Chapter 2

Foreign Direct Investment Regime

Ukraine's legislation embodies the principle of non-discrimination of foreign investment and general provisions on foreign investment protection. Its legal framework provides for national treatment for firms' establishment, but despite recent efforts to enhance the country's business environment foreign investors have often been discouraged by complex, protracted and costly procedures and resulting regulatory uncertainty. Ukraine applies several trans-sectoral and sectoral restrictions on foreign investment which qualify for the list of exceptions to national treatment and measures reported for transparency in the meaning of the OECD Declaration on International Investment and Multinational Enterprises. Taking into account the existing statutory FDI restrictions, Ukraine's score under the OECD FDI Restrictiveness Index is higher than the OECD members' average but lower than the average of non-OECD countries covered by the Index. Ukraine's score considering formal FDI restrictions as captured by the Index contrasts, however, with a poor perception of its investment climate in most international comparisons which assess actual implementation of existing laws and regulations.

Guarantees for protection of foreign investment but registration required

The Commercial Code of Ukraine defines foreign enterprises as those with at least 10% foreign investment in their charter capital. All investment, profits, legitimate interests and rights of foreign investors in Ukraine enjoy the following protection and guarantees:[1]

- Protection against changes in foreign investment legislation for a period of 10 years after their introduction (Article 8).
- Protection against nationalisation except in the case of emergency measures (*e.g.* national disasters or epidemics) and only if based on the decision of the Cabinet of Ministers of Ukraine. In case of nationalisation, a foreign investor must be compensated in the currency in which the investment was made or in any other currency acceptable to the investor. Decisions on requisition of foreign investment and compensation may be appealed in the courts (Article 9).
- Guarantee of compensation and reimbursement of losses resulting from actions, the omission of actions or the improper performance by state or municipal bodies (Article 10).
- Guarantee in the event of the termination of investment activity to remit the revenues and withdraw the investment without paying export duties within six months after the termination of the investment activity (Article 11).
- Guarantee of repatriation of profits after the payment of taxes, duties and other mandatory payments (Article 12).

To qualify for these guarantees, foreign investors have to register. Registration is not mandatory, but unregistered foreign investment does not benefit from the guarantees provided by the law (Article 13). Some bilateral investment treaties, such as with Poland, provide for the same guarantees without registration. State registration of foreign investment is performed within three working days by the Government of the Autonomous Republic of Crimea or regional state administrations of the cities of Kyiv and Sevastopol. Registration can be refused only if the documentation is incomplete or the investment is considered contrary to Ukraine's legislation. Refusals have to be communicated in writing and can be appealed in the courts.

It should be noted that the legal obligation to provide protection against changes in foreign investment legislation for a period of 10 years was breached when special economic zones were abolished in 2005, resulting in the elimination of preferences to foreign and domestic investors in these zones without any compensation.

After temporary derogations, the non-discrimination principle has been reinstated

Under Ukraine's Constitution, the State protects property rights and economic activity for all subjects which are equal before the law (Article 13). The non-discrimination principle for foreign investors is enshrined in the 1991 legislation on investment activities,[2] which guarantees protection to all investment in Ukraine irrespective of the nationality of investors.

In response to the 2009 economic crisis, temporary measures[3] were introduced which were initially expected to apply until January 2011. Foreign investors were obliged to register with the National Bank of Ukraine (NBU) and to make their monetary contribution exclusively through "investment accounts" opened with Ukrainian banks. The investment in foreign currency had to be converted into Ukraine's national currency, *hryvnia* (UAH). These measures were considered burdensome by foreign investors and were eliminated in April 2010.[4]

Complex establishment procedures

When establishing, foreign investors face the same requirements as domestic investors: obtaining state registration and business permits and, for certain activities, licensing. The law on state registration[5] effective since 1 July 2004 list the documents required for state registration.[6] If the procedure concerns a foreign legal entity, an additional document is required to confirm its registration in the country of residence, *i.e.* an extract from the trade, banking or judicial registry. The law also sets up the timeframe for this procedure (three working days) as well as the amount of the fees (UAH 170).[7] The registration certificates are valid without time limits. The state registration is carried out by some 680 registration offices throughout Ukraine operating as "single window" facilities. A new law adopted in October 2010[8] urges rapid implementation of e-registration for businesses, allowing them to reduce the number and duration of registration procedures and making possible an electronic exchange of information among all participants involved in state registration.

The 2005 law[9] codified procedures for business permits and defined the role and responsibilities of various state agencies in charge of issuing them,

such as the State Committee on Industrial Safety, Labour Protection, the Sanitary and Epidemiologic Service or the State Fire Safety Department. These agencies have to make publicly available free-of-charge all information related to the procedures of issuing permits. They should also keep the register of issued permits open for consultation. The law clarifies the main procedural aspects such as the nature of documents to be submitted by the applicants and different steps in the delivery of permits. In the case of refusal of a business permit, the applicant can lodge a lawsuit and the non-respect of existing legal provisions by public servants is subject to sanctions foreseen by the Code of Administrative Violations. Although the business permit law establishes the main conditions and principles, in practice procedures for delivering business permits remain regulated by the decisions of the Cabinet of Ministers and the responsible agencies.

The main innovation of the 2005 business permit law was the introduction of the "declarative" or self-certification principle which allows companies to undertake their activities before receiving the business permit if they submit the documentation to relevant administrative or inspection agencies certifying their conformity with relevant legal and technical requirements. Until recently, the possibility of self-certification has been offered only by the State Fire Safety Department, thereby shortening delays and reducing costs for business.[10] In the absence of similar procedures offered by other agencies issuing required business permits, notably the State Committee on Industrial Safety, Labour Protection and the Sanitary and Epidemiologic Service, the number of days required to collect all necessary permits remained important. The 2005 Law also foresaw the establishment of local centres (one stop-shops) which would bring together all agencies involved in issuing business permits.

Recent initiatives to streamline establishment procedures

The recent legislation adopted in 2010[11] allows most businesses to start their operations immediately based on their own declaration of conformity to responsible state agencies, except for 91 specific permits covering 144 activities and services[12] which remain subject to prior authorisation before starting their operations. The activities excluded from the application of the declarative principle include production, processing and distribution of food products under the control of the sanitary and veterinary services, exports and imports of grain and grain products, production of oil and gas and some categories of construction works.

A number of laws adopted in 2009-2010 revised several legal provisions to facilitate administrative procedures related to establishment by both domestic and foreign entrepreneurs, in particular:

- The Law "On Companies" (19 September 1991 as amended): the minimum charter capital of a limited liability company has been considerably decreased from the equivalent of 100 minimum salaries to one minimum salary (EUR 65).
- The current number of procedures (10) and the period required for establishment of a company (27 days) have to be reduced.[13]
- The Law "On Business Permits": most business permits (except some particular cases subject to specific laws) should be issued within 10 days. The adoption of the principle "silence is consent" implies that if an applicant has not received a reply from the relevant agency after this fixed period, a permit is considered to be granted.
- Specific provisions for small enterprises:[14] a moratorium on all state controls and inspections of these enterprises applied until January 2011, except for some specific cases such as high-risk activities, on-site inspection by tax services, pension fund and customs services. The State Property Fund is prohibited from increasing lease payments of state property for these enterprises.
- The amendments to the Law on state registration creating a unified system of state registration of legal entities, simplifying the procedures of state registration and abolishing the obligation of state registration for some categories of legal entities.[15]

All these recent legislative initiatives respond to many long-standing concerns of the business community and address the most serious obstacles faced by local and foreign companies in establishing and operating in Ukraine. It is important to ensure a prompt and thorough application of the new legislation by responsible agencies at all levels so as to avoid – as often happened in the past – that well-conceived laws and regulations have not been adequately implemented.

Licensing procedures

The 2000 Law on licensing[16] provided initially the list of 60 different activities subject to mandatory licensing. Since then, various amendments have been introduced to reduce the number of activities and to clarify and facilitate licensing procedures, notably in June 2009:[17]

- No new activities subject to licensing may be added to the existing list without adequate justification.

- New licences are granted for an unlimited time period; only certain specific activities subject to licences issued by the Cabinet of Ministers are delivered for periods limited to 5 years (see below); the licensing fees remain unchanged and fixed at the equivalent of one minimum salary.
- The period for appeal by an applicant against a decision of the licensing authorities has been extended from 10 to 30 days.
- The administrative liability of officials of licensing authorities has been included in the Code of Administrative Violations.

Furthermore the State Committee on Issues of Regulatory Policy and Entrepreneurship, the main licensing authority, has introduced additional measures aimed at streamlining licensing procedures. First, the list of documents attached to the application for a licence has been considerably reduced. Second, the licensing authorities responsible for specific licences have to publish information on required documents and procedures on their websites. Finally, the role of independent experts and representatives of the business community in licensing procedures has been strengthened: their participation in the expert and appeal council that makes recommendations on licensing procedures and reviews complaints has been increased from 20% to 50% of the seats.

The list of activities subject to mandatory licensing has been gradually reduced, most recently in October 2010 to cover currently 45 sectors (see below).

Efforts to reduce the administrative burden have to be pursued

According to the latest *2011 World Bank Doing Business* database (World Bank, 2010b), recent streamlining of establishment procedures has been acknowledged as the main business reform successfully carried out by Ukraine in 2010, which has allowed it to improve its international ranking (from 147 in 2010 to 145 in 2011 out of 183 economies). The country's overall and regional rankings nevertheless remain unsatisfactory as many other countries of the former Soviet Union perform better in this World Bank international comparison, notably Georgia (12), Kazakhstan (59) and Russia (123).

The main problems remain inadequate enforcement of existing legislation due to delays in adopting implementing regulations and often insufficient administrative and technical capacities of responsible executive agencies. Several draft laws are awaiting discussion and approval by the Verkhovna Rada (Parliament), such as on unifying requirements for issuing business permits by authorities at different government levels. The Parliament has to consider a draft law "On Accreditation of Representative Offices and Branches of Foreign Companies in Ukraine" proposing to include these entities in the Uniform Registrar of Legal Entities and Individual

Entrepreneurs, a publicly available computerised information system on companies in Ukraine. Some business facilitation measures are not yet completely operational, such as electronic registration allowing enterprises to make their declaration with tax, social security and statistics authorities automatically. The involvement of various agencies and interlocutors at different governmental levels and the lack of harmonisation in procedures inevitably leave room for discretion with an inherent risk of corruption. While the use of national treatment provided in legislation as a guiding principle is welcome, current regulatory uncertainties have a dissuasive effect especially on new foreign investors less familiar with local practices than incumbent firms.

Employing foreigners

Foreign citizens seeking employment in Ukraine have to apply and obtain work permits issued for a period of up to one year and up to three years for intra-corporate transferees, which can be extended. Recent regulations[18] specify the list of documents to be submitted for the application, including a certificate by a future employer confirming that he has no debts to the State Insurance Fund against Unemployment and a certificate that the future employee is not under a criminal investigation. The applications for work permits are considered by a commission consisting of representatives of the Ministry of Interior, the State Security Service, the State Tax Service and the Ministry of Labour. Work permits are issued by the relevant regional employment centres within 30 calendar days from the date of the submission of the application. State fees for issuing a work permit amount to the equivalent of four minimum monthly wages. To obtain a work permit, an employer should present supporting evidence that there are no local employees able to perform the work proposed to foreigners.

The foreign business community considers that the formalities necessary to obtain visa, temporary stay and work permits remain difficult in practice notably because of complex procedures and numerous registration requirements often subject to different interpretations by administrative officers.

Foreign exchange regulations

Ukraine's national currency was introduced in September 1996. On 24 September 1996, Ukraine accepted the obligations of Article VIII of the IMF Articles of Agreement and thus a commitment to maintain an exchange system free of restrictions on payments and transfers for current international transactions. Foreign currency operations are regulated by a 1993 Decree[19] and by numerous implementing rules issued by the National Bank of Ukraine.

Foreign investors are entitled to repatriate profit, income or other investment-related funds without any restrictions, after the payment of applicable taxes. They are guaranteed the right to the prompt and unimpeded repatriation of profits and other funds in foreign currency resulting from their investments in Ukraine. Conversion of funds for repatriation is processed through the Ukrainian Inter-bank Currency Exchange.

The turnover tax on wholesale currency exchange operations introduced in 1999 payable to the State Pension Fund was gradually reduced from the initial 2% to 0.5% in 2010 and finally abolished in 2011. Foreign investors are nevertheless concerned about the prohibition of foreign exchange orders and complex procedures for foreign currency exchange of more important amounts. In response to the 2008 financial crisis and in an attempt to prevent capital outflows, the government adopted a number of temporary provisions such as the obligation for foreign investors to open two bank accounts in Ukraine, which has been now eliminated. The 180-day limit on prepayment of imports and exports continues to apply.[20]

Foreign companies have to transfer at least 50% of their charter capital in cash or in kind before registering a company. After the registration with relevant state authorities, the company can open an operational or current bank account. Foreign firms operating in Ukraine are free to open and maintain their bank accounts in foreign currency.

National security considerations and "strategic sectors"

Investment failing to meet sanitary, hygiene, radiation or environmental requirements or infringing the rights and interests of Ukraine's citizens and legal entities is prohibited.[21] These general provisions apply equally to both foreign and domestic investors.

Several Ukrainian laws refer to national security and strategic sectors, which – according to the Commercial Code (Article 117) – could justify sectoral and territorial restrictions on FDI. The law "On the Fundamentals of National Security of Ukraine" provides the following definition of economic threats to national security: "critical dependence on the business cycles of international markets" and "increases in the share of foreign capital in the strategic sectors of the Ukrainian economy such that they jeopardise its economic independence" (Article 7), without, however, listing the sectors concerned.

The 1992 privatisation law stipulates that legal entities in which more than 25% of equity is owned by a state cannot participate in the privatisation of state and municipal property.[22] Based on this provision, such companies were barred from participating in bids for privatisation of the fixed-line telecommunication monopoly *Ukrtelekom* in 2010. There are, however, no

restrictions on the resale of privatised shares by residents to non-residents or established foreign-controlled enterprises on the secondary market.

Neither domestic nor foreign investors may participate in a number of activities defined as "strategic" which have to remain in the hands of more than 1000 state-owned enterprises and are therefore excluded from privatisation. The 1992 privatisation law established that participation of foreign investors in privatisation of "strategic" enterprises (the so-called G-group) requires a special permit of the Parliament and the Cabinet of Ministers but has not specified the modalities of authorisation procedures. This incomplete legislative framework has opened the possibility for non-transparent privatisation deals, enabling certain investors from countries with better local connections to get stakes in key industries, which can be considered "strategic", such as the oil industry or the gas transport network (Dubrovskiy *et al*., 2007).

As already mentioned the government's economic reform programme for 2010-2014 underlines the role of privatisation and encourages participation of foreign investment in the modernisation of the national economy. It sets the objectives on one hand to define clearly the sectors and enterprises in which the state will continue to maintain exclusive or majority ownership and, on the other hand, to foster privatisation, including with foreign participation, in other sectors. The new law on privatisation currently under preparation intends to introduce a methodology for determining the "critical" level of foreign ownership in "strategic" sectors, which would then be used by state agencies managing state property to define the level of foreign ownership in specific "strategic" sectors.

Ukraine's current legislation hence refers to the terms "national security" and "strategic sectors" in relation to foreign investment in different contexts without clearly defining the sectors concerned and specifying relevant authorisation procedures for possible entry or participation in privatisation by foreign investors. New legislation in preparation seems to aim to define more precisely the notion and coverage of "strategic sectors" in the context of privatisation, but procedures envisaged for selecting sectors and determining the level of authorised foreign participation in privatisations appear to leave considerable room for administrative discretion.

The Ukrainian authorities should consider adhering to the recommendations of the OECD *Guidelines for Recipient Country Investment Policies relating to National Security* (OECD, 2009), which were adopted by the OECD Council in May 2009. These *Guidelines* help countries to design and implement national security goals with the smallest possible impact on investment flows by complying with the principles of non-discrimination, proportionality, transparency and accountability. The *Guidelines* recommend

that governments treat similar investors in the same way, make transparent their regulatory objectives and practices, notably by publishing relevant laws and consulting interested parties when considering legal or regulatory changes. To ensure procedural fairness and predictability, the review or authorisation procedures for foreign investment should be based on clear criteria and specify the modalities, including the documents to be submitted by applicants, the timeframe for replies by relevant authorities and the possible appeal or redress procedures against administrative decisions. Such measures would help reduce the current legal and regulatory uncertainty not only in the area of strategic sectors and national security but also, more generally, enhance the transparency and predictability of the investment regime in Ukraine.

Persistent problems with ownership registration for land and other forms of property

As in other transition economies, Ukraine has had to establish a formal ownership registration for land and other forms of property. Progress in this area has been gradual: many property titles have not been formalised and the unified property and land cadastre is not yet operational. As a result, the risk of misappropriations and fraudulent transactions remains high, provoking a considerable number of disputes in courts.

Foreign companies can buy privately-owned, non-agricultural land within city limits for construction or business purposes and outside of city limits when they buy real estate. The purchase of publicly-owned land is possible but subject to complex procedures and requires consent by relevant ministries or the Parliament. Leasing of land in public (state or municipal) ownership is either decided by the respective local council or is subject to tender procedures.

According to the Land Code of Ukraine, which came into force on 1 January 2002, foreign entities are not allowed to own agricultural land. The Forest Code (Articles 7 and 10) also prevents foreigners from owning forests. Foreigners can nevertheless lease agricultural land either on a short-term (up to 5 years) or long-term (up to 50 years) basis. After the repeated rejection by the Parliament of the draft laws on the land market and the land cadastre, the moratorium on sales of agricultural land to foreigners was extended in 2009 and will continue to apply until 2012.

A 2009 law[23] clarified the procedures for expropriating land and real estate property based on "public needs", due to "social necessity" or justified by construction of communications, utilities and transport or energy infrastructure. Such expropriations can only arise based on a decision by

administrative courts, and the former owners are entitled to receive full compensation for the value of the property.

Despite several government programmes targeted at rural areas and a number of specific laws on land protection and land leasing, Ukraine's property market remains underdeveloped, with adverse effects on private investment especially in agriculture, real estate and housing. In the 2011 World Bank *Doing Business* database, Ukraine continues to perform poorly under the indicator "registering property" and its current ranking (164 out of 183 economies) has even worsened in 2011 compared to 2010. Registering property in Ukraine requires many procedures (10 compared to fewer than 6 on the average in Eastern Europe and Central Asia) and long delays (117 days against 38.3 in the region). Ukraine's worst ranking (179) is in the related area "dealing with construction permits" (World Bank, 2010b).[24] The recently adopted law on city planning[25] developed in accordance with the objective of the 2010 government programme should reduce significantly the number of required permits and streamline licensing procedures in construction.

In addition to removing the moratorium on the sale of agricultural land, the business community proposes the following steps to tackle existing bottlenecks in land ownership and management:

- Unify land and real estate registers currently kept at the regional level; establish a common national register and make it publicly available.
- Simplify and improve the transparency of procedures for changing the land purpose (agricultural/non-agricultural).
- Clarify the criteria of state-owned and communal land plots and generalise tender procedures for their sale and lease.

Economic activities subject to mandatory licensing under general legislation

Mandatory licensing is governed by the 2000 Law "On licensing of certain activities" (hereinafter the Licensing Law) and its numerous amendments, including recent ones introduced at the end of 2009 (see above) and most recently in October 2010.[26] The law specifies the main procedures and responsibilities of licensing bodies and stipulates that licensing cannot be used to limit competition (Article 3).

The law lists a number of economic activities which are subject to specific licensing procedures as defined in relevant laws, namely:

- banking;
- professional activities in the securities market;
- provision of financial services;
- foreign trade;

- radio and TV broadcasting;
- electricity and nuclear energy;
- education services;
- intellectual property rights;
- production and trade of ethanol, alcoholic beverages and tobacco;
- telecommunications;
- construction activities.

Production and trade of narcotics, drugs and psychotropic substances as well as lotteries and gambling, are also subject to specific legislation. In 2009, several activities were eliminated from the list of mandatory licensing such as medical, legal and psychological services for disabled persons or disaster victims; seed sales, sale of art and the organisation of art auctions; and the design and reconstruction of objects of cultural heritage. In October 2010, further activities were removed so that the total number of business activities which are subject to mandatory licensing covers at present 45 sectors, including:

- production and repair of ammunition and arms;
- development, manufacturing, trade and repair of weapons, military equipment and explosives;
- production of industrial explosives, dangerous chemicals; operations in hazardous waste handling, collection and storage of some types of waste as secondary raw materials;
- production, wholesale and retail trade of pharmaceuticals;
- production of veterinary medicines and preparations, wholesale and retail trade of veterinary medicines and drugs;
- trade in pesticides and certain agrochemicals (growth plant regulators);
- development, production and trade of special techniques for removing information from information channels;
- centralised water supply and sanitation;
- development, production and exploitation of carrier rockets, space vehicles and space infrastructure;
- medical and veterinary practices;
- provision of transport services of passengers and cargo by air, river, sea, road and rail;
- processing and storage of ferrous and non-ferrous metals;
- tourist operator services;
- services related to land management, assessment and land auctions;

- industrial fisheries, except in inland waters;
- production of thermal energy, its transportation, local distribution and heat supply network;
- genetic engineering activities in a closed system;
- trade in liquid fuels from biomass and biogas.

The 2000 Licensing Law has introduced specific procedures for some activities involving the use of limited resources, which remain under the responsibility of the Cabinet of Ministers. Licences for these activities are obtained through tenders and, following the 2009 amendments, are issued for five years. After recent amendments,[27] which cancelled mandatory licensing for mining of natural resources from deposits of national importance included in the State Fund of Mineral Reserves, the following activities remain subject to licensing procedures based on tenders: *i)* extraction of precious metals and precious stones, *ii)* transport via pipelines of oil and gas; supply of natural gas subject to regulated or non-regulated tariffs and *iii)* storage of natural gas in volumes exceeding the threshold. Licensing authorities should establish and maintain the specific register of licences granted for such activities.

The Ukrainian authorities have repeatedly emphasised, notably during the WTO accession negotiations, that existing licensing procedures do not discriminate against foreign investors. Despite an important reduction of activities covered by mandatory licensing, there are still some concerns regarding the complexity of licensing procedures and insufficient harmonisation in issuing procedures for national and local licences.

Sector-specific regimes

Natural resources

Ukrainian and foreign legal entities, as well as individuals, require authorisation to use the Ukrainian subsoil which remains the exclusive property of the State.[28] Most activities concerned are subject to standard mandatory licensing covered by the amended Licensing Law. The 2010 law[29] has cancelled licensing requirement for mineral prospection and extraction from deposits registered in the State Fund of Mineral Reserves. Some other activities require special licences delivered by the Cabinet of Ministers, including for extracting deposits considered of state importance and for extracting and producing precious metals and precious stones (see above). If a deposit has been already explored and registered in the State Fund of Mineral Reserves of Ukraine, the interested company has to reimburse the state for the completed geographical survey (the so-called "geological information package"), which varies depending on the composition of the particular deposit.

In line with current legislation, subsoil rights have to be granted on a competitive basis, *i.e.* through tenders or auctions. A subsoil right user is not authorised to bestow, sell or otherwise transfer the rights granted by a permit.

Production sharing agreements (PSAs) may be concluded by foreign investors with the Cabinet of Ministers, together with the relevant local authorities, for certain mining activities for a period agreed by the parties but not exceeding 50 years.[30] The state retains ownership of the deposits and foreign investors, selected through tenders, have to undertake activities at their own expense. They are entitled to a share of the output, which may not exceed 70% of total quarterly production. Foreign investors enjoy some additional incentives, in particular exemptions from VAT and customs duties on imported equipment and on exports of products resulting from PSA activity and an exemption from the profit repatriation tax. So far, only one PSA has been concluded. According to international energy companies interested in investing in Ukraine, future PSAs should include a "stability clause".

The trunk pipeline transport system is run by the state and is excluded from privatisation. Industrial pipeline transport facilities for oil and gas, as well as storage of natural gas are subject to licensing from the National Energy Regulation Commission.

Ukraine's WTO accession commitments provide for full transparency in formulating, adopting and applying measures affecting market access to, and service delivery in, pipeline transport services. Ukraine adheres to the principle of non-discriminatory treatment for access to, and use of, the pipeline network under its jurisdiction, within the technical capacities of these networks, with regard to the origin, destination or ownership of the product transported, without imposing any unjustified delays, restrictions or charges, and with no discriminatory pricing based on origin, destination or ownership (WTO, 2008).

Electricity generation, transmission and distribution

Privatisation of the electricity sector has been carried out in several waves: some thermal generation and distribution companies were privatised in 1995, followed in 1999 and 2002 by the sale of controlling (50%) and blocking (25%) shareholdings in Ukrainian energy distribution companies to private investors through open tenders. In 2004, the remaining state-owned shares of energy distribution companies were transferred to the national joint stock "Energy Company of Ukraine". Privatisation of nuclear and hydropower stations is prohibited by law.

Ukraine's Unified Energy System (UES) brings together all electricity generation, transmission and distribution networks. The State controls the majority of regional power generation companies, but a part of the shares is

privately owned and listed on the Kyiv Stock Exchange. Electricity transmission is a state monopoly, controlled by the state-owned company *Ukrenergo*. State ownership also dominates in electricity distribution: 27 regional distributors purchase electricity on the wholesale electricity market and sell it at a regulated retail tariff, set up by the National Electricity Regulatory Commission of Ukraine. The government envisages gradually opening regional electricity companies to investors (see Chapter 4).

The authorities have developed several action plans for gradual liberalisation of the wholesale electricity market with the objective of achieving a competitive market operating on the basis of bilateral contracts between producers, suppliers and consumers in line with the EU Directives on Electricity. To enhance competition, the construction of new generation plants is subject to tender procedures and the export, import and transit of electricity must be carried out in accordance with EU energy legislation.

Transport and communications

There are no limitations on foreign equity in transport services. Recent amendments[31] abolished mandatory licensing requirements for transporting passengers and cargo by air, river, sea, road and rail and maintained it only for transporting dangerous commodities. Local incorporation is required for road (freight and passenger) transport companies.

As in most other countries, Ukraine has gradually liberalised its telecommunication sector. The first "Communication Law" introduced in 1995 was replaced in 2003 by the new law "On Telecommunications", which regulates fixed-line and mobile telephone communications, air and cable broadcasting and television networks as well as the leasing of electronic communications services based on the Internet protocol. As part of its WTO/GATS commitments, Ukraine opened its telecommunications services to foreign investment.

The main regulator – the National Commission on Regulating Communications, established in January 2005 – is responsible for issuing licences and allocating radio frequencies. The following telecommunications activities are subject to licensing:

- provision of local/inter-city/international fixed-line telephone communications services, including those using wireless access to the telecommunications network;
- provision of mobile telephone communication services;
- provision of services on maintenance and exploitation of telecommunication networks, air and cable broadcasting and television network;
- provision of local/inter-city/international electronic communications channels.

Internet service provider services are not subject to licensing.

Radio/television broadcasting, news agencies and wholesale trade of books, newspapers and magazines

Restrictions on the share of foreign capital in the charter fund of television and radio broadcasting companies were eliminated in 2006.[32] The amendments to the 2003 law "On Information Agencies" established the maximum level of foreign capital in the charter funds of information agencies at 35%. Ukraine currently limits foreign participation to 30% in wholesale trade of books, newspapers and magazines but accepted to eliminate this restriction five years after its WTO accession.[33]

Banking

The main legal acts concerning the banking sector are the 2000 Banking Law,[34] as amended, and the 2001 Financial Services Law.[35] The level of authorised funds in the banking sector is the same for domestic and foreign banks. The last amendments to the Banking Law, which entered into force on 16 May 2008, abolished the previous 35% threshold on foreign participation in the charter capital of Ukrainian commercial banks and, in line with Ukraine's WTO accession commitments, made it possible for foreign banks to open branches in Ukraine. Prior permission by the National Bank of Ukraine (NBU) is required for establishing a commercial bank with foreign participation or when converting an existing commercial bank into one with foreign participation.

Banks with foreign participation are subject to the same requirements as Ukrainian banks and must obtain a licence for conducting standard or specific categories of banking transactions. They should also meet the same requirements concerning the level of provisions for different categories of loans and regarding the disclosure of consumer information on the cost of credit. All banks irrespective of their ownership have to obtain permission from the NBU each time there are changes in the equity thresholds (10%, 25%, 50% or 75%) in banks' charter capital or the voting rights in their governing bodies.

Among 182 operating banks registered in Ukraine at the beginning of 2010, the two large state-owned banks (the Ukrainian Export-Import Bank: *Ukreximbank* and the State Saving Bank: *Oschadsbank*) represented 11% of total assets. The capital of 51 banks with foreign participation (18 of which are fully foreign-owned) corresponds to almost 36% of the total statutory capital of the Ukrainian banking sector.

Insurance

The 1996 Insurance Law,[36] amended in 2002 and 2006, stipulates that insurance activities can be provided only by a Ukrainian legal entity in the

form of a joint-stock company (open or closed), which has been properly registered with the State Register of Financial Institutions and has obtained an insurance licence.

To register as a financial institution with the State Register of Financial Institutions, the company's charter capital has to be at least EUR 1 million for an insurance company and EUR 1.5 million for a life insurance company. The company should also have the required number of qualified staff, adequate office premises and technical equipment. The insurance licence is delivered by the State Commission for the Regulation of Financial Services Markets, which imposes additional requirements, in particular regarding qualification of key personnel of insurance companies (the general manager and the chief accountant) and documents such as a bank or auditor certificate confirming the amount of paid charter capital. The State Commission is also authorised to examine and inspect insurance companies. All these regulations apply irrespective of the origin of investors.

As a part of its WTO commitments, Ukraine will allow foreign insurance companies to deliver insurance services through their branches five years after its WTO accession, *i.e.* in 2013 (WTO, 2008).[37]

Professional and other services

Ukraine's legislation imposes a Ukrainian nationality requirement for providing notary services.[38] As this measure concerns natural persons, it is not taken into account in the list of measures qualifying for exceptions to national treatment in the meaning of the OECD *Declaration on International Investment and Multinational Enterprises* given that the scope of the OECD National Treatment instrument covers incorporated enterprises. The sectoral legislation amended in 1993 has removed nationality requirements for auditing and legal services.

In addition to professional qualification requirements, medicals professions, including paramedical personnel, should be provided by persons speaking Ukrainian. Postal and courier services, comprising handling of registered letters, parcels and packages up to 30 kg are no longer subject to licensing but remain under a general universal service obligation.

Primary, secondary and higher education institutions, irrespective of the type of ownership, may be headed only by a Ukrainian citizen.

Monopolies

Ukrainian legislation defines a natural monopoly as an activity in which the absence of competition is beneficial for the market due to specific features of production or produced commodities and when

products/services provided by natural monopolies cannot be replaced by other goods/services.[39] The current list of natural monopolies includes the following nine activities:

- transport of oil and oil products by major pipelines: national shareholding company *Naftogaz* represented by the open joint stock company *Ukrtransnafta*;
- transport of natural gas by major pipelines: national shareholding company *Naftogaz* represented by its subsidiary *Ukrtransgas*;
- transmission of electricity via national and international electricity grids: state enterprise *National Energy Company Ukrenergo*;
- railways, dispatcher services, railway stations and other rail infrastructure: state administration of Ukraine's railway transport *Ukrzalinitsya*;
- air traffic control services: state enterprise *Ukraerorukh*;
- specialised services of transport terminal and warehouses for ammonia: open joint stock company *Odessa Preport Plant*;
- universal postal services: state enterprise *Ukrposhta*;
- technical broadcasting means and services related to radio broadcasting; business holding *RRT*;
- local telephone communications, services related to electricity-based communications channels: open joint stock company *Ukrtelekom*.

A 1999 law contained the initial list of state-owned enterprises (SOEs) which could not be privatised; it has since been amended several times to reduce gradually the number of enterprises concerned.[40] The list covers currently 1538 enterprises, including some 500 agricultural entities, some of them part of the state holding *Ukrspyrit* specialised in ethyl and alcohol production.

State-owned enterprises, defined as entities in which the share of the State exceeds 50%, included more than 1000 joint-stock companies, 90 limited liability companies and 32 national State holding companies. The State Property Fund has the right to be represented on the supervisory boards of joint-stock companies when the State's share exceeds 25%. Ukraine's legislation does not provide for a "golden share" mechanism. State-owned enterprises are present in most sectors of the economy and represented in 2006 an important share of output in transport and communication (43%) and to a lesser extent in industry (21%) and agriculture/forestry and construction (10%) (WTO, 2008).

New developments in legislation on concessions

Ukraine's legislation on concessions introduced in 1999 and amended in 2010[41] stipulates that individuals and business entities, both resident and non-resident, can bid for concessions. It also establishes the possibility to lease state and municipal property for up to fifty years for the purpose of concession arrangements. The 1999 law was supplemented by specific legislation to design and manage concession deals for constructing and operating motorways, and more recently (October 2010) on concessions for municipal heating and water and sewage systems. As there is no official and centralised register of concession deals, it is difficult to know how many actual projects have been carried out under the initial legislation.

The Law "On Public-Private Partnership" (PPPs), which supplements the law on concessions was adopted on 1 July 2010 and entered into force in November 2010. As with the Concession Law, the new legislation (Article 1) also stipulates that foreign investors can participate in public-private partnerships, defined as co-operation between the State of Ukraine and territorial communities and, on the other side, individual entrepreneurs based on an agreement, which can be maintained for a period of five to fifty years. Such co-operation can take the form of a concession, production sharing agreement or joint activities. The law outlines general principles of PPP projects, in particular a fair allocation of risks and access to land plots. It specifies that PPPs may be established in the following activities:

- exploration, prospecting of mineral deposits and production thereof;
- heat production, transport and supply, and natural gas distribution and supply;
- construction and/or operation of highways, roads, railroads, runways at airports, bridges, overhead roads, tunnels and subways, river and sea ports and infrastructures thereof;
- machine building;
- water collection, purification and distribution;
- health care;
- tourism, leisure, recreation, culture and sports;
- support of operation of irrigation and land improvement systems;
- waste management;
- electric power production, distribution and supply;
- property management.

To ensure effective realisation of PPP projects, this general legal framework should be accompanied by more detailed regulations, regarding *i.a.* permit procedures, tariff-setting rules and state budgetary regulations.

Foreign investors enjoy non-discriminatory access to government procurement but problems remain

Until recently, government procurement in Ukraine was regulated by a 2000 law[42] based on the UNCITRAL model law on government procurement. The law incorporated some provisions of the WTO on government procurement and European Union Directives. It contained provisions regulating tender procedures for public procurement financed by the state budget and local governments. Open international tenders had to be used for procurement financed by an entity outside of Ukraine. The law referred explicitly to the principle of non-discrimination, stating that no supplier can be excluded from procurement procedures based on its national affiliation. The law also specified the appeal procedures in the case of complaints. The March 2007 amendments established an Interdepartmental Commission on Public Procurement to oversee procurement practices, imposed stricter advertising requirements and eliminated preferential provisions in favour of domestic bidders on tenders below certain values.

The new law on implementation of public procurement adopted in June 2010[43] maintains the non-discrimination principle, allowing foreign entities to participate in public procurement tenders on equal terms (Article 5). All government procurement of goods and services valued at least UAH 100 000 are subject to the provisions of the law. The Ministry of Economic Development and Trade is responsible for regulating and controlling government procurement procedures and the Antimonopoly Committee is in charge of considering claims of tender participants. Article 10 of the law specifies the obligations of the Ministry of Economic Development and Trade to provide all relevant information on government procurements on its official website – Ukrainian Public Procurements Portal (*https://tender.me.gov.ua*). Although the law stipulates that open tenders should remain the main method to carry out government procurement, it refers to other possible procedures including the two-stage tender, the preliminary participant qualification and procurement from one participant if negotiations confirm its qualification requirements.

Amendments to the law on implementation of public procurement have introduced exceptions limiting the scope of the law. In early 2011, the parliament further amended the law by excluding energy commodities and utility services from competitive bids.[44]

Although the new legislation does not restrict foreign enterprises from participating in the procurement process, foreign companies often consider that they face additional difficulties, particularly insufficient public information on tender rules and requirements and an ineffective dispute

resolution mechanism. Ukraine is not a signatory of the WTO Agreement on Government Procurement.

OECD FDI Restrictiveness Index of Ukraine

The OECD FDI Restrictiveness Index (FDI Index) seeks to gauge the restrictiveness of a country's FDI rules (see Box 2.1). The FDI Index is currently available for 34 OECD countries, 8 countries adhering to the OECD *Declaration on International Investment and Multinational Enterprises* and a number of other countries, including China, Indonesia and Russia (OECD, 2010). It constitutes one component of indicators used for the OECD's *Going for Growth* policy recommendations. It is also used on a stand-alone basis to assess the restrictiveness of FDI policies in reviews of candidates for OECD accession and in OECD Investment Policy Reviews, including reviews of new adherent countries to the OECD *Declaration*.

Box 2.1. **Calculating the FDI Restrictiveness Index**

The OECD FDI Restrictiveness Index covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transports, construction, distribution, communications, real estate, financial and professional services).

For each sector, the scoring is based on the following elements:

1) the level of foreign equity ownership permitted;
2) the screening and approval procedures applied to inward foreign direct investment;
3) restrictions on key foreign personnel; and
4) other restrictions such as on land ownership, corporate organisation (*e.g.* branching).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a weighted average of individual sectoral scores.

The measures taken into account by the index are limited to statutory regulatory restrictions on FDI without assessing their actual enforcement. The discriminatory nature of measures, *i.e.* when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored.

For the latest scores, see *www.oecd.org/investment/index* and for a discussion of the methodology: *OECD Working Paper on International Investment* No. 2010/3 *OECD's FDI Restrictiveness Index: 2010 Update* available at *www.oecd.org/dataoecd/32/19/45563285.pdf*.

The FDI Index does not provide a full measure of a country's investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the nature of corporate governance, the extent of state ownership, and institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the FDI index, used in combination with other indicators measuring various aspects of the FDI climate, contributes to assessing countries' international investment policies and to explaining variations among countries in attracting FDI.

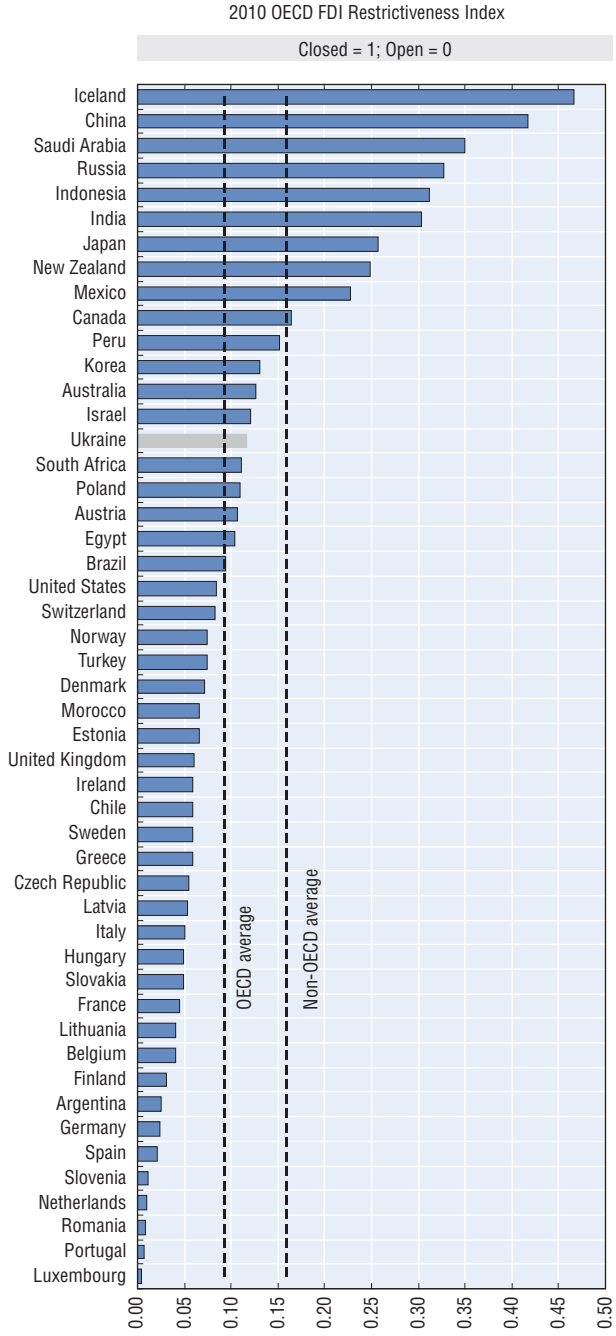
With a total score of 0.116, Ukraine ranks above the OECD average and below the average of non-OECD countries (Figure 2.1). Its score reflects the restrictions on equity in two sectors (information agencies and wholesale trade of books and newspapers), which are to be eliminated in 2013, and a number of operational restrictions, notably in insurance (branching not allowed) and agriculture (agricultural land ownership not allowed). In line with the FDI Restrictiveness Index methodology, Ukraine's current prohibition of foreign investment in unspecified "strategic sectors" and related non-transparent authorisation procedures are taken into account and considered as equivalent to general screening and approval procedures.

Figure 2.2 provides the correlation between the FDI Index scores and FDI stocks expressed as a share of GDP. Countries with more restrictions tend to receive less FDI relative to the size of their economy. Given that Ukraine, despite its comparatively moderate FDI index score, still attracts relatively limited FDI, this would suggest that Ukraine could perform much better in attracting FDI, even under the current investment regime.

For a more complete picture of countries' FDI attractiveness, it is useful to go beyond formal FDI restrictions and to consider other measures of the business climate, particularly the time and costs required to comply with various establishment procedures as regularly evaluated by the World Bank's *Doing Business* indicators. According to the last 2011 survey, Ukraine ranked 145th out of 183 countries which is only a slight improvement from 147th in the previous year. It also ranks poorly in a group of 13 neighbouring or former Soviet Union countries (Figure 2.3).

Figure 2.4 compares the Ukrainian performance against the best and worst scores observed for each individual measure reported by *Doing Business* for 12 other countries listed in Figure 2.3. A lower number implies a better performance by a country within the group. Figure 2.4 shows that although Ukraine does relatively well in terms of getting credit and enforcing contracts, it is still well behind the top performers even in these two areas. In almost all other areas, Ukraine is either the worst or one of the worst performers.

Figure 2.1. **2010 FDI Indexes by country**



Source: OECD

Figure 2.2. **FDI stocks and the FDI Index**

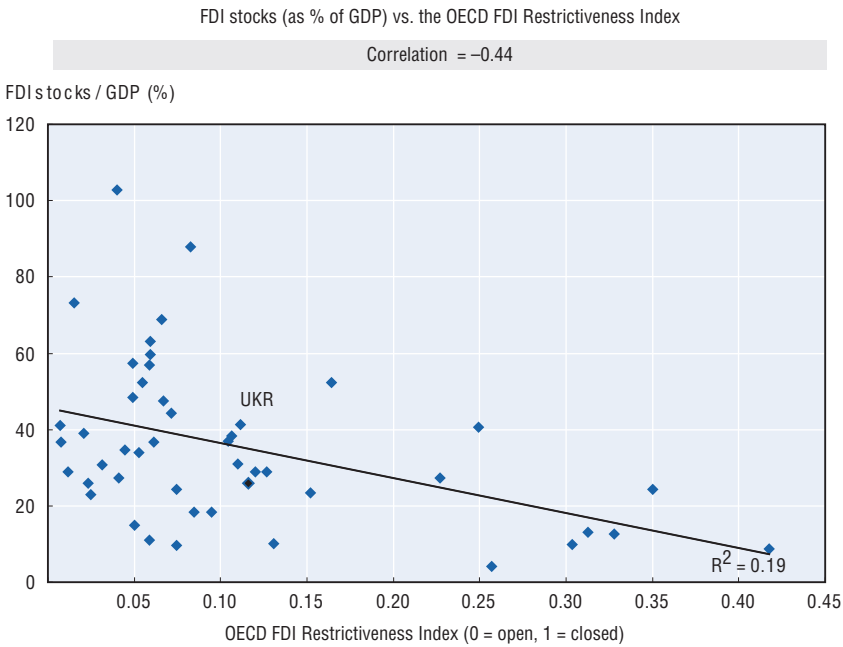
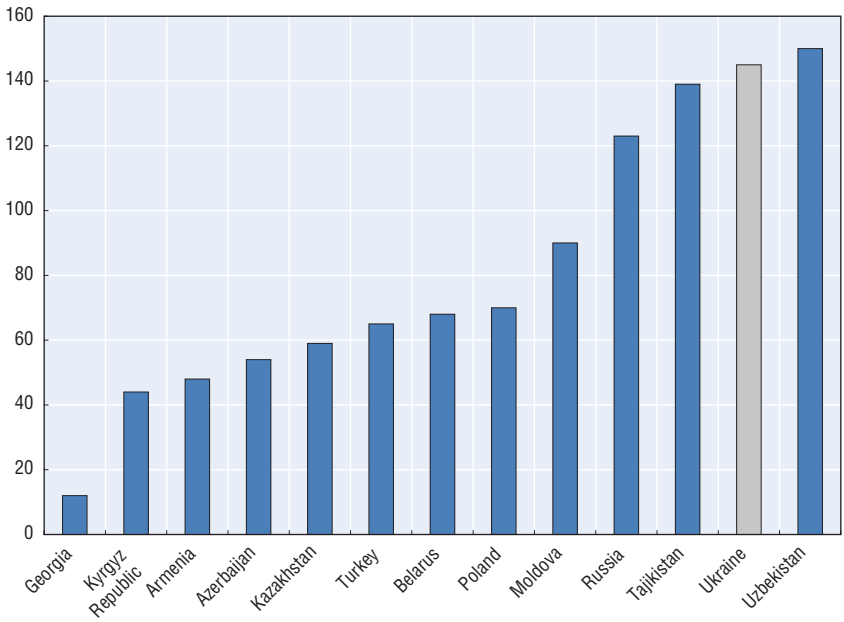
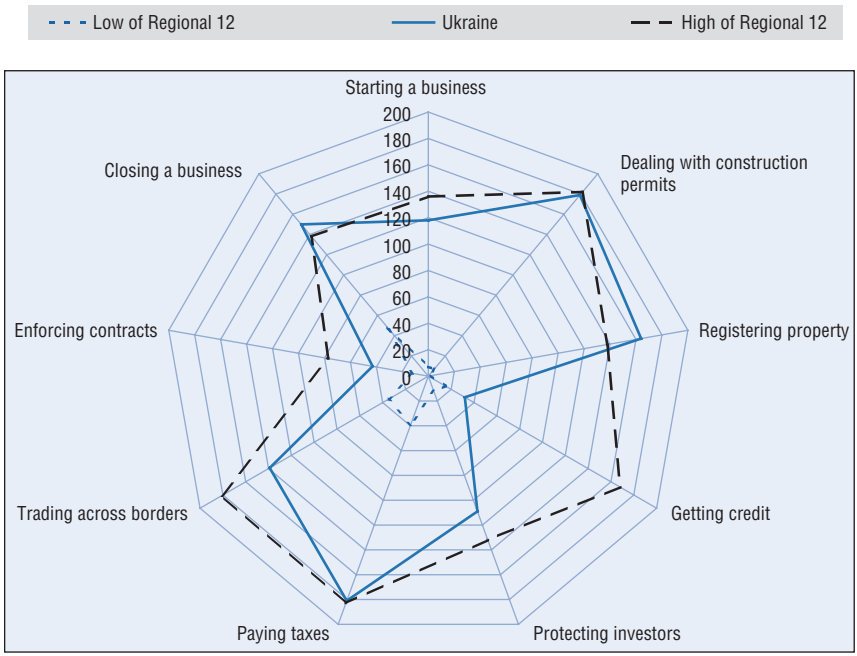


Figure 2.3. **Ease of Doing Business Rankings in selected countries**



Source : Doing Business 2011, World Bank.

Figure 2.4. **Ukraine's business climate in a regional context (ranking by measure, 183 countries)**



Source : World Bank, Doing Business 2011.

Notes

1. Law No. 93/96-VR "On the Regime of Foreign Investment" (19 March 1996) as amended.
2. Law No. 1560-XII "On Investment Activity" (18 September 1991).
3. Law No. 1533-VI "On Amending Certain Laws of Ukraine to Prevent Negative Consequences of the Financial Crisis" (23 June 2009).
4. Amendments to Legal Acts of Ukraine to Stimulate Foreign Investment and Crediting (27 April 2010).
5. Law No. 755-IV "On the State Registration of Legal Entities and Individual Entrepreneurs" (15 May 2003).
6. The following documents should be submitted in view of the state registration: *i)* the charter; *ii)* minutes of founders' meeting; *iii)* application form (registration card); *iv)* banking document confirming payment of registration fees; *v)* proof of payment of minimum capital requirement.
7. On 29 April 2011, the Hryvnia (UAH) exchange rate was 1 USD/UAH 7.97 and 1EUR/UAH 11.85.
8. Law No. 2609-VI "On Amending the Law On State Registration of Legal Entities and Individual Entrepreneurs to Conduct Electronic Registration" (19 October 2010).

9. Law No. 2806-IV "On the Permit System in the Field of Economic Activity" (6 September 2005).
10. Self-certification by companies to the State Fire Safety departments increased almost four-fold between 2006 and 2008 and the time to prepare, submit necessary documentation and obtain a fire permit was considerably reduced. See the 2009 Survey by the International Finance Corporation, IFC (2009).
11. Law No. 2451-VI "On amending the Law on licensing in the sphere of economic activity" (7 July 2010).
12. Resolution of the Cabinet of Ministers No. 725 "On approval of the list of certain activities related to business activity or types of business activity which cannot be conducted on the basis of submitting the Declaration of conformity of the material and technical conditions of the business entity to the requirements of the legislation" (25 August 2010).
13. Law No. 1759-VI "On Amending the Law on Liberalising Conditions for Doing Business in Ukraine" (15 December 2009).
14. According to the Ukrainian Commercial Code, small enterprises are defined as entities with up to 50 persons employed during one year and with an annual income not exceeding UAH 70 million (USD 8 million).
15. Law No. 2555 "On Amending the Law on State Registration of Legal Entities and Individual Entrepreneurs" (23 September 2010); Law No. 7516 "On Amending Certain Legislative Acts regarding the Cancellation of Certificates of State Registration of Legal Entities and Individual Entrepreneurs" (24 December 2010); Law No. 8294 "On Amending Certain Legislative Acts to Liberalise/Simplify Launching of Business Activities" (24 March 2011).
16. Law No. 1775-III "On Licensing of Certain Economic Activities" (1 June 2000).
17. Law No. 1571-VI "On Amending Certain Laws of Ukraine on Further Improving Business Licensing Procedures" (25 June 2009).
18. Resolution of the Cabinet of Ministers No. 322 "Regulation on the Issuance, Extension and Annulment of Work Permits for Foreigners and Stateless Persons" (8 April 2009).
19. Decree of the Cabinet of Ministers "On the System of Currency Regulation and Currency Control".
20. Law No. 185/94-BP "On Payments in Foreign Currency" (23 September 1994) as amended on 11 February 2010.
21. Law "On Investment Activity" (18 September 1991).
22. Law No. 2544-XII "On Privatisation of State Property" (7 July 1992), Article 8.
23. Law No. 1720-IV "On Amendments of Certain Ukrainian Legislation to Counteract Illegal Takeovers and Acquisitions of Enterprises" (17 November 2009).
24. At the beginning of 2011 the Parliament adopted a new law "On development of municipal territories", which could facilitate procedures related to construction permits. The President vetoed the law and sent it back to the Parliament with his remarks.
25. Law No. 3038-VI "On regulation of city planning" (17 February 2011).
26. Law No. 1775-III "On Licensing of Certain Economic Activities" (1 June 2000) as amended on 19 October 2010.

27. Law No. 2608 "On amending some legal acts with respect to limiting the state regulation of economic activities (19 October 2010).
28. Ukraine's Code "On the Subsoil".
29. Law No. 2608 "On Amending Some Legal Acts of Ukraine with respect to Limiting the State Regulation of Economic Activity" (19 October 2010).
30. Law No. 1039-XIV "On Production Sharing Agreements" (14 September 1999).
31. Law No. 2608 "On amendments to some legislative acts on deregulation of economic activities (19 October 2010), Article 76.
32. Law No. 3317-IV "On Introducing Amendments to the Law on Television and Radio Broadcasting" (12 January 2006).
33. Law 317-V "On Amendments to Article 25 of the Law of Ukraine "On Publishing" (2 November 2006).
34. Law No. 2121-III "On Banks and Banking" (7 December 2000).
35. Law "On Financial Services and the State Regulations of the Market of Financial Services" (12 July 2001).
36. Law No. 85/96 "On Insurance" (7 March 1996). Law 357-V "On Amendments to the Law of Ukraine "On Insurance" (16 November 2006) applies currently. Law No. 2774-IV "On Amendments to the Law of Ukraine "On Insurance" (7 July 2005) will take effect in 5 years after Ukraine's WTO accession.
37. Law No. 250-VI "On Ratification of the Protocol on Ukraine's Accession to the WTO" (10 April 2008).
38. Law No. 3425-XII "On Notariat" (2 September 1993).
39. Law No. 1682-III "On Natural Monopolies" (20 April 2000) as amended.
40. Law No. 847-XIV "On the List of State Property Assets not Subject to Privatisation" (7 July 1999).
41. Law No. 997-XIV "On Concessions" (16 July 1999), amended on 23 September 2010.
42. Law No.1490-HI "On Procurement of Goods, Works and Services" (22 February 2000) as amended.
43. Law No. 2289-VI "On Implementation of Public Procurement" (1 June 2010).
44. Yuriy Onyshkiv, "Disappointed with corruption, EU holds us aid to Ukraine", *KyivPost*, 11 January 2011.

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