I. SETTING THE SCENE

OECD-UKRAINE CO-OPERATION IN THE FIELD OF INTERNATIONAL INVESTMENT

Eric Burgeat[*]

The inaugural meeting of the OECD-Ukraine Forum on Investment and Enterprise Development marked the start of the second phase of the OECD-Ukraine co-operation on investment policies. The first phase was completed in May 2001, when the OECD released the Investment Policy Review of Ukraine. In response to the request of the Ukrainian government, this Review was undertaken not as a desktop study, but in a dynamic framework as a joint exercise involving key players, domestic and international alike, on Ukraine's investment scene. It identifies the obstacles to investment and private sector development, and puts forth practical recommendations for an improved business climate.

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The preliminary findings of the Review were discussed in February 2001 at a Kiev Roundtable. During the Roundtable, we also agreed to establish this OECD-Ukraine Forum with a view to monitoring the implementation by Ukraine of the recommendations contained in the Review and providing further practical advice and support to Ukraine on investment issues.

Increasingly, FDI has been recognised as a powerful engine and a major catalyst for achieving development, poverty-reducing growth and furthering the process of global integration. Competition for FDI is increasing worldwide. Hence, like Ukraine, many countries are intensifying their efforts to attract more FDI flows.

The vast majority of countries have liberalised considerably their rules and regulations. Efforts towards traditional liberal policies (i.e. national treatment, most-favoured-nation, investment protection treaties, and market access) are now almost taken for granted. Since its creation, the OECD has been in the forefront in developing such "rules of the game" amongst its Members and, increasingly, beyond its membership. However, while open FDI policies are necessary to attract and maximise the benefits of FDI, they are no longer a sufficient condition. We need to go beyond them. Indeed, a wide range of other policies can influence the level of foreign – but also domestic – investments, as well as the positive returns they bring to the economy. I would distinguish three types.

A first set of policies includes measures that influence the broad economic environment in which investors operate: policies that promote infrastructural and skill endowments, policies that ensure macroeconomic and political stability.

A second set of policies determine the rules of the game for businesses: strong competition policy, good corporate governance rules, a non-distortionary tax system, and adequate standards in the financial sector.

Last, but not least, a third set of policies should aim to improve the efficiency and transparency of the public administration and to fight corruption. Empirical research shows a significant correlation between the quality of governance, reduced levels of corruption and economic development indicators such as the growth rate of GDP and GDP per capita.

These and some other issues addressed by speakers and panellists during the Forum meeting are reported in this publication.

Despite the significant progress made by Ukraine towards macroeconomic and financial stability since 2000, Ukraine still has a considerable way to go to make its growth sustainable and fully realise its vast potential as a destination for FDI.

Much has been said about what needs to be done. Two main challenges have to be kept in mind. First, the emphasis in reform should be on *a web of policies* that provide a favourable environment for investment and private enterprise development in general. This requires a strong commitment to reform by all levels and sectors of government and efficient synergies between a wide range of actors. Second, an effective and timely *implementation* of reforms is a key requirement. Adopting new laws and regulations is not enough, and indeed, as noted by many at the Roundtable last year, too many laws may kill the rule of law.

The task ahead remains challenging, but let me underline that Ukraine is not alone in this endeavour. Our Member countries, multilateral organisations, the private sector and civil society at large - all of us have a shared responsibility to support Ukraine's efforts on the path of policy reforms. I trust that we can help in two main ways.

First, policy makers from many OECD countries have faced similar challenges and their experience should be able to assist Ukrainian policy makers in selecting the right policy approaches. Such exchange of policy experience is at the core of the OECD's role, and the Organisation is actively engaged in open dialogue and experience sharing with both Members of the OECD and others.

Second, we should assist Ukraine in implementing the reforms needed. The OECD cannot, however, do it all by itself. The need for co-ordination and participation of many donors and international institutions in the field of international investment is particularly important, and I am pleased to note that the World Bank, IMF, EBRD, USAID and European Commission were all represented at the Forum meeting. In this context, the OECD sees very much its role as a facilitator, focussing our own efforts on contributing to building consensus on a "roadmap for reform", monitoring and helping with implementation of reforms, and then encouraging bilateral and multilateral donors to make use of our work in targeting their own assistance programmes to Ukraine.

We believe that this Forum can indeed contribute to strengthen our sense of a shared responsibility and help to further focus the co-operation between the OECD, Ukraine and other partners on priority policy issues.

The Forum is meant to be a dynamic process in which all the stakeholders looking forward to an improved business environment are actively involved. Our aim is to engage the participants in frank and lively exchanges, without refraining from expressing praise or - positive - criticism as long as it is based on solid facts and sound analysis.

In concluding, let me recall the final statement of the Kiev Roundtable meeting last year: “Ukraine has the potential to be transformed from ‘a miracle in waiting’ to ‘a miracle in making’”. Almost one year afterwards, we have a unique opportunity to see how this transformation is being realised and how we can contribute to deepen and speed up the important process of Ukraine’s greater integration into the international community.

AN ASSESSMENT OF CHALLENGES AND POLICY REFORMS FOR IMPROVED INVESTMENT ENVIRONMENT IN UKRAINE

*Mehmet Ögütçü and Anna Stepanenko-Malan**

Despite significant growth in foreign direct investment (FDI) flows throughout the world in the past decade, the immediate outlook for fresh inflows of investment dollars does not appear to be very optimistic. Governments all over the world continue to actively seek FDI, and the competition for attracting the "quality" FDI will likely become even more intense over the next decade. In this context, it is critically important for countries like Ukraine to create an enabling framework for investment and further advance the reform agenda with a view to retaining and attracting greater inflows of FDI. This is particularly crucial given that Ukraine needs FDI in almost every area from agriculture to telecommunications.

Although Ukraine achieved an impressive economic growth rate in 2000-2001 , as compared to previous years, largely thanks to the comprehensive reform programme launched in early 2000, the country has still a considerable way to go to be qualified as an attractive destination for FDI. The new Ukrainian government, led by Prime Minister Anatoly Kinakh, seems to have realised the importance of building investors' confidence and the need to implement the reform agenda without further delay. What needs to be done by Ukraine is crystal clear; its achievements will be judged by the vigour with which these reforms will be carried out.

The OECD's Review of Ukraine's investment policies shows the way forward through a series of practical policy recommendations. How decisively these

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recommendations will be put into practice remains a key challenge for Ukraine, and might determine its future place and orientation in the world economy.

Recent FDI Trends and Implications for Transition Economies

The fact that virtually all countries are competing to attract FDI inflows demonstrates that the opportunities for growth and development generated by FDI are now widely acknowledged. In addition to capital inflows, FDI can lead to transfers of technology and know-how, improve access to international markets, and spur competition.

However, despite its growing role in the globalisation process, FDI flows are set to decline in 2001, for the first time in a decade.[1] According to projections released just before the tragic September events in New York and Washington, world FDI flows were expected to drop by 40 % this year, to $760 billion.

FDI Trends in Transition Economies

The transition countries currently preparing for EU accession attracted the largest inflows in the period 1990-1999, with Poland, Hungary and the Czech Republic as main recipients, bringing their combined stock above $65 billion in 1999. This compares with an estimated FDI stock in the Russian Federation of $19.7 billion in 2000.[2]

On a per capita level, inflows into Estonia, Latvia and Slovenia have also been significant placing them ahead of Poland according to this indicator. The smaller CEE countries are also showing the highest share of FDI in terms of total fixed capital formation, with levels well above 20 % for the period 1996-1998. Poland and the Czech Republic range closer to 15 % in terms of this indicator, while in the Russian Federation the share of FDI in fixed capital formation remains closer to 5 % in 2000.[3]

1. Karl Sauvant (UNCTAD), Recent trends, Implications for Developing Countries and Policy Challenges, OECD Global Forum on International Investment, 26-27 November 2001, Mexico City.

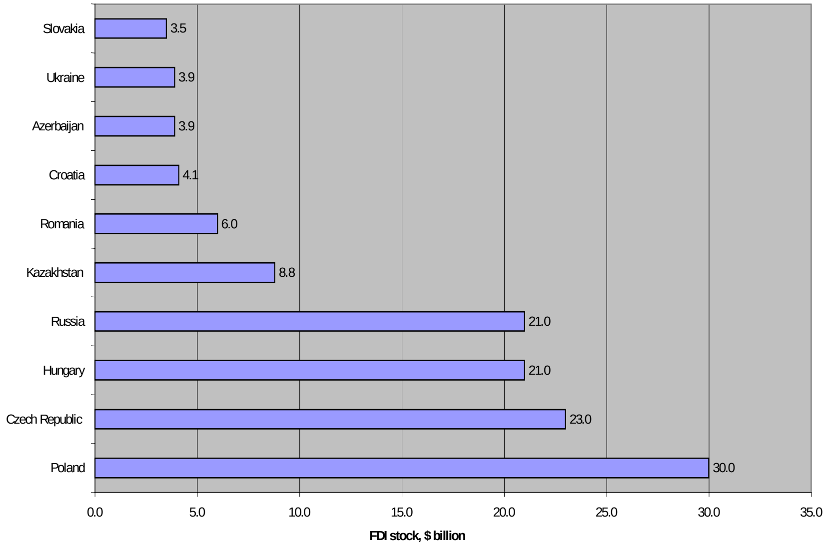
2. Evgeny Gavrilenkov, *Achievements or Missed Opportunities: Factor of Economic Growth in Russia. What lessons are relevant to Ukraine?,* Fostering Sustainable Growth in Ukraine, Physica-Verlag, 2002.

3. Eva Thiel, *The Investment Environment in Russia and Ukraine: Common Weaknesses in the Institutional and Policy Framework*, Fostering Sustainable Growth in Ukraine, Physica-Verlag, 2002.

The projected decline of FDI is likely to affect mostly developed countries, largely through the decrease in mergers and acquisitions (M&As). In the case of developing countries, where most FDI is greenfield investment, the decline is estimated to be around 6 %, from $240 billion to $225 billion. FDI inflows in Central and Eastern Europe, increased by 9 % (to $27 billion, representing 2 % of world inflows) in 2000, are expected to remain stable.[1]

An accentuation of the slow-down in the world economy may prompt some companies to relocate production resources to low-cost producing countries; in this case there may be some redistribution of FDI flows towards developing and transition economies. Under these circumstances, transition countries – a group still accounting for a relatively modest share of total world FDI stock – could use their comparative advantage to attract such relocated investment. The decline of FDI may lead governments to increase their efforts to boost FDI inflows and to try to secure greater benefits from FDI received. Hence, establishing an enabling framework in key policy areas and improving the overall business climate will become even more important in the years ahead.

Chart 1. Top Ten FDI Destinations in Central Europe, 1990-2000



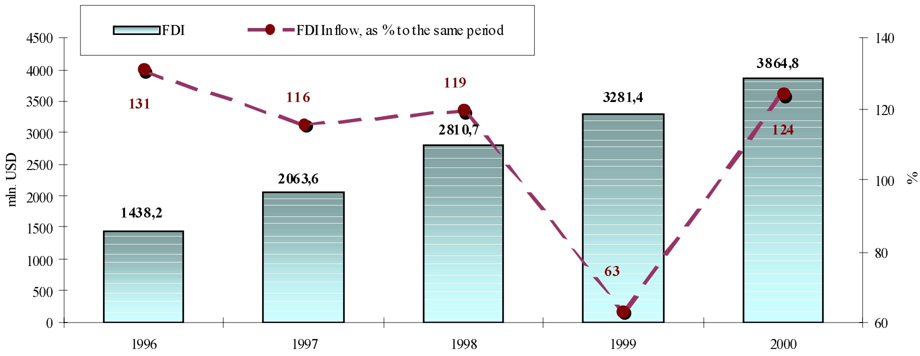
Source: OECD Investment Policy Review, Ukraine, 2001.

1. Ibid.

Foreign Direct Investment in Ukraine Today

Ukraine is one of the transition economies with potential for investment and growth, but also with huge challenges. Its large landmass, domestic market of about 50 million people, highly educated labour force, rich natural resources, and strategic location, provide a solid base for sustained economic growth and a fertile soil for investment inflows, domestic and foreign alike. Yet, despite its perceived sound fundamentals, Ukraine lags behind most Eastern European transition economies, both in terms of growth and the volume of FDI it has attracted.

FDI Inflow to Ukraine (1996-2000)



Source: OECD Investment Policy Review, Ukraine, 2001

Some projections indicate that Ukraine should raise at least an estimated US$40 billion of investment for rehabilitating its ailing infrastructure alone. FDI is urgently required in almost every area from agriculture to telecommunications. Yet, FDI inflows remain marginal. According to official Ukrainian data, as of 1 October 2001, total FDI stock Ukraine has accumulated since independence is some US$4.2 billion. This translates into about US$83 per capita, placing Ukraine the second lowest among CIS countries, ahead of only Belarus; and amounting to less than 10 % of per capita FDI to Central and Eastern European countries such as Poland and Hungary. Also, the USA invested 10 times more in the Polish economy than in that of Ukraine.[1]

1. Stefan Lutz and Oleksandr Talaverda, EERC annual conference paper, April 28-29, 2001.

The legal regime specifically addressing foreign investment is set out in both Ukraine's domestic legislation (in particular 1996 Law on the Regime of Foreign Investment amended in 1999), and in international agreements. Some national legislation, while not expressly distinguishing between domestic and foreign investment, applies in practice to foreign investment only, notably the laws on production-sharing and concession agreements.

FDI Trends in Ukraine

By origin of investment, the United States has been the dominant foreign investor ($ 590 million, which represents 18 % of all FDI), followed by the Netherlands with 9 %, the Russian Federation (9 %), Germany (7 %) and the United Kingdom (7 %).

From a sector perspective, as of January 2000, the main destination of FDI in Ukraine, was the domestic food industry (20 % of cumulative FDI), followed by domestic commercial operations (over 17 %) and mechanical engineering/metals (almost 11 %).

FDI flows into Ukraine are highly concentrated in a few regions. Kiev and its surroundings receive over one-third of all FDI; Donetsk, Zaporozhye, Poltava, Odessa and Dnipropetrovsk regions together account for another third; leaving less than one-third for the remainder of the country.

Major amendments to Ukraine's FDI legislation enacted during the past few years constitute a shift from a generous, but ineffective system, of specific incentives to a system of non-discriminatory legal conditions for all investors, including more extensive investment protection. Access for foreign investors to the Ukrainian market has also been considerably liberalised, though limitations remain in certain sectors.

Ukraine has signed a significant number of bilateral investment treaties (67 treaties, 43 of which are in force), including some with OECD Member countries. The bilateral treaties, which supersede the Ukrainian Foreign Investment Law and prevail over it in case of conflict, conform, in most cases, to international standards. In addition, Ukraine has signed several multilateral agreements related to foreign investment, such as the 1965 ICSID Convention, the 1994 Energy Charter Treaty, and the 1998 Partnership and Co-operation Agreement with the European Union.

The mechanism for implementing foreign investment regulation has also been streamlined. In 2000 the main central government agencies with FDI-related responsibilities were integrated into the Ministry of Economy and European

Integration. This concentration of FDI expertise now offers an opportunity for implementing a coherent investment strategy.

Why then, if the legal and institutional framework for foreign investment seems satisfactory, do FDI inflows still represent only a small fraction of Ukraine's potential? The answer appears to be that substantive flaws in Ukraine's general legislation, and especially the lack of transparency and legal insecurity, constitute a much more important investment barrier than some minor shortcomings in specific foreign investment regulation. Hence, to attract investment, the reforms should address structural reform and the policy deficiencies as a whole, and not be confined to the revision of foreign investment regulations alone.

Major Challenges…

In spite of recent economic growth, most international ratings and investment climate surveys place Ukraine among the least advanced transition economies with respect to its macroeconomic and microeconomic conditions. The contribution of the private sector to GDP is quite low, at about 20 % of GDP, compared to around 70 % to 80 % in Hungary, Poland and Russia.[1]

An unfavourable environment for business has contributed to substantial capital outflows, estimated to have reached around $20 billion since Ukraine's independence. Estimates on the size of the informal, "shadow", economy range from 14 % (official estimates) to a more realistic 60 % of total GDP. Persistent fiscal and current account deficits – even taking into account the fact that they have gradually decreased since 1994 – as well as high inflation – around 20 % per annum – testify of grave economic difficulties.

Effectiveness in affording property security and enforcing contractual rights also appears to be poor. Investors complain of complex and often ambiguous legislation.[2] Indeed, despite a vast body of law, Ukraine still lacks a coherent, effective and transparent legal system. To date, fundamental codifications, such as civil code, tax code, and legislation concerning the judiciary system, are pending before Parliament or the Presidency.[3] Moreover, frequent legislative

1. Sigma Bleyzer, 2001.

2. "Report on Impediments to Foreign Investment in Ukraine" carried out by the TACIS-funded Ukrainian-European Policy and Legal Advice Centre in 1999.

3. Thus, the draft Civil Code has passed three readings (September 2001) and is to be signed into law by the President.

and regulatory modifications, rather than helping to establish transparent rules, have often contributed to discretionary interpretation and unpredictable implementation.

Although the major reform programme has demonstrated some encouraging achievements, the structural reforms remain incomplete and the economic growth fragile. The most pressing economic priorities include:

– ***Accelerating privatisation*** of many large State-owned enterprises: Progress in the area of structural reform, in particular privatisation of the energy sector, has slowed down recently. Mr. Kuchma, President of the Ukraine, put a temporary moratorium on privatisation of electricity distribution companies in May 2001, although his recent Decree of December 2001 will lift this ban as of spring 2002.[1]

– ***Restructuring unwieldy governmental apparatus, and combating corruption:*** Public governance marked by bureaucratic interventionism and corruption remains one of the priorities of the reform. According to the Transparency International 2001 "Corruption Index", Ukraine ranks in 83rd position, leaving behind only 8 countries.[2]

– ***Re-organising the court system:*** A comprehensive re-organisation of the court system is required in order to improve courts' technical and financial resources, as well as the competence of judges, and to ensure effective protection of investors' rights.

– ***Streamlining the tax system:*** Taxation tops the list of investment disincentives in Ukraine. The lack of a comprehensive and coherent tax code is one of the main shortcomings of the business climate. The reduction of tax burden, in terms of both tax rates and the number of taxes, is also required.

– ***Overhauling agricultural sector:*** The new Land Code establishing private land ownership is an important step towards transforming agriculture into a market-based sector, but it requires

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1. Oxford Analytica Daily Brief, June 6, 2001, II.

2. The Index is based on 1999, 2000 and 2001 data provided by the Economist Intelligence Unit, the Global Competitiveness Report, the World Business Environment Survey and the Freedom House.

implementation of legislation relating to key issues such as land valuation, the establishment of a property registry, the creation of a mortgage bank and bankruptcy procedures.

- ***Completing reforms necessary to enter the World Trade Organisation*****:** Though Ukraine has liberalised its trade regime in recent years and lowered its tariffs, considerable non-tariff barriers remain, especially the imposition of cumbersome technical standards and certification requirements. At present, Ukraine is actively seeking WTO membership but must l implement a host of reforms in order to qualify.

- Further reforms of banking and capital market systems, accounting and auditing, ensuring better protection of property rights, and completing land reform.

- Providing a foreign investor-friendly climate by liberalising capital, foreign exchange and profit expatriation controls, lifting restrictions on foreign ownership and control, and minimising red tape.

…and First Achievements

There are, however, some encouraging signs. First signs of success of a comprehensive reform programme, implemented since 1999-2001, are now becoming visible.

Significant progress could be seen in macroeconomic and financial stability during 2000-2001. Real GDP grew by 14 % in two years, inflation declined to an average 12 % in 2001 and the fiscal deficit was cut to 1.3 % of GDP. Net general government public and external debt decreased to 29 % of GDP and 23 % of exports, respectively, in 2001, down from a peak of 54 % of GDP and 63 % of exports, respectively, in 1999.[1] Added to this list are recent significant improvements in liquidity reflecting the restructuring of liabilities to the Paris Club, the settlement of natural gas arrears, and rising international reserves. Reserve coverage of the external financing gap increased to over 300 % in 2001, up from a trough of 21 % in 1998. These developments hold out hope for an economic revival.

1. Standard & Poors’ rating of 26 December 2001.

Progress has been achieved in the field of small business. There are over three million small and medium enterprises (SMEs) operating in Ukraine, which contribute to job creation,[1] although the share of SMEs in total output and total employment is not high: in 2000 it constituted 8.4 % and 8 % respectively.[2] The government needs to pay special attention to the needs of SMEs and help open avenues for SMEs to enhance linkages with foreign direct investment.

One should also acknowledge some strategically important decisions that have already been taken to provide a solid base for sustainable economic growth, such as:

- Approval, for the first time since independence, of a realistic budget for 2000; this was repeated in 2001 and 2002 and sustained by a rather tight budgetary and fiscal policy. The 2002 budget allows for a deficit of 1.7 % of GDP, or US$811 million. The budget is based on the new Budget Code (enacted in March 2001) providing for decentralisation of local public finance, which is one of the key elements of current budgetary reforms. On the negative side, due to delays in the adoption of the new Tax Code, the 2002 budget is based on the existing taxation system with its high tax burden.[3]

- Implementation of policies that have reduced the share of non-cash transactions in the economy, notably a ban on non-cash settlements with the budget.

- Amendments to the Law on electricity, which significantly restricted the scale of non-payments in the electricity market

- Approval of the 2000-2002 Privatisation Program, which sets the baseline for transparent and foreseeable sales of State property. The programme aims at privatising most of the 200 large enterprises holding over 80 % of assets in the industrial and utilities sectors. Unlike previous privatisation rounds, the 2000-

1. Mr. Carlos Pascual, the US Ambassador to Ukraine, *What can place Ukraine on a path to Sustainable Growth,* (lecture at the Kyiv-Mohyla Academy of April 25, 2001).

2. Iryna Akimova, *Performance of Small and Medium Sized Manufacturing Firms in Ukraine: Does the Quality of Governance Matter?*, Fostering Sustainable Growth in Ukraine, Physica-Verlag, 2002.

3. Oxford Analytica (http://www.oxweb.com).

2002 programme targets primarily long-term strategic investors and foreign investors in particular. To attract them, it is envisaged to re-organise enterprises earmarked for privatisation and to restructure their debt. Also, a Working Group to review such progress has been established.

– Privatisation of collective agricultural enterprises, demonopolisation of lending to the agricultural sector, and finally, adoption of the Land Code. Agriculture (13 % of GDP), the most depressed sector during the 1990s, grew by 7.6 % in real terms in 2000 and by an estimated 6.5-7.5 % in 2001. This year's bumper crop resulted in Ukraine tripling its grain exports, and contributed significantly to lowering food prices and inflation.[1] The new politically challenging and economically important Land Code was finally approved in November 2001 and came into effect on 1 January 2002. It introduces a formal mechanism for private land ownership and allows agricultural land to be bought and sold and used as collateral (effective as of 1 January 2005), which should facilitate farmers' borrowing. The pace and detail of land reform will be determined by legislation adopted to implement the land code.

– Introduction, within the framework of the administrative reform, of a new mechanism for collective decision-making that prevents the approval of decisions hindering entrepreneurial activity, and requires publication of government decisions.[2]

The Way Ahead in Reforms: Implementation is the Key

Despite recent favourable macroeconomic indicators, Ukraine has still some considerable way to go to make its growth sustainable. FDI is one but not the only mechanism to increase economic growth. As mentioned above, the emphasis in reforms should be on a web of policies that provides a favourable environment for investment and private enterprise in general.

If this is done properly and regulatory barriers are eliminated, investment flows, including FDI, will increase and the economy will prosper with complementary developments in the foreign-owned and domestic enterprises. It should be

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1. Standard & Poors' *op. cit.*

2. ICPS newsletter, No. 109, 28 May 2001.

understood that if policy-makers focus solely on trying to attract FDI to the economy, which has a “hostile” business environment, by favouring foreign investors over domestic ones, the results are likely to be less positive with respect to the long-term development of the economy.

To support Ukraine’s reform efforts, the OECD and other international donors have come up with a number of policy recommendations aimed at improving the overall business environment.

The **OECD Investment Policy Review**[1] recommends, *inter alia,* that the Ukrainian authorities:

- Reorient government administration away from micro-managing the economy towards a strategic formulation of framework conditions conducive to private sector development.
- Develop a transparent, predictable, and stable process for case-by-case privatisation, and ensure that the tender commission is independent.
- Phase out non-transparent and distortive investment incentive schemes.
- Open the way to international arbitration of disputes under the foreign investment law, and establish courts of appeal for economic disputes.
- Align Ukraine’s accounting and auditing practices with international standards, in particular for publicly-traded companies and financial institutions, so as to avoid double book-keeping and attendant costs, simplify financial reporting and ensure transparency and proper performance evaluation.
- Simplify interaction between foreign investors and Ukrainian authorities by considering the creation of a "one-stop-shop" that obtains for foreign investors all required licences, approvals and permits.

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1. The executive summary and the recommendations are available at the OECD website (http://www.oecd.org/daf/investment/ukraine.htm).

Ukraine faces a choice between drastic policy and institutional reforms to further improve the environment for investment and enterprise development and a gradual but irrevocable decline of the economy. To mobilise investments now, it is necessary to strengthen investor confidence in the will and ability of Ukraine to implement reforms, persuading investors that it pays to buy into the Ukrainian economy today, when entry prices are still moderate, and reap returns tomorrow, when business conditions will be favourable.

It would not be an exaggeration to call Ukraine today a “miracle in waiting” that has all the necessary potential to become a reality.

A SYNTHESIS OF FORUM DELIBERATIONS

Jaroslav Kinach[*]

The crucial difference between this Forum and other meetings on Ukraine's investment policy and private sector development is that the Forum continued the discussions and analyses by experts which started a year ago at the initiative of the Ukrainian government, and which resulted in OECD's publication *Ukraine: Investment Policy Review* in May 2001. Indeed, the OECD has a pivotal role to play in spearheading discussions leading to reforms in these and other vital sectors in Ukraine, particularly since the OECD, unlike other international financial institutions, offers expert and professional advice without any pre-conditions.

The *Investment Policy Review* synthesises practical advice and recommendations which, when implemented, will lead to improvements in Ukraine's investment climate and also facilitate business formation and private sector growth. Both are critical to Ukraine's economic development and growth, and these factors will contribute significantly to its prosperity.

Ukraine's transition from a centrally planned to a market economy has been difficult and complex. An efficient market economy requires appropriate institutional, legal and regulatory conditions. An open market economy also requires a government that understands its role, which is essentially to protect the national interest via legislative and regulatory mechanisms, rather than active involvement and interference in the marketplace.

While these concepts are fundamental and self-evident to many westerners, they are not as easily understood, let alone accepted, by officials in the executive and legislative branches of power in most countries comprising the Former Soviet Union (FSU). These concepts and recommendations are in fact opposite (and alien) to what the previous regime represented, namely, control of all economic and most social activities. Accordingly, modifying attitudes and motivating officials to establish the 'rules of the game' and apply these fairly to all is an

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* Advisor to the Prime Minister of Ukraine.

equally important dimension in creating an attractive investment climate and appropriate conditions for business to flourish. As one observer noted at the Forum, laws and regulations are important, but too many of them will inevitably create more problems than solutions.

This Forum was important not only because it provided another opportunity for experts from the OECD and its member countries, as well as members from the Ukrainian business community, but also to assess improvements and shortcomings in the legislative and regulatory environment over the last year. This meeting also provided government officials with an important opportunity to debate these and other issues openly and frankly, and in the context of improving attitudes and modifying administrative behaviour, there is no replacement for an active, face to face, discussion.

The Forum comprised three key sessions. In the first session, senior government officials presented a general, but comprehensive, overview of the economic situation in Ukraine during the last two years, and a detailed report on the implementation status of OECD recommendations contained in the *Investment Policy Review*. A panel of experts from the IMF, World Bank, the local business community and other resident advisors and economists presented their views of these developments. All acknowledged that economic growth in Ukraine was indeed the highest among transition countries and that structural and administrative reforms were underway.

However, they also agreed that there were still many opportunities for improvement in terms of structural and administrative reforms in various sectors of the economy, and that existing institutional, legal and regulatory frameworks were either lacking or were ineffective in supporting a vibrant open market economy. In this context, taxation merited special attention inasmuch as the government and parliament are drafting a new Tax Code that would streamline tax law and regulations, including administration thereof, as well as align tax policies with international practice.

Two interesting comments highlighted the discussion in this session: first, that Ukraine should benchmark its economic performance against its neighbours and other countries that it wishes to emulate in order to assess its performance and potential. And, secondly, that Foreign Direct Investment (FDI), which is one of the lowest in *per capita* terms in the region, is a good litmus test of how foreign investors view Ukraine. All speakers acknowledged the need for more FDI. And many reasons for shortcomings in attracting FDI were again recited, although these have been extensively described in the *Investment Policy Review.*

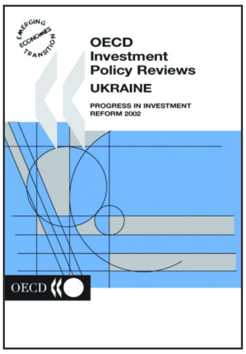
The second session was more focused on topics of special interest to investors and businessmen. On the issue of Privatisation, a succinct overview of the process and its critical components was described. It was also acknowledged that substantial progress has been made in the privatisation process, as witnessed by several successful large- scale privatisations in 2000/01. The Forum also heard about the challenges faced by owners of a recently privatised major electricity distributor. Their experience in Ukraine was markedly different from similar privatisations in neighbouring countries. Again, we heard about administrative intrusion in the electricity market place, and the need to establish fair "rules of the game" and apply them without exception and consistently.

An insight was also offered into the fragile, and yet undeveloped, capital and securities market in Ukraine. The absence of a functioning and effective capital market in Ukraine is a serious and major drawback in Ukraine's economic development. Themes of good corporate governance, respect for minority shareholder rights, financial reporting according to international accounting standards and other desirable issues were discussed, and it was encouraging to hear from the authorities present that these shortcomings were recognized and that appropriate legislative and regulatory changes were imminent.

The banking sector was also examined in view of its critical importance in supporting enterprise development. It was noted that despite a large number of banks, (over 150 registered), the top ten banks represented over 70% of all bank activities, and that bank loans represented less than 15% of GDP, an insignificant level of financing in the economy. The ineffectiveness of the banking system in intermediating between savers and users of financial capital was examined and traditional themes of trust, integrity and reliability were highlighted. Again, notwithstanding the shortcomings in this important sector, major improvements in regulatory and legislative areas were identified, and new bank supervisory and monitoring standards were being developed and implemented.

The third and closing session focused on the near term and next steps. Officials provided an outline of priority areas requiring attention, and it was not a coincidence that many initiatives had already been launched to address areas of concern identified by the many speakers. The government, it was noted, would continue with reforms to improve the welfare of its citizens, modernise its extensive industrial base and elimination of barriers to investment and business formation and growth. It was also made clear that the government required professional assistance and advice from the international and bilateral communities. And in this regard, the OECD could also play a pivotal role in co-ordinating and encouraging technical assistance from its member countries.

Overall, the participants in the Forum were pleased that progress was being made in many areas of the economy. However, there was also a feeling that more extensive reforms were needed, including an accelerated tempo, if Ukraine is to take its rightful place in the region and globalized economy.



From:
OECD Investment Policy Reviews: Ukraine 2002
Progress in Investment Reform

Access the complete publication at:
https://doi.org/10.1787/9789264175969-en

Please cite this chapter as:

OECD (2003), “Progress Report by the Government of Ukraine”, in *OECD Investment Policy Reviews: Ukraine 2002: Progress in Investment Reform*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264175969-2-en