

**PARTNERSHIP FOR SUCCESSFULLY COMPETING
IN THE GLOBAL ECONOMY**

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EXECUTIVE SUMMARY

The Partnership is an action-oriented program of policy, legal, and regulatory reforms that is designed to improve Ukraine's competitiveness in the global economy. To make the Partnership operational, the American Chamber of Commerce in Ukraine (Chamber) has focused on selected sectors and policy areas, largely grounding their choice on the most relevant indicators from the Global Competitiveness Index (GCI), an internationally recognized measure of competitiveness formulated by the World Economic Forum (WEF).

The WEF's "Global Competitiveness Report" defines competitiveness as "the set of institutions, policies, and factors that determine the level of productivity of a country," while "the level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy." In other words, more competitive economies tend to be able to produce higher levels of income for their citizens.

Those countries that have competitive strengths in a variety of areas can be expected to recover from the global financial crisis faster and to rebound more strongly. This is a key

idea that Ukrainian policy makers and their private sector partners must keep in mind as they work together to strengthen the Ukrainian economy for the benefit of the population and the investment community.

Below we provide a brief summary of the progress achieved in selected sectors and policy areas monitored by the Chamber and of further actions need:

1. **Agriculture:** Directed state interventions into the functioning of agricultural markets (export restrictions, minimal prices etc.) were at the core of the development of agriculture in the 2010/2011 marketing year. The Chamber will continue targeting improvement of market regulation on the basis of free-market principles, minimizing future ad hoc direct state interventions, and ensuring a transparent and predictable market environment.

Yet other policy changes concern introduction of new tax legislation that requires a certain period of time for adjustment. The Chamber will pay special attention to monitoring and evaluation of the new procedure for automatic VAT reimbursement, an extremely important innovation for the sector's development.

The acceleration of agricultural land market reform is a very positive signal for investors. It is important to overcome the problem of asymmetric information, and the Chamber should continue its efforts in this area.

2. **Banking and Financial Services:** The banking system continues to recover from the crisis. The Chamber Action Plan for the sector is quite ambitiously aimed at further improvement of regulatory foundations, to facilitate the development of the financial intermediation sector and increase its transparency. Special attention is paid harmonizing Ukrainian legislation with international practices, which will sharpen Ukraine's competitive edge.
3. **Fuel and Energy:** Reforms in Ukraine's energy sector are at the top of the country's policy agenda, given its low energy efficiency and dependence on imported resources and growing world energy prices. To facilitate sector development and attract investments, further efforts should be made to introduce transparent and competitive licensing process in exploration and production of oil and gas. In this sphere, no progress has recently been achieved.

Equally important, developing the renewable energy sector deserves attention. Ukraine needs a balanced new Energy Strategy to support this sector, in line with energy-saving policies.

Yet another issue that calls for further dialog with the Government is the cross-subsidization of energy-related products, induced by the state. The current system of cross-subsidies makes pricing in the energy sector non-transparent and unpredictable, and constrains market restructuring and modernization, thus hampering Ukraine's competitiveness.

4. **Information and Communication Technologies:** Ukraine's ICT sector is among the most rapidly developing sectors of its economy, providing huge opportunities for investment and increasing the competitiveness of the country as a whole. Among the recent positive developments in the sector have been the adoption of the Law "On Personal Data Protection" and increased official interest in e-government. The Chamber continues to work on regulations to further facilitate ICT sector development.
5. **Real Estate and Construction:** 2011 was marked by significant progress in simplifying bureaucratic procedures in the sphere of real estate construction and development. Major achievements include adoption of the Law "On Regulation of City Construction," which envisages simplifying permitting procedures in construction, including the introduction of the principle of implicit consent to regulatory procedures in construction. However, further efforts are required to ensure smooth implementation of the new provisions.

Development of the land market after the elimination of the moratorium on alienation of agricultural land plots should become another important stimulus for sector growth, but so far the draft legislation on the topic has been raising concerns among market participants. The Chamber continues its dialog with stakeholders to improve legislation in the sphere.

6. **Retail Trade:** The sector was hit hard by the crisis, but it is recovering alongside the gradual recovery of the Ukrainian economy.
7. **Telecommunication and Data Transmission:** The development of the sector is very important for the country's competitiveness and prosperity. Despite the dynamic growth of the industry, Ukraine's telecom infrastructure development is lagging behind that of its European counterparts due to inadequate investment in network development and to regulatory gaps. Further Chamber actions are needed to facilitate improvement of Ukrainian regulation in the sphere in line with Western standards and to support effective implementation of already adopted legislation, including the Amendments to the Law "On Telecommunications" enacted at the beginning of 2011.
8. **Travel and Tourism:** Despite huge investment potential, the Ukrainian travel and tourism sector is developing sluggishly and faces a lack of funding. To boost the sector's development, it is important to improve the country's infrastructure, increase the level of service standards, train personnel, establish a well-functioning network of information centers for visitors to ensure exchange and dissemination of complete and reliable information about Ukraine's tourism assets, and improve taxation in the sphere.
9. **Customs Policy:** Cumbersome customs procedures have been considered an important stumbling block hindering the development of the country's competitiveness. The State Customs Service of Ukraine responded by introducing a concept of customs reform entitled "Facing the People," containing both positive initiatives and some controversial measures, including a proposed increase in the authorities' power over operational activities and in prosecution.

The government and the State Customs Service have been taking certain specific and targeted measures to facilitate customs procedures, including introduction of a unified list of goods subject to preliminary documentary control, and establishment of a standard for completing customs clearance within two hours of the declaration of goods.



Amendments to the Customs Code that recently passed in the first reading in Parliament in early 2011 constitute yet other important development in customs policy. Amending the Customs Code of Ukraine will bring it in line with the EU customs legislation and international conventions, as well as with the Framework Security and Trade Facilitation Standards of the World Customs Organization. The Chamber took part in the process of the amendments development and will continue to be actively involved in further legislation improvement, including preparation of the Code for the second reading.

Another issue continuing to spark the interest of the business is that of customs value. The State Customs Service has issued a series of internal regulatory orders that have made significant changes to the guidelines for control of declared customs value. However, the orders still leave open the possibility of customs officials' determining customs value by methods other than the price of the contract. In this context the Chamber has established permanent dialogue with the Leadership of the State Customs Service of Ukraine that provides us with an opportunity to participate more in the improvement of the customs regulations in general and solve particular problems of companies which they face during the customs clearance procedures.

10. **Healthcare Policy:** Improvements in healthcare policy are extremely important for Ukraine given the long-term demographic challenges the country faces, such as continuing depopulation and population ageing. The market for medical services and the medical care system in general remain significantly underdeveloped, requiring further state and private efforts. Introduction of compulsory medical insurance should substantially improve the situation as regards financing healthcare.

Special attention should also go to protecting intellectual property rights and fostering transparent and efficient quality control for medicines in Ukraine. There are certain risks to implementing an inadequate medicine import substitution policy for foreign pharmaceutical companies specializing in R&D based on the Draft Concept of the State Target Program "Development of Import Substitution Production in Ukraine and Substitution of Imported Medicinal Products by National, Including Biotechnological, Products and Vaccines" for 2011–2021. The Draft Concept should exclude any possibilities for corrupt schemes in state procurement tenders and unjustified discrimination against foreign manufacturers.

11. **Human Resources and Labor Policy:** An efficient and flexible labor market is important for the country's competitiveness. The functioning of the Ukrainian labor market is adversely affected by several factors, including contradictions between state personnel policy and the requirements of the transformational processes in the country, imperfect legislation, lack of a strategic focus on personnel training to meet the needs of society, and the poor functional certainty of HR structures. The Draft Strategy for Personnel Policy for 2011–2020 is important, but the document's content is too general and it lacks an action plan for its implementation. Moreover, adoption of the Strategy is insufficient for the further development of Ukraine's labor market and HR policy. Introducing qualitative changes to the legislation on labor relations remains a pressing issue.

Among those qualitative changes is first of all the approval of the new Labor Code. The Draft Labor Code of Ukraine has been developed and is aimed at revising the Soviet labor relations heritage. The Code's contents and the rules it establishes are not ideal, but it does contain a number of good ideas. Further Chamber Committee efforts are required to advocate a balance of interests between employers and employees in the Code.

12. **Tax Policy:** The introduction of the Tax Code marks a major change in Ukraine's tax policy. Key principles introduced in the Code include: (a) unification and simplification of tax rules; (b) simplification of tax administration, including introduction of an "automatic" VAT refund; and (c) the mutual responsibility of business and the government in the tax sphere.

Still, the original version of Code contained several significant limitations for businesses that negatively impacted foreign investors in Ukraine. They included a prohibition against businesses, except for those operating in the IT area, deducting the costs of goods, works, and services purchased from individual entrepreneurs who pay the Unified Tax; limitations on businesses for deducting royalties and consulting, advertising, marketing, and engineering fees payable to non-residents; non-deductibility of costs for promotion of goods, works, services, and trademarks; and non-deductibility of VAT payable by new businesses in their start-up phases. Some of these limitations were resolved in mid-2011 when the Parliament introduced amendments to the Code.

However, further dialog between business and the Ukrainian authorities regarding the Code is needed.

13. **Intellectual Property Rights Policy:** An effective state system for protecting intellectual property rights is crucial for Ukraine's competitiveness. The Ukrainian intellectual property legislation is commonly recognized as good, but there is still room for improvement. In particular, the collection and further allocation of royalties for the public use of copyright is still non-transparent and inefficient. New mass media spheres lack a proper regulatory framework. Ukraine has for more than two years delayed the adoption of a special EURO 2012 intellectual property protection law.

A continuous dialog with the state is required to ensure that new legislative initiatives are in line with international practices and do not complicate market relations.

14. **Anti-bribery Policy:** Corruption is acknowledged as a major constraint in the development of Ukrainian society. In July 2011, anticorruption legislation came into force in Ukraine, save for articles 11 and 12 of the Ukraine Anti-Bribery Act, which are contemplated to take effect in January 2012. The new laws broaden the definition of corruption, expand the range of persons who may incur corruption offence liability, and define a civil service conflict of interests and the manner of its resolution, among other things. The law contemplates the material enhancement of liability for any corruption offences, while all corrupt persons will be entered in a special register.

The Anti-Bribery Act vests in the President the right to establish a special anticorruption policy authority, which will coordinate the implementation of anticorruption strategy, laid out by the President, in accordance with the requirements provided by law.

However, the issue of the implementation of the new anticorruption legislation raises doubts.

Summing up, despite the significant progress that has been achieved in the areas of monitoring, more work remains to be done. This calls for the continuation and even intensification of the dialog between the Ukrainian authorities and the business community. That is why the American Chamber of Commerce in Ukraine has been consistent in contributing to the discussion of Ukraine's competitiveness issues and offering its vision of specific paths and steps to address them, based on the rich and comprehensive experience of the Chamber member companies.

The Chamber's "Partnership for Successfully Competing in the Global Economy" is a living document that will be continuously updated with input from our partners in the NGO, expert, donor, and international financial institution communities. The Chamber Committees and Working Groups and our interlocutors in the Ukrainian political establishment will also play a key role.

The American Chamber of Commerce in Ukraine welcomes comments and criticism so that the contents can be improved and aligned and serve further as one of the most complete reform agendas that the investment community has prepared.

1

SECTOR BRIEFS



1. AGRICULTURE

The development of the agricultural market is essential for the overall growth of the Ukrainian economy. Ukraine's agricultural sector did relatively well during the recent economic crisis. This is true even though the Ukrainian government intervened in key market operations by introducing export limitations and price regulations. Agriculture accounted for 7.2 percent of GDP and 13.7 percent of export in 2010.

The State Statistics Service of Ukraine reported that agricultural production in 2010 was 98.5 percent of what it was in 2009. The decrease in output was induced mainly by a decrease in crops, while livestock production increased. Production fell both at agricultural enterprises and in private households. Production of grain crops, as can be seen in Table 1, was 15 percent lower than in 2009 and 26 percent lower than in pre-crisis 2008. The main reason for the decline in grains was unfavorable weather conditions. At the same time, production of sugar beets increased by 37 percent compared to the same period in 2009.

Table 1. Main types of agricultural output of Ukraine in 2010

Type of output	2010 in % to	
	2008	2009
Grain and leguminous plants	74	85
Sugar beets	102	137
Sunflower seeds	104	106
Potatoes	96	95
Vegetables	102	97
Meat	108	107
Milk	96	97
Eggs	114	107
Wool	112	102

Source: State Statistics Service of Ukraine

As can be seen in Table 2, the number of pigs and poultry increased in 2010 by 5 and 6 percent, over 2009. The number of cattle, sheep and goats slightly decreased. As reported by the State Statistics Service of Ukraine the profitability of agriculture in 2010 was 21.1 percent (26.7 percent for crops and 7.8 percent for livestock), which is substantially higher than it was in 2009 (13.8 percent). Considering the sector's performance results for the last three years, we are expecting a positive development trend in the agricultural sector in the future.

Table 2. Cattle stock of Ukraine in 2010

Type of output	2010 in % to	
	2008	2009
Cattle	88	93
Pigs	122	105
Sheep and goats	100	94
Poultry	115	106

Source: State Statistics Service of Ukraine

Ukraine’s agriculture production has a substantial effect on the world markets. Even though the agriculture markets are dominated by price competition, Ukrainian producers tend to have an influence on world prices. A temperate climate, large intact tracts of land, fertile soils, proximity to different markets, skilled and relatively abundant labor, and the low price of productive inputs together offer a global competitive advantage for the development of Ukraine’s agricultural sector. Ukraine established itself as the third largest grain exporter worldwide in the 2008–2009 and 2009–2010 seasons. Only the USA and the EU export more grain. Thus Ukraine is an important player in the world grain trade, alongside Russia, Australia, Argentina, and Canada.

A low agriculture yield is one of the main limiting factors preventing Ukraine from utilizing its agro potential more efficiently. Due to a lack of technology and capital in the sector, Ukraine is characterized by lower agriculture productivity than are other countries of the region — the Czech Republic, Poland, Lithuania, Belarus, and Latvia (See Figure 1).

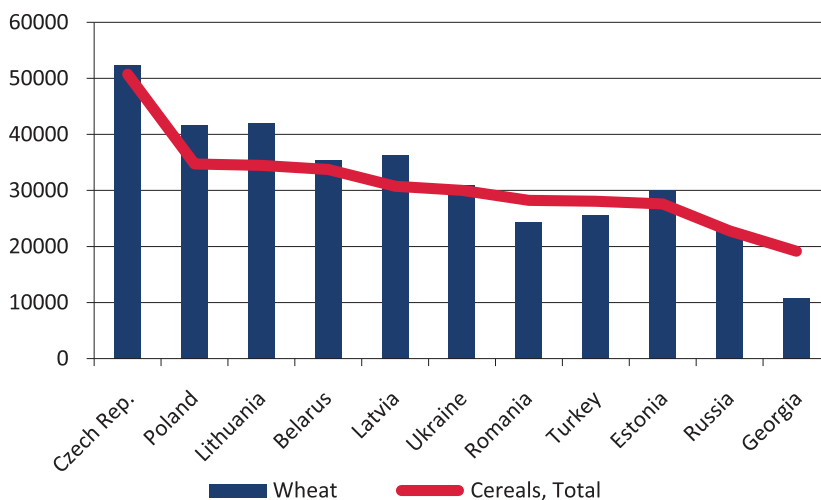


Figure 1: Cereals yield in selected countries in 2009, hectogram/hectare

Source: Food and Agriculture Organization.

Overall, the agricultural sector’s export capacity is quite impressive. According to FAS USDA data, in the 2009–2010 marketing year Ukrainian agricultural producers controlled 36.3 percent of the world’s barley exports, 5.2 percent of corn, 6.9 percent of wheat, and 22.6 percent of sunflower seeds. They were also the leaders in sunflower oil exports, providing 58.1 percent of the world’s total. In the 2010–2011 marketing year, due to the introduction of export quotas by the Ukrainian government, exports of some cereals (barley, rye and wheat) decreased twofold.

On the whole, the sector is contributing substantially to the country’s overall exports and in the 2011–2012 marketing year Ukraine will remain a key player on the world grain market. The main factors contributing to the positive trends are:

- The agricultural sector has generally become more efficient and competitive. Ukrainian farmers are adopting modern management and production technologies. Foreign investors are bringing capital and new technologies into the sector.
- The downstream sector, especially processing, logistics, and trade, has undergone substantial changes. Currently, competition in grain and oilseed trade and processing is very strong, and both domestic and foreign companies have invested substantially in inland and port storage and logistics infrastructure, making the latter more efficient.

A more efficient agricultural industry must be based on free market principles and on the abolishment of restrictions. Government involvement in the market has to be minimized and instead non-governmental organizations have to proactively participate in market regulation activities. The principal negative factors influencing Ukrainian agribusiness in 2010–2011 were:

- Direct state interventions into the functioning of agricultural markets (export restrictions, introduction of minimal prices etc.)

- Recent amendments to the tax code, to which markets were forced to spend a certain amount of time adjusting in the 2010–2011 marketing year;
- Inadequate regulation of agricultural markets;
- Lack of an agricultural market infrastructure, which negatively affects market links between producers, intermediaries, and customers;
- Dominance of asymmetric and unreliable market information;
- Low credit availability;
- Low level of labor and land productivity;
- Absence of a land market.

Introduction of a land market is considered to be the major factor for improving agriculture sector investment attractiveness. Currently the Draft Law “On the Land Market” (#9001-1 of July 19th) is under consideration in the Verkhovna Rada. However, the legislation related to the establishment of a fully functional land market cannot be limited to one law, will be quite complicated in terms of drafting and practical implementation, and must include a system of laws that have yet to be adopted. The adoption of the Law “On the State Land Cadaster” on July 7th is a major step towards the establishment of a fully functioning land market. However, the new legislation and the recent amendments to the tax code are tending to decrease the confidence of market agents. Therefore, the expert and business community has been watching the legislation closely and would like to reiterate the need to inform businesses in advance of any changes and new mechanisms that will be implemented, as well as to ask for professional feedback from the private sector — feedback that is based on the best international practices.

Improvement of legislation, elimination of administrative barriers and burdens, fundamental reform of the VAT refund system, predictable and transparent grain export regulations, completion of land reform, and an equitable and transparent distribution of Government Domestic Loan Bonds for VAT Reimbursement to exporters and producers are acutely required. Some reforms, especially those related to VAT regulations, have been launched, which is discussed in more detail in the tax policy section of this document. However, these issues have been and will remain important ones, and they will require constant monitoring by the Ukrainian and international business communities. There should be identified a clear list of basic conditions that are both simple and effective enough to attract investment into the Ukraine agricultural sector, such as:

- Ensuring of minimum government interference in the sector, based on clear and transparent national food security policy mechanisms and implementation of state programs aimed at decreasing transactional costs for all market participants, especially producers;
- Justification and probable abolition of some state authorities, like the Grain Bread Inspection and the Quarantine and Veterinary Inspections, thereby minimizing possibilities for corruption and unfair treatment of market participants;
- Equal treatment of all market participants;
- Further improvement and simplification of the tax system and of tax administration and collection, including implementing of an effective non-discriminatory VAT refund system;
- Finalizing all the necessary legislation to launch an agro-land market.

The Ukrainian government still needs to send a strong signal to foreign investors by reducing government interference in the markets and eliminating such negative factors as poorly drafted and conflicting legislation.

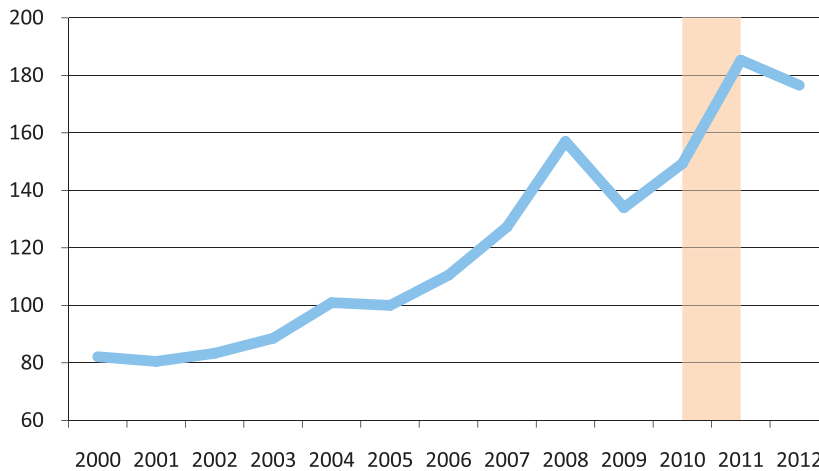


Figure 2: Food price index — includes cereal, vegetable oils, meat, seafood, sugar, bananas, and oranges price indices for the world, index, 2005=100.

Source: EconomyWatch

It is expected that world grain and food consumption as well as food price indices will continue to increase in the nearest future, increasing the attractiveness of the agricultural sector of Ukraine to foreign investors. If serious reforms are intelligently implemented in Ukraine, the country’s agricultural sector will maximize domestic investments and involve new technologies in the sector.

The American Chamber of Commerce in Ukraine will continue to conduct a wide advocacy campaign and maintain a working dialog with relevant government authorities and representatives of the investment community. It will also work with partner organizations and international financial institutions to address all the issues and problems in this sector, to update policy and to promote adequate, clear, and transparent rules for business operations in Ukraine.



2. BANKING AND FINANCIAL SERVICES

2.1. Size and Structure

There were 198 banking entities as of July 1st 2011 that were legally organized as public or private joint-stock companies. Nineteen of them are currently in the process of liquidation and one is in the merging process. The National Bank of Ukraine is the central bank conducting regulation and supervision of the banking sector. The total assets of the banking system amounted to 995 bln UAH (125 bln USD) as of April 1st, 2011. Banking assets accounted for 88 percent of GDP in 2010 compared to 51 percent in 2005 and 23 percent in 2001. This dynamic reflects the development of the economy after the 1998 crisis and the growth of confidence in the banking system within the country, but it is also the result of credit expansion by foreign banks coming en masse to Ukraine since 2005. At the same time, the assets-to-GDP ratio in most new EU members is above 150 percent, indicating even deeper penetration of banking services into the economic life of businesses and households in these countries.

The development of the banking business in Ukraine has been driven by several banks with nationwide networks, some of them created during the Soviet era and others newly established by private business in the late 1980s and early 1990s. The top 10 banks comprise about 50 percent of all bank assets and capital. Concentration in the banking business is not significant and, for instance, is higher in Eastern Europe, where the top five banks control more than 50 percent of the sector.

Table 1. Bank assets of top 10 banks in Ukraine (as of July 1st, 2011)

Name	Assets, mln. UAH	Share of total, %
Privatbank	135 741	13
Ukreximbank	80 011	8
Oschadbank	72 452	7
RaiffeisenbankAval (AT)	55 090	5
Ukrsibbank (FR)	46 286	5
Ukrsotsbank (IT)	39 968	4
Prominvestbank (RU)	35 870	4
VTB Bank (Ukraine) (RU)	34 590	3
Alfa-Bank Ukraine (RU)	28 786	3
Finansy i Kredyt	24 410	2
Total top 10 banks	553 205	54

Source: National Bank of Ukraine.

Key groups of Ukrainian banks that have certain type-related features and behavior patterns are:

- Ukrainian state-owned banks;
- Ukrainian private banks (subdivided into big systemic and small local (often “pocket”) banks);
- Foreign-owned banks controlled by Western banking groups and capital from other emerging market countries.

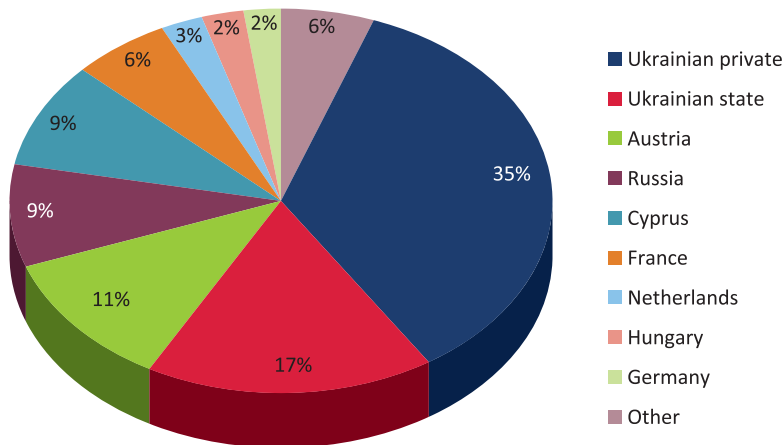


Figure 1: Ownership structure of Ukrainian banking system total assets based on significant authorized capital share (as of April 1st, 2011).

Source: National Bank of Ukraine.

There are five state banks in Ukraine. Ukreximbank and Oschadbank were established as and should remain 100 percent state-owned banks. The term “nationalized” is commonly applied by the Ukrainian press to Ukgazbank, Bank Kyiv, and Rodovid, which became insolvent in 2009 and were taken over and recapitalized by the state via purchase of shares. It was largely anticipated that those state-owned shares would eventually be sold and those banks would be reprivatized once stability and profitability returned. In March 2011, the Ministry of Finance of Ukraine proposed that Rodovid would become a “bad asset bank” that receives the bad assets of the other two banks, and that its retail deposits would be transferred to Oschadbank. The decision to transfer Rodovid’s assets and liabilities to Oschadbank was adopted by a National Bank of Ukraine Decree in April; as of August 1st, 2011, 90 percent of Rodovid’s private deposits were reported to have been repaid. Ukgazbank has received additional capital from the government of 4.3 bln UAH (totaling 10 bln UAH), while Bank Kyiv’s future is still undecided. Intentions have been expressed to make it a bank that specializes in financing the agriculture sector. There are also several private banks run by temporary state administration, including Rodovid, SotsKomBank, Bank Stolysia, Volodymyrskyy, and Inprombank.

As of July 1st, 2011, there were 56 banks with foreign capital, 21 of which had 100 percent foreign ownership. The total share of foreign capital in Ukrainian banks’ authorized capital is 38.9 percent.

2.2. Balance Sheet Analysis of the Ukrainian Banking System

Ukrainian regulation (in line with Basel 2) stipulates, and the National Bank strictly controls, that banks obey minimum regulatory (i.e. equity + subordinated debt) capital requirements of 8 percent. In fact, the average capital adequacy ratio of Ukrainian banks over the last five years was above 10 percent. Capital was growing in line with the overall development of business.

The last two years’ inflow of additional share capital has been the result of the 2008 crisis (there were heavy losses due mostly to bad loans) and of IMF-requested stress tests, which were conducted twice, in 2009 and 2010.

Prior to the seismic changes in the local market following the global financial turmoil in 2008, the sources of funding for Ukrainian banks were fairly split between three categories: accounts of business entities, at-call and term deposits of individuals, and borrowing from abroad.

The dynamics from 2003 to 2008 were marked by an increase in disproportions in favor of foreign currency funding.

The weight of foreign borrowings grew from 18 percent in 2005 to 44 percent on the verge of the crisis. Respectively, the share of total liabilities in foreign currencies grew from 39 percent in 2005 to 56 percent in 2009.

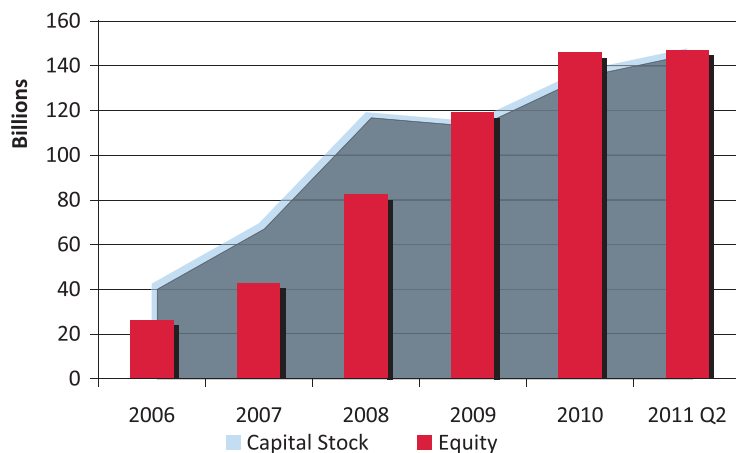


Figure 2: Ukrainian banks' equity, bln UAH.

Source: National Bank of Ukraine.

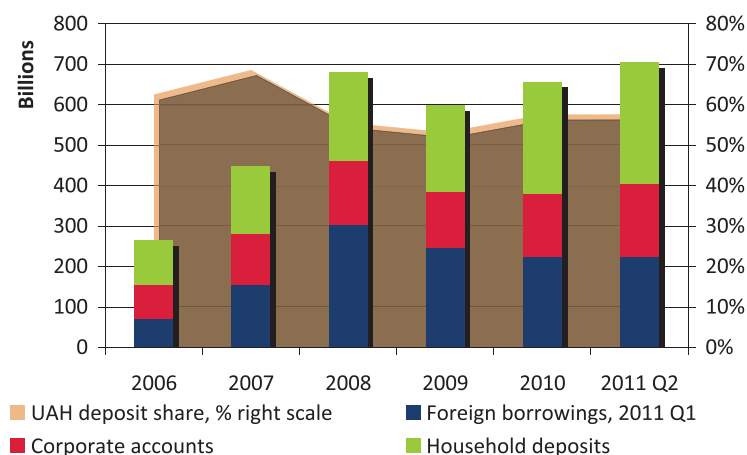


Figure 3: Ukrainian banks' liabilities, bln UAH.

Source: National Bank of Ukraine.

The search for credit from abroad was essential to building up lending. In addition, this trend has of course been magnified by the expansion of loosely regulated global capital to new markets, a phenomenon that was closely connected to a consumer lending spree. Funding in foreign currencies took the form of one- to two-year syndicated loans, trade and other structured facilities, Eurobonds, and direct lending to local subsidiaries of global banks.

After the repayment and restructuring of credits from abroad that many Ukrainian banks conducted over the last two years, domestic funding once again became a focus of local bankers. After a significant drop during the first six months of the crisis (25 percent for UAH deposits and 20 percent for foreign currency deposits), customers' liabilities have since March 2009 increased fast: by 55 percent in UAH and by almost 37 percent in hard currencies as of July 1st, 2011. At the end of the first half of 2011 total customer liabilities amounted to 466 bln UAH (58 bln USD), with 58 percent of those in UAH.

Dependence on foreign funds is explained by the generally low level of wealth and cash holdings on the part of the population (the average deposit is only 840 USD per adult individual; that is up from 360 USD in 2005, however). It must also be noted that a majority of deposits are short-term: 60 percent of corporate and 30 percent of individual funds are kept in at-call accounts, while the rest is mostly made up of deposits of a maturity of up to one year.

Short-term lending to businesses and the population is the key activity of Ukrainian banks due to an underdeveloped and quasi-inexistent fixed income and other securities market, to the low penetration of payment services, and to the lack of demand for sophisticated or long-term banking products.

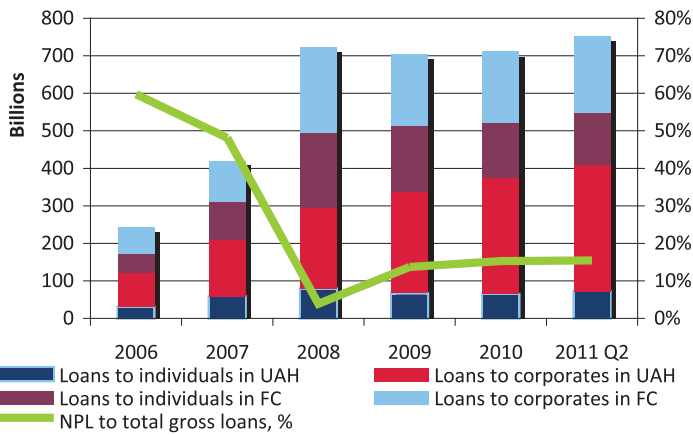


Figure 4: Loans of Ukrainian banks, bln UAH.

Source: National Bank of Ukraine

Expressed in UAH, and with UAH devaluation helping, the total loans portfolio of Ukrainian banks reached its peak at the end of 2008, hitting 734 bln UAH. This was split into 300 bln UAH in local currency and the equivalent of 56 bln USD in foreign currencies. Over the last two years UAH loans grew further to reach 340 bln UAH as of Q2 2011, partially due to conversion of loans denominated in other currencies into UAH.

At the same time, at the end of Q2 2011 foreign currency loans shrank to 43 bln USD (the equivalent) following regular or accelerated repayments, restructuring that included partial write-offs, and the bankruptcies of several banks.

Globally speaking, lending by banks expressed in UAH since the end of 2008 till the end of 2010 (the period during which no appreciation/depreciation of the UAH took place) has been stable at 730 bln UAH, with a low point of 696 bln UAH in mid-2010; growth started in 2011 (+40 bln UAH or 5.5 percent for the 1st half of 2011).

The main directions of lending to the corporate sector, representing about two-thirds of the banks' total credit portfolio, have been and remain trade and services (37 percent), manufacturing (24 percent), and the real estate/construction businesses (jointly 24 percent).

Lending to individuals (36 percent of total volume in 2008, as compared to 29 percent in 2010) is focused on financing consumer goods and car purchases (>60 percent) and on mortgages, with construction loans comprising the remainder. Statistics show that as of 2010, more than 30 percent of adult Ukrainians had banks loans or had taken them out in the past. Such a penetration rate is explained by the massive expansion of banking sales efforts to shopping centers in 2006–2008. Mortgage loans are less popular, and only 2–5 percent of the population report having been involved in purchasing property with the help of bank credit.

There is a perception that, in line with “purpose structure,” loans to private individuals are mostly short-term ones. Although the National Bank reports that 50 percent of consumer loans and 90 percent of mortgage loans are for longer than five years, such statistics should be perceived with caution. These loans were often taken for longer terms, but repaid prior to maturity to cut borrowers' interest expenses.

Interest rates in Ukraine are well above international levels: before the crisis interrupted active lending, they were often above 15 percent p.a. in USD and above 25 percent p.a. in UAH. The difference in favor of foreign currency in 2010 and the continued stability of the UAH/USD exchange rate led to the building up of foreign currency loans, which made the burden of repayment even heavier after the 60 percent devaluation of the hryvnia in 2008.

As the crisis emerged, banks experienced a deterioration of the quality of both retail and corporate loan portfolios, which used to be quite good. Non-performing loans surged from around 5 percent in 2007 to an officially reported 18 percent in 2010 or, as some analysts estimate, to even 30–40 percent of total loans. Some banks, particularly Western ones, preferred to provision non-performing loans, requesting additional capital injections from parent banks. Banks also managed to extend the maturity of loans or arrange

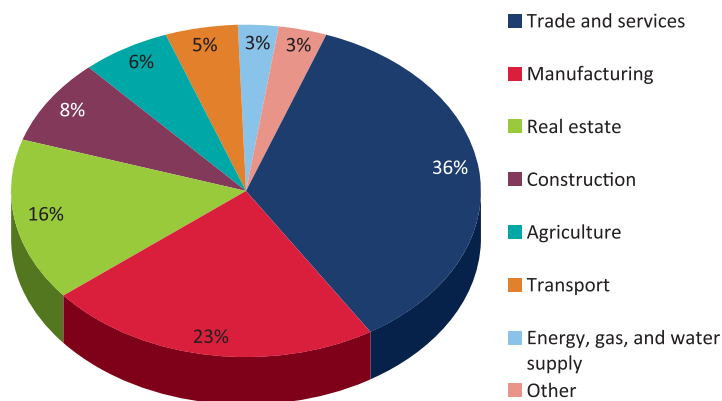


Figure 5: Ukrainian banks' loans portfolio structure (as of Q2 2011).

Source: National Bank of Ukraine

restructuring to help customers to perform partial repayments and qualify as regular borrowers. According to the rating agencies (S&P, Moody's, and Fitch), which rate the banks that account for more than 50 percent of the Ukrainian banking system's assets, at those banks NPL (non-performing loans) amounted as of mid-2010 to 18 percent of total loans, and approximately 35 percent of other loans were "rescheduled." As of December 31st, 2010, the Western-owned banks had, from an IFRS standpoint, provisioned on average around 40 percent of their assets. Those figures testify to the shock that the banks have been facing, and to their prudence today.

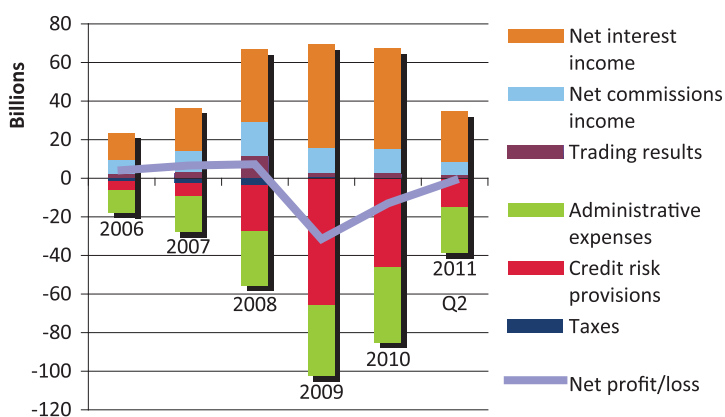


Figure 6: Ukrainian banks' financial results, bln UAH.

Source: National Bank of Ukraine.

For years the banking business in Ukraine was profitable and offered good prospects to both domestic and international investors. Consolidated net banking income (NBI) jumped from 14.5 bln UAH in 2005 to 67 bln UAH in 2008, growing at a very high average rate of 66 percent p.a., together with assets.

The cost to income ratio (CI) gradually improved, from 52 percent in 2005 to 47 percent in 2008.

With NPL provisions building up as described above, the modest operating results of Ukrainian banks in 2009–2010 can be well understood. Total net banking income has stabilized (69 bln UAH net in 2009, 67 bln UAH for 2010), while the net result is negative (-31.5 bln UAH for 2009 and -13 bln UAH for 2010). The constituted yearly NPL provisions decreased from 66 bln UAH in 2009 to 15.3 bln UAH for Q2 2011 which, as many analysts tend to think, should mean that the Ukrainian banking system has overcome the most severe phase of the crisis, has defined its problems, and is moving toward reopening some lending and earning profits.

2.3. Trends and Prospects

As economic recovery has, to a large extent, been achieved with the help of the International Monetary Fund and has been supported by the extension of its lending program, Ukraine is poised to maintain certain trends in the development of its financial and banking

sectors. Namely, the focus should be put on restoring and safeguarding bank soundness and on building strong banks, which requires complete bank re-capitalization by the end of 2011. Improving financial system oversight has also been mentioned as a strategic goal.

Lately there has been a noticeable expansion of Russian banks in Ukraine thanks to available (and cheaper) funding from the oil-and-cash-rich Russian state. Russian companies and/or banks controlled over 12 percent of assets in 2010 (vs. 2.4 percent at the end of 2005). This is explained by the wide-ranging business interests of the Russian government and of both big and small Russian companies, which are buying resources and production capacities in a market the Russian authorities consider a strategic growth area.

In terms of technology, Ukrainian banks are well-equipped by international standards in terms of communication, automation, and card handling. The next step should be to increase the penetration rate of automated and electronic banking services, such as payment card settlements and online and mobile banking.

Provided that the IMF and the authorities of Ukraine continue to implement what was agreed upon in mid-2010 and do it in a disciplined manner, the banking system should, step by step, recover in sync with the economy. A 10 to 15 percent increase of its activity in 2011 (loans, deposits, NBI) sounds likely under such conditions, even if this percentage is probably not far from the expected Ukrainian inflation rate for 2011.

2.4. Insurance Sector

In early 2011 there were still about 500 insurance companies in Ukraine, including around 70 in the life insurance subsector. Those companies were regulated by the Financial Services Commission.

The reinsurance premium collected by 456 companies, including the 67 that were surveyed, increased by 5.3 percent in 2010 to 13.3 bln UAH. Net premiums so far in 2011 are up 10 percent. Those figures take into account tax-driven insurance schemes: i.e. they do not describe the real evolution of the sector.

The driver of this insurance market was banks' new loans to the population (mostly car and real estate loans). This activity collapsed at the end of 2008 and is recovering slowly in 2011.

The top player is AXA, a French company, now number 1 with more than 10 percent of the classic insurance market. The share held by Oranta (the ownership of which is not fully clear) has decreased to less than 10 percent by now.

The assets managed by the insurance sector are in the range of 40 to 50 bln UAH and have been stable for the past two years. Marketable assets, i.e. mostly deposits at banks, come to about 25 bln UAH.

The classic insurance sector sells motor third party liability insurance (MTPL), property insurance, KASKO (voluntary motor insurance), medical insurance (which is still developing), and personal accident and travel accident insurance.

The tax regime of the insurance sector has so far been specific (there is a 3 percent sales tax on the premiums received instead of a regular corporate profit tax regime). The new Tax Code changes this, and insurance companies will be subject to a "regular" tax regime starting in 2013. One issue in the sector is the enactment of new tax rules, mainly concerning the tax deductibility of reserves and the continuation of the exception for social charges on life insurance premiums when paid by employers.

Other issues in the sector are linked to its development and its adaptation to EU standards. Pension reform and insurance sector involvement in pension-related products are yet other issues.

The development of an institutional investors' base, which is today almost non-existent, has been and remains key for the development of Ukraine's financial sector.

3. FUEL AND ENERGY

3.1. Oil and Gas Exploration and Production

In the short and medium terms, Ukraine's energy mix will continue to be dominated by conventional energy sources — mainly oil and gas. However, domestic production meets only one-third of the country's natural gas and oil needs. This is because the “easy” oil and gas reserves in Ukraine have been largely developed and production from these mature fields is generally in decline. The remaining resources are more difficult to find and produce — they are located either very deep in the ground onshore, or in deep water offshore, or are unconventional, or require complex enhanced recovery methods. Increased capital expenditures and the application of modern technologies are therefore needed to find and develop the estimated 232 billion cubic meters of natural gas yet to be discovered in Ukraine (State Service for Geology and Subsoil of Ukraine estimates).

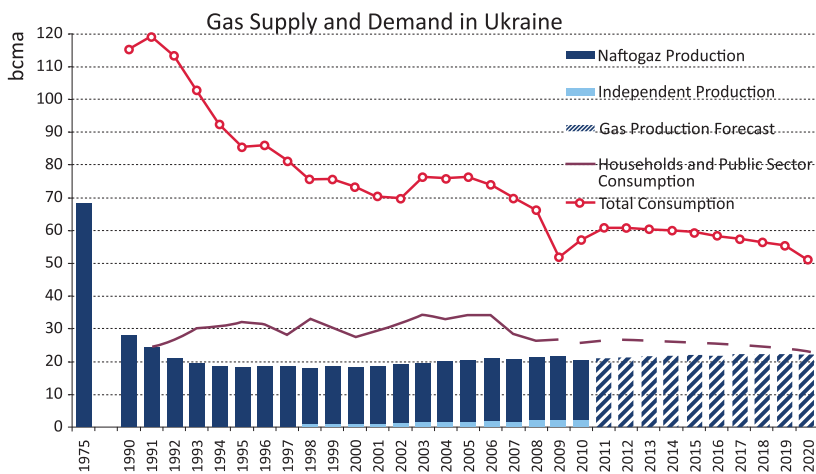


Figure 1: Gas supply and demand in Ukraine, bln cubic m.

Source: Ministry of Energy and Coal Industry of Ukraine.

None of the domestic state companies in Ukraine, however, have the financial, technical, and human resources or experience and expertise to develop these difficult deposits. The Ukrainian government should therefore encourage foreign investment in the sector and encourage public-private partnerships. Unfortunately, inconsistencies in the provisions of the main legislative acts regulating the oil and gas sector (i.e. the Subsurface Code and the Ukrainian Law “On Oil and Gas”) allowing for ambiguity and misinterpretation of those acts fail to stimulate the inflow of much-needed investment. In addition, although the Law “On the Functioning and Development of the Natural Gas Market” (the Gas Law) was adopted as a condition of Ukraine's accession to the Energy Community Treaty, subsequent bylaws required to enforce this law are still not in place. This means that in theory any

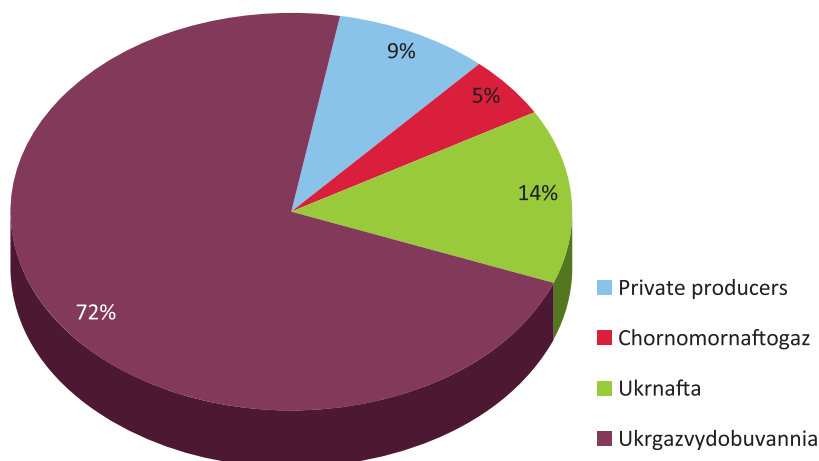


Figure 2: Gas production: state and private shares in 2010.

Source: Ministry of Energy and Coal Industry of Ukraine.

market player can access Ukraine's gas transportation system, but in reality and from a legal standpoint there is no legislative and regulative framework to implement such a procedure. A stable and consistent legislative platform is needed to encourage investment.

To ensure a transparent and competitive licensing process the Ukrainian government should also provide clear and consistent legal mechanisms for attracting investments. Unfortunately, during the course of 2008–2010, the State Tax Administration of Ukraine challenged joint activities (JAA) on a regular basis, claiming that they are not a valid mechanism for investments. Moreover, in 2011, because of certain legislative changes, the JAA mechanism in fact became unusable, despite provisions in the Gas Law that clearly stipulate it as a legitimate tax regime for exploring and producing hydrocarbons in Ukraine. At the same time, a joint ventures mechanism is not workable because of the legislative ban on transferring licenses.

Therefore, the only viable mechanism currently available for investors is a production sharing agreement (PSA). In 2011 the so-called Stabilization Clause was re-introduced into the PSA Law, which significantly added to the attractiveness of this mechanism in the eyes of the investment community. Also in 2011, new permanent Conditions for Issuing Special Permits and a procedure for conducting auctions were adopted. Still, it is also expedient to introduce regular auctions and licensing rounds for exploration acreage and provide investors with data packages containing all the information necessary for assessing the offered fields. In addition, to address above-mentioned problems to the full extent, the government should introduce further changes to the Subsoil Code and the Law "On Oil and Gas."

It is expedient to improve licensing in close connection with liberalization of the gas market. Natural gas prices should be progressively de-regulated to stimulate competition and investment while protecting the most vulnerable members of society during the de-regulation process. Legislation relating to natural gas pricing should be more precisely drafted to ensure non-discriminatory competitive conditions (a "level playing field") for all market participants. This will encourage investors and facilitate clear, transparent regulation by the National Electricity Regulatory Commission of Ukraine.

3.2. The Oil Refining Industry and Oil Products Market

The oil refining industry is one of the biggest taxpayers to the State Budget of Ukraine and employs tens of thousands of people throughout the country. Yet there is no government program or policy for supporting and developing this sector, despite the billions of dollars in foreign investment some local fuel producers and traders have already attracted. As a result, only three of seven refineries located in Ukraine (Lisichansk owned by TNK-BP, Kremenchug owned by UkrTatNafta, and Shebelinka owned by the state) are operating in a relatively stable manner. Still, in general the Ukrainian refining sector is currently operating at 16 percent of its capacity. Today, the country's oil products market is 50 percent import-dependent: in H1 2011 the share of imported motor fuel rose to 55 percent, of which 40 percent was shipped from the territory of the customs union of Russia, Belarus, and Kazakhstan, while imports from the EU accounted for about 11 percent only. Volumes of domestic production have also been shrinking notably. The oil refining industries in Russia, Belarus, and Kazakhstan have been continuously subsidized by their states and receive Russian crude oil at a preferential price (minus the oil export duty), which is significantly lower than the market price set for Ukraine, the European Union, and the rest of the world, and which gives those oil products an uncompetitive advantage of up to 160 USD per ton (around 23 USD per barrel). A key concern of international investors that own refineries in Ukraine has been that the countries of the customs union have been abusing this uncompetitive non-market advantage to oust European and Ukrainian oil products, which are unable to compete with the subsidy, from the market.

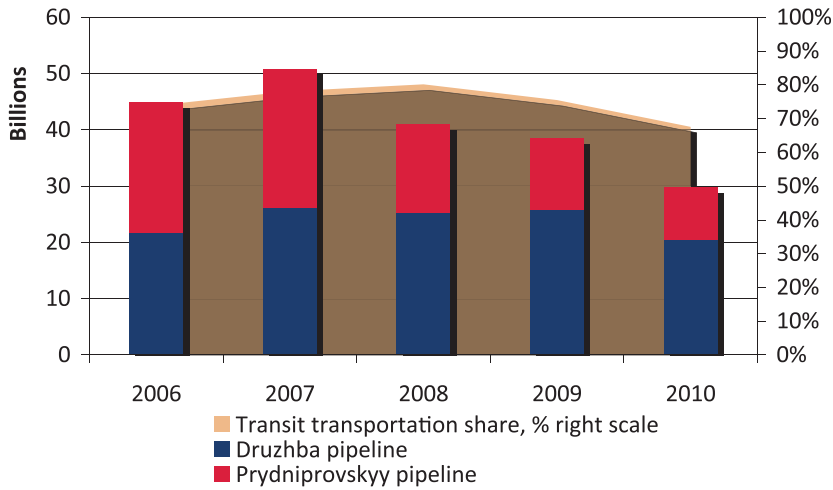


Figure 3: Crude oil pipeline transportation, mln tons.

Source: Ministry of Energy and Coal Industry of Ukraine.

Ukraine's transition to international fuel quality standards also largely depends on an effective fuel quality control system. Today, the controlling bodies are heavily underfunded and possess neither up-to-date equipment nor staff sufficient to carry out frequent and thorough on-site checks. Moreover, the legislation envisages only small fines for violating

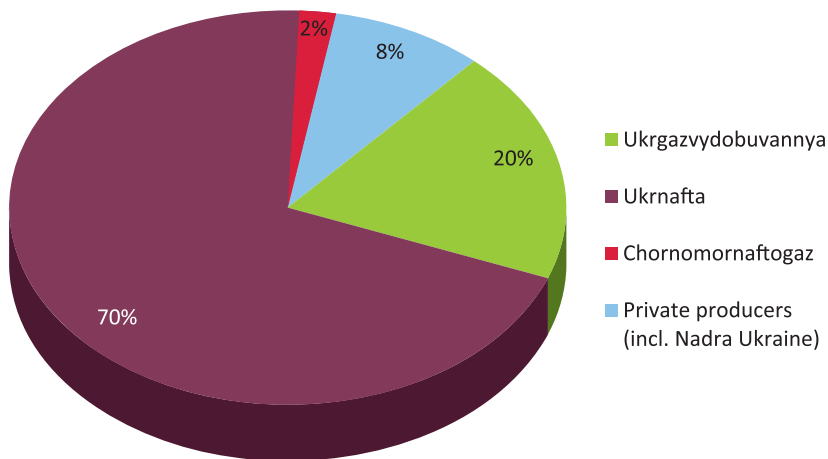


Figure 4: Crude oil production: state and private share.

Source: Ministry of Energy and Coal Industry of Ukraine.

fuel quality standards. As a result, up to 15 percent of the Ukrainian fuel market consists of counterfeit products, on which VAT and excise and other taxes are not paid. This leads to serious annual losses for the State Budget, distorts competition on the market, and discourages Euro-quality fuel producers and importers.

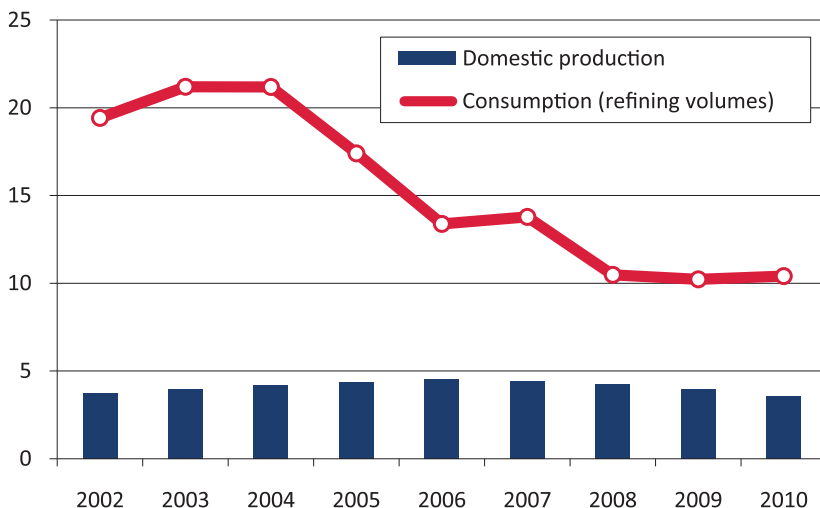


Figure 5: Crude domestic production and oil refining volumes, mln tons.

Source: Ministry of Energy and Coal Industry of Ukraine.

Finally, the government of Ukraine again prolonged old motor fuel standards (corresponding to Euro-0–Euro-3 standards) and deferred introduction of the new Euro-4 standard. This move not only discourages any further modernization of local refineries, but also discriminates against and makes uncompetitive those international oil and gas majors that have already invested hundreds of millions of dollars in production of European-quality motor fuel in Ukraine.

3.3. Renewable Energy

Alternative energy in Ukraine is seen as a high priority due to the need to increase the country’s energy security and decrease dependence on traditional fuels. In 2010 this sector became one of the National Projects of Ukraine.

In April-May 2009 two laws concerning renewable energy sources were approved that significantly increased investor interest in the sector. Both laws still require introduction of important amendments in order to establish transparent functioning mechanisms.

On the positive side, the increase in gas prices for housing and communal sectors, and for the population from August 2010 and April 2011, has already resulted in enhancement of the economical indexes for alternative energy projects.

Issues related to the country’s energy balance are always very complicated. A comprehensive approach is required, which first of all has to do with the country’s energy efficiency policies. Given net losses in Ukraine in both the electricity and heating networks, investments in expensive renewable energy are often questioned by experts. While more and more projects appear to be bankable and attractive to investors, the lack of a functioning and transparent legal framework causes high country risk, whereas there exist more attractive markets for business. Ukraine needs a new, balanced Energy Strategy that will support the development of a renewable energy sector in line with energy-saving policies.

3.4. Electricity Sector of Ukraine

The Ukrainian energy sector infrastructure is extremely (up to 65 to 85 percent) depreciated. Lack of investment in the network’s development has made the energy sector unreliable, which leads to a low quality of supplied electricity and low customer satisfaction. Another huge problem is that distribution companies’ (DistCos) networks remain designed for a certain number of customers and cannot meet constantly increasing demand for new capacities. DistCos thus become a bottleneck for new business development.

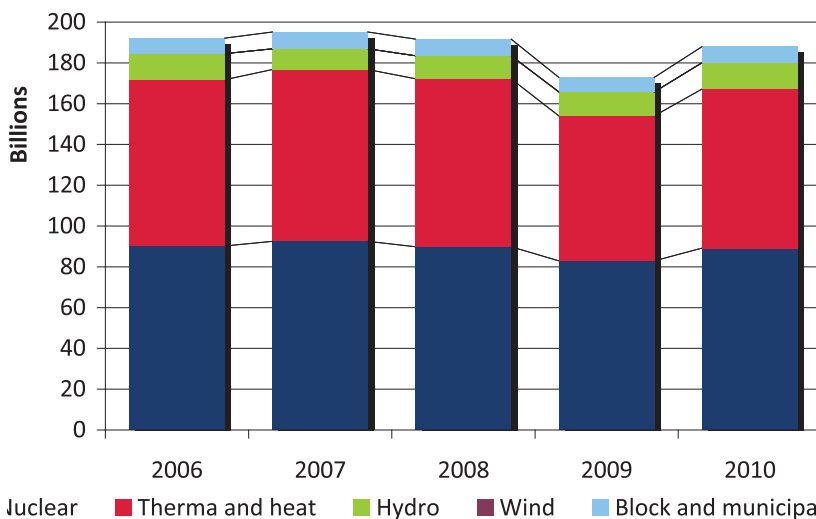


Figure 6: Electricity production in Ukraine by energy source, bln kWh.

Source: Ministry of Energy and Coal Industry of Ukraine.

An effective tool for channeling investments into modernization of aging networks is to implement incentive regulation directed at (i) stimulation of sustainable investments, (ii) improvement of the quality of supply and (iii) constant improvements in the efficiency of DistCos operations. Stimulating or incentive tariff methodology is a universally recognized etalon of tariff regulation for the DistCos. Introduction of incentive regulation in the Ukrainian energy distribution sector involves a number of benefits:

- promotion of capital investments in network development;
- stimulation of metallurgy, engineering, and construction sector development, as more than 90 percent of DistCos construction materials suppliers are Ukrainian-based;
- a significant increase in DistCos availability to meet constantly growing demand for capacity, leading to industrial and small business development;
- job creation and higher employment, leading to an increase in public welfare;
- increase in tax revenues to the state budget; and other benefits.

Retail tariffs for households are currently not set according to the total cost recovery principle, but rather are set below the total cost of services. During 2006–2010 Ukrainian household tariffs remained fixed. The household tariffs approved back in 2006 covered 60 percent of the economically substantiated level (the cost of energy production and supply). As of January 1st, 2011 the refunding level had reached the threshold level — 24 percent of the economically substantiated level. EU member-countries and post-Soviet countries have an average household electricity tariff that is around five to six times higher than the Ukrainian tariff.

The 10 percent growth in actual consumption by Ukrainian households in 2008–2009 (when the country was struck by the financial crisis) confirms that current household retail tariffs are economically unsubstantiated and that there is a lack of incentives for households to practice energy efficiency. Such price distortion gives rise to huge cross-subsidies in the energy sector.

The only way to eliminate cross-subsidies is to raise household tariffs to an economically justified level. Residential tariffs should be increased by at least three times. The increases in household electricity tariffs as of February 1st, 2011 and April 1st, 2011 failed to have any substantial impact on covering the economically substantiated level, as the refunding level increased to only 27–30 percent. Raising residential tariffs up to the point where they are economically justified will:

- eliminate conditions under which the financial burden is shifted to industry and DistCos;
- improve the system of targeted assistance to low-income people;
- create a strong incentive for energy efficiency on the part of residential customers.

The current system of cross-subsidies makes pricing in the energy sector non-transparent and unpredictable. It is also a strong constraint on electricity market restructuring, on the creation of bilateral agreements, on the creation of a balanced market, and on implementation of new incentive tariff methodology.

The energy sector should be at least two years ahead of other industries in development to fully meet consumption (capacity) needs. At the same time, to improve the process of adding new connections to the grid, regulations on connection rules and connection fee methodology need to be adopted.

The Ukrainian government recognizes the problems in the energy sector. The President's official program of economic reforms for 2010–2014 provides for solving them. Unfortunately, the declared reform plan has been delayed, which is leading the sector into a dead end. Sustainable investment and reform will bring the sector to a new stage and foster energy independence, efficiency, and conservation.

4. INFORMATION AND COMMUNICATION TECHNOLOGIES

Information technology is an effective means of solving many social problems. It qualitatively determines new stages of economic, political, and socio-cultural activity. Moreover, the information and communication technology (ICT) sector offers huge opportunities for growth and investment.

The IT industry has been developing the most rapidly of all the areas of our social and economic life during the last 20 years. Ukraine has already become a fast-growing and recognized location for the IT outsourcing industry. Taking into account the importance and prospects for the development of this sector, the American Chamber of Commerce in Ukraine (Chamber) IT Committee aims to enhance Ukraine's investment attractiveness in the regulatory and tax areas.

Ukraine has one of the highest growing Internet user communities in the region. The number of Internet users grew 76 times during 2000–2011. However, Ukraine remains one of those countries with the lowest levels of Internet penetration, with only 34 percent of population using the Internet. Ukrainian Internet users are very active in social networking in comparison to users in other nations in the region, which makes it possible to effectively use modern ICT in market related and e-government activities.

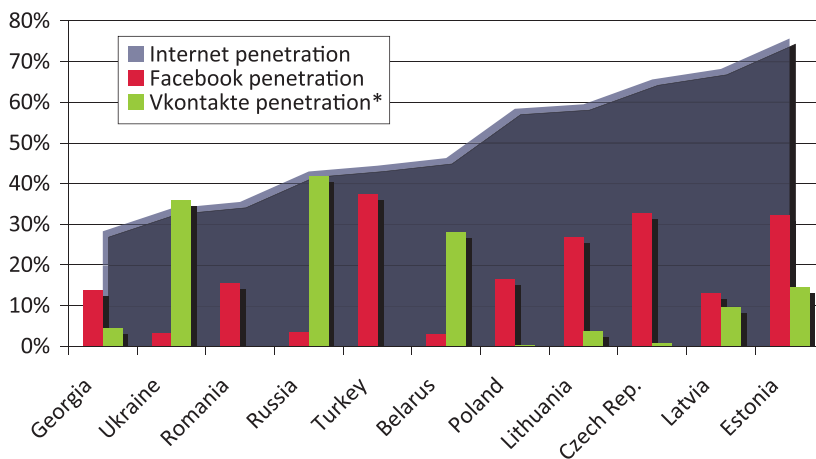


Figure 1: Internet and major social networks penetration in selected countries as of Q2 2011, % of population.

* as of March 15th, 2011.

Source: *Internet World Stats*,
A. Brunov's Blog

The Chamber is continuing to work on the further development of the Ukrainian ICT sector, which will provide a basis for socio-economic transformation, develop a functioning market economy, strengthen civil society, and promote the democratization of the Ukrainian state.

The Chamber monitors structural changes in this area on a regular basis. Over the first half of 2011 a number of positive developments in the ICT sphere took place.

Parliament, for example, in June 2011 adopted amendments to the Law of Ukraine “On Personal Data Protection” in order to strengthen responsibility for breaking the law. It does the following:

- Enhances conditions for the effective protection of personal data, and provides for the European concept of human rights and freedoms, by improving the balance between human rights, society, and the state in this area;
- Promotes information resource development, the strengthening of private ownership of information products, the provision of information sovereignty, economic prosperity, and national security;

- Enhances the ability to combat computer crime;
- Provides for the further development of the information society.

The Chamber is devoting special attention to this law and aims to achieve a balance between the rights of individuals and the interests of business.

The responsible governmental authorities are preparing draft laws that will significantly reduce the tax burden on companies in ICT. The Chamber is monitoring new legislative initiatives in this sphere and is continuing its ongoing dialogue with the Ukrainian government and business, with the aim of developing the most favorable tax regime for IT businesses.

It is very important for Ukraine to develop the ICT sector in line with global tendencies. The Chamber pays significant attention to developments in the EU ICT sector. The main concepts of the new Digital Agenda initiative of the EU, the i2010 strategy's successor, have to be implemented in Ukraine.

An essential role in ICT development in Ukraine will be played by e-government — a form of government in which there is active interaction between the state and local authorities, as well as with the information society, people, and businesses via information and communication technologies. This technology substantially increases the efficiency of government functions and can drastically decrease the midlevel corruption that is responsible for administrative burdens and excess transaction costs.

E-government is already functioning in all neighboring countries, providing much more comprehensive services to its users. Ukraine seems to lag behind in this process, which adversely affects its competitiveness. Taking into consideration the importance of establishing e-government, the Chamber is helping elaborate the Draft Concept of E-government in Ukraine for the period till 2015. The existing Committee on e-government within the FDIC under the President of Ukraine, on which the Chamber plays an active role, is also involved in this work.

Currently Ukraine is making significant progress in establishing an e-government system. Strong political will for moving in this direction has been expressed by top state officials. As the Head of the State Committee on Science, Innovation, and Information reported in August 2011, the Ukrainian government will switch to using electronic documents in January 2012.

Considering all of the above, it is worth mentioning that ICT development in Ukraine will, first of all, contribute to Ukraine's European integration. ICT can also strengthen state information security, improve Ukraine's information environment, and avert the information wars and special operations that occur in other countries. The future of Ukraine depends on its ability to develop and implement public information policy, but this is impossible due to its lagging behind other countries in terms of technology and regulation.

The IT Committee, along with the Chamber's Telecom Committee, has become a collaboration platform for ICT businesses on both technical and business matters. The American Chamber of Commerce, having drawn on the experience of numerous experts and partners from the Public Council on ICT, has thus developed a comprehensive action plan for ICT development in Ukraine.

The 2011–2012 version of the “Partnership for Successfully Competing in the Global Economy” contains a special section entitled “The Role of ICT in National Competitiveness” that digs deeper into this subject and puts forward 10 concrete recommendations on how Ukraine can move forward in this regard.

5. REAL ESTATE AND CONSTRUCTION DEVELOPMENT

The real estate and construction industry suffered the most during the recent economic crisis. The decline in construction works began in August 2008 and continued till the beginning of 2011. Construction works in Ukraine in 2008 were only 84.2 percent of what they were the previous year; in 2009 and 2010, meanwhile, this indicator was 51.8 and 94.6, respectively. Currently, in 2011, we can affirm the beginning of sector recovery; but even though the construction works index in June 2011 was 114.5 percent of what it was in the same period in 2010, it accounted for only 41.8 percent of the value of construction works in June 2008 (See Figure 1).

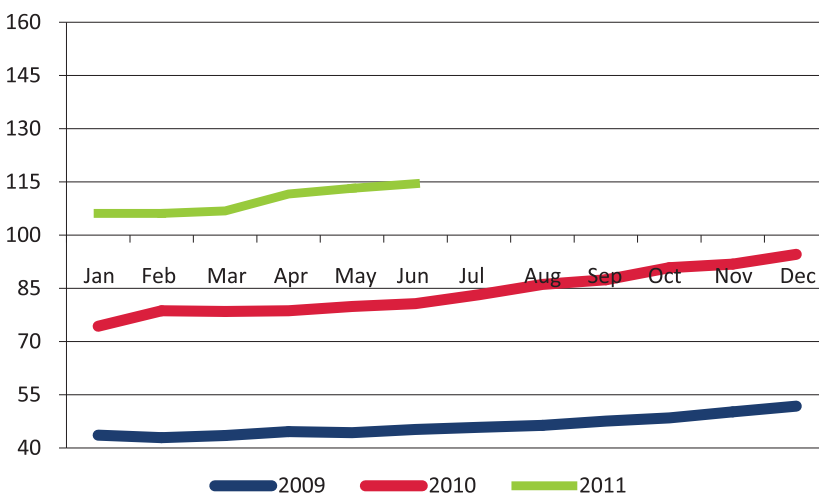


Figure 1: Construction works index in Ukraine compared to the same period of the previous year, %.

Source: State Statistics Committee of Ukraine

Improvements in real estate and construction legislation are a critical driver for Ukraine’s economy, as most significant investments are related to real estate and construction. Without major improvements in these areas Ukraine will not be able to attract significant investment. The major change needed is a free and open market for land ownership.

Following the protracted financial crisis, the Ukrainian government undertook the simplification and even total elimination of the bureaucratic procedures that businesses face in the real estate and construction field. In conjunction with Ukrainian business associations and legal experts, the Ukrainian government and Parliament took drastic remedies, adopting sweeping changes to minimize the number of permissions that need to be obtained and the permit issuance procedures that need to be passed in this sphere.

Among the most significant events was the Law of Ukraine “On Regulation of City Construction (Reduction of Permission Procedures in Construction),” which came into force on March 12th, 2011. The law provides for the substantial simplification of permitting procedures in construction. In particular, it reduces the terms for the issuance of construction permits; replaces permit issuance procedures with notifications or with registration of declarations to commence construction work and provides for registration of declarations for commissioning certain types of construction objects; and introduces the principle of implicit consent to regulatory procedures in construction, whereby the failure of any authority to respond to a submission within an established certain term amounts to a positive decision/approval. Still, Ukrainian legal experts are rather afraid that the rule of implicit consent will not work in practice in the nearest future. Particularly, developers may face difficulties in putting objects into operation because of imperfect bylaws, which do not envisage implicit consent at the stage of commencement of construction works. Moreover, Ukrainian legislation implemented the rule of implicit consent long ago in the Law of Ukraine “On the Permitting System for Doing Business” dated September 6th, 2005. But no facilitation has been remarked in this respect in recent years.

From now on, the construction procedure will differ depending on the category of the construction object (the categories are numbered I-V). Development of objects of the I-III categories (objects that are not sophisticated from a technical and engineering standpoint) will no longer require a permission for construction work or a commissioning certificate. On the one hand, the simplified procedure will significantly speed up the construction process and make it substantially cheaper. On the other hand, however, certain experts say the existing wording of the Law of Ukraine “On Regulation of City Construction” does not provide for effective state control over building compliance with state construction norms and regulations. This may jeopardize the safety and security of objects in the I-III categories of complexity. Furthermore, the Law provides no effective mechanisms for controlling, in the design stage, whether built objects are eligible for inclusion in categories I-III.

One more significant peculiarity of the Law concerns the use of land plots for construction purposes. Beginning on January 1st, 2012, land plots will be allocated for construction activity only provided that there is supporting town-planning documentation (zoning). Moreover, a change in the designation of a particular land plot will not be allowed if it contradicts this documentation. This approach is expected to create uniform equal treatment for all investors in land allocation as well as other approval procedures that will help to considerably reduce corrupt practices in the field. It should be stressed that respective town-planning documentation (zoning) should be elaborated and voted by each particular municipal council, which in its turn may create certain time delays in practice. Herein we cannot but hope that respective municipal councils will react in a timely manner to get the town-planning documentation (zoning) adopted prior to January 1st, 2012. Otherwise, the land market may encounter temporary stagnation.



In addition to the Law “On Regulation of City Construction,” there is the significantly amended Law of Ukraine “On Land Lease,” which treats renewal of land lease agreements for public lands. In particular, silent inaction on the part of state and municipal authorities in response to a lessee’s application to renew a land lease agreement will be considered silent consent, leading to automatic lease renewal for the same lease term. This legislative novelty is meant to put an end to the numerous court disputes between lessees and the state and municipal authorities, challenging the inaction on the part of the latter that has in the past been a problem. For now, however, this legislative provision still does not work in practice. Lessees are thus coerced into applying for the execution of supplementary lease agreements via judicial proceedings. At the same time, we may not exclude the risk that such a legislative novelty will not be implemented in practice in the future due to reluctance on the part of the municipal authorities. Thus, pursuant to the Law of Ukraine “On Land Lease” the supplementary renewal agreement should be signed by the authorized representative of the lessor elected by vote. Hence, it is not

ruled out that the municipal authorities will not vest their representative with powers for the automatic renewal of lease agreements.

One more progressive novelty was introduced in the amended Law of Ukraine “On Land Lease” in respect of pre-emptive developer rights to the land plot underneath a constructed object. Particularly, pursuant to the recent amendments of the Law “On Land Lease,” upon setting an object into operation the bona fide lessee of the land plot given for construction purposes has the pre-emptive right to obtain the land plot in lease for the next 50 years.

The American Chamber of Commerce (Chamber) Real Estate Committee Leadership, Chamber Real Estate Experts, and Chamber Policy Team have been actively involved in the development of this document and have participated in numerous meetings of the Working Group under the Cabinet of Ministers of Ukraine.

The Law of Ukraine “On the State Land Cadaster,” signed in the beginning of August 2011 by the President of Ukraine, seems to be quite progressive, although it does not mention in what way the state land cadaster will be formed and how the information gaps in the existing state land register will be filled in.

The State Agency for Land Resources of Ukraine is planning to launch online access to the automated land cadaster system starting on January 1st, 2013. It is anticipated that it may contain 1–1.5 meter errors for some land plots, although state officials report that they will be corrected by 2020.

Land market players and all of Ukrainian society are anticipating the adoption of the Law of Ukraine “On the Land Market,” which will establish a starting point and preconditions for the abolition of the moratorium on alienation of agricultural land plots. A draft law has already been elaborated and adopted in the first hearing. The most recent wording of the Draft Law “On the Land Market” contains certain unpleasant elements that may lead to speculation and create a non-transparent land market. In particular, it states that agricultural land plots for commercial farming may be acquired exclusively by:

- Individuals-residents of Ukraine who have received a farming education or worked in farming;
- The state of Ukraine, as represented by specialized state organizations or municipal councils.

The draft law forbids legal entities irrespective of their residency, as well as individuals-non-residents, from acquiring agricultural land plots for commercial farming.

We believe this draft law should be significantly amended, since only a transparent and accessible land market can attract considerable investment, especially foreign investment.

There has been progress in terms of legislation during 2011, but not in terms of practice. There exists the same practical problem that affects new construction legislation. While the legislative norms look better, the bureaucrats managing the processes, who are the actual barriers in the sector, have not changed. The government needs to focus on providing instructions/clarifications and processing changes to ensure that legislation gets properly implemented.

Recovery in the sector will depend on the political situation. The commercial and residential property sectors remain chronically and structurally undersupplied in the biggest cities of Ukraine, and the quality of the existing stock is generally poor. This leaves the market a big window of opportunity for developing almost any kind of real estate, as the majority of negative factors are legislative and political, rather than based on poor market fundamentals. Most experts agree that real sector growth should be expected in the medium- and long-terms. The American Chamber of Commerce in Ukraine is committed to helping Ukraine take the necessary actions to boost real estate sector development.

6. RETAIL TRADE

6.1. Macroeconomic Situation

The Ukrainian economy is still recovering after the crisis, which impacted retail sales volumes. During the first half of 2011 retail turnover in comparative prices was more than 15 percent higher than in the same period of 2010. The same indicator for the first half 2010 in comparison to 2009 was just above 2 percent. One of the main drivers has been growth of income: in the first half of 2011 real wages rose by 8.1 in percentage y-o-y. There has, however, been a slow increase in consumer lending by commercial banks, despite positive development on the part of domestic industries. The main constraint has been inflation (ca. 10 percent in 2009–2010), including an increase in utility and food product prices, which reduces the purchasing power of consumers.

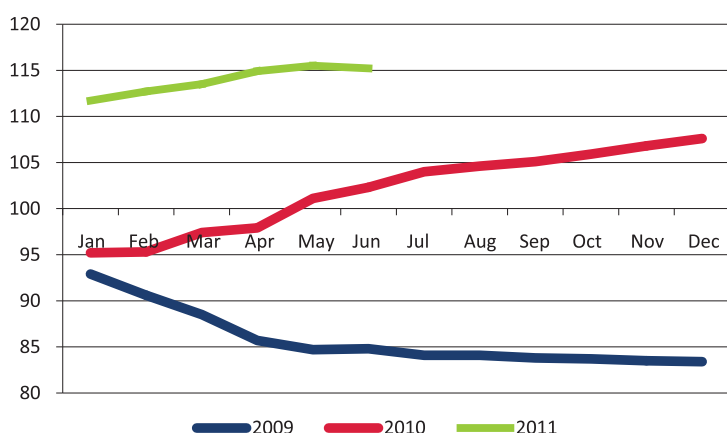


Figure 1: Retail turnover index in Ukraine compared to the same period of the previous year, %.

Source: State Statistics Service of Ukraine

Ukrainians spend more than half their incomes on food products. Before the crisis they were more inclined to spend money; since the crisis, consumers have become more rational and willing to save. They have reduced their visits to shops and started spending more money per visit, likely due to inflation. This phenomenon could be temporary. According to the GfK Consumer Confidence Index, in summer 2011 the successive renovation of optimism in consumer confidence that started in April continued. It increased from 61.8 in March to 76.1 in June and slightly dropped back to 73.6 in July. This growth was mainly the result of better expectations regarding changes in the current situation while economic expectations decreased. The growth was ensured more by the western regions of Ukraine and mostly by villages in Ukraine overall. The Indexes of Current Personal Financial Standing and Propensity to Consume both increased in June, by 8.2 and 6.1 p.p. respectively, with minor deterioration in July.

As expected, the crisis also influenced buyers' decisions. According to the World Economic Forum's survey, the buyer sophistication index, answering the question of how buyers make purchasing decisions — based solely on the lowest price or based on a sophisticated analysis of performance attributes — dropped significantly in 2010 in comparison to 2009. Although Ukraine took 81st place among 131 countries in 2010, which is the same place it occupied in 2008 (on comparable lists), this drop was deeper in comparison those of other countries. In other words, Ukrainians became much more driven by price factors in 2009–2010 than in 2008, even taking into account the global consumption slowdown. The same indicator for 2011, when Ukraine dropped to 85th place, shows that the budget constraints of Ukrainian customers became higher and that they can spend even less.

6.2. Retailers

The retail market in Ukraine is not excessively concentrated. Actually, the top five retailers by volume have a market share of about 25 percent of the total market. Among them

are Fozzy Group, Metro Cash & Carry, ATB-Market, Furshet, and Kviza Trade. Among foreign retailers, Metro Group, Auchan, Billa, and Spar, via franchises, are represented. Non-transparent procedures for acquiring land and construction approvals are the main constraints on developing the retail business in Ukraine.

Over the last year retailers have been reviewing their assortment/pricing and optimizing their processes. Non-rentable products were reduced in the assortment, increasing the share of low- and mid-price level products and domestic products. Introduction of new private label products was also observed; their share in retail companies' turnover is still very low (below 8 percent) compared to their share in European countries, but it is constantly increasing.

Retail chains have also been optimizing their logistics expenses by creating their own logistics schemes or outsourcing. For example, Eurotek set in operation its own logistics chain, which provides 50 percent of all its deliveries. PAKKO Holding Ltd. was set to increase its goods turnover by 40 percent by introducing its own distribution centers. ATB chain considers its own logistics as an integral component of its discount trade format. Finally, other retailers, such as METRO Cash & Carry Ukraine, cooperate with professional logistics companies.

In terms of store formats, supermarkets are the most popular in almost all regions of Ukraine. Hypermarkets are in second place and will increase their share in the future because of their lower prices and wider assortment. The only constraint is the low level of car ownership per capita in Ukraine in comparison to European countries. As consumers became more price-oriented post-crisis, the popularity of discounters increased. For example, one of the top five retailers, ATB Market, used the crisis period to expand; it has the highest number of store openings among its competitors.

Some experts predict that a multifunctional retail format where consumers can buy not only food and non-food products, but also spend leisure time with their families, will become more popular in the future.

With the growth in the number of Internet users, the popularity of online shopping is increasing too. According to the Gemius company survey, the share of people who purchased something online in April 2011 reached 52 percent of Internet users in Ukraine. Products bought online are primarily non-food products such as laptops, mobile phones, cameras, etc. However, young people in Ukraine use the Internet less than young people in Poland do in their everyday lives; their level of Internet usage is almost the same as it is in Russia.

6.3. Future Trends

The future development of the retail industry will highly depend on the overall economic situation in the country and consumer confidence. The main factors of influence will be the existing debt burden of enterprises, continued meager lending by commercial banks, and slowly increasing rental rates for retail space.

Supermarkets will continue to hold the leading positions in all regions of Ukraine. The main reason is that Ukrainians prefer to buy in food shops that are located not far from their homes or places of work. There are no restrictions on operating hours, the majority of food shops in big cities being open on weekends.

Hypermarkets, due to their low prices and wide assortment, will be more popular in big cities with populations over 700 thousand. The low level of car ownership per capita in Ukraine in comparison to European countries will remain a constraint. The popularity of discounters and hypermarket discounters will also increase. In the future, retail chains will continue their regional expansion.

Assorted other changes will include a rising share of domestic goods and private labels and a declining share of imported goods as a result of unstable foreign exchange rates. And in the long term, the anticipated influence of the Free Trade Agreement with the EU can influence the increase of imports, balancing the effect of an unstable economic environment.

7. TELECOMMUNICATIONS AND DATA TRANSMISSION

Telecommunications and data transmission capabilities are an essential element of Ukraine's infrastructure, enabling business to be successful. The social and economic value of data transmission and of the continuous flow of information cannot be overestimated. Telecoms increase the efficiency and productivity of every sector of the economy and spread the benefits of improved communications beyond the country's capital to rural areas and small towns. The industry plays a significant role in Ukraine's economy, contributing 5.9 percent to Ukraine's GDP and employing more than 270,000 people.

The highly competitive Ukrainian mobile market of several years ago has reached its saturation penetration level of about 117 percent and is characterized by what is probably the lowest average monthly revenue per subscriber (ARPU) in the European region — about 40 USD. According to the International Telecommunication Union, the number of subscriptions per 100 inhabitants reached 119 back in 2007, which is around the average value of EU countries. It can be also noted that some countries of the region, such as Georgia, Belarus, and especially Russia, still have dynamically growing markets.

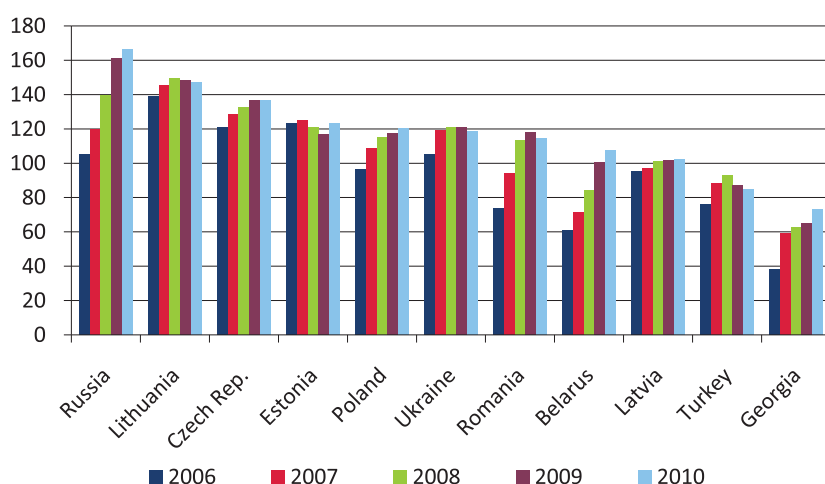


Figure 1: Mobile cellular subscriptions per 100 inhabitants in selected countries.

Source: International Telecommunication Union.

Once the mobile segment is saturated, broadband Internet is projected to make a rapid take-off, with the main growth coming from home users with a dominant >90 percent share. Analysts forecast that broadband services will grow at an average yearly rate of more than 40 percent over the next five years. The number of broadband connections exceeded 3 million at the end of 2010, including mobile, nomadic, wireless, and wire line. Technologies are various and include ADSL, WiMax, WCDMA, UMTS, and WiFi. The B2B communications segment of the data transmission market is showing slow recovery because of regulatory limitations and barriers and lower demand after the crisis. M&A and optimization of existing assets represent major trends.

Compared with the other countries of the region, Ukraine has one of the lowest numbers of fixed broadband subscriptions per 100 inhabitants in the Europe, three times lower than the average in the EU. Although this indicator grew twofold during 2009–2010, it remains lower than in any analyzed neighboring country, with the lowest average growth rate over the last five years. The highest market growth dynamics was observed in Belarus, where the number of fixed broadband subscriptions grew by on average 1.2 times annually over 2008–2010.

The main directions for boosting mobile operator revenues are high-speed mobile data and video, active development of new types of content-oriented services for the mass

market, mobile advertising, programs, e-education, telemedicine, electronic commerce, implementation of M2M (machine-to-machine) applications such as telemetry, collection of meter utilities, remote monitoring and management of transportation, and various engineering systems. Mobile broadband is the main driving force behind further development of UMTS and CDMA.

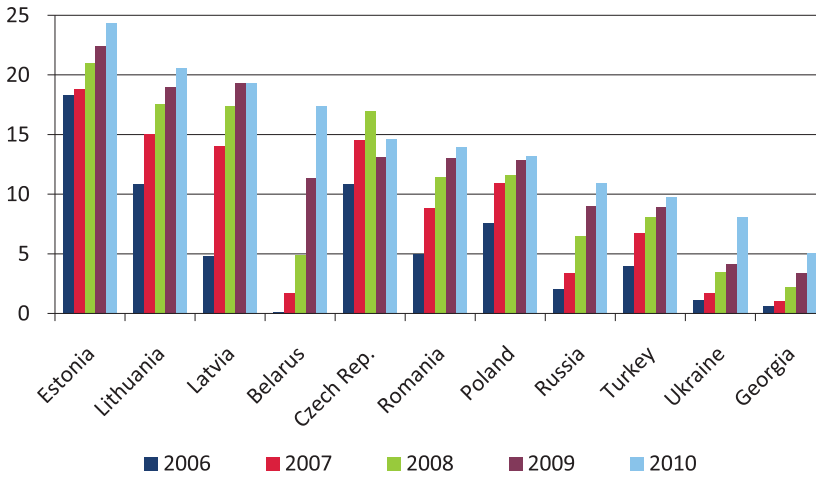


Figure 2: Fixed broadband subscriptions per 100 inhabitants in selected countries.

Source: International Telecommunication Union.

Ukraine enjoys healthy competition in the 2G market. KyivStar is the leader in market share, with MTS and Astelit as its key competitors. Ukrtelecom’s ineffective strategy of introducing 3G technology is leading other operators to search for new services, skipping third generation technologies and moving to the LTE standard. 2.5G mobile operators (GSM GPRS/EDGE) also expect a tariff increase in connection with the increase in users of mobile data services. The development of the mobile broadband market trend will increase the number of active users of leading high-speed data transmission services too.

Despite the dynamic growth of the industry, Ukraine’s telecom infrastructure development is lagging behind that of its European counterparts due to inadequate investment in network development. Ukrainian telecommunications legislation is insufficient and fails to address a number of issues that are normally managed in most Western jurisdictions.

Ukrtelecom privatization, which ended in March 2011, can also seriously affect the future development of the telecom market. It is expected that the new owners of Ukrtelecom will soon make public their new strategy for this major operator. For instance, the company’s management informed its shareholders meeting in June 2011 of its intent to sell its 3G network, which will provide a whole new range of products to existing 2G network operators.

The growing market demand for highly advanced applications and platforms that support the provision of television and content-oriented services such as IPTV/CDN should be mentioned. Telecom operators are seeking to enter the market and are selling television advanced technologies that support the transmission of television programs in broadcast mode and the transmission of individual programs, movies on demand to individual users, and video on demand. Many traditional telecom operators consider IP-TV (content delivery) to be a promising segment and plan significant investment in it.

There are still some important issues to be resolved in order to secure the ongoing development of the telecom market in Ukraine.

The main issues and necessary steps for the further development of this sphere are the following:

- technological neutrality for existing frequency licenses;
- additional 3G/4G license provision;
- mobile payments;

- increased requirements for telecom service quality levels;
- unified rules for environmental infrastructure access for providers and telecommunications operators.

The Ukrainian government has to efficiently implement already adopted legislation. The Verkhovna Rada of Ukraine adopted in 2010 the Law #2751-VI “On Amendments to the Law ‘On Telecommunications,’” which came into force at the beginning of 2011. It introduced phone number transfer services and terms and regulations for telecom operators with significant market powers. However, there is an unnecessary delay in the adoption of the corresponding bylaws needed to implement the new legislation. The American Chamber of Commerce in Ukraine has followed the entire process of the new legislation’s development beginning at the stage of the draft law’s development and will continue to follow it through the legislation’s actual implementation.

The American Chamber of Commerce in Ukraine Telecom Committee will continue its ongoing dialogue with the governmental authorities responsible for regulating the telecommunication sphere in order to contribute to the development of the telecom market in Ukraine.

The 2011–2012 version of the “Partnership for Successfully Competing in the Global Economy” contains a special section entitled “The Role of ICT in National Competitiveness,” which digs deeper into this subject and puts forward 10 concrete recommendations on how Ukraine can move forward in this regard.



8. TRAVEL AND TOURISM

In 2010 Ukraine experienced increases in internal tourist flow and in incoming tourism. In 2010 Ukraine was visited by 21.1 million foreign tourists: 2 percent or 381.2 thousand more than in 2009.

Table 1. Rating of 10 major countries for incoming tourism in 2010.

		Persons	Share, %	2010/2009
1	Russia	7 881 321	37	+13%
2	Moldova	4 057 678	19	-6%
3	Belarus	3 056 157	14	+2%
4	Poland	2 085 245	10	-18%
5	Hungary	941 240	5	+16%
6	Romania	909 553	4	-15%
7	Slovakia	609 279	3	+13%
8	Germany	225 356	1	+6%
9	USA	122 955	0,6	+2%
10	Uzbekistan	104 719	0,4	+9%
Total of 10 countries		19 993 503	94	

Source: State Service of Tourism and Resorts of Ukraine

The outgoing tourist flow of 2010 amounted to 17.2 million persons, which was 12 percent or 1.8 million persons more than in 2009.

Table 2. Rating of 10 major countries for outgoing tourism in 2010:

		Persons	Share, %	2010/2009
1	Russia	5 233 972	30	+5%
2	Poland	3 999 602	23	+35%
3	Moldova	1 889 724	11	-5%
4	Hungary	1 789 308	10	+12%
5	Belarus	1 135 094	7	+9%
6	Romania	503 195	3	-8%
7	Turkey	459 061	3	+4%
8	Slovakia	383 961	2	+2%
9	Germany	383 325	2	in 2 times
10	Egypt	328 623	2	+39%
Total of 10 countries		16 105 865	93	

Source: State Service of Tourism and Resorts of Ukraine

Thus, during the first six months of 2010, entities in the tourism sector provided services in the amount of 3.4 bln UAH, which is 21 percent more than they provided in the same period of the previous year. They provided revenues to the state budget of 100.5 mln UAH, which is 17 percent more than during the first six months of the previous year.

As estimated by representatives of the State Service of Tourism and Resorts of Ukraine, the market for tourist services in the country has today seen a recovery from the fall that came after the world economic crisis.

Nevertheless, there are certain problems in Ukraine that pose a significant deterrent to economic growth in the tourist sphere. The lack of regular and substantial funding pre-

vents Ukraine from achieving competitive positions in the world tourist market. Sector development is financed both by private investors and by state allocations.

State tourism sector development programs envision that the government will provide only 20 percent of the needed investment; the rest is expected to come from private investors. However, private businesses do not seem to be eager to invest in the Ukrainian tourism sector. There is widespread agreement among experts that a lack of political stability and poor or unenforced legislation, especially in the areas of taxation, land, construction, customs, and permit issuance are the key factors restraining private investors from investing. Yet many investors recognize the potential of Ukrainian tourism and would be interested in launching projects in this country if the legislation became more transparent and the political situation grew more stable.

In this regard it is worth mentioning that Ukraine's tourist industry has huge investment potential. The country has a rich historical and cultural legacy, diverse natural conditions for recreation, a favorable geographical location, a large number of recreational facilities, a market economy, aspirations for European integration, and substantial land resources that could be used by investors for developing the tourism infrastructure.

Obviously, to create incentives for investors and attract them to the Ukrainian tourism sector, it is necessary to create an enabling business environment overall and in the sector specifically. The government took some steps toward that in 2008 when the Cabinet of Ministers approved the "Tourism and Resorts Development Strategy," aimed at improving the investment climate in tourism. However, most state officials in charge of the tourism sector regulation admitted that there have been problems with the proper enforcement of this strategy, which undermines the achievement of its goals. In addition, the Draft Law "On Measures of State Support for Development of the Tourism Industry in Ukraine to Ensure Preparation for the EURO 2012 Football Championship," which is meant to remedy the situation in the sector, has yet to be adopted.

Further development of the travel and tourism sector and the enhancing of its competitiveness depend on reforming its legal and regulatory environment to create a business climate that is attractive for investment. In addition, several more steps are critical for growth in Ukrainian tourism:

- Improving the country's infrastructure;
- Ensuring that the level of tourist services in Ukraine corresponds to international standards;
- Developing new or enhanced diversified tourism products and destinations;
- Cultivating a skilled, educated, and motivated workforce with knowledge of English and other widely spoken languages;
- Building the country's brand and marketing it regionally, nationally, and internationally; and
- Establishing a well-functioning network of information centers for visitors to ensure exchange and dissemination of complete and reliable information about Ukraine's tourism assets.

Without these reforms, significant development of the tourism sector in Ukraine is very unlikely.

Another important step for sector competitiveness development is improving the taxation of travel services. At present the elaboration of proposals and amendments to the Tax Code of Ukraine is the main objective and agenda of the American Chamber of Commerce in Ukraine Travel and Tourism Committee.

Tourism development in Ukraine means creating a favorable organizational, legal, and economic environment for the development of this industry, and the development and marketing of domestic tourist services, which are competitive regionally and internationally. All this can be accomplished using the natural, historic, and cultural potential of Ukraine, even while protecting Ukraine's social and economic interests, historic sites, and environmental security.

2

POLICY INSIGHTS



1. CUSTOMS POLICY

As reported by the State Customs Service of Ukraine, Ukrainian customs bodies transferred almost 10.8 bln USD of revenues to the State Budget of Ukraine in total, representing 35 percent of state income of 2010. VAT revenues account for a lion's share of these revenues. The weighted mean of the applied tariff rate for all products in 2010 was 2.78 percent in Ukraine and 1.44 percent in the EU. The relevant data of 2009 demonstrate, as shown in Figure 1, that Ukrainian tariffs can be considered as average in the region.

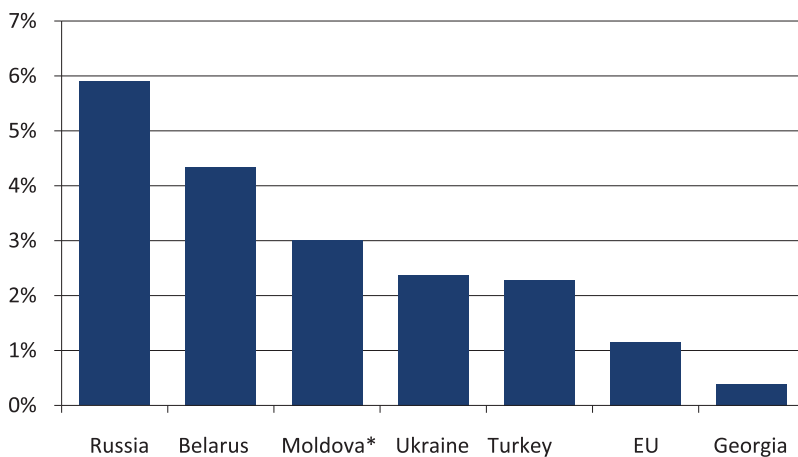


Figure 1: Applied tariff rate for all products, calculated as a weighted mean for selected countries in 2009.

* data available for 2008.

Source: World Bank DataBank

Unfortunately, as far as simplicity, transparency, and speed of customs formalities and transit procedures, Ukraine is far from occupying leading positions. The 2010 World Bank report “Ukraine: Research on Trade Facilitation and Transit” suggested that Ukraine finds itself in 102nd place out of 155 countries in the world logistics index, mostly because of opaque and inefficient customs procedures. At the same time, because of the establishment of the Customs Union of Russia, Belarus, and Kazakhstan, Ukraine, with its complex, time-consuming, and murky customs procedures, risks becoming a “black hole” between two economic entities without internal customs and technical trade barriers that cover more than half of the Eurasian continent, i.e. the European Union and the Customs Union.

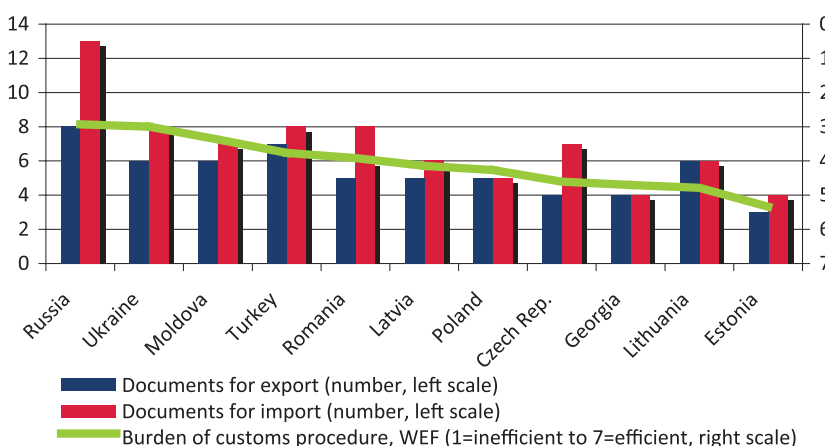


Figure 2: Number of documents and overall burden of customs procedure in 2010.

Source: World Bank DataBank

The Government and the State Customs Service of Ukraine understand that lack of initiative under such circumstances can lead to the ultimate loss of potential trade growth. Thus, the beginning and the first half of 2011 were marked by considerable changes in and discussions about customs policy. These recently initiated changes in customs policy are essential for the further inflow of investments into Ukraine, especially in proximity to two customs unions that stretch from Western Europe to the Far East.

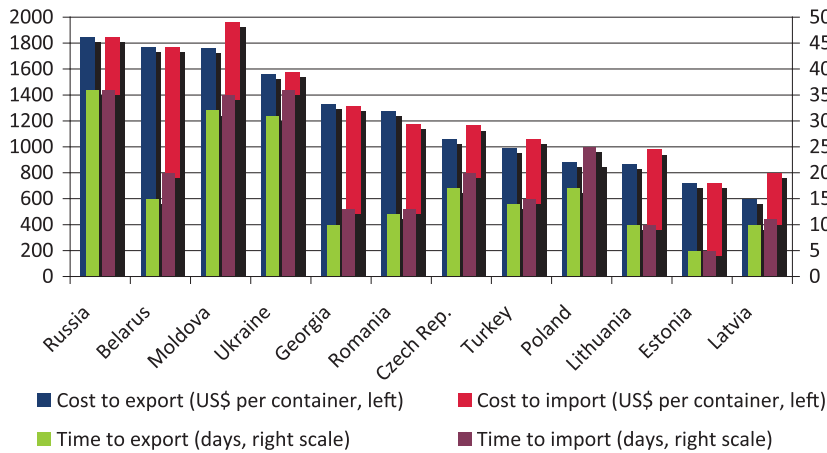


Figure 3: Time and costs related to customs procedures in 2010.

Source: World Bank DataBank

According to the World Economic Forum the customs clearance procedures in Ukraine are rather complicated in comparison with those in Estonia, Georgia, Poland, and the Czech Republic. The number of documents required for submission to the customs authorities of Ukraine for customs clearance is also very large. Figure 2 illustrates the difference between countries according to the documents necessary for import and export, as well as according to the burden of customs procedures.

Figure 3 shows that the goods customs value and time required for customs clearance, both for export and import, are very high, which in turn complicates the customs clearance procedure in Ukraine.

Taking into account these disadvantages, as well as the gaps in the legislation that regulates the customs sphere, the State Customs Service of Ukraine has introduced a concept for reforming the customs service. It is entitled “Facing the People.” According to Customs, the goal of reform is to increase the transit potential of Ukraine and prevent the re-orienting of cargo to neighboring countries, thereby improving the international image of the state. The concept also states there are plans to shift the customs focus towards economic and regulatory and informational components. This represents the biggest and most radical customs reform since Ukraine became independent.

The concept contains 66 basic problems and eight key initiatives that are to be implemented by 2015:

- Optimization and improvement of the structure of the customs authorities;
- Simplification of customs procedures;
- Improvement of customs control checkpoints and promotion of transit;
- Improvement of legislation regulating customs;
- Improvement of the administration of customs duties;
- International activity;
- Electronic customs;
- Development of logistics and infrastructure.

Some of the proposed measures are controversial, namely:

- Giving the authorities more power over operational activities and more powers of prosecution, which has long been a subject of dispute between the public and the customs authorities;
- The proposal to increase fines for breaking customs regulations in connection with the movement of goods outside customs control or concealed from customs control (as

of today, penalties range from 8,500 to 17,000 USD for such violations, with confiscation of the goods and vehicles that were the subject of the offense);

- A legal entity will now be legally liable for violations of customs regulations committed by its employees;
- The introduction of fees for customs procedures performed outside customs authority locations, even when the authority itself orders these customs procedures.

There are also many other areas in which the Customs Service needs to be reformed and which will radically change how attractive Ukraine is for business.

With regard to the above, on May 17th, 2011, the Verkhovna Rada adopted in the first reading the Draft Law of Ukraine #8130-D “On Amending the Customs Code of Ukraine”, as elaborated by the Parliamentary Committee on Finance, Banking, Taxation, and Customs Policy from two previously filed drafts.

The main improvements of the draft are the following:

- Maximum application of direct action norms, thereby eliminating divergences in interpretation of the Code;
- The possibility of free choice of customs clearance location;
- Defined timeframes for customs clearance procedures with the use of the cargo customs declaration;
- The opportunity to change customs declarations after customs clearance;



- Introduction of an electronic customs declaration;
- Extending the maximum periods for temporary import up to three years and for processing up to one year and other major changes to customs procedures;
- Introducing an authorized economic operator and special simplifications for it;
- Reducing the post-entry customs control periods to 20 days.

Amending the Customs Code of Ukraine will bring it in line with the EU Customs legislation and international conventions, as well as with the Framework Security and Trade Facilitation Standards of the World Customs Organization.

The American Chamber of Commerce in Ukraine (Chamber), via its Customs Committee, took an active part in developing the amendments, offering proposals to change certain provisions of the drafts, particularly those that concern post-audit procedures, the e-declaration procedure, amending customs declarations after customs clearance, customs value determination, and other customs procedures. All the proposed amendments will bring customs legislation into compliance with international standards.

In another step forward, at the very beginning of the year the Law of Ukraine “On Amending the Law of Ukraine on the Customs Tariff of Ukraine” was adopted, bringing the commodity coding system of Ukraine into conformity with the Harmonized System version 2007, which is used worldwide. This step will simplify trade procedures, ensuring the compatibility of the European and Ukrainian tariff codes. However, the World Customs Organization has already developed the HS Nomenclature 2012, which will take force on January 1st, 2012. If adopted soon by the EU and by other developed countries, the major changes in the HS Nomenclature 2012 (deletion of 43 subheadings and implementation of new subheadings for specific chemicals and other goods that are increasingly traded), it may lead to new divergences between the codes applied in the Ukrainian Customs Tariff and the tariff codes of other countries.

Both the government and the State Customs Service have been taking certain specific and targeted measures to facilitate customs procedures.

For example, a draft Resolution of the Cabinet of Ministers of Ukraine approves a unified list of goods subject to preliminary documentary control in accordance with the Law of Ukraine “On Amending Certain Statutory Acts in Respect of Performance of Preliminary Documentary Control in Ports of Entry at the Customs Border of Ukraine.” According to these statutory acts, the customs authorities are delegated to perform sanitary, phytosanitary, veterinary, and ecological controls in ports of entry at the customs border only for the goods listed. For goods not approved by this Resolution, such controls will not be performed.

The State Customs Service Order #216 “On Approval of the Terms of Electronic Declaration” dated March 17th, 2011 makes it easier for foreign trade participants to gain access to electronic declaration technologies. In addition, the State Customs Service started a pilot project featuring an electronic declaration covering import, transit, and customs warehouse customs procedures. The Head of the State Customs Service has strongly encouraged that e-declarations be implemented in full by the end of 2011. Some Chamber member companies have been taking part in this pilot project and actively participate in giving proposals to the state authorities regarding possible ways of improving the procedures of e-declaration.

Another example: to set time standards, the State Customs Service passed the Order “On Setting Time Standards and Customs Clearance for Cargo Customs Declaration” (# 1205 dated October 13th, 2010). This Order establishes a standard for completing customs clearance within two hours of the declaration of goods. However, the order also establishes a number of exceptions for certain customs procedures the timing of which is not part of the standard timeframe, namely:

- Performing customs procedures outside the location of the customs authority;
- Carrying out customs inspection of goods;
- Research (analysis, expert evaluation) of samples and models of goods;
- Consideration of requests by specialized units of the customs authority; and
- Provision by the applicant of additional documents for verifying customs value or characteristics of goods that are crucial for classifying them according to the foreign trade nomenclature.

The “Facing the People” concept does not cover the issue of customs value, which in 2010 sparked the most complaints from businesses. At the same time, the State Customs Service has issued a series of internal regulatory orders that have made significant changes to the guidelines for control of declared customs value.

Order #1263 dated October 20th, 2010 amended the guidelines for applying certain provisions of the legislation relating to issues of customs valuation in terms of clarifying the inclusion of the customs value of the commission (agency) fees and the methods for determining the customs value of medicines imported for conducting preclinical research and clinical trials. In practice, Customs almost always increases the declared value of medicines imported for clinical research.

Another decree adopted with a view to controlling the accuracy of customs valuation (#1242 dated October 19th, 2010) establishes requirements for a consistent approach to those documents that the customs authority may require from the applicant to validate the declared customs value. However, this order also leaves open the possibility of customs officials’ determining customs value by methods other than the price of the contract.

One of the reasons the customs authority denies customs value as the cost of operations is the presence of doubts about the authenticity of the information necessary for verifying declared customs value. This doubt negates efforts to prevent unreasonable requests; the customs authorities continue to doubt the authenticity of applicants’ declared values, usually without explaining the reasons behind these doubts. There exists no list of the grounds on which the customs authorities can express doubt.

Proceeding from world practices, the following could constitute grounds for doubting the validity of declared customs value:

- Signs of document forgery;
- Mathematical errors and inaccuracies in the documents submitted for verifying the customs value components determined by the contract price;
- Discrepancies between documents.

Customs sometimes drafts other regulations that do not correspond with legislative requirements. In late December 2010, for example, the government regulation #1229 “On Amending the Procedure of Control over the Accuracy of Determination of Customs Value” was adopted. According to individual comments, most of its provisions continue to set rules for controlling declared customs value, in contradiction to the Agreement on the Application of Article VII of GATT.

Thus, in 2010 and in the first half of 2011, valuation for customs purposes remained a leading problem in the process of applying customs procedures, and a stumbling block between the government and business circles. In order to bring the current legislation into line, the American Chamber of Commerce in Ukraine Customs Committee developed and submitted certain proposals to the customs authorities. Reforming the system in general interests the Chamber, which will continue to participate in the formation of customs policy. The second half of 2011 should bring clearer perspectives regarding a number of tasks and priorities advanced by Customs and the government.

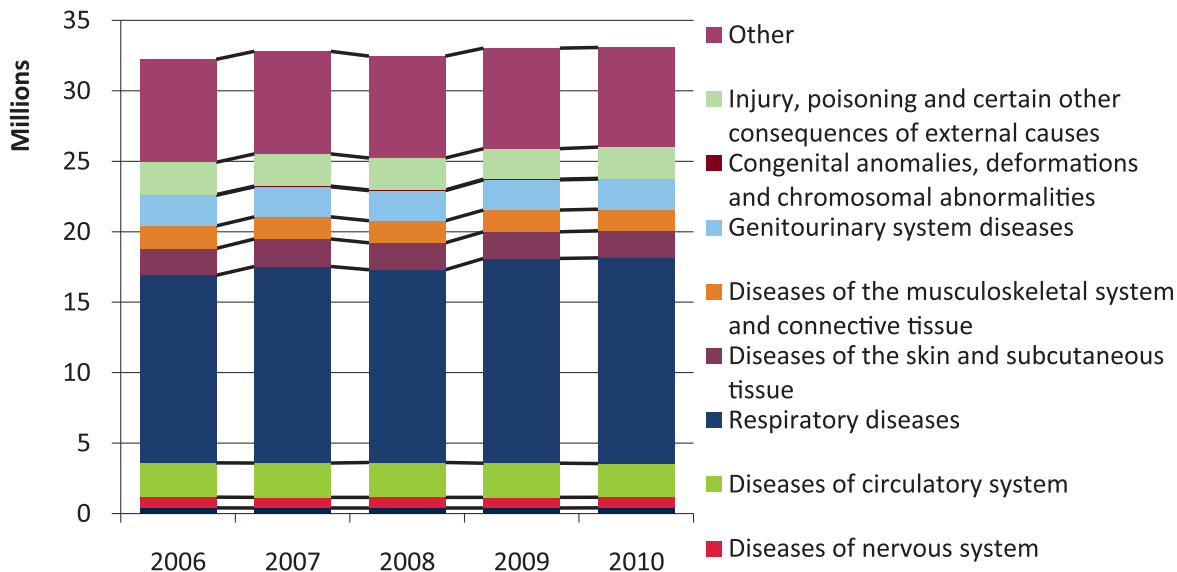
2. HEALTHCARE POLICY

During the 20 years of Ukraine's independence the life expectancy of Ukrainians at birth has deteriorated: from 70 years in 1990 to 68 in 2008, although it has returned to 70. Ukraine is the only country among its neighbors where this indicator in 2008 is the same as it was back in 2000. Moreover, Ukraine shares with Russia the lowest life expectancy value in Europe. It seems obvious that Ukraine's healthcare policy has to be significantly improved.

2.1. Reimbursement System and Compulsory Medical Insurance System

Each year almost 33 million Ukrainians turn to hospitals for help. In up to 45 percent of all cases it is for a respiratory disease. Diseases of the circulatory and genitourinary systems, as well as injury, poisoning, and certain other consequences of external causes, each represent 7 percent of the total number of illnesses (see Figure 1). However, this figure does not make clear that in 2008 Ukraine was in 188th place out of 193 countries according to number of estimated total deaths per capita caused by cardiovascular diseases. In addition, Ukraine has the second highest percentage of HIV prevalence among adults aged 15 to 49 in Europe and the highest among the CIS countries; in 2009 it took 131st place among 145 countries in number of deaths due to AIDS, coming in between Ghana and China. According to the World Health Organization, Ukraine and Moldova were in 2009 the countries with Europe's highest numbers of deaths due to tuberculosis among HIV-negative people: 26 people per 100 000 population.

Figure 1: The dynamics and structure of first-time registered diseases in Ukraine in 2010.



Source: State Statistics Service of Ukraine

The market for medical services and the medical care system in general remain significantly underdeveloped. This is due, first of all, to lack of financing from state and local budgets and inefficient use of available funds.

Moreover, the government's unclear vision and the lack of open discussion concerning a strategic plan for healthcare system development and declared reforms hold back sector competitiveness. While formally a country with free medical care, Ukraine remains the only European country without any reimbursement system in terms of expenses for ambulatory treatment and related medicines. This does not provide for the existence of facilities for improving quality of life or for increasing Ukrainians' life spans. We believe

that step-by-step implementation of a reimbursement system on the basis of the experience of both post-communist countries and major world democracies will create the grounds for developing the system. Moreover, introduction of compulsory medical insurance should substantially improve the situation as regards financing healthcare.

The American Chamber of Commerce in Ukraine (Chamber) Healthcare Committee wishes to provide input into healthcare system reform that incorporates Committee members' expertise and experience from other countries.

2.2. IPR and a Transparent System of Market Authorization for Medicines

Since 2008, when Ukraine became a WTO member, its legislation protecting the rights of intellectual property owners has developed significantly. This has been an important step towards the Ukrainian market's being competitive and attractive for foreign investors in the pharmaceutical and healthcare sector. In addition, the current market authorization (registration) system for medicines is acknowledged as advanced. Taking into account the recently announced plans to adopt the new version of the Law on Medicines, it is crucial to ensure a high level of intellectual property protection in the sector, the efficiency of enforcement mechanisms and the full transparency and efficiency of the market authorization system in the country. This protection should of course be in line with a modern approach to access to medicines and medical treatment, the sort of approach used in countries with market economies (which Ukraine has been for many years).

2.3. A Transparent and Efficient Quality Control System

Equal treatment and non-discrimination principles with respect to both locally produced and imported medicines should form the cornerstone of the quality assurance system for medicines in Ukraine. Despite numerous rumors that there is a significant amount of counterfeit products on the domestic market, there is no compelling evidence for that opinion. The role of the state as regulator, which is without a doubt very important, must in no case replace its role as a guarantor of the physical accessibility of medicines. Neither technical barriers to import nor unjustified bureaucracy or overregulation should start to characterize the Ukrainian market in terms of its quality control system. Moreover, increasing transparency in this sphere will strengthen Ukraine's competitiveness on global markets even more.

2.4. Medicine Import Substitution

There are certain risks to implementing an inadequate medicine import substitution policy for foreign pharmaceutical companies specializing in R&D based on the Draft Concept of the State Target Program "Development of Import Substitution Production in Ukraine and Substitution of Imported Medicinal Products by National, Including Biotechnological, Products and Vaccines" for 2011–2021. It is important that the program protect the intellectual property rights of foreign pharmaceutical companies and improve patients' health by guaranteeing their access to quality and safe medicines. The Draft Concept should exclude any possibilities for corrupt schemes in state procurement tenders and unjustified discrimination against foreign manufacturers.

The criteria to be applied in the governmental import substitution program are also important. Foreign companies are ready to provide price discounts at state procurement tenders; this document, however, does not provide for transparency in the realization of import substitution policy.



Draft Law #7412 “On the Amendments to Article 9 of the Law of Ukraine ‘On Medicinal Products’ Regarding Bringing the Registration Procedure for Medicinal Products into Correspondence with International Standards” (passed in the first reading on April 19th, 2011) indicated heightened government pressure on the import market for medicinal products.

It is important to include such terms as “data exclusivity” and “patients’ rights” into the State Target Program.

There are also IPR risks involved in import substitution policy, in the plans for preferences for national medicine producers, in violations of GATT/WTO rules, etc.

The Chamber Healthcare Committee supports the idea of import substitution, which should be openly discussed and developed with the involvement of experts and all interested parties. In its current version, however, the Draft Concept does not protect the interests of patients or of foreign and Ukrainian pharmaceutical producers. It is important to establish a favorable climate for the development of a pharmaceutical market first. This is possible only after the adoption of the corresponding Law “On Medicinal Products.”

The Chamber continues to follow the changes in the legislative and regulatory fields of healthcare policy. The members of the American Chamber of Commerce in Ukraine in conjunction with its partners are working to develop the comprehensive long-term policy position needed to improve healthcare in Ukraine — the pillar of the country’s competitiveness.

3. HUMAN RESOURCES AND LABOR POLICY

The efficiency and flexibility of the overall labor market are key factors in a market economy, and are essential tools for increasing employment and improving economic indicators.

Countries moving to an efficiency-driven stage of development must begin developing more efficient production processes and increasing product quality. At this point, competitiveness is increasingly driven by well-functioning labor markets, along with effective higher education and training systems.

The labor policy of Ukraine is generally considered to be good. Currently, however, Ukraine's labor market is characterized by some adverse factors. According to the World Economic Forum Reports of 2008–2011, some indicators worsened in a particularly noticeable manner. The brain drain index, which addresses the question of whether the country is retaining and attracting talented people, has dropped by 36 positions, from 82nd in 2008 to 97th in 2009 to 110th in 2010 and to 118th in 2011 (out of 131 on comparable lists), meaning that the surveyed subjects more often answer this question with the following answer: “no, the best and brightest normally leave to pursue opportunities in other countries.” The indicator showing cooperation in labor-employer relations, showing whether they are confrontational or cooperative, dropped from 68th place in 2008 to 93rd in 2009, and to 104th in 2010 with small recovery in 2011 — 100th place. These tendencies highlight the existence of complex problems in state policy.

The level of Ukraine's labor productivity in terms of GDP output per employed person is one of the lowest in the region. As can be seen from Figure 1, one employed Ukrainian produces just about the half of one employed Russian or Belarusian. Moreover, each GDP dollar produced in Ukraine costs more to produce than in Belarus or Lithuania. This figure looks even worse if we take into account that official Ukrainian statistics constantly and significantly underestimate wages paid to the labor force.

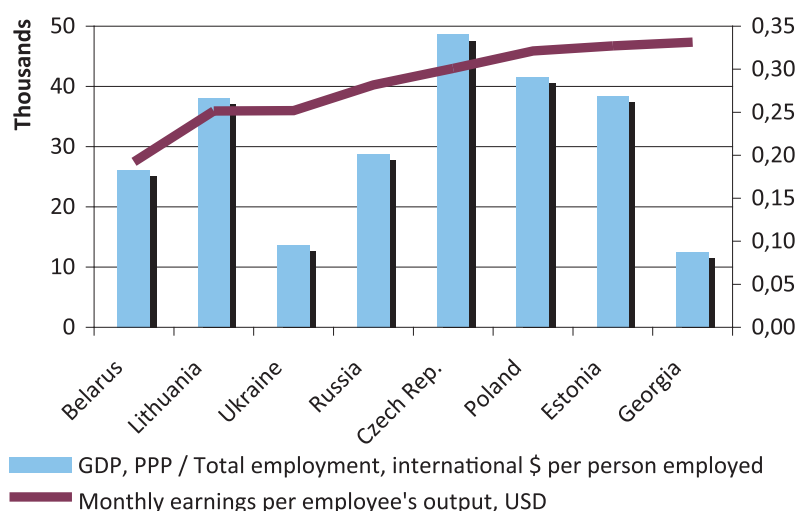


Figure 1: GDP per employed person and monthly earnings of an employee per output in selected countries in 2010.

Source: International Labor Organization, World Bank DataBank, National Statistical Committee of the Republic of Belarus, National Statistics Office of Georgia.

Certainly, one must make allowances for the fact of the different capital intensities of the observed countries and different levels of education attainment. The government, however, plays the major role when it comes to these factors.

In this context it should be noted that the Ukrainian labor market is characterized by a gap between the state's existing model of human development potential and a market economy.

Factors adversely affecting the functioning of the Ukrainian labor market include contradictions between state personnel policy and the requirements of the transformational

processes in the country, imperfect legislation, lack of a strategic focus on personnel training to meet the needs of society, and the poor functionality of HR structures.

Taking into account the current problems, the government drafted a Strategy for personnel policy for 2011–2020. It is meant to guide state formation and management of human resources.

The Strategy means to impact the following important areas:

- Achieve a high level of professional, intellectual, creative and moral human potential and meet public expectations regarding professional self-realization and decent wage levels under the conditions of its implementation;
- Supply all economic sectors with qualified personnel, increase the country's economic power, raise the general welfare and reduce the cost of effecting these achievements;
- Regulatory provision; the ability of the HR field to improve staff management and HR work based on democratic principles;
- Development of a personnel management system on the basis of the rule of law, a social dialogue and the partnership of all interested participants in state HR policy.

Experts from the American Chamber of Commerce in Ukraine's (Chamber) Human Resources Committee support the idea in general and the Strategy's concept, even while noting the too-general content of the document and that there exists no specific action plan for its implementation.

Chamber experts, however, are ready to participate in the implementation of the state Strategy, specifically in the area of education, which corresponds to the "HR University" project, which was initiated and implemented over a two-year period by the Human Resources Committee of the American Chamber of Commerce in conjunction with the Kyiv National Economic University.

At the same time, the adoption of the Strategy is insufficient for the further development of Ukraine's labor market and HR policy. Introducing qualitative changes to the legislation on labor relations remains a pressing issue.

Among those qualitative changes, is first of all, the approval of the new Labor Code. The Draft Labor Code of Ukraine has been developed and is aimed at revising the Soviet labor relations heritage. The Code's contents and the rules it establishes are not ideal, but it does contain a number of good ideas.

The Chamber HR Committee participates in the Working Group on Labor Market Liberalization and continues to advocate for a balance of interests between employers and employees. The members of the HR Committee Working Group on the Draft Labor Code have developed suggestions from Chamber Member Companies about the Draft Labor Code and will provide them to the Parliamentary Committee on Social Policy and Labor.

There are also some other issues that are important for the Chamber's members. The problem of the entry into Ukraine of family members or close relatives of foreigners who have obtained work permits is among them. The Chamber is following the progress of the adoption of Draft Law #8570 "On the Legal Status of Foreigners and Persons without Citizenship," which foresees temporary residence permits for family members, permits that will allow them to travel freely into and out of Ukraine over long periods of time. It passed its first reading in July 2011 and is being prepared for the second reading.

In general, improving the labor market requires effective long-term partnership. In this context, the American Chamber of Commerce in Ukraine and its international membership are preparing specially designed projects in the HR and education spheres. The country's competitiveness depends on having well-educated specialists and professionals who can be trained and re-trained so that they can move forward towards success.

4. TAX POLICY

In December 2010 the new Ukrainian Tax Code was signed by President Yanukovich and officially published. On January 1st, 2011 this document, which has sparked heated debate in the Parliament and drawn healthy criticism from the international and domestic business communities, became effective, with the following exceptions:

- The corporate profits tax chapter, which generated some of the most debate, took effect on April 1st, 2011;
- The real estate tax for individuals will be introduced from 2012;
- The new transfer pricing rules will come into effect in 2013; and
- Taxation of interest income earned by individuals from deposits is deferred until 2015.

The logical question is whether this new Tax Code is a good or bad thing for international businesses that operate in Ukraine or that have Ukraine in mind for potential expansion.

Earlier in 2010, in the days following the presidential elections, the new Ukrainian government publicly declared its intention to reform the tax system. In light of this declaration, it was, in our professional view, a good thing for both Ukrainian and international businesses to have codified tax rules that would replace the hundreds of currently existing laws, regulations, and interpretations, which were in many cases inconsistent with one another.

The American Chamber of Commerce considers this to be only the start of reform. It matters a great deal for the business community how the Tax Code looks now, but it is no less important what will happen in terms of the implementation of and changes to this document in the first several years after its enactment. Much will depend not only on the new legal norms, but on the approach that the Ukrainian authorities take in monitoring the impact of the changes on business and adjusting the new rules to make the Ukrainian economy attractive to new foreign investment.

The American Chamber of Commerce Working Group on the Tax Code has been and continues to be actively involved in discussions of the new tax rules. It also takes into account the concerns of the international business community and their suggestions for further cooperation with the Ukrainian government and Parliament.

The Tax Code has been twice amended since its enactment in January 2011, with some amendments having retrospective effect.

4.1. Key Points of the New Tax Code and its Impact on Ukrainian Businesses

The Ukrainian government positions the new Tax Code as a progressive document that, among other measures, reduces the rate of corporate profits tax and, starting on January 1st, 2014, reduces the rate of VAT, eliminates some small but burdensome local taxes, unifies statutory and tax accounting rules, and simplifies VAT recovery procedures. (VAT recovery currently represents a major tax issue for exporters and for long-term projects that require significant capital investments.)

It should be noted, however, that tax rates, per se, are not the major tax issue for Ukraine; they are quite comparable with European rates. Poor tax administration, absence of the rule of law in tax matters, misbalance of tax rights and obligations in favor of the tax authorities, and ambiguous tax rules that are fiscally interpreted by the tax authorities and courts are the real issues. Ukraine is currently ranked by PwC, the World Bank, and the IFC as one of the least attractive countries when it comes to ease of paying taxes.



The Ukrainian business community was shocked by the initial version of the draft Tax Code that Ukrainian Parliament passed in the first reading in June 2010. That version was based on the assumption that a taxpayer is always wrong and guilty. Inconsistent compilation of existing tax laws with significant revision of rules for tax audits, tax assessments, and appeals against them in favor of the tax authorities, combined with a proposal to give the tax office almost unlimited powers to control business and collect taxes at its own discretion, were the reasons why business said a clear “no” to that document. The business community clearly expressed to the authorities that that version of the Tax Code would never ease doing business in Ukraine.

Upon reading the Code now, we are glad to say that the voice of business was partially heard by the government. The most disputable administrative rules were taken out of the draft, and the following key principles were introduced into the Code:

- **Unification and simplification of tax rules.** The new document is a bit more consistent than the original draft was. The first steps are being taken toward unifying statutory financial and tax accounting, which eases the lives of accountants and finance personnel.

Currently, multinational corporations keep three sets of accounts in Ukraine: IFRS, statutory financial, and statutory tax. The extra steps towards the unification of accounting and the tax sets of accounts are clearly on the positive side.

Still, many other things need to be done in this area. They include unification of statutory accounting rules with international financial reporting standards (IFRS), simplification of the procedures for preparing tax returns, etc.

The Code has also reflected the concept of the stability of tax rules: that is, the concept that business should be notified at least six months in advance of any future significant tax changes. But we have yet to see how this principle will be adhered to in practice.

- **Tax administration.** Tax administration rules expanded the list of grounds for requesting additional tax and other information, especially copies of documents, from taxpayers, which is time-consuming and puts an additional workload on taxpayers. In addition, the authorities have agreed to introduce less frequent and more simplified tax reporting for relatively small businesses.

Another positive example of recent tax changes is the introduction of a single personal income tax rate for both Ukrainian tax residents and non-residents. Before, non-residents were subject to tax at a double rate, and establishing Ukrainian tax residency was a long and burdensome process, requiring lots of time and effort from both individuals and their employers.

This is only the first step in the improvement of tax administration in Ukraine. What goes beyond the Tax Code is the qualitative improvement of tax audits. The tax au-

thorities must understand the industries they are auditing, market trends, and the financial indicators of these industries at a particular point in time, so that the tax audits focus on identifying and understanding deviations from these trends and the indications for a particular taxpayer. The authorities should also discuss their rationale with the taxpayer prior to tax assessment.

We would separately like to mention that the Tax Code has introduced the concept of the “automatic” VAT refund, which is one of the key tax issues for exporters in Ukraine. Over the last several years Ukraine has consistently failed to refund VAT to business in cash. The procedure for the refund the Code introduces is very straightforward; it allows transparent businesses to get cash from the government in a few weeks, compared to the months and years of waiting that had been the case in the past. However, for this new rule to work, the government still has to develop an electronic register for all VAT invoices in the country and make this register work efficiently. This is not easy task and may take time to complete; nevertheless, the government should set a timetable for implementing an electronic VAT registry.

- **Mutual responsibilities of businesses and the government in the tax sphere.** Given that the Ukrainian tax system is still developing, tax penalties on bona fide companies should be fair. International businesses are glad that the government partially heard their concerns on this issue and reduced some tax penalties in the Tax Code.

Another positive change is that the government has agreed to be financially liable for late refund of VAT. Late payment interest payable by the government is introduced for each day of delay of the refund. However, the business community expects that the tax authorities will ultimately be subject to financial fines and penalties for their failure to comply with the tax laws and to refund all taxes (not just VAT) on a timely basis. Also, it would be fair to introduce financial responsibility for the tax authorities in case of the accruing of additional tax assessments that are not supported by the courts. Such an approach should encourage the tax authorities to take more objective decisions as a result of tax audits.

Given that the Tax Code is a new document that became law less than a month before the start of the new fiscal year, it gave businesses very little time to adapt to the changes, i.e. read the document, adjust their accounting policies and procedures, make necessary changes to accounting software, and reorganize tax-compliance and tax-planning functions. The authorities have agreed to establish a six-month “grace period.”

4.2. Impact of the Tax Code on Foreign Investments in Ukraine

It is expected that the proposed improvements to the tax rules will reduce state budget revenues in the short term. It is our understanding that in trying to compensate for this, the Ukrainian authorities have introduced in the Tax Code several significant limitations for businesses that negatively impact foreign investors in Ukraine. They include:

- A prohibition for businesses on deducting the costs of goods, works, and services purchased from individual entrepreneurs who pay the Unified Tax, except for those operating in the IT area;
- Limitations on businesses for deducting royalties and consulting, advertising, marketing, and engineering fees payable to non-residents;
- The Tax Code includes a new tax concept of the “beneficial owner” that is not well-defined and that is thus expected to result in numerous tax disputes when tax authorities apply it;
- The Code contains discrepancies regarding the terms for appeal to court in case of taxpayer disagreement with the results of a tax audit;

- Taxpayers in their start-up phases, if their share capital or balance value of assets does not exceed 300 thousand UAH, cannot be voluntarily registered as VAT taxpayers and thus are unable to recover VAT paid to suppliers.

We understand that the government’s rationale for these limitations is to prevent non-transparent businesses from using tax schemes to reduce their Ukrainian tax liabilities. Transparent international businesses fully support this intention, but the format of the limitations is unacceptable to them.

Take services payable to non-residents, for example. Recharging group costs as a service fee is a generally accepted business practice for multinational groups. It is aimed at allocating relevant costs to the entities that obtain economic benefits from services; the tax deductibility of such fees should thus be economically justified. While the government has heard the voice of business and rejected the original idea of completely prohibiting tax deduction of such fees, the limitations the Tax Code introduces are still not good for the investment image of Ukraine. As a result, making further investments in Ukraine may not be attractive for international businesses compared to the opportunities in neighboring countries. In addition, Ukrainian subsidiaries of international businesses will compensate their additional tax costs (corporate profit tax, VAT, excise tax if applicable) via increases in prices for their goods, works, and services in Ukraine. As a result, Ukrainian consumers will suffer from higher prices for high-quality products.

The Ukrainian authorities need to further revisit this and other rules that discriminate against international businesses. In our view, the best way to balance the interests of both the government and businesses is to follow best international practices. For example, it is well known that no developed countries prohibit the deduction of service fees payable to foreign suppliers. As a rule, service fees payable to unrelated foreign suppliers are fully tax deductible. When such payments are made to a related party, other countries allow tax deduction to the extent that the payments do not exceed the level of similar payments to unrelated parties (the “arm’s length” principle). Other countries have developed transfer pricing legislation that defines “arm’s length” and for Ukraine it would be more useful to apply already existing international rules and apply them consistently. At the moment it is unclear both for the taxpayers and tax authorities how to apply existing national transfer pricing rules, as there no clear legislative guidance — that’s why they are rarely used in practice. In this case the OECD directive regarding transfer pricing issues may serve as a good practical basis.

A final aspect worth mentioning when discussing the new Tax Code is that it does not offer any specific tax incentives for foreign investments. While incentives as such should not be a decisive factor for an investor in making a decision about whether to invest or not, they may serve to differentiate Ukraine from neighboring countries. We believe that Ukraine needs to revisit its approach to stimulating foreign investment activity.

To conclude this short summary of the Tax Code, it is important that the Ukrainian authorities be prepared to maintain active dialogue with the business community about any issues that businesses run into after the enactment of the Code. The authorities should further amend this document to stimulate business activity in Ukraine. Businesses should thus not miss their chance to voice their issues and concerns during this dialogue.



5. INTELLECTUAL PROPERTY RIGHTS

An effective state system for protecting intellectual property rights is a key element in enhancing Ukraine's competitiveness on the global marketplace. It is critical to Ukraine's successful integration into the international community.

Today, Ukraine has a well-established institutional system for IPR protection, which includes five regulatory bodies and one educational state body within the Ministry of Education, Science, Youth, and Sports of Ukraine or governed by it, 10 laws, and more than 100 bylaws, in addition to international agreements and special provisions of the Constitution, Civil, Criminal, Customs, and Administrative Codes. Essential improvements in IPR legislation were made after Ukraine got membership in TRIPS in 2008.

According to State Intellectual Property Service of Ukraine data, it received 47 thousand applications for intellectual property objects registration on average annually over the last five years. Almost 65 percent of the applications are for trademark registrations and almost 20 percent and 10 percent of the total number of applications are, respectively, for utility models and inventions. While there is no apparent upward trend in the number of applications for IPRs, the number of innovative products and new technological processes introduced increased over the observed period, and reached about 9 percent of

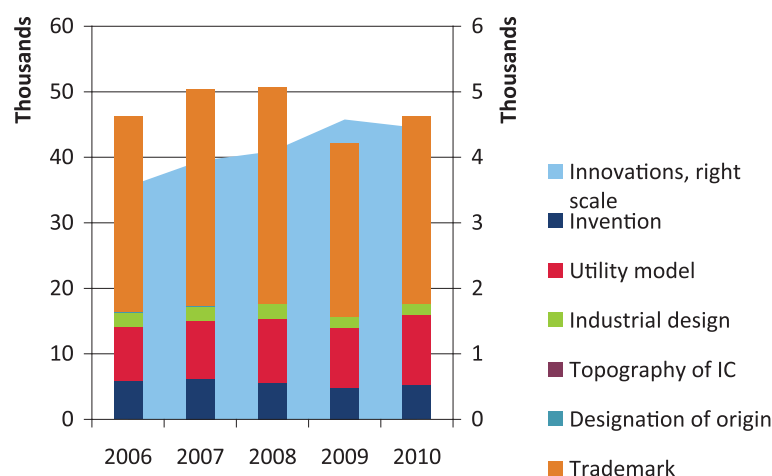


Figure 1: Number of applications for IPRs and new innovations introduced by Ukrainian companies in 2006–2011.

Source: State Intellectual Property Service of Ukraine, State Statistics Service of Ukraine.

applications for intellectual property objects (see Figure 1). Still, annually, just about 11 percent of all Ukrainian companies were engaged in innovative processes during the last decade, as reported by the State Statistics Service of Ukraine.

State bodies today lack efficiency in the field of intellectual property rights regulation. A survey conducted by the American Chamber of Commerce in Ukraine (Chamber) in February 2011 shows that 56 percent of surveyed Chamber members are most often involved in matters connected with administrative bodies and 22 percent are most often involved in matters connected with courts. The vast majority of the surveyed companies (89 percent) expressed interest in practical issues of intellectual property rights enforcement. A fully functioning intellectual property rights system would give a clear signal that intellectual property is a driver of innovation, competitiveness, and growth for Ukraine in a global economy.

Despite that Ukrainian intellectual property legislation is commonly recognized as good, there is still room for improvement. In particular, the collection and further allocation of royalties for the public use of copyright is still non-transparent and inefficient. Ukrainian legislation is out of date in regard to Internet intellectual property infringements as well. Ukraine has for more than two years delayed the adoption of a special EURO 2012 intellectual property protection law.

Taking into account the recently announced plans to adopt the new version of the Law on Medicines, it is crucial to ensure a high level of intellectual property protection in the sector, the efficiency of enforcement mechanisms, and the full transparency and efficiency of the market authorization system in the country. This protection should of course be in line with a modern approach to access to medicines and medical treatment, the sort of approach used in countries with market economies.

The constant emergence of new products, services, and content provision by the mass media necessitates further improvement of the legislative base. New media spheres that lack regulation restrain the development of the media market, damage transparent economic relations, and in general decrease the taxation base.

The changes in customs legislation enforcing intellectual property rights should support the customs authorities' power to seize goods that infringe intellectual property rights whenever they are physically on Ukrainian territory, including goods in transit. This enforcement is in line with current EU intellectual property rights protection policy.

On the other hand, all new legislation has to fully comply with basic intellectual rights protection principles, even as it does not complicate free market relation or make them opaque. For instance, Draft Law #6523 "On Amendments to Some Legislative Acts on Regulation of Issues of Copyright and Related Rights," adopted in the first reading in June 2010, which aims to improve IPR regulation, includes norms that could have significant adverse influence on the producers or importers of some equipment and media materials that are used for private reproduction of copyright objects.

The Chamber also addressed the government with regards to the amendments introduced with Draft Law #6595 "On Amendments to Certain Legislative Acts (regarding the protection of citizens' health from the use of tobacco)". The changes offered by the developers suggest, among other things, the mandatory use of only black and white colors for marking tobacco products. This provision contravenes the provisions of the TRIPS. The Chamber's position was supported by the Ministry of Economy of Ukraine, but its recommendations were not accepted by the draft law's developers.

The comprehensive changes suggested by Draft Law #7205 "On Amendments to Some Legislative Acts on Regulation of Issues of IPR" aim at bringing the existing legislation into conformity with EU legislation. However, the offered amendments have major conceptual drawbacks and in some cases do not fully adjust the existing legislation to the EU *acquis communautaire*.

The American Chamber of Commerce in Ukraine initiated dialog about these matters, but it still unclear if the position of its members will be taken into account. Quality, cost-effectiveness, efficiency, and legal certainty must be the objectives of any change to the legal framework for intellectual property rights protection. Special attention has to be paid to support design protection rights. All the legal norms that could threaten design protection rights or hinder effective and transparent market relations have to be avoided.

The Ukrainian government, in cooperation with NGOs, should support robust protection of intellectual property. Efficient protection of inventions, utility models, and content, and the fight against counterfeiting and piracy, will boost the development of the innovative economy.



6. ANTI-BRIBERY POLICY

Corruption remains a significant problem, pervading all levels of Ukrainian society. Transparency International's 2010 Corruption Perception Index ranked Ukraine 134 out of the 178 countries surveyed, making it among the worst performers on the list (it was 146 out of 180 in 2009). The Heritage Foundation's 2011 Index of Freedom from Corruption also gave Ukraine a poor score, ranking it 152 out of the 179 states surveyed (it was 141 out of 179 in 2010). Moreover, according to the Freedom House Corruption Index in the Nations in Transit 2011 Report, Ukraine was ranked (along with Russia, Belarus, and Moldova) as showing the worst performance among European countries in transition.

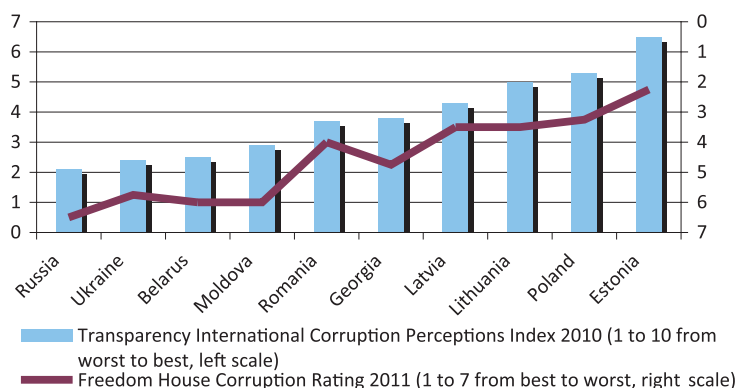


Figure 1: Transparency International Corruption Perceptions Index 2010 and Freedom House Corruption Rating 2011 for selected countries.

Source: Transparency International, Freedom House.

There is a generally recognized need to fight corruption as a crucial problem associated with the country's development efficiency. The delays in dealing with the problem just make the state system worse each year.

On April 7th, 2011 the Ukrainian Parliament passed the Laws #3206–17 “On Foundations of Prevention and Combating Corruption” (the Ukraine Anti-Bribery Act) and #3207-17 “On Amendment of Certain Legal Acts of Ukraine on Liability for Corruption Related Offences”.

The anticorruption legislation came into effect on July 1st, 2011, save articles 11 and 12 of the Ukraine Anti-Bribery Act, which are contemplated to take effect in January 2012. Article 11 stipulates procedures for special background checks for applicants for offices associated with central or local governmental functions. Article 12 of the Ukraine Anti-Bribery Act defines requirements for financial control of state officials.

Novelties Introduced by the Ukraine Anti-Bribery Act

The definition of the term “corruption” has been significantly broadened, now covering private as well as public sectors, and the receipt as well as the promise/offer of any illegal proceeds will constitute a corruption offence.

The law significantly expands the range of persons who may incur corruption offence liability. Among them are state officials, including the President, Prime Minister, and Parliamentary Speaker. Also among them are any persons who provide public services, such as auditors, notaries, experts, receivers, arbitrators, foreign officials (particularly any persons holding offices in a foreign legislative, executive, or judicial body), foreign arbitrators, and persons authorized to resolve any civil, commercial, or labor disputes in any foreign states, in a manner alternative to that of the judiciary.

The Ukraine Anti-Bribery Act introduces provisions that define a civil service conflict of interests and the manner for resolving it as follows.

According to the law, any persons authorized to carry out central or local government functions are prohibited from using their official authorities and any possibilities associated with them to obtain illegal proceeds or in connection with the acceptance of any promise/offer of such proceeds for their own benefit or for the benefit of other persons.

Nor can they pursue other paid or entrepreneurial activities or sit on the management body or supervisory council of any commercial venture or organization.

Further, the said persons are prohibited from directly or through other persons receiving any gifts (donations) from legal or physical entities in exchange for any decisions, acts, or omissions in the interests of a donor, or in a situation when a donor reports to such a person.

The President, a Cabinet of Ministers member, the General Prosecutor, the Head of the National Bank, and a number of other top governmental officials are prohibited from having their close relations reporting to them and from reporting directly to their close relations in connection with their official duties.

For any corruption offences, the said persons shall incur criminal, administrative, civil, and disciplinary liability in the manner established by law.

The civil servants and officers of any public law legal entities who receive their compensations from the funds of public or local budgets, and any persons who are not civil servants or local government officials but who provide public services (auditors, notaries, appraisers, experts, receivers, independent intermediaries, members of labor dispute tribunals, and arbitrators, when discharging their respective functions, and other persons, in events provided for by law), may receive gifts provided that their value (donations) does not exceed 50 percent of the minimum wage (currently 480 UAH) per single occurrence; the aggregate value of such gifts (donations) received from one source within a year cannot exceed one minimum wage as determined as of January 1st of the current year (as of January 1st, 2011, according to the Law of Ukraine “On the 2011 State Budget of Ukraine”, this minimum wage was 941 UAH).

Any gifts received by the said persons as gifts to the state, the Autonomous Republic of Crimea, a local community, any state or communal institutions, or organizations are deemed to be state or communal property, respectively, and shall be transferred to such body, institution, or organization in the manner established by the Cabinet of Ministers of Ukraine.

Yet another anticorruption enhancement is in store for civil servants: both officials and deputies will be obliged to declare their expenses on top of their incomes. This rule will apply if they incurred with a reporting year a one-time expense exceeding 150 000 UAH. The obligation to report incomes and expenses will also extend to deputies of all levels, judges, police officers, tax officials, prosecutors, and customs officers. Furthermore, officials will be prohibited from having relatives reporting to them, while concealment of any information will be treated as equal to corruption. The new law expands the range of persons who may incur liability for bribery (it now includes members of the High Council of Justice and the Central Election Commission) and introduces checks for civil servant candidates (monitoring for criminal records, if any, for the authenticity of data in candidates’ declarations, and for the state of their health). The law also enhances liability for bribery. Bribes of up to 85 UAH will make the perpetrator liable to pay a penalty of up to 12 700 UAH. Bribes between 85 UAH and 3 339 UAH will lead to fines of up to 25 500 UAH or prison terms of up to 5 years.

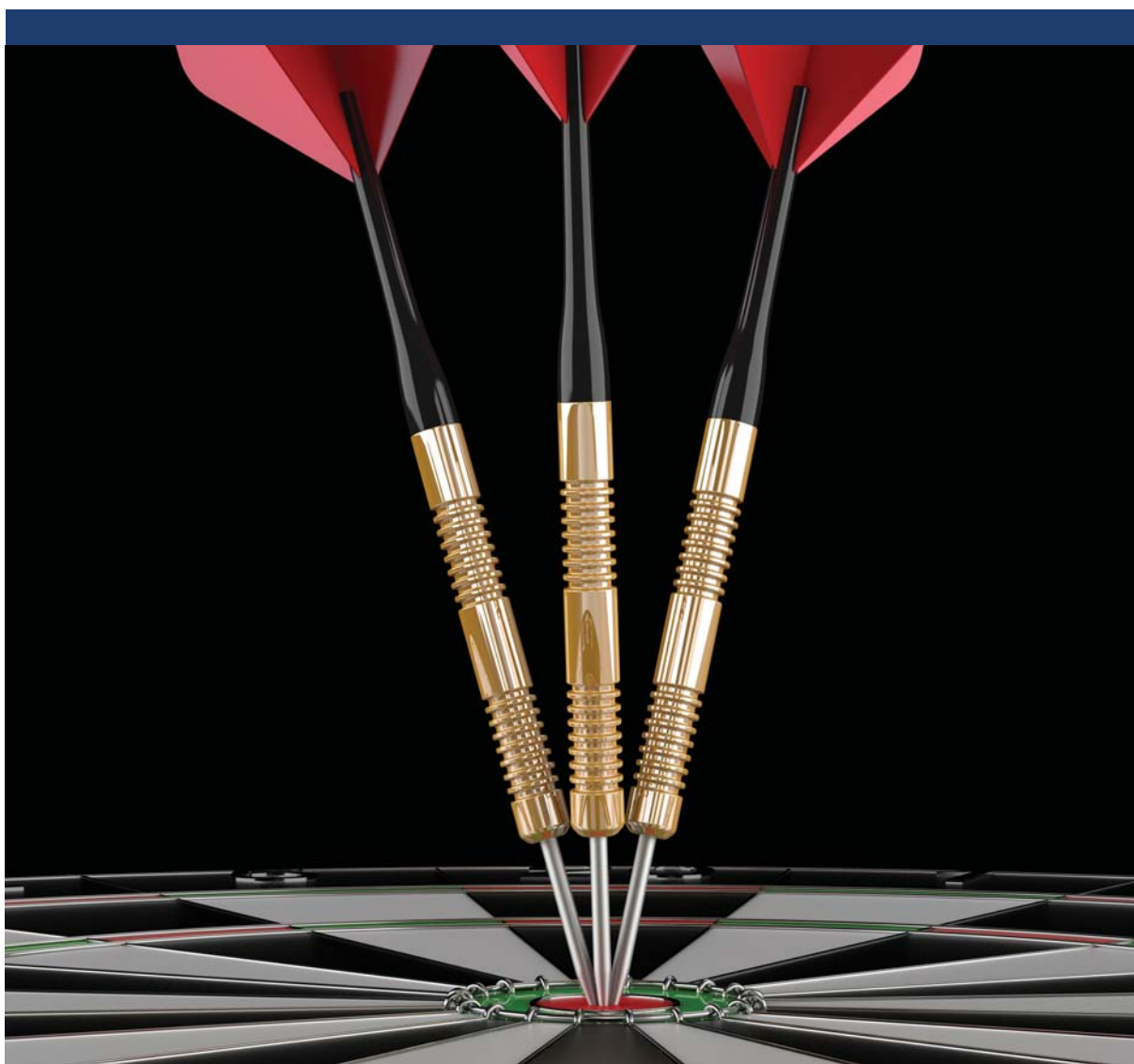
Furthermore, the Ukraine Anti-Bribery Act vests in the President the right to establish a special anticorruption police authority. It will coordinate the implementation of anticorruption strategy as laid out by the President, in accordance with the requirements provided by law.

The law contemplates material enhancement of liability for any corruption offences, while all corrupt persons will be entered in a special register.

In summary, we should note that the issue of the implementation of the new anticorruption legislation is generating doubts. Pursuant to the law, the implementation of this legislation is vested in a special authority; however, that authority will exist only next year at the earliest, since this year’s public budget allocates no funds to maintain it. Until then, this authority’s functions will be carried out by the Ministry of Justice of Ukraine and the Security Service of Ukraine.

3

IN FOCUS: 10 RECOMMENDATIONS TO IMPROVE UKRAINE'S COMPETITIVENESS WITH THE HELP OF ICT



1

INTRODUCTION



The sustainable development of any country depends on its competitiveness. The recent global economic crisis has proven this point once again. According to the World Economic Forum (WEF), governments should complement any strategy to exit the economic crisis with “competitiveness-enhancement efforts aimed at improving the potential for growth in the medium to longer run, which will in turn help to eliminate fiscal imbalances. Competitive economies are those that have in place factors driving the productivity enhancements on which their present and future prosperity is built”.¹

Today, national competitiveness increasingly depends upon the “technological readiness” factor, as technological progress has become a powerful driver of social and economic development. In this context, specific emphasis is given to a country’s capacity to utilize information and communication technologies (ICT). ICT development generates essential spillovers to other economic sectors, thus contributing to economic growth and prosperity.

Even though the Ukrainian government has historically pronounced the improvement of national competitiveness and ICT development as policy priorities, the rankings of the country in overall competitiveness and in implementation of ICT policies remain low. According to the World Economic Forum, Ukraine is ranked 89th among 139 countries of the world by the Global Competitiveness Index, lagging behind all EU-27 member-states and most of CIS countries. The Technology Readiness ranking for Ukraine stands at 83, which is also quite low. Moreover, the country ranks 90th in the Networked Readiness Index, indicating extremely low ICT diffusion and prioritization.

International experience shows that ICT has been increasingly integrated into daily life and has become an important instrument of business strategies, government activities and service provision.² As a result, the concepts of e-government and e-skills have become an applied tool of policy-making. Sound governance is a prerequisite for improving business climate and, thus, securing economic growth. From the other side, today one cannot imagine modern education without ICT, especially when it refers to lifelong learning process. In a knowledge-based economy, the importance of e-skills for a country’s competitiveness significantly increases as it improves the employability of the workforce.

Ukraine’s Ranking in ICT-Related Indices

Index	Ukraine (vs. total number of countries)
WEF Global Competitiveness Index 2010–2011	89 (139)
WEF Technological Readiness Index 2010–2011	83 (139)
WEF Networked Readiness Index 2010–2011	90 (138)
Government readiness	122 (138)
Government usage	75 (138)
EIU eReadiness Ranking 2010	64 (70)
UN e-Government Index 2010	54 (192)

¹ World Economic Forum, *The Global Competitiveness Report 2010–2011*, 2010

² *The Global Information Technology Report 2010–2011: Transformations 2.0. 10th Anniversary Edition*. INSEAD, World Economic Forum.

2

ICT AS A FACTOR OF COMPETITIVENESS



2.1. Concept of ICT

Information and communication technologies (ICT) include a broad set of tools and resources used to communicate, create, disseminate, store and manage information. These technologies include:

- computers
- Internet
- broadcasting technologies (radio and television)
- telephony

Over the last years, broadband, mobile and Internet connectivity rates have steadily increased across all countries. The use of ICT has become an integral part of modern life as it improves access of individuals, businesses and governments to information. Information is now considered a valuable asset for all individuals as a resource for creating knowledge. Therefore, today, most countries declare transformation into a knowledge-based society as a priority. In this respect, the major goal of ICT could be formulated as obtaining the knowledge and skills necessary to meet the challenges of a knowledge-based society.

Recent ICT developments have created enormous opportunities. ICT is considered a driver and facilitator of economic development as it de facto reduces restrictions originating from costs, time and distance. However, the availability of ICT is not enough to ensure its successful application: quality and cost must also be addressed.³ As the fees for cellular phone services and broadband have substantially declined over the last years, Internet and cellular phone penetration has surged. Cellular phones are now used not only for “traditional” phone communication, but also for broadband and Internet access, payment authorization, etc.

In Ukraine, the development of ICT has been declared as one of the priorities during recent years. In 2007 the Parliament approved the Law “On the Foundations of the Development of Ukrainian Information Society between 2007 and 2015” and a special Action Plan on Implementation was adopted. Both documents are aimed at promoting the development of information society and include information technologies implementation among the priorities of the state policy. Unfortunately these intentions have failed to be fulfilled, which is reflected in Ukraine’s low ratings of competitiveness and networked readiness. The country’s rank of 130 out of 138 on the question of “Importance of ICT to government vision” is extremely worrying. While most countries defined clear strategies to move towards a knowledge economy, Ukraine has been lagging behind. Such a trend is dangerous for the country whose competitiveness is already quite low.

2.2. ICT and Competitiveness

The World Economic Forum defines competitiveness as “the set of institutions, policies and factors that determine the level of productivity of a country”. As the number of jobs using ICT has increased substantially during recent years, the component of Technological Readiness, in particular, ICT usage becomes more important. Figure 1 shows that Technological Readiness significantly correlates to the country’s overall Global Competitiveness Index (GCI) ranking. Ukraine occupies 89th position out of 139 countries according to the GCI while its rank for Technological Readiness (83) is only slightly better. It lags behind all EU member-states and most CIS countries. Ukraine needs a stronger competitive position to ensure better economic development in the medium and long-run, as higher Technological Readiness rankings are linked to higher GDP per capita (Figure 2). Therefore, the government should recognize the necessity to stimulate ICT diffusion and usage of ICT for the benefit of long-run competitiveness and welfare of the society.

³ *Digital economy rankings 2010: Beyond e-readiness, EIU, 2010*

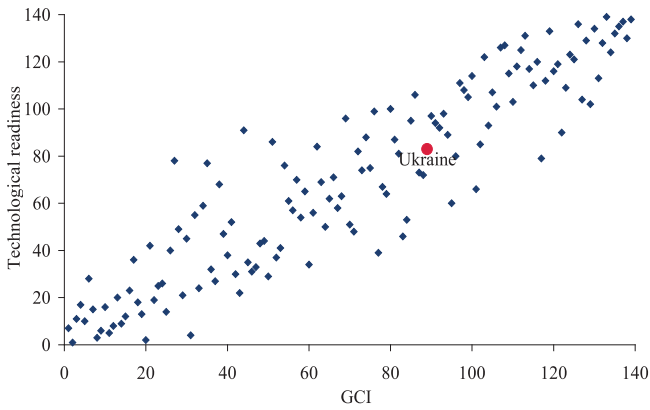


Figure 1: Ranking by competitiveness

Note: higher ranking means lower standing of a country in the global competitiveness and technological readiness
Source: WEF

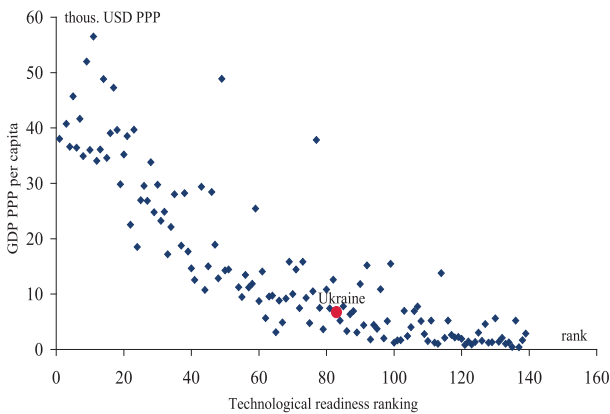


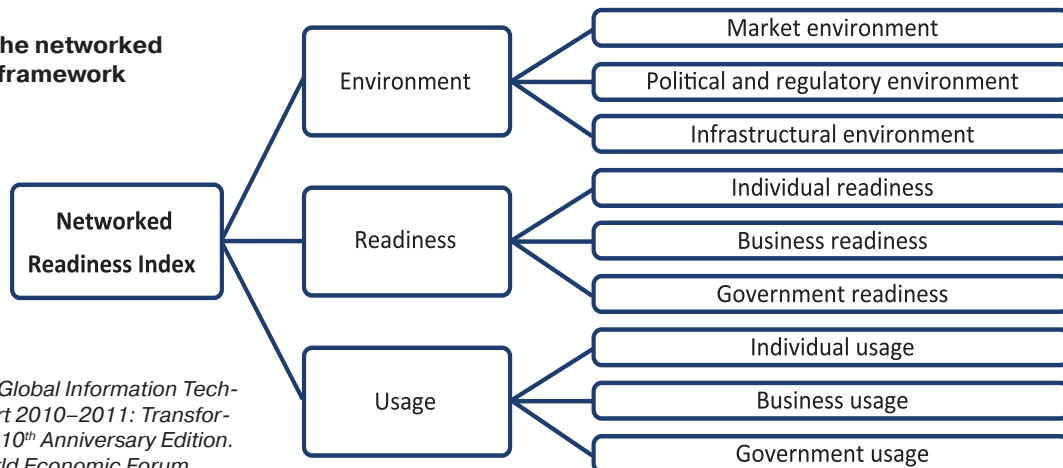
Figure 2: Importance of technological readiness for economic development

Note: higher ranking by Technological Readiness means lower standing of a country
Source: WEF, IMF

2.3. Networked Readiness

Recently the focus of attention in most countries has shifted from the issue of ICT access to the problems of making the best use of ICT to facilitate business innovation and to improve governance and social cohesion. In particular, according to WEF, the successful application of ICT is enabled by the country’s overall ICT environment, including market conditions and the regulatory climate. Networked readiness requires society-wide efforts, namely respective actions by individuals, business and government. At the same time, ICT readiness of stakeholders results in higher effectiveness of their daily activity. These factors are represented by the Networked Readiness Index (NRI), which illustrates the national environment for ICT development and diffusion (including business climate, human and hard infrastructure needed for ICT).⁴ Additionally, it also highlights the joint responsibility of individuals, businesses and government in respect to leveraging ICT.

Figure 3: The networked readiness framework



Source: The Global Information Technology Report 2010–2011: Transformations 2.0. 10th Anniversary Edition. INSEAD, World Economic Forum

⁴ The Global Information Technology Report 2010–2011: Transformations 2.0. 10th Anniversary Edition. INSEAD, World Economic Forum

The connectivity of individuals, business and the government becomes more important as the role of Internet increases. The intensive use of Internet requires faster and higher quality broadband as well as fixed and wire-less networks. The governments in many countries invest into building digital highways — nationwide high-speed broadband based upon a combination of fixed and wireless networks — as they foster socioeconomic development of a country.⁵

Even though Ukraine has mobile penetration rate above 100,⁶ fast growing Internet usage and a dynamic ICT sector, it does not have a favorable environment for ICT diffusion, which is a prerequisite for sustainable economic growth. Ukraine ranks 90th out of 138 countries according to the NRI 2010–2011.⁷ The country has lost 15 places as compared to the NRI 2008–2009⁸ due to lagging behind other countries in promoting ICT. The country occupies 98th position in the Environment subindex, 82nd in the Readiness subindex, and 86th in the Usage subindex. Ukraine's market environment (128th place) is unattractive, while the regulatory framework for ICT uptake (122nd) leaves much to be desired. The Readiness subindex illustrates that individual readiness is rather high in Ukraine (28th), while business and government readiness are low (106th and 122nd respectively). Low business readiness is likely to be explained by the unfriendly business environment,⁹ while low government readiness could be attributed to a lack of a clear official ICT strategy and low capacity to use ICT. Ukraine ranks 120th out of 138 according to “government prioritization of ICT”. Therefore, ICT development desperately needs active government policies.

Box 1: National Broadband Plan, the USA

In March 2010 the US Federal Communications Commission (FCC) released The National Broadband Plan at the request of Congress. The underlying premise of the plan is that increasing broadband access is a key mechanism for achieving other national objectives, including improving education, healthcare, energy efficiency, public safety, job creation and economic growth. The plan envisages a key role for the government in facilitating broadband development, including:

- creating policies to ensure robust market competition in the broadband ecosystem
- efficiently allocating assets controlled or influenced by the public sector, such as spectrum and public infrastructure
- encouraging the deployment, adoption, and use of broadband in areas where the market alone is not enough (e.g. where the deployment cost is too high to earn a private capital return or where households cannot afford to connect)
- providing firms and consumers with incentives to extract value from the use of broadband, particularly in sectors such as education and healthcare, among others.

Source: *The Global Information Technology Report (GITR) 2010–2011: Transformations 2.0*. INSEAD, World Economic Forum.

5 *The Global Information Technology Report (GITR) 2010–2011: Transformations 2.0. 10th Anniversary Edition*. INSEAD, World Economic Forum.

6 *The participants of different mobile operators on the market defining favorable tariffs for communication within home network pushed some people to purchase more than one Sim-card*.

7 *The Global Information Technology Report (GITR) 2010–2011: Transformations 2.0. 10th Anniversary Edition*. INSEAD, World Economic Forum.

8 *The Global Information Technology Report (GITR) 2008–2009: Mobility in a Networked World*. INSEAD, World Economic Forum.

9 *Ukraine was ranked 77 (out of 82 countries) between 2006 and 2010 in the EIU Business Environment ranking, and it was the last among countries of regions (Azerbaijan, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine)*.

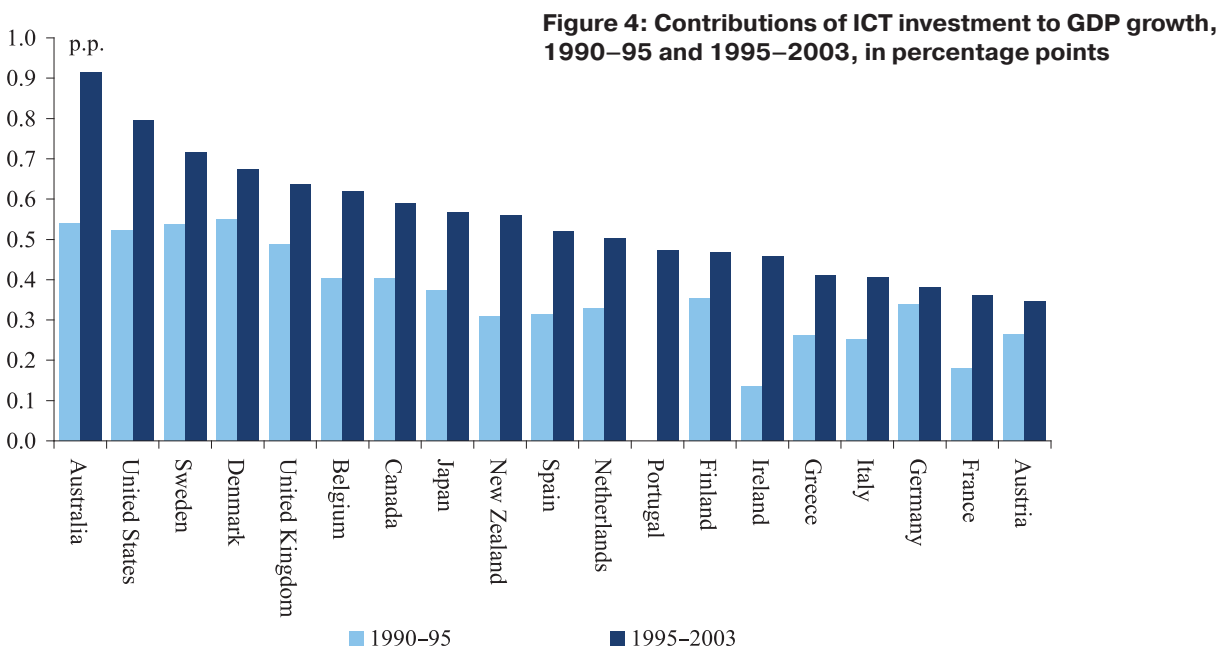
2.4. Impact of ICT on Social and Economic Development

ICT generates a wide range of economic effects, which can directly or indirectly enhance welfare and facilitate social and economic development.¹⁰ Direct impact relates to the positive effect of ICT on productivity growth resulting from an increase in employment in ICT and ICT related sectors. There is also an indirect impact on welfare and economic growth. The list of the principal effects is as follows:

- increase in employment due to investments into the ICT sector and due to ICT-enabled reforms and structural changes
- higher labor market flexibility
- creation of new business models as many services could be provided from any location
- improved business environment due to more efficient and high-quality government e-services
- rapid increase in trade in services as trade costs decline, information improves, while the range of tradable goods increases
- improved health care provision
- decline in poverty

As a result, ICT diffusion helps to meet UN Millennium Development Goals, which is a strategic priority for any country.

The contribution of ICT investments to GDP growth increased as compared to the beginning of 1990s. Between 1995 and 2003 it ranged from 0.347 percentage points to 0.915 percentage points of annual GDP growth in OECD countries (see Figure 4). This translates to just under 20% of economic growth for those countries during this period. Since 2003, we can expect that this contribution has increased due to higher ICT diffusion.



Note: 1995–2002 for Australia, France, Japan, New Zealand and Spain.

Source: OECD Productivity Database, September 2005, (www.oecd.org/statistics/productivity)

¹⁰ Measuring the Information Society 2010, Informational Telecommunication Union, 2010

Other estimates show that increased specialization in knowledge-intensive activities and broadband-based developments resulted in a growth of European Gross Value Added by 0.71% in 2006 (by 0.89% for the most advanced countries), explaining on average near 23% of real GDP growth in the region.¹¹ In countries where broadband is less developed, the impact on growth made up 0.47%.

Box 2: Impact of the Internet on economic development

According to a recent McKinsey research conducting for 13 largest countries, which generate near 70% of world GDP and are on the different stage of development, Internet accounts for 3.4% of their GDP. The Internet is still in its infancy, and the weight of the Internet in GDP varies drastically, even among countries at the same stage of development. While the Internet accounts for around 6 percent of GDP in advanced countries such as Sweden and the United Kingdom, in 9 out of the 13 countries its contribution is below 4 percent, leaving tremendous room for further Internet development. The study showed that 75% of Internet impact arises from traditional industries and not the IT sector itself. As a result, Internet drives modernization. Moreover, Internet generates astonishing consumer surplus and improves living standards.

Internet usage helps to increase labor productivity, which results in lost jobs. On the other hand, it creates jobs. In particular, 2.6 jobs are created for every job lost.

Source: Internet matters: The Net's sweeping impact on growth, jobs, and prosperity, McKinsey Global Institute, May 2011

Overall, ICT development and its impact on a country's competitiveness and social and economic situation depend on the government policies and respective regulatory framework for ICT development and diffusion. All stakeholders should be ready to use ICT in their everyday life, which requires improved ICT infrastructure.

2.5. Lessons for Ukraine

Improve environment and infrastructure for stimulating ICT diffusion

According to the Networked Readiness Index (NRI), Ukraine has one of the most unfriendly environments for ICT development and usage. Overall investment climate remains poor. In 2011 Ukraine is ranked 145 (out of 183 countries) according to *Ease of Doing Business*.¹² Therefore, it is crucial for Ukrainian authorities to prioritize efforts to improve the business climate. Higher credibility of government actions will inevitably result in larger investments in ICT and higher ICT diffusion.

The government should also ensure development of high-capacity fibre-optic access lines in the country's total broadband connections, because this technology is cost-effective and has a much higher capacity than other facilities based on wireless or enhanced copper access. The respective projects could be implemented in the form of public-private-partnership (PPP).

The government would also benefit from fostering wireless broadband access, in particular through facilitating the development of WiFi, WiMax and 3G mobile and ensuring efficient competitiveness of operators. Such policies would increase much-needed Internet and broadband access in rural areas.¹³

¹¹ *The Impact of Broadband on Growth and Productivity, MICUS, A study on behalf of the European Commission (DG Information Society and Media), 2008*

¹² <http://www.doingbusiness.org>

¹³ *A rural-urban digital divide is typical for most countries. However, it is mainly a question of finding venues with technology to access the Internet (See e.g.: Furuholt, B., Kristiansen, S. A Rural-Urban Digital Divide? Regional Aspects of Internet Use in Tanzania, Proceedings of the 9th International Conference on Social Implications of Computers in Developing Countries, Sao Paulo, Brazil, May 2007).*

Box 3: Increasing ICT diffusion with the help of PPP. Guatemala case

In the mid-2000s the Ministry of Education of Guatemala formed a strategy to increase the use of ICT in the learning process. As many teachers lacked IT skills mostly due to the fact that they did not own a computer, the Ministry formed a public-private partnership (PPP) “Opening Futures” in 2007. It teamed with the Microsoft, banks, hardware producers, banks and retailers. In less than 6 months 58,000 computers were delivered to Guatemala’s teachers. 75% of the cost of purchasing the computers was covered by the state, while the teachers paid the rest with a 3-year loan with a monthly payment at near USD 10. Teachers could choose one of 20 types of computers in a retail store. Participation in a one-year IT training course was a prerequisite for purchasing the computer within the framework of the program. Additionally, to improve the IT skills of the teachers, all of the computers were preloaded with IT resources and materials that would be helpful in the teaching process. Overall, nearly 6 out of 10 teachers took advantage of the program and purchased a computer. As a result, “Opening Futures” reduced the digital divide among teachers and increased IT usage in the learning process. It also supported one more goal of the state policy — namely, the decentralization of teacher training. Connection to ICT saved time for traveling of teachers to cities from remote areas, enhanced efficiency of training, and increased the quality of teaching resources.

Source: mms://wm.microsoft.com/ms/industry/publicsector/pta/guat_subtitles.wmv

Box 4: WiFi use in remote and rural areas

The Estonian case reveals that the increase in access to the WiFi could be achieved relatively quickly. For this, the initiative and competitive market is needed. Today, Estonia offers free and public WiFi access even in remote districts.

India has also decided to stimulate WiFi usage as it turns out to be cheaper than costs of land-line telephony. As a result, without having infrastructure for fixed-line communication, India has directed efforts to implement more advanced ICT.

The U.S. authorities support the development of WiFi in order to improve access of rural areas to the Internet with the aim to stimulate job creation and lay the groundwork for future business growth. In particular, the federal government awards grants as part of the federal American Recovery and Reinvestment Act to help residents and businesses gain access to the Internet. In particular, the grants were envisaged for areas underserved by Internet service providers (e.g. grant was provided for more than 68,000 residents in rural Stevens, Spokane and Ferry counties).

Source: <http://www.csmonitor.com/World/Global-News/2011/0304/In-Estonia-Communism-s-collapse-paved-the-way-for-Wi-Fi-everywhere>, <http://www.spokesman.com/stories/2010/sep/14/federal-grant-bringing-wi-fi-rural-areas/>

The government could also consider the possibility to install public Internet access facilities either itself or in cooperation with business and other institutions. In particular, it could become more active in providing the Internet access in public libraries, thus, contributing to the successes that have been achieved already by the project “Bibliomist”.¹⁴

The state policies should be based on the concept of e-inclusion, which relates to higher connectivity of people to ICT. Therefore, the use of computers and Internet should be promoted. The implemented measures should ensure that population has affordable access to high quality fixed and wireless data and voice connections.

¹⁴ The “Bibliomist” project aims to increase access to the information with the help of libraries (<http://bibliomist.org/>). The project’s goals are to provide IT & Internet access to to 1,600 public libraries, ICT training to around 1,000 librarians, and promote the role of the library and increase public awareness on the role played by libraries. The project is financed by the Bill and Melinda Gates Foundation with support from Microsoft, IREX, USAID, , the Ministry of Culture and the Association of Ukrainian Librarians.

3

IMPORTANCE OF E-GOVERNMENT TO COUNTRY DEVELOPMENT



3.1. The Concept of E-government

E-government has developed significantly in recent years in many countries, though, with varying success. E-government could be defined as the use of an ICT-based tool to provide better public services to citizens and business.¹⁵ Traditionally, three major forms of e-government are defined: government-to-citizens relations (G2C), government-to-business relations (G2B) and relations between different government agencies (G2G). E-government enables citizens and businesses to communicate and interact with public servants primarily using Internet. As a result, major types of activities conducted within e-government are: provision of information (regulatory and legislative issues), communication between government entities and citizens / business, conducting transactions (tax declarations, applying for social benefits or grants), and governance (participation of citizens in decision making process). As a result, the most popular form of implementing e-government is a creation of e-government portals and platforms.

3.2. Benefits of E-government

If implemented properly, e-government enables citizens, companies and organizations to carry out their business with government more easily, more quickly, more transparently and at a lower cost. As a result, e-government has become a force for effective governance and citizen participation at national and local levels.¹⁶ However, effective e-government requires organizational change and new skills. International evidence demonstrates that e-government has the potential to:

- Reduce corruption and increase transparency
- Increase efficiency and effectiveness
- Radically change access to information and the government
- Increase opportunities for underprivileged groups
- Offer services according to citizens' choices
- Ensure and facilitate inclusion of weaker groups
- Strengthen democracy

Due to the benefits of e-government, many countries have become active in this area. In May 2010, the European Commission (EC) approved the Digital Agenda for Europe, a roadmap defining the ICT role for the economy. The EU, as a single market combining many countries, emphasizes unified rules and information sharing, which requires well-functioning e-government between the governments of member-states (G2G).

International experience proves the importance of government-to-government (G2G) relations with the use of broadband. It involves primarily the use of broadband for information sharing, which creates significant potential savings.¹⁸ These savings are mostly related to reducing time needed for completing tasks by public servants as all required information is provided rather automatically. As a result, they might have more time for providing additional user-friendly services to business and citizens.

¹⁵ European Commission Information Society, http://ec.europa.eu/information_society/activities/egovernment/index_en.htm

¹⁶ United Nations: *E-government Survey 2010. Leveraging e-government at a time of financial and economic crisis*, United Nations, 2010

¹⁷ *The Global Information Technology Report (GITR) 2010–2011: Transformations 2.0. 10th Anniversary Edition*. INSEAD, World Economic Forum.

¹⁸ *Potential savings by public service from using broadband in G2G is estimated at EUR 176 bn per year for Europe* (Source: *The Impact of Broadband on Growth and Productivity*, MICUS, A study on behalf of the European Commission (DG Information Society and Media), 2008).

Box 5: YESSER, the Saudi National e-government Program

The National e-government Program in Saudi Arabia, YESSER, was launched to provide better government services, increase efficiency in the public sector, and contribute to the creation of a knowledge-based society in the country.¹⁷ Simultaneously, the government conducted extensive regulatory changes, approving legislation favorable to ICT development.

Within the first five years, progress was made in two directions. First, is the implementation of robust shared services ensuring delivery of secure online services by the government. The second relates to the provision of organizational infrastructure to help government agencies successfully design and implement their e-government transformation plans, namely to transform traditional services to online ones, improving convenience as well as reducing time and costs. Over 1,000 e-services ranging from informative to transactional are now available on the national portal.

The next five year stage of the program began in 2011 and the focus has shifted to developing a skilled workforce. In particular, four topics are defined in the plan for this stage: building a sustainable e-government workforce; improving the public's experience interacting with the government; developing a culture of collaboration and innovation; and improving government efficiency. Human capital became the cornerstone of the program as there is a critical need to increase the number of skilled and experienced people available to deliver e-government in the country.

The advantage of the Saudi program is its consideration of e-government not just as a provision of public services online, but also as a tool to improve the relationship between government, business and citizens.

Source: The Global Information Technology Report (GITR) 2010–2011: Transformations 2.0. 10th Anniversary Edition. IN-SEAD, World Economic Forum.

Box 6: Case studies of e-government application

Angola's government has launched a portal that brings all governmental public information and services under the same platform and makes them available to citizens via the internet. Angolans can thus find information on government programs and are given the option to send their views and comments to the government. The information on government programs has increased tremendously the transparency of public services. The features included in the portal do allow for the performance of government functions online, as well as receiving feedback from the citizens.

In Peru the National Superintendent of Tax Administration, charged with the collection of taxes, initiated a computerized tax system in an effort to make its operations more efficient by using ICT. In 2003, tax payments started to be accepted online. In addition to tax administration, ICT has also been of benefit to other public institutions. For example, it has enabled the Office of Social Security Normalization and Social Security and Health of Peru to relinquish their tax collection function to the National Superintendent of Tax Administration. ICT has reduced the costs of digitizing forms by 20 per cent, and this efficiency in tax administration has reduced the number of personnel required to process taxes. At the same time, the number of returns that require verification and correction has been reduced, and fines for incomplete tax returns have been eliminated since the system rejects such returns.

Source: <http://www.unpan.org/DPADM/EGovernment/KnowledgeBaseofEGovernmentPractices/tabid/828/language/en-US/Default.aspx>

3.3. E-government as an Enhancer of Business Environment

Efficient e-government could result in lower queues and delays within a process of tax declaration, accounting and reporting, goods clearance, benefits collection, etc. and, consequently, reduce costs of taxpayers and business. Lower costs of tax declaration and other bureaucratic procedures for business result in lower overall administrative expenditures, leaving more funds for development. This is crucial for the development of small and medium enterprises.

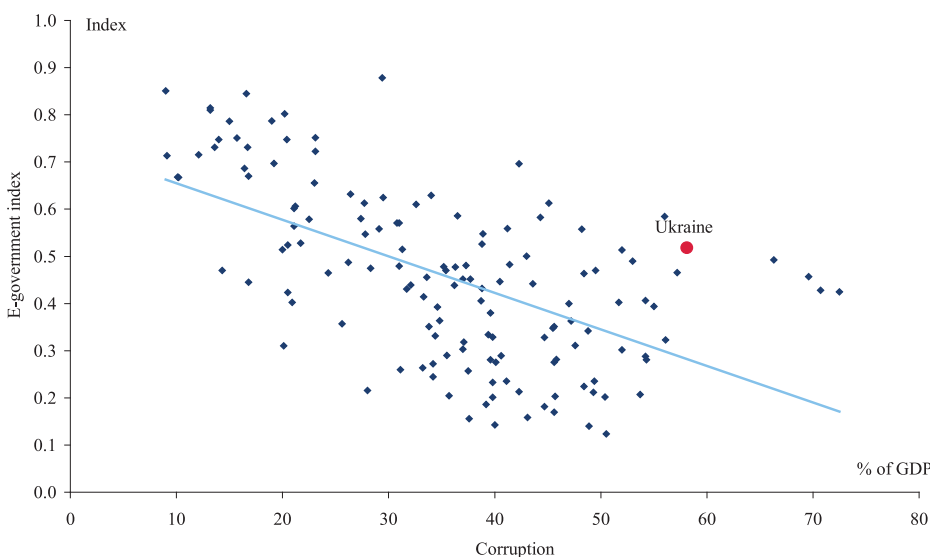
Box 7: E-government impact on costs

The introduction of electronic invoicing in Denmark saves taxpayers EUR 150 m and business EUR 50 m a year.¹⁹ According to the estimates of the European Commission, if electronic invoicing is introduced across the EU, savings would amount to over EUR 50 bn. In Italy e-procurement systems result EUR 3 bn lowered costs.

As e-government significantly decreases the number of face-to-face procedures between officials and citizens/business, corruption is likely to decline (Figure 5). In particular, the reduction in corruption with the help of e-government could be reached due to:²⁰

- *Prevention:* the e-government usually results in simplification of rules and procedures, as well as depersonalize and standardize delivery of services, thus reducing possible discretions;
- *Enforcement:* ICT allow for better opportunities to track decisions and actions;
- *Access to information and empowerment:* accountability to citizens increases due to government information published online;
- *Capacity building:* e-government requires that telecommunication infrastructure is strengthened, human resources are more ICT literate, and the culture of good governance is promoted.

Figure 5: E-government index and corruption



Source: UN Public Administration Program; Shadow Economies All Over the World: New Estimates for 1999–2007, Schneider, Buehn and Montenegro, 2009

¹⁹ http://ec.europa.eu/information_society/tl/soccul/egov/index_en.htm

²⁰ Fighting Corruption with E-government Applications, UNDP, APDIP e-Note, 8/2006.

One of the important components of e-government is e-procurement, which could be defined as the purchase and sale of goods, works and services with the help of ICT, primarily through Internet. E-procurement is typically organized as a government web-portal containing information related to procurement. The information provided on such websites varies by country. Usually it includes announcements of new tenders, stages of current tenders, applicants, final bids, etc. The costs of final bids are often published. As such, e-procurement provides buyers and sellers with the real-time information on current tenders. Thus, it provides interested stakeholders with more information and higher possibilities to monitor the results of tenders.

3.4. Extent of E-government Usage

The provision of information by government entities to the public (e-government availability) through Internet and other ICT does not solely define the level of e-government development in the country. A very important element is the use of information and e-services provided by the government (e-government usage), which depends on several factors, including:²¹

- Trust: citizens and business should have trust in the Internet as a tool to exchange personal information as well as trust in government and public sector entities;
- Easy access: the information and e-services provided by government agencies should be easy-to-find and meet quality standards;
- Awareness: low awareness results in low use of e-services provided by government agencies;
- Perceived benefits: the most basic benefits are those efficient and time-saving e-services.

Table 1: 20 basic public services which should be supplied online

Citizens	Businesses
Income Taxes Social	Contribution for Employees
Job Search	Corporate Tax
Social Security Benefits	VAT
Personal Documents	Registration of a New Company
Car Registration	Submission of Data to the Statistical Office
Application for Building Permission	Custom Declaration
Declaration to the Police	Environment-related Permits
Public Libraries	Public Procurement
Birth and Marriage	Certification
Enrolment in Higher Education	
Announcement of Moving	
Health-related Services	

Source: European Commission, <http://ec.europa.eu/>

Such factors, especially the latter, seem to be taken into account by the European Commission while defining 20 basic public services for citizens and business, which are to be supplied online (see Table 1). Between 2007 and 2010 the percentage of online availability of these public services in EU-27 increased from 58.27% to 84.28% with Austria, Italy, Sweden, Ireland, Malta and Portugal delivering all these services online in 2007.²²

²¹ Based on: Study on the Measurement of E-government User Satisfaction and Impact. European Commission study report, Deloitte Consulting and Indigov, Brussel 2008.

²² <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsiir120>

However, during this period e-government usage increased only from 30% to 32%, with only Iceland, Denmark, Sweden, and Norway registering over 60%.²³

Box 8: E-government requires e-citizens: case study of Argentina

After the crisis in 2002 the National Administration of Social Security Provider of Argentina (ANSES) faced the problem of long queues of vulnerable people eligible for social security, many of whom came from remote distances. In order to more efficiently serve pensioners, ANSES started placing more services online. At the same time, there was a large gap between the online services provided and the possibility of pensioners to use them due to lack of IT knowledge. To address this problem ANSES together with Microsoft, Intel and other local companies formed a public-private partnership “Grandparents PCs”. The program was aimed at increasing access of pensioners to credit and to technologies. The pensioners now can purchase their own PCs via access to credit from the National Bank. The zero-percentage 40-month loan payment is deducted directly from the pension. PC training is included into the purchasing price. Moreover, the digital gap is reduced as every computer sold contributes to a fund to provide PCs to senior citizens centers.

Source: http://www.microsoft.com/industry/publicsector/pta/downloads/arg_subtitles.wvx

Overall, the government policies should be aimed at stimulating usage of e-services provided by government and public entities taking into account large investments into bringing services online. Otherwise, new types of exclusions and lost opportunities for higher growth might be generated. As a result, many governments have shifted focus in the formation of e-government from supply-side issues to the user-centric approach.

3.5. E-government Regulation in Ukraine

The issue of implementing e-government seems to have been in the policy agenda of Ukrainian policy makers for several years. It has started from widespread presence of the central executive bodies and other authorities in the Internet with developed websites. However, real steps forward were made only last year.

First, in April 2010 the Cabinet of Ministers created the National Center on E-Government (<http://www.nc.gov.ua/>). The center was created with the help of the International Renaissance Foundation (IRF), which financed the project. The major objectives of the Center include coordination of work on implementing e-government, and conducting research, expert, consulting, learning activities in supporting central executive bodies and local government entities (LGEs), business and public organizations in implementing and usage of e-government. Even though this Center was created mainly by the government and for government purposes, the projects developed by this organization are created in close collaboration with the IRF and financed by IRF. In particular, the project on creation and implementation of e-platform for public appeals is to be conducted.

Moreover, in March 2010 there was initiated the project “Electronic government”, which involved the State Committee on Science and Information, Ministry of Social Politics, Ministry of Building and Regional Development, the Main Department of Civil Service of Ukraine, State Administration of Communication, State Committee on Archives, Pension Fund, State Tax Administration, Dnipropetrovsk Regional State Administration (RSA) and Rada, Odessa RSA and Rada, and Rivne RSA, with the participation of the International Renaissance Foundation, East Europe Foundation and the OSCE co-coordinator. The latter three organizations are currently financing several projects primarily on the local government level. However, so far, no budget financing has been allocated for the project. In the first quarter of 2011, no hryvnia were allocated for the purpose, even though the State Budget Law envisaged UAH 1.0 m spending on e-government in 2011.

²³ <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tsiir130&plugin=1>

The National Center on E-Government proposes three courses for civil servants and other interested people: organization of work with public appeals, basics of electronic documentation and electronic signature, and tax code. The first two courses are suggested to be learned on the basis of downloadable materials distributed by topics. At the same time, the Tax Code course is available at the webpage on the website of State University of ICT (<http://www.duikt.edu.ua/>), where the texts of the Code and the official handbook on its application are available for downloading as well as suggested video-seminars on various chapters. However, the possibility for feedback from the Center to the learner is not envisaged.

In addition, there was elaborated a web-portal of state system of electronic public appeals to the central government bodies as well as LGEs (<http://www.cwn.com.ua/z/>). This portal is working under testing mode at the moment. In order to make an e-appeal a person should have electronic signature, which is provided by yet another organization 'Central certification body' (<http://czo.gov.ua/>). However, in order to apply for the electronic signature the company or physical person — (entrepreneur) should go to the Committee on Science, Innovations and Informatization for the application and the list of required documents. Therefore, it is a longer process. Then, in December 2010 the Government approved the Concept on the E-government Development in Ukraine,²⁴ which states that one of Ukraine's priorities is the development of information society, which needs developed e-government. The document is short (6 pages) and rather vague. On the first stage of implementing the concept (between 2011 and 2012) it is planned to develop the necessary legislative base, unification of standards for web-sites of central executive bodies and LGEs, creation of single web-portal of administrative services and of national register of e-resources, etc. On the second stage (2013–2014) the government plans to ensure provision of the e-services in all spheres of life, learning how to use e-government for efficient communication between government and citizens / business, etc. The final stage (2014–2015) is planned to be characterized by creation of a single web-portal of e-government and national depository of e-resources. Overall, the approval of the concept is a step forward, however it is still rather general and lacks any defined indicators for measuring e-government in different agencies, thus, making efficient monitoring of its implementation a difficult task.

The implementation of e-government in Ukraine was also named as one of the priorities in the annual Address of the President of Ukraine, Victor Yanukovich, to the Verkhovna Rada on April 7, 2011.²⁵ This should become the next step following the administrative reform, which was started in December 2010. The final goal is to approach best standards in this sphere. The Presidential address envisaged plans to approve the concept and the action plan for implementing e-government in the country. This is somewhat surprising taking into account that the concept was approved several months before the Presidential address was made. Therefore, it is not clear whether a new concept is to be approved. The address foresees the use of electronic documentation and electronic official signature in the government bodies as well as the electronic provision of state services. Additionally, the President acknowledges the role of e-government as of a tool for combating corruption. However, full introduction of e-government still seems to be a long way ahead.

3.6. E-government Development in Ukraine

As of today, central executive bodies, the President, the Parliament as well as the biggest local government entities have already launched their web-sites providing information to citizens and business. However, the level of services provided on-line is rather limited.

The number of e-services provided is on the upward trend. In particular, they include the possibility of asking questions online and receiving answers by e-mail or in the official forums. Additionally, several large cities have already made it possible to pay for utility services online.

²⁴ The draft Concept was developed by the National Center on E-government in close cooperation and with financing from IRF.

²⁵ Address of the President of Ukraine to the Verkhovna Rada in 2011 "Modernization of Ukraine — our strategic choice".

Box 9: Web-portal of the Ministry of Education

The Ministry of Education, Science, Youth and Sports supports the web-portal ‘Single educational informational window of Ukraine’.²⁶ This web-portal contains hassle free information on educational establishments of Ukraine, provides selected educational books for free downloading and contains recent news related to the education.

Since April 2011 the Government approved the experimental program “Electronic application for an admission to universities 2011”, which provides chances to school graduates to apply for studying online. The web-portal already contains the video-information explaining the e-application procedure.

Box 10: E-government in Kyiv

The level of e-government in the regions differs. The major success in e-government was made in Kyiv, where all housing and utility services bills can be paid through Internet via system WebMoney. As a result, citizens with access to the Internet received a possibility to avoid usual long queues for paying for such services.

Since May 2011 it is planned to launch the possibility to apply for car registration in Kyiv through the Internet. The applicant would fill out a special application online and the next day could come for the registration. Thus, the required time for the procedure and paperwork would decline.

One of the examples of e-services provided by the State Tax Service is the possibility to submit electronic tax declarations, even though it is still limited due to several reasons. First, the software for electronic tax declaration is not always provided free of charge. Second, not all business and private entrepreneurs — nor tax inspectors — have enough e-skills to use this e-service. Third, there is still little trust in such form of tax declaration.

Vinnitsa oblast administration is an interesting example of using ICT for improving quality of services provided to individuals and business. In particular, the ‘Transparent Office’ is opened there, which represents a one-stop-shop. Citizens could come and make an appointment for any service provided by the LGE using the e-terminal. All personnel working in this Office are equipped with computers connected to the same data set, intranet and documents, which makes their work more effective.

The widespread presence of government agencies in the Internet resulted in rather favorable ratings of Ukraine by e-government. Even though all components of environment index in NRI are evaluated as very negative, the ranking for the indices of e-governments are much better.²⁷ In particular, the ranking of the quality of services provided by the government online is 60th, while the rank in the e-participation index²⁸ is 47. According to the UN e-government ranking, Ukraine is 54th out of 192 countries. At the same time, according to the subindex of NRI on impact of ICT on access to such basic services as education and health, the country is at 105th position. An extent to which ICT helped the government to improve quality of its services is even lower (112th), which is likely to be explained by little service provision with the help of ICT.

E-procurement in Ukraine remains low, which prevents the country from reducing administrative costs. According to the index of government procurement of advanced technology products, the country is ranked 111th, lower than most emerging economies. Success in government promotion of ICT is low (103rd), however it is still higher than in Poland, Bulgaria, Slovak Republic, Russia and Hungary.

²⁶ <http://www.osvita.com/ev/>

²⁷ *The Global Information Technology Report (GITR) 2010–2011: Transformations 2.0. 10th Anniversary Edition. INSEAD, World Economic Forum.*

²⁸ *E-participation assesses quality, relevance, usefulness and willingness of government websites for providing online information and participatory tools and services to people.*

3.7. Lessons for Ukraine

Introduce a comprehensive and efficient e-government system

E-government should become a part of the philosophy and bureaucracy of the government and government agencies on all levels. Such a process is multidimensional and requires the focused attention of policy makers. It is clear that the government should increase the level of e-government availability as well as stimulate e-government usage. For this, a comprehensive program on e-government should be designed and implemented extending the provisions of the previously approved concept. The following program's objectives should be defined:

- Development of electronic services
- Provision of high quality public services
- Reduction in the administrative burden for citizens and business
- Development of a skilled workforce;
- Improved quality and accessibility of electronic public services for citizens and businesses
- Increased government efficiency
- Stimulation of innovations.

The Program should focus on such issues as e-participation, administrative innovation (including reduction in bureaucracy) and putting the Internet at the core of public service delivery. It should envisage transition to paperless management of work in public administration. It would be beneficial to use ICT not only in public administration, but also in delivering services in such public sectors as health and education.

A clear action plan on implementing the Program should be approved and published. The progress of the Program implementation should to be monitored and the plans of every stage could be updated accordingly. For this, the Program should contain developing indicators for tracking progress against defined objectives. In particular, the Document should clearly specify which services should be delivered online in central executive bodies as well as at the level of LGEs. The list could be similar to the 20 basic public services approved by the European Commission. Besides, Ukraine should adopt the list of indicators for measuring e-government development.

Connect all local and central governmental departments to the Internet

The Government should create a unified government portal, which brings all governmental public information and services under the same platform and makes them available to citizens via the Internet. Ukrainians should be able to find information on government programs, and be given the option to send their views and comments to the government. The system should enable usage of all available online public services and provide information on governmental programs. The portal should contain official government forms and provide for the possibility to make appointments with government official and to download documents.

All central government bodies and LGEs should establish their own websites to provide all the required and useful information. In particular, it would be beneficial to ensure wide-scale provision of goods and services online, which provides high utility to citizens and businesses. The information on the websites should be easy-to-find and of high quality. E-services should be clearly defined on different Internet platforms. In order to measure the adequacy of provided information, the surveys could be conducted.

The State Statistical Committee's website should provide information on the national system of ICT related indicators. Other statistical publications should also be made public online.²⁹

²⁹ Recently, the SSCU has already moved into this direction. However, not all statistics is available on the web-site.

The government agencies would benefit from creating intranets, which would help them to exchange information within one agency. The collaboration across all levels of government should be ensured. The G2G component of e-government should be strengthened as today information sharing by different government entities is at a very low level, wasting time and money for government as well as for citizens and business. In particular, interconnected and interoperable basic public registries are necessary.

All civil servants should be equipped with computers with Internet access and should have their own e-mail addresses. Besides, all public employees should be aware of the issues related to e-government. For efficient use and delivery of e-government, the e-skills of civil servants must be improved.

Stimulate e-government usage

The government would benefit from conducting an awareness campaigns for citizens and business to inform which services are provided online. Having this in mind, the Government could create a one-stop-shop government network of all contact points providing e-government services.

User-centricity should become a core element of e-government. The government agencies should provide quality e-services to citizens and business, so as to ensure a good experience of e-government. This would result in higher trust in e-government. At the same time, the policies should be also aimed at securing personal information of individuals and business provided on the official web-sites.

Surveys of individuals and business could help government agencies to improve the quality of information and content on their websites.



4

NEED FOR E-SKILLS IN THE KNOWLEDGE ECONOMY



4.1. Importance of E-skills for Employability

4.1.1. Concept of E-skills

The introduction of ICT has led to structural changes in the global economy. Countries move towards knowledge-based economies, where knowledge and skills of a workforce, rather than physical capital, determine country's economic and social development. Thus, promoting innovations, productivity and competitiveness of individuals, enterprises and countries is becoming of great importance. Individuals' knowledge and skills increasingly determine one's employability and lifetime income. Ensuring that all people have access to learning and training opportunities during their entire life cycle by means of lifelong learning becomes an important pillar of human resource development and training policies and programs.

The changes in the type of economy impacted labor markets through shifts in traditional labor movements and types of required skills. To reap the rich benefits of knowledge-based economy, it is important for workers to be able to cope with technology-related shifts in the labor demand and adapt to changes in required skills. Without skills, investments in other resources (e.g. new technologies and infrastructure) collapse. As a result, demand for people with "e-skills" (ICT skills), which are generally defined as skills required in knowledge-based society, is steadily growing. Non-ICT related professions increasingly require at least basic user e-skills.

Box 11: IT training in Japan

Japan has two types of government-supported IT training programs. Local governments support basic IT training courses (basic computer operations, e-mail, Word, etc.). In 2000 (ending March 2011) just over 100,000 people had enrolled in over 6,000 classes. By the end of 2001, the number had increased to just over 5 million and over 300,000 classes.

The government also supports training for professional IT skills (Information and Communications Personnel Training Support System), which is organized by non-private organizations and public corporations. 1,299 and 5,065 individuals enrolled in these courses in 2001 and 2002, respectively.

Source: OECD Information Technology Outlook 2004

There are several possible definitions of e-skills. In the European Commission's report "e-Skills for the 21st Century", the term 'e-skills' covers three main categories:³⁰

- ICT practitioner skills: capabilities required for researching, developing, designing, strategic planning, managing, producing, consulting, marketing, selling, integrating, installing, administering, maintaining, supporting and servicing ICT systems.
- ICT user skills: capabilities required for the effective application of ICT systems and devices by the individual. ICT users apply systems as tools in support of their own work. User skills cover the use of common software tools and of specialized tools supporting business functions within an industry. At the general level, they cover digital literacy: the skills required for confident and critical use of ICT for work, leisure, learning and communication.
- E-business skills (also called e-leadership skills): capabilities needed to exploit opportunities provided by ICT, notably the Internet; to ensure more efficient and effective performance of different types of organizations; to explore possibilities for new ways of conducting business/administrative and organizational processes; and/or to establish new businesses.

³⁰ Husing Tobias, Korte Werner B. *Evaluation of the implementation of the communication of the European Commission : E-skills for the 21st Century*, October 2010, Bonn

4.1.2. Impact of E-skills on the Labor Market

Apart from the above described skills, ICT facilitates the acquisition and deployment of traditional skills that employers need the most: literacy, numeracy, teamwork and collaboration, meeting deadlines, critical and strategic thinking.³¹ The study of International Data Corporation (IDC) shows that there is a universal belief that e-skills are a prerequisite to succeeding at work, regardless of country, type of industry or function held in the organization. Overall, 40% of respondents interviewed said that a person without basic ICT skills would likely not be considered for a job. Depending on the position, this can increase to as much as 66% of respondents.³² In the current and future work environment, ICT skills are seen as key to be able to perform the job — and those without e-skills, particularly basic e-skills, are severely hampered when competing in the job market. For example, only in the EU jobs occupied by highly qualified people are expected to rise by 16 million between now and 2020, while those held by low-skilled workers will decline by around 12 million.³³ The Table 2 provides the list of occupations in the EU and USA that already require developed e-skills.

International evidence and research indicate that e-skills are increasingly important for sustainable economic growth. At the same time, today there is an increasing lack of e-skills in many countries as the number of jobs requiring e-skills constantly increases. According to one survey,³⁴ 90% of jobs in the EU will require some sort of ICT skills by 2015. In particular, the study conducted for the EU revealed that there is an increasing lack of e-skills in the European workforce. Resulting e-skills shortages are estimated to create an excess demand of at least 384,000 ICT practitioners in the EU by 2015.

ICT does not only challenge workers' qualifications, but also changes modes of employment. On the one hand, ICT has made many jobs outdated. For example, some routine jobs were replaced by automatic machines controlled by computers. On the other hand, ICT created multiple new jobs and changed working patterns (see Box 12). The creation of entirely new industries such as the software, computer, micro-electronic, the GSM industries, has brought about new employment opportunities in the form of outsourcing, which provided distance jobs to many IT specialists. In particular, with the rapid ICT development and diffusion the potential for tasks that can be carried out remotely has recently significantly increased. For OECD countries around 20% of total employment is accounted for by people who are performing such types of activities that could be potentially carried out from any location, based on the following four characteristics:³⁵

- People carry out jobs likely with an intensive use of ICTs in order to produce their output.
- Their output can be traded/transmitted with the help of ICTs (such as ICT-enabled trade in services).
- The work has a high explicit information or “codified knowledge” content (and no or little implicit knowledge).
- The work does not necessarily require face-to-face contact.

Under the condition that required infrastructure and skills are in place, such tasks could be completed from home in remote or rural areas, in developing countries. As a result,

31 *Task-Force on ICT Sector Competitiveness and ICT Uptake. Working Group 5. Skills and employability. TOPIC PAPER. October 2006*

32 *E-Skills — The Key to Employment and Inclusion in Europe. Sponsored by Microsoft. Marianne Kolding. Vladimir Kroa. January 2007*

33 *An Agenda for new skills and jobs: A European contribution towards full employment, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions.*

34 *Husing Tobias, Korte Werner B. Evaluation of the implementation of the communication of the European Commission : E-skills for the 21st Century, October 2010, Bonn*

35 *Measuring the Information Society 2010, ITU*

outsourcing and offshoring contribute to higher self-employment, women's and disabled people's employment opportunities.

At the same time, e-skills are often developed outside formal education as there is a gradual shift from teacher-centered education and training towards self-directed learning.³⁶ This shift has been accelerated by the necessity of individuals to use selectively all available knowledge. Such learning tends to be informal. Therefore, recognition and certification of informally acquired skills and knowledge become key components of the policies that endeavor to enhance individuals' motivation to learn, improve their access to further learning opportunities, and reward them for qualifications gained.

Box 12: New working patterns induced by ICT

Coventry University Enterprises: Flexible Working. Coventry University Enterprises Ltd (CUE Ltd) provides a range of business and IT services to companies across the UK and Europe. In particular, it introduced an initiative called 'Location-Independent Working' (LIW) to test employee flexible working schemes. The initiative has led to the development of a formal written flexible working policy that covers areas such as hours of work, health and safety, insurance, travel arrangements, data security, training and equipment. Employees are encouraged to work 'out of the office' between 40–60% of the time. Since the start of the initiative, 100% of the participants have chosen to work flexibly. Flexible workers are equipped with the necessary technology to do their jobs.

Redbrick Enterprises Ltd: Boosting Productivity at Home. Redbrick Enterprises Ltd is a consultancy business run from a head office in the UK. The company has 5 home-based employees who utilize broadband connections to service clients across the UK. The employees communicate using instant messaging tools and keep in touch with client projects through an online project management tool. The team has reaped the rewards of being home-based by saving up to one day per week through cutting out the daily commute and the increased productivity that comes with working at home. Having recognized a dramatic increase in the number of businesses being started from a home base (around 75% of new start-ups are based at home) Redbrick has launched a website that offers information and inspiration to home workers across the UK.

Source: *Improved Work-Life Balance: The Role of ICT. Orange. September 2006*

4.1.3. E-skills in Ukraine

Ukrainians are considered to be well-educated, if measured by enrollment rates. In 2010, Ukrainian higher education institutions produced nearly 33,000 computer science graduates,³⁷ which constitute 5% of total amount of graduates and is large enough.³⁸ However, employers often cite inadequate skills of the workforce as one of the major obstacles for their business development (see Box 13). So, a large share of the labor force does not have the necessary competencies for successful employment. Adults with low educational attainment are seven times less likely to be involved in continuing education and training than those with high attainment levels, and, thus, face increasing difficulty in adapting to newly-emerging and evolving skills needs. Such situation exists not only in Ukraine: more than 30% of Europeans have rarely or never used the Internet (as reported

36 *Learning and Training for Work in the Knowledge Society. Report IV (1). ILO// http://www.ilo.org/public/libdoc/ilo/2002/102B09_22_engl.pdf*

37 *Here, computer science cover such fields as: computer science; computer systems, automatics and management; Computer engineering; telecommunications; automation of computer-integrated technology. Graduates could be of different qualification level: junior specialist (10,127 persons), bachelor (5,474), specialist (13,358), master (4,176).*

38 *Source: State Statistics Committee of Ukraine*

for 2007), which significantly hampers their employability.³⁹ Ukraine belongs to the group of 'Low Internet Penetration Countries' with 14.6% of the population having access as of March 31, 2009.⁴⁰ Therefore, it could be expected that Internet usage for employment opportunities and development of e-skills is even lower in Ukraine than in the EU.

Box 13: Ukrainian employers complain about shortage of computer science specialists

According to a survey of Ukrainian managers, there is shortage of computer science graduates, while at the same time, managers complain about low quality of the graduates' competencies. According to Alina Sigda, the head of PR department of Volia, there is huge deficit of highly qualified computer science specialists, even though there are also talented, hard-working and ambitious young people, willing to study and develop. At the same time, Mrs. Sigda complained about poor knowledge of IT specialists, insufficient level of digital literacy, and lack of fundamental knowledge and skills. She also acknowledged another trend: while skills may be inadequate, the expected salaries of the youth labor force are quite high.

According to employers, educational institutions provide in better case sound theoretical basis. Young graduates are forced to acquire practical skills on the job. According to Irina Konstantinovskaya, the director of the HR department of Nemiroff UVC, educational institutions offer standard programs, and each enterprise of a particular sector requires specific qualifications, therefore enterprises are obligated to invest in training workers.

Source: Dengi.ua // http://dengi.ua/clauses/60873_Vypusknikam_kakih_vuzov_platyat_bolshe.html

In Ukraine the ICT development and diffusion has resulted in broad employment forms and opportunities. The survey conducted by one of the employment agencies indicates that 70% of respondents have an experience of freelance work.⁴¹ And 53% of all respondents constantly or temporarily combine full employment and freelance projects, while 11% state that freelancing is their main employment. It could be expected that in the nearest future distance employment, in particular, outsourcing, would develop rather rapidly in Ukraine. In particular, in relation to the ICT sector, Ukraine was among the five most attractive outsourcing directions in several Western countries in 2006 and 2007.⁴² In 2010 Ukraine ranked 11 in the list of TOP100 outsourcing destinations.⁴³

4.1.4. Lessons for Ukraine

Develop and implement a long-term e-skills development strategy

E-skills in Ukraine should be improved. The starting point could be the development and implementation of clear long-term e-skills strategy, which would contain government commitments on the issue. The strategy should indicate that everyone should have the necessary skills to benefit from a knowledge-based society. It could stress that capacity building and digital literacy are essential. The possible ways to enhance e-skills could be education and training.

The strategy should clearly define the priority areas for training teachers in education establishments. Besides, it could stress different possibilities for formal and informal training, which impact level of e-skills.

39 *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. An Agenda for new skills and jobs: A European contribution towards full employment.*

40 *List of countries classified by Internet penetration rates* // <http://www.internetworldstats.com/list4.htm#high>

41 <http://www.Rabota.ua>

42 *Central & Eastern Europe IT Outsourcing Review 2007, Ukrainian Hi-Tech Initiatives, 2008.*

43 <http://nearshoreoutsourcing.blogspot.com/2010/10/ukraine-ranks-11-in-list-of-top100.html>

Several indicators should be defined in the Strategy, which would enable monitoring of its implementation. These could be indicators, similar to those used in the EU, including e-skills activity index and e-skills gap. The annual surveys of enterprises should be conducted in order to define the situation with e-skills and future expectations.

Promote e-skills through lifelong learning

The government policies should promote lifelong learning of every individual. ICT enables even disadvantaged groups to obtain education informally. The regulation should allow the possibility of recognition and certification of informally acquired skills and knowledge, which would result in higher employability of the population.

Young people and adults should become interested in e-skills. The information campaigns could be conducted with the aim to increase awareness of different stakeholders (including employers, teachers, tutors, students) with an accurate understanding of the broad range of future job opportunities arising from an ICT education beyond ICT practitioners; introduction of new forms of attractive part-time and flexible working practices.

Enhance the employability of workforce with e-skills

An increase in the employability of the workforce depends on the mutual work of different stakeholders with the major role played by government and business.

On the policy making side, the labor market regulation should be liberalized in Ukraine. It should envisage clear regulation and protection of workforce rights for different types of employment, which are enabled by the e-skills. These are regulation on outsourcing, part-time jobs, etc.

To reduce the skills mismatch and skills gap, the Ministry of Social Policy and the State Employment Centers should assess the labor market needs. In response to that, the Ministry of Education should consider changes in the curriculum, as appropriate.

Box 14: Partnership between government and business for the benefit of e-skills

'Elevate America' is an example of a partnership between business and government with the goal of increasing the skills of the workforce. Developed by Microsoft, Elevate America focuses on providing technology skills training and resources to help people find employment. It is comprised of four major components:

- Veterans initiative: to help U.S. veterans to transition from military to civilian employment;
- Community initiative: to support nonprofit organizations that provide technology access and training in their local community to help people find employment;
- Online resources: to offer no-cost and low-cost training assets that help people develop better technology skills;
- State voucher program: launched in partnership with states across the country, to provide nearly 900,000 training and certification vouchers through local state workforce programs as of August 2010.

A similar program initiated by Microsoft in Russia, *'Tvoi Kurs'* ('Your Course'), is aimed at increasing the ICT knowledge of the general population. The Tvoi Kurs portal (<http://tk-edu.ru>) provides online trainings and resources at the basic and advanced level, targeted to several groups: students, teachers, IT specialists, and unemployed people.

Source: <http://www.microsoft.com/about/corporatecitizenship/en-us/community-tools/job-skills/elevate-america/>, <http://tk-edu.ru/index.html>

The government should attempt to ensure re-skilling of excessive labor. Additionally, the possibilities for skills mobility between regions could be envisaged. The government could consider the provision of transfers to unemployed willing to move to another region where there are vacancies.

At the same time, business should ensure training and qualification enhancement of its own employees if new technologies are installed. In addition, internship programs of companies, stimulated by the respective government policies, should be implemented in order to ensure enhanced e-skills for youth.

The State Employment Centers should be more effective in conducting trainings for disadvantaged groups (e.g. young under- and unemployed workers, older at-risk workers, and people with disabilities) and placing them in jobs.

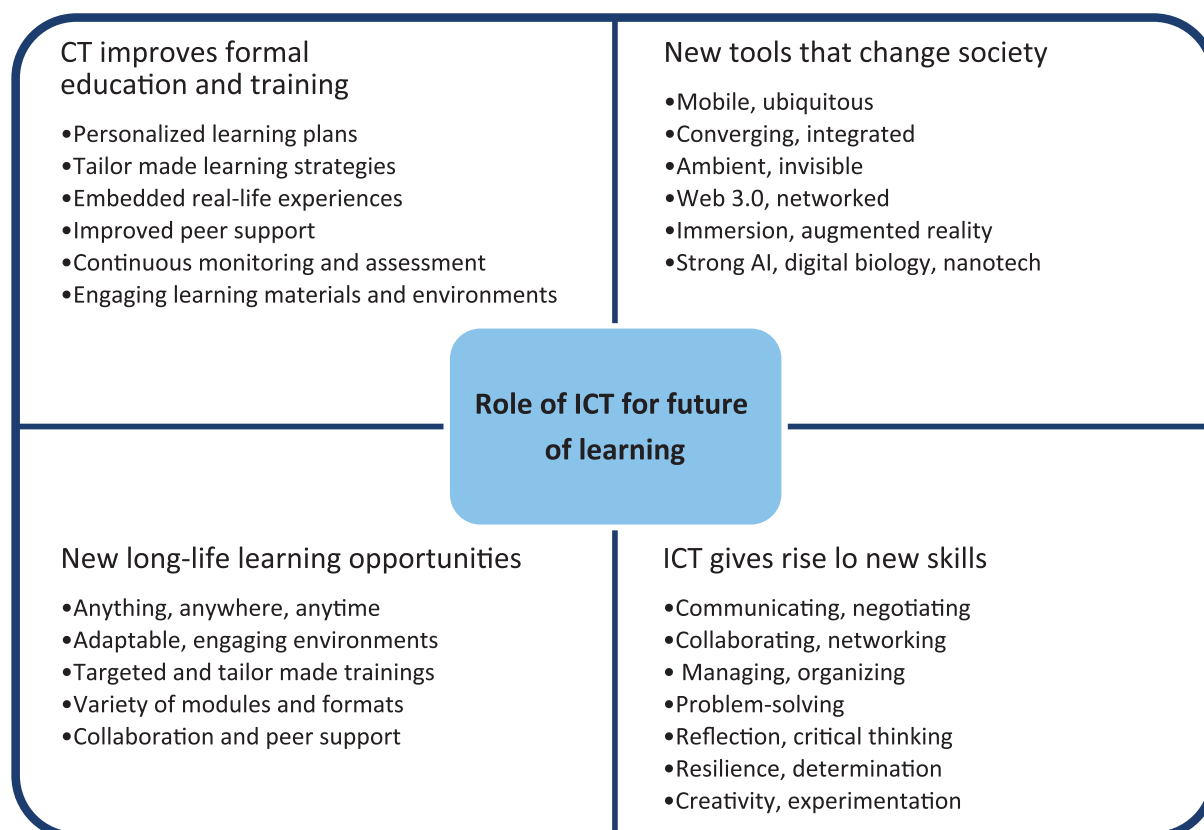
There will be also a high benefit from partnerships between local governments, the ICT industry, the local and regional job centers, Chambers of Commerce and Federations of SMEs that bring together the leading e-skills training knowledge and resources with providers of wider business skills training and job placement support services.

4.2. Changing Role of ICT in Education

4.2.1. Benefits of ICT Usage in Education

ICT has the potential for increasing access to and improving the relevance and quality of education. It represents a potential for equity in education system. ICT greatly facilitates the acquisition and absorption of knowledge, offering unprecedented opportunities to enhance educational systems, improve policy formulation and execution, and widen the range of opportunities for business and the poor. ICT use in education results in lower costs of printing and distribution of books.

Figure 6: View on role of ICT in education



Source: Yves Punie & Christine Redecker. Challenges for the future of learning in Europe. JRC



Improving the quality of education and training is a critical issue, especially at a time of educational expansion. ICT can enhance the quality of education in several ways:⁴⁴

- **Motivating to learn.** ICT such as videos, television and multimedia computer software that combine text, sound, and colourful moving images can be used to provide challenging and authentic content that will engage the student in the learning process. Interactive radio likewise makes use of sound effects, songs, and other performance conventions to compel the students to listen and become involved in the lessons being delivered. More than any other type of ICT, networked computers with access to the Internet can increase learner motivation as they combine the media richness and interactivity of other ICT with the opportunity to connect with real people and to participate in real world events.
- **Facilitating the acquisition of basic skills.** The transmission of basic skills and concepts that are the foundation of higher order thinking skills and creativity can be facilitated by ICT through drill and practice. Educational television programs use repetition and reinforcement to teach the alphabet, numbers, colors, shapes and other basic concepts. Most of the early uses of computers were for computer-based learning (also called computer-assisted instruction) that focused on mastery of skills and content through repetition and reinforcement.
- **Enhancing teacher training.** ICT has also been used to improve access to and the quality of teacher training. For example, institutions like the Cyber Teacher Training Center (CTTC) in South Korea are taking advantage of the Internet to provide better teacher professional development opportunities to in-service teachers. In China, large-scale radio and television-based teacher education has for many years been conducted by the China Central Radio and TV University, the Shanghai Radio, and TV University and many other Radio and TV Universities (RTVU) in the country.

⁴⁴ Tinio, Victoria L. *ICT in Education* // <http://www.apdip.net/publications/iespprimers/eprimer-edu.pdf>

In the knowledge-based society ICT is regarded as a potentially powerful enabling tool for educational change and reform. Learning with the help of ICT is usually called e-learning, which could be considered as “the use of new multimedia technologies and the Internet to improve the quality of learning by facilitating access to resources and services as well as remote exchanges and collaboration”.⁴⁵ In this way ICT facilitate access to education for remote and rural populations, groups traditionally excluded from education due to cultural or social reasons such as ethnic minorities, girls and women, persons with disabilities, and the elderly, as well as all others who for reasons of cost or time constraints are unable to enroll on campus. Besides, e-learning reduces costs of vocational training and lifelong learning.

Two main characteristics of e-learning could be defined:⁴⁶

- *Access anytime and anywhere.* One defining feature of ICT is its ability to transcend time and space. ICT make possible asynchronous learning, or learning characterized by a time lag between the delivery of instruction and its reception by learners. Online course materials, for example, may be accessed 24 hours a day, 7 days a week. ICT-based educational delivery (e.g., educational programming broadcast over radio or television) also dispenses with the need for all learners and the instructor to be in one physical location. Additionally, certain types of ICT, such as teleconferencing technologies, enable instruction to be received simultaneously by multiple, geographically dispersed learners (i.e., synchronous learning).

Box 15: Real-time learning: case studies

Several examples of real-time learning:

- *The Faulkes Telescope Project:* U.K. students have received free access to two high-powered robotic telescopes (one in Hawaii and the other in Australia) that are used remotely to carry out their own scientific investigations (<http://faulkes-telescope.com/>)
- *WorldWide Telescope:* this initiative is a Web 2.0 visualization software environment that enables the PC to function as a virtual telescope — bringing together imagery from the world’s best ground — and space-based telescopes for the exploration of the universe. It blends terabytes of images, information, and stories from multiple sources into a seamless, immersive, rich media experience delivered over the Internet. Students are empowered to explore and understand the cosmos using WWT’s simple and powerful user interface.
- *Hands-On Universe (HOU):* students have been provided with image-processing software to visualize and analyze data obtained through requests from professional astronomy observatories
- *The Bugscope project:* primary and secondary students received an access to a scanning electron microscope located at the University of Illinois. Students can send to Illinois any insects they have captured, and then log on with their computers to control the microscope in real time and view their specimens.

Source: http://www.ictliteracy.info/rf.pdf/ict_education_sd_trends.pdf, <http://www.worldwidetelescope.org>, <http://www.handsonuniverse.org>, <http://bugscope.beckman.uiuc.edu/>

- *Access to remote learning resources.* Teachers and learners no longer have to rely solely on printed books and other materials in physical media housed in libraries (and available in limited quantities) for their educational needs. With the Internet and the World Wide Web, many learning materials in almost every subject and in a variety of

⁴⁵ *The eLearning Action Plan: Designing tomorrow’s education, 2001, Communication from the Commission to the Council and the European Parliament, COM, 172*

⁴⁶ *Tinio, Victoria L. ICT in Education // <http://www.apdip.net/publications/iespprimers/eprimer-edu.pdf>*

media can now be accessed from anywhere at anytime of the day and by an unlimited number of people. This is particularly significant for many schools in developing countries, and even in developed countries, that have limited and outdated library resources. ICT also facilitates access to resource persons — mentors, experts, researchers, professionals, business leaders, and peers — all over the world.

Box 16: Learning Resource Centre: case study

The Learning Resource Centre (LRC) is a project of the Kenya Technical Teachers College (KTTC), funded by the Flemish Office for Development Cooperation and Technical Assistance (VVOB), with some additional support from the United Nations Educational, Scientific and Cultural Organization (UNESCO). The KTTC established the LRC in 2002 as a part of its educational management program. The LRC integrates the provision of the Internet into a well developed capacity building program, mainly targeting teacher educators, in-service and pre-service teachers, but also reaching out to the entire KTTC community.

LRC was established using flexible modes and innovative methods as a learning centered place where lecturers and students come to teach, learn, or undertake research. The LRC now embodies an ICT unit of 48 networked computers next to a documentation unit and working space. UNESCO provided funding to link the ICT unit to a wireless satellite connection that provides 24-hour Internet access. The LRC remains open after hours and on Saturdays to allow lecturers, students, and non-teaching staff to browse. This is done at a fee of one Kenya shilling per minute — about 75 cents.

Action research is undertaken on a regular basis in the LRC to improve practice, assess impact, and to inform institutional policy. In this way, the researchers and project personnel try to look at the deeper meaning of teachers' ICT experiences.

Source: http://www.idrc.ca/en/ev-93060-201-1-DO_TOPIC.html

E-learning should be considered not as a substitute, but as a complement to the traditional learning mode. In other words, “e-learning is not intended to replace face-to-face classroom training but it can be used to enhance the traditional training”.⁴⁷ The data reveals that students are not very active in taking online courses. They are less likely to use the Internet for receiving knowledge otherwise provided by professors, but rather for searching required information to solve problems.

Box 17: Learning Management System (LMS)

E-learning is based on a special information system called Learning Management System (LMS) and is widely used in universities. LMS automates the administration and training process. The use of LMS requires registration of users with ID logins and passwords, and allow for tracking students' study process and monitoring results. More than 200 Learning Management Systems have been developed.⁴⁸

Striving for penetration and active use of ICT in education, many international agencies are venturing into technical cooperation programs that use ICT for delivering education and training.⁴⁹ They are also assisting countries with training programs to build up their pool of ICT-skilled professionals, another prerequisite for using and developing the new technology in the economy. The Distance Education and Learning Technology Applications (DELTA)

⁴⁷ *Multimedia and eLearning: a new direction for productivity promotion and enhancement*. Asian Productivity Organization. Tokyo. APO. 2003. ISBN: 92-833-2344-0

⁴⁸ *Itmazi Jamil Ahmad, Megias Miguel Gea. A Comparison and Evaluation of Open Source Learning Management Systems*, IADIS, 2005.

⁴⁹ *Learning and Training for Work in the Knowledge Society. Report IV (1)*. ILO // http://www.ilo.org/public/libdoc/ilo/2002/102B09_22_engl.pdf

program of the International Training Centre of the International Labor Organization (ILO, Turin Centre) provides technical assistance and teacher courses on the use of distance learning, multimedia and ICT in education and training. In Latin America, the Inter-American Development Bank (IDB) has supported correspondence, television, radio and Internet-based approaches to training delivery. The World Bank is financing the African Virtual University (AVU), which delivers science and engineering (non-degree) program using television and the Internet in universities and colleges in 15 countries. Along with these efforts, the governments also introduce policies inducing e-learning practices (see Box 18).

Box 18: European Policy Context

The European Commission has been very active in supporting and complementing the efforts of EU Member States to modernize education and training systems. At practitioner level, current efforts in this direction focus on the e-Learning Program (2004–2006). This initiative has four components:

- to equip schools with multimedia computers,
- to train European teachers in digital technologies,
- to develop European educational services and software,
- to speed up the networking of schools and teachers.

The budget available for 2004–2006 was EUR 44 million, 45% of which was for twinning and networking schools via ICT (eTwinning). New organizational models were developed to create virtual campuses to add a virtual dimension to European cooperation between universities. Digital literacy was also promoted by encouraging new skills needed in an information-driven society.

In particular, 7 800 schools were involved in eTwinning. More than 98% of the eLearning coordinators consulted considered that their project had made a positive impact on cooperation between institutions. Especially prominent institutional benefits included involvement in transnational cooperation, establishment of contacts and exchanges of good practice. eLearning was also effective at producing significant results for staff and teachers. 75% of the respondents agreed or strongly agreed that project had made a positive impact on the quality of teaching, learning and curricula. Overall, the eLearning program contributed positively to the objectives of Education and Training 2010. It performed especially well on developing skills for the knowledge economy and ensuring access to ICTs. Between 67% and 75% agreed or strongly agreed that their project had produced higher standards of digital literacy. eTwinning was particularly effective at providing an innovative and interesting model offering schools free access to the eTwinning portal, a partner-finding service, support for school-level projects, pedagogical advice and good practice. This approach proved popular with the target audience and highly cost-effective. It exceeded stakeholders' and participants' expectations.

The established European e-Learning portal now (<http://www.elearningeuropa.info>) provides the support structure and act as a hub for promotion and exchange of best practice.

Source: Policy Link: Information Society & Education// http://ec.europa.eu/information_society/newsroom/cf/itemlong-detail.cfm?item_id=3293, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009DC0159:EN:NOT>

Overall, the benefits of ICT use in education can have following effects on the entire education system:⁵⁰

- Improved teaching and learning processes and allowing students to acquire new sets of skills required for the information society;

⁵⁰ *Monitoring the WSIS Targets: A mid-term review. World Telecommunication/ICT Development Report 2010*

- Provision of learners with access to Internet resources and computers as pedagogical tools;
- Supported teacher training through ICT-enabled distance-education programs;
- Improved administration of educational institutions, enhanced quality and efficiency of services.

The experience of introducing different ICT in the classroom and other educational settings all over the world over past several decades suggests that the full realization of the potential educational benefits of ICT is not automatic.⁵¹

4.2.2. ICT and the Educational System of Ukraine

Education with the help of ICT in Ukraine is rather limited. Ukrainian education institutions lack the first element necessary for e-learning — the availability of ICT. The study conducted by Microsoft with the support of the Ministry of Education and Science shows that the main barrier to ICT penetration into education process is lack of personal computers (PCs).⁵² According to official statistics, 97.8% of rural schools and 93.4% of urban schools are equipped with PCs, but the number of computers is low. In particular, at the beginning of 2010–2011 academic year there was an average of one computer per 28 pupils.⁵³ Furthermore, 40% of PCs owned by Ukrainian schools are outdated.⁵⁴ ICT available in schools consists mostly of computers, and those are not always used in the teaching process, either because the teachers lack the skills or experience, or because the computers are reserved for administrative purposes, situated in the offices of the school. An additional barrier is quality access to the Internet, which again may be limited to the administrative offices rather than the school's computer lab.

Another obstacle for e-learning is the insufficient readiness of teachers to use ICT in the teaching process, even though this problem becomes less important during the recent years. While 67% of teachers reported low ICT knowledge in 2010, this share has declined to near 50% in 2011.⁵⁵ Such barriers result in low information sharing by teachers on issues of learning material as well as methods of teaching, thus, terminating enhancement of quality of education.

Ukraine also faces a regional digital divide. Residents of the capital of Ukraine, Kyiv, and large cities, Dnipropetrovsk, Donetsk, Zaporizhzhya, Lviv, Mykolaiv, Odesa, Kharkiv, Sevastopol, enjoy better access to ICT that can be used for education purposes (see Figure 7). While difference in number of computers might be attributed to different household income, divergence in subscribers to Internet could be associated with difference in access. According to the Microsoft study, the readiness of teachers to use ICT in education also varies by regions.

At the same time, Ukrainian authorities and educational institutions try to promote the introduction of the best practice of ICT use in education. In particular, distance learning becomes more popular in Ukraine as it is supported by the Ministry of Education and Science, which provides a number of e-sources devoted to this topic.⁵⁶ The number of universities providing distance learning has increased during recent years. The programs

51 Tinio, Victoria L. *ICT in Education* // <http://www.apdip.net/publications/iespprimerseprimer-edu.pdf>

52 *There are not enough computers in Ukrainian schools (В Україні не хватає комп'ютерів для учеників шкіл), 2010* // <http://ht.ua/news/96320.html>; *Insufficient computerization of schools remains the obstacle for developing innovative education (Недостатня комп'ютеризація шкіл залишається перешкодою для розвитку інноваційної освіти), 2011* // <http://ua.partnersinlearningnetwork.com/Pages/ArticleViewer.aspx?listname=ITNFeaturedArticle&itemid=74>

53 *For comparison, in the EU and USA there is one computer per 5–7 pupils.*

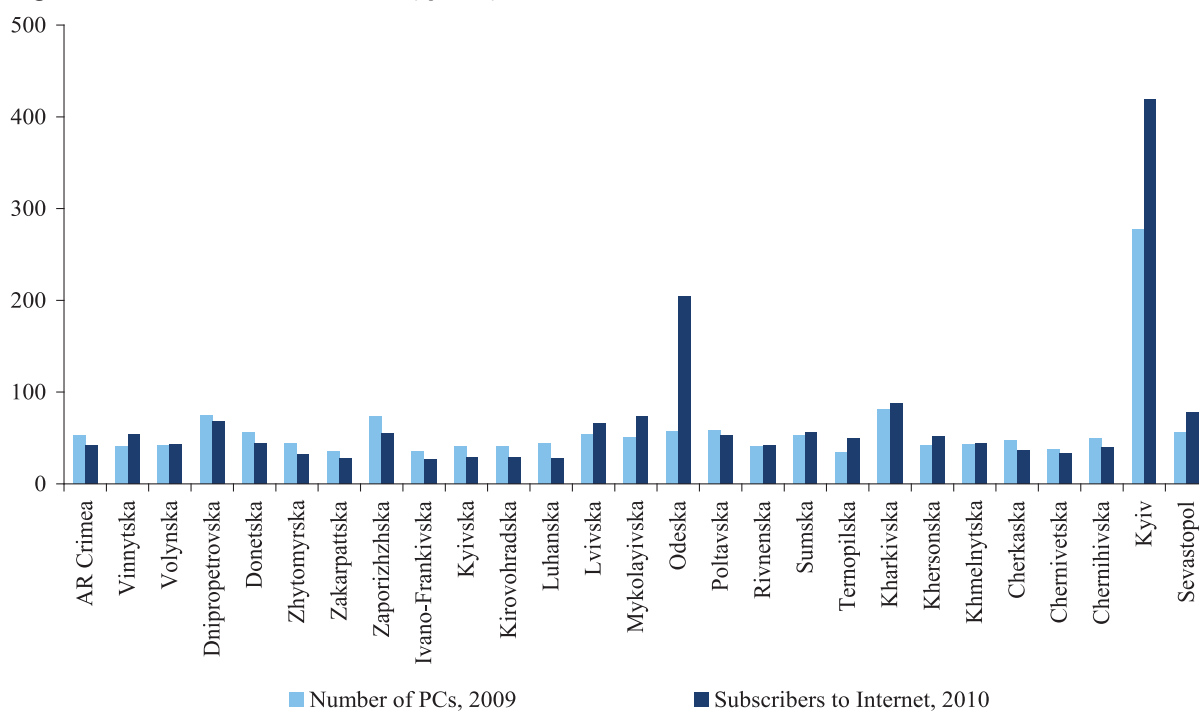
54 *Source: The State Statistics Committee of Ukraine.*

55 *Insufficient computerization of schools remains the obstacle for developing innovative education (Недостатня комп'ютеризація шкіл залишається перешкодою для розвитку інноваційної освіти), 2011* // <http://ua.partnersinlearningnetwork.com/Pages/ArticleViewer.aspx?listname=ITNFeaturedArticle&itemid=74>

56 <http://www.mon.gov.ua/education/distance>

of distance learning are available more often for post-graduate education, master level studies, or the enhancement of qualification. Most distance learning programs are provided on a 'for-fee' basis. Even though the number of education establishments delivering distance learning is rather large, the coverage is still low due to several reasons. Low broadband access at educational establishments results in their inability to have many online accesses by students at one point of time. Furthermore, teachers often cannot respond quickly or frequently to students' online and emailed communications due to high workload. Meanwhile, low e-skills may also explain poor online communication of teachers.⁵⁷

Figure 7: ICT indicators in Ukraine, per 1,000 inhabitants



Source: State Statistics Committee of Ukraine

Therefore, while initiatives to introduce ICT in education have already been started in Ukraine, there are still many measures which should be implemented to strengthen the educational system and empower its residents with knowledge and e-skills.

4.2.3. Lessons for Ukraine

Define ICT as a cornerstone of an efficient educational system

ICT has the ability to go beyond national barriers to reach international legal frameworks. Therefore, required laws and regulations can serve as facilitators in the promotion of easy and equal access to ICT and at the same time as watchdogs to deter unethical, illicit and illegal use of ICT. Deregulation against monopolies by government or private organization, accreditation and certification especially in e-learning and the protection of intellectual property are a just few areas requiring legal frameworks.

National policies in ICT education and a priority list need to be formulated accordingly. Ukraine should clearly outline a roadmap for introducing the major principles of ICT in education. Policy makers should define ICT as a focal point of education, and ensure students at all levels learn how to use digital technology to their benefit.

Besides, technology integration implementation plans should be prepared at the strategic, management and operational levels, with clearly defined milestones and schedules.

57 <http://www.osvita.org.ua/distance/ukraine/vprov/>

Plans should be prepared by responsible and qualified persons in light of information gathered on real school needs, goals and objectives, availability of resources, training and staff development needs, and funds. The goals should be specific, measurable, achievable, realistic, and time-bound. The effectiveness of the plans and goals achievements should be monitored and evaluated. Moreover, plans should be updated after evaluation process.

Promote ICT access and usage in the educational system

Setting up adequate school technological infrastructure will allow the provision of easy access to ICT to all teachers and students. To achieve this goal, universities, colleges, secondary schools and primary schools should be connected with ICT. Connectivity provides a platform for students to obtain ICT skills, and can reduce costs associated with the printing and distribution of books. Outside school hours, connected schools can also be used to provide connectivity for the community, including marginalized groups. ICT can act as a catalyst for alleviating bottlenecks in education systems, particularly teacher shortages, poor access of scattered communities to education, etc. Therefore, the government should ensure better equipment of education establishments with ICT. Besides, schools should be equipped with high-speed internet access, which opens up access to educational materials and totally integrates educational establishments into the knowledge-based society.

Major stakeholders, such as teachers, schools administrators and parents, should be involved in the process of taking decisions on ICT integration in education. Also, change in the attitudes of teachers towards such integration is essential. Many teachers are apprehensive about using computers for instructional purposes as they have low digital literacy. As a result, the training of teachers in ICT usage should be conducted in education establishments of all levels.

Ensure partnership between educational establishments and business

Higher education institutions and business can support e-learning through additional funding and the provision of technical and technological expertise. Computers and other technological devices could be obtained either as donations or purchased in bulks. Higher education institutions can be a platform for technology-enhanced education project on a pilot basis before formulation and introduction of large-scale programs and allocation of scarce public finances. Conducting a pilot run of the project in some schools may help to identify and correct problematic areas before more investment is allocated.

Higher education institutions should have legal possibilities to attract funding for ICT development and deployment. This could include school budgets, education collaborations, central or local budget funds, corporate grants, private gifts, and donor funds. Opening school computer laboratories after school hours to the community can also be a source of finance.



5

RECOMMENDATIONS



Based on the lessons drawn in this paper, the following key policy recommendations are proposed to the Ukrainian government to ensure an increase in the country's global competitiveness with the help of ICT:

1. Identify and empower an e-government champion who is accountable for developing a clear e-government concept and action plan, with input from a cross-sector of business, government and international experts, implementing e-government in Ukraine that aligns with international best practice with a realistic but speedy time-frame.
2. Develop a unified standard and framework for inter-governmental (G2G), government to business (G2B) and government to citizens (G2C) information sharing, to ensure interoperability and communication between the various municipal, regional and national systems.
3. Support and scale current regional and municipal e-government initiatives, such as Kyiv City Administration "Strategic Development Plan Through 2025", Dnipropetrovsk region "Vidkryta Vlada", and Vinnitsa City Administration e-Government project, and develop a plan for a national e-government program.
4. Create a unified standard for e-signatures and authorize one single government entity to manage the process.
5. Enable implementation of e-government by adding ICT training to the pre- and in-service training requirements for government employees at the national and local levels. ICT training and testing should also be a mandatory element of the teacher certification and in-service training program.
6. Ensure broad access to ICT through a nationwide program to scale Internet access through wi-fi coverage, IT access points in public places like libraries, schools and community centers.
7. Develop a Public-Private-Partnership with financial institutions, hardware/software providers, telecoms, and other stakeholders, to offer a subsidized and discounted PC with Internet access to teachers, schoolchildren, other public employees and vulnerable groups of population, which they pay off through discounted monthly payments. ICT access barriers should also be addressed through the development and scaling of free public access programs.
8. Prioritize the modernization of schools' ICT infrastructure with a plan to install high-speed Internet, modern hardware and licensed software in every school.
9. Update the current educational standards for primary and secondary school to include specific guidelines on ICT access and usage in education, including ICT curriculum, e-content, distant learning supported by a unified Learning Management System (LMS), Content Management System (CMS) and School Management System (SMS). Reevaluate barriers to current ICT access in the classrooms, including out-of-date phytosanitary norms which limit hands-on ICT usage for schoolchildren.
10. Boost the employability of the workforce with e-skills trainings, focusing special attention on disadvantaged groups (e.g. young under- and unemployed workers, older at-risk workers, and people with disabilities) and help them to find new jobs.

4

FINAL REMARKS



The “Partnership for Successfully Competing in the Global Economy” (Partnership) was launched by the American Chamber of Commerce in Ukraine (Chamber) in 2009. The Partnership is aimed at joining the efforts of public officials and business to create effective tools to address the pressing economic policy issues in the country, thus boosting its competitiveness and allowing for overcoming the consequences of the global economic and financial crisis.

Since then, the global economic situation has improved and growth has been restored. According to IMF projections, world output will increase by 4.3 percent and 4.5 percent year on year in 2011 and 2012 as compared to the 0.5 percent drop observed in 2009.

However, it is too early to say that the world economy has overcome the consequences of the global financial crisis. The world economic outlook is uncertain, and the global recovery remains unbalanced. Fiscal challenges and renewed financial sector volatility have jeopardized recovery in many advanced economies, while many emerging and developing economies have demonstrated signs of overheating.

According to the Summit on the Global Agenda 2010, held by the World Economic Forum (WEF), the world has entered a new reality, the manifestations of which have included global power shifts, economic uncertainty, resource scarcity, and institutional weaknesses. In particular, Summit participants highlighted that “Governments and global institutions that were fragile before the crisis have, by and large, become even more so in the face of global instability. The world is in no state to withstand further shocks.”

In the current situation of global instability and institutional fragility, cooperative efforts start to play an even more important role than ever. Isolation is not a viable alternative for any stakeholder, given the increased complexity of relationships. Only the consistent and relentless efforts of the state and business to coordinate efforts, plans, and policies across various stakeholder groups will restore institutional soundness, boost competitiveness, and ensure steady economic development.

Ukraine entered the global financial and economic crisis with uncompleted reforms, fiscal and banking system imbalances, political instability, and forthcoming presidential elections. The country, suffering from institutional weaknesses and thus low competitiveness, appeared very sensitive to external shocks.

Soon after President Viktor Yanukovich was sworn into office in February 2010, a new Cabinet of Ministers was formed with a mandate to stabilize the macroeconomic situation and implement a comprehensive reform agenda aimed at mitigating the recession and positioning the country to take advantage of global growth trends.

After more than a year in power, the authorities have made progress in several important reform areas, including the introduction of the Tax Code, simplification of social contributions administration, deregulation of the construction sector, acceleration of agricultural land market reform, renewal of privatization, advancement in technical barriers reform, and commitment to energy market reform, as Ukraine joined the European Energy Community Agreement.



Despite the progress, however, a lot of issues have remained unresolved, either at the regulatory stage or at the stage of implementation.

According to Doing Business 2011, Ukraine's rank has improved very modestly, as the country was ranked 145 out of 183 as compared to 147 a year before.

The WEF Report 2011–2012 has also registered only humble progress in Ukraine's competitiveness. One of the lowest rankings that Ukraine received was for the Institutions category. Here Ukraine was ranked as the 130th economy out of a total of 133 in regards to the "Efficiency of legal framework in settling disputes." It was ranked 128th in "Efficiency of legal framework in challenging regulations," 127th in "Property rights," and 123rd in "Judicial independence."

Another pillar for which Ukraine received very low rankings was that for "Goods market efficiency." Ukraine demonstrated low rankings as follows: It was 128th in "Extent and effect of taxation," and 125th in "Prevalence of foreign ownership." The Partnership will outline the reforms and actions that need to be implemented to significantly improve these rankings.

Dialog among various stakeholders, such as the private sector, experts, NGOs, the donor community, and international financial institutions, as well as Ukrainian political elites, is critical to develop structured, consensus-driven policies and thus improve the business environment and competitiveness.

That is why the American Chamber of Commerce in Ukraine has been consistent in contributing to the discussion of Ukraine's competitiveness issues and offering its vision of specific paths and steps to address them, based on the rich and comprehensive experience of the Chamber's member companies. The Partnership Project is an integral and important part of the Chamber's efforts.

In its Partnership, the Chamber has selected the most relevant indicators for strategic and institutional investors from the Global Competitiveness Index, an internationally recognized measure of competitiveness formulated by the World Economic Forum to benchmark Ukraine's results. A special section is dedicated to the ICT sector, as it is one of the main influences on an economy's competitiveness across all industry sectors.

The Partnership's objective is not simply to analyze the barriers and obstacles that businesses and investors face in Ukraine or the difficulties that the government of Ukraine must confront during the reform process. Rather, it establishes an action-oriented, structured program that directly engages the government — and one that will be continuously updated. This program is available for use by the government of Ukraine, the Chamber, its members, independent think tanks, NGOs, donors, international financial institutions, and other interested parties who seek to promote positive change and reforms in Ukraine, to stimulate dialogue between the public and private sectors on national development strategy, and to monitor the status of reforms.

This is a living document that is regularly updated. Thus, the Chamber welcomes comments and criticisms so that the contents can be continually improved and aligned.

The American Chamber of Commerce in Ukraine and its internationally oriented membership comprise the largest strategic and institutional investors, and the service providers around them, who have invested a majority of the total foreign direct investment into the country, employ close to a million Ukrainians, and bring international expertise and best practices to the table. They remain committed to the ultimate success of Ukraine.

The American Chamber of Commerce and its membership represent a reliable and consistent partner that will continue to work with Ukrainian stakeholders, sharing their professional knowledge and vast experience to promote development and to stimulate the overall competitiveness of the economy.

5

ACTION PLAN OF POLICY, LEGAL, AND REGULATORY REFORMS



1. Agriculture

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Amend the Law "On Agricultural Cooperation"		+	Cabinet of Ministers, Parliament	To be amended
2. Develop draft and support adoption of the Law "On the Land Market"	+		Cabinet of Ministers, State Agency for Land Resources, Parliament	To be developed
3. Support adoption of the Law "On the State Inventory of Land"	+		Cabinet of Ministers, State Agency for Land Resources, Parliament	To be adopted
4. Develop draft and support adoption of the Law "On Management of State-Owned Land"		+	Cabinet of Ministers, State Agency for Land Resources, Parliament	To be developed
5. Support adoption of the Law "On the Procedure for Buying Land for Public Needs"	+		Cabinet of Ministers, State Agency for Land Resources, Parliament	To be adopted
6. Develop draft and support adoption of the Law "On the State Program for Usage and Protection of Land"	+		Cabinet of Ministers, State Agency for Land Resources, Parliament	To be developed
7. Support adoption of the Draft Law "On the Agrarian Chamber of Ukraine" (registration #7190 dated October 1 st 2010)		+	Parliament	To be adopted

2. Banking and Financial Services

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Banking, Investment, Currency Control				
1.1. Amend the Law "On Investment Activity" dated August 18 th , 1991 #1560-XII to enact clear rules for procedure of foreign investment and resident investment into foreign assets	+		Parliament	To be developed
1.2. Adopt the Draft Law "On Currency Regulation and Currency Control in Ukraine" to allow for investment/divestment flow regulation	+		Cabinet of Ministers, NBU, Parliament	To be developed

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1.3. Amend the Law “On the National Bank of Ukraine” and the Law “On Banks and Banking Activity” so that the NBU will be under obligation to ascertain the real and final beneficial owners of Ukrainian commercial banks and make such information public		+	Parliament	To be developed
1.4. Amend the Law “On Joint Investment Institutions” to allow the establishment of investment funds with compartments and funds-of-funds, and to allow retail investors to participate in Unit Investment Trusts	+		Parliament	To be developed
1.5. Create, make public, and update on a regular basis an accessible database of NBU answers to bank requests		+	NBU	To be developed
1.6. Simplify the NBU Resolution on Approval of Regulation on the Procedure for Establishment and State Registration of Banks and Establishment of their Branches, Representatives, Departments #375, dated August 31 st , 2001		+	NBU	To be developed
1.7. Revoke provisions of Regulation #597 Transferring Funds Payable to Non-residents under Certain Transactions that are in conflict with the Law		+	NBU	To be developed
1.8. Approve Regulation of the State Commission for Regulation of Financial Services Markets on Provision of Certain Financial Services by Legal Entities-Subjects of Economic Activities, the Legal Status of which is Not a Financial Institution		+	State Commission for Regulation of Financial Services Markets	To be developed
1.9. Implement IFRS (and not “Ukrainian” IFRS) in the Financial Sector (with an agreed upon transition period)		+	Cabinet of Ministers	To be implemented
1.10. Amend further NBU Orders #280 and #281	+		NBU	To be amended

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1.11. Amend NBU Order #122 to lower requirements for obtaining a permit/license for a resident's investment outside of Ukraine		+	NBU	To be amended
1.12. Amend NBU Order #49 to make the system of NBU penalties for banks for violation of currency control more flexible and dependent on the degree of violation		+	NBU	To be amended
1.13. Amend the Law "On Insurance" in line with EU standards	+		Parliament	To be amended
1.14. Adopt necessary legislation for operation of the State Register of Rights to Im-movable Property and Their Limitations	+		Ministry of Justice, Cabinet of Ministers, Parliament	To be developed
1.15. Ministry of Justice to establish an electronic public register of court decisions on financial sector and corporations — related issues		+	Ministry of Justice	To be developed
1.16. Amend the Law "On Prevention and Counteraction of Legalizations (Laundering) of Incomes Received as a result of Criminal Activities" and related bylaws.	+		Parliament	To be amended
1.17. Adopt the Draft Law "On Derivatives" in line with international practices	+		NBU, Securities and Stock Market State Commission, Parliament	To be amended
1.18. Amend and make IFRS compliant the Regulation of the NBU #279 "On Approving the Regulation for the Procedure for Establishing and Using Reserves for Compensation of Possible Losses under Credit Operations of Banks" dated July 6 th , 2000	+		NBU	To be amended
2. Leasing				
2.1. Amend the Law "On Financial Leasing"	+		Parliament	To be adopted
3. Securities and Stock Market				

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
3.1. Adopt the Draft Law “On Assets Management” in line with international practices	+		Securities and Stock Market State Commission, Parliament	To be adopted
3.2. Amend and make it international practice compliant the Law “On the System of Depository Records in Ukraine”	+		Securities and Stock Market State Commission, Parliament	To be developed
3.3. Develop bylaws about correspondent relations between the Depository/ies of Ukraine and foreign depositories	+		Securities and Stock Market State Commission, Parliament	To be developed
3.4. Amend NBU #36 to limit the NBU license requirement for sale of securities by non-resident to resident if amount of transaction exceeds 1 mln EUR	+		NBU	To be amended
4. Mortgages				
4.1. Replace the temporary procedure for registration of mortgages with a permanent one	+		Ministry of Justice, Cabinet of Ministers	To be developed
4.2. Adopt the Draft Law “On Amending Certain Legislative Acts of Ukraine on Mortgage Bonds”		+	Parliament	To be adopted
5. Mergers and Acquisitions				
5.1. Amend the Competition Law and related procedures	+		Parliament	To be adopted

3. Fuel and Energy

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Develop and adopt amendments to various legislative acts regulating the oil and gas sector to make them consistent and stabilize them by fixing them at the level of law (i.e., the Subsoil Code, the Law on Oil and Gas, and relevant CMU regulations)	+		Parliament, Ministry of the Environment and Natural Resources, State Geological Service	To be developed

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
2. Develop secondary legislation to implement provisions of the Law "On the Principles of Gas Market Operations"	+		Cabinet of Ministers, NERC	To be adopted
3. Develop and adopt amendments to the Law on Oil and Gas and the Subsoil Code to allow combined licenses and to resolve issues with license transfers, license durations, etc.	+		Parliament, Cabinet of Ministers	To be adopted
4. Introduce clear fiscal and legislative stimuli for domestic refineries to encourage the sector's modernization and production of European-standard motor fuel in Ukraine	+		Parliament, Cabinet of Ministers	To be adopted
5. Adopt a resolution to increase household tariffs and bring them up to economically justified levels	+	+	Cabinet of Ministers, NERC, Ministry of Energy and the Coal Industry, Ministry of Economic Development and Trade	To be adopted
6. Develop and adopt amendments to various legislative acts for all types of cross-subsidy limitations	+	+	NERC, Ministry of Energy and the Coal Industry, Ministry of Social Policy	To be developed and adopted
7. Develop and adopt new incentive tariff methodology directed to attracting investment, modernizing assets, and fostering energy efficiency	+		Cabinet of Ministers, NERC, Ministry of Energy and the Coal Industry, Ministry of Economic Development and Trade, Antimonopoly Committee	To be developed and adopted
8. Develop and adopt connection rules and connection fee methodology	+		Cabinet of Ministers, NERC, Ministry of Energy and the Coal Industry	To be developed and adopted

4. Information and Communications Technology

Action	Short Term 2011	Long Term 2012-14	GOU Partners	Status
1. Harmonize national regulation in the field of e-signatures with internationally adopted principles.	+	+	Ministry of Economic Development and Trade of Ukraine, State Agency for Science, Innovation and Information, Administration of the State Service for Special Communications and Information Protection	In progress
2. Deploy a national personal data protection system.	+	+	Parliament	In progress
3. Develop and adopt e-commerce regulation	+	+	Parliament, State Agency for Science, Innovation and Information	In progress
4. Define limitations and obstacles for accelerated development of the hi-tech industry, including tax, customs and social burdens in this sector; and implement necessary changes, taking into account proposals from business representatives and investors		+	Cabinet of Ministers, Ministry for Infrastructure, State Agency for Science, Innovation and Information, and sphere players (NGOs)	To be developed
5. Create an incentive system for cooperation between higher education institutions, scientists, students, businesses and investors by creating joint education and applied projects, innovation centers, business incubators and technological parks with defined specialization		+	Cabinet of Ministers, Ministry of Education, Science, Youth and Sports	To be developed
6. Adopt the concept of e-government in Ukraine in 2015	+		Cabinet of Ministers, Parliament	In progress

5. Real Estate and Construction Development

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Improve the Law "On the Regulation of City Construction" (Regarding the Reduction of Permission Procedures; target purpose of land plots within categories)	+		Parliament	To be improved
2. Elaborate subordinate regulatory acts under the Law "On the Regulation of City Construction" (Regarding the Reduction of Permission Procedures)	+		Cabinet of Ministers of Ukraine, Ministry for Regional Development, Building and Housing, Construction and the Residential-Municipal Sector of Ukraine	
3. Elaboration of the Draft Law "On the Land Market"	+		Parliament	To be adopted
4. Cancellation of agricultural land sale moratorium;	+		Parliament	To be introduced
5. Amendments to Article 82 of the Land Code which will enable 100% foreign owned companies to buy land within cities;	+		Parliament	To be introduced
6. Improve VAT refund procedure for real estate investors;	+	+	Ministry of Finance, State Tax Service, Parliament	To be introduced
7. Revise the Decision of the Kyiv City Council "On Amendments to Decision #810/3385 of the Kyiv City Council dated July 19 th , 2005 "On Regulation of the Issues of Land Plot Sale in Kyiv City";	+	+	Kyiv City Council	To be amended
8. Enhance existing land legislation to stimulate renewables development (use of agricultural lands for development and operation of renewable energy utilities);		+	Parliament	To be introduced
9. Draft legislation on land lease regulation to make the land lease renewal process transparent.		+	Parliament	To be introduced

6. Retail Trade

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Adopt the Draft Law “On Internal Trade” to the elaborated Chamber position.	+	+	Parliament	To be adopted

7. Telecommunications and Data Transmission

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Clearance of and tender for 3G frequencies	+		National Commission on Communications Regulation, Ministry of Defense, Cabinet of Ministers	To be performed
2. Mobile number portability	+	+	NKRZ	To be implemented
3. New rules for providing and receiving telecommunication services	+		NKRZ, Cabinet of Ministers	To be adopted
4. M-commerce (integral to e-commerce)	+	+	NKRZ, National Bank, Ministry of Finance, State Commission for Financial Services	To be developed and implemented
5. Technological neutrality (draft law to amend the Laws “On Telecommunications” and “On the Radio-Frequency Resource”)	+		NKRZ, Ministry of Finance, Parliament Committee on Telecommunications	To be amended

8. Travel and Tourism

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. To develop a concept for a corporate card in order to simplify the process of doing calculations for business travel		+	Parliament	To be developed
2. To improve the Tax Code of Ukraine in the part concerning the simplification and improvement of taxation of tourist services	+		Parliament	To be developed

9. Customs Policy

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Customs Code of Ukraine	+		Parliament	In the process of being amended and made more compliant with WTO and international conventions on customs matters

10. Healthcare Policy

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. New law on medicinal products	+	+	Ministry of Healthcare, State Expert Center of the MoH, Parliament's Healthcare Committee	To be adopted
2. Set up a reimbursement system in Ukraine		+	Ministry of Healthcare, Ministry of Social Policy	To be adopted
3. Improve the procedure for state quality control over medicines	+		Ministry of Healthcare, State Service on Medicinal Products	To be improved and amended
4. Improve public procurement of medicinal product procedures (including unification of requirements for local and foreign manufacturers)	+	+	Ministry of Healthcare, Ukraine State Expert Center of the MoH	To be amended
5. Improve regulations concerning clinical trials in Ukraine	+	+	Ministry of Healthcare, Ukraine State Expert Center of the MoH, Central Ethics Committee	To be amended
6. Cancel VAT on imported drugs for clinical trials by changing the legislation in force	+	+	Cabinet of Ministers of Ukraine, Ministry of Healthcare, Ukraine State Expert Center of the MoH	To be developed

11. Human Resources and Labor Policy

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Amend the Labor Code's labor management sections according to international legislation and best practices, and reduce the tax burden on salaries	+		Parliament, Committee on Social Policy and Labor	To be amended and adopted in the second reading
2. Amend the Draft Law #8570 "On Legal Status of Foreigners and Persons without Citizenship" regarding the problem of entry of family members or close relatives of a foreigner, who has obtained a work permit.	+		Parliament	To be amended and adopted in the second reading

12. Tax Policy

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Amend the Tax Code based on the recommendations of Chamber members and the business community	+	+	Ministry of Finance, State Tax Service, Parliament	To be amended
2. Balance the rights and obligations of the taxpayers and tax authorities	+	+	Ministry of Finance, State Tax Service, Parliament	To be balanced
3. Introduce extended tax periods and deadlines for tax filing (e.g., annual corporate income tax filing and quarterly VAT filing)	+	+	Ministry of Finance, State Tax Service, Parliament	To be introduced
4. Ensure fair and unbiased trials and resolution of tax disputes	+	+	Ministry of Finance, Ministry of Justice, Supreme Administrative Court, Parliament	To be improved
5. Harmonize Ukrainian tax legislation and practices with those of the EU and OECD		+	Ministry of Finance, Ministry of Justice, State Tax Service, Parliament	To be amended

13. Intellectual Property Rights

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Amend the Law "On Staging and Hosting the Final of the Football Championship of Europe 2012 in Ukraine"	+	+	Cabinet of Ministers, Ministry of Economic Development and Trade, Patent Office, Parliament	To be amended
2. Elaborate Customs Code with norms enforcing IPR and supporting Customs authorities' with power to seize goods that infringe IPR	+	+	Cabinet of Ministers, Parliament	To be balanced
3. Amend Draft Law #6523 "On Amendments to Some Legislative Acts on Regulation of Issues of Copyright and Related Rights" to change norms that can have significant adverse influence on the producers or importers of certain equipment and media materials that are used for private reproduction of copyright objects.	+	+	Parliament	To be amended
4. Amend the norms of Draft Law #6595 "On Amendments to Certain Legislative Acts (regarding the protection of citizens' health from the use of tobacco)," regarding the mandatory use of black and white colors only for marking tobacco products.	+	+	Parliament	To be improved
5. Amend the Draft Law #7205 "On Amendments to Some Legislative Acts on Regulation of Issues of IPR," improving its conceptual drawbacks, in particular as related to the EU <i>acquis communautaire</i> .		+	Parliament	To be amended
6. Introduce new legislation regulating new media spheres and related to new ways of product, service and content provision by the mass media.			Parliament	To be introduced

14. Anti-bribery Policy

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Fully introduce the e-government system, especially in the field of state permits and regulations: increase its availability in all local and central governmental departments and stimulate its usage.		+	Government, Parliament	To be introduced
2. Ensure the implementation of the state budget by the allocation of the envisaged funds on e-government state programs	+		Government	
3. Design and implement a comprehensive program on e-government extending the provisions of the previously approved concept	+	+	Government, Parliament	To be introduced
4. Amend the Law #3206-17 "On the Foundations of Corruption Prevention and Counteraction" based on the recommendations of Chamber members as manifested in the Chamber's Position Letter.	+	+	Parliament	To be amended

15. Legal policy

Action	Short Term 2011	Long Term 2012-13	GOU Partners	Status
1. Amend the Law #2806-15 "On the Permit System in the Field of Economic Activity," improving its regulatory norms.	+		Parliament	To be amended
2. Amend the Law #1775-14 "On Licensing of Certain Economic Activities" regarding the terms of the launch of licensed activities.	+		Parliament	To be amended
3. Amend the current regulatory legislation to cancel the requirement for permits not included in Law #3392-17 "On the List of Permits in the field of Economic Activity"	+	+	Parliament	To be amended
4. Amend the Law #877-16 "On the Foundations of Government Oversight (Control) of Economic Activity" in the norms for routine checks conducted by the state regulatory bodies.	+		Parliament	To be amended

6

ANNEXES



1. Selected World Economic Forum Global Competitiveness Index Ranking

1.1. Global Competitiveness Index Rankings

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
67	Greece	77	El Salvador	82	Trinidad and Tobago	75	Romania
68	Romania	78	Peru	83	Philippines	76	Albania
69	Azerbaijan	79	Sri Lanka	84	Algeria	77	Macedonia, FYR
70	Vietnam	80	Guatemala	85	Argentina	78	Botswana
71	Philippines	81	Gambia, The	86	Albania	79	Trinidad and Tobago
72	Ukraine	82	Ukraine	87	Ukraine	80	Ukraine
73	Morocco	83	Algeria	89	Gambia, The	81	Namibia
74	Colombia	84	Macedonia, FYR	90	Honduras	82	Guatemala
75	Uruguay	85	Argentina	91	Georgia	83	Argentina
76	Bulgaria	86	Trinidad and Tobago	92	Jamaica	84	Honduras
77	Sri Lanka	87	Philippines	93	Serbia	85	Algeria

1.2. Burden of Government Regulation

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
85	Australia	102	Cote d'Ivoire	113	Vietnam	115	Poland
86	Cambodia	103	Burundi	114	Belgium	116	Philippines
87	Trinidad and Tobago	104	Spain	115	France	117	Belgium
88	Nepal	105	Vietnam	116	Argentina	118	Portugal
89	India	106	Colombia	117	Colombia	119	Syria
90	Ukraine	107	Ukraine	118	Ukraine	120	Ukraine
91	Madagascar	108	Mongolia	119	Philippines	121	Argentina
92	Dominican Republic	109	Argentina	120	Portugal	122	Russian Federation
93	Spain	110	Poland	121	Russian Federation	123	Greece
94	South Africa	111	Belgium	122	Greece	124	Serbia
95	Colombia	112	Philippines	123	Syria	125	Hungary

1.3. Extent and Effect of Taxation

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
119	Guyana	121	Jamaica	123	Romania	125	Burundi
120	Turkey	122	Bosnia and Herzegovina	124	Bosnia and Herzegovina	126	Belgium
121	Denmark	123	Bolivia	125	Italy	127	Argentina
122	Dominican Republic	124	Italy	126	Croatia	128	Italy
123	Sweden	125	Zimbabwe	127	Belgium	129	Croatia
124	Ukraine	126	Ukraine	128	Ukraine	130	Ukraine
125	Poland	127	Denmark	129	Argentina	131	Brazil
126	Italy	128	Belgium	130	Hungary	—	—
127	Argentina	129	Argentina	131	Brazil	—	—
128	Zimbabwe	130	Hungary	—	—	—	—
129	Belgium	131	Brazil	—	—	—	—

1.4. Life Expectancy

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
87	Trinidad and Tobago	88	Guatemala	88	Guatemala	87	Indonesia
88	Egypt	89	Trinidad and Tobago	89	Azerbaijan	88	Guatemala
89	Guatemala	90	Azerbaijan	90	Egypt	89	Azerbaijan
90	Indonesia	91	Egypt	91	Trinidad and Tobago	90	Egypt
91	Philippines	92	Indonesia	92	Thailand	91	Trinidad and Tobago
92	Ukraine	93	Ukraine	93	Ukraine	92	Ukraine
93	Bolivia	94	Tajikistan	94	Russian Federation	93	Thailand
94	Kyrgyz Republic	95	Bolivia	95	Kyrgyz Republic	94	Russian Federation
95	Mongolia	96	Kyrgyz Republic	96	Guyana	95	Kazakhstan
96	Russian Federation	97	Russian Federation	97	Tajikistan	96	Guyana
97	Timor-Leste	98	Bangladesh	98	Nepal	97	Kyrgyz Republic

1.5. Business Impact of Rules on FDI

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
113	Algeria	115	Lithuania	116	Serbia	115	Burundi
114	Albania	116	Mongolia	117	Lithuania	116	Serbia
115	Croatia	117	Paraguay	118	Algeria	117	Slovenia
116	Bulgaria	118	Iceland	119	Bulgaria	118	Mauritania
117	Paraguay	119	Croatia	120	Russian Federation	119	Greece
118	Ukraine	120	Ukraine	121	Ukraine	120	Ukraine
119	Mongolia	121	Kyrgyz Republic	122	Kuwait	121	Algeria
120	Italy	122	Italy	123	Croatia	122	Bolivia
121	Kyrgyz Republic	123	Russian Federation	124	Chad	123	Kuwait
122	Timor-Leste	124	Algeria	125	Iceland	124	Kyrgyz Republic
123	Chad	125	Kuwait	126	Argentina	125	Chad

1.6. Prevalence of Trade Barriers

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
105	Senegal	103	Sri Lanka	115	Syria	123	Bolivia
106	Uganda	104	Malawi	116	Brazil	124	Ethiopia
107	Vietnam	105	Mozambique	117	Malawi	125	Russian Federation
108	Colombia	106	Pakistan	118	Dominican Republic	126	Chad
109	Syria	107	Nigeria	119	Tajikistan	127	Burundi
110	Ukraine	108	Ukraine	120	Ukraine	128	Ukraine
111	Russian Federation	109	Lesotho	121	Nigeria	129	Venezuela
112	Pakistan	110	Dominican Republic	122	Burundi	130	Ecuador
113	Nicaragua	111	Azerbaijan	123	Kyrgyz Republic	131	Argentina
114	Burundi	112	Egypt	124	Bolivia	—	—
115	Egypt	113	Ethiopia	125	Azerbaijan	—	—

1.7. Hiring and Firing Practices

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
6	United States	12	Kazakhstan	13	El Salvador	12	Kenya
7	Hong Kong SAR	13	Qatar	14	Qatar	13	United Arab Emirates
8	Iceland	14	United Arab Emirates	15	Canada	14	Kyrgyz Republic
9	Azerbaijan	15	Gambia, The	16	Cameroon	15	Canada
10	Nigeria	16	Taiwan, China	17	United Arab Emirates	16	Cameroon
11	Ukraine	17	Ukraine	18	Ukraine	17	Ukraine
12	Uganda	18	El Salvador	19	Bangladesh	18	Armenia
13	Tajikistan	19	Mongolia	20	Guyana	19	Guyana
14	Kyrgyz Republic	20	Albania	21	Albania	20	Bangladesh
15	Costa Rica	21	Canada	22	Saudi Arabia	21	Albania
16	Armenia	22	Armenia	23	Mongolia	22	Brunei Darussalam

1.8. Pay and Productivity

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
10	Albania	17	Azerbaijan	21	Israel	37	Morocco
11	Russian Federation	18	Lithuania	22	Czech Republic	38	Germany
12	Japan	19	Albania	23	Bahrain	39	India
13	Czech Republic	20	Kazakhstan	24	Korea Republic	40	Australia
14	Korea Republic	21	Gambia, The	25	United Kingdom	41	Armenia
15	Ukraine	22	Ukraine	26	Ukraine	42	Ukraine
16	Vietnam	23	Denmark	27	Denmark	43	Chile
17	Indonesia	24	United Kingdom	28	Iceland	44	Oman
18	Qatar	25	Iceland	29	Thailand	45	Poland
19	United Arab Emirates	26	Canada	30	Canada	46	Finland
20	Chile	27	New Zealand	31	Oman	47	Bulgaria

1.9. Soundness of Banks

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
105	Russian Federation	126	Kazakhstan	125	United Kingdom	125	Azerbaijan
106	China	127	Kyrgyz Republic	126	Burundi	126	Nigeria
107	Uganda	128	Iceland	127	Zimbabwe	127	Algeria
108	Serbia	129	Zimbabwe	128	Mongolia	128	Burundi
109	Egypt	130	Mongolia	129	Iceland	129	Iceland
110	Ukraine	131	Ukraine	130	Ukraine	130	Ukraine
111	Vietnam	—	—	131	Ireland	131	Ireland
112	Turkey	—	—	—	—	—	—
113	Bangladesh	—	—	—	—	—	—
114	Azerbaijan	—	—	—	—	—	—
115	Taiwan, China	—	—	—	—	—	—

1.10. Ease of Access to Loans

2008-2009		2009-2010		2010-2011		2011-2012*	
Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country	Rank out of 131	Country
61	Namibia	81	Madagascar	118	Latvia	116	Cameroon
62	Brunei Darussalam	82	Uganda	119	Nigeria	117	Jamaica
63	Latvia	83	Nepal	120	Zimbabwe	118	Nigeria
64	El Salvador	84	Mexico	121	Jamaica	119	Ghana
65	Indonesia	85	Kazakhstan	122	Kyrgyz Republic	120	Korea Republic
66	Ukraine	86	Ukraine	123	Ukraine	121	Ukraine
67	Japan	87	Philippines	124	Mali	122	Mozambique
68	Poland	88	China	125	Cameroon	123	Kyrgyz Republic
69	Morocco	89	Bosnia and Herzegovina	126	Mauritania	124	Ireland
70	Honduras	90	Tajikistan	127	Argentina	125	Ethiopia
71	Albania	91	Serbia	128	Burundi	126	Argentina

* The WEF Global Competitiveness Report 2011/12 includes 142 countries. We have compared Ukraine only to the 131 countries that were included in all WEF surveys from 2008 to 2011 in order to control for the addition or subtraction of the surveyed countries. We excluded 12 countries: Angola, Belize, Cape Verde, Haiti, Islamic Republic Iran, Lebanon, Libya, Moldova, Rwanda, Suriname, Swaziland and Yemen.

- **Burden of Government Regulation** — How burdensome is it for businesses in your country to comply with governmental administrative requirements (e.g., permits, regulations, reporting)? [1 = extremely burdensome; 7 = not burdensome at all]
- **Life Expectancy** — life expectancy at birth (years)
- **Extent and effect of taxation** — What impact does the level of taxes in your country have on incentives to work or invest? [1 = significantly limits incentives to work or invest; 7 = has no impact on incentives to work or invest]
- **Prevalence of Trade Barriers** — In your country, to what extent do tariff and non-tariff barriers limit the ability of imported goods to compete in the domestic market? [1 = strongly limit; 7 = do not limit]
- **Business Impact of Rules on FDI** — To what extent do rules governing foreign direct investment (FDI) encourage or discourage it? [1 = strongly discourage FDI; 7 = strongly encourage FDI]
- **Hiring and Firing practices** — How would you characterize the hiring and firing of workers in your country? [1 = impeded by regulations; 7 = flexibly determined by employers]
- **Pay and Productivity** — To what extent is pay in your country related to productivity? [1 = not related to worker productivity; 7 = strongly related to worker productivity]
- **Ease of Access to Loans** — How easy is it to obtain a bank loan in your country with only a good business plan and no collateral? [1 = very difficult; 7 = very easy]
- **Soundness of Banks** — How would you assess the soundness of banks in your country? [1 = insolvent and may require a government bailout; 7 = generally healthy with sound balance sheets]



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