1999 Country Reports on Economic Policy and Trade Practices
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UKRAINE

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1997	1998	1999 1/
Income, Production and Employment:			
Nominal GDP	44.00	40.76	31.37
Real GDP Growth (pct) 2/	-3.2	-1.7	-0.7
GDP by Sector:			
Agriculture	5.21	4.48	5.51
Manufacturing	14.46	11.80	12.15
Services	20.1	16.7	16.9
Government	N/A	N/A	N/A
Per Capita GDP (US$)	863	850	629
Labor Force (millions)	22.6	22.3	N/A
Unemployment Rate (pct)	3.1	3.2	5.95
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	39.3	33.2	27.8
Consumer Price Inflation	10.3	29.0	16
Exchange Rate (Hryvnia/US$ annual average)	1.9	2.7	N/A
Official	1.85	2.50	4.1
Balance of Payments and Trade:			
Total Exports, FOB 3/	15.4	16.4	14.8
Exports to U.S. (US$ millions) 4/	414	634	N/A
Total Imports, CIF 3/	19.6	17	13.9
Imports from U.S. (US$ millions) 4/	404	887	N/A
Trade Balance 3/	-4.2	-0.6	0.9
Balance with U.S. (US$ millions) 4/	10	253	N/A
External Public Debt/GDP (pct)	23.8	29.0	40
Fiscal Deficit/GDP (pct)	5.6	2.5	1.5
Current Account Deficit/GDP (pct)	-2.6	-2.8	-3.03
Debt Service Payments/GDP (pct)	3.3	N/A	5.4
Gold and Foreign Exchange Reserves	2.4	1.2	1.2
Aid from U.S. (US$ millions) 5/	369	225	195
Aid from All Other Sources	N/A	N/A	N/A

1/ 1999 figures are all estimates based on available monthly data through September 1999, or are 1999 forecast. Source: Government of Ukraine. Depreciation of local currency in relation to dollar accounts for significant portion of annual drop in nominal dollar amounts.

2/ Percentage changes calculated in local currency, adjusted for inflation.
3/ Merchandise trade.
4/ Source: U.S. Department of Commerce and U.S. Census Bureau; exports FAS, imports customs basis.
5/ Figures are actual FY expenditures. Cumulative budgeted assistance (credits and grants) for FY 92-97 totals approximately $2.46 billion.

1. General Policy Framework

Since achieving independence in August 1991, Ukraine has followed a course of democratic development and gradual economic reform. After a period of hyperinflation, it curbed inflation and successfully introduced a new currency, the "hryvnia," in 1996. A tremendous amount of work still lies ahead in the area of economic development and the creation of an economic environment conducive to foreign investment and governed by market forces. Ukraine's economic inheritance from the Soviet Union of a large defense sector and energy-intensive heavy industry has made the transition to a market economy particularly difficult. Ukraine's principal resources and economic strengths include rich agricultural land, significant coal and more modest gas and oil reserves, a strong scientific establishment, and an educated, skilled workforce. Ukraine is an important emerging market at the crossroads of Eastern Europe, Russia, Central Asia, and the Middle East, and holds great potential for becoming an important new market for U.S. trade and investment. A significant number of both large multinationals and smaller foreign investors are present, although private investment (including U.S. investment) is greatly hampered by overregulation, lack of transparency, high business taxes, and inconsistent application of local law.

Ukraine still has much progress to make in the areas of large-scale privatization, tax reform, and contract enforcement. The government has generally been successful in efforts to achieve macroeconomic stability. After initially being hard hit by the August 1998 Russian financial crisis, Ukraine weathered the effects of this crisis relatively well during 1999. Economic growth in the formal sector showed signs of a modest recovery after nearly a decade of decline. Inflation remained relatively low, at slightly more than 10 percent during the first nine months of 1999. September 1998 saw the first disbursements to Ukraine from the International Monetary Fund (IMF) Extended Fund Facility (EFF). The three-year, $2.2 billion EFF program stipulated that the Ukrainian government take steps towards tax reform, a lower budget deficit, and further progress in privatization, deregulation, and other measures to encourage private investment. Several times during 1999 Ukraine fell out of compliance with IMF conditionalities, causing the IMF temporarily to hold up EFF disbursements. In most instances, Ukraine took steps to bring itself back in line with EFF requirements, and disbursements were resumed. However, Ukraine fell off track again with the IMF in September, 1999 due to a failure to follow through on communal tariff increases, and as of late 1999, they had not yet secured IMF funding. Ukrainian foreign currency reserves increased during the period January-November 1999, reaching approximately $1.2 billion.

Nevertheless, the Ukrainian government's financial problems continued. Following the Asian and Russian financial crises, Ukraine's previously easy access to private foreign financing diminished. Deterioration of the important Russian market for Ukrainian goods caused a significant drop in exports. The situation of the private banking sector, rife with non-performing loans and lacking good lending opportunities, remained precarious. Despite some progress in deregulation in 1999, Ukraine still awaited a much-needed surge in new investment. Domestic and foreign investors remained discouraged by a confusing and burdensome array of tax, customs and certification requirements, corruption, and the absence of an effective system of commercial law.

The exchange rate relative to the U.S. dollar had remained steady within a narrow band in 1996 and 1997, but between August 1 and September 30, 1998, the hryvnia depreciated approximately 40 percent against the dollar before stabilizing. The hryvnia depreciated by approximately 35 percent during the first ten months of 1999.

Ukraine's budget deficit has largely been the result of excessive spending on social programs and subsidies to both noncompetitive industries and private consumers, coupled with inadequate revenue collection. Financing was achieved through a combination of issuance of T-Bills to domestic and foreign borrowers, borrowing from the National Bank of Ukraine (NBU), assistance from international financial institutions (IFIs), and accumulation of wage and pension arrears. With the onset of the Russian financial crisis in August 1998, however, the market for government debt has largely dried up, and the government has had to rely increasingly upon credits from international financial institutions (IFIs), especially the IMF and World Bank. Ukraine has followed a relatively strict monetary policy for the past several years as part of its effort to control inflation and maintain the value of the hryvnia. During 1999, it continued efforts to reduce liquidity through raising bank reserve requirements, although it at the same time it relaxed somewhat its control of foreign exchange operations. Domestic arrears for wages and pensions has also been an important source of funds to finance the deficit.

2. Exchange Rate Policy

In February 1999, the NBU established a new official currency exchange band range of 3.4 to 4.6 hryvnia per dollar. Although the NBU lifted most currency transaction restrictions during March through June (including a ban on advance payment on import contracts) and opened an interbank market for foreign exchange, some restrictions remain. Enterprises are still obliged to sell 50 percent of their hard currency earnings. The NBU also limited deviation of the cash market exchange rates from the official rate to 10 percent.

Such restrictions have produced hardships for U.S. firms doing business with Ukraine. U.S. exporters were reluctant to ship goods without prior payment, while U.S. businesses operating in Ukraine (many of which are highly dependent on imports) have had difficulties in obtaining materials necessary for their operations. The NBU has stated it may give up the currency band in 2000.

3. Structural Policies

There are no pricing requirements for consumer goods in Ukraine. Stiff import tariffs and VAT taxes, along with the small number of suppliers of Western products in Ukraine, tend to keep prices of imported goods high.

Ukraine's burdensome and nontransparent tax structure remains a major hindrance to foreign investment and business development.   Personal income and social security taxes remain high. Combined payroll taxes were reduced by Presidential Decree from 48.5 percent to 37.5 percent effective January 1, 1999. Tax filing and collection procedures do not correspond to practices in Western countries. Import duties and excise taxes are often changed with little advance notice, giving foreign investors little time to adjust to new requirements.

The regulatory environment is chaotic and Ukraine's product certification system is one of the most serious obstacles to trade, investment, and ongoing business. Although new licensing legislation is being drafted, procedures for obtaining various licenses remain complex and unpredictable, significantly raising the cost of doing business in Ukraine, and encouraging corruption and the development of the shadow economy.

4. Debt Management Policies

Ukraine's foreign debt stood at $12.4 billion in July 1999, around 40 percent of GDP. The largest amount is owed to Russia and Turkmenistan, primarily for past trade credits for deliveries of gas, which have been rescheduled into long-term state credits. Ukraine owed about $5.07 billion to international financial institutions and bilateral export credit agencies. External debt service as a percent of GDP was expected to be 5.4 percent in 1999. This figure for 2000 is expected to reach ten percent because of large foreign debts that will become due during that year.

In September 1998 the IMF approved a three-year, $2.2 billion Extended Fund Facility (EFF) intended to overcome balance of payments difficulties stemming from macroeconomic imbalances and structural problems. Monthly disbursements under the EFF are conditioned on Ukraine pursuing more aggressive economic reform, and maintaining foreign reserve levels and a low budget deficit. As noted above, in 1999 Ukraine has periodically fallen out of compliance with IMF conditionalities but then taken steps to bring itself back in accord, allowing the resumption of EFF disbursements. In August, the government rescheduled part of an approximately $160 million dollar sovereign debt due to foreign investors.

5. Aid

Ukraine is one of the leading recipients of U.S. assistance. The FY 99 Foreign Assistance Act set aside $195 million for Ukraine, focused on economic reform and privatization, business development, energy and environment (including nuclear safety/Chernobyl), democracy and local government, legal reform, and health and social development. In addition, around $100 million in other U.S. funding went for exchange programs, Peace Corps, transport of humanitarian supplies, and the Nunn-Lugar Cooperative Threat Reduction Program.

U.S. assistance also reaches Ukraine indirectly through international financial institutions. As stated above, in September 1998, the International Monetary Fund approved a three year, $2.2 billion Extended Fund Facility designed to promote fiscal reform, financial stabilization, and the accelerated development of a market economy. Disbursements under the EFF amounted to $630 million during January-November 1999. Major World Bank loans have promoted agricultural reform, privatization, modernization of the financial sector, and reform in the energy sector. The only major World Bank disbursement expected in the near term is for financial sector reform, although there is the possibility of large new programs in 2000 for administrative reform and restructuring of privatized enterprises. The European Bank for Reconstruction and Development is expanding its role in financing small business development (in conjunction with USAID), and is considering a major role in the nuclear sector, including in improvement of safety at Chernobyl and the possible completion of new nuclear reactors.

6. Significant Barriers to U.S. Exports

The daunting menu of a VAT (20 percent), import duties (ranging from 5 to 200 percent) and excise taxes (10 to 300 percent) present a major obstacle to trade with Ukraine. A limited number of goods, including raw materials, component parts, equipment, machinery, and energy supplies imported by commercial enterprises for "production purposes and their own needs" are exempted from VAT. Many agricultural enterprises are also exempt from the VAT.   While investors' statutory funds are exempt from VAT, fixed capital investments, including plant equipment are often subject to VAT tax. This, coupled with inconsistent application of the law by customs and tax authorities, leads to investor uncertainty.

Import duties differ and largely depend upon whether a similar item to that being imported is produced in Ukraine; if so, the rate may be higher. Goods subject to excise taxes include alcohol, tobacco, cars, tires, jewelry, certain electronics, and other luxury items. Excise duty rates are expressed as a percentage of the declared customs value, plus customs duties and customs fees paid for importing products. This often results in duties and fees amounting to over 100 percent of the declared value of the item.

The significant progress made in the last few years on economic stabilization and the reduction in inflation have improved conditions for U.S. companies in Ukraine. However, foreign firms need to develop cautious and long-term strategies that take into full account the problematic commercial environment. The weak banking system, poor communications network, difficult tax and regulatory climate, prevalence of economic crime and corruption, non-transparent tender procedures, limited opportunities to participate in privatization, and lack of a well-functioning legal system, impede U.S. exports to and investment in Ukraine.

Ukraine's domestic production standards and certification requirements apply equally to domestically produced and imported products.   Product testing and certification generally relate to technical, safety and environmental standards, as well as efficacy standards with regard to pharmaceutical and veterinary products. Such testing often requires official inspection of the company's production facility at the company's expense. Testing is often done in sub-standard facilities and on a unit-by-unit basis rather than "type" testing. In cases where Ukrainian standards are not established, country of origin standards may prevail.

Duties on goods imported for resale are subject to varying ad valorem rates. Imported goods are not considered legal imports until they have been processed though the port of entry and cleared by Ukrainian customs officials. Import licenses are required for very few goods, primarily medicines, pesticides, and some industrial chemical products.

7. Export Subsidies Policies

As part of its effort to cut the budget deficit, the government has significantly reduced the amount of subsidies it provides to state owned industry over the last several years. Nonetheless, subsidies remain an important part of Ukraine's economy, particularly in the coal and agriculture sectors. These subsidies, however, appear not to be specifically designed to provide direct or indirect support for exports, but rather to maintain full employment and production during the transition to a market-based economy. The government does not target export subsidies specifically to small business. (Ukrainian exporters, however, now enjoy a number of tax benefits, such as the VAT applied at a zero rate.) Ukraine's subsidy policy may change in the context of its negotiations to join the World Trade Organization (WTO). The country's sixth WTO Working Party meeting was held in the summer of 1998. Ukraine has tabled WTO market access offers for both goods and services, though its accession process is proceeding slowly.

8. Protection of U.S. Intellectual Property

Since gaining its independence, Ukraine has made significant progress in enacting legislation and adopting international conventions to protect intellectual property rights, though much still needs to be done to reach the level required by TRIPs. Ukraine is a member of the Universal Copyright Convention, the Convention establishing the World Intellectual Property Organization - WIPO, the Paris Convention, the Madrid Agreement, the Patent Cooperation Treaty, the International Convention for the Protection of New Varieties of Plants, the Berne Convention, the Trademark Law Treaty, and the Budapest Treaty. Nonetheless, in 1998 Ukraine was placed on the Special 301 Watch List because copyright piracy is extensive and enforcement is minimal, causing substantial losses to U.S. industry. On May 1, 1999 Ukraine was moved to the Priority Watch List. Ukraine has taken some steps to improve its Intellectual Property Rights (IPR) regime, in accordance with its two-year plan to make its IPR legislation TRIPS-compliant, including ratification by Parliament in June 1999 of the Geneva Phonogram Convention. The President now must deposit the ratification with the World Intellectual Property Organization (WIPO) for it to take effect. Numerous pieces of additional legislation are pending.

Ukrainian legislation has inadequate criminal penalties for copyright piracy and none for infringement. Enforcement is negligible or non-existent. Courts do not provide a reliable means to address copyright infringement. Piracy has become an even more serious problem as pirate factories displaced from Bulgaria have found a home in Ukraine. This was one of the contributing factors in the decision to move Ukraine to the Priority Watch List. To address this problem, Ukraine announced that it was creating an anti-piracy committee with authority to conduct unannounced searches and to confiscate pirated goods, but thus far it has made little progress. The government openly acknowledges its problems with piracy and actively seeks help from the U.S. in combating it.

Ukraine is in the process of acceding to the WTO. The U.S. Government has taken the strong position that Ukraine's IPR regime must be TRIPs-compliant at the time of accession, with no transition period. Ukraine has established a working group with the U.S., which has met twice, the last time in April 1998.

9. Worker Rights

a. The Right of Association: The constitution provides for the right to join trade unions to defend "professional, social and economic interests." Under the constitution, all trade unions have equal status, and no government permission is required to establish a trade union. The 1992 Law on Citizens' Organizations (which includes trade unions) stipulates noninterference by public authorities in the activities of these organizations, which have the right to establish and join federations on a voluntary basis. In principle, all workers and civil servants (including members of the armed forces) are free to form unions. In practice, the government discourages certain categories of workers, for example, nuclear power plant employees, from doing so. A new trade union law designed to replace Soviet-era legislation was signed by the President in September 1999. The successor to the Soviet trade unions, known as the Federation of Trade Unions (FPU), has begun to work independently of the government and has been vocal in advocating workers' right to strike. Independent unions now provide an alternative to the official unions in many sectors of the economy. The constitution provides for the right to strike "to defend one's economic and social interests." The constitution also states that strikes must not jeopardize national security, public health, or the rights and liberties of others.

b. The Right to Organize and Bargain Collectively: The Law on Enterprises states that joint worker-management commissions should resolve issues concerning wages, working conditions, and the rights and duties of management at the enterprise level. Overlapping spheres of responsibility frequently impede the collective bargaining process. The government, in agreement with trade unions, establishes wages in each industrial sector and invites all unions to participate in the negotiations. The Law on Labor Disputes Resolution that came into force in March 1998 provides for establishment of an arbitration service and a National Mediation and Reconciliation Service to mediate in labor disputes. These services, however, have not yet been established. The manner in which the collective bargaining law is applied prejudices the bargaining process against the independent unions and favors the official unions. The collective bargaining law prohibits antiunion discrimination, but there have been cases in which such disputes have not been settled in a fair and equitable manner. Independent unions claim that the new trade union law is more restrictive than the old Soviet legislation because of difficulty in obtaining national status and registration, which confer the right to acquire space, property, maintain bank accounts and enter legally binding agreements. To acquire national status, a union must have representation in more than half of the regions of Kiev, or at one third of the enterprises in a regionally-based sector, or to have a majority of union members in the sector. These new requirements will make it difficult for miners and sailors to organize. Another contentious requirement is mandatory registration by the Justice Ministry. Independent unions are concerned that the Ministry could deny registration to unions seen as undesirable.

c. Prohibition of Forced or Compulsory Labor: The constitution prohibits compulsory labor, and it is not known to occur. The government does not specifically prohibit forced and bonded labor by children, although the constitution and the Labor Code prohibit forced labor generally, and such practices are not known to occur. Human rights groups described as compulsory labor the common use of army conscripts and youths in the alternative service for refurbishing and building private houses for army and government officials. Student groups have protested against a Presidential Decree obliging college and university graduates, whose studies have been paid for by the government, to work in the public sector at government-designated jobs for three years or to repay fully the cost of their education.

d. Minimum Age for Employment of Children: The government does not specifically prohibit forced and bonded labor by children. The minimum employment age is 17 years. In certain non-hazardous industries, however, enterprises may negotiate with the government to hire employees between 14 and 17 years of age, with the consent of one parent.

e. Acceptable Conditions of Work: The Labor Code provides for a maximum 40-hour workweek, a 24-hour day of rest per week, and at least 24 days of paid vacation per year. The law contains occupational safety and health standards, but these are frequently ignored in practice. During the first half of 1999, 913 people were killed and over 18,000 injured in accidents at work. In theory, workers have a legal right to remove themselves from dangerous work situations without jeopardizing continued employment. Independent trade unionists have reported, however, that asserting this right would result in retaliation or perhaps dismissal by management.

f. Rights in Sectors with U.S. Investment: Enterprises with U.S. investment frequently offer higher salaries and are more observant of regulations than their domestic counterparts. Otherwise, conditions do not differ significantly in sectors with U.S. investment from those in the economy in general.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment in Ukraine **--** 1998

(Millions of U.S. Dollars)

Category		Amount
Petroleum		0
Total Manufacturing		(1)
Food & Kindred Products	5	
Chemicals & Allied Products	0	
Primary & Fabricated Metals	0	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	0	
Transportation Equipment	0	
Other Manufacturing	(1)	
Wholesale Trade		-26
Banking		0
Finance/Insurance/Real Estate		(1)
Services		0
Other Industries		(1)
TOTAL ALL INDUSTRIES		92

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.