

30 Years Later: Will Soviet Legacy Still Shape Ukraine's Future?



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IRYNA
FEHETS

After thirty years since the fall of Communism in Europe, Ukraine remains a country with unfinished institutional reforms and significant barriers for business and trade. The country gained independence when the Soviet Union dissolved two years later – in 1991. Since then, the reluctance of the pyeapolitical elite to embrace market economy rules led to an incomplete transformation exacerbated by cemented oligarchic influence and rampant corruption.

Entrepreneurship was forbidden in Ukraine when the country was a part of the Soviet Union. Only in the late 1980s, the perestroika resulted in legalization of some forms of private businesses – such as individual entrepreneurship and cooperatives. Before that, small manufactures and shortage goods traders operated illegally on the black market. Such businesses often relied on “protection” by racket gangs.

The Ukrainian economy was heavily industrialized and connected to Russia through centralized planning. In 1991, industry contributed almost 55% of Ukrainian GDP – much more than the current 23%, according to the 2018 data¹. The social context – virtually absent civil society and the lack of experience of private ownership and entrepreneurship – contributed to insufficient public pressure for market economy and the rule of law².

The economy of Ukraine took the biggest hit during the country’s first post-

¹ World Bank (2019) *Industry (Including Construction), Value Added (% of GDP). Ukraine*. Available [online]: <https://data.worldbank.org/indicator/NV.IND.TOTL.ZS?locations=UA>

² Kupfer, M. (2018) “Why Poland and Ukraine Took Different Post-Communist Paths”, [in]: *Kyiv Post*. Available [online]: <https://www.kyivpost.com/world-in-ukraine-poland/why-poland-and-ukraine-took-different-post-communist-paths.html>

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RECOVERING FROM AN ECONOMIC DOWNTURN AND WITH OCCUPATION AND A WAR ON ITS TERRITORY, UKRAINE IS ONE OF THE POOREST COUNTRIES IN THE REGION

independence decade. In 1999, Ukraine’s GDP reached its lowest point contracting down to 41% of its 1990 volume. The upward trend in the 2000s brought the GDP to its currently highest level over the last two decades of almost 75% of the 1990 benchmark. But the 2009 recession brought it down again. The most recent downturn happened after 2014, when the Russian occupation and the war in the eastern Ukraine started. The country’s GDP plunged down to 59% of its 1990 volume and has grown only to 64% by 2018 [See: Figure 1]³.

Now, slowly recovering from an economic downturn and with occupation and a war on its territory, Ukraine is one of the poorest

³ World Bank (2019) *GDP (constant 2010 US\$). Ukraine*. Available [online]: <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD?locations=UA>

Figure 1: GDP in Ukraine in constant 2010 US dollars [percentage to 1990]



Source: World Bank

countries in the region. The World Bank estimates that with the current growth rate, it will take Ukraine more than fifty years to reach the income levels of today's Poland⁴. The country's growth could be accelerated if it overcame the bureaucracy and corruption that restrict doing business and affect competitiveness. To achieve this, Ukraine needs to conduct institutional reforms that counter vested interests, while Ukrainian society should demand tangible transformations from political leadership.

POPULIST POLICIES

Unlike in the neighboring EU countries, economic reforms and liberalization did not take off in Ukraine right after regaining independence.. The reasons

for such a situation may be found in political infighting (the then president, Leonid Kuchma, and the parliament opposed each other) as well as in the lack of public consensus about the necessity of the transition to the market economy. The decision makers were unwilling to undertake unpopular reforms that would bring systemic changes to the economy and would go against deep-rooted social expectations about state control over land and enterprises⁵. In addition, the growing influence of financial industrial groups that would later transform into state capture by oligarchs was shaping the distorted economic system with special conditions for businesses with political ties⁶.

⁴ World Bank (2019) *Ukraine. Special Focus Note. Tapping Ukraine's Growth Potential*, May 23. Available [online]: <http://pubdocs.worldbank.org/en/927141558601581077/Ukraine-Special-Focus-Note-Spring-2019-en.pdf>

⁵ Ishaq, M. (1996) *The Ukrainian Economy and the Process of Reform: An Overview*. Available [online]: <https://www2.hw.ac.uk/sml/downloads/cert/wpa/1996/dp9616.pdf>

⁶ Balabushko, O., Betsly, O., Movchan, V., Piontkivsky, R., and M. Ryzhenkov (2018) *Crony Capitalism in Ukraine*.



PUBLIC POLICY IN UKRAINE DID LITTLE TO ENCOURAGE SMALL AND MEDIUM ENTERPRISE GROWTH

The government subsidized certain sectors at taxpayers' expense – including under-priced energy. These were mainly traditional industries that relied on cheap raw materials and, due to global conjuncture, did not require diversification and modernization. With favorable conditions for these products on foreign markets and the fact that the enterprises in these sectors were owned by financial groups with political influence, public policy in Ukraine did little to encourage small and medium enterprise growth.

The populist policies went hand in hand with restrictions and discretion towards businesses. Complicated and limiting regulations did not allow businesses to grow, operate freely, and enter foreign markets, while unequal treatment of businesses of different sectors or ownership cultivated corruption and gave rise to an oligarchic economy.

Relationship between Political Connectedness and Firms' Performance. Available [online]: <http://documents.worldbank.org/curated/en/494271528822739302/pdf/WPS8471.pdf>

PRICE REGULATIONS

Ukrainian government reacted to high inflation in the 1990s by “manually” regulating prices and salaries, instead of ensuring the central bank's independence and sound monetary policy⁷. Prices for certain commodities – coal, oil, electric energy and heating, transport services, and others – were capped, followed by price limits on some types of bread, fruit, and vegetables, as well as gas and running water.

Forced to pay much more for gas and coal than households, businesses financed the subsidized domestic prices. In mid-1990s, the Ukrainian government eliminated markup restrictions on a wide range of products. Yet, gas prices for households remained heavily subsidized, which created opportunities for arbitrage – a corruption scheme where regional gas distribution companies resell the low-priced gas that was allocated for households to industrial consumers for higher prices⁸. In addition, Ukraine's reliance on relatively cheaper Russian gas gave Russia political leverage over Ukraine, and did not encourage enterprises and households to increase their energy efficiency.

Ukraine substantially increased gas prices for private consumers only in 2018 in order to meet the conditions of the International Monetary Fund (IMF) under the new Stand-By Agreement⁹. However, unlike liberalized prices for industrial consumers, the

⁷ Vox Ukraine (2016) *Bad Decisions: How to Build the Poorest Country in Europe*. Available [online]: https://voxukraine.org/longreads/poor-country/index_en.html

⁸ Saha, S. and I. Zaslavskiy (2019) “Cleaning Up Ukraine's Energy Sector”, [in]: *The American Interest*. Available [online]: <https://www.the-american-interest.com/2019/01/31/cleaning-up-ukraines-energy-sector/>

⁹ Zinets, N. and M. Williams, (2018) “Ukraine Secures New \$3.9 Billion IMF Deal after Gas Price Hike”, [in]: *Reuters*. Available [online]: <https://www.reuters.com/article/us-ukraine-imf-gas/ukraine-secures-new-3-9-billion-imf-deal-after-gas-price-hike-idUSKCN1MT2J6>

household gas prices still have not reached import parity and are regulated by the public service obligations adopted by Ukrainian government that set a price cap for the household price. Should the market gas prices rise above the maximum price for households in Ukraine, this again will give room for illicit trading.

In addition, the government of Ukraine had regulated prices for food products since 1996. A maximum trade margin was set for a range of products, such as flour, bread, sugar, beef, milk, cheese, and sour cream, among others. The government also required businesses to declare changes in their wholesale prices for specific sorts of milk, butter, meat, and other products, and determined upper profit margins for production of flour, “socially important” types of bread¹⁰ and baby food.

This policy restricted businesses and distorted market competition. Ukraine’s Ministry of Economic Development and Trade found that the prices for state-regulated food products had grown by 20% faster from 2003 to 2013 than other, unregulated, products¹¹. This state regulation of food prices was temporarily discontinued in 2016 and completely abandoned only in 2017¹².

¹⁰ Several sorts of bread designated by the government. For details see: *Resolution of the Cabinet of Ministers of Ukraine #1548 of December 25, 1996 On Establishing the Powers of Executive Bodies and of City Councils’ Executive Bodies to Regulate Prices (Tariffs)*. Available [online]: <https://zakon.rada.gov.ua/laws/show/1548-96-%D0%BF/ed20170617> (the version of June 17, 2017 before the cancellation of price controls) [in Ukrainian]

¹¹ Ministry of Economic Development and Trade of Ukraine (2016) *Debureaucratization of Regulation of Food Prices (Amendments to CMU Resolution #1548)*. Available [online]: https://issuu.com/mineconomdev/docs/1548_update [in Ukrainian]

¹² The Cabinet of Ministers of Ukraine (2017) *The Government Abolished State Regulation of Prices For Food and Services in The Markets*. Available [online]: <https://www.kmu.gov.ua/ua/news/250054696> [in Ukrainian]



TODAY, THE LARGE SOE SECTOR REMAINS AN AREA OF UNFINISHED REFORM AND A SOURCE OF RENT-SEEKING AND STATE CAPTURE IN UKRAINE.

PRIVATIZATION PROBLEMS

Another instance of restricted access to capital and limitation of property rights was privatization through assets certificates setting privileges for specific social groups: managers and employees of the enterprises. They had a primary right to buy out shares¹³. Meanwhile, owners of the privatization certificates could not sell them for cash. Therefore, potential investors were not permitted to buy certificates from citizens on the secondary market¹⁴. As a result, the control over previously state-owned enterprises (SOEs) was mostly transferred to their managers.

Today, the large SOE sector remains an area of unfinished reform and a source of

¹³ CASE Ukraine (2007) *Conditions for Finishing Privatization in Ukraine*. Available [online]: http://c-e-d.info/img/pdf/111_Russian_Full_With_Cover.pdf [in Ukrainian]

¹⁴ Vox Ukraine (2016) *Bad Decisions: How to Build the Poorest Country in Europe*. Available [online]: https://voxukraine.org/longreads/poor-country/index_en.html



rent-seeking and state capture in Ukraine. The National Anti-Corruption Bureau of Ukraine (NABU) reports that corruption schemes their detectives investigate at SOEs are mostly implemented by purchasing goods or services at inflated prices, and by selling their products at a reduced price.

Ukraine has made steps towards the privatization of its remaining 3,000+ SOEs in 2018 by adopting the law to classify them into large and small ones, and to set clear privatization procedures¹⁵. However, the actual revenues from privatization have fallen far short from the projected ones. By mid-2019, the state budget received only 1.6% of the proceeds planned for the entirety 2019; in 2018, the proceeds were only 2% of the expected revenues¹⁶.

A key obstacle to SOE privatization is the insufficient demand. Additionally, as the government admits, the lack of an organizational capacity of the public administration to prepare the units for sale is another considerable problem (the preparation requires financial expertise and human resources that are not available)¹⁷.

Moreover, due to recent developments, the efforts to combat corruption at SOEs are likely to meet a legal impasse. Specifically, in 2019, the Constitutional Court of

Ukraine deprived NABU of the authority to invalidate illegal agreements by SOEs in court¹⁸.

(UN)FREE ECONOMIC ZONES

By the mid-2000s, several free economic zones were set and operated in Ukraine. They proved to be inefficient, nontransparent, and distorted economic opportunities in favor of selected businesses. Declared as instruments for attracting investment and boosting economic growth, the zones brought in about eight times less capital than intended and created about three times fewer jobs than planned.

Most of the invested funds came from domestic companies¹⁹. In addition to low efficiency, special economic zones were venues for tax evasion and duty free imports. And, as investment projects were subject to approval by public officials, such zones created opportunities for corruption²⁰.

LAND OWNERSHIP: STILL RESTRICTED

Still today, Ukraine prohibits sale of agricultural land, which hinders the country's citizens to use their land as property. It also prevents private individuals and businesses from receiving adequate payment for selling or renting out land plots and to use land as collateral for loans. The moratorium has been in effect since 2001, when it was adopted by the Ukrainian parliament as a temporary step to prevent land sales

¹⁵ Bedratenko, O. (2018) "Ukraine Is Serious about Privatization This Time", [in]: *Atlantic Council*. Available [online]: <https://www.atlanticcouncil.org/blogs/ukrainealert/ukraine-is-serious-about-privatization-this-time>

¹⁶ Ministry of Finance of Ukraine (2019) *Budget in The First Half of 2019: Challenges and Liquidity Management*. Press release. Available [online]: https://www.minfin.gov.ua/news/view/biudzhet-v-pershii-polovyni--roku-vykyky-i-upravlinnia-likvidnistiu?category=novini-ta-media&fbclid=IwAR0I3b_LUHhEtW-2oyHOwNyBoa3u-cilPsOBvG9CtttuY320niqOh43x1Jx8 [in Ukrainian]

¹⁷ *Ekonomichna Pravda* (2019) *Nobody Wants to Take Most of the Big Privatization Objects – Ministry of Economic Development and Trade*. Available [online]: <https://www.epravda.com.ua/news/2019/01/27/644698/> [in Ukrainian]

¹⁸ National Anti-Corruption Bureau of Ukraine (2019) *Constitutional Court of Ukraine Eliminated an Effective Tool for Liquidation of Corruption Schemes at State Enterprises*. Press release. Available [online]: <https://nabu.gov.ua/en/novyny/constitutional-court-ukraine-eliminated-effective-tool-liquidation-corruption-schemes-state>

¹⁹ Vox Ukraine (2016) *Bad Decisions: How to Build the Poorest Country in Europe*. Available [online]: https://voxukraine.org/longreads/poor-country/index_en.html

²⁰ The World Bank (2005) *The Debate on Elimination of Free Enterprise Zones in Ukraine*. Available [online]: <http://siteresources.worldbank.org/INTUKRA/NE/147271-1089983407712/20757196/FreezonesEng.pdf>

until the necessary legislative framework for the land market was ready²¹.

According to World Bank estimations²², the Ukrainian economy loses USD 15 bn of annual output due to reduced agricultural productivity caused by the prohibition of land sale. Lifting the moratorium would increase Ukraine's annual GDP by about 1.5 percentage points, according to the World Bank data, and would dramatically increase public revenue both from the sale of the state-owned land as well as from land leases.

Currently, the land market legislation has not been adopted and the ban is still in place, which results in unofficial sales deals and low land prices²³.

BUSINESS CLIMATE AND DEREGULATION

Entrepreneurship had been heavily regulated in Ukraine over the post-Soviet period.

In 2013, due to administrative and trade barriers, paired with high amounts of time and money needed to comply with regulatory requirements, Ukraine was placed in the 137th position in the World Bank's *Doing Business Report* (DBR)²⁴.

²¹ Yaroshchuk, O. (2016) "15 Years of the Moratorium – Will the Land Market Reform Finally Be Completed?", [in]: *AgroPolit.com*. Available [online]: <https://agropolit.com/spetsproekty/167-15-rokiv-moratoriyu-chi-zak-lichitsya-nareshiti-zemelna-reforma> [in Ukrainian]

²² Kahkonen, S. (2017) "Ukraine Can Boost Annual Output by US\$15 Billion with Land Reform", [in]: *The World Bank. Opinion*. Available [online]: <https://www.worldbank.org/en/news/opinion/2017/10/02/ukraine-can-boost-annual-output-us15-billion-with-land-reform>

²³ CASE Ukraine (2016) "25 Years of Schemes and Losses. What Land Sales Moratorium Did to Us", [in]: *Ekonomichna Pravda*. Available [online]: <https://www.epravda.com.ua/publications/2016/07/13/598945/> [in Ukrainian]

²⁴ The World Bank (2013) *Doing Business 2013. Smarter Regulations for Small and Medium-Size Enterprises*. Available [online]: <https://www.doingbusiness.org/en/reports/global-reports/doing-business-2013>

In 2019, the country moved up to the 71st rank thanks to simplifying key administrative procedures. The government allowed online business registration, improved the regulation of limited and additional liability companies, giving them more rights to run their own business, canceled several permits related to construction, and made steps towards deregulation in a number of specific sectors (such as oil and gas, transport, and telecommunications)²⁵.

Moreover, Ukraine simplified the registration of medicines, which reduced the time they enter the Ukrainian market from ninety days to just seventeen²⁶. In addition to registering businesses, it is possible to pay taxes and obtain different certificates online – for example, those that provide information on taxpayer status and land ownership. Overall, the number of government services available online exceeds sixty²⁷.

However, some barriers of doing business remain unresolved. In regards to the electricity grid, Ukraine ranks 135th in the 2019 DBR. When it comes to resolving insolvency, it holds the 145th position. These procedures remain costly and time-consuming for businesses²⁸. The reform of labor regulations is overdue in Ukraine as

²⁵ NGO "Internews-Ukraine" (2017) *The Reforms Guide. Deregulation and Entrepreneurship Development*. Available [online]: <http://reformsguide.org.ua/analytics/deregulation-and-entrepreneurship-development/>

²⁶ Ministry of Health of Ukraine (2017) *Medicines Registration Procedure Simplified: Effective Drugs Will Arrive to Ukraine over 17 Days*. Press release. Available [online]: <http://moz.gov.ua/article/news/efektivni-preparati-z%60javljatimutsja-v-ukraini-za-17-dniv> [in Ukrainian]

²⁷ Nekrasov, V. (2019) "11 Most Popular Electronic Government Services for Business", [in]: *Ekonomichna Pravda*. Available [online]: <https://www.epravda.com.ua/publications/2019/06/26/649088/> [in Ukrainian]

²⁸ The World Bank (2019) *Doing Business 2019. Ukraine Economy Profile*. Available [online]: <https://www.doing-business.org/content/dam/doingBusiness/country/ukraine/UKR.pdf>



ENTREPRENEURSHIP HAD BEEN HEAVILY REGULATED IN UKRAINE OVER THE POST-SOVIET PERIOD

outdated and inflexible legislation prevents businesses from using market instruments like equity-based compensation plans for employee motivation and limits the grounds for employee dismissal²⁹.

The government also severely increased fines for labor law violations. In 2019, a fine for hiring an employee without a job contract may reach more than UAH 125,000 (about USD 5,000), while a fine for not allowing a government official to inspect a business for violations of the labor law may be as high as UAH 417,000 (about USD 17,000)³⁰. Noteworthy is the fact that the size of these fines directly depends on minimum wages – i.e. by increasing the size of the minimum wage, the government not only affects the decisions of businesses regarding employment and employee

compensation, but increases the burdensome fines they have to pay.

STATE INSPECTIONS REVISITED

Sporadic and unwarranted inspections of businesses by government control agencies had been a major business impediment. In particular, small and medium enterprises (SMEs) spent a significant amount of time being inspected by state officials. As the control bodies have the discretion to decide which businesses to inspect and what violations to look for, the inspections were susceptible to corruption.

The Business Ombudsman Council is the consulting and advisory body in Ukraine that investigates complaints from businesses regarding violations of their rights by government institutions and agencies. One of the Council's 2018 reports lists key issues related to state supervision that negatively affected business climate³¹. These issues included: undefined scope of supervisory functions of control bodies, which results in duplication of these powers and dual burden on business, as well as these bodies' focus on identifying and imposing sanctions, rather than preventing offences.

In 2014, the new Parliament of Ukraine reacted to this problem by enacting a moratorium on business inspections that was aimed at decreasing administrative costs for businesses and corruption. However, since 2015, more and more government agencies were exempted from the moratorium and only businesses earning up to UAH 20 m per year (about USD 0.8 m) were relieved from inspections.

²⁹ American Chamber of Commerce Ukraine (2019) *Ukraine Country Profile 2019*. Available [online]: http://chamber.ua/Content/Documents/1247607269Country_Profile_2019_EN.pdf

³⁰ State Service of Ukraine for Labor: Ivano-Frankivsk Division (2019) *Clarification on the Amount of Penalties for Violations of Labor and Employment Laws in 2019*. Available [online]: <http://dspif.gov.ua/news/3163-rozlyashennya-schodo-rozmru-shtrafv-za-porushennya-zakonodavstva-pro-pracyu-ta-zaynyatst-naseleennya-u-2019-roc.html> [in Ukrainian]

³¹ Business Ombudsman Council (2018) *Systemic Report "Control Over Controllers: Status of Control Bodies Reform Implementation"*. Available [online]: https://boi.org.ua/media/uploads/system_jan2018/4_2017-sytem_en.pdf

Over the years, legislation was changed to introduce a risk-based approach to inspections. The powers of control authorities were delineated more clearly, their responsibility was increased, and the risk criteria for businesses and institutions were outlined. The annual plans of inspections by a number of state supervision bodies are available online³² so that businesses are informed about the time and purpose of planned inspections.

TAXES REMAIN A PROBLEM

A significant part of Ukraine's businesses operated in a shadow economy in the 1990s. This is why the tax burden, including contributions to the underfunded Pension Fund of Ukraine, was being distributed among legal tax-paying businesses and their employees.

To combat the shadow economy and increase the narrow tax base, Ukraine introduced the simplified tax system in 1999 with lower tax rates and less administration. Businesses using the simplified system pay only one tax – instead of several other taxes, such as corporate income tax, personal income tax, and value-added tax³³. However, similarly to other businesses, those that use the simplified tax system still pay the payroll tax. The simplified tax system was adopted by hundreds of thousands of the country's SMEs, most of them being individual entrepreneurs.

In recent years, reforms were implemented to reduce tax rates and streamline tax administration. Since 2016, the payroll tax

³² Better Regulation Delivery Office (2019) *The Plan of Complex Measures of State Supervision (Control) for 2019*. Available [online]: <https://inspections.gov.ua/projects-plans/approve-complex> [in Ukrainian]

³³ USAID Leadership in Economic Development Program (2105) *Simplified Taxation System in Ukraine: Assessment in the Context of Current Reality*. Available [online]: http://www.ier.com.ua/files/publications/Books/SSO_IER.pdf [in Ukrainian]

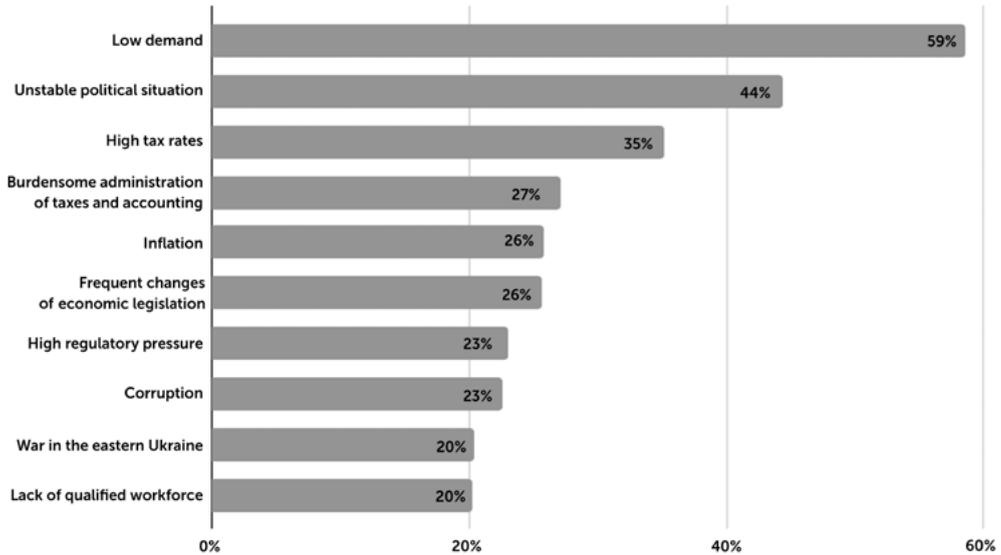


WHAT WE NEED IS PRO-COMPETITIVE LEGISLATION THAT WOULD ALLOW MARKET FORCES TO OPERATE AND CHALLENGERS TO CONTEST THE INCUMBENTS, AND NOT SPECIFIC REGULATIONS THAT MAKE IT UNPROFITABLE TO EXPAND THE SCALE OF OPERATIONS

rate was decreased almost twofold – from 40% to 22% of the gross earnings, and a flat income tax at 18% was introduced. On the other hand, some taxes and duties were added (real estate tax) or increased (excise duties)³⁴. In addition, Ukraine introduced a 1.5% military tax in 2014 intended to

³⁴ NGO "Internews-Ukraine" (2017) *The Reforms Guide. Tax Reform*. Available [online]: <http://reformsguide.org.ua/analytics/tax-reform-2/>

Figure 2: Top ten impediments for SMEs in Ukraine



Source: 2016 Annual Business Climate Assessment Survey by the IER as a part of the USAID Leadership for Economic Development (LEV) Program

support the Ukrainian armed forces in the fight against Russian aggression.

In 2017, the previous manual VAT refund mechanism that was prone to delays, corruption, and kickbacks was substituted by an electronic VAT return registry that enabled automatic and transparent VAT refunds. A personal “electronic cabinet” hosted at Ukraine’s tax authority website allows taxpayers to submit tax reports and to communicate with tax inspectors online³⁵. Alas, several problems related to both tax rates and their administration still remain. The total tax and contributions’ rate for Ukraine, as estimated by PwC, is

41.7% in 2019³⁶. 35% of small and medium businesses surveyed by Kyiv-based Institute for Economic Research and Policy Consulting (IER) in 2016 said high taxes were an inhibiting-growth factor, the third most important barrier after low demand and unstable political situation in Ukraine [See: Figure 2]³⁷.

As the ratio of the entrepreneurs and employees contributing to the Pension Fund of Ukraine (a solidarity-based system) to the number of retired people remains

³⁵ Shevchenko, P. (2019) “Taxpayer’s Electronic Cabinet – How to Use It. Step-by-Step Instruction”, [in]: *Novoye Vremya*. Available [online]: <https://biz.nv.ua/ukr/markets/elektronniy-kabinet-platnika-podatki-2019-povna-in-strukciya-fop-yesv-50031566.html> [in Ukrainian]

³⁶ PwC (2019) *Paying Taxes 2019*. Available [online]: https://www.pwc.com/gx/en/services/tax/publications/paying-taxes-2019/overall-ranking-and-data-tables.html?WT.mc_id=CT13-PL1300-DM2-TR2-LS1-ND30-TTA4-CN_payingtaxes-2019-ranking-data-table-button

³⁷ Institute for Economic Research and Policy Consulting (2017) *Annual Business Climate Assessment 2016: National and Regional Dimensions*. Available [online]: http://www.ier.com.ua/ua/sme_development/ABCA?pid=5789 [in Ukrainian]

deficient for covering the retirement payments, it puts a significant burden on taxpayers. Therefore, tax rates are unlikely to be reduced soon. In 2017, the Ukrainian government obliged all registered individual entrepreneurs to pay payroll tax even if they do not work and have zero income. This means that even those who temporarily do not receive any income should pay the tax. Clearly, this policy discourages potential or budding entrepreneurs from official registration. The administration of taxes continues to create difficulties for Ukrainian businesses. 27% of SMEs surveyed by the IER in 2016 said growth was inhibited by the complicated administration of taxes – the fourth worst factor affecting business growth, according to this survey. As stated in the World Bank's 2019 *Doing Business* report, it takes 328 hours per year to comply with tax regulations³⁸. Ukraine's general taxation system involves many more procedures and payments than the simplified one, which may be a factor preventing a part of small and medium businesses from growing, as in this case they would have to leave the less burdensome simplified system.

CURING THE PUBLIC PROCUREMENT

Reducing corruption and increasing transparency in the public procurement sector saved Ukraine billions of dollars and provided competitive access for businesses to participate in bids for public tenders. Unlike the former system, where tender criteria were frequently set so that they would fit the designated companies and thus allowed handpicking winners, the online platform, called ProZorro and introduced in 2015, digitized the process of procurement. Holding an electronic auction

through the ProZorro system became obligatory for all government entities.

Comparison of pre- and post-ProZorro procurements shows evidence that the new system resulted in a greater number of bids, higher savings of public funds, and greater participation of businesses in provision of contracted goods and services: now, there are more unique winners per tender³⁹. The total amount of public funds saved due to transparent tenders on this platform has been estimated at UAH 55 bn (more than USD 2 m) in 2018⁴⁰.

It is still possible to conduct non-transparent procurement using the online system – for example, by creating false competition, entering a tender with fictitious companies, splitting a larger procurement into smaller parts to avoid compliance with the ProZorro procedures, and, again, discriminating and selectively picking tender winners – even with the new digital system in place. These practices are investigated as violations by government audit authorities, which may lead to the cancellation of tenders⁴¹.

RULES OF TRADE

In the early 1990s, the government introduced export restrictions – a practice that led to a special class of the enterprises that could sell abroad and, as a result, obtain higher profits than their counterparts that

³⁸ The World Bank (2019) *Paying Taxes. Doing Business 2019*. Available [online]: <https://www.doingbusiness.org/en/data/exploretopics/paying-taxes>

³⁹ Kovalchuk, A., Kenny, C., and M. Snyder (2019) *Examining the Impact of E-Procurement in Ukraine*. Available [online]: <https://www.cgdev.org/publication/examining-impact-e-procurement-ukraine>

⁴⁰ Interfax Ukraine (2018) *ProZorro Saves over UAH 55 bln of Budget Funds in Two Years of Operation*. Available [online]: <https://en.interfax.com.ua/news/economic/522386.html>

⁴¹ Polishchuk, O. (2018) "ProZorro: Seven Ways to Circumvent It – and Seven Methods to Fight the Circumventions", [in]: *Ukrinform*. Available [online]: <https://www.ukrinform.ua/rubric-economy/2543102-prozorro-sim-shem-obhodu-sim-metodiv-borotbi-z-tim.html> [in Ukrainian]

could sell only domestically for a much lower price. The export of the goods of whole sectors – such as iron ore, coal, petroleum gas, and crops – was under restriction unless licensed by the government⁴².

This is an example of market distortion where a smaller share of businesses enjoys unjustified privileges. The exports were liberalized in the mid-1990s. Exporting of some types of goods and services still requires a license in Ukraine, but these are mostly health and security related ones, such as medicines, alcoholic beverages, firearms, hazardous chemicals, as well as transportation and tour operators' services⁴³.

Under the Deep and Comprehensive Free Trade Agreement (DCFTA), which is a part of the EU-Ukraine Association Agreement signed in 2014, Ukraine committed to gradually decreasing tariffs for European goods and services and aligning its regulations and standards in food and consumer safety, customs and trade facilitation, intellectual property rights, and others

with the EU ones⁴⁴. The "single window" mechanism introduced at the customs

allowed importers and exporters to exchange invoices, certificates, and other documents with government agencies in an electronic form, which reduces the time

⁴² Vox Ukraine (2016) *Bad Decisions: How to Build the Poorest Country in Europe*. Available [online]: https://vox-ukraine.org/longreads/poor-country/index_en.html

⁴³ The Verkhovna Rada of Ukraine (2019) *The Law of Ukraine "On Licensing of Types of Economic Activity" adopted by the Verkhovna Rada of Ukraine in 2015*. The latest edition of July 2019. Available [online]: <https://zakon.rada.gov.ua/laws/show/222-19> [in Ukrainian]

⁴⁴ European Commission (2019) *Countries and Regions. Ukraine*. Available [online]: <http://ec.europa.eu/trade/policy/countries-and-regions/countries/ukraine/>



SMUGGLING,
NONTRANSPARENT
GOODS VALUATION,
AND ADDITIONAL
REQUIREMENTS
IMPOSED
ON BUSINESSES
CONTINUE
TO INHIBIT CROSS-
BORDER TRADE
FOR UKRAINIAN
BUSINESSES

required for customs clearance. The export of services was simplified. Now, cross-border contracts can be signed in electronic form, while invoices may be used as contracts and primary accounting documents.

At the same time, smuggling, nontransparent goods valuation, and additional requirements imposed on businesses continue to inhibit cross-border trade for Ukrainian businesses. An investigation by *Süddeutsche Zeitung* showed that Ukraine loses billions of US dollars annually due to large-scale smuggling schemes when the imported goods are intentionally misclassified as cheaper ones⁴⁵.

⁴⁵ Hassel, F. (2018) "Korruption ruiniert die Ukraine", [in]: *Süddeutsche Zeitung*. Available [online]: <https://www.sueddeutsche.de/politik/exklusiv-korruption-ruiniert-die-ukraine-1.4081856> [in German]

On the other hand, legally trading businesses often face the problem of over-estimation of customs value of imported goods. The 2018 Business Ombudsman Council's special report states that a vast majority of criticism about customs authorities concerns inefficient and non-transparent determination of customs value. As a result, businesses have to pay higher import duties⁴⁶. In addition, customs authorities have been reported to demand additional documents from businesses, including those that are not foreseen by legislation, which adds an administrative burden for entrepreneurs and creates delays in customs clearance.

JUSTICE VS. CORRUPTION

A weak and dependent justice system and widespread corruption and rights abuse in the judiciary and law enforcement prevents Ukraine from establishing the rule of law that would ensure a fair and transparent environment necessary for its citizens, entrepreneurs, and foreign investors.

It seems quite ironic that being a country with an active military conflict going on, Ukraine scored best on the "order and security" indicator of the World Justice Project's 2019 *Rule of Law Index* while receiving much lower scores on other factors contributing to its 77th place overall in the ranking of 126 countries – such as civil and criminal justice, constraints on government powers, and absence of corruption⁴⁷.

Justice system reform included steps on introducing more transparency into selection of judges, launching a new Supreme

Court, and reorganization of the first instance courts⁴⁸. However, in spite of the objections of the Public Integrity Council, comprised of civil society activists, the selection process allowed judges who have made unlawful decisions or whose property declarations list unjustified assets to keep their offices⁴⁹. The unreformed judiciary is a systemic problem in Ukraine, as questionable court decisions can undermine even successful policy steps.

Corruption in the justice system and civil service is one of the reasons why property rights are not sufficiently protected in Ukraine⁵⁰. There is an app on the market in Ukraine that notifies you if your property is being raided⁵¹. Raids are carried out by forging documents to change the information in property registers, and then seizing a farm or a factory⁵². The General Prosecutor's Office reports that approximately 400 hostile takeovers take place every year⁵³. Their number had been growing up until 2018 when new legislation was adopted, requiring notarizations

⁴⁸ VoxUkraine Editorial Board (2017) "Three Years of Reforms. Has Ukraine Reformed Enough for Surviving.", [in]: *Vox Ukraine*. Available [online]: <https://voxukraine.org/longreads/three-years-of-reforms/index-en.html>

⁴⁹ Shtohrin, I. (2019) "44 Judges of the Supreme Court are Dishonest – Public Integrity Council", [in]: *RadioFreeEurope/RadioLiberty*. Available [online]: <https://www.radiosvoboda.org/a/29926985.html> [in Ukrainian]

⁵⁰ Kuklin, D. (2017) "Why Ukrainian Agribusiness Cannot Prevent Property Raiding for Now", [in]: *Euromaidan Press*. Available [online]: <http://euromaidanpress.com/2017/11/20/why-ukrainian-agribusiness-cannot-prevent-property-attacks-of-raiders/>

⁵¹ Liga:Zakon (2019) *SMS Beacon*. Available [online]: <https://smsmayak.ligazakon.net/> [in Ukrainian]

⁵² Melkozerova, V. (2017) "Activists, Entrepreneurs and Lawmakers Unite to Protect Farm Businesses from Raiders", [in]: *Kyiv Post*. Available [online]: <https://www.kyivpost.com/business/activists-entrepreneurs-lawmakers-unite-protect-farm-businesses-raiders.html>

⁵³ Opendatabot (2019) *About Four Hundred Hostile Takeovers Take Place in Ukraine Every Year*. Available [online]: <https://opendatabot.ua/blog/336-raiders-2019> [in Ukrainian]

⁴⁶ Business Ombudsman Council (2018) *Systemic Report "Main Problems Faced by Business in Customs Sphere"*. Available [online]: https://boi.org.ua/media/uploads/systemic_report_ii_2018/ii_2018_sytem_en.pdf

⁴⁷ World Justice Project (2019) *WJP 2019 Rule of Law Index – Ukraine*. Available [online]: <http://data.worldjusticeproject.org/#groups/UKR>



IT SEEMS QUITE IRONIC THAT BEING A COUNTRY WITH AN ACTIVE MILITARY CONFLICT GOING ON, UKRAINE SCORED BEST ON THE “ORDER AND SECURITY” INDICATOR OF THE WORLD JUSTICE PROJECT’S 2019 *RULE OF LAW INDEX*

of any changes made to public registers of property rights and increases criminal and administrative responsibility for takeovers⁵⁴. Most recent legislative initiatives aim to digitize the registers in order to better detect risky property transactions⁵⁵.

Another threat for doing business regarding justice and the rule of law comes from law enforcement bodies. Ukrainian businesses report being unlawfully searched and their assets seized by the police, tax police, and Ukraine’s Security Service. Business Ombudsman Council lists numerous cases of law enforcement agencies inflicting pressure on businesses by launching groundless criminal proceedings and seizing property and documentation or, vice versa, refusing to open criminal proceedings following applications from businesses⁵⁶.

Legislation adopted in 2017 and 2018 that allowed searches only with the presence of lawyers, required the law enforcers carrying out searches to video record their actions, and prohibits seizing documents and hardware from businesses was intended to protect businesses from unjustified and illegal searches by law enforcement agencies. But law enforcement agencies still create significant problems and delays in business operations by carrying out searches and opening criminal proceedings⁵⁷.

In the years following the Euromaidan protests, which called for eliminating corruption, and with demands to reform prosecution of corruption by the civil society and international lenders such as the IMF, Ukraine created a set of specialized anti-corruption bodies from the ground up. These include the already mentioned NABU – investing high-profile corruption cases, the Specialized Anti-Corruption Prosecutor’s Office (SAPO) tasked with

⁵⁴ DLF Attorneys at Law (2016) *Law on Anti-Raiding Adopted*. Available [online]: <https://dlf.ua/en/law-on-anti-raiding-adopted/>

⁵⁵ President of Ukraine Volodymyr Zelensky (2019) *President of Ukraine signed a decree aimed at countering raiding*. Press release. Available [online]: <https://www.president.gov.ua/en/news/glava-derzhavi-pidpisav-ukaz-spryamovanij-na-protidiyu-rejde-56585>

⁵⁶ Business Ombudsman Council (2016) *Systemic Report “Abuse of Powers by the Law Enforcement Authorities on Their Relations with Business”*. Available [online]: https://boi.org.ua/media/uploads/sysrep_criminal_eng_final.pdf

⁵⁷ Skryl, O. (2018) “Why Searches of Businesses Continue in Spite of Legislative Changes”, [in]: *Delo.ua*. Available [online]: <https://delo.ua/economyandpoliticsinukraine/chomu-popri-zakonodavchi-zmini-obshuki-biznesu-prodovzhujutsja-341938/> [in Ukrainian]

prosecuting corruption, and the National Agency for the Prevention of Corruption (NAPC), which should verify whether the assets listed in public electronic declarations by civil servants correspond to their incomes.

The newly established infrastructure of corruption prosecution bodies is completed by the High Anti-Corruption Court, which is set to start considering corruption cases in 2019. The existing agencies, however, have already been accused of breaking professional ethics and interfering in cases (SAPO), as well as of selectivity and political dependence (NAPC⁵⁸).

PUBLIC OPINION: PATERNALISTIC EXPECTATIONS DECREASING

When asked to choose between two alternative views on the role of the government – the first one being that the government should bear full responsibility for providing each person with everything they need, and the second one being that it should provide equal “rules of the game”, while the people themselves should be responsible for using these chances – most Ukrainians choose the latter. A recent survey⁵⁹ shows that the majority of Ukrainians (61%) would choose fair rules and personal responsibility over completely relying on the government. Only a year ago, in 2018, this share was smaller: 45%.

However, when answering more specific questions regarding their attitude about

the influence of the state on entrepreneurship and personal life, most Ukrainians tend to select answers that put them into the “authoritarian left” corner of the “Political Compass”. The Political Compass⁶⁰ is a typology of political opinions, which is plotted on 2 dimensions: economic and social. It allows classifying those who take the online test into four groups: “authoritarian right”, “democratic right”, “democratic left”, and “authoritarian left”.

A survey of 1,200 respondents was adapted from the Political Compass and carried out in Ukraine in 2019. Participants of the survey were asked to agree or disagree with such statements as “The government should take care of the welfare of every citizen” or “Ukraine needs a strong leader with unlimited powers”. The answers of 73% of those surveyed classify them as having leftist and authoritarian views, while 17% were grouped into the “democratic left”⁶¹. Only 2% of the respondents fit into the “democratic right” category, while the answers of 1% of the respondents put them in the “authoritarian right” field.

This indicates that while Ukrainians may be becoming more freedom-minded regarding the role of the government in personal matters, they are likely to support specific policies that allow for more regulation by the state and give the government (rather than the citizens) the power to influence their welfare.

⁵⁸ Romanenko, M. (2017) “Scandal Casts Light on Corruption in Ukrainian Corruption Prevention Agency”, [in]: *Hromadske International*. Available [online]: <https://en.hromadske.ua/posts/when-ukrainian-anti-corruption-agencies-fight-each-other-not-corruption>

⁵⁹ Democratic Initiatives Foundation (2019) *Reforms in Ukraine: Public Opinion*. Press release on the survey conducted by the Democratic Initiatives Foundation together with the sociological service of Razumkov Center from 13 to 20 June 2019. Available [online]: https://dif.org.ua/article/reformi-v-ukraini-gromadska-dumka-naselennya_pyaty [in Ukrainian]

⁶⁰ The Political Compass (2019) Available [online]: <https://www.politicalcompass.org/>

⁶¹ Brik, T. and O. Krymeniuik (2019) “From Right to Left: What Ukrainians Think about the State Control over the Economy and Personal Freedoms?”, [in]: *Vox Ukraine*. Available [online]: <https://voxukraine.org/uk/sprava-nalivo-shho-dumayut-bilshist-ukrayintsiv-pro-derzhavnij-kontrol-ekonomiki-ta-osobistih-svobod/> [in Ukrainian]



CORRUPTION IN THE JUSTICE SYSTEM AND CIVIL SERVICE IS ONE OF THE REASONS WHY PROPERTY RIGHTS ARE NOT SUFFICIENTLY PROTECTED IN UKRAINE

Evidence from another survey that was already cited above illustrates this point well. A 2019 sociological survey conducted by Ukrainian polling agencies⁶² shows that compared with the most popular anti-corruption, healthcare, and pension reforms that are expected from the government by more than half of the respondents, tax reform is not as popular – with only 13% in support. Additionally, a mere 10% of Ukrainians said they wanted deregulation and promoting entrepreneurship to be among top government priorities, and only 7% supported land market reform as a priority policy step. This demonstrates that there is little demand for pro-market reforms among the Ukrainian public.

⁶² Democratic Initiatives Foundation (2019) *Reforms in Ukraine: Public Opinion*. Press release on the survey conducted by the Democratic Initiatives Foundation together with the sociological service of Razumkov Center from 13 to 20 June 2019. Available [online]: https://dif.org.ua/article/reformi-v-ukraini-gromadska-dumka-naselennya_pyaty [in Ukrainian]

CONFLICTING ATTITUDES ABOUT CORRUPTION AND MARKET DISTORTIONS

Public opinion polls repeatedly show that fighting corruption is the most demanded policy step in Ukraine. In a recent sociological survey, 63% of the respondents said that the anti-corruption reform should be a priority for the government⁶³. In previous surveys over the last four years, this share always exceeded 50%. This suggests that Ukrainians are aware of the negative impact of corruption on institutions and the situation in the country, and have clear expectations about overcoming this problem from the government.

Surveys of entrepreneurs clearly indicate that they consider corruption one of the most important problems. In the 2018 Foreign Investor Survey by a Ukrainian think tank and a business association, foreign investors doing business in Ukraine placed widespread corruption on the top of the list of obstacles to investment⁶⁴.

Nevertheless, both individual Ukrainians and local businesses demonstrate quite a substantial degree of tolerance towards corruption. According to a 2018 survey⁶⁵ conducted, almost 15% of the respondents across the country reported having offered to pay a bribe by their own initiative, while 17% said they used personal connections to solve problems. A 2017 survey by consulting company EY⁶⁶ showed that 37% of

⁶³ Ibid.

⁶⁴ European Business Association, Dragon Capital, Center for Economic Strategy (2018) *Third Annual Foreign Investor Survey*. Available [online]: https://ces.org.ua/wp-content/uploads/2018/09/2018_investorsurveyresults_presentation.pdf

⁶⁵ Ukrinform (2018) *Ukrainians Said Where They Encounter Corruption Most*. Available [online]: <https://www.ukrinform.ua/rubric-society/2545529-ukrainci-skazali-de-najbilse-stikautsa-z-korupcieu.html> [in Ukrainian]

⁶⁶ EY (2017) *According to EY Research, Executives Are*



UKRAINIAN BUSINESSES REPORT BEING UNLAWFULLY SEARCHED AND THEIR ASSETS SEIZED BY THE POLICE, TAX POLICE, AND UKRAINE'S SECURITY SERVICE

business managers in Ukraine are ready to offer a “cash reward” in exchange for closing or prolonging a contract. Meanwhile, in a 2018 survey of Ukrainian exporters and importers conducted by the IER, 39% of the respondents believed it was necessary to maintain personal relationships with officials of at least one government body in order to do business successfully⁶⁷.

REFORMS ON POLITICAL AGENDA

The newly elected President of Ukraine, Volodymyr Zelensky, and his Servant of the People political party, which entered the

Unable to Effectively Shape the Principles Of Business Ethics. Available [online]: <https://www.ey.com/ua/uk/newsroom/news-releases/news-ey-senior-managers-failing-to-set-right-tone-on-business-ethics-finds-ey-fraud-survey> [in Ukrainian]

⁶⁷ Institute for Economic Research and Policy Consulting (2019) *Trade Facilitation in Ukraine: Business Assessment and Expectations. Executive Summary.* Available [online]: <http://www.ier.com.ua/en/publications/reports?pid=6168>

parliament with the majority of votes, both ran on the platform of deregulation and fight against corruption.

Mr. Zelensky's political program lists the promise of ensuring freedom of competition and simple and clear taxation. He made a commitment to work on reducing the shadow sector of the Ukrainian economy and to introduce a transparent land market. In terms of the fight against corruption, the president's platform includes such policy steps as more severe punishment for corruption, protection and rewards for whistleblowers, stopping harassment of businesses by law enforcement agencies, and support for newly formed anti-corruption bodies (such as the High Anti-Corruption Court)⁶⁸.

However, some areas are rather vague in Volodymyr Zelensky's platform. The section on justice includes promises to reduce political dependency of the judicial branch of the government and restoring trust and respect for the courts without listing more specific steps. There are also fairly populist promises in his platform, such as delegating legislative decisions to referendums and distributing the income from the country's natural resources among all citizens. Under the Constitution, the president's authority lies mostly in the areas of foreign affairs and national security, so he needs to cooperate with the parliamentary coalition in order to implement economic and judicial reforms. The program of the Servant of the People party that secured the majority of votes in the July 2019 parliamentary elections echoes the one of Mr. Zelensky. It contains commitments to reduce the size of the government and to further decrease payroll tax, digitize tax reporting and cus-

⁶⁸ Presidential Candidate of Ukraine Volodymyr Zelensky (2019) *Election Program.* Available [online]: <https://program.ze2019.com/> [in Ukrainian]

toms clearance, ensure independence of anti-corruption bodies, and take away the powers of law enforcement and security agencies that allow them to obstruct businesses⁶⁹.

With the presidential and legislative powers controlled by Mr. Zelensky and his party, they have a chance to improve conditions for business in Ukraine and remove corruption and distortions that affect competition. If they do implement necessary changes, they will benefit from quite a high acceptance of unpopular reforms by Ukraine's citizens. In 2019, Ukrainian public opinion shows an unprecedented willingness to deal with temporary difficulties in order to improve the situation in the country overall. 59% of the respondents surveyed by Ukrainian polling agencies throughout the country said they were ready to have their standard of living lowered for some time if this meant that the government could carry out necessary reforms⁷⁰.

This is the highest percentage over the last five years – the previous record share of Ukrainians ready to sacrifice personal welfare for reforms (44%) was registered in 2014, right after the Euromaidan revolution, followed by presidential and parliamentary elections. The high level of willingness to face difficulties for the sake of reforms lends a lot of trust to the newly elected president and parliament of Ukraine and gives them leeway to take unpopular steps that would lead to the liberalization of the

⁶⁹ Servant of the People (2019) *Election Program*. Available [online]: <https://sluga-narodu.com/program> [in Ukrainian]

⁷⁰ Democratic Initiatives Foundation (2019) *Reforms in Ukraine: Public Opinion*. Press release on the survey conducted by the Democratic Initiatives Foundation together with the sociological service of Razumkov Center from 13 to 20 June 2019. Available [online]: <https://dif.org.ua/article/reformi-v-ukraini-gromadska-dumka-naseleennya-pyaty> [in Ukrainian]



UKRAINE CREATED A SET OF SPECIALIZED ANTI-CORRUPTION BODIES FROM THE GROUND UP

country's economy, stopping corruption, and establishing a fair justice system.

OCCUPIED CRIMEA AND EASTERN UKRAINE: BASIC FREEDOMS TAKEN AWAY

In the occupied parts of Ukraine (the Autonomous Republic of Crimea occupied by Russia and the eastern parts of Donetsk and Luhansk oblasts controlled by combined Russian-separatist forces), personal and economic freedoms have been strictly restricted and local residents live in the environment of security threats and the absence of the rule of law. Under Russian control, the situation in these parts of Ukraine is similar to the repressions under the Soviet Union, exacerbated by torture and killings of activists and shelling of civilian homes and infrastructure.

Combined Russian-separatist forces seized the companies under Ukrainian jurisdiction operating in the occupied territories. At the beginning of the occupation, half of all companies were closed, destroyed or seized by Russia-backed separatists, according to estimations⁷¹. Private

⁷¹ Bird, M., Vdovii, L., and Y. Tkachenko, (2015) "The Great Looting of Donbass", [in]: *EUobserver*. Available [online]: <https://euobserver.com/investigations/131428>

businesses are being forced to register under the authority of the Russia-led separatists and to pay taxes to their budgets. After Ukraine prohibited trade across the conflict line, the Russia-led separatists took over even more companies that were still operating on the uncontrolled territory, including coal mines, factories, energy companies, as well as transport and telecommunication companies⁷².

The war waged by combined Russian-separatist forces cut away the occupied territories in the eastern Ukraine from transport and power infrastructure, while local businesses lost suppliers and buyers from the rest of Ukraine and are compelled to trade with the only available market – Russia.

All Ukrainian and international banks have closed their branches on the occupied territories, while Russia-led separatists created their own bank, which is the only option in these areas. Russia has consolidated its occupation in the eastern parts of Ukraine by financing pensions and public sector salaries⁷³, introducing the Russian currency, and issuing Russian passports for Ukrainian citizens that live on the occupied territories. Active conflict is continuing in this area, so many homes, business properties, schools, hotels, and other buildings have been hit by shelling or destroyed completely – such as the Donetsk airport, which was destroyed by combined Russian-separatist forces back in 2015.

⁷² Zoria, Y. (2017) "What Assets Did Russia's Puppet Republics Seize from Ukraine? Full List", [in]: *Euromaidan Press*. Available [online]: <http://euromaidanpress.com/2017/03/04/stolen-ukrainian-assets-in-donbas/>

⁷³ Zverev, A. (2016) "Moscow Is Bankrolling Ukraine Rebels: Ex-Separatist Official", [in]: *Reuters*. Available [online]: <https://www.reuters.com/article/us-ukraine-crisis-separatists/moscow-is-bankrolling-ukraine-rebels-ex-separatist-official-idUSKCN1251UQ>



UNDER RUSSIAN CONTROL, THE SITUATION IN THESE PARTS OF UKRAINE IS SIMILAR TO THE REPRESSIONS UNDER THE SOVIET UNION, EXACERBATED BY TORTURE AND KILLINGS OF ACTIVISTS AND SHELLING OF CIVILIAN HOMES AND INFRASTRUCTURE

In occupied Crimea, which Russia recognizes as its territory, the businesses are forced to register under the Russian law, while public officials are required to take Russian citizenship in order to keep their jobs. Minus the war, the situation with civil and political liberties in Crimea is comparable to the one in the occupied eastern territories of Ukraine. As reported by the United Nations (UN), the Russian authorities in Crimea commit numerous human rights



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violations – including arbitrary arrests and torture⁷⁴. The 2019 Freedom House report on Crimea states that corruption is widespread in the territory of the occupied peninsula, and some representatives of the Russian-backed leadership are, allegedly, tied to organized crime⁷⁵. Free speech and media are severely limited in Crimea, while some religious organizations face pressure from occupation authorities.

The war and Russian occupation of Crimea and the eastern regions of Ukraine damaged the economy of the rest of the coun-

⁷⁴ Office of the United Nations High Commissioner for Human Rights (2018) Report on the Situation of Human Rights in the Temporarily Occupied Autonomous Republic of Crimea and the City of Sevastopol, Ukraine, 13 September 2017 to 30 June 2018. Available [online]: https://www.ohchr.org/Documents/Countries/UA/CrimeaThematicReport10Sept2018_EN.pdf

⁷⁵ Freedom House (2019) *Freedom in the World 2019. Crimea*. Available [online]: <https://freedomhouse.org/report/freedom-world/2019/crimea>

try by confiscating assets of banks and businesses and disrupted trade and business links. This forced hundreds of thousands of Ukrainians to move out of the affected territories due to their pro-Ukrainian political positions, civic activism, or religious beliefs.

CONCLUSIONS

In conclusion, lack of necessary pro-market reforms on the one hand, and reinforcing politically influenced distortions to competitive environment on the other, have prevented Ukraine from developing institutions needed for reaching economic freedom and the rule of law in the decades following the collapse of the Soviet Union. The recent years after the Euromaidan revolution brought much needed changes in the areas of deregulation, privatization, public procurement, and customs clearance. Government regulation on food prices was finally canceled. More and more government services for businesses are available online.

At the same time, certain regulations (such as labor law) remain restrictive for



UKRAINIANS WOULD
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entrepreneurs, gas prices for businesses and households still have not reached complete import parity, and efforts to combat corruption and reform the judiciary proved to be rather nominal and did not bring the expected results. Many state-owned enterprises need to be privatized to increase their efficiency and prevent rent-seeking, whereas selling agricultural land is still prohibited.

Some policy steps brought about contradictory results. Businesses have better access to information about government inspections, but are also forced to pay higher sums if fined by these inspections. Payroll tax has been cut, but private entrepreneurs were required to pay it even if they earn no income.

The new president, Volodymyr Zelensky, and his party, which make up the parliamentary majority, were elected in Ukraine on the platform of creating favorable conditions for businesses and fighting corruption. The window of opportunity in terms of public opinion seems to be open for them at the moment: a record high percentage of Ukrainians say they would not mind facing temporary difficulties for the sake of efficient reforms.

Meanwhile, prosecution of dissidents and restrictions for private property on the territories of Ukraine that are occupied by Russia not only take their residents back to the repressive conditions under the Soviet Union, but also add a constant threat for life and physical well being because of the ongoing war and unlawful arrests combined with torture. Entrepreneurship is constrained and private property is being seized and destroyed. Russia cuts business and trade connections in Crimea and the occupied eastern regions of Ukraine from the rest of the country, and integrates these parts of Ukraine into its own economy.

Considering the checkered transformation progress so far, it is unlikely that Ukraine will reach a significant breakthrough if it keeps current administrative barriers in place and does not make more active efforts to fight corruption. Without serious steps towards economic freedom, transparency, and competitiveness, Ukraine's economy will continue to serve vested interests, while private business will be alienated by bureaucracy, corruption, and obstruction by government authorities and the law enforcement system. What the country needs to do first and foremost is to ensure the rule of law, create fair conditions for businesses, and eliminate market distortions, as well as to simplify doing business and international trade. This will make Ukraine an attractive place to invest and to do business in, subsequently boosting economic growth.



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IRYNA
FEDETS

Senior Research Associate of the Institute for Economic Research and Policy Consulting. Research and advocacy professional with expertise in business climate, economic freedom, democracy and trade. She has provided policy recommendations for Ukrainian government based on her analysis of multiple nationwide surveys in Ukraine where she studied opinion of the country's entrepreneurs and business managers on administrative barriers, corruption, and expectations about reforms