



U.S.-UKRAINE POLICY DIALOGUE

A Discourse Among Partners

September 2006 | Washington, DC



International Centre for
Policy Studies



Task Force Members

Co-Chair: Ariel Cohen, PhD., Senior Research Fellow, Heritage Foundation
Andriy Bihun, President, Global Trade Development

Robert Boehme, Director, Office of Ukraine, Moldova, & Belarus Affairs, U.S. State Department

George Chopivsky, President, Ukrainian Development Company, L.L.C.

Michael Considine, Director, Eurasia and Intellectual Property Affairs International, U.S. Chamber of Commerce

Keith Crane, Senior Economist, RAND Corporation

Irina Paliashvili, President, Russian-Ukrainian Legal Group

E. Morgan Williams, Director, Government Affairs, Washington Office, SigmaBleyzer Private Equity Investment Group

Co-Chair: Igor Shevliakov, Public Policy Analyst, International Center for Policy Studies

Igor Burakovsky, Director, Institute for Economic Research and Policy Consulting

Lyudmyla Denysyuk, Deputy Head, Kyiv City Administration

Natalia Izosimova, Director of Corporate Restructuring, System Capital Management

Andriy Pinchuk, Deputy of the Verkhovna Rada of Ukraine, Party of Regions

Igor Shumylo, Executive Director for Economic Policy, National Bank of Ukraine

Olga Shumylo, Head of European Integration and Foreign Affairs Program, International Center for Policy Studies

Economics and Business Task Force: Action Plan

As an independent country, Ukraine has so far lacked an effective and focused economic policy. After a decade of economic decline and collapse in 1990s, limited economic reforms coupled with a favorable world market for Ukrainian exports, led to an economic recovery beginning in 2000. However, Ukraine's gross domestic product (GDP) has yet to reach the level achieved in 1990—sustainable economic growth thus, is desperately needed.

Starting in 2005 (when President Yushchenko and new Government came to power), the people of Ukraine (as well as its supporters around the world) had expected improvements in democratic governance and effective and comprehensive economic reform. Instead, over the last two years Ukraine has experienced political uncertainty and a series of economic crises. As a result, Ukraine has missed a window of opportunity to create the preconditions for sustainable economic development.

Today Ukraine is losing in global competition for investments not only to Central European and Baltic states, but to its peers in CIS such as Russia and Kazakhstan. It fails to begin the EU ascendancy process.

In August 2006 a new Parliamentary Coalition was formed and a new cabinet was appointed, headed by Victor Yanukovych. The cabinet and the coalition now have full authority over economic policy making and implementation with enough power and capacity for effective work.

With roughly three years remaining until the next national elections, Ukrainian political elites have a tremendous opportunity to forego political competition and concentrate instead on the development of the country—a task that will require meticulous design and careful implementation of the economic reforms the country desperately needs.

The Economics and Business Task Force of the U.S.-Ukraine Policy Dialogue supports many of the economic policy recommendations for Ukraine proposed by international organizations such as the World Bank, the Organization for Economic Cooperation and Development (OECD), the United Nations Development Programme (UNDP) and the Blue Ribbon Commission, as well as by Ukrainian and foreign think tanks, business associations and outside experts.

The September 2006 Task Force recommends the following priority steps for economic policy in Ukraine:

For more information, please contact the U.S.-Ukraine Foundation at:

1701 K St., NW, Suite 903, Washington, D.C. 20006

Tel: 1-202-223-2228 | Fax: 1-202-223-1224

www.usukraine.org/PD06/index.shtml



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CREATE A NEW SYSTEM FOR FORMULATING AND IMPLEMENTING ECONOMIC POLICY

- **All parties to the coalition should reaffirm the vision of economic reforms contained in the Declaration of National Unity (the Universal).** The Government and the coalition should base their economic policies on two principles. Firstly, to ensure the long-term growth of the living standard of every Ukrainian, not the individual benefit of narrow interest groups as the result of law-based free market development. Secondly, the President, Prime Minister, and coalition leaders should reaffirm the role of the Ukrainian government in creating a free, competitive market environment in which the private sector is able to flourish and sustain itself.
- **Economic decision-making in the Government should be made public and transparent.** The Task Force recommends that the Government propose its Economic and Social Development Program “Competitive Ukraine” to Ukrainian and international experts for their review and comments, followed by a series of public consultations involving all of the stakeholders at the central and regional level. Completion of the program should be based upon the results of the experts’ reviews and public consultations, and only then, approved by the Government and the Parliament.
- **Institutional capacity for policy-making at Secretariat of the President should be strengthened.** The Task Force recommends the creation of a policy analysis and policy making unit based on the model of the Council of Economic Advisors (CEA) to the President of the United States (U.S.). This unit should be made responsible for the preparation of the Annual Statements of the President to the Verkhovna Rada, and the development of all strategic economic policy documents. The Secretariat should solicit the aid of the U.S. Administration in the creation of this unit, including twinning projects.
- **Strategic planning should be introduced to the work of the Government.** Every ministry should prepare its strategic plans compliant with strategy of the Government. Where necessary, strategic planning units should be created.
- **Public administration reform should be accelerated.** The Task Force recommends the preparation and approval of the Cabinet of Ministers of Ukraine Law and the Law on Public Service based on the report and recommendations of the SIGMA program of the OECD. Moreover, the Ukrainian Government should immediately begin designing and implementing a comprehensive reform of the civil service while reviewing current staffing levels based on best practices in Europe and other developed countries. Rigorous qualifications should be set for each position and current civil servants should be allowed to apply and compete for these positions. Adequate pay scale should be adopted so that corruption in the civil service is drastically reduced. The Government should also set up national and local ombudsmen to whom Ukraine’s citizens can petition about treatment by the civil service. To these ends, a Code of Ethics should be developed, adopted and enforced. Civil servants who are incompetent, corrupt, or fail to respect Ukrainian citizens should be subject to termination. Department heads should be held responsible for the actions of their employees.



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IMPLEMENT A SOUND AND EFFECTIVE INTERNAL AND EXTERNAL ECONOMIC POLICY

- **Sustain Fiscal stability.** The Government and the coalition should avoid taking budgetary commitments that cannot be financed by the public.
- **Improve the country's competitiveness and national security by making energy savings and efficiency an ultimate priority.** The Government should design and implement effective and focused measures to expand energy saving and efficiency to the public and private sector. Additionally, the granting of subsidies to inefficient energy enterprises through regulated tariffs should be subject to sunset clauses.
- **Concentrate state investments on the reconstruction and creation of business infrastructure, primarily transportation and roads.** Allow foreign investment and domestic businesses to play a significant role in these programs. Develop and implement bond issue mechanisms on the federal and local level as necessary, as well as expansion of toll roads.
- **Accelerate efforts to accede to the World Trade Organization (WTO).** The Government should ensure quick and effective completion of all measures for Ukraine's accession to WTO, including cooperation with the Verkhovna Rada to pass the necessary legislation. As long as Ukraine remains outside the WTO, Ukrainian farmers and manufacturers will face discrimination in foreign markets. At the same time, the Government should carefully avoid approving decisions that may contradict Ukraine's current WTO-related commitments and WTO principles.
- **Prepare for negotiations with the European Union (EU) on establishing a Free Trade Area (FTA).** The Government should immediately design and launch a public information campaign highlighting the benefits of free trade (especially with Europe) as well as run a series of public consultations on the costs and benefits of an FTA for all potential stakeholders. Moreover, the Government should develop its position for negotiations based on the consultations.

CREATE A MARKET-FRIENDLY REGULATORY FRAMEWORK FOR BUSINESSES AND CONSUMERS

- **Request the Verkhovna Rada to abolish the Commercial Code and amend the Civil Code using the Netherlands Code as a model.** Businesses in Ukraine operate in an unpredictable and chaotic legal environment where transactions can not be structured in full compliance with the law due to two contradictory legal codes: One pertaining to business affairs—a Commercial Code, styled on Soviet-era laws—and the second, a more market-oriented yet imperfect Civil Code.
- **Prepare a new draft law on joint stock companies based on EU standards and work with the Verkhovna Rada to pass the law.** Under the existing law, majority managers can easily loot companies of their property, majority shareholders cheat minority shareholders, and



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minority shareholders force extra-legal, and at times, illicit changes in management and ownership.

- **Cancel excessive regulations according to the list proposed by the Council of Entrepreneurs; bring all remaining regulations in accordance with the new law on the system of permits, and enhance the effectiveness of one-stop shop procedures.** Ukraine's regulatory system imposes enormous costs on businesses and fosters corruption. It needs to be reformed and streamlined.
- **Adopt new laws modernizing the financial sector including derivatives, leasing and other financial instruments and transactions in accordance with best OECD practices.**

ADOPT EFFECTIVE MEASURES TO FIGHT CORRUPTION

- **Approve the anti-corruption package proposed by the President.** The Government should issue regulations requiring all government appointees, as well as family members, to submit the following documents to be scrutinized so to prevent corruption: a declaration of income, expenses, assets and property; and the public transfer of businesses to asset management companies.
- **Develop and approve Ethics Code for public servants.**
- **Improve the management of state-owned enterprises.** Some managers are looting their enterprises, stealing funds and property that belong to the people of Ukraine, costing the public billions of hryvnias each year. Managers of state-owned enterprises suspected of fraud and corruption should be immediately placed on leave until the end of an investigatory process, prosecuted (if legally deemed necessary), and subject to a legally mandated punishment. The appointment of state enterprise managers should be competitive and transparent.
- **Introduce transparency of the biggest state holdings.** State holdings such as Ukrzaliznytsya, Naftogaz and Ukrtelecom, etc. should prepare and issue annual public reports on their performance. They should be audited under internationally recognized rules (such as the Generally Accepted Accounting Principles or GAAP) by certified auditing firms.
- **Provide a public inventory of all property owned by the state.** The Government should transfer all government property, including property owned by the Presidential Secretariat and the Rada, to the State Property Fund. A register of state-owned property needs to be compiled and made public.
- **Remaining state-owned enterprises should be auctioned off.** Privatization should be accelerated with a target end date of 2008 for auctioning-off all remaining state-owned assets to be privatized.
- **Land ownership reform should be completed.** The Government should complete a comprehensive land register and land title registry, and the all restrictions on the sale of land should be lifted.



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FIX THE TAX SYSTEM

- **Reform the value-added tax (VAT).** In March 2005, the Ukrainian government introduced a highly distorting VAT on imports of equipment that form part of a foreign investment in Ukraine. This measure effectively imposes a 20 percent tax on foreign investments, discouraging investors and slowing economic growth. The Ukrainian government should eliminate this tax.
- **Speed customs clearance and refund of VAT payments to exporters.** The new Government gives controversial signals on the system of import duties and VAT refunds for exporters. By not refunding the VAT to exporters, the Ukrainian government expropriates money from businesses and prevents the expansion of exports, investment, and jobs.
- **Grant local authorities the right to levy and collect taxes, decentralizing the financing and provision of government services.**

FACILITATE THE DEVELOPMENT OF NOT-FOR-PROFIT ORGANIZATIONS IN UKRAINE

- **Revise tax legislation to encourage the development of the not-for-profit sector.** The not-for-profit sector plays an important role in market economies and democratic societies, providing charity, encouraging policy debates, and contributing to the public good. Ukrainian not-for-profits are not allowed to generate revenues and their sponsors are taxed heavily, limiting the activities and development of this sector.
- **Facilitate the capacity building of Ukrainian non-government organizations, think tanks and business and trade associations for their public policy work, such as policy analysis and lobbying through coalitions and public pressure.**

RECOMMENDATIONS TO THE U.S. GOVERNMENT

- **Concentrate technical assistance to Ukraine on implementing the recommendations of the US-Ukraine Policy Dialogue.** Provide technical assistance to Ukrainian non governmental organizations (NGOs) involved in public policy work, including twinning projects with US-based NGOs, think tanks and business and trade associations.
- **Fund the completion of the land register and title registry for all Ukrainian land.**