



## GETTING OUT OF THE SHADOW OF CORRUPTION

UKRAINE STILL HAS MUCH TO DO TO REDUCE THE IMPACT OF CORRUPTION ON ITS ECONOMY, BELIEVES **TATYANA KHAVANSKA**, DEPUTY COUNTRY DIRECTOR, AMERICAN BAR ASSOCIATION, CENTRAL EUROPEAN AND EURASIAN LEGAL INITIATIVE, ANTI-CORRUPTION COORDINATION INITIATIVE

A broad range of successful anti-corruption measures have been introduced in the economic sphere in Ukraine. Thus, according to the World Bank, the quality of the business environment has improved through reform of business registration and government inspection procedures. The introduction of a simplified tax structure for small business has led to a reduction in the shadow economy. Audits and enforcement procedures have been made more efficient. The reform of the tax administration has been progressing, although there is still a need for a simpler policy framework, with a greater degree of oversight and accountability.

All of these successes have been achieved, however, under an economic and legal structure that has not been sufficiently transformed to give investors confidence that the economy is on a sustainable path of growth.

Recent political events have highlighted tensions in the system that could impede further economic progress. There is no clear delineation of functions between the main government agencies on setting state anti-corruption policies, and no agency responsible for coordinating the government's response that has the necessary mechanisms to carry out and monitor the effect of these policies.

Although Ukraine has demonstrated its commitment to public integrity by ratifying key international anti-corruption agreements, and a number of steps have been undertaken that indicate progress (e.g., the package of anti-corruption legislation which is currently before parliament, the adoption of an anti-corruption strategy and work on developing its implementation plan, etc.), Ukraine still falls short of meeting its commitments in terms of European integration.

Among the challenges which directly impact the economic sphere which, if addressed, could have a positive impact on the economy of Ukraine, are the need for continued reform to establish: (a) more effective operations of the government and the public sector through public administration and civil service reform; (b) better accountability for public funds; (c) greater transparency in budget preparation; (d) an improved legal and institutional framework for efficient public procurement; and (e) a transparent judiciary, coupled with deregulation and other legal reforms that reduce the number of encounters that businesses must have with judges and other court personnel.

**CORRUPTION CAN BE REDUCED THROUGH BROADER EFFORTS TO PROMOTE TRANSPARENCY AND MECHANISMS FOR REDRESSING CITIZENS' GRIEVANCES**

The existing challenges should help demonstrate the need for reform and point to potential areas for assistance from international donors. The MCC Threshold Program for Ukraine addresses a number of these issues, but goes beyond reform of the economic sphere. It is a joint effort with the government of Ukraine and, if successful, will contribute to the achievement of the government's overall goals in the area of anti-corruption.

True commitment to reducing corruption can make a real difference through the promotion of a variety of economic and institutional reforms. These measures could include more efficient fiscal policies; trade liberalization; streamlined business regulations through one-stop shops, one-day business registration, and limits on the number

of inspections per year; as well as stronger tax and customs administration, coupled with policy reforms; improvement of the procurement system, focusing on transparency, competition, and standardization; civil service reform; and judicial reform.

Corruption can be reduced through broader efforts to promote transparency and mechanisms for redressing citizens' grievances (i.e., conflict of interest laws, asset declaration rules for public officials, Freedom of Information legislation, the establishment of auditing institutions, ombudsman offices, anti-corruption commissions, hotlines and other avenues for citizen complaints).

Corruption distorts economic decision-making and deters investment, undermines competitiveness and, ultimately weakens economic growth. The social, political, legal and economic aspects of development are all linked, and corruption in any of these sectors impedes development in all of them. Thus, reduced levels of corruption would ensure a broadening of confidence in good governance, the rule of law and economic stability. Moreover, lower levels of corruption would further reduce the size of the shadow economy, ultimately providing for a competitive market climate that eases the regulatory burden on businesses and reduces the chance of the special privileges and opportunities of the state being controlled by large financial industrial groups. ■



### YUSHCHENKO, GERMAN CHANCELLOR DISCUSS UKRAINE-EU TIES

■ During his working visit to Germany on February 8-10, Ukrainian President Viktor Yushchenko met with German Chancellor Angela Merkel for talks in Berlin. The two leaders discussed regional and European issues, and especially how to build closer ties between Ukraine and the European Union.

Yushchenko and Merkel agreed to formulate new energy policies to ensure that European consumers get oil and gas deliveries transparently and on time. The Ukrainian leader said Ukraine was aware of its significant role in Europe's energy security and would thus adhere to the European Energy Charter to fulfill its obligations. Merkel said

in turn that their meeting had reassured her that "Ukraine is ready to take responsibility for transporting energy to Europe."

Discussing Ukrainian domestic politics, they agreed there should not be a power struggle but reform for the sake of the country's development, as this will help to improve Ukraine's image as a reliable partner worldwide.

Speaking at a joint press conference after the talks, the Ukrainian president said: "There is no doubt Ukraine will be a member of the European Union, but we understand that this ambition is not immediate...Our priorities are economic association and political integration into European structures."

Merkel said in turn a new agreement with the EU would "support Ukraine's desire for reform" and confirmed her intention to visit our country this fall to attend a Ukraine-EU summit.

While meeting Bavarian Prime Minister Edmund Stoiber, President Yushchenko praised Ukraine's ties with Bavaria and thanked Mr. Stoiber for his personal contribution to the development of the partnership. He said the activities of the Ukrainian-Bavarian Commission were very important and added that Ukraine was interested in attracting foreign investment, particularly from Bavaria's world-famous companies.

Yushchenko also addressed German business leaders, politicians and journalists while attending a meeting of the German Association for East European Studies (Deutsche Gesellschaft für Osteuropakunde, or DGO) in Berlin.

His speech focused on Ukraine's relations with the European Union and the country's role in Europe's energy system.

"The reason I came here is to develop Ukraine's ties with Germany and to help our voice be heard through the prism of this relationship," he said, describing his meeting with Chancellor Angela Merkel as successful.

### PRESIDENT YUSHCHENKO ATTENDS INAUGURATION OF NEW TURKMEN PRESIDENT

■ Ukrainian President Viktor Yushchenko on February 14, 2007, attended the inauguration ceremony of new Turkmen President Gurbanguly Berdimukhammedov in Ashgabat. Berdimukhammedov's inauguration was attended by delegations from 30 countries, including Kazakhstan, Tajikistan, Georgia, Afghanistan, Iran, Russia, Turkey, Armenia and Uzbekistan.

Yushchenko and Berdimukhammedov agreed that Turkmenistan would remain Ukraine's strategic gas provider. The two presidents discussed ways to develop Ukraine's ties with Turkmenistan, particularly in the energy sector and education. They agreed to formulate a 2007-2009 cooperation plan. They also discussed the implementation of Ukrainian investment projects in Turkmenistan.



## UKRAINE, SLOVAKIA SIGN NUMBER OF AGREEMENTS

■ Ukraine and Slovakia on February 26, 2007, signed an intergovernmental agreement on international combined shipments. The document was signed by Ukrainian Premier Viktor Yanukovich and Slovakian Premier Robert Fico. The sides also signed a plan for Ukrainian-Slovakian cooperation as part of the implementation of the Ukraine-EU 2007 action plan and an intergovernmental agreement on the facilitation and mutual protection of investments.

Speaking at intergovernmental negotiations on the same day, Yanukovich said Ukraine had offered several energy security projects, including the construction of a

European oil transport corridor, to Slovakia. Ukraine "is interested in close energy security cooperation," especially the coordinated transit of Russian energy resources to Europe and diversified energy imports from EU member countries, he said. The government thinks it important to build the European oil transport corridor, Yanukovich said, adding that Poland, Slovakia and Ukraine should pool efforts.

Slovak Prime Minister Robert Fico said his country is also interested in diversifying energy deliveries and is ready to take part in the transportation of light Caspian oil through the Odesa-Brody pipeline.

Ukraine also proposed to Slovakia to hold a meeting of the intergovernmental commission for economic cooperation in May-



June 2007 in Kyiv. Ukrainian Premier Viktor Yanukovich submitted the proposal during a meeting of government delegations of the two countries. The commission has not met for five years.

## YANUKOVYCH SATISFIED WITH HIS VISIT TO GERMANY

■ Ukrainian Prime Minister Viktor Yanukovich, who was on a one-day working visit to Germany on February 28, 2007, said he is satisfied with his talks with German Chancellor Angela Merkel.

"Frau Merkel gave clear answers to the questions that concerned us. We received a signal that the door to the European Union is open for Ukraine and this will be expressed in a new agreement covering the next 10 years," he said at a joint news conference after talks in Berlin.

"We support Ukraine on the road of reform and are ready for cooperation on both a bilateral level and as the country presiding in the European Union," she said.

Germany supports Ukraine in its aspiration to join the World Trade Organization. German investors are interested in the improvement of the investment climate in Ukraine. Germany will support Ukraine's ef-

orts to integrate with the European Union, she said.

She also said that the stipulation of Ukraine's determination to form a free trade

zone with the European Union in a new Ukrainian-EU partnership and cooperation agreement would indicate progress in bilateral relations.



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## YUSHCHENKO, SAAKASHVILI SIGN BILATERAL AGREEMENTS

■ Ukrainian President Viktor Yushchenko and his Georgian counterpart Mikheil Saakashvili on March 1, 2007, attended a ceremony to sign a number of bilateral agreements. The two presidents signed documents after chairing Ukrainian-Georgian talks. Yushchenko and Saakashvili signed an agreement to liberalize citizenship procedures for Georgians living in Ukraine and Ukrainians residing in Georgia. Ukrainian Acting Foreign Minister Volodymyr Ohryzko signed an agreement on the legal protection of toponyms used to name wines, mineral water and alcoholic beverages. Kostiantyn Vaschenko, the first deputy head of the State Committee for Regulatory Policy and Entrepreneurial Activity, signed a business cooperation agreement and Leonid Vitkin, the deputy head of the State Committee for Technical Regulations and Consumer Policy, an agreement for standardization and metrology cooperation. Ukraine's Ambassador to Georgia Mykola Spys signed a

memorandum between the Ukrainian Labor Ministry and Georgia's Healthcare and Social Security Ministry.

The two presidents also stressed that relations between their countries are developing positively. Yushchenko said trade between the two countries reached almost \$500 million in 2006. "The early [setting up] of a free trade zone is our key priority," he said, adding that a respective document that was recently signed contained only two problematic clauses, which could easily be resolved. He also said they had discussed how to build a railroad to connect Baku, Tbilisi and Kars, and open a ferry route between the Ukrainian port of Kerch and Georgia's Batumi. They also spoke about cooperation in the energy sector, particularly creating a Euro-Asian oil corridor. Saakashvili, in turn, described his country's economic cooperation with Ukraine as a landmark example of how the two countries can cooperate. Yushchenko was on a two-day official visit to Georgia on March 1-2.



## MOODY'S FORECASTS UKRAINIAN GDP GROWTH IN 2007

■ On February 23, 2007, Moody's Investors Service published its annual report on Ukraine with a forecast of the country's real GDP growth in 2007 set at about 6%. Jonathan Schiffer, the author of the report, concludes that Ukraine's recovery has been driven by heavy industrial, energy-intensive sectors of the economy. "The recent growth has been driven by higher global prices for metallurgy and metal working," he said. "Ukraine's final data for 2006 will likely show an economy that performed well, high consumer demand, strong investment in fixed assets, and GDP growth that exceeded 5.5%, thanks to favorable world steel market prices," reads the report. "Although higher gas import prices have increased, inflation and the current account deficit, Ukrainian industry seems to have absorbed them without losing its competitiveness," said Schiffer. He also credited the government with "reasonable macroeconomic policies." Despite an export base that lacks diversity, he said, Moody's expects relatively strong growth to continue, while the final budget deficit for 2006 should remain less than 3% of GDP. "Less political uncertainty, improved growth prospects, and reasonable liquidity and debt payments combine to make the rating outlook positive," said Schiffer. Still, he said, "institutional weaknesses, the relatively slow pace of structural reforms, and risks associated with the country's fractious political spectrum remain."

## UKRAINE CANCELS QUOTAS ON BARLEY, MAIZE EXPORTS

■ Ukraine cancelled quotas and licenses for the export of maize and barley on February 27, 2007.

The according cabinet resolution, No.290 of February 22, was published in the press and came into force on February 27, 2007.

Ukraine on December 14 introduced a

1.106-million-tonne grain export quota until the end of the current marketing year, which will end in June. Quotas for the export of wheat and rye are 3,000 tonnes each, while those for the export of barley stand at 600,000 tonnes and for maize at 500,000 tonnes.

The cancellation of quotas for export

of maize and barley was initiated by the Agriculture Ministry, after intensive lobbying by the business community and diplomatic community active in Ukraine, which believes the domestic supplies of these crops are enough to permit exports without risking shortages on the domestic market.



**WORLD BANK CONFIRMS SUPPORT TO UKRAINE**

■ World Bank Vice President for Europe and Central Asia Shigeo Katsu, completed his visit to Kyiv on February 9, met with Prime Minister Viktor Yanukovich, Parliament Speaker Oleksandr Moroz, and First Deputy Prime Minister Mykola Azarov.

During his bilateral meetings, the sides discussed recent economic and social developments in Ukraine, the results of implementation of the current Bank program for the country, as well as future support from the World Bank Group.

Commenting on Ukraine's recent progress in advancing economic growth, Katsu stressed that the World Bank welcomed the Ukrainian government's commitment to maintain good macroeconomic performance and continue to pursue structural reforms as necessary underpinning for sustained growth and poverty reduction.

The new Country Partnership Strategy for 2008 -2011 is currently

being prepared, according to Katsu. This Strategy will be designed to flexibly respond to Ukraine's economic and social needs over the medium term as is expected to be expressed in the upcoming government strategy of social and economic development of Ukraine until 2011. It will be prepared following broad consultations within Ukraine, including with civil society, academia, the business community, and regional representatives.

The new Partnership Strategy could support Ukraine's competitiveness in laying the foundations for sustained economic growth; the efficiency of Ukraine's public sector to deliver better quality public services; greater social inclusion to share the benefits of growth more equitably and protect vulnerable groups; and improved energy efficiency, natural and agricultural resources management, and environment protection.

**TYMOSHENKO VISITS USA**

■ BYT leader Yulia Tymoshenko says she is satisfied with the outcome of her visit to the United States early in March 2007, as she had achieved her goals in meetings with representatives of the U.S. administration.

In her words, she "managed to explain at the top level the development of events in Ukraine and to clear up all of political nuances going on in our political life, and to uncover the roots of the constitutional crisis." As she put it, she managed to explain her position that the only solution to the current crisis in Ukraine would be the endorsement of new wording of the Constitution and early parliamentary elections in Ukraine.

"Given that the political chaos will continue, Ukraine will lose its power and authority in the world and a leading position on the post-Soviet space until 2011," she said.



**DRAFT LEGISLATION**

■ **New Draft on Insurance Market**

Verkhovna Rada Deputy Sergey Terekhin (Block Yulia Tymoshenko) has registered Draft Law #3085 "On Changes to the Law "On Insurance"". The authors of the document state that its main goal is the further liberalization of the Ukrainian financial markets in light of the WTO accession process as well as standard harmonization of insurance regulations in Ukraine with IAIS and EU requirements. Select provisions include the following: classification of the types of insurance and sectors according to EU Directive 72/239/EEC; allowing trans-border insurance; decreasing the list of obligatory insurance types according to EU recommendations; defining the rules of information disclosure by insurance companies; defining access requirements for foreign insurance companies to operate in Ukraine; and corporate governance policy.

The Chamber Policy Team was approached by the Banking and Finance Committee of the Parliament with an invitation to participate in special Committee Hearings devoted to consideration of the new version of the insurance legislation. Mr. Petro Poroshenko, the Head of the Parliamentary Committee, presided over the hearings. Also, Mr. Valeriy Alyoshyn, Head of the State Commissions for Regulation of Financial Services Markets of Ukraine, Mr. Filoniuk, the President of the Insurance League and author of the Draft Law took an active part in the discussion. It was decided to create a special working group that will analyze the combined version of the Draft Law "On Insurance", which unites the documents developed by Mr. Terekhin and the Draft Law, elaborated jointly by the Commission for Regulation of Financial Services Markets and Insurance League. The Chamber's Banking and Financial Services Committee will be the primary Chamber Committee responsible to work on this piece of legislation.

■ **Draft Law 'On Joint Stock Companies'**

In mid February the Cabinet of Ministers of Ukraine approved the final version of the Draft Law "On Joint Stock Companies" that was submitted to the Parliament for consideration. A properly drafted JSC Law is very important for all sectors of business operating in Ukraine and is a major cornerstone for the protection of minority shareholder's rights and fostering proper corporate governance.

■ **Reforming the Tax System**

The Government of Ukraine approved the "Concept of Reforming of the Tax System of Ukraine" with Resolution of Cabinet of Ministers of Ukraine #56. The Concept envisages three stages for Tax System Reform and outlines the following actions:

Due to the importance of this piece of legislation for the business climate and in protecting current investors as well as attracting additional foreign and domestic investment, the Chamber's Policy Team has assembled a special Joint Stock Company (JSC) Working Group.

The JSC Working Group is comprised of interested Chamber Members who are professionals in their respective fields and can contribute positively in the process of reviewing the draft legislation to ensure that the concerns of the legitimately operating business community are taken into account during the process of passing and signing into Law this important piece of legislation. The Chamber Policy Team will be responsible for taking the recommendations and amendments developed by the Working Group forward and monitoring the process in the Parliament ensuring that the Chamber Member's viewpoint is taken into consideration. The Verkhovna Rada Committee on Economic Policy, Committee Head of the Committee Mr. Volodymyr Zaplatynsky, will be responsible for consideration of the Draft Law in the Parliament.

■ **Draft Tax Code**

The Chamber continues to monitor and participate in the process of development of the Draft Tax Code of Ukraine, an important document that will define State tax policy and impact the business community, as well as the economic and social situation in Ukraine for the future.

The work on the Draft Tax Code has been divided into different groups, each devoted to a Chapter of the Draft Tax Code. The Chamber Policy Team has been participating in the work of the Groups "Corporate Profit Tax" and "Value Add Tax" of the STA, which has been identified by the Chamber Tax Committee as critical sections of the future tax system for business operating in this market.

On February 16th the Working Group on Corporate Profit Tax presented the final version of their relevant Chapter. On February 20th the Chamber Policy Team participated in the meeting of the Working Group on VAT. During the meeting a number of controversial issues were raised and discussed, such as the possibility of introduction of varied VAT rates, shift from joint (full VAT value chain) to individual responsibility, simplification of procedures for VAT reimbursement etc.

**ADOPTED LEGISLATION**

2007 — improvement of tax mechanisms for operations in Free Economic Zones and Techno Parks in Ukraine, elaboration and approval of the Tax Code of Ukraine.

2008-2012 — simplification of tax and fees administration in Ukraine, liberaliza-

State Tax Administration representatives noted that the Draft Tax Code is planned to be submitted by the Ministry of Finance for the Cabinet's approval by April 2nd, 2007. If adopted (most likely in June 2007), the new Tax Code will become valid starting from January 1st, 2008. The Chamber's Tax Committee will continue to work on this important issue ensuring that the business community's concerns are addressed and international best practices are incorporated into the ultimately adopted Tax Code.

■ **Draft Unified Social Tax Update**

The Chamber took part in the round table discussion organized by the Banking and Finance Committee of the Verkhovna Rada, and devoted to the Unified Social Tax. The Meeting was chaired by Mr. Petro Poroshenko, Head of the Committee and Mr. Mykhajlo Papiyev, Minister of Social Policy of Ukraine, as well as many Peoples Deputies, representatives of central executive bodies, Federation of Employers of Ukraine, Federation of Trade Unions, etc.

During the meeting five draft laws regarding Unified Social Tax (Payment) were presented by their authors and further discussed. Most attendees expressed their support to Draft Law #2691 "On System for Collecting and Audit of Unified Social Payment for General Obligatory Social Insurance", developed by the Ministry of Social Policy and submitted for Parliamentary consideration by the Cabinet. During the discussion several controversial issues were raised. In particular, attention was paid to the format of the Unified Social Payment, instead of tax, and in this context the Minister of Social Policy stated that he believes the payment system is the most appropriate and would provide a possibility for public control over the funds generated.

Also, participants discussed whether the transition to Unified Social Payment will decrease administration related expenses, and addressed officials with a request to manage a system in such a way, that insurance fees will be destined for insurance payments only, not for budget related issues. Also, the necessity to clearly define the mechanisms for defining the Unified Social Payment was discussed. As per the problem of legalizing the salary system of Ukraine, it was proposed to divide the proposed 41.5% of social payments in half between employers and employees.

tion of the tax system as a part of State regulation and reforming of the customs tariff policy.

2013-2015 — bringing Ukrainian Tax System to conformity with European Union Standards.