and local budgetary proceeds stop sinking in the national budget, government agencies at various levels will be more interested to support and develop regional business.

Hence, the State Committee for Regulatory Policy and Entrepreneurship should take the following steps. Firstly, the Committee should enlist support of the President and Premier in introducing the regulatory reform. As the State Committee for Regulatory Policy and Entrepreneurship is actually subordinate to ministries it controls, it can hardly control them without support of the two political leaders. This problem calls for a step-wise solution. Adoption of the laws on public regulatory policy and on the State Committee for Regulatory Policy and Entrepreneurship should be planned for the future, whereas at present, it is enough to enlist get support of political leaders.

Secondly, it is necessary to improve and, probably, simplify a procedure for regulatory impact analysis and more closely monitor regulatory application practice. The above procedure should be simplified because state officials can hardly bear responsibility for improper compliance as often they are just unable to abide by all rules due to their complexity. Thirdly, it is important to finish establishment of regional departments of the Committee, determine their functions and responsibilities, employ well-trained personnel, and strictly control their activities. Regional departments of the State Committee for Regulatory Policy and Entrepreneurship must be involved in the decision-making process and if so the Committee will become a powerful organization.

As for other government agencies, ministers must realize that public regulatory policy serves not only their personal interests but also those of the state and its citizens. There is a need to retrain ministerial employees so that

regulations in force.

## *Viewpoint of Businessmen on Public Regulatory Policy*

*By Vyacheslav Kredisov, president of the National Business Association “New Formation”, honored economist of Ukraine; Leonid Biryukov, executive director of the National Business Association “New Formation”*

In Ukraine, equality of forms of ownership is legally declared. As a result, even directors of state-owned enterprises are now called entrepreneurs. However, it should be mentioned that an entrepreneur is a person, who carries on business to derive profit at his/her own risk. And what risk do directors of state-owned enterprises run? Of course, it is not the risk of financial loss. The only risk is their dismissal from office by state authorities.

Regulatory policy in the sphere of entrepreneurship should be rather called regulatory policy in the economic sphere, since regulatory and deregulatory acts deal with such issues as:

- Certification of goods
- Responsibility of suppliers for deliveries of low-grade products
- Licensing of business (economic) activities
- Registration procedures, etc.

At the present stage of Ukraine’s economic development, government agencies rather have to realize the following objectives:

- Simplify procedures for starting and winding up a business
- Develop procedures ensuring equal (competitive) access to such resources as budget funds, state-owned enterprises that stand idle or are under construction, etc.
- Elaborate and introduce procedures for repayment of arrears
- Elaborate and introduce procedures for control over use of public funds
- Elaborate and introduce procedures for demonopolization of the market, where state-owned enterprises dominate

In the viewpoint of private entrepreneurs, the state should pay closer attention to regulation of economic activity (entrepreneurship) in the public sector. At the same time, the state should also regulate activity of state officials and control enforcement of the law “On Civil Service” as well as other laws of Ukraine, since some ministries and administration do not have their own respective regulatory rules.

It is not the state but the market that should regulate entrepreneurship as activity targeted toward deriving profit at an entrepreneur’s own risk. Hence, even registration of a company should exist in the form of announcement about beginning of its operation, since the company’s owner bears sole responsibility for accuracy of statutory documents and business performance.

Nowadays, personality of a state official, a businessman and a top manager plays the major role in Ukraine. On their own initiative, entrepreneurs are making efforts to form systems of self-regulation, such as, for example, the Code of Honor of Ukrainian Entrepreneurs. They voluntarily assume more obligations and liabilities than it is provided by various laws, rules and regulations. It is the future of Ukraine. The state governed by responsible people and patriots will ensure economic development of Ukraine. On the contrary, state officials caring exclusively about personal profit will give rise to public regulation of free business or the so-called political business.

First and foremost, it is necessary to change the key principle of relationship between the state and economic entities: the latter do not have to work for the state but the state as the form of social governance must work for its citizens, including entrepreneurs and private companies. Personal interests of an individual, citizen, businessman should always dominate over the interests of the state acting just as his/her representative. And only in the event of violation of human rights the state must interfere.

Introduction of the above new principle is absolutely necessary to encourage rapid economic development, especially development of medium-sized and small businesses. As a result, the 11% share of Ukrainian small and medium-sized enterprises may increase to 75% like in the economically advanced economies.

Only free people can become reach and then promote prosperity of their state and provide social security to the impoverished.

### **Impact of Entrepreneurs on the Elaboration of Legal Documents**

Business associations produce just weak impact on elaboration of legal acts. First and foremost, extent of that influence depends on their desire to exert it. Notwithstanding deficient legislation impeding activity of Ukrainian businessmen, the above desire remains purely declarative. Unfortunately, the majority of Ukrainian entrepreneurs seem to be afraid or unwilling to discuss their problems.

Businessmen can influence elaboration of regulatory documents during sessions, seminars and roundtable discussions of drafts. Furthermore, they can announce their position in the mass media, formulating their viewpoint clearly and forthrightly.

Entrepreneurs can also influence the afore-mentioned process through participation in non-governmental organizations like the New Formation. Its experts work out regulatory models and present them for discussion. Subsequent to the discussion, changed or amended regulations are lobbied in various parliamentary committees, such

generalizing proposals, recommendations and amendments made by business associations and NGOs.

Though, at present, neither businessmen nor business associations can effectively lobby their interests due to the absence of respective efficient mechanisms. Ukraine's business community is still learning to lobby. Within the frameworks of the BIZPRO Program, the National Business Association "New Formation" in cooperation with other business organizations and think tanks is working on the new Program "Lobbying of Business Interests in the Sphere of Technical Regulation of Economic Activity". We believe that members of the New Formation will gain international experience and become civilized lobbyists.

### **Barriers and Prospects**

For the time being, an outdated viewpoint on relationship between the state and the business community still prevails in Ukraine. In brief, the situation looks as follows. Ukrainian enterprises have to obtain various licenses, permits and certificates, comply with quotas etc. In other words, whatever an enterprise is going to do, it should be clearly indicated in legal acts, whereas in the advanced economies businessmen may do anything that does not run counter to laws in force.

As the key principle of relationship between the state and enterprises is old-fashioned and unsound, relations between state officials and entrepreneurs are often inadequate. Unfortunately, Ukrainian businessmen have to ask state officials to grant them a required permission or license. On the contrary, Western entrepreneurs do not have to stand in line waiting for reception and just don't care whether a state official is in high or low spirits. They can obtain such documents by mail on sending necessary application forms in the event they are not involved in business activities regulated by special rules and procedures.

As a matter of fact, government agencies responsible for granting permissive documents should control their adequate use. However, in many civilized countries, such inspections are held rarely (once every three years) and not weekly like in Ukraine.

Due to inefficient relationship between power and business in Ukraine, a system of responsibility of the parties was distorted. Entrepreneurs bear heavy criminal responsibility for every mistake, whether it is occasional or willful. For instance, over 20,000 criminal proceedings exclusively with respect to tax evasion were instituted against entrepreneurs in 2000. The overwhelming majority of those people are private entrepreneurs, who cannot afford employing accountants, auditors or legal experts. On the contrary, state officials are exempt from any criminal responsibility for financial loss suffered by enterprises as a result of their activity. There is no statistical data on such losses but they are very high anyway.

Psychological characteristic of a typical state official and businessman looks as follows. Most entrepreneurs believe that they have to bribe state officials so that to obtain a permit or have no troubles with a regular inspection. As a rule, state officials dealing with permits and revisions are confident they will receive considerable illegitimate income and disregard low salaries. It is a vicious circle. Entrepreneurs cannot prove in court the fact that they suffered financial loss as a result of misconduct of state officials and demand even a token compensation from either government officials or agencies, since they all bear no criminal responsibility. In advanced economies, prior to any revision, state officials will necessarily phone a director and ask permission to carry out an inspection on a convenient day. Exclusively in the event such permission is given, respective officials can start a revision. In Ukraine, the situation is completely different. Unceremonious manner of Ukrainian state officials used to enter private territory without any permission can be compared only to that of foreign law-enforcement agencies chasing to seize drug traffickers or terrorists.

Therefore, it is necessary to take a number of urgent measures to accelerate introduction of public regulatory policy in the business sphere and enhance efficiency of existent deregulatory mechanisms, especially procedures for registration and liquidation of economic entities.

Nowadays, the above procedures are too complex and expensive. Regardless of organizational form of a new business, it creates new jobs and is a potential taxpayer. Nevertheless, an owner has to pay the state for a license and wait it for months. It is generally known that in many developed countries registration of economic entities is conducted easily on the basis of applications. Unlike Ukrainian entrepreneurs, foreign businessmen do not have to waste their time and money and face no administrative problems, whose solution implies bribes. In our viewpoint, it would be expedient to introduce the same procedure in Ukraine, since it will stimulate efforts to start business and create new legal jobs.

## **Challenges of the Uniform Public Regulatory Policy in the Business Sphere**

*By Serhiy Bereslavsky, expert at the Institute for Competitive Society*

The January 22, 2000 presidential decree “On Introduction of the Uniform Public Regulatory Policy in the Business Sphere” prioritized realization of the uniform public regulatory policy in the business sphere by executive authorities. On February 3, 1998, the President of Ukraine signed the decree No. 79/98 “On Removal of Barriers Impeding Business Development” targeted toward introduction of deregulation as one of the integral parts of the uniform public regulatory policy in the business sphere.

Nowadays, it is safe to state that some goals declared at the initial stage of the regulatory reform in Ukraine were achieved.

Firstly, the following prerequisites for the regulatory reform in Ukraine were formed:

The system of procedures for elaboration and adoption of regulatory acts. The procedures are designed to prevent enactment of deficient regulations and ensure adoption of exclusively economically expedient and realistic documents having public support. Those procedures are based on the principles of publicity and competitive opinions and arguments.

The State Committee for Regulatory Policy and Entrepreneurship (SCRPE) as the body of government self-control was empowered to coordinate regulatory activities of executive authorities, necessarily approve economically efficient draft regulations, organize their public discussion etc.

Secondly, the number of elaborated regulations submitted for consideration to the State Committee for Regulatory Policy and Entrepreneurship and the share of properly substantiated drafts are increasing. Public discussion of those documents is becoming more animated as well.

Thirdly, joint activities of the SCRPE, business associations and NGOs contributed to removal of many barriers to entrepreneurship.

The extent, to which the above implications of public regulatory policy were positive, should be estimated from the viewpoint of benefits derived by business community. Though, such an assessment is rather ambiguous and complex.

Undoubtedly, stronger impact of business associations and NGOs on the decision-making process is one of the benefits from implementation of the uniform public regulatory policy. As a consequence, business community became more active. However, this advantage is of instrumental nature.

On the other hand, implications of public regulatory policy in Ukraine should be assessed in view of better efficiency of both the regulatory process and legal acts regulating the business sphere. Such assessment can be made on the basis of the following criteria:

- Predictable behavior of executive authorities in the process of elaboration and adoption of regulations
- Simple and intelligible regulatory requirements
- Expenses incurred by entrepreneurs due to compliance with regulatory documents
- Fair regulatory requirements from the viewpoint of balance of interests of business community, the state, and general public

By means of assessments based on the above criteria, it is possible to determine compliance of declared goals of public regulatory policy with those achieved. Unfortunately, such analysis has never been made in Ukraine.

Taking into account the fact that the above criteria are very difficult to measure, it can be possible to adequately estimate regulatory policy implications only by means of various surveys, including sociological ones. And even in this event, there is a threat to overestimate impact of some measures of the uniform public regulatory policy in the business sphere.

For example, it is quite possible to state that predictability of behavior of executive authorities in the process of elaboration and adoption of regulations has recently improved. Though, it is still unclear, whether the predictability indicator increased due to introduction of elaboration schedules. The matter in question is not that some executive bodies fail to plan those schedules and present the State Committee for Regulatory Policy and Entrepreneurship with them. Relationship between introduction of elaboration schedules and higher extent of predictability is not as obvious as it may seem, since a large number of regulatory drafts are unscheduled on the one hand and most of those schedules are not made public on the other.

Regardless of inability to make analysis of regulatory implications, further realization of the uniform public regulatory policy depends on solving some knotty problems.

One of them is that in practice, executive authorities do not make regulatory impact analysis of their own draft regulations and consider no alternatives.

Informal statistical data indicate relative increase in the number of regulatory drafts, whose impact is analyzed by executive authorities. Though, in reality, those bodies apply a purely bureaucratic approach to this analysis.

Substantiation of Draft Regulations” was targeted toward introduction of the uniform approach to substantiation of regulatory drafts. Under the resolution, in the process of regulatory impact analysis, national and local executive authorities should give consistent and clearly formulated answers to the following questions that should ensure realistic approach to regulatory impact analysis:

- What sort of problem should be solved by means of a particular regulation?
- What are the objectives of a regulation?
- What are alternatives to a proposed regulatory document? Are they realistic?

Analysis of answers of executive bodies that elaborated a draft regulation provides an estimate of expediency and efficiency of its adoption. Developing as realistic as possible model of regulatory impact and estimating its advantages and drawbacks for the state, economic entities and population, regulatory impact analysis should also perform a disciplinary function. Prior to calculation of potential advantages and expenditures, an executive authority should get convinced that a certain problem really requires state interference, since the simplest alternative to any regulation is total rejection of public regulation in favor of market mechanisms of control.

Experience of public regulation indicated some cases, when state interference with market relation is justified, and respective regulatory tools were worked out. However, those tools do not serve as a panacea and, as a rule, there are alternative measures enabling the state to achieve the same goals in a certain economic sector. Effectiveness of the above measures, their side effects, compliance with legal rights and interests of business community and general public are different.

It is a common practice to make regulatory impact analysis without indicating alternative regulations. Absence of alternatives also stems from the fact that chairmen of executive authorities are not presented with regulatory impact analysis so that they could choose the most efficient draft from a large number of options. In conformity with the presidential decree “On Introduction of the Uniform Public Regulatory Policy in the Business Sphere”, it is prohibited to present the President of Ukraine and the Cabinet of Ministers of Ukraine with regulatory drafts without forecast of social and economic regulatory implications, proper substantiation of expediency of state interference with a certain type of business, adequacy and effectiveness of proposed methods of solving problems.

Experience proves, it is not the Cabinet of Ministers of Ukraine or a respective national and local executive authority but the State Committee for Regulatory Policy and Entrepreneurship that is presented with regulatory impact analyses. Hence, decisions are not made on an alternative basis.

Due to the fact that regulatory impact analysis of each legal document is not based on thorough calculations of its advantages and expenses, it is hardly possible to determine clear and measurable indicators of compliance of that document with declared objectives. Consequently, an executive body responsible for elaboration of this regulation and general public will not be able to estimate its efficiency and review or abolish some of its provisions.

As a result of failure to make comprehensive qualitative and quantitative analysis of potential advantages and expenditures on the part of executive authorities, most regulations are rather expensive for both business community and the state, since the national and local budgets incur financial loss in the form of reduced tax proceeds. Thereafter, entrepreneurs evade some regulatory acts, for any regulation can be enforced only in the event that its violation is disadvantageous. Otherwise, businessmen will search for legal and illegal methods to evade regulatory requirements.

Efficiency of regulatory impact analysis certainly depends on the will of executive authorities responsible for elaboration of regulatory drafts. Hence, it is necessary to offer state officials a powerful incentive but a respective mechanism is still absent. Experience indicates that firmer executive discipline alone is not sufficient.

Furthermore, regulatory impact analysis is a long process, whereas executives, as a rule, are short of time, for they always have to urgently fulfill different tasks. Reduction in the number of duties would not settle the issue as well. Regulatory impact analysis calls for respective training and permanent improvement of acquired skills. Therefore, it would be expedient to delegate powers relating to regulatory impact analysis to competent officials (in the future – to special departments) of each executive authority.

The Cabinet resolution “On Approval of Procedural Recommendations for Substantiation of Draft Regulations” was targeted toward introduction of the uniform approach to substantiation of regulatory drafts and prevention of adoption of economically ineffective documents. However, this document failed to describe classification of problems that should be settled by means of state interference and established neither basic principles, on which analysis of potential expenses and advantages should be based, nor rules of alternative analysis. Hence, the State Committee for Regulatory Policy and Entrepreneurship should provide officials in charge of regulatory impact analysis with detailed recommendations and thereby accomplish formation of its methodological basis.

Competently made regulatory impact analysis will produce a strong impact on debates between executive bodies responsible for elaboration of draft regulations and business community. Should it be the case, to express their negative view about definite regulatory drafts entrepreneurs and business associations will just have to draw attention of executive authorities to the absence of alternatives and incorrect calculations of potential expenses and advantages.

The July 31, 2000 Cabinet resolution No. 1182 “On Approval of Procedure for Elaboration of Regulations” established detailed procedures for public discussion of regulatory drafts in the mass media and on the Internet. The essence of this procedure is to provide entrepreneurs, business associations and NGOs with as much information as possible on new draft regulations and ensure freedom of speech.

initiative of executive authorities. Usually, the most active entrepreneurs and representatives of business associations participate in public discussions organized by the SCRPE. Though, it is hardly possible to assume that information on elaboration of a regulatory draft is furnished to all interested persons.

Moreover, public discussion lead in compliance with a legally established procedure enables the SCRPE to control steps taken by an executive authority to analyze comments and proposals. Subsequent to public discussion of a regulatory draft, an executive authority responsible for its elaboration is to present the SCRPE with a checklist indicating both recommendations taken into account and reasons for rejection. Otherwise, an executive authority could have ignored proposals of participants in public discussion.

At the same time, public discussions envisaged the Cabinet resolution No. 1182 are seriously impeded by the fact that it is not legally determined whether the SCRPE or an executive authority that elaborated a draft regulation should incur organizational expenditures. Besides, public discussion should take not more than 20 workdays, whereas the elaboration term is often shorter.

To successfully perform its function of government self-regulation, the work of the State Committee for Regulatory Policy and Entrepreneurship should be transparent and understandable for both executive authorities and general public. Holding the Committee accountable to the public for results of its activities within a reporting period will enhance transparency of its work. Such reporting will be the best advocacy of the need for further realization of the regulatory reform in Ukraine. It will also allow business community to announce that their further influence on the decision-making process strongly depends upon social support for measures of the uniform public regulatory policy in the business sphere.

To maintain vigorous activity of business community it is necessary to form mechanisms ensuring their real influence on the decision-making process and prioritize consideration of viewpoints of business associations and NGOs in the process of elaboration of regulatory drafts. Should the state fail to do it, entrepreneurs may get disappointed with the regulatory reform.

It is extremely important to apply comprehensive deregulatory measures in some sectors of the national economy or reform definite types of public regulatory tools.

Resources of the SCRPE and business associations are mostly allocated for prevention of adoption of new inefficient regulations and abolition or change of previously enacted documents. In other words, at the moment, the SCRPE and business associations mostly perform preventive functions.

As for the whole body of regulations in force, actually no changes or amendments are made. In other words, the status quo is maintained within the system of public regulation in the business sphere. Such a situation is brought forth by the fact that executive authorities and business circles lack resources that should be earmarked for making analysis of regulatory climate in some economic spheres and putting forward proposals for optimization of public regulation in those branches.

The way out of this situation is approval, by a government agency, of a resolution on the need to carry out sector deregulation.

It does not mean that day-to-day deregulation implemented following the procedure established by the presidential decree "On Removal of Barriers to Business Development" should not be regarded as out of use mechanism. Such deregulation is focused on specific objectives and can serve as a tool for restructuring some economic sectors.

For the time being, the legal basis for realization of the current stage of the regulatory reform has been formed. However, there are discrepancies between legal acts passed in the light of introduction of the uniform public regulatory policy in the business sphere and other documents regulating procedures for elaboration and adoption of regulatory documents and identification of day-to-day deregulatory measures.

The State Committee for Regulatory Policy and Entrepreneurship is also vested with enforcement powers, for instance, those relating to day-to-day deregulation, which frequently engenders accusations of interference with activities of other executive bodies. For the above reason, it is necessary to legalize the special status of the SCRPE. The draft law of Ukraine "On Principles of Public Regulatory Policy in the Business Sphere" serves as a response to the January 22, 2000 presidential decree No. 89/2000 "On Introduction of the Uniform Public Regulatory Policy in the Business Sphere". The draft clearly describes a special status of the SCRPE as the national executive authority and improves, on the basis of hands-on experience, procedures for elaboration and adoption of draft regulations and day-to-day deregulatory mechanisms. Under the draft, local executive authorities and, in some cases, local self-regulatory bodies should comply with the above procedures.

Unfortunately, due to a long-lasting discussion about the future of the regulatory reform in Ukraine stirred up between the SCRPE and other national executive authorities, presentation of the Verkhovna Rada with the draft "On Principles of Public Regulatory Policy in the Business Sphere" was postponed without any plausible excuse. Forthcoming consideration of this draft and resolution on its enactment will serve as ample and convincing evidence of availability or absence of national executive authorities' political will to further realization of the uniform public regulatory policy in the sphere of entrepreneurship.

## *Viewpoint of Businessmen on Public Regulatory Policy*

*By Volodymyr Barabash, director general of the Monomakh Company.*

Nowadays, representatives of small and medium business much better understand opportunities of their impact on public regulatory policy. Entrepreneurs feel the need for such policy ensuring formation of favorable business environment from the moment they start to do business, since they experience numerous problems that hamper their activity. For the time being, the major and actually the only positive implication of regulatory policy is simplified taxation of small business. The overwhelming majority of regulations provide for advantages of large business and thereby state officials, who use their powers to lobby personal interests.

At present, it is possible to influence elaboration of regulatory documents through the State Committee for Regulatory Policy and Entrepreneurship, mostly at the deregulatory stage, and the Advisory and Coordinating Center of Ukrainian Business Associations (ACCUBA). Under the Yushchenko government, the ACCUBA analyzed almost all draft regulatory documents considered by the Cabinet Economic Committee headed by first Vice- Premier Mr. Yekhanurov, whereas under the Kinakh government, the Center plays minor role.

Unfortunately, influence of business associations on elaboration of regulatory drafts is not strong enough. On the one hand, they don't make strenuous efforts to participate in the elaboration process, are rather inert and, therefore, have no opportunity to present their own draft regulations for consideration. On the other hand, most regulations adopted by government agencies are anonymous. Very often such regulations emerge as a result of the so-called hidden lobbying. Their authors make efforts to conceal elaboration, and sometimes, even enactment of such legal documents as long as possible so that to prevent negative public response and opposition. The above can also serve as an explanation for adoption of such ill-designed and ineffective legal act as the decree "On Holographic Protection of Goods and Documents" designed to bring some interested persons profit from mandatory sales of expensive holograms. Authors of this "masterpiece" are anonymous and none of them participated in public discussion of this decree. However, it should be mentioned that a lot of identical legal acts did come into force. For instance, the Makarovsk administration of the Kyiv region banned trade in bread baked outside this district pursuing personal interests in the Makarovsk-based bread-baking plant.

The following factors explain the need for strong and efficient influence of entrepreneurs on elaboration of draft regulations at various levels:

- Officials at various levels own their personal business or a share in a number of companies
- The mass media do not pay close attention to the process of elaboration of dubious draft regulations and, especially, their authorship
- Adoption of inefficient regulations has no serious and inevitable consequences for state officials, especially policy-makers, responsible for their elaboration
- Representatives of fire prevention agencies, sanitary and veterinary stations introduce various duties and fees to cover budget deficits
- Relationship between the power and the public inherited from the former Soviet Union produces an adverse affect because power never recognizes its incompetence and people, including businessmen, cannot realize that they have rights to hold power accountable

What should be done? Of primary importance is vigorous activity of business associations. Business organizations involving medium and small entrepreneurs also inherited Soviet traditions. Moreover, power deliberately drives many entrepreneurs into the informal or semi-formal sector. Hence, it is very difficult for businessmen to act as bona fide taxpayers enjoying the right to put forward and enforce their demands.

Taking the above into account, political will of the Ukrainian establishment dominating over personal interests of policy-makers is a necessary and sufficient prerequisite for efficient public regulation. After all, most popular politicians should return to such moral values as Ukrainian state and national progress.

Measures for legalization of some types of business having nothing in common with trafficking in drugs, people, illegal weapons and firearms will facilitate effective implementation of public regulatory policy in the sphere of entrepreneurship. In Ukraine, those measures should include, first and foremost, legalization of wages and salaries by means of cutting relevant taxes and charges. The Russian Federation demonstrated the latest positive example in this field. On the contrary, in Ukraine, the Verkhovna Rada once again rejected the draft Small Taxation Code providing for solution to this issue.

As for deregulation, it would be expedient to comprehensively analyze and review regulations enacted under the Soviet Union and essentially hampering business.



## **Viewpoint of a Businessman**

*Interview with Mykola Georgievsky, director general of the Enran-Akros Company*

*ERT: In your opinion, what is the role of public regulatory policy in the business sphere and what are aspirations of business community?*

Mr. Georgievsky: Very positive is the fact of formation of the State Committee for Regulatory Policy and Entrepreneurship (SCRPE), whose major goal is to provide public support for business. The Committee founded at the initiative of the national political elite makes representatives of government agencies and state officials at various levels reckon with its decisions.

Public regulatory policy should be enforced by responsible government agencies. However, numerous rules and procedures established in presidential decrees and other legal documents lack mechanisms ensuring their implementation. Except for the right to suspend some legal acts running counter to Ukraine's legislation and conflicting with interests of business community, those legal documents do not indicate administrative responsibility of both state officials and various departments of the SCRPE. As a matter of fact, the above regulations are sometimes applied despite their suspension. Hence, there is a situation, when the state demonstrates its desire to uphold business community and mechanisms for such public support are still absent.

*ERT: What are key challenges of and barriers to introduction of public regulatory policy?*

Mr. Georgievsky: Unfortunately, it is hardly possible to speak about equal opportunities of businessmen and the state. The state was, is, and should be the major monopolist in some regulatory aspects but not without reasonable restrictions. As state officials are empowered to exercise public regulatory rights, absence of clear, popular, transparent and easy of access mechanisms entails problems. For instance, in the city of Kyiv, there are numerous bureaucratic barriers to acquisition or transfer of a land share.

The land tax is another issue in question. Proceeds from the land tax and rent payments are transferred to local budgets. Their amount must be set by a regional state administration. It should be mentioned that the amount of rent payment for land used for trade is higher than for that used for industrial purpose. This fact cannot be explained from the viewpoint of common sense, since quality of land is not variable. Should a city intend to tax more, it will have to make this land more attractive. Construction of a commercial complex means capital investment, creation of new jobs, provision of infrastructure etc. In other words, notwithstanding expenses a businessman incurs to make that land share more attractive, he has to pay higher taxes. Of course, it is not right. However, as the state is the monopolist, it alters the rules but only for one player and simply informs a businessman about its decision. The State Taxation Administration is to collect all land taxes and rent payments. Let's return to the question at hand: businessmen must solve a lot of problems to ensure protection of their rights, whereas the state can easily settle any issue through different taxes. The problem of such injustice, such disparity of rights and responsibilities must be solved first of all. Decisions of law-makers and executive authorities should be based on conceptual approach ensuring equal rights and responsibilities. For the state has efficient mechanisms for protection of its interests, businessmen should be offered an opportunity to safeguard their rights as well.

*ERT: Do business associations have any influence on elaboration of regulatory drafts?*

Mr. Georgievsky: I am absolutely convinced that impact of business organizations on elaboration of regulatory drafts is not sufficient at the local level though their efforts are gaining strength. Earlier on, I have never been presented with draft regulations, never participated in their discussion, my proposals and recommendations were always disregarded. Nowadays, the situation changed for the better due to several years' activity of the State Committee for Regulatory Policy and Entrepreneurship and support on the part of the mass media. In other words, attitude of state officials, business community and general public to regulatory policy is changing. After all, state officials start realizing that it is impossible to work out a regulatory draft without due consideration of interests of business community.

*ERT: What mechanisms can ensure strong and efficient impact of entrepreneurs on elaboration of regulations?*

Mr. Georgievsky: The most important one is targeted toward thorough analysis and discussion of pending draft regulations and search for alternatives.

Establishment of advisory boards at regional state administrations is under way. Unfortunately, those boards do not function properly everywhere but they produced some positive results.

should necessarily prove such a fact, first of all, at the local level. As soon as complaints are analyzed and generalized by local business organizations, businessmen should present national executive authorities with those claims. They must not adhere to a wait-and-see policy, anyway. Only a strong position and active participation in discussion of regulatory drafts can protect business community against inefficient public regulation. Business associations should assume and maintain a firm position on forthcoming parliamentary elections.

*ERT: What should businessmen do to change the situation for the better?*

Mr. Georgievsky: In Ukraine, there are numerous business and public organizations that are little known and can hardly influence the decision-making process. They should consolidate at various levels so that to clearly formulate their opinion and be able to advocate it. They should also give support to the SCRPE and be supported by it.

It is necessary to realize huge potential of such organizations as the Ukrainian Union of Industrialists and Entrepreneurs and the Ukrainian Union of the Owners of Small, Medium and Private Business for the purpose of lobbying interests of business community. Both the Ukrainian Union of Industrialists and Entrepreneurs and the State Committee for Regulatory Policy and Entrepreneurship are deeply engrossed in such work. I am not afraid to repeat that still there is an unbridgeable gap between state officials and entrepreneurs in comprehension of and approaches to the same issues.

We all have been brought up under the identical conditions but life has drastically changed afterwards. Behavior of officials salaried by the state radically differs from that of businessmen. State officials are responsible only to their higher-ups guided by the same interests, whereas entrepreneurs bear full responsibility. By virtue of Ukraine's legislation, they risk not only their own welfare but also freedom. Those two ideologies are completely opposite. It will take many years, till Ukrainians change their attitude of mind and adhere to the same principles.

### ***Tapping Hidden Fortunes***

**By Catherine Kuchta-Helbling, Ph.D.**

*Center for International Private Enterprise (www.cipe.org)*

Billions of dollars in potential profits are lost each year in emerging democracies and economies threatening to derail political and economic transitions worldwide. These losses result from ill-designed, complex laws and regulations that exclude millions of citizens from the political and economic system and unnecessarily raise the cost of doing business in the formal sector. High business costs force entrepreneurs of modest means to survive by operating low-income, low-growth activities in the informal sector, squandering their economic potential. Moreover, costly business regulations encourage investors to flock to more hospitable business climates causing other countries the loss of millions of dollars in badly needed investment. These factors greatly hinder competitiveness, profit-making and overall economic growth. They also impede a country's ability to benefit from globalization. As a result, many citizens feel that they have not benefited enough from democratic and market-oriented reforms and oppose further reform initiatives. In some countries, widespread demands to reverse past reforms are mounting. Unless barriers to political and economic participation are removed in the near future, democratization and market-reform could unravel across the globe.

A key barrier is the cost of doing business in the formal economy. Entrepreneurs who want to become and remain formal must spend time and money to:

- obtain a business license
- acquire land titles or leases hire employees
- comply with government laws and regulations—pay taxes, for example obtain credit
- hook up and maintain electricity and telephone services enforce contracts, and so forth.

How expensive these procedures are fluctuates wildly from country to country. Exorbitant business costs are found in nations where business people must follow burdensome laws and regulations and deal with inefficient, corrupt government agencies which offer few benefits. High costs force entrepreneurs to make calculated decisions as to which rules they will respect or violate based on what they can afford without having to go out of business, what they expect to receive in return, and the cost of noncompliance. Many entrepreneurs producing legitimate products lower their business costs by operating informally without proper permits and legal status. Hence, they are called the informal sector or "informals."

Every economy—developed or emerging—has an informal sector. New York City sweatshops are notorious examples of informality in the US. What is alarming is that the already large informal sectors in many emerging democracies and economies continue to grow. A recent IMF study reveals that about nine trillion dollars—roughly a third of the GDP of emerging markets—was produced informally.

Similarly, 1999 International Labor Organization figures indicate that 17% to 84% of the urban labor force in developing countries work informally. What's wrong with high business costs and large informal sectors? To begin

Informals, if given the opportunity, are likely to suggest useful policy changes that would reduce the cost of doing business and level the playing field. Yet, their illegality prevents them from voicing their concerns to government officials and holding them accountable. As a result, reforms that would increase private sector activity and growth are not implemented. Moreover, because informal sector activity is unreported, policymakers don't have the necessary information to make good decisions. Unsound macroeconomic policies can seriously harm an economy.

High business costs also damage an economy because they lower productivity and competitiveness and encourage informality. This happens in several ways. One is through costly business licenses that grant rich, but not necessarily efficient, producers an unfair advantage over potentially productive start-ups with limited funds. Another is through stringent, costly labor codes. Formal businesses reduce labor expenses by overusing scarce capital and under-employing available labor; conversely, informal entrepreneurs rely too heavily on informal labor and not enough on cost-effective capital. Either way, resources are misallocated, productivity is stunted and workers suffer. Formals lose hard-won benefits whereas informals are forced to accept low wages, unstable jobs and poor working conditions.

More familiar causes of low productivity and informality are complex and costly taxation and regulatory schemes. Many entrepreneurs avoid the time, money and headaches of burdensome regulations through tax evasion and noncompliance. This lowers government revenue to finance essential business-related goods and services such as the court system, administrative agencies, roads, and health care. As a result, their quality declines as does entrepreneurs' productivity levels, unleashing a vicious circle. Poor quality services discourage even more entrepreneurs from paying taxes and business-related fees which, in turn, further decreases government revenues and quality of service levels encouraging informality and corruption.

Informality and corruption waste vital resources and weaken political and economic institutions. Because informals are illegal, they don't benefit from law enforcement services such as the courts and the police that could offer them protection and reduced business risks. Some informals survive without these services by signing short-term, small-scale agreements with known partners. Yet, this greatly lowers their productivity and flexibility. Other informals bribe government officials to obtain services or escape costly punishment for their illegality. Corruption pads the pockets of officials, robs the government of much-needed revenue for essential services and raises the price of goods and services. Moreover, routine violation of government laws and regulations erodes their credibility and scares investors.

Complicated, costly and insecure property rights systems are equally harmful to economic performance. Assets lacking secure property rights tend to remain in the informal sector because they can't be converted into "productive economic currency" such as collateral for reasonably priced loans to start or expand a business or shares in incorporated companies. Without legally protected property rights, entrepreneurs will have difficulty attracting investors and will have little incentive to train personnel or purchase capital (such as computers or high-tech machines) in order to undertake large-scale, long-term investment, specialize and be competitive. As a result, the economic potential of assets worth trillions of dollars is squandered in small-scale, short-term, low-surplus generating informal sector activities.

Costly, insecure property rights damage economic performance in other ways as well. Obtaining water, electrical and telephone services usually requires a property title. Entrepreneurs without property titles can gain access to these services only through illegal tapping. Widespread siphoning forces providers to charge regular subscribers more. Higher prices, in turn, harm the competitiveness of companies that use these services.

Where do high business costs and large informal sectors come from? The answer is from badly designed laws and regulations and poor quality government services that stack the deck against the entrepreneur of modest means. This is particularly the case when entrepreneurs are locked out of the policymaking process and thus can't tell government representatives which policies help or hurt their business activities. As a result, laws and regulations are made by a handful of individuals for the benefit of themselves and/or their cronies, and may not encourage overall, long-term economic growth.

The failed crony capitalist systems in Asia illustrate just how disastrous such arrangements can be. Such crises also show that those who created or have adapted to such a system stubbornly defend it because significant changes will be costly and risky for them. As a result, poorly designed institutions often enjoy extended life spans.

There are plenty of examples of ill-designed rules and regulations. Among the most common are taxation and labor policies. High tax rates and poorly administered taxation systems reduce profit margins encouraging tax evasion and informality. Similarly, restrictive labor regulations impose substantial, fixed burdens on firms (especially low income-earning ones) and make hiring informal workers attractive.

In some countries, setting up a business is akin to a multi-year marathon. One of the first hurdles is acquiring legal property titles for assets such as land or scientific discoveries. Complex and lengthy titling procedures can prevent even the most determined entrepreneurs from setting up shop. Examples from Hernando de Soto's recent book, *The Mystery of Capitalism*, illustrate just how burdensome obtaining legal real estate titles can be in some countries: in the Philippines it requires 168 bureaucratic steps, involves 53 public and private agencies and takes 13 to 25 years; in Egypt it requires 77 bureaucratic procedures, involves 31 public and private agencies, and takes five to 14 years; and in Haiti it requires 111 bureaucratic hurdles and takes approximately 12 years.

complicated license and permit requirements. The Harvard Institute of Economic Research recently published a survey of the official requirements to set up a business in 75 countries. The results indicate that the process entails, at best, two steps, two days, and US\$280 in Canada; at worst, 20 steps, 82 days, and US\$2,696 days in Bolivia; and, on average, 10.2 procedures and 63.1 days.

Entrepreneurs' headaches and high costs do not disappear once their business is finally registered. Now they must comply with a whole host of administrative and operative regulations ranging from paper filing requirements to price, interest rate, and import and export controls. In Peru, 73% of the cost of remaining formal came from following administrative rules. In Brazil, entrepreneurs must abide by over 50 sets of filing and payment requirements and must comply with endless record-keeping demands including filing four copy slips per sale. Complying with numerous laws and regulations becomes even more overwhelming and costly if government agencies lack adequate financial, technical and human resources to administer and enforce them quickly and correctly. When it takes five months to get a business license or resolve a contract dispute, economic opportunities are lost. Paying bribes to speed up the process or avoiding the hassles altogether by operating informally become tempting solutions.

Remaining formal is exacerbated by unclear, unknown, conflicting, and frequently changing laws and regulations. This forces government officials and entrepreneurs to spend time and money figuring out which laws and regulations apply or risk noncompliance fines. It also breeds corruption by enabling government personnel to use their power to control the pace and the outcome of administrative and enforcement processes in return for illicit payments. A startling example is the Brazilian state and local safety codes that indicate different heights for fire extinguishers. A clever businessman put two sets of brackets per extinguisher and switched the extinguisher according to inspector. His scheme was foiled by conspiring inspectors who arrived together so that they could cite a violation and extract a payment.

Poor quality and/or nonexistent infrastructure can also bleed entrepreneurs' pocketbooks dry. Business costs rise significantly if entrepreneurs must travel long distances on unpaved roads or wait years to get a telephone line or electricity. Similarly, insufficient technological infrastructure hinders the creation and maintenance of business-related databases that contain essential information such as credit reports. Without credit reports, creditworthy borrowers can't benefit from lower interest rates.

#### **How can business costs be lowered?**

Lower business costs and economic revitalization are within reach thanks to a handful of policy recommendations. These entail reforming specific laws and regulations and decision-making practices as well as government agencies' operating procedures.

Unsuitable laws and policies have a better chance of being reformed if entrepreneurs participate in and oversee policymaking. To this end, governments should make laws and regulations (draft and enacted), budgets and legislators' voting records available to the public by adopting and enforcing freedom of information laws. They should also ensure that decision-making procedures are transparent and inclusive so that citizens can easily comment on existing and draft laws or propose new ones. (For other ways of enhancing citizens' involvement, see the Sana'a Declaration.

Streamlining legal and regulatory codes can greatly reduce business costs. This can be done by eliminating duplicative, outdated, complex, and conflicting laws and regulations and replacing them with ones that clearly define rights, responsibilities and compliance procedures. Property rights laws, for example, need to establish straightforward standards to identify asset owners and to indicate how property can be combined, leased, or exchanged. Tax codes and fiscal report requirements need to be simplified, and overall tax rates lowered. Similarly, labor codes should be revamped to eliminate outdated laws and to allow for more flexible employment contracts. Equally important are simple and well-publicized business registration requirements. Having a one-stop registration process that can be completed in every region of the country is one way to greatly reduce start-up costs.

Instituting corporate governance measures can work wonders for a country's business climate. What is needed is legislation that protects investors, shareholders and other stakeholders, requires transparent shareholder registries, and upholds the Organization for Economic Cooperation and Development's (OECD) Convention on Corporate Government and the International Standards Organization's (ISO) accounting standards. (For more information, see: [www.cipe.org/efn/governance.php3](http://www.cipe.org/efn/governance.php3).)

The same is true for regulations affecting the financial sector and government procurement. Implementing prudential supervisory mechanisms within the banking and financial sector can significantly reduce the risk of resources being drained by an "Asian flu." Similarly, fewer funds will pad the pockets of government cronies and their private sector pals if conflict of interest laws are clarified, Transparency International's government procurement codes are adopted, and OECD anti-bribery principles are upheld.

Overhauling government agencies can lower entrepreneurs' costs and improve the commercial environment. To this end, agencies' internal operating procedures need to be simplified and their performance regularly evaluated according to well-defined standards. Staff should be hired and promoted based on verifiable professional standards, and they should receive appropriate salaries. Agencies, particularly the judiciary, should be provided with sufficient,

efficiently and fairly.

Maintaining adequate checks and balances between government branches helps minimize frequent, radical changes to the legal and regulatory framework. This reduces the burden on the judicial system and inhibits abuses of governmental power—especially in countries where commercial activities are governed by civil codes that can be overturned by decree.

Providing quality, efficient and cost-effective infrastructure substantially lowers business expenses. To this end, government should ensure a healthy degree of competition in these domains by privatizing inefficient state services or by subcontracting with private sector providers based on transparent guidelines. With cutting edge telecommunication systems and computer systems, the public and private sectors can maintain up-to-date, accessible databases of essential business-related information such as property title records, licensing and permit requirements and credit histories.

### **Converting ideas into action**

Knowing the types of measures that will reduce business costs, strengthen democracy and establish a level playing field for all entrepreneurs is only half the battle. Victory requires a well-designed reform platform and advocacy strategy. Developing a national business agenda is one way to promote legal and regulatory change effectively. The agenda sets reform priorities by indicating which laws and regulations need to be modified in the near future and provides concrete suggestions for change.

Formulating a national business agenda requires the private sector to take action. Heads of private sector business associations should take the lead by asking their members to indicate which laws and regulations raise the cost of doing business. Association leaders should collaborate to compile these in a single list. They should then get together to review the list and select reform priorities. Next, private sector leaders, alone or in collaboration with pro-reform think tanks, should draft a national business agenda.

The agenda should clearly identify which laws and regulations are being targeted for reform. Each should be described in straightforward terms. Each description should be followed by a simple presentation using basic charts or graphs that shows how the policy in question raises business costs and how alternative laws or regulations can reduce these expenses. This will provide powerful evidence that certain business costs are unnecessarily high and that solutions are within reach.

Spokespersons for the business community, allied with others in their communities, must take up the cause of reform and liberalization. Armed with the national business agenda, business people must make common cause with political leaders, journalists, academics, civic organizations, and others concerned with the economic future of their country. Coalitions can be formed to advance reform based on a simple proposition: A country that denies its own citizens the right to entrepreneurship is jeopardizing the future of its children. It is the entrepreneurs who will create new technologies, new jobs and access to international markets. This message must become a national call to action, to reform.

### **Reducing barriers to participation strengthens democracy and economic growth**

Emerging democracies and economies are struggling to provide their citizens with better lives marked by political participation and economic prosperity. Yet, excessively high transaction costs hinder such efforts. Making this aspiration a reality hinges on instituting democratic governance in the public and private sectors. Such a change will contribute to more responsive policies and will increase efficiency, transparency, accountability, and growth, as well as reduce corruption. Moreover, if citizens are granted a greater voice in the reform process, they will gain a sense of ownership over reform measures. This will strengthen democracy and help to build a broader pro-reform constituency essential to consolidate political and economic reforms.

*\*More information on the informal sector is available on CIPE's Web site at: [www.cipe.org/efn/informalsector/papers/](http://www.cipe.org/efn/informalsector/papers/)*

## **Results of Focus Group Research**

### **“Goals and Practice of the Public Regulatory Policy in the Business Sphere”**

On July 10, 2001, in the framework of the Information for Reform Program, the Ukrainian Center for Independent Political Research and the Institute for Competitive Society in co-operation with the Center for International Private Enterprise conducted a focus group research “Goals and Practice of the Public Regulatory Policy in the Business Sphere”. The goal of this focus group was to characterize Ukraine’s regulatory policy in business sphere, identify its primary objectives, specify major problems and propose respective solutions.

#### ***Objectives of the focus group research were as follows:***

- Formulate the most important tasks of today’s public regulatory policy
- Specify key problems impeding efficient realization of the public regulatory policy
- Estimate the nature and strength of influence of businessmen on elaboration of regulatory documents
- Determine measures necessary to improve implementation of the public regulatory policy

The research was carried out using expert assessments and depth conjoint interviewing technique (focus group methodology) and a sample of eight public regulatory policy experts selected on the basis of the snow-ball method. The focus group included private entrepreneurs, state officials, academicians and independent analysts so that to carry out a multi-faceted and comprehensive study of problems on the agenda.

#### **Members of the focus group:**

- Volodymyr Barabash, director general of the Monomakh Company
- Serhiy Bereslavsky, expert at the Institute for Competitive Society
- Dmytro Lyapin, vice-president of the Institute for Competitive Society
- Ksenia Lyapina, project coordinator at the Institute for Competitive Society
- Andriy Palyanytsya, independent expert
- Serhiy Sehedra, member of the Secretariat of the Council of Business Associations at the State Committee for Economic Development
- Konstyantyn Tkach, head of the regulatory policy department at the State Committee for Regulatory Policy and Entrepreneurship
- Ludmyla Khomenko, head of the regulatory policy methodology department at the State Committee for Regulatory Policy and Entrepreneurship

The research gave much information on today’s investment climate in Ukraine in general, highlighted its key problems and some advantages. A lot of proposals to improve the situation were made.

*The research produced complete and reliable qualitative information that can be used for quantitative analysis and academic study of the given problem.*

*Findings of the focus group may be interesting for representatives of government agencies, entrepreneurs, academicians, journalists and the public.*

#### ***Summarized Research Findings***

In the opinion of the focus group experts, the need for the public regulatory policy has already been understood and state authorities are now working on its formation and realization. Public regulatory policy got cheaper, more predictable and coherent. Though, some problems as to consideration of interests of wide strata of population still exist. A number of legal documents dealing with a procedure for elaboration of regulations by central and local agencies have been worked out and enacted. However, social and economic conditions are constantly setting new requirements in the sphere of public regulatory policy.

*Participants emphasized the following objectives of the public regulatory policy at the present stage of reforming Ukraine’s economic system:*

- Achieve the most possible efficiency of public regulation through introduction of a number of documents regulating procedure for elaboration of legal acts by central and local authorities
- Eliminate existent economic, administrative, political and legal barriers to development of entrepreneurship in the process of introduction of the above legal documents
- Balance interests of the national and local budgets, consumers and manufacturers in the process of introduction of any legal act
- Introduce and apply methods for regulatory impact analysis
- Transform any policy pursued by the government, the Verkhovna Rada and the President of Ukraine into the public one by involving the private sector in discussion of drafts
- Monitor adopted legal acts and necessarily apply deregulation mechanisms
- Institute measures ensuring regular interaction of society and the government

State conditions urging state and local authorities, prior to adoption of a regulatory document, to prove that a) regulation will produce expected effect; b) its cost will be lower than relevant expenses of economic entities; c) suggested public regulatory policy is the most expedient

- Work out rules and procedures ensuring enactment of important, effective and coherent regulations
- Search for solutions to existent problems advocating interests of as many economic entities as possible
- Ensure that the public regulatory policy and the administrative reform are complementary
- Minimize risks of regulation and maximize possibility of its positive effect

*Experts indicated the following key problems impeding realization of the public regulatory policy in the business sphere:*

- Public regulatory policy had been introduced when power and the public were not yet ready to perceive it
- People have not yet realized the idea of the public regulatory policy
- Higher echelons of power are not willing to carry out the public regulatory policy
- Entrepreneurs do not believe that introduction of the public regulatory policy can positively influence its activity
- Public actually does not insist on compliance of government agencies with principles of the regulatory policy
- Accumulated quantitative shifts in regulatory domain are not transformed into qualitative ones
- Legal status of the State Committee for Regulatory Policy and Entrepreneurship and the law of Ukraine dealing with the public regulatory policy are absent
- Very often state officials prove to be incompetent to meet requirements of the public regulatory policy
- Disposition of labor force in executive bodies remains inefficient
- Drafts are elaborated on the basis of the outdated branch approach without application of new administrative principles
- Analysis of the regulatory influence of legal acts is not made properly
- Monitoring of efficiency of the previously adopted legal acts is absent
- It is impossible to analyze impact of some regulatory decisions because expected indicators are not calculated
- Contradictory functions of the State Committee for Regulatory Policy and Entrepreneurship provoke conflict of interests, since this body controls efficiency of state regulation on the one hand and performs licensing functions on the other
- Expectations of state authorities related to financing of their work considerably exceed opportunities of the national economy at present
- As state officials are paid meager salaries, they have no incentive to perform their duties properly and are forced to search for sources of additional income to support their families. In such a situation there is a threat that state officials may elaborate and enact legal documents and regulations lobbying exclusively their own interests
- Delay in effecting the administrative reform hampers efficient realization of the state regulatory policy
- Administrative and command methods inherited from the former USSR impede application of regulatory mechanisms
- Miscomprehension of the need for the state regulatory policy on the part of Ukraine's political elite hinders its introduction
- Process of making governmental decisions remains unpredictable and inconsistent
- Responsibility of state officials for implementation of the regulatory policy is not determined
- The State Committee for Regulatory Policy and Entrepreneurship and other national executive authorities do not make public reports on realization of the regulatory policy
- Alternatives to proposed regulations are not considered at all
- Regulation policy hampering entrepreneurship cannot engender growth of budget receipts and increase in salaries of state officials
- Regional business association frequently demonstrate inertness and formal approach to their work
- Regulatory measures are taken only in response to negative trends instead of preventing them

*Members of the focus group pointed out the following positive aspects of influence of business community on the process of adoption of regulatory documents:*

- Influence of business community on the process of making important decisions is rather strong and expected to enhance in the future. As the number of entrepreneurs is growing, their influence on state authorities will get stronger
- Nowadays, businessmen lobby their interests and protect their rights more intensively than ever before
- It is strong influence of public opinion on social development that urges state officials to conceal important draft regulations and avoid their public discussion
- Entrepreneurs got an opportunity to participate in the process of adoption of regulatory acts through public discussion, foundation of advisory and administrative boards, coordinating committees etc.
- There are numerous examples of positive impact of businessmen on draft regulations, such as abolition of strict control over reporting forms, defeat of a bill on holographic protection of some goods and documents.

*Experts accentuated the following factors impeding business community to influence enactment of regulatory acts:*

activity of entrepreneurs and business associations aimed at protecting impact on the process of elaboration and enactment of legal acts is not sufficient

- As a rule, not bills essential for many businessmen but those insignificant ones are proposed for public debate
- Very often entrepreneurs make efforts to protect their personal interests in lieu of the need for equal opportunities
- Incentives to elaboration of regulatory documents are targeted not toward best effectiveness possible but realization of momentary goals
- Regional mechanisms ensuring influence of business community function the worst because personal will of local authorities is always determinant
- Structuring of Ukraine's society in the business sphere remains inefficient. Business associations are still too weak to protect their interests. Besides, there are the so-called pseudo-business organizations acting in the interests of power.

*Participants emphasized the following measures that should be taken by entrepreneurs and government agencies to improve the situation in the field of public regulatory policy:*

- Initiate adoption of the law on principles of the public regulatory policy
- Carry out educational activity so that to make business community and business associations aware of ideology of the public regulatory policy
- Reform and improve existent procedures for regulatory impact analysis
- Conduct functional inspection of executive bodies apropos of coordination and interaction of their departments in the process of working out draft regulatory acts
- Hold training seminars for representatives of business community and state officials so that to keep them aware of methods of public discussion of drafts and disseminate information on methodologies of regulatory impact analysis
- Make political parties and organizations raise such strategic issues as the public regulatory policy and deregulation in their election campaigns
- Oblige the State Committee for Regulatory Policy and Entrepreneurship to more closely study draft regulatory documents and make thorough analysis of their regulatory influence
- Maintain and enhance transparency of both elaboration and implementation of decisions by means of free access to relevant information
- Actively involve business associations in elaboration of regulatory drafts and estimation of their efficiency
- Restructure ministries according to a functional principle, reduce their staff and increase salaries
- Exercise permanent control over effectiveness of legal regulatory documents and apply deregulation tools, if necessary.



## **Results of Focus Group Research**

### **“Ukraine’s Investment Climate: Problems and Prospects”**

On May 23, 2001, in the framework of the Information for Reform Program, the Ukrainian Center for Independent Political Research and the Institute for Competitive Society in co-operation with the Center for International Private Enterprise conducted a focus group research “Ukraine’s Investment Climate: Problems and Prospects”. The goal of this focus group was to characterize Ukraine’s investment climate and predict its prospects for the future.

*Objectives of the focus group research were as follows:*

- Make vast range of assessments of positive and negative features of the investment climate in Ukraine
- Estimate activity and role of investment intermediaries in formation of a favorable investment climate in Ukraine
- Outline both potential need of the Ukrainian economy for investments and their sources
- Model a desirable investment climate in Ukraine

*The research was carried out using expert assessments and depth conjoint interviewing technique (focus group methodology) and a sample of eight investment experts selected on the basis of the snow-ball method. The focus group included private entrepreneurs, state officials, academicians and independent analysts so that to carry out a multi-faceted and comprehensive study of problems on the agenda.*

Members of the focus group:

• *Olexandr Baranovsky, Doctor of Economics, head of the analysis and methodology department at the Accounting Chamber of Ukraine*

• *Vadim Hryb, director general of the Tekt investment company*

• *Markiyan Datsyshyn, expert at the Institute for Reforms*

• *Volodymyr Dubrovsky, expert at the Center for Social and Economic Research*

• *Ksenia Lyapina, project coordinator at the Institute for Competitive Society*

• *Olexandr Onufrienko, head of the law department at the Kinto investment company*

• *Anatoliy Otchenash, the Avtoalliance investment company*

• *Serhiy Tchegrahkchi, deputy head of the foreign economic relations department at the Kyiv State Administration*

The research gave much information on today’s investment climate in Ukraine in general, highlighted its key problems and some advantages. A lot of proposals to improve the situation were made.

*The research produced complete and reliable qualitative information that can be used for quantitative analysis and academic study of the given problem.*

*Findings of the focus group may be interesting for representatives of government agencies, entrepreneurs, academicians, journalists and the public.*

#### ***Summarized Research Findings***

Experts identified the following negative characteristics of the investment climate in Ukraine:

- Insufficient development of institutions facilitating attraction of investments in the Ukrainian economy
- Non-transparent and unpredictable behavior of the government
- Absence of mechanisms for attraction of population’s savings to the investment process
- Excessively tough state fiscal policy
- Frequent changes in the legislation
- High risks of unfair competition
- Inconsistent state policy in the investment sphere
- Weak judicial system unable to advocate interests of investors and creditors, consider cases relating to violation of investor/stockholder rights
- Unwarranted state interference with activity of investment companies
- Failure to use high potential for economic growth
- Ineffective secondary market for securities (the point is that privatization carried out in the interests of oligarchs seriously undermined liquidity of the secondary market for securities, since only controlling blocks of shares are sold, whereas the necessary characteristic of the free market, i.e. free circulation of minor stockholdings, is absent)
- Permanent shrinkage of the secondary market for securities
- Limited sources of profit for investment companies (stock market transaction are the major source)
- Decrease of the capital investments to GDP ratio
- Inefficient activity of some free economic zones and territories of priority development as a result of inconsistent and unsound state policy in this field
- Inability of foreign investors to work in Ukraine’s business environment

- Unclear legal status of agricultural lands
  - Absence of private property in land
  - Inability of foreign investors to forecast and plan potential costs of business in Ukraine
  - Imbalance of well-grounded long-term investment strategies and “pilot” projects in favor of the latter
  - Poor knowledge of investment activities on the part of regional and local state officials
  - Minor importance of return on investments in the eyes of top managers of state-owned enterprises, who derive personal profit at the stage of investment inflow
  - Small volume of foreign direct investment as a result of low investment activity of Ukrainian entrepreneurs
- Experts also indicated the following positive characteristics of Ukraine’s investment climate:*
- Very high rate of economic and investment growth are anticipated
  - Owners of previously exported domestic capital are confident that investments in the Ukrainian economy are profitable
  - Some owners of exported capital make efforts to repatriate and legalize funds and invest them in the real sector of the national economy
  - Recently enacted law of Ukraine on mutual investment institutions envisages opportunities to legalize capital
  - Local authorities begin to comprehend advantages relating to attraction of funds on the financial markets
  - The number of “unfair” participants in the investment market has reduced
  - Legal culture of managers of enterprises is improving, as modern corporate governance methods are introduced
  - Civil and Commercial Codes were approved at the first reading
  - Governmental decisions are gradually becoming more predictable and formation of mechanisms enabling economic entities to influence them is under way
  - State officials are getting less reluctant to divulge information and make it public
  - Owing to more intensive use of available production capacities and infrastructure, there is tangible economic growth in the Eastern Ukraine

#### Assessment of Activity of Investment Intermediaries and Their Role in Formation of Favorable Investment Climate in Ukraine

Taking into account today’s complex situation and atypical functions investment intermediaries are forced to perform, experts gave generally positive estimate of their activity. The above functions are not typical because investment intermediaries have to “bring up” the market they operate in.

It must be emphasized that intermediaries waste most of their time and money to sort out their relationship with government agencies, tax authorities and management of enterprises. And almost no time is left to develop a favorable image of Ukraine’s business environment.

Investment companies make efforts to positively influence such a situation through purchasing controlling blocks of shares of enterprises, substituting top managers, launching and developing investment projects. Big business is oligarchic and shared between power bodies. Therefore, investment intermediaries have to operate in the market for middle-sized companies.

Investment intermediaries also perform such a function as search for actual investors. In other words, they have to look for and find an investor who is really interested in definite project.

*In the opinion of experts, the following factors hamper more efficient activity of Ukrainian investment intermediaries:*

- Commercial banks extend loans at high interest and to repay such loans, efficiency of an investment project funded by a company must exceed 30%, which is unrealistic
- Financial resources companies may use are limited solely to their own assets
- It is almost impossible to gain access to the markets for real estate, innovative business products, intellectual property articles etc.
- “Red directors” offer strong resistance to restructuring of enterprises and cooperation with investment companies
- It is difficult to work with large investment projects because of limited investment resources, opposition of some government agencies and oligarchs
- Low level of capitalization of Ukrainian banking institutions does not allow them to finance risk investments thereby preventing development of the newly formed venture business
- Portfolio investments are hardly possible, since only controlling block of shares enables investor to safely place assets, properly manage them and expect profit
- Business ethics and corporate culture are low
- Both adequate insurance market and marketing research in this field are absent in Ukraine, which results in limited number and poor quality of insurance services
- National banking system is underdeveloped
- There are no conditions necessary for legalization of shadow capital

Focus group participants cited estimates of Ukraine's potential need for investments made in early 90's. In their viewpoint, within ten years following declaration of independence, Ukraine could have received investments in the amount of USD40-50 billion or USD5-8 billion annually.

Experts determined volume of investments sufficient for national security of Ukraine, i.e. amount and sources of investments that would ensure expanded reproduction and balance between domestic and foreign investments. It was proved that investment to GDP ratio should be not less than 25%. By comparison, in 2000 this figure equaled 11.1%. Foreign investment to GDP ratio is another important indicator. Its minimum value is 5%, whereas in Ukraine it amounted to just 2% in early 2000.

Members of the focus group also mentioned that further delay in tackling the above problems would lead to extinction of social mechanism of self-reproduction. Moreover, many able-bodied citizens have already lost motivation to work and this trend is gaining momentum.

*Experts pointed out that to improve Ukraine's investment climate it is necessary to:*

- Consistently and transparently carry out the final stage of privatization
- Radically change human psychology, cultivate the drive to earn, consume, save and invest money, as world experience indicates that households are major investors on the financial market
- Institute tough budget constraints
- Form transparent competitive business environment
- Implement the pension reform and encourage establishment of private pension funds
- Limit informal economic sector, create conditions for legalization of shadow capital, thereby ensuring large inflow of investments in the national economy
- Develop depositary system
- Reform labor payment system (increase salaries and wages, abolish a large number of social payments etc.)
- Change tax policy in the sphere of investments
- Reduce tax burden on the national economy
- Elaborate and introduce a code of business ethics or a code of corporate governance
- Facilitate attraction of population savings to the investment process
- Work out and apply national marketing and PR strategies to attract foreign investments
- Render information services to potential investors
- Ensure profitability of state-owned enterprises
- Train new generation of market-oriented managers able to work according to the best world standards
- Enhance efficiency of investments through transparency of business environment (for this purpose it is necessary to adopt regulations simplifying accounting procedures and establishing clear disclosure requirements)
- Introduce corporate property tax promoting more effective use of production capacities
- Fight barter transactions
- Combat corruption
- Restructure large loss-making enterprises and foster development medium-sized businesses
- Ensure equitable treatment of investors
- Support development of an efficient banking system and insurance market