Proposed Action Plan to Attract International Capital To Ukraine

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Measures to Attract International Capital

I. Liberalization of Business Activity

1. Publish and disseminate widely the Government’s de-regulation Strategy (to reconfirm to firms that they are allowed to operate in a market economy with more degrees of freedom and less interference from government agencies).

2. Strengthen the Committee on Regulatory Policy and Entrepreneurship and provide it with the resources to continuously review all existing and new regulatory legislation to assess their impact on businesses. Only this body should have the final responsibility to introduce new licensing and business regulations.

3. Adopt licensing and other Government control requirements that conform to European Union and international standards. This should simplify business licensing to facilitate and reduce the amount of time required to: (i) complete business registration to start a new business, (ii) operate a business and to (iii) import/export goods, as follows:

   (i) Start a business registration system based on a one-stop process. Show that government is trying to focus only on those areas where it has a public duty to ensure adequate standards (e.g. health and safety). Consider moving to a system of issuance of licenses without preliminary business inspections. Ensure that local registration offices comply with national company registration requirements, in terms of time, cost and documentary burden.

   (ii) Implement the following deregulation measures for ongoing businesses:
   - reduce the number of bodies that have the power to inspect businesses.
   - reduce the number of individual business inspections by government agencies and coordinate inspections among agencies.
   - limit or eliminate unplanned business inspections (to cover all inspecting agencies). If an unplanned business inspection is required then this should only be done with a court order.
   - remove ability of state bodies to close businesses, unless there is a direct threat to safety, health or the environment. Even then only with a court order.
   - remove constraints to the purchase and leasing of commercial premises, land and housing.
   - reducing the number of planning regulations developers have to meet for refurbishment of new buildings (related to property
development, especially in Kiev, where signals that are given to foreign investors are strongest).

- move towards level business playing field by eliminating distortions caused by preferential access to land, state contracts, infrastructure, and credit.

(iii) To streamline customs service for imports and exports:

- develop a custom code and other international trade laws in line with international standards.
- consider partial (or full) privatization of customs service.
- consider contracting out the customs function to a reliable international pre-shipment inspection firm to improve service and reduce corruption (like in Indonesia).
- streamline product certification and ensure effective oversight over certification laboratories, to eliminate corruption and unnecessary delays. Move towards recognizing international certification standards (e.g. European Union, World Trade Organization).

4. Eliminate incentives to excessive Government intervention, such as:

- disallowing all regulatory agencies from keeping any part of fines they collect,
- do not allowing implementing agencies such as State Tax Authority, SCS to get too independent or fund themselves. Get their reporting lines under the control of the Government and Ministry of Finance.

5. Reduce shadow economy activities by drastically lowering cost of compliance with legislation in effect. Eliminate all back dated laws and regulations, allow sufficient time for businesses to adapt to changes in legislation. Increase cost of non-compliance through more effective use of the courts.

II. Legal Environment

1. Create an independent and incorruptible judiciary. In order to achieve this, it is necessary to:

   - Provide adequate funds from the fiscal budget to support the work of courts and independent judges (in 1999 only 50% of funding required was supplied by the government).
   - Increased resources for judiciary are also needed for computers with legal databases and Internet access, web site with compilations of court decisions, academic treatises, Judicial training on issues associated with modern commercial transactions, etc.

2. Pass new or modify existing legislation as required to provide a stable legal framework for businesses. Codes should set the framework for any special legislation
needed by a modern economy on banks, joint stock companies, investment institutions, securities and stock markets, etc. There should not be special regulations for individual investors but improvement of general legal and investment climate. This legislation includes:

- the draft civil code.
- a new labor code that allows restructuring of enterprises.
- new criminal code.
- new tax code.

3. Create a Legislative Center to expedite the above work and coordinate the preparation and drafting of laws and regulations. In general, drafting and passing modern commercial laws and codes is uncoordinated and is occurring way too slowly in Ukraine and is holding up reform. Have public hearings with interested groups as part of legislative process. At the very least publish all drafts of legislation in order to stimulate debate.

4. Make the Civil Courts more efficient and enhance commercial courts for settling disputes and enforce contracts. For this:
   - Introduce mechanisms for the enforcement of court decisions.
   - Move to a legal precedent system. At the moment courts are not obliged to take into account decisions made by other courts in similar cases, only Supreme Court decisions.
   - Ensure the independence of the judiciary, particularly by removing the dependency of judges and courts on local/oblast authorities.
   - Implement a compulsory retraining of judges and court officials.
   - Ensure that private business has an equal voice in court as the state.
   - Ensure that any and all penalties against the state are effectively levied.

5. Empower the Courts to deal with jurisprudence. For this purpose, the Judiciary should have its own independent budget. Separate the judicial and executive branches (while legally they are separate, in terms of day-to-day operations the executive still decides on office space, communication, staffing, etc.) This is especially obvious at the local level, when executive officials can influence judiciary. Do not allow executive agencies to do jurisprudence (today, for instance, Tax authorities make the jurisprudence).

6. Improve the regulations and implementation of the new Bankruptcy Law.
   - Although Ukraine has a Bankruptcy Law on the books, it is still ineffective. The existence of a credible threat of bankruptcy is one of the most effective ways of assuring the enforcement of contracts.
   - Amend the bankruptcy legislation with a provision that would make asset stripping impossible. Managers must not be able in case of bankruptcy, to sell property illegally or to hand it over to other enterprises instead of using it as a payment to the creditors.
7. Abolish the practice of backdating any legal decisions. Ukraine is known for passing legal acts that come into effect a couple of months prior to the date of the passage of the law.

8. Review existing legislation from the point of view of consistencies among different legal documents. There is a need to harmonize the existing body of Ukrainian law, to eliminate inconstancies. There is also a need to implement a permanent program to update basic Ukrainian laws and codes regulating business.

9. Allow international arbitration.

III. Financial Sector

III (A) Banking Subsector

1. Pass required regulations on the recently approved law “On Banks and Banking Activity”, including a requirement that bank employees and controlling shareholders adhere to specified standards of integrity and fiduciary responsibility.

2. Improve commercial bank supervision and prudential regulation.
   - Bring supervision of commercial banks up to international standards.
   - Strictly enforce requirements regarding minimum capitalization (seeking to vastly expand the capitalization of the banking system), capital/asset ratios, loan classification and provisioning, and lending to related parties. Lax application of these requirements undermines confidence in the banking system with negative effects on foreign investment.
   - Complete the development of the early warning system — with sensitivity analysis capabilities — to identify banks at risk.
   - Complete the preparations of contingency plans for dealing with possible troubled banks, including bankruptcy procedures with an efficient enforcement mechanism.
   - Initiate the closure or merge of any bank not showing any real prospects for recovery out of the seven large banks that signed Commitment Letters with the NBU.
   - Carry out the restructuring of commercial banks that are now in financial difficulties, but have prospects for recovery restructuring or writing-off bad loans within set period of time. Otherwise debt-equity swaps or bankruptcy procedures should be used.

3. Improve the independence of the banking sector, as follows:
   - The Government should sell shares of commercial banks that it holds today.
   - Under no circumstances grant any Government guarantees to commercial banks for foreign credit lines.
- Reduce the amount of government debt that commercial banks are obliged to hold and thereby lower interest rates and free bank capital for investment.
- Government should abstain from placing political pressure on commercial banks to lend to specific sectors or enterprises.
- Ensure the independence of the NBU by ensuring that its Governor be also the Head of the 15 members’ Board and that the Board makes only recommendations, but not decisions.
- Ensure separation of responsibilities in commercial banks by establishing that their Boards of Directors are in charge of strategy, and prevented from day-to-day lending/borrowing decisions. The President and/or Board members should be prevented to have operational functions and/or offices at the bank.
- The financial statements of commercial banks should be systematically audited by one of the big five international auditing firms. The audit should include a statement about undue influence of third parties on the business of the bank.
- Accounting should be strictly in conformity with International Accounting Standards.
- Develop arbitrage possibilities to serve as the referee for the banking sector when NBU and/or banks consider that they have been improperly dealt with.

4. Abolish the “Kartoteka” and replace it with normal court-based lien and bankruptcy procedures. The State Tax Authority should no longer have the unilateral right to freeze and seize bank accounts of companies for alleged tax arrears without prior substantiation of the claim and an opportunity for the company to seek protection in the courts. The Government cannot take money out of bank accounts without due process. Also reduce and control the requirement for banks to report on client bank accounts.

5. Take the following measures to encourage the growth of bank assets (Hryvnia lending) by minimizing lending risks, as follows:
- Develop “loan” and “pledge” database, which should be accessible by all banks, including information on existing lines of credit, outstanding balances, and liens for all bank debtors.
- Enhance the legal environment for Secured Transactions by simplifying procedures for registration of liens and other security, permitting the unrestricted possibility of pledges over assets, permitting the possibility of pledges for a fluctuating pool of accounts receivable for working capital financing, improving the protection of bona fide acquirers, including those acquiring in the ordinary course of business; and improving enforcement procedures by easing repossession from delinquent borrowers (including housing and land - which would help allow mortgage lending to develop).

6. Facilitate the growth of bank deposits and other liabilities, through the following actions:
- Facilitate the development of current accounts with checking privileges, and an ATM system.
• Though allowing the use of cash in transactions, encourage entrepreneurs to make payments on bank accounts above a minimum level.
• Encourage shops in Ukraine to accept card payments, above a minimum amount.
• Encourage consumers to pay utilities via banks.
• Introduce inflation-related banking instruments/liabilities.
• Introduce a modern deposit insurance scheme, increasing its current limit of UAH 500 and ensuring that the insurance fees are invested by an independent body, which could issue marketable instruments.
• Develop money market instruments by creating a pool of resources that could issue money market instruments which could to be exchanged between banks.

7. Restructure the Savings Bank in order to improve solvency and profitability.
• Development criteria for successful work of its branches and their employees.
• The network of Savings banks should also be used to provide consulting services to individual depositors, small and medium business.
• Establish close cooperation with foreign organization that allows the transfer of “know-how” in relevant areas.
• Close branches that do not meet new requirements.

III (B) Securities and Stock Markets

8. Strengthen the Securities and Stock Market State Commission (SSMSC) by:
• Increasing it’s resources,
• Ensuring it functions as a truly collegial body, as designed in the Law “On State Regulation of Securities Markets in Ukraine.”
• Improving its licensing and monitoring of market participants,
• Expanding the mandate of the SSMSC to include the overseeing of the security-related activities of all non-bank financial institutions.
• Securing agreement between the Security Commission and the NBU on their scope and rules for the regulation of banks.
• Clarifying the role of the Security Commission on T-Bills and derivatives.
• Make necessary adjustments to the Law on a National Depositary System for securities to improve its effectiveness.

9. Develop the infrastructure necessary to facilitate the activities of the Secondary Market for securities

III (C) Pension System.

9. To correct financial imbalances of the pension system and to better target benefits, enact legislation to increase the retirement age.
10. To supplement the “Pay-As-You-Go” state pension system, introduce gradually a regulated mandatory component to the pension system with a fully funded element, based on capitalizable individual accounts managed by private pension funds. First step is to finalize and pass the draft pension laws currently being developed.

11. Financing at the expense of state fiscal budget that part of pension contributions that are entered into personal accounts for funding pensions for the elderly. It means that rates of pension contributions for the younger generation will remain unchanged. Therefore, part of these contributions, that is nearly 2% of the current rate of pension contributions should enter personal savings account.

III (D) Financial Sector Infrastructure

12. Accelerate implementation of the Accounting and Auditing Reform:
   - pass amendments to the law “On Auditing Activity”;
   - bring the National Accounting Standards closer to International Accounting Standards,
   - require that companies whose shares are listed on a stock exchange or trading and information system file annual reports in accordance with IAS, not NAS, by the year of 2003,
   - expand efforts to teach new accounting and auditing methods at the Ministry of Education, etc.)

13. Encourage competition and efficiency in the financial sector by facilitating the expansion of foreign banks and the formation of non-bank financial institutions, such as investment funds, factoring companies, leasing companies, credit unions, venture capital funds, etc. For this:
   - liberalize rules regulating foreign banks.
   - Finalize and pass the law “On Investment Institutions”
   - Pass prudential rules concerning the activities of non-bank financial institutions and improving supervision over their activities.

IV. Corporate and Public Governance and Privatization

IV (A) Corporate Governance

1. Demonstrate corporate financial discipline by closing 10-20 big loss-making companies within next two years. This should send a strong signal that financial performance in a market environment is the only criterion for survival in the long term. For this purpose, remove soft budget constraints caused by tax and energy arrears, remove entirely mutual debt settlement and offsets – cash only, and enforce bankruptcy procedures.

2. Bring Ukrainian corporate governance legislation in line with legislation of the European Union. For this purpose:
Enacting the Joint Stock Company Law of Ukraine. The current company law of Ukraine does not reflect the progress of market changes taking place. The 26 articles of the present Law of Ukraine “On Business Associations” regulating the activity of joint stock companies do not adequately regulate matters such as minority shareholder rights, board responsibility and remedies. A draft law is presently in the Cabinet of Ministers and is to be passed on to Parliament in the near future.

Amend the Labor Code to allow managers and workers to be laid off more easily.

Draft and officially issue a “Corporate Governance Code,” as is being done in Russia now - a set of specific voluntary principles to which companies are encouraged to comply. It should include topics such as the limit of the role of Board members in day-to-day matters/management.

3. Require all companies, starting with bigger ones with large number of shareholders, to switch over to international accounting standards and to submit annual reports on economic activity. Balance sheets and profit and loss accounts need to be established in accordance with international standards.

4. Encourage the creation of non-government institutions to improve corporate governance, such as:
   - a shareholder associations. This is needed to protect shareholders’ rights encouraging shareholder activism, facilitating the bringing of court actions, and engaging in public awareness raising. This would contribute to shifting the balance away from dominant shareholders and managers who systematically abuse these rights.
   - a private rating agency for corporate governance. This will bring transparency to good and poor governance in companies,
   - an association of issuers. To protect issuers’ rights.

5. Implement a comprehensive corporate governance training program. This is needed to improve corporate governance knowledge. Special attention should be paid to implementation of training program designed for different categories of target recipients:
   - Supervisory Board members.
   - Investors and shareholders.
   - Managers of JSCs.
   - Public officials/employees.
   - Judges from arbitration courts and courts of general jurisdiction.

6. For all state owned companies, empower a “cours des comptes”, i.e. a body of auditors that would look at the way public companies are managed and make public statements, as well as request and impose enforcement and correction of malpractices.
IV (B) Public Administration Governance

7. Public Administration Reform of state agencies needs to continue, giving special attention to the following:
   - Define and widely disseminate the role of the Government as that of supporting - and not replacing - private sector business activities.
   - Reduce the number of separate Government agencies that have the power to interfere in private business.
   - Reduce the number of central bodies that are members of the Cabinet of Ministers.
   - Continue reorganization of the Cabinet of Ministers to delegate decision-making to line ministries.
   - Focus the Cabinet of Ministers on overall strategies and in exercising ex-post control to stop line ministries and central state bodies from issuing decrees, instructions, and rules by fiat.
   - Improve policy-making capacity and efficiency of line ministries, with clear functions and roles that support, rather than replace, private sector activities.

8. Administrative reform should be extended to local state bodies, including:
   - Mechanisms to ensure the compliance by local officials with the requirements of national legislation.
   - Adoption of clear and enforceable rules to limit the power of state officials to monitor and hence interfere with local business,
   - Introduce more transparency in decision making at the oblast, rayon and town levels.
   - Publish clear and transparent accounts of local finances.
   - Develop mechanisms to ensure that entrepreneurs have proper recourse against local officials.

IV (C) Privatization

9. Secure the early approval and determined implementation of the Land Code to promote private ownership of land, the development of a deep land market, the implementation of the mortgage law, and the development of a clear system for registering titles to fixed assets. This reform is crucial in developing social attitudes towards privatization, as well as a crucial step towards making mortgage-based financing possible for Ukraine’s sector of greatest comparative advantage.

10. Encourage the independent functioning, professional development and proper funding of the State Property Fund (SPF), while subordinating it formally to the Prime Minister. The privatization process in Ukraine has no credibility. The need of the SPF to answer to the highest authority has not allowed it to develop the necessary courage to proceed confidently with some early potential demonstration cases.
11. Complete the privatization of virtually all medium and large enterprises — including the sale of “golden” shares and “blocking” minority positions in all areas including energy, telecom and agro-industry -- through transparent processes consistent with international standards. This should be done with commitment to “letting go,” i.e., fully privatizing companies as quickly as reasonably possible. Abandon incremental privatization.

12. In the privatization process, prepare the companies for privatization, including:
   - Having the State Property Fund put in the charters of companies undergoing privatization adequate protections for non-government private shareholders, including cumulative voting provisions. Also initiate legislation to protect other minority shareholder rights, including restrictions on insider dealing.
   - Transferring social assets to local authorities from enterprises to accelerate privatization and facilitate enterprise restructuring
   - Disclosing the nature of ownership,
   - Disclosing to what extent the enterprise management has ownership rights in the companies with which this enterprise has business relations. Even slight suspicion about possible conflict of interests is enough to demand the sale of these ownership rights.

13. The privatization should be carried out under clear and transparent procedures, which would include the following:
   - Reliance on pre-screening of bidders to exclude dishonest bidders, rather than using such methods like retaining 25% and 50% blocks of shares by the SPF.
   - If there are concerns about abuses by a controlling strategic investor, consideration could be given to selling two or three large blocks (balance of power approach) so long as this doesn’t scare away bidders.
   - Be prepared to accept a higher percentage of foreign shareholding than 49% in more cases. There should be no indiscriminant disqualification of foreign investors to drive down prices.
   - Abolish the minimum share price requirement
   - Remove certain conditions attached (profile preservation, retention of the number of employees, investment obligations) that reduce the attractiveness of enterprises offered to privatization as well as the price investor is willing to pay.
   - Give consideration to the sale of some blocks of shares on the PFTS trading system to build a liquid securities markets. Also encourage the expansion of the secondary market to facilitate the emergence of individuals or groups with controlling blocks of shares who can then provide strong corporate governance.
V. Political Risk

1. The Government of Ukraine should give demonstration in its public statements that it understands the importance that foreign investors place to expropriation. This includes “creeping expropriation” as opposed to fear of outright re-nationalisation of assets.

2. From the point of view of foreign investors, the Tax collectors and local authorities are frequently “out of control” (i.e. do not respond to orders form the centre) and the worst deterrent to would-be investors.

3. The Prime Minister and his Cabinet should be given total authority to do their jobs unimpeded by vested interests — this reduces political risk.

VI. International Capital and Foreign Trade Restrictions

1. Liberalize foreign exchange transactions, including the following:

   - Amend the Decree of the Cabinet of Ministers “On the System of Currency Regulation and Currency Control” to cancel the requirement regarding proof of initial internal transfer of funds in order to buy hard currency for its export from the country.
   - Cancel the requirement that a foreigner that acquired securities abroad cannot sell them in the Ukrainian market unless there is documentary prove confirming that the initial buyer imported dollars into the country and that income tax was paid.
   - Eliminate all restrictions concerning the use of foreign exchange gained as a result of foreign trade transactions or spent for needs of foreign trade.
   - Remove deadline for pre-payment of export and receipt of imported goods.
   - Improve licensing procedures and registration of foreign loans

2. To cancel all restrictions on purchase of securities in foreign currency by residents, by amending the above mentioned CoM decree “On the System of Currency Regulation and Currency Control” as well as the law “On the Procedure of Making Settlements in Foreign Currency”.

3. Remove restrictions to Imports, as follows:

   - Reduce import duties to levels consistent with international agreements on tariff reductions under WTO. Reduce high and variable tariff rates to levels more consistent with average tariffs. Remove most import tariff exemptions, and raise exceptionally low rates closer to the average level. Alternatively, consider the enactment of a unified customs duty for all categories of imported goods, for example, 10% no matter what type of goods their origin country.
• Eliminate the critical import list.
• Tighten customs procedures for dealing with illegal imports (these imports can represent a relatively high share of the market in some sectors, for example agribusiness and branches of manufacturing, which given the scale of import duties paid by law abiding companies, results in unfair competition).

4. Remove restrictions to Exports:

• Ukraine badly needs foreign exchange from exports. Virtually all remaining barriers to export such as quotas, export duties, existing indicative prices, advance deposits and foreign exchange surrender requirements should be abolished, the only exception being the unfortunate cases where the EU and other countries impose export quotas on Ukrainian industries to protect their own high-cost producers.
• Remove the 23 percent duty sunflower and other oil seed exports, and in general avoid using export duties to control production and distribution in the economy.

5. Accelerate accession to the World Trade Organization. Complete process of accession to the WTO as quickly as possible, thus allowing Ukraine to participate fully on a stable basis in world trade and the privileges pertaining to WTO membership.

6. Custom service should be comprehensively reformed. Introduce the system of pre-inspection of import by international certified companies. Allowing mutual recognition of international certification standards and procedures. The right to have all export (custom) procedures done within 24 hours. If violating these instructions, custom officers take personal responsibility in the most severe cases. Ensuring the flow of goods across the borders between oblasts.

7. Develop more modern and consistent procedures for certification requirements and standards of products (which in general apply to imported goods and goods produced domestically). This should focus on the procedures at the State Committee for Standardization (SCS). Agree to recognize certain foreign product certification standards and stop subjecting products meeting those standards to inspection in Ukraine. (The SCS is often reluctant to recognize product certificates issued outside of Ukraine. Current procedures tend to result in lengthy delays and high fees to obtain necessary certification, even for companies with an international reputation. A specific issue is that there are in practice a large number of certification agencies under the general supervision of the SCS leading to problems of differing interpretation or at the very least companies having to secure numerous certificates to meet the requirements of the different agencies with responsibilities in this field).

8. Eliminate restrictions on Foreign Direct Investments in certain sectors - insurance, publishing, broadcasting and telecom. Remove impediments for return of Ukrainian funds to the country.
VII. Corruption

VII (I). Corruption

1. Undertake corruption prevention measures to reduce opportunities for corruption, and to make corruption more difficult to undertake. Prevention would involve:
   - Fund the judiciary and independent agencies (such as the SPF, the various sector Regulatory bodies) to ensure they can be run by professionals capable of earning public confidence in their integrity, ensuring that the STA and STC do not have incentives to “look after themselves” and that they are run by the promoters of key reform-policies.
   - Reduce the frequency and intrusiveness of contacts between the private sector and bureaucrats with discretionary power by deregulating the economy - simplify rules and regulations, and lower the number of inspections and the number of required licenses and registrations.
   - Introduce Government agency budget and financial systems with built-in controls, and agency procedures that require internal review and oversight of regulatory approvals, licensing decisions, and decisions to impose sanctions.
   - Reduce the number of benefits that are subject to the discretion of public officials through either eliminating (or privatizing) public activities or subjecting them to competition and market forces.
   - Eliminate Government discretionality, by eliminating “exemptions” to laws and regulations and making laws more precise.
   - Eliminate the over-complex, non-transparent tax system that allows interpretation by tax inspectors according to whim, conflicting legislation leading to bureaucratic paralysis and requests for “lubrication”, excessive certification requirements.
   - Introduce open and competitive procedures for public procurement and bidding for public works.
   - Reduce the size of the Government and re-focus its role to minimize opportunities for improper interventions and corruption.
   - Decentralize Government functions to bring decisions closer to the public and improve accountability
   - Reform the Civil Service to make it more professional, including (i) increasing salaries of key government officials; (ii) rotate frequently public servants in “vulnerable” positions; (iii) mandate public servants to declare their income/assets.
   - More closely tie pension benefits to contributions, and improve record keeping, so that employees have an incentive to receive their wages legally.
VII (B) Enforcement of Anticorruption

2. Develop the legal framework to ensure the enforcement of anticorruption measures. This would involve:
   - Improve contract enforcement and legal protections for property so that parties have an incentive to move into the formal sector in order to enjoy these protections.
   - Impose harsh, swift and certain penalties for official corruption, including legislation which facilitates the confiscation of the proceeds of crime.
   - Development of adequate avenues for “appeals” of Government decisions, including a system for review of tax decisions.
   - Develop effective channels for complaints of Government actions.
   - Increase the probability of detection and punishment of official corruption through special investigative units comprised of auditors, lawyers, investigators, IT experts and other strong “watchdog” agencies.
   - Improve the court system (Judiciary) to expedite the processing and resolution of cases.
   - Strengthen Enforcement agencies, such as FBI equivalents.

VIII (C) Public Awareness

3. Make people aware of their rights and the rules of the game. For this:
   - Initiate a public education campaign to develop a culture of zero tolerance of corruption so that people are taught the real cost of corruption to society (e.g., it has been estimated that the wealth of the average citizen can be doubled by eradicating corruption).
   - Increase the transparency of Government actions through clear and simple laws.
   - Launch Government wide ethics guidelines, as well as integrity pledges and personal financial disclosure by top officials.
   - Improve Government Information Systems at all levels to keep the Government and the public informed of payments, expenditures, subsidies, etc.
   - Publish widely Government rules, such as Tax Bulletins, customs regulations, quality certifications, etc.
   - Enlist the support of the Press and NGOs in dealing with corruption.
   - Use surveys of opinions to disseminate widely concerns on corruption.

VIII. Government Business Promotion

1. Announce widely in the domestic and international press, the Government’s policy and commitment to implement strong market oriented policies; and then actually follow through. Officials must convince investors that things have changed.
2. The Government should be vocal in supporting foreign investment. It needs to change the attitude of officialdom at central and local levels towards foreign investors. It needs to encourage a long view rather than short-term exploitation. It needs to speak out clearly in favour of investors who bring the prospects of new jobs, investment in modernization and a culture of paying taxes voluntarily. It should implement a top-down championing of the benefits of foreign investment, particularly by inaugurating a major Public Relations campaign by the Presidential administration and GoU targeted at central and local officials.

3. All Ukrainian embassies abroad should have their commercial section strengthened, and go on a sales drive in each country to promote better dissemination of Ukrainian business opportunities.

4. The Government should go on a sales drive on Privatization. This could be underwritten by the European Bank or the World Bank.

5. Government should operate on the principle that the best type of government promotion is to leave the private sector alone. Unless there is an overwhelming need to interfere or legislate in the affairs of private business, government needs to abstain.

6. Consider the utilization of a private investment promotion agency to promote the Country abroad.

**IX. Corporate Taxes and Investment Incentives**

**IX (A) Investment Incentives**

1. The Ukrainian Government should not be offer any “special” investment incentives for particular sectors or companies. A level playing field should be the goal. This requires taxes and investment incentives that are stable, simple, and predictable. Investment incentives are ineffective because, in Ukraine, investors believe that: (i) they will not enjoy the investment benefits as promised - the law may change at any time, and (ii) that these benefits are not to attract legitimate foreign investment, but just to bettering the oligarchs who have influence to create these incentive plans for their own benefit to increase their monopoly position.

2. Eliminate existing incentives and other privileges related to ‘special economic zones’ as well as for producers of some goods and services, which distort the incentive framework.

**IX (B) Corporate Taxes**

3. Reduce the total fiscal burden on enterprises by reducing the number of taxes, duties, fees, fines and other contributions to which enterprises are subject.
4. Broaden the tax base by eliminating tax privileges (concessional rates and exemptions) so that all economic activity is subject to essentially the same rates of tax (aside from “sin” taxes on alcohol, tobacco and a limited list of luxury items). To the extent possible, a flat rate of VAT should apply across the board, except for exports which, by international convention, are zero-rated.

5. Enact the new Tax Code that would decrease the number of taxes and surcharges, reduce tax rates and pay for the cut by eliminating tax privileges.

6. Improve the Value Added Tax system by:
   - operating the VAT system on international standards in terms of accrual accounting and auditing procedures for tax debate claims. Move and keep the VAT on an accrual basis, preferably without the dual accounting system required under current transitional arrangements.
   - The VAT on coal, gas, and electricity consumption should be taxed at the normal VAT rate; the agricultural sector should not be exempted any longer.
   - Treat VAT refunds a major priority in 2001. VAT payments are made immediately but there are long delays in re-funds (for overpayments), with the problem accentuated in periods when inflation is high, which lowers the value of the late payment made in Hryvnia. Ensure that the budget has the funding for this at the level where it is required. Ensure that responsibility for refunds does not devolve to local authorities who do not have the money.
   - VAT should not be applied to enterprises on their in-kind capital contributions made in the form of equipment. (Although the tax law states that capital contributions made in the form of equipment are not subject to VAT, there is some experience of tax inspectors applying VAT, with only a promise of a rebate at some point in the future).
   - Alter the basis for charging VAT on leased, imported equipment. (Someone who purchases a piece of equipment is subject to VAT at double the normal rate if they lease as oppose to buying the item).

7. Improve Personal income tax to increase revenues, reduce corruption, and be reasonably progressive, particularly at the lower income levels. For this:
   - Introduce a flat Income tax rate of about 25% with almost no exemptions or deductions.
   - Introduce a liberal minimum income cutoff level before any tax is paid.

8. Improve the Corporate income tax.
   - Introduce a flat corporate income tax rate equal to the top personal income tax rate. This would reduce corruption, legal manipulations, and increase tax revenues by encouraging enterprises to rejoin the official sector.
   - Eliminate the existing exemptions to income taxes, such as the privileges for agriculture, car producers, agricultural machinery, TV-sets, etc.
   - Abolish the current depreciation ratio rule and any charge on depreciation.
• Introduce a symmetric treatment of foreign exchange losses and profits.
• Base income taxes on international accounting standards for all non-financial enterprises (with the exception of small businesses only).
• In order to expand and make efficient use of enterprises’ self-financing capabilities, reduce taxes on the profits that are retained by the enterprise.
• Introduction of the new system under which losses at the initial stage can be compensated by future profits and thus reduce the tax burden.

9. Increasing consumption charges (especially for oil products) up to the average Western European level.

10. Alter the tax treatment of unrealized foreign exchange gains on equity investment made in enterprises in hard currency (which includes financial institutions, given that in these cases the investment must be made in hard currency). The tax penalizes companies by imposing a tax on a notional profit.

11. Aim to minimize subsequent tax changes. In general, it is desirable to aim for much more stability in the tax regime, especially as applied to enterprises. The new Tax Code should, for instance, be accompanied with a moratorium of 5 years during which it would not be modified.

12. Improve Tax Administration by putting into effect international standards for tax collection.
• Change the reporting line of the STA to make the STA report to the Ministry of Finance. The concept of a self-financing, autonomous, aggressive and barely accountable tax inspectorate which reports not to the Ministry of Finance but to a higher authorities, is proving unhelpful both to the volumes of tax collected and the image of the country. More tax is collected in countries where there is a voluntary system in which the rules are clearly understood.
• Change the mentality of the tax collectors from trying to maximize revenues to monitoring adherence to well grounded legislation - loose the predatory nature of the tax police / inspectorate towards foreign investors who are seen ‘to have the money’. A tax administration system that has to be quite frequently challenged in the courts by foreign investors is not a good advertisement for Ukraine. Examples include the introduction of Order 306 of the STA relating to the issues of foreign exchange loss/profit reporting and which conflicts with the provisions of the profit tax law. This creates obscurity, has led to court cases and is also clearly aimed at exploiting those who, in a weak currency environment, borrow in hard currency to finance investment.
• foster voluntary tax compliance to reduce tax evasion and promote a compliance-based revenue administration equipped with business processes, skills, management systems, and operation tools.