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TRADE SUMMARY

The U.S. trade deficit with Ukraine was $51 million in 2003. U.S. goods exports in 2003 were $231 million, down 9.4 percent from the previous year. Corresponding U.S. imports from Ukraine were $282 million, down 22.2 percent from 2002. Ukraine is currently the 88th largest export market for U.S. goods. The flow of U.S. foreign direct investment (FDI) into Ukraine was $272 million in 2003, an increase from $235 million in 2002.

Trade relations between the United States and Ukraine are governed by the 1992 United States-Ukraine Trade Agreement which provides for normal trade relations (NTR) between the United States and Ukraine and governs other aspects of the bilateral trade relationship. Ukraine is not a member of the World Trade Organization (WTO), but it is in the process of negotiating terms of accession.

IMPORT POLICIES

Ukraine continues to maintain a number of barriers with respect to imports, including discriminatory fee and certification regimes. Import tariffs generally range from 2 percent to 50 percent, and combined with high value-added tax (VAT) (currently 20 percent) and excise taxes these charges can act as a hindrance to U.S. exports to Ukraine. Import tariffs are particularly high with respect to petroleum products (5-40 EUR/ton) and distilled spirits (7.5 EUR/1liter). The import tariff on alcohol amounts to an *ad valorem* tariff of 50 percent to 100 percent.

Excise taxes generally range from 5 percent to 100 percent. Four categories of imports were subject to discriminatory excise taxes in 2003: alcohol, tobacco, petroleum products, and automobiles. Excise duty rates are assessed as a percentage of the sum of the declared customs value, customs duties, and fees paid for importing products. On October 24, 2002 President Kuchma signed a law On amending some laws of Ukraine on Taxation, Production, and Circulation of Excisable Goods, which became effective on January 1, 2003. This law increased excise rates on alcohol, beer and gasoline. The discriminatory tax regime for alcohol was scheduled to be eliminated effective January 1, 2004.

Import licenses are required for some goods, primarily pesticides, alcohol products, CD production inputs, some industrial chemical products and equipment containing them, official foreign postage stamps, excise marks, officially stamped/headed paper, and checks and securities. The U.S. distilled spirits industry reports particularly burdensome import permit requirements for alcohol products, under which certificates of conformity are issued to importers only after officials of the Ukrainian Government have conducted an exhaustive and costly inspection of the producer’s facilities. In some cases, these practices haves led exporters to withdraw their products from the Ukrainian market.

The U.S. Embassy in Kiev estimates that Ukrainian barriers to U.S. agricultural goods cost U.S. producers between $10 million to $25 million annually. Talk of increasing tariffs and introducing quotas, possibly limiting imports of U.S. poultry into Ukraine's tax-free Free Economic Zones (FEZs), may further hamper U.S. exports.

Sales of U.S. non-agricultural goods and services, including agricultural and food processing equipment, electrical power equipment and oil and gas pumps, are generally not hampered by non-tariff barriers, and Ukrainian importers typically find ways to circumvent existing import restrictions, e.g., by importing through FEZs.

STANDARDS, TESTING, LABELING AND CERTIFICATION

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Foreign investors regard Ukraine's product certification system and licensing procedures as some of the most serious obstacles to trade, investment, and ongoing business. The standardization-certification body in Ukraine is the State Committee for Technical Regulation and Consumer Protection, the former "DerzhStandard of Ukraine. As of June 2002, DerzhStandard had a network of 143 accredited certifying bodies and 824 testing laboratories (centers) throughout Ukraine.

U.S. businesses have complained that the standards and certification procedures affecting the consumer goods industry: (1) lack constant, clearly defined standards and regulations; (2) include registration schemes that are not feasible for mass trade; (3) lack procedural flexibility; (4) involve complex and lengthy import licensing procedures; (5) impose overly complex and expensive certification requirements; (6) are unevenly enforced; and (7) involve high certification and licensing fees. While the standards process has been significantly streamlined over the past two years, it remains complex and is subject to frequent changes.

While Ukrainian law formally stipulates equal treatment of domestic and foreign companies, U.S. businesses often experience arbitrary application of the law against foreign companies, and discrimination against foreign companies is common. Although Ukraine belongs to international standardization bodies, such as the International Standards Organization, it often fails to recognize foreign product certificates unless recognition is mandated through an international treaty signed by Ukraine.

Ukraine applies a range of sanitary and phytosanitary (SPS) measures that are not consistent with the international, science-based approach to regulation. The certification and approval process is lengthy, duplicative, and expensive, with politics and corruption often behind arbitrary application of regulations.

In 2001, Ukraine's Chief Veterinarian abruptly banned the importation of U.S. poultry and red meat, alleging that several U.S. production practices were not in accordance with a new interpretation of existing Ukrainian veterinarian requirements. Poultry imports finally resumed in the fourth quarter of 2003 under a new veterinary license. Ukraine continues to limit red meat imports by approximately $500,000 due to a ban on hormone additives in feed.

The government of Ukraine restricts imports of a number of other U.S. agricultural products, allegedly for reasons of food safety. Exports of dried-egg products, potentially valuing $2 million, are restricted allegedly due to salmonella. In addition, bans on producers of biotechnology may cost American farmers $2 million in lost sales of corn and soybeans. U.S. pork exports are impacted by regulations regarding trichinosis.

Numerous certification bodies in Ukraine effectively operate as independent (often monopolistic) entities on a profit basis, turning over just 20 percent of their fees to the state. The State Committee for Technical Regulation and Consumer Protection does not properly supervise or enforce pricing rules. Consequently, agencies do much of their legislative and interpretive work with little or no coordination. Many products require multiple certificates from different agencies, with local, regional and municipal authorities often requesting additional documentation beyond that required by central bodies. Some companies report that they have been required to pay exorbitant additional fees (up to $20,000) to purchase equipment needed to test ingredients that have been used safely for many years.

On October 15, 2003, the Cabinet of Ministers of Ukraine issued Resolution #1611 requiring that goods subject to mandatory certification be accompanied by the original, letterhead copies of state-issued certificates with holographic marks. This measure entered into force on February 1, 2004 and will be expensive and disruptive to business.

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Ukraine has begun regulation of accreditation and certification, and regulatory reform has been introduced at the regional and municipal levels. Further reform is needed, however, as government employees are underpaid and the shadow economy provides many opportunities for corruption.

While costs related to business registration have been reduced, Ukraine still requires numerous permits to conduct business and engage in foreign trade. According to U.S. telecommunications industry sources, access to the Ukrainian market is impeded by numerous burdensome certification and licensing procedures for equipment.

GOVERNMENT PROCUREMENT

Government procurement is conducted under Ukraine's Law on Procurement of Goods, Works and Services Using State Funds, which came into force on February 22, 2000. Under this law, all government procurement of goods and services valued above EUR 40,000 must be conducted via tenders (either open, or open with pre-qualification). Open international tenders must be conducted when procurement is financed by any entity outside Ukraine. Information on government procurement is published in the "State Procurement Bulletin" by the Ministry of the Economy and European Integration. Among the problems still faced by foreign firms (particularly for smaller procurements) are: (1) the absence of public notice of tender rules; (2) the failure to state tender requirements; (3) covert preferences in tender awards; (4) awards made subject to conditions that were not part of the original tender; and (5) the lack of an effective avenue for firms to air grievances over contract awards or an effective means to resolve disputes. Ukraine is not a signatory of the WTO Agreement on Government Procurement.

EXPORT SUBSIDIES

The Ukrainian government continues to maintain some industrial policies aimed at import substitution and export promotion, although these practices are reportedly decreasing. Some Ukrainian enterprises are not required to pay taxes, do not pay for energy usage, clear transactions by offsetting mutual debts, and receive free or below-cost government inputs.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Trade sanctions remain in place on a number of Ukrainian exports to the United States due to Ukraine’s failure to put in place an effective licensing regime for the manufacture of compact disks. Ukraine was named a Priority Foreign Country in both the 2003 and 2002 Special 301 reviews. Ukraine was elevated from the Special 301 Watch List, on which it appeared in 1998, to the Priority Watch List in 1999 due to growing optical media piracy in Ukraine.

In an effort to address the piracy problem, in June 2000 the United States and Ukraine agreed to the U.S.-Ukraine Joint Action Plan to Combat Optical Media Piracy. As a result of Ukraine's failure to enact most of the plan's provisions, USTR designated Ukraine a Priority Foreign Country in March 2001, launched a Section 301 Investigation of Ukraine's IPR regime, and, following review, revoked Ukraine's benefits under the U.S. Generalized System of Preferences (GSP) program in August 2001. Ukraine's inability to pass appropriate legislation to establish a licensing regime for the manufacture of compact disks -- the Joint Action Plan's most important provision -- led USTR to announce trade sanctions in the amount of $75 million on December 20, 2001. The sanctions, which went into effect on January 23, 2002, affect a number of Ukrainian products, including metal products, footwear, and chemicals. The Government of Ukraine has drafted amendments to the existing optical media licensing law to address the law’s inadequacies, but the Ukrainian Rada has failed to pass these amendments on several occasions. While piracy has been reduced as a result of Ukraine’s efforts since 2001, Ukraine’s optical media law remains deficient and Ukraine remains a key transit country for pirate products.

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As part of its ongoing efforts to negotiate accession to the WTO, Ukraine has adopted legislation to bring its legislative regime further into compliance with the WTO Agreement on Trade- Related Aspects of Intellectual Property Rights (TRIPS Agreement). Despite these efforts, however, legal protection and enforcement remain weak. In addition to optical media piracy, patent and trademark violations are common in Ukraine, and U.S. industries report rampant counterfeiting of pharmaceuticals and consumer products. The Ukrainian Ministry of Health reportedly does not check the validity of patents when it issues them to market pharmaceuticals in Ukraine.

In order to increase IPR enforcement, the Ministry of Internal Affairs and the State Customs Service have set up units to deal exclusively with IPR violations. The State Department of Intellectual Property has trained 20 inspectors to enforce Ukraine's CD licensing regime. These understaffed units cannot, however, adequately deal with the enormous number of IPR infringements. In many cases, the rights holder must actively and continually engage with the Ministry of Internal Affairs or the State Customs Service to obtain enforcement.

The judicial system does not provide reliable recourse against IPR infringement, because the number of judges trained in IPR law remains low and enterprises generally lack the confidence in the Ukrainian judicial system to seek a court settlement. Legal experts and government officials have called for the formation of a special patent court in Ukraine to adjudicate IPR cases, but to date there has been no concrete action towards this end.

SERVICES BARRIERS

Ukraine has few explicit restrictions on services. Foreign professionals are permitted to work in Ukraine, but the lack of transparency and the multiplicity of licensing authorities hinders foreign access to the Ukrainian services market. A local content requirement exists for radio and television broadcasting, although it has not been stringently enforced. Foreign insurance firms are permitted to operate in Ukraine, but they cannot open branches, a requirement that impedes participation of foreign businesses in Ukraine.

INVESTMENT BARRIERS

An underdeveloped banking system, poor communications networks, a difficult tax and regulatory climate, crime and corruption, and a weak legal system create major obstacles to U.S. investment in Ukraine.

Ukraine's burdensome and frequently-changing tax structure has been a major hindrance to foreign investment and business development. In 2003, Ukraine passed legislation on tax reform, establishing a flat rate on Personal Income Tax of 13 percent and lowering Enterprise Profit Tax from 27 percent to 25 percent. After the President twice vetoed laws reducing Value Added Tax (VAT) from 20 percent to 17 percent, the Parliament postponed lowering the VAT until 2005.

The accumulation of VAT refund arrears has also been a serious obstacle for foreign and domestic exporters in Ukraine. The stock of arrears was 2.9B in local currency (hryvnia) at the end of 2002 and 4.4B hryvnia at the end of August 2003. The 2004 budget includes a plan to reduce 1.9B hryvnia of these arrears this year, but the VAT system will require further reform in order to prevent additional accumulation of arrears.

Combined payroll taxes (mainly for pensions) remain high at an average of 37.5 percent. There are frequent changes in other tax laws and regulations, such as import duties and excise taxes, often with little advance notice, giving companies little time to adjust to new requirements. Improvements are being made in tax filing and collection procedures, although these still differ significantly from those in western countries. The Chairman of the State Tax Administration established an advisory committee on the tax problems of foreign companies, which has been functioning for about two years and has achieved resolution of some difficult issues brought before it by U.S. and other foreign companies.

The United States has a Bilateral Investment Treaty (BIT) with Ukraine, which took effect on November 16, 1996. The BIT guarantees U.S. investors the better of national and MFN treatment, the right to make financial transfers freely and without delay, international legal standards for expropriation and compensation and access to international arbitration. U.S. investors, however, face numerous day-to-day problems and regard recourse under the BIT as only a last resort.

To attract investment and remove obstacles to trade, Ukraine created eleven Free Economic Zones (FEZs), and nine Priority Development Territories (PDTs), reportedly covering some 10 percent of Ukrainian territory. In August 2002, the Cabinet of Ministers introduced a moratorium on the establishment of FEZs and PDTs until January 1, 2005. There is no single, clear law that regulates the FEZs. Legislative loopholes permit companies to misuse FEZ status, and to avoid taxes and import duties. Profits from such activity are used to finance political campaigns.

Privatization rules generally apply to both foreign and domestic investors, and, in theory, relatively level playing field exists. In practice, however, the privatization process continues to lack transparency. Clear qualification requirements for advisors need to be established, and recognition of procedures and financial information need to be more public, complete, and timely. Phased implementation of a 2002 privatization which provides for the cash sale of majority shareholdings in several strategic large-scale enterprises, has been patchy. A number of large-scale privatizations conducted since early 2000 have been marked by unclear, non-transparent and changing regulations and by heavy political interference.

ELECTRONIC COMMERCE

The Internet and electronic commerce are underdeveloped in Ukraine. Recently, the Ukrainian Parliament voted in favor of two draft laws to control the Internet. A third draft law “On Monitoring of Telecommunications,” is being considered.

On November 19, 2003 the Parliament passed the law “On Telecommunications,” which would oblige Internet service providers to purchase, install and maintain all monitoring equipment necessary for the carrying out of operational and investigative measures by the authorized bodies. These expenses will be incurred by service providers. If this law is put into effect, there will be no inviolability of e-mails. The potential effect of this legislation on electronic commerce is unknown.

OTHER BARRIERS

Ukraine imposed an export duty of 30 euros per metric ton on ferrous steel scrap during the second quarter of 2002. This export duty has contributed to a decline in scrap exports from Ukraine, at a time when global demand and prices for steel scrap are rising. The export tax provides an artificial advantage to Ukrainian steel producers by increasing domestic steel scrap supply, providing producers with an unfair advantage in Ukraine and in third markets. Moreover, it constricts global supplies of a key steel input, which has the effect of raising prices of steel scrap for otherwise competitive producers elsewhere, including those in the United States.