

Investment Climate Statement 2008 -- Ukraine

A.1. Openness to Foreign Investment

GOVERNMENT'S ATTITUDE TOWARDS FOREIGN INVESTMENT

Since taking office in January 2005, President Viktor Yushchenko has made improving the investment climate one of his top economic policy goals. While progress has not been as swift as some may have hoped, almost all of Ukraine's major political forces remain committed to improving the business and investment climate. There have been several positive steps for U.S.-Ukraine trade and investment relations over the past several years. Both the United States and the European Union granted Ukraine market economy status, in February 2006 and December 2005, respectively. In March 2006 the United States terminated the application of the Jackson-Vanik amendment to the Trade Act of 1974 to Ukraine, providing Ukraine permanent normal trade relations status.

After eight years of decline following independence, the Ukrainian economy has been growing steadily since 1999, with real GDP growth at about 7% in 2007. Over the past few years, Ukraine has taken steps to liberalize its markets, reduce regulation, eliminate most licensing requirements, eliminate most restrictions on foreign exchange, and begin the transformation of the agricultural sector from state-run farms to private agriculture. After years of hyperinflation and plummeting currency values, the national currency, the hryvnia (UAH), has been stable against the U.S. dollar for over six years. The inflation rate remains high, however, and was 16.6% in 2007. Ukraine remains in need of substantial reforms in order to achieve full economic liberalization. Ukraine's economy is still shackled by corruption, poorly developed rule of law, over-regulation, and excessive government interference in what should be private business decisions.

Ukraine is in the process of negotiating terms of accession to the World Trade Organization (WTO). Ukraine made significant progress during 2007 in adopting legislation and regulations needed for compliance with WTO requirements, enacting some 11 WTO-related laws in May and adding to its steady progress in this area during the previous three years. Ukraine also made a major breakthrough in signing a bilateral market access agreement with Kyrgyzstan, the last such agreement outstanding. Ukraine had signed a bilateral agreement with the United States in March 2006. Accession to the WTO remains a priority for the government and now appears imminent.

Foreign investors continued to express little confidence in the Ukrainian court system. In a noticeable number of cases, predatory minority shareholders have been able to procure dubious court decisions in an effort to wrest control of companies away from the majority investors. Some researchers claim that as many as 2,500 Ukrainian enterprises have suffered so-called corporate hijacking attempts in the last several years. Ukrainian courts have a long record of striking down or ignoring contractual provisions that assign legal responsibility for dispute resolution to a foreign court or arbitrator.

Many investor complaints over the years have involved the State Tax Administration's (STA) selective enforcement of tax policy. Businesses have claimed that STA local and regional branches use investigative authority to advance favored political or business interests. Arrears in the payment of VAT refunds to exporters have also been a serious problem. The GOU decreased the pace of VAT refunds beginning in August 2006, reimbursing only 76 percent of verified claims, down from 87 percent refunded in 2005. VAT refund problems continued in 2007, leading to calls for an overhaul of the VAT reimbursement mechanism. Delays in reimbursements can create opportunities for tax officials to demand kickbacks in return for quicker processing of rebates. Numerous exporting companies, both Ukrainian and foreign, claim that STA officials openly expect bribes between 10 and 30 percent of outstanding VAT refunds in order to process reimbursement. Currently, the process for obtaining a refund of VAT payments can take from 3 to 18 months for foreign companies. Increasingly, the delays in reimbursement are becoming an important cost factor for many foreign companies and are seriously affecting the profitability of planned investments.

MAJOR LAWS/RULES AFFECTING FOREIGN INVESTMENT

Ukraine's Law "On the Foreign Investment Regime" (1996) provides for equal treatment of foreign and Ukrainian-owned business with some restrictions in broadcasting and weapons manufacturing.

Both a new Civil Code and a competing new Commercial Code went into effect on January 1, 2004. Lawyers and judges continue to grapple with how to implement the two laws, whose approaches to the regulation of business activities are contradictory. The Commercial Code has a number of provisions considered to be incompatible with market economics, and most experts believe it should be eliminated entirely.

In October 2001, the Ukrainian Parliament passed a Land Code. It provides for private ownership of land, facilitating the privatization of land for agricultural purposes, but also provides for a moratorium on agricultural land sales. This moratorium has been extended until the GOU succeeds in adopting new legislation necessary to open the land market. This legislation has been drafted, but prospects for its enactment are currently unclear. The moratorium blocks private investors from purchasing some of the 33 million hectares of agricultural land in Ukraine and constitutes a serious obstacle to the development of the sector. The Land Code also prohibits foreign ownership of farmland.

A new Customs Code that went into effect in January 2004, along with December 2005 amendments to the Customs Code and Single Customs Tariff, brought Ukraine's customs regime into near-complete compliance with WTO rules. Problems, particularly in the area of customs valuation, remain, however, and industry representatives have expressed concern with current draft amendments meant to fix the Customs Code. Cabinet of Ministers Resolution #269 from 2005 introduced preliminary documentary control at customs checkpoints in order to simplify customs clearance of goods entering Ukraine, and to reduce the wait time for importers. Implementation of this resolution has been imperfect, however, as imported goods entering Ukraine often still must be "cleared" by a

number of state bodies, some of which do not operate 24 hours a day, causing extended delays. Corruption also remains a serious problem. President Yushchenko pushed in November 2007 for the dismissal of several high-level Customs officials and for the creation of a new body within the State Security Service to combat smuggling. Prime Minister Yuliya Tymoshenko announced in January 2008 that her government would restart an anti-smuggling campaign that had had some success back in 2005.

Under the 2001 Law "On the Customs Tariff of Ukraine," only Parliament can introduce or change tariffs. The import tariff system of Ukraine has 21 sections, encompasses 97 groups of goods, and lists over 11,000 import duty rates. In 2005, Parliament passed amendments to the Customs Code to decrease tariff rates in an effort to meet WTO accession requirements. The average applied tariff rate for all goods is now 6.5 percent, and 61.5 percent of the total tariff lines face *ad valorem* rates of five percent or less. For agricultural goods, the average applied rate is 13.8 percent (down from 19.7 percent) and for industrial goods the average applied rate is 4.4 percent (down from 8.3 percent).

Ukraine's Anti-Monopoly Committee implements anti-monopoly, competition, and consumer protection legislation under the March 2002 Law "On Protection of Economic Competition." New companies and mergers/acquisitions face strict controls. Most investments, joint ventures with multiple partners, and share acquisitions require the Committee's approval. Those violating fair competition rules may be fined up to 10% of the prior year's turnover. If unfairly gained profit exceeds 10% of income, up to three times the normal penalty can be collected. The applicant, defendant, or a third party may appeal a Committee decision, but the appeal must be filed within two months after the decision is taken.

PRIVATIZATION AND FOREIGN PARTICIPATION

The State Property Fund oversees the privatization process in Ukraine. Privatization rules generally apply to both foreign and domestic investors, and, in theory, a relatively level playing field exists. Observers claim, however, that a common abuse of privatization laws is the adjustment of the terms of a privatization contest to fit the characteristics of a certain, pre-selected bidder. Few major, new privatizations have been conducted since the privatization rush of 2004. As of September 2007, revenues from privatization were only 15.4 percent (\$320 million) of the fiscal year's budget target. In 2005, the GOU revoked the privatization of the Krivoriizhstal steel factory, which had been sold to a group of domestic investors for \$800 million, and subsequently sold it in a fair and transparent tender to Mittal Steel for \$4.8 billion. Since then, the GOU has taken no further steps to reverse previous privatizations, although Prime Minister Tymoshenko has stated she expects the government may stage re-privatizations in a handful of cases where the courts have overturned privatizations.

The few privatizations that took place in 2007 were often marked by controversy. In March, the State Property Fund sold a majority share in Luganskteplovoz (a Ukrainian locomotive manufacturer) to Russian-owned CJSC Bryansk Machine Building Plant. Only two bidders (both related parties) were able to meet the tender requirements as set

by the State Property Fund, and the Fund also appeared to have violated rules governing the announcement of the tender, making it impossible for potential investors to learn of the tender in time to submit bids. The courts subsequently ruled that the sale was in fact illegal.

In August, the state-owned electricity generation company Dniproenergo increased its capital by 52 percent, allowing the Donbas Fuel and Energy Company (DTEK), owned by a Member of Parliament in the then-ruling coalition, to purchase the fresh capital and causing the state's share in the company to shrink from 76 percent to 50 percent plus one share. The transfer was conducted as a controversial debt-for-shares swap, whereby DTEK acquired the shares in exchange for covering a debt owed by Dniproenergo to coal suppliers. Some experts claimed that DTEK acquired the shares in Dniproenergo for only 30-40 percent of the market value. A court of first instance ruled the sale to be illegal, but an appeal is pending.

Ukrainian law authorizes the government to set limits on foreign participation in "strategically important areas," although the wording is vague and rarely used in practice. Some strategically important companies, including natural monopolies, producers of military equipment, and some fuel and energy companies, are barred from privatization and foreign ownership. A company's "strategic status" can be lifted by Parliament, on the recommendation of the Cabinet of Ministers, and foreign entities would then be allowed to participate in its privatization. Foreign shares of TV and radio broadcasting and publishing companies are restricted, and can generally not exceed 30%. In January, 2006, Parliament adopted a new law "On Television and Radio Broadcasting" that eliminated restrictions on the share of foreign capital in the charter funds of television and radio broadcasting companies. Foreigners are prohibited from founding TV or radio stations, however.

PROCUREMENT

Ukraine is not currently a signatory to the WTO Agreement on Government Procurement (GPA), but will become an observer to the GPA upon WTO accession, and has promised to then begin negotiations to accede to the GPA.

Most experts agree that recent amendments to the law "On Procurement of Goods, Works and Services Using State Funds" have been a step backwards in terms of bringing Ukraine's procurement system into compliance with international norms. A recent study on Ukraine by the Atlantic Council of the United States concluded that "government procurement is one of the most corrupt spheres of state activity." Amendments to the procurement law passed in March 2006 transferred the authority to coordinate government procurement from the Ministry of Economy to the Anti-Monopoly Committee of Ukraine, a body with no particular expertise in regulating public procurement, and one that has struggled to secure compliance with its own rulings. The amendments scattered policy and oversight functions across several bodies, including the Anti-Monopoly Committee, the Accounting Chamber of Ukraine (reporting to Parliament), the State Control and Audit Unit (under the Ministry of Finance), and the

Tender Chamber of Ukraine. The amendments have been criticized for creating an overlap in authority of various regulatory agencies and decreasing the transparency of the system.

The 2006 amendments granted the Tender Chamber of Ukraine, purportedly a non-governmental organization for monitoring the procurement process, a number of key operational functions that are inherently governmental. The Tender Chamber has exclusive authority to maintain a catalog of bidders, consider claims of tender participants, and issue conclusions. It also maintains a UAH 7000 (\$1400) obligatory fee for bidders that want to be registered in the catalogue, in conflict with the international practice of free listing for all interested parties. The Tender Chamber has faced widespread criticism, including from some of its former members, as contributing to the procurement system's corruption and lack of transparency.

The March 2006 amendments also introduced special security requirements for websites in order to be eligible for tender announcements. Only one organization, the European Consulting Agency, a Ukrainian private enterprise with links to the Tender Chamber, has been allowed to operate a website announcing tenders. Several observers have charged that this intermediary fosters corruption in the process and decreases transparency. In addition, the March 2006 amendments introduced burdensome and lengthy procurement procedures, and required all tender proposals to be secured by collateral, limiting the number of tender participants and increasing the cost of participation. For some procurements, the Tender Chamber assesses fees at four percent of the value of the procurement, which in many cases makes the fees extremely high by international norms.

December 2006 amendments to the law created a legion of special public sectors, such as defense, postal and telecommunications services, and railways, for which procurement rules do not apply for all tenders. Yet the December 2006 amendments also required most state-owned and municipal companies to follow state procurement procedures, resulting in some disruptions, most notably for procurement done by municipal hospitals and the military. Parliament attempted to amend the law again in June 2007 in order to exempt all state-owned enterprises from government procurement rules, but the President and the Kyiv Commercial Court blocked the amendment from taking effect.

All government procurement of goods and services valued at more than \$10,000 and works valued at more than \$80,000 must be procured through competitive tenders. Open international tenders must be used when procurement is financed by any entity outside of Ukraine. The Tender Chamber publishes information on government procurement in the "State Procurement Bulletin."

The procurement law does not restrict foreign enterprises from participating in government procurement, but in practice foreign companies are rarely able to compete on an equal footing. Foreign companies generally win only a tiny fraction of the total tenders (0.01 percent during the first nine months of 2006, with no more recent statistics available). Among the problems faced by foreign firms are: (1) the lack of public notice of tender rules and requirements; (2) covert preferences in tender awards; (3) subjecting

awards to conditions that were not part of the original tender requirements; and (4) non-effective grievance and dispute resolution mechanisms, which often allow a losing bidder to block the tender after the contract has been awarded. March 2007 amendments to the law did eliminate preferential provisions in favor of domestic bidders on tenders below certain values. Some regulations still serve to exclude foreign bidders, however. For example, there is a practice in health sector procurement of only accepting bids from Ukrainian resellers or Ukrainian producers of pharmaceuticals.

The Law "On Production Sharing Agreements" (PSA), effective October 1999, provides a legal framework guaranteeing that the terms of agreements between foreign investors and the GOU for natural resources development cannot be changed once an investment is made. However, additional enabling legislation is needed in order to harmonize Ukrainian laws with the PSA's joint exploration and production license. Also needed are Cabinet of Ministers resolutions to establish special tax benefits envisioned by the PSA law, such as the amount of profit tax revenue the government will receive from the PSA producer. The development of PSAs was tested after the GOU awarded the U.S. company Vanco a tender for the Prikercheskiy block for offshore oil exploration in the Black Sea in April, 2006. Vanco and the GOU signed Ukraine's first-ever production sharing agreement in October 2007. It is unclear, however, if the GOU is willing to pursue additional PSAs for offshore exploration at this time, especially since additional PSA legislation is still required.

A.2. Conversion and Transfer Policies

RESTRICTIONS ON CONVERTING/TRANSFERRING FUNDS

The 1996 Law "On Foreign Investment" guarantees the "unhindered transfer" of profits, revenues, and other proceeds in foreign currency after taxes and other mandatory payments. By intervening in exchange markets, the National Bank of Ukraine (NBU) maintains a de facto peg of Ukraine's currency, the hryvnia, to the dollar. In 2007, the hryvnia traded against the U.S. dollar at or near UAH 5.05 to the dollar.

While foreign investors may repatriate earnings, companies must obtain a license from the NBU for some operations. For repatriation of hard currency, each transaction over \$50,000 must be approved by the NBU. The NBU also charges a fee to review the transaction. In view of increased hard currency inflows, the NBU in 2005 canceled its 1998 surrender requirement that exporters convert half of their hard currency revenues into hryvnias. As of January 2008, foreign currency derived from export sales has to be repatriated within 180 days. Foreign exchange is readily available at market-determined rates, which generally do not vary greatly from the daily official exchange rate. In February 2005, the NBU lifted the 2% limitation on deviation of bank exchange rates from the official exchange rate, which had been in effect since October 2004. A pension fund tax is levied on transactions to purchase hard currency. The Law on the 2008 Budget lowered the tax from 1.0% to 0.5%.

Foreign investors have complained of cumbersome NBU regulations (2005 Resolutions 280 and 281) requiring them to open local accounts in Ukrainian banks and to use the services of Ukrainian brokers in order to make investments in Ukraine. Past direct investors seeking to liquidate and repatriate their investments face stringent documentary requirements, though the NBU has stated its willingness to waive requirements if documents from the original transactions are no longer available. On December 4, 2007, the NBU issued a new regulation requiring nonresident investors who wish to convert dividends or divestment income into foreign currency to provide proof of the initial foreign investment, making such operations more difficult.

Investors convert their earnings into foreign currency through commercial banks, which purchase foreign currency on the electronic inter-bank currency market. Commercial banks may trade foreign currency in electronic form with other banks through participation in electronic inter-bank currency market, regulated and operated by the NBU. To purchase hard currency, companies must provide their banks with a copy of their foreign trade contracts. In an attempt to expedite purchases of hard currency, in March, 2005, the NBU cancelled the requirement that companies obtain State Tax Administration permission to purchase hard currency. Commercial banks must announce their clients' intentions to sell on inter-bank currency market if the transactions exceeded \$500,000. The Law "On the Circulation of Promissory Notes" provides an opportunity for payments in foreign currency and issuance and circulation of promissory notes, in accordance with the 1930 Geneva Convention "Providing a Uniform Law for Bills of Exchange and Promissory Notes." Residents may transfer up to USD 600 abroad without opening a bank account. Illegal trade of hard currency is not a criminal matter but brings administrative penalties.

A.3. Expropriation and Compensation

Under the 1996 Law "On the Regime of Foreign Investment," a qualified foreign investor is provided guarantees against nationalization, except in cases of national emergencies, accidents, or epidemics. Expropriation of property is rare. International institutions have recommended that definitions of expropriation and nationalization in the foreign investment law and bilateral treaties be expanded to include indirect and creeping expropriation. Courts can determine whether owners of privatized enterprises failed to pay for an enterprise or to implement investment commitments in a privatization sale. Failure to pay or invest allows the GOU, with court permission, to revoke ownership and resell the property.

A.4. Dispute Settlement

EXTENT AND NATURE OF INVESTMENT DISPUTES

The Embassy continues to provide advocacy on behalf of U.S. investors. For many years, investment disputes frequently have involved key problems with the investment climate such as the lack of adequate rule of law, fair and impartial dispute resolution mechanisms, and enforcement of domestic court and international arbitration decisions.

Another problem is poor corporate governance (inadequate protection for shareholder rights, inadequate disclosure, asset-stripping, and voting fraud). Currently, there is no single point of contact in the Ukrainian government tasked to help resolve business and investment disputes involving foreign companies, although the Ukrainian Center for Foreign Investment Promotion, a state body commonly known as InvestUkraine (<http://www.investukraine.org>), has pledged to take on this role. Most U.S. businesses have little confidence in Ukrainian courts. Commercial contracts may permit the parties to use international arbitration or specified foreign courts to settle disputes. Though Ukrainian legislation recognizes international arbitration decisions, in practice such decisions can be very difficult to enforce in Ukraine.

Corruption continues to lie at the heart of many investor disputes. Laws and regulations are vague, with considerable room for interpretation, providing officials at every bureaucratic layer ample opportunities for rent seeking.

DESCRIPTION OF UKRAINE'S LEGAL SYSTEM

Ukraine has a civil law system relying on codes and separate legislative acts. The court system comprises the Constitutional Court, which interprets the Constitution and laws of Ukraine, and a system of courts of general jurisdiction. The courts of general jurisdiction are further divided into general courts, which handle civil, criminal, and administrative matters, and specialized commercial courts, which review business disputes, bankruptcy, and anti-monopoly cases. Both the general and commercial court systems feature a hierarchy of local and/or regional courts and appeals courts. The Supreme Court of Ukraine is the highest court in the system of courts of general jurisdiction.

The Law "On the Judiciary," in force as of June 2002, creates four levels of courts -- local courts, courts of appeal, courts of cassation (higher specialized courts), and the Supreme Court. This law also establishes an independent judicial department, the State Judicial Administration, to manage the court system, with the exception of the Supreme Court, which is self-administered. There is also a separate system of Administrative courts, and the Supreme Administrative Court started its work in 2005. The Administrative Procedural Code, which entered into force on September 1, 2005, governs the organization and work of the administrative courts.

ENFORCEMENT OF RIGHTS

Investors criticize Ukraine's legal system for its inefficiency, burdensome procedures, unpredictability, corruption, and susceptibility to political interference. Even when they obtain favorable decisions, investors claim the decisions are often not enforced. The enforcement responsibilities fall under the State Enforcement Service, which reports to the Ministry of Justice, but whose head is appointed by the Cabinet of Ministers.

The procedure for recognizing and enforcing foreign court decisions is regulated by Section 8 of the Code of Civil Court Procedures of Ukraine. In accordance with the Code, a foreign court decision is recognized and enforced in Ukraine if such recognition

and enforcement is provided for in international treaties, the mandatory nature of which has been endorsed by the parliament, or based on a mutual ad-hoc agreement with a foreign state whose court has rendered a decision that is to be enforced in Ukraine.

The State Enforcement Service implements decisions rendered by foreign courts and arbitration tribunals in accordance with the Law "On Enforcement Proceedings." The Law "On Implementing Decisions and Applying Practices of the European Court of Human Rights" entered into force on March 30, 2006. Along with a subsequent Cabinet of Ministers implementing Resolution, the law obligates the Ministry of Justice to ensure implementation of the Court's decisions.

COMMERCIAL LAW

A new Civil Code and a competing Commercial Code both went into effect on January 1, 2004. Lawyers and judges have since grappled with how to implement the two conflicting laws. Despite heavy criticism of the Commercial Code by businessmen and GOU officials, Parliament has not yet taken action to amend or annul it. The Civil Code ensures protection of the rights of private property, of engaging in contracts, and of entrepreneurial activity. It provides a unified framework for economic regulations.

The Civil Code is generally market-oriented and modern, but the Commercial Code is often contrary to market economy principles and directly contradicts provisions of the Civil Code in numerous instances. The Commercial Code aims to preserve a privileged position for the public sector of the economy and allows for governmental interference in private commercial relations. Further, in both codes gaps in regulation exist. The existence of these two codes creates uncertainty in planning and structuring transactions, and leaves questions surrounding transactions unanswered. Problems arising from these two codes also surface in the resolution of disputes, as courts are not able to resolve the conflicting provisions of the codes, or are not able to fill in the gaps in regulation that arise as a result of the missing provisions in the codes. Finally, other commercial laws have not been harmonized with these codes.

A 1999 bankruptcy law provides for debtor-led reorganization, a meaningful moratorium on payment and collection of pre-existing debt, and a tax forgiveness provision. The 1999 law provided thousands of heavily indebted industrial enterprises with an alternative to liquidation that did not exist under Ukraine's original 1992 bankruptcy law. Since then, many firms have reached amicable settlements with their creditors and established a workable schedule of debt forgiveness and repayment. Creditors protect their rights under the law by electing a creditors' committee, which is actively involved in the bankruptcy proceedings.

Most observers believe the bankruptcy laws must be amended to provide more protection for creditors. Notice provisions, protections for the rights of minority shareholders, and procedures for valuation and the sale of assets to satisfy liabilities are undeveloped.

CORPORATE GOVERNANCE

Problems with corporate governance in Ukraine involve corporate ownership, shareholder rights, transparency, and disclosure. The Law "On Companies" offers scant protection for minority shareholders against insider dealing, asset stripping, profit skimming, and share dilution. Corporate finance is restricted. Some examples of shareholder rights abuses include limited disclosure, capital restructuring without shareholders' consent, and shareholder voting fraud. Nevertheless, a Company Register that was established in 2004 improved transparency. A new Joint Stock Company law was first drafted in 1998 to improve the current law by introducing sound corporate practices that meet international standards. It has failed repeatedly in Parliament, despite increasing interest in the business community. In May 2007, Parliament passed the latest version of this draft law in the first reading, but a protracted political crisis prevented the law from moving forward.

BINDING INTERNATIONAL ARBITRATION

Ukraine enacted an international commercial arbitration law in February 1994, which parallels commercial arbitration laws set forth by the United Nations Commission on International Trade Law. Ukraine is a member of the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitration Awards. Some investors have problems enforcing foreign arbitration awards in Ukraine. Foreign arbitral award enforcement procedures in Ukraine are regulated by a number of statutes and regulations, including the Section 8 of the Civil Procedural Code and a law "On Enforcement Proceedings." In early 2000 Ukraine ratified the Washington Convention, providing for use of the International Center for Settlement of Investment Disputes (ICSID), an internationally recognized mechanism for resolving investment disputes between investors and the GOU. The U.S.–Ukraine Bilateral Investment Treaty (BIT), signed in November 1996, recognizes arbitration of investment disputes before the ICSID. One major investment dispute involving a U.S. company was resolved in May 2006 through a combination of direct consultations with the Ukrainian government and international arbitration by ICSID.

A.5. Performance Requirements/Incentives

PERFORMANCE REQUIREMENTS

There are no known cases of performance requirements imposed on foreign investors other than those clearly spelled out in privatizations conducted via open tender. Ukraine has pledged to eliminate measures that conflict with the WTO Agreement on Trade-Related Investment Measures (TRIMs) in the automobile industry and other sectors in the context of its accession efforts.

INVESTMENT INCENTIVES

Ukraine modified its foreign investment law of 1996 to provide foreign investors a number of state guarantees, the most important being the unhindered and immediate

repatriation of profits and stable regulations for the time of the investment. Foreign investors are exempt from customs duties for any in-kind contribution imported into Ukraine for the company's charter fund. Some restrictions apply and import duties must be paid if the enterprise sells, transfers, or otherwise disposes of the property.

VISA/WORK PERMIT REQUIREMENTS

According to Ukrainian Presidential Decree No. 1008 dated June 30, 2005 (with amendment dated August 18, 2005), U.S. citizens traveling to Ukraine on short-term tourist, business, or private travel do not need a visa to enter Ukraine. Visas are still required of other categories of travelers including those who intend to study, reside, or work in Ukraine. Short-term travelers entering Ukraine under the auspices of this decree can stay in Ukraine up to 90 days during a 180 day period. Any requests for extension of stay due to extenuating circumstances should be directed to the Ministry of Interior's Department of Citizenship, Immigration and Registration (formerly known as OVIR). Extensions are not automatic, however, and are valid only for continued presence in the country. It is not possible to depart Ukraine and return on the extension, nor can an adjustment to visa status be made from within Ukraine. Visas may be obtained from the Consular Office of the Embassy of Ukraine in Washington, D.C., or from Ukrainian Consulates General in New York, Chicago, or San Francisco.

Ukrainian law requires that foreign residents of Ukraine register with local authorities. American travelers entering Ukraine under the visa-free regime do not have to register any stays of 90 days or less. Travelers entering Ukraine on a visa must register after six months' stay in Ukraine. Registration is done at the local offices of the Department of Citizenship, Immigration, and Registration.

All foreigners -- except those with permanent residency status -- are required to have a work permit to work in Ukraine. The Laws of Ukraine "On Population Employment" and "On the Legal Status of Foreigners" define the procedures for obtaining a permit at the State Employment Service. Cabinet of Ministers Resolution #917 from July 11, 2007 introduced some changes to the rules surrounding work permits, although implementation of this new regulation has been unclear and inconsistent.

Resolution #917 states that, if a foreigner intends to travel to Ukraine for employment, the employer in Ukraine must obtain a work permit from the Ministry of Labor. The foreigner should then apply at a Ukrainian Consulate for an IM-1 visa. After the applicant enters Ukraine, he/she should submit his/her passport with the IM-1 visa and work permit to the local Department of Citizenship, Immigration, and Registration, which will provide a passport stamp allowing the person to leave and re-enter Ukraine. For stays longer than one year, the employer must apply to the Ministry of Labor for an extension of the work permit. If a foreigner enters Ukraine without a visa, the employer must apply to the Ministry of Labor for a work permit, and, upon approval, the employee must register with the Department of Citizenship, Immigration, and Registration. Spouses/family members of IM-1 visa holders are not automatically entitled to IM-1 status. However, if they intend to stay in Ukraine for more than 90 days, they must have

a visa - most likely a P-1 (private) visa. When the IM-1 visa holder registers his/her work permit at the Department of Citizenship, Immigration, and Registration, he/she should request the same status for family members. Family members will receive a different stamp (most likely a permit for temporary residence) to allow them to stay in Ukraine and travel in/out of the country just like the IM-1 visa holder.

Cabinet of Ministers Instruction No. 892, dated September 12, 2005, extended work permits from one year to the tenure of employment for foreign citizens working in managerial or specialized positions in Ukraine and individuals providing services without their commercial presence in Ukraine. Employers must notify employment centers, police, and the State Committee for Border Protection three days before revoking contracts with foreign nationals.

A.6. Right to Private Ownership and Establishment

The Constitution of Ukraine guarantees the right to private ownership, including the right to own land. A new Land Code consistent with the Constitution was adopted on October 25, 2001. The Land Code provides for foreign ownership of non-agricultural land and clarifies the rights of foreign investors.

The major provisions of the Land Code address the right of individuals to own, buy and sell land. It classifies land into seven categories, based on potential use including agricultural, industrial and natural reserve lands. The mix of state control and ownership rights varies with each type of land. It is easier to own, buy, sell, and mortgage industrial land than agricultural land. A moratorium on the sale of agricultural land remains in place, and the Land Code also restricts agricultural land purchases by any one legal entity (Ukrainian citizen or Ukrainian-based business) to no more than 100 hectares until 2015. Efforts to cancel the moratorium on agricultural land sale in 2007 failed. The Land Code continues to prohibit foreigners from owning agricultural land directly. The creation of a legal Ukrainian-registered business to purchase and manage land in Ukraine is not prohibited. The Land Code codifies the state's right to oversee private land transactions via registration, the court system, and dispute mediation, as well as broad government/state rights to "influence" the land market. In 2003, Parliament adopted a new law on mortgages that allows the use of agricultural land as collateral and spells out foreclosure and eviction procedures.

Ukraine's Law "On Ownership" recognizes private ownership and includes Ukrainian residents, foreign individuals, and foreign legal entities among those entities able to own property in Ukraine. It permits owners of property (including foreign investors and joint ventures) to use property for commercial purposes, to lease property, and to keep the revenues, profits, and production derived from its use. The Law "On Ownership" is not comprehensive and mechanisms for the transfer of ownership rights are weak. Some difficulties have arisen when foreigners acquire majority control of enterprises, with the government or the current management in some cases continuing to exercise effective control of company decisions.

A.7. Protection of Property Rights

MORTGAGES

During the last few years, Ukraine's policymakers have launched several initiatives to develop a mortgage market, which have resulted in a strong increase in the number of mortgages and laid the legislative and administrative groundwork for a functioning mortgage market. Adoption of the Law "On Withholding Land Shares in Kind" in 2002 and the Law "On Mortgages" in 2003 was particularly important. The GOU created the State Mortgage Institution (SMI) in October 2004 with authorized capital of UAH 50 million (\$10 million) as a liquidity facility largely aimed at putting downward pressure on lending rates by allocating capital efficiently. The SMI began issuing corporate securities during the first quarter of 2007. The use of mortgages in Ukraine to secure ownership in property is growing – apartments, houses, office buildings, other types of buildings, and summer house (dacha) plots have secured mortgages. Development of the secondary mortgage market is underway -- enabled by passage of the Covered Bond Law in late 2005. To test the law, USAID assisted a local bank in the spring of 2007 to issue a pilot mortgage covered bond to demonstrate how residential mortgages can be traded as securities. The pilot issue identified a number of deficiencies in the law and resulted in a package of amendments now being considered by the government. Their passage is likely to result in rapid development of the secondary market and securitization of nearly \$10 billion in residential mortgages -- an increase of \$9.5 billion since the beginning of 2005. USAID helped create of a pledge registry, the first of its kind in the former Soviet Union, which applies to individuals' obligations with regard to movable property and tax liens. Though rudimentary, the registry is nationwide, providing a more transparent lending market for personal property.

INTELLECTUAL PROPERTY RIGHTS (IPR)

The United States withdrew Ukraine's benefits under the Generalized System of Preferences (GSP) program in 2001 and imposed trade sanctions and elevated Ukraine to the Special 301 Priority Watch List in 2002 as a result of Ukraine's failure to adequately protect intellectual property, particularly copyrighted music. The United States lifted sanctions in August 2005, after the Ukrainian government made significant improvements to IPR protection over a number of years, culminating in the passing of amendments to the Law "On Laser-Readable Disks" in July 2005. In January 2006, the United States reinstated GSP benefits for Ukraine and lowered Ukraine's designation under Special 301 from Priority Foreign Country to Priority Watch List. Also in January 2006, the GOU agreed to work with the U.S. Government and with U.S. and domestic industry to monitor the progress of future enforcement efforts through the IPR Enforcement Cooperation Group. This bilateral group has conducted a series of successful dialogues, meeting roughly once every four months. The GOU has also agreed to meet biannually with European Commission officials as part of an EU-Ukraine IP Dialogue. Despite these positive developments, Ukraine remains a trans-shipment point, storage location, and market for pirated and counterfeit goods produced in Russia and elsewhere.

Ukraine is an active member of the World Intellectual Property Organization and a signatory to a number of IPR-related international agreements and conventions. As part of its ongoing efforts to negotiate accession to the WTO, Ukraine has adopted a series of laws to bring its IPR regime into compliance with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Parliament passed amendments to its Customs Code in November 2006 that provide customs officials the ability to use *ex officio* authority to seize suspected pirated or counterfeit goods. In May 2007, Parliament passed a law amending the Civil and Criminal Codes of Ukraine in order to provide for the seizure and destruction of IPR-infringing goods and equipment, in line with Article 46 of TRIPS.

Ukraine amended its Law "On Medicinal Drugs" in November 2006 to provide a five-year period for the protection of pharmaceutical test data that is submitted to government authorities to obtain marketing approval. In September 2007, the Ministry of Health issued a regulatory act to ensure implementation of this law and to clarify some procedures. Pharmaceutical industry representatives complain that implementation of the law remains a problem, however. Parliament also passed an amendment to the Law "On Pesticides and Agrochemicals" in November 2006 that provides a ten-year period of protection for agricultural chemicals. In September, the Cabinet of Ministers issued a regulation to abolish discriminatory fees on the testing and registration of plant varieties.

The State Department of Intellectual Property (SDIP) is responsible for the formulation and implementation of Ukraine's intellectual property policy. In order to improve IPR enforcement, the Ministry of Internal Affairs and the State Customs Service have also set up units to deal exclusively with IPR violations. These under-staffed units have difficulty dealing with the large number of IPR infringements. Amendments to the Criminal Code of Ukraine passed in February 2006 lowered thresholds, so that violations with smaller amounts of damage to rights holders can also be prosecuted as IPR infringement. As a result, prosecutions and convictions of IPR-related crimes have increased significantly in recent years. However, in many cases, the rights holder must actively engage with the Ministry of Internal Affairs or the State Customs Service to obtain enforcement. Judges too often dismiss cases for improper reasons, or hand down minimal sentences. Generally speaking, the number of judges trained in IPR law remains low.

Trademarked and copyrighted goods must be registered for a fee (\$400 for the first good for the first year) in Customs' rights holder database in order to be guaranteed protection. Generally low confidence in the Ukrainian judicial system has meant few enterprises have brought private lawsuits to protect intellectual property rights, although there was a landmark ruling in September 2007 by Ukraine's High Commercial Court against an illegal music download website. Legal experts and government officials have called for the formation of a special patent court in Ukraine to adjudicate patent cases, but to date there has been no concrete action towards this end.

A.8. Transparency of the Regulatory System

BUREAUCRATIC REGULATORY PROCEDURES

The number of regulations, required certificates, and inspection regimes in Ukraine imposes a significant regulatory burden on private enterprise. While the time and costs related to business registration have been reduced, the GOU still requires enterprises to obtain numerous permits to conduct business. The Law "On Permits System in Economic Activity," which entered into force in January 2006, canceled more than half of the required permits and increased the number of locations for obtaining permits six fold. The government also tried to expand "One-stop Registration Shops" that allow new businesses to be registered within two to three days, instead of a month, as in the past. The World Bank "Doing Business" database rated Ukraine 109th in 2008 for ease in starting a business, down from 105th in 2007. "Doing Business 2008" estimates that on average it takes 27 days and \$152.10 (7.8% of GNI per capita) to open a business in Ukraine; OECD averages are 14.9 days and 5.1% of GNI per capita.

LICENSING

Ukraine applies both activity and import licensing regimes. The Law "On Licensing Certain Types of Economic Activities" of June 2000 (and amended on January 17, 2002) provides a list of activities subject to licensing. Licensing applies to nearly 60 economic activities and is meant for protection of human, animal or plant health, the environment, public morals, and national security, or for prudential regulation of the financial sector. Businesspeople continue to cite burdensome activity licensing requirements as major impediments to commerce in Ukraine. Fees are described as high and compliance burdensome, particularly for telecommunications equipment.

Import licenses are required for some goods. The list of goods covered by the licensing regime and the license terms are decided annually by the Cabinet of Ministers. In 2007 the list included pesticides, alcohol products, optical media production inputs, some industrial chemical products and equipment containing them, official foreign postage stamps, excise marks, officially stamped/headed paper, checks and securities, some goods that contain sensitive encryption technologies, and ozone-depleting substances. For some products an importer is required to receive prior approval, which may or may not be automatic, from the relevant administrative agency before receiving the necessary import license from the Ministry of Economy. For some goods, product certification is a prerequisite for an import license. Importers can certify the compliance of a foreign facility to Ukraine's technical regulations applied to imports. The U.S. distilled spirits industry reports that this option usually involves a burdensome visit and costly inspection by Ukrainian government officials. If approved, however, the supplier receives a certificate of conformity valid for two to three years, which avoids the burden of certifying each shipment and subjecting goods to mandatory laboratory tests upon arrival in Ukraine.

RULEMAKING/INSPECTIONS

Proposed draft laws and regulations are available on Parliament's website for public review, but there is no formal procedure for submitting comments.

Current Ukrainian legislation envisages a mandatory financial inspection of a business entity per year and requires a minimum of 10 days notice. Non-financial inspections (i.e. taxes, fire safety, sanitation, etc.) can be burdensome and impediments to doing business in Ukraine.

CERTIFICATION/HEALTH AND SAFETY POLICIES

Technical standards and certification requirements are imposed on many imports. The certification body is the State Committee of Ukraine for Technical Regulation and Consumer Policy ("DerzhSpozhyvStandard"). Although Ukraine belongs to several international standardization bodies, such as the International Organization for Standardization (ISO), for many years it generally had not recognized foreign product certificates, even if they are issued in line with international standards, unless recognition is mandated through an international treaty signed by Ukraine. Standardization procedures can be lengthy, burdensome, and expensive; standards can be vague, inflexible, and subject to frequent changes. Product standards are compulsory for a larger percentage of goods and services than in most of the world. According to a 2007 survey by the International Finance Corporation, over 60% of Ukrainian businesses have to comply with compulsory standards and/or technical specifications.

DerzhSpozhyvStandard is responsible simultaneously for development and approval of standards, issuing certificates, conducting inspections of producers, and ensuring market surveillance and protection of consumer rights, which some experts consider a conflict of interest. DerzhSpozhyvStandard has a network of 114 accredited product certifying bodies, including 60 accredited certifying bodies for quality management systems, as well as about 780 testing laboratories throughout Ukraine, 170 of which are accredited by the National Accreditation Agency as complying with international standards. Depending on the type of product, testing and applicable certification scheme, the certification process can take from three days to one month. Companies seeking testing should contact DerzhSpozhyvStandard.

Importers can apply for three types of technical standard certificates: a certificate for a single batch of goods; a certificate for one year, which is valid for all imported goods during that year with one or two additional selective tests (this type of certification is the most common in Ukraine); and a certificate for five years, which requires inspection of production facilities.

Some certification agencies do much of their regulatory work with little or no coordination with other Ukrainian bodies performing similar tests. Many products require multiple certificates from different agencies, with local, regional, and municipal authorities often requesting additional documentation beyond that required by central bodies. Experts allege that government officials responsible for issuing licenses often require businesses to provide documents that are not mandatory, deliberately conceal

information in order to confuse a potential licensee, or delay issuing documents in order to induce licensees to offer a bribe.

These issues are being addressed during Ukraine's WTO accession negotiations, and, as recently as September 2007, Ukraine has reduced the number of products subject to mandatory certification. Upon WTO accession, Ukraine will be obliged to apply such mandatory requirements only in conformity with WTO provisions on technical regulations (i.e., only in defense of human, animal, and plant health and safety), and only based on sound science. A May 2007 amendment to the Law "On Standards, Technical Regulations and Conformity Assessment Procedures" helped to guarantee precedence of international over regional standards and introduced provisions related to conformity assessment recognition, although further amendments may be needed to ensure that Ukrainian authorities will accept the results of conformity assessment procedures performed in the United States. Ukraine's National Accreditation Agency is taking steps to become a member of the International Laboratory Accreditation Cooperation (ILAC), anticipated in 2009. Once an ILAC member, Ukraine should significantly increase the acceptance of test results of laboratories accredited with, and notified by, ILAC member bodies.

In addition, Ukraine has, in the past, applied a range of sanitary and phytosanitary (SPS) measures that restrict imports of a number of U.S. agricultural products, among them, pork, beef, and poultry. Ukraine's certification and approval process is lengthy, duplicative, and expensive. Ukraine maintains a complex and non-transparent system for overseeing human and animal health measures that involves overlapping authority by the Veterinary Service, Sanitary Service, and DerzhSpozhyvStandard. Over the past few years, however, Ukraine has passed amendments to several laws and regulations, most importantly to the Law "On Veterinary Medicine" and the Law "Quality and Safety of Food Products and Food Raw Materials," to bring its legislative and regulatory framework into compliance with requirements of the WTO SPS Agreement.

Ukraine's biotechnology approval process has been inoperative for some time. This has resulted in unpredictable sales conditions for corn products, soybeans, and meal. The United States is working with Ukraine to establish procedures regarding biotechnology that are based on modern, science-based risk assessment principles and guidelines, including those of the WTO SPS and Technical Barriers to Trade (TBT) Agreements, the Codex Alimentarius, and the International Plant Protection Convention (IPPC). In May 2007, Parliament passed a new law establishing a framework for the creation, testing, and use of products of biotechnology. The government still needs to issue implementing regulations for the law to take practical effect, however.

For many years, Ukraine has worked to bring its standardization system into conformity with the European Standards System. The law "On Assurance of Conformity" is replacing mandatory certification for many types of products with assessment procedures in conformance with international standards and the "New Approach" directives of the European Union, including the principle of "presumption of conformity to standards." On August 1, 2002, the National Accreditation Body started operations to ensure the use

of standards and procedures consistent with European Cooperation for Accreditation (ECA) policy.

A.9. Efficient Capital Markets and Portfolio Investment

BANKING

The Ukrainian banking system consists of the National Bank of Ukraine (NBU) and commercial banks. The NBU is responsible for monetary policy, licensing of commercial banks, and oversight of their activities.

Ukraine's banking sector is modernizing and growing rapidly, and is playing a growing role in Ukraine's economy. Bank capital is about 10% of GDP. Total bank assets in Ukraine are about UAH 510 billion, with total loan assets of UAH 370 billion (as of October 2007). Money lending and deposits grew at a fast 56% and 36% respectively in January-October, 2007. Bank deposits account for 40% of GDP. Interest rates continued to decline from 15.0% in 2006 to 13.8% in 2007, making credit more accessible. There are 154 banks operating in Ukraine, but a handful of banks dominate the market. The top fifteen banks control 64% of the loans outstanding and own 45% of the total capital of the system. As the volume of consumer lending grew by over 70% in January-October, 2007, the share of loans exceeding one year stood at 44% of the total loan portfolio of the banking system, up from 43% last year. Non-performing loans were registered at 2% of the total lending portfolio in 2006, the latest data available. Foreign borrowing by Ukrainian banks has grown rapidly in recent years, from \$7.8 billion at the beginning of 2006 to \$25.7 billion after nine months of 2007. Greater reliance of banks on foreign borrowing to fund domestic lending operations raised concerns about the sensitivity of Ukraine's banking sector to international shocks. Borrowing rates for Ukrainian banks on international markets rose substantially as a result of the summer 2007 sub-prime crisis and credit crunch, yet as of December 2007 banks were still able to raise funds abroad, in part because several larger banks are now owned by foreign banks and can rely on their parent bank. Borrowing by Ukrainian banks from other banks grew by over 70% in 2007.

In January 2002, the Law "On Banks and Banking Activity" eliminated discrimination against foreign banks. It entrusted the NBU with issuing banking licenses and includes provisions to prevent money laundering. The NBU sets minimum capital requirements each year to be met by the banks by the year-end. Current minimum capital requirements range from UAH 20.04 million (\$4 million) to UAH 133.3 million (\$26.3 million). Foreign licensed banks may carry out all the same activities as domestic banks and there is no ceiling on their participation in the banking system. Foreign banks can operate via subsidiaries in Ukraine. In November 2006, Parliament approved an amendment to the law "On Banks and Banking Activity" permitting foreign banks to operate via branch offices. The law anticipates a transition period of five years and sets requirements for branches of foreign banks, including cooperation with the Financial Action Task Force and UAH 68.8 million (\$13.6 million or EUR 10 million) minimum capital of the branch. Foreign banks have significantly increased their presence in Ukraine's banking sector in

recent years, usually through the acquisition of Ukrainian banks. Foreign banks now account for approximately 31% of bank capital in Ukraine.

Ukraine remains a cash economy, but the use of credit cards is on the rise. From January through September 2007, the use of credit cards increased by 13% and use of ATM cards increased by 51%, despite widespread credit/ATM card fraud in Ukraine.

INSURANCE

Currently, based on the 1996 Law "On Insurance," only insurance companies registered in Ukraine may carry out insurance operations. There is a lower minimum capital requirement for domestic insurance companies than insurance companies with foreign shareholders. Foreign insurance companies can invest in local companies, but to operate locally they are required to open branch offices. Parliament adopted amendments to the Law "On Insurance" in November 2006 and May 2007, however, that give foreign companies the right to operate in Ukraine through affiliates five years after Ukraine accedes to the WTO.

CAPITAL MARKETS

The legal and regulatory framework, as well as financial disclosure systems for the securities market, continues to lag behind international standards. Basic market infrastructure exists as does a competent regulator, but the legislative basis for capital market operations is weak. Rulings of the Securities and Stock Market State Commission (SSMSC) have insufficient enforcement power and are not always followed by the courts. Investors continue to face low market confidence, transitional accounting standards, a lack of accurate company information, inadequate protection of minority shareholders' rights, and a macroeconomic environment that, despite marked growth and economic modernization in recent years, remains volatile. Deficiencies in regulations governing operation of registrars led to frequent cases of double registration of shares, resulting in low protection of shareholders' rights.

Ukrainian law allows for the following types of securities:

- share securities (shares, investment certificates);
- debt securities (bonds of enterprises, state bonds of Ukraine, bonds of local loans, treasury obligations of Ukraine, savings (depository) certificates, bills of exchange);
- mortgage securities (mortgage bonds, mortgage certificates, mortgages, certificates of funds of operations with real estate);
- privatization securities;
- derivative securities;
- title securities

According to the SSMSC, 29 collective investment institutions, 757 securities traders, 186 custodians, 2 depositories, 361 registrars, and 11 self-regulatory organizations (six of which are associations) operated in Ukraine last year. Seven stock exchanges were registered in Ukraine. A Ukrainian securities industry broker/dealer self-regulatory

organization (SRO) and its nationwide electronic trading system (PFTS) are the largest stock exchange with about 94.8% of secondary onshore trading. PFTS Stock Exchange market capitalization was UAH 565 billion (USD 112 billion) in late 2007. The Ukrainian government is currently considering options to consolidate the remaining, mostly dormant stock exchanges to enhance price transparency, and improve stock exchanges listing standards to establish corporate governance and information disclosure based on international norms.

The absence of a central securities depository complicates transparent and efficient transfer of ownership records, protection of ownership rights and clearance and settlement of trades. Although a state-owned National Depository was created in 1999, the market-owned MFS Depository has been operating commercially as the Ukrainian Depository since 1997 in line with current international practice. The Ukrainian government is currently considering reform options to establish a predominately privately owned Ukrainian Central Depository through the merging of the two institutions.

Principal laws, decrees, and regulations governing Ukraine's capital markets include: the Law "On Securities and Stock Exchanges" (1991), replaced in May 2006 by the Law "On Securities and the Stock Market" (2006), the Law "On Business Associations" (1991), a Presidential Decree "On Investment Funds and Investment Companies" (1994), the Law "On State Regulation of Securities Markets" (1996), Amendments to the Law "On Business Associations" (1996), the Law "On the National Depository System" (1997), the Law "On Accounting and Financial Reporting" (1999), the Law "On Bankruptcy" (1992), the Law "On Collective Investment Institutions" (2001), and the Law "On Financial Services" (2001).

The Law "On Collective Investment Institutions" encourages the creation of mutual funds, introduces the idea of a licensed asset manager, regulates the establishment and operation of subjects of mutual investment, provides guarantees of ownership rights to securities, and protects rights of exchange market participants. The Law "On the Circulation of Promissory Notes" (2001) provides a framework for the circulation of promissory notes in accordance with the Geneva Convention of 1930.

The new Law "On Securities and Stock Market" (2006) represents a major improvement over the prior Law "On Securities and Stock Exchanges" (1991), especially regarding internationally compliant disclosure requirements for listed companies, issues of transparency of ownership, and the new rules for insider information and insider trading.

The Law "On Business Associations" is vague and does not support basic shareholders rights and facilitates a large number of corporate governance abuses (including share dilution, asset stripping, and dubious transfer pricing). The law is widely recognized to be inadequate and in need of reform.

A.10. Political Violence

Ukraine is largely free of significant civil unrest or disorders. However, occasionally, mass demonstrations occur in larger cities, such as Kyiv, usually sponsored by individual political forces. Pre-term parliamentary elections took place in September 2007 without any significant disruptions or violence. The likelihood of future widespread, politically inspired violence that would affect foreign property interests remains relatively low.

A.11. Corruption

Corruption pervades all levels of society and government and all spheres of economic activity in Ukraine and is a major obstacle to foreign investment. President Yushchenko has made combating corruption a top priority, although much remains to be accomplished. Ukraine worsened in Transparency International's Year 2007 Corruption Perception Index (CPI), which was published in September 2007. The country moved down to 105th place in 2007 on the list of 180 countries, from 99th place out of 163 countries in 2006. In 2007, Transparency International rated Ukraine at 2.7 points on the CPI's 10-point scale, a decline from the 2006 rating of 2.8 points.

Corruption stems from a number of factors, such as a lack of institutional traditions of transparent decision-making and low societal understanding of the importance of corporate governance and transparency. Low public sector salaries fuel corruption in local administrative bodies such as the highway police, the health system, the tax administration, and the education system. Corruption within the Customs Service often makes it more difficult and more costly for businesses to import/export goods. High-level corruption ranges from misuse of government resources and tax evasion to non-transparent privatization and procurement procedures. In short, corruption impacts the daily lives of Ukraine's citizens and important decisions taken at the state level.

Ukraine's prosecution of corruption is based on the Law "On Combating Corruption," which was passed in October 1995. The law is rarely enforced, and on the rare occasions it is enforced, it is normally aimed at lower-level state employees or used retributively in political vendettas. In January 2006, the President Yushchenko signed a decree requiring Ukraine to honor its obligations to the Council of Europe, which include several anti-corruption provisions. In September 2006, the President signed a separate decree adopting a national anti-corruption strategy that directs all branches of government to support these efforts, and the Government of Ukraine followed up by adopting an Action Plan to implement this strategy. In October 2006, the President submitted to parliament a package of draft laws on anti-corruption and ratification instruments for the Council of Europe Criminal Law Convention on Corruption and the UN Convention against Corruption. In August 2007 the President announced a list of several "anti-corruption initiatives" that includes the setting up of a single anti-corruption agency that would develop a comprehensive anti-corruption policy and implement various anti-corruption measures.

In 2006 the U.S. Millennium Challenge Corporation funded Ukraine's proposal for a Threshold Country Program aimed at reducing corruption. This two-year program is providing about \$45 million in assistance to reform the judiciary, streamline regulatory

procedures, institute internal assets declaration and inspector generals, enhance civil society and media monitoring of corruption, and reduce corruption in higher education admissions through standardized testing.

Although government action is still limited and uncoordinated, fundamental changes have taken place in the GOU's attitude towards corruption. Gone are the days when GOU officials refused to admit that corruption existed in Ukraine. Government and parliamentary officials now openly discuss the problem of corruption with USG contacts and with the press and public at large. In March 2005, Ukraine ratified the Council of Europe Civil Law Convention on Corruption and became a member of the Council of Europe's Group of States Against Corruption (GRECO). GRECO has concluded its Joint First and Second Rounds of Evaluation of Ukraine and published its report in October 2007. Parliament has passed laws to ratify the Council of Europe Criminal Law Convention on Corruption, signed in January 1999, and the UN Anticorruption Convention, signed in December 2003. However, ratification of these Conventions will come into effect only when additional implementing legislation is adopted. Ukraine is not party to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

A.12. Bilateral Investment Agreements

BILATERAL INVESTMENT AGREEMENTS

The Bilateral Investment Treaty between the United States and Ukraine came into force on November 16, 1996. The following countries have also signed bilateral investment agreements with Ukraine: Albania (2004), Austria (1996), Argentina (1995), Armenia (1994), Azerbaijan (1997), Belarus (1995), Belgium (2001), Bulgaria (1994), Brunei (2006), Canada (1994), Chile (1995), China (1992), Cuba (1995), Croatia (1997), the Czech Republic (1994), Denmark (1992), Egypt (1992), Estonia (1995), Finland (1992), France (1994), Gambia (2006), Georgia (1995), Germany (1993), Greece (1994), Indonesia (1996), Iran (1996), Israel (1995), Italy (1993), Hungary (1995), Kazakhstan (1994), Korea (1996), Kyrgyzstan (1993), Latvia (1997), Lebanon (1996), Lithuania (1994), Macedonia (1998), Moldova (1995), Mongolia (1992), the Netherlands (1994), Panama (2005), Poland (1993), Portugal (2003), Russia (1998), Saudi Arabia (2003), Slovakia (1994), Slovenia (1999), South Korea (1996), Spain (1998), Sweden (1995), Switzerland (1995), Turkmenistan (1998), Turkey (1996), UK (1993), Uzbekistan (1993), Vietnam (1994), Yugoslavia (2001), Yemen (2002).

A.13. OPIC and Other Investment Insurance Programs

The U.S.-Ukraine Overseas Private Investment Corporation (OPIC) Agreement was signed in Washington on May 6, 1992. OPIC halted support for projects in Ukraine in 1999, however, after the government of Ukraine failed to reimburse OPIC for OPIC's payment of a claim by a U.S. business whose investment had been expropriated. The government is now actively working to find a resolution to this dispute so that OPIC can resume its activities in Ukraine.

In July 2002, the Board of the U.S. Export-Import bank opened facilities for short and medium-term (up to seven years) lending for commercial, and sub-sovereign projects. Ukraine is a member of the Multilateral Investment Guarantee Agency (MIGA).

A.14. Labor

LABOR AVAILABILITY

Ukraine has a well-educated and skilled labor force with nearly a 100 percent literacy rate. As of September 2007, unemployment (ILO methodology) stood at 6.2 percent, although unemployment in some regions, particularly in western Ukraine, was significantly higher.

WAGES

Wages in Ukraine are very low by Western standards but continue to grow steadily. As of October 2007, the nominal average monthly wage in Ukraine was UAH 1475 (\$292), up 35.6% from UAH 1088 (\$215) in October 2006. Real wages grew 12.6% between January and October 2007, compared to the same period in 2006. The highest wages are in the financial and aviation sectors while the lowest wages are paid to agricultural and public health workers.

MINIMUM WAGE

The minimum monthly wage was increased on January 1, 2008 to UAH 515 (\$102). Regular increases of the minimum wage are planned.

PENSIONS

In 2004 Ukraine began a comprehensive pension reform program, based on international standards, which envisaged a three-pillar system: Pillar I, a solidarity system, Pillar II, a mandatory accumulation system, and Pillar III, a voluntary private pension system.

For the solidarity system, Pillar I, retirement payouts are determined on the basis of the individual's labor records and contributions. Despite the major reform, the Pillar I system is complex with low retirement ages (60 for men and 55 for woman), full retirement benefits based on 20 years of service for woman and 25 years of service for men, and many special early retirement provisions.

Pillar II, the Mandatory Accumulation System, is to be funded by pension contributions made by individuals. The conditions for the introduction of Pillar II have been met, but new legislation is required. The draft law to introduce Pillar II was submitted to Parliament in December 2006 and passed the first reading in April 2007. The draft law provides for a gradual phase-in of employee contributions to the Accumulation Fund starting with 2% in 2009 and increasing by 1% per year to 7% in 2014.

Pillar III, voluntary private pension funds, began actual operations at the end of 2004. The development of private pension funds was positive in 2006, with an almost three-fold increase in assets and a 46 percent increase in the number of funds (from 54 private pension funds to 79).

According to the financial services regulator, private pension fund assets have increased by an average 35 percent per fiscal quarter since becoming available in 2004. In Q1 2005, assets under management of Private Pension Funds were \$2.53 million, in Q4 2006 - \$27.20 million, and in Q3 2007 - \$44.85 million. However, Ukraine's capital markets remain underdeveloped and do not provide these funds with enough sound, long-term investment opportunities in the equity, debt and real estate markets. As a result, assets of private pension funds continue to be invested primarily in bank deposits, which do not meet the long-term portfolio needs of these funds. The ongoing weakness of the market regulatory structure compounds the problem. If the situation continues, the risk will grow that private pension funds will fail to perform in line with the overall growth of the economy in the future. Various international donor initiatives are supporting the Ukrainian government's efforts to strengthen the breadth, liquidity and regulatory framework of the country's markets with the goal of creating the conditions for sustainable long term investment opportunities.

LABOR/MANAGEMENT RELATIONS

Ukrainian workers are generally accustomed to "top-down" management practices and therefore tend not to demonstrate initiative. A younger, more independent-minded generation is slowly moving into the workforce, and it is becoming easier to find professional personnel who function independently.

Although investors may encounter government resistance to trimming the work force to an efficient level, across-the-board demands to maintain employment levels are disappearing. Ukrainian enterprises often still maintain much of the social infrastructure of their immediate community (schools for local children, cafeterias, and medical facilities). While many local officials are willing to work with businesses to identify social services that an enterprise must support, such arrangements should be clearly spelled out before investments are started.

Ukraine's Labor Code remains outdated and inappropriate for a market economy. The government has drafted a new, more modern Labor Code, but it failed to move forward in Parliament in 2007 due to a protracted political crisis in the country.

A.15. Foreign Trade Zones/ Free Ports

Ukraine has in the past maintained two forms of special economic zones (SEZs): Free Economic Zones (FEZs) and Priority Development Territories (PDTs). In April 2005, Ukraine canceled all tax exemptions (i.e., from land tax, corporate income tax, import duty, and VAT on imports) to investors in all SEZs to stop large-scale misuse of these zones for tax evasion and smuggling. While the step reduced corruption and expanded

the tax base, the abrupt cancellation of privileges and lack of compensatory provisions caused losses to some legitimate investors. At the end of 2006, the Ukrainian government announced its intention to renew tax privileges granted to businesses operating in some SEZs and to introduce a compensation mechanism for investors, but a draft law on the subject never went forward. At least one SEZ had retained tax privileges due to a court ruling, but those and all other privileges were again annulled by the new Ukrainian government in December 2007. In November 2005, the Parliament adopted legislation to create technology parks, providing for some government financial support, targeted subsidies, and tax privileges for a list of 16 technoparks based on existing scientific and research institutes.

A.16. Foreign Direct Investment Statistics

FOREIGN DIRECT INVESTMENT

According to Ukraine's State Statistics Committee, as of October 2007 the total stock of FDI in Ukraine was \$26.9 billion, or \$576 per capita. This was a 35.2% increase from October 2006, when the total stock of FDI stood at \$19.9 billion, or \$424 per capita.

Mittal Steel's October 2005 purchase of the Kryvorizhstal Steel Mill represented a major inflow of FDI, at \$4.8 billion, into Ukraine. Purchases of Ukrainian banks by European banks have represented another major inflow of foreign direct investment in recent years: Raiffeisen International acquired Bank Aval for \$1.0 billion in 2005; BNP Paribas acquired Ukrsibbank for \$360 million in 2005; UniCredit Group acquired Ukrsotsbank for \$2.1 billion in 2007; Swedbank acquired TAS-Kommerzbank for \$735 million in 2007; and Commerzbank acquired Forum Bank for \$600 million in 2007. Also in 2007, PepsiAmericas and PepsiCo jointly purchased 100% of the leading Ukrainian juice producer Sandora for a total of \$679 million.

FDI BY COUNTRY

As of October 1, 2007 Ukraine's major investors included: Germany (21.4% of total FDI), Cyprus (18.5%), the Netherlands (8.1%), Austria (7.5%), the United Kingdom (6.8%), the United States (5.3%), and Russia (5.0%). Cyprus remains a popular offshore destination for Ukrainian and Russian enterprises through which to channel investments.

FDI BY INDUSTRY SECTOR DESTINATION

Over the first 9 months of 2007, 15.7% of new FDI went to the financial sector, 8.5% -- to domestic trade, 8.4% -- to real estate, 5.7% -- to the metallurgy sector, 5.6% -- to food, beverages, and tobacco production, 5.2% -- to construction, and 3.8% -- to machine building.