



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 20.11.1996
COM(96) 593 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Action Plan for Ukraine

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Subject: Action Plan for Ukraine

This document addresses two complementary objectives : giving The Ukraine authorities a strengthened political signal of support from the EU and exploring the means for an improved development of the existing assistance and the synergetic ties between the Community and the Member States in this area.

1. The political signal is in response to a request from the Ukraine authorities. This request comprises, first, a short-term aspect : to receive visible support from the EU. Over the longer term, it is a matter for the EU to take note of the request from the Ukraine authorities to secure a firmer anchorage in the European structures and possibly membership in the EU.

Confronted by serious challenges in consolidating its independence and in its integration into the world economic market, Ukraine has achieved substantial advances particularly since October 1994. It now finds itself, as it were, standing at a crossing point of a river, in having established the basis of a democracy, achieved a true macro-economic stability, initiated the transformation of its economy and found a position in the international community. It is now facing perhaps the most difficult stage of its economic and political transformation : the restructuring of its industry and energy base, the implementation of the rule of law and of a democratic society and the strengthening of the parameters of its independence, particularly the lifting of the Russian yoke.

The results obtained are to be credited to the courageous and determined policy followed since the election of President Kuchma in 1994, and also to the resolute support of the international community, particularly the EU and the United States. This support must be maintained and developed in response to the request of the Ukraine authorities and should accompany a deeper transformation of the economy and of society.

The political question posed by Ukraine about its place in Europe cannot be given a definitive response here. Rather, it is suggested that this leads to consideration within the framework of the Community and of the Common Foreign and Security Policy (CFSP) of the type of relationship to be established with a country that is near to the EU, one that is important in terms of trade and security.

2. The development of European assistance: this document attempts to assess what has been accomplished and to highlight both the strong and the vulnerable points of Ukraine after five years of independence. On the basis of this assessment, it proposes six approaches for action for the Community and its Member States :

- support for the reform of the economy;
- social transformation;
- introduction of Ukraine into the European security architecture and the strengthening of the political dialogue;
- support in regional cooperation;

- the deepening of contractual relationships;
- the reform of the energy sector.

The short-term priority measures are as follows : (i) the ratification of the PCA by the Member States and its entry into effect, (ii) the decision concerning balance of payments assistance for 1997, (iii) the financing and the implementation of the agreement between the G7, the EC and Ukraine on the closing down of Chernobyl, (iv) the work of the working group on bilateral trade and (v) putting in place an environment conducive to private investment in Ukraine.

The support for Ukraine as conceived under the Common Position of November 1994 is a collective EU action, and the PCA is an agreement of a mixed type. In this perspective, this document incorporates the suggestions made by the Member States in particularly in the area of the CFSP. Similarly, its implementation will involve close cooperation between the Community and the Member States.

This document, which is addressed to the Member States for their general guidance comprises proposals for concrete action. These are presented in the last section in the order of priority corresponding to the topics discussed in the document. However, while the strategy of the EU towards Ukraine is uniform, the legal bases of the concrete measures are diverse. The measures indicated may give rise to (i) measures of assistance within the competence of the Community, covered by the Tacis regulation, (ii) measures within the competence of the Community to implement the Interim Agreement, (iii) measures falling within mixed competence to implement the PCA when ratified, (iv) measures arising under Titles V and VI of the Treaty on European Union, (v) measures arising within the sole competence of Member States.

This document has no budgetary implications apart, of course, from the Chernobyl matter, the financing of which should be specified in 1997 by G7 and from possible macro-financial assistance for 1997 which will be the subject of a Council decision (15% of the amount to be established must be guaranteed under the budget).

Conclusion: the Commission should transmit this action plan to the Council to be incorporated, where appropriate, in the conclusions of the Dublin European Council (14 and 15 December).

Brussels, 20 November 1996

Action Plan for Ukraine

For five years Ukraine has affirmed its independence and taken up an appropriate position for itself in the continent of Europe, that of a large country occupying a key position, destined to one day become an immediate neighbour of the EU. It has been able to maintain its cohesion, begin developing a democratic system, engage in an economic transition which is progressively opening it up to the world economy and appear on the international scene as a reliable partner, playing a stabilizing role in the region.

These results are due to the courageous and determined policy conducted since the election of President Kuchma in 1994 but also to the resolute backing of the international community, notably the EU, whose technical and financial assistance from its whole range of instruments was ECU 2.8 billion over five years (1991-95). US assistance amounted to ECU 1.05 billion over that period.

The European Union has consistently reaffirmed the importance which it attaches to Ukraine.¹ The objectives, as announced in the **Common Position of November 1994**, are : the development of a strong political relationship, support for Ukraine's independence, the development of democracy, economic reform and its entry into the world economy. **The Union welcomes the Ukrainian desire for rapprochement with Europe and it intends, within the framework of the European architecture drawn up by the Copenhagen European Council, to develop partnership relations with Ukraine. The Community and its Member States have, in the light of this, signed a Partnership and Cooperation Agreement and developed an overall strategy of support for transition and for Ukraine's integration into the European arena.**

Ukraine recently celebrated the fifth year of its independence. Consideration of this period enables one to better gauge the results of the reforms undertaken and to understand what remains to be accomplished in terms of social and economic transformation. This document, on the basis of such an analysis, seeks specifically to determine the thrust of priority action which should lead to the establishment of a real partnership by the year 2000.

UKRAINE AFTER FIVE YEARS OF INDEPENDENCE :

1. The achievements of the policy of reforms are substantial :

a) Politically, the progress of democracy in Ukraine is real (free elections, a multi-party system, freedom of the press, freedom of religion, respect for Human Rights and fair treatment of minorities). Ukraine has demonstrated its capacity to resolve internal conflicts by political dialogue and compromise. The adoption of a new Constitution on 28 June 1996 constitutes decisive progress in the stabilization of the system. This text, which still has to be implemented, establishes a parliamentary system which conforms to the traditional

¹ The most recent positions taken are those in the Declaration made by the Presidency in Rome in May 1996 and the conclusions of the Troika Meeting of Political Directors of November 1996.

principles of separation of powers, executive responsibility, application of the rule of law and independence of the judiciary.

The entry of Ukraine into the Council of Europe (in Nov. 1995) constitutes a recognition of these initial achievements and encouragement to push ahead with them.

b) **Economically** : in spite of a slow start (Oct. 1994), Ukraine has very quickly implemented a macro-economic stabilization policy, the results of which have borne fruit (see Annex III). Microeconomic liberalization has started (freedom of internal and external trade, freeing of prices and a reduction of state intervention). Structural reforms (privatization and conversion of public enterprises, administrative reform and tax reform) have begun and are expected to be accelerated in the coming years.

c) **Foreign policy** : Ukraine has emerged as an element of stability in the region. The policies adopted (on nuclear disarmament, adherence to preventive diplomacy, the policy of conciliation towards Russia and rapprochement with the West) have increased Ukraine's international credibility. Similarly, Ukraine has affirmed its identity by an active policy of diplomatic presence at important international occasions and fora (the 1995 Euro-Mediterranean Conference, implementation of the Bosnia Peace Plan). The country, which remains a substantial military power, has participated in peacekeeping operations (the Ukrainian contingent in IFOR) and in joint exercises with Western forces. Political dialogue with the EU has developed in an intensive and consistent manner.

d) **Consolidation of independence** : although Ukraine lacks an ethnic identity and a unitary culture, this consolidation has benefited from the will of its people to control their own affairs. Trends towards the breaking up of society have not solidified, in spite of economic and social difficulties.

2. **Weaknesses remain** :

a) **the consolidation of democracy** and of the process of transformation in general requires the development of a free civil society (political parties, free trade unions, media) and also a substantial effort at the training of leaders among the population. The transformation of the country and its entry into the world economy takes effect through the improved understanding by the people as a whole of the working of the democratic system and of the market economy.

This requirement is of particular importance to the civil administration, which should be able to assume the functions incumbent on it within a state based on the rule of law (defence of the general interest rather than sectoral or group interests, impartiality and respect for the law) and in a free economy (regulation rather than management, comprehension of the increased complexity of autonomous market mechanisms and of an economy open to world trade). This requirement is also relevant to managers in the private sector and business leaders.

b) **economic transformation** is difficult but also crucial, in that it is a necessary condition for the maintenance of independence.

- The economic situation remains uncertain : GDP in real terms is 42% of the 1989 level, industrial production has fallen continuously since independence ². A **substantial budget liquidity crisis** has developed, the decrease in structural expenditure not having been sufficient to achieve budgetary deficit targets, due to the fall in tax receipts.

Although the underground or black economy, estimated to be 50% of GDP, compensates to some degree, its scale is a sign of serious economic and social disruptions.

- Reform of the economic, industrial, financial and administrative structure remains to be implemented. These reforms have begun but there are serious countervailing forces : the political opposition of the officials of the previous administrative system, the highly inappropriate nature of the means of production (heavy industries which are difficult to transform), shortage of capital, scarcity of leadership potential and the reduction in living standards.

In May 1996 the EU recognized that Ukraine was an **economy in transition**. In fact, with respect to liberalization and share of the private sector in the economy, Ukraine is in the last group among countries in transition, according to World Bank figures ³. The decisive switch to a market economy has not yet taken place in Ukraine, unlike in certain other countries in Central Europe. The Ukrainian economy is thus deprived of the benefits of integration in the world market, such as foreign investment, which is itself an important source of competition on the home market, transfer of know-how and creation of jobs.

c) **Energy**, and nuclear safety in particular, is foremost amongst the challenges facing Ukraine, whose economy must cope with an energy crisis greater than that experienced by the West in the 1970s, while simultaneously coping with substantial restructuring of its economy.

The energy problem is closely intertwined with the main challenges facing reform in Ukraine : its independence as a nation is linked to its dependence on foreign primary sources of energy ⁴ and its accumulated debt, production processes and jobs are related to doubts about the viability of many of its companies once energy is only available at market prices, social cohesion is linked with the drastic impact of price changes on the standard of living, the restructuring and the environmental and safety linkages of the coal and nuclear sectors. The issue of nuclear safety also influences Ukraine's relations with its western partners to the extent that this country is still too often perceived, domestically and internationally, in the light of its capacity to meet its commitments with respect to Chernobyl. Likewise in Ukraine, the credibility of Western countries will depend to a large extent on their ability to fulfill their commitments regarding Chernobyl.

d) The future is subject to four potential obstacles :

- **The level of dependence on Russia**, which is perceived as critical by the Ukrainian authorities, preoccupied as they are by the ongoing disputes and the pressures

² Production has fallen consistently since 1990. Industrial production in real terms has fallen to 35% of the 1990 level, agricultural production has fallen to 65%.

³ "From Plan To Market", July 1996.

⁴ 60% of primary energy is imported; 90% of oil comes from Russia and Turkmenistan.

being exerted for increased integration within the structures of the CIS. The key aspects of this dependence are : the energy imbalance, commerce (half of visible trade), unresolved conflicts (the Black Sea fleet), latent disputes (frontier recognition, Crimea) and the presence of a large Russian minority in Ukraine⁵.

- **The loyalty of the population is one of the major challenges of the transition.** The durable maintenance of independence largely depends, on the capacity of the regime to create an economic system which satisfies the expectations of the population : these expectations are closely related to the standard of living in Russia⁶. The sharp deterioration in living standards limits support for the reforms. In this respect regular payment of public sector salaries by the state constitutes a prerequisite in restoring the credibility of the new economic policy.

- **The heterogeneous nature of Ukrainian society** is marked by the dichotomy between and the divergent historical experiences of the russianised east and the more nationalist, pro-European west. A prolonged deterioration of the economic situation or an over-strong pro-Ukrainian linguistic shift in the public authorities cannot but bring out latent separatist tendencies.

- **The position of Ukraine within Europe** : the Ukrainian authorities fear that any enlargement of NATO and the European Union to the Central and Eastern European countries will leave their country in a "security vacuum" between the Euro-Atlantic bloc and the Russian sphere of influence/Treaty of Tashkent. The pivot of Ukraine's foreign policy is the parallel improvement of its relations both with Russia and with the West. Ukraine seeks in and from Europe a stable anchorage which would provide a concrete guarantee of its independence. The United States, which is very attentive to this country and very active there, has shown its wish to establish a "strategic partnership" with Ukraine, which has taken the form in particular of a mechanism of dialogue and cooperation at a very high level (the Gore-Kuchma Commission).

The Ukrainian authorities expect from the EU comparable political responses substantial enough to meet the strong challenges of stability and social and economic progress which the Community pursues in Europe as a whole.

3. International aid is substantial : so much so that the problem lies more in the capacity of the country to absorb it, and in its capacity for repayment of loans in the long run, unless there is significant economic growth.

EU assistance may be calculated, taking all instruments into account, at **ECU 2.8 billion over five years (1991-95)**, of which 1215 from Community sources and the rest from Member States. Since the acceleration of the reforms, a spectacular growth of macro-financial assistance has taken place. No doubt this should be followed up within the framework of the IMF and of the World Bank and in liaison with the principal donors, to accompany the deepening of the structural reforms and their budgetary implications.

⁵ Over 11 million Ukrainians (22% of the population) are Russian. They are heavily concentrated in certain regions; 44% of the population in the Donbass are Russians, 33% in Donetsk and 63% in the Crimea.

⁶ Real wages in Ukraine are about 62% of the level in Russia.

Assistance from the USA (ECU 1,05 billion or US \$1405 million between 1991 and 95), is strongly increasing since 1996, with Congress having decided to make Ukraine a priority for American aid in that region. Ukraine is the third largest recipient of American aid (after Israel and Egypt). Coordination is implemented with the Community, notably via Transatlantic Cooperation.

EU OBJECTIVES AND ACTION GUIDELINES

The Ukraine authorities have clearly indicated their objective of integrating the country into the various European structures. This strategy conforms to the objective of regional stability sought by the EU, and also to the objectives of the Common Position. A **strengthened partnership** corresponds to the particular situation of Ukraine, which occupies a pivotal position in Europe.

Consideration should be given to the place of Ukraine on the map of Europe which will emerge from the enlargement of the Union to the countries of Central and Eastern Europe, and to the type of relations to be established with this country. The importance of Ukraine for the Union, already perceptible, will be clear to all when it has a common border with the EU : comparable to a large European country in the size of the population (52 million), one of the biggest potential economic markets at the very gates of the Union, a transit area for Russian gas on its way to the EU, with coastal access to the Black Sea, this country is an essential element in the stability of the region. To this has to be added a favourable political consideration that the Union cannot ignore : Ukraine is an emerging democracy, and it takes its inspiration from Europe.

The support of the Community and its Member States may be developed in the six following directions (see the last part of this document for concrete measures):

- 1) support for the reform of the economy; (Community + Member State action);
- 2) social transformation; (Community + Member State action);
- 3) introduction of Ukraine into the European security architecture and the strengthening of the political dialogue; (CFSP 2nd Pillar : Commission + Council + Member States);
- 4) support for regional cooperation; (Community + Member State action);
- 5) deepening of contractual relationships; (Community + Member States);
- 6) reform of the energy sector. (Community + Member State action);

1) support for the reform of the economy : the Community will continue to support a policy of macro-economic stabilization in conjunction with the IMF and will develop its backing for the deepening of the reforms, both in the framework of the multilateral aid system of the IFIs and through its own means of action. It will attempt to accelerate the transition to a market economy, particularly through its assistance with the privatization process, the development of small and medium-sized enterprises, and also a more dynamic labour market.

2) the transformation of Ukrainian society : the EU will back the legislative and administrative reforms which will promote the emergence of a pluralist society, the consolidation of democratic institutions and of a state based on the rule of law, the protection of individual rights, (in conformity with the political principles of the Council of

Europe, implementation of the Constitution). This implies the opening and modernization of education systems, the development of human resources, the training of officials of the civil administration, the private sector and also the components of a pluralist society (associative system, media, trade unions, political parties), and the development of a new system of social security.

Entry into the Council of Europe involves several obligations for Ukraine, in particular the establishment of an independent system of justice, reform of the electoral law and the abolition of the death penalty which has not yet become effective.

3. Introduction of Ukraine into the European security architecture. Consideration of Ukraine's place in the European security architecture has to be pursued, **mainly through a strengthened political dialogue**, and in respect both of the positions of Ukraine and that of the EU, the evolution of which is still in progress. The measures enunciated in the Common Position, already broadly under way, must be reinforced : political dialogue, cooperation of Ukraine with the Stability Pact, the North Atlantic Cooperation Council and the Partnership for Peace, as well as with the WEU.

Beyond this, the strengthening of the partnership with Ukraine will take place in parallel with the enlargement of the EU to the countries of Central and Eastern Europe. This enlargement will itself contribute to the improvement of security in the region and thus Ukraine's own security. The new developments may be defined on the basis of the Council's ongoing deliberations on the integration of the countries of Central and Eastern Europe into the European Security Architecture and the position of Russia and Ukraine and the contribution of the EU to the drawing up of a model of European security within the framework of the OSCE.

- Strengthening of political gatherings at various levels between the EU and Ukraine, including where necessary summit meetings;

- The widening of the political dialogue to security topics, the development of common orientations with Ukraine in the area of international relations on topics of common interest, will constitute the next stages of development of this partnership.

- Strengthening the OSCE will be pursued in order to provide for the integration of Ukraine into the European security model;

- Consultations will be stepped up with the WEU. But the "special partnership" with NATO requested by Ukraine would no doubt be a more effective response to the security guarantees that country seeks.

4. Support in regional cooperation will be developed to contribute to a "re-balancing" vis-à-vis the CIS and to "anchor" Ukraine within the continent of Europe. Ukraine has clearly indicated its rejection of a strengthening of the CIS and the priority which it gives to recognition of its independence and its territorial integrity⁷.

⁷ Although Ukraine is "founder member" of the CIS, it has not signed neither the January 93 Charter, nor the October 92 agreement on the concept of military defence, nor that concerning the common defence of frontiers proposed by the Russians in February 95. It rejects the customs union.

- The multi-disciplinary regional measures which contribute to the development of Ukraine's relations with its immediate neighbours, particularly the countries associated with the Community, should be developed. In this respect, the joining of Ukraine to the CEFTA is to be encouraged and the Stability Pact constitutes a framework for the settlement of differences, as does the cross-frontier cooperation between Ukraine and the countries associated with the Community, who now possess experience of the transition to the market economy.

- The EU could additionally use the political dialogue with Ukraine's neighbours to explain to them its policy to Ukraine and contribute to a balanced settlement of differences. (For example, for Russia, the solution of the current differences with Ukraine could ensure the existence of a stable and friendly partner on its south west flank. Such a development would constitute an advantage for Russia, since it would contribute to its own stability.)

- **The cooperation of the states bordering the Black Sea** assumes a particular importance in this context. The interests of the Union in this region seem to converge with those of Ukraine, for whom this is of crucial importance : a potential access way to the Caspian basin and to Central Asia, allowing diversification of energy supplies, support for economic cooperation with a potentially strong grouping and seeking the stabilization of a particularly fragile geopolitical area.

The Commission plans to strengthen its role in Black Sea cooperation, by participating actively in the activities of the Black Sea Economic Cooperation Council and better utilizing and coordinating the intervention of its aid programmes for the countries bordering the Black Sea (Takis, Phare, Meda).

5. The deepening of contractual relationships :

a) the implementation of the IA and the potential of the PCA⁸ is a priority of the Union in its relations with Ukraine for the years to come, as the Presidency, on behalf of the EU, stated in the Declaration of Rome in May 1996 :

i) the ratification of the PCA by the Member States of the Union is a political priority. This already long process is currently faced by an unforeseen legal situation, linked to the need to also ratify the supplementary protocol following the enlargement to three new Member States. It is imperative, leaving aside the legal difficulties, to find a solution to enable the PCA to be implemented without waiting for the supplementary protocol. The Community and its Member States should be in a position to face up to their commitments with respect to Ukraine which, for its part, immediately ratified this agreement and for which its coming into effect assumes a high degree of political priority.

⁸ PCA = Partnership and Cooperation Agreement between the European Communities and their Member States and Ukraine, signed in June 1994 currently being ratified;
IA = Interim Agreement on Trade between the European Communities and Ukraine, signed in June 1995, (consisting of the commercial parts of the PCA pending the latter's ratification), which came into effect in February 1996.

ii) the development of the contractual relations provided by the Agreement should lead to a progressive rapprochement between the parties in the very broad area of economic cooperation : commercial, industrial, scientific and administrative cooperation, coordination of laws⁹. The PCA also represents a framework for **sustained cooperation in the key areas of social transformation** : education, transport, or of **direct concern for the integration of Ukraine into the European arena** : protection of the environment, customs cooperation, control of illegal immigration, drug trafficking and money laundering.

Without listing here the various measures provided for under the PCA, certain areas of action deserve to be highlighted due to their particular importance or their potential for rapid development:

- **Transport** (art. 64 of the PCA) is a major element in the development of economic activity and trade. The current situation, marked by the delay in privatization and under-investment, is inappropriate to the development of a modern and open economy.

Infrastructure: The development now in progress of the **TEN networks** should go hand in hand with economic and trade rapprochement between Ukraine and Europe. The definition in 1994 of nine European corridors, two of which concern Ukraine, provides a framework for trade and investment coordinated by the Commission which has led to the signing of development agreements and the launching of measures on routes and frontier crossings. But a much more global effort is necessary. Since the aspect linked to structural investments is decisive, it is necessary to seek other sources of finance, notably in the private sector. A more active contribution by EBRD would also be desirable. But the participation of private investors in this market should be facilitated by the improvement of the legislative framework and particularly by a better transparency of the conditions for awarding public contracts in Ukraine.

Transport services: In this context, the counterproductive Ukrainian policy of protectionism in air transport cannot be ignored. The benefit of public assistance by the Community in the improvement of the transport system must go hand in hand with the elimination of obstacles in terms of taxation of foreign companies.¹⁰

- **Telecommunications** (art. 66 of the PCA) : they play a vital role (together with information technology) as the enabling mechanism of the Information Society. In this respect the Community will support the following measures : (i) the adoption of a framework of laws and regulatory policies that encourage all types of investment in the telecommunications infrastructure and which maximize open access to it; (ii) the use of appropriate technical standards for hard-ware and services so that telecommunications TENs can be extended easily into Ukraine, (iii) the use of telematic services for vital sectors of the economy, e.g. for education, for health services, for transport, for publishing, for government administration and for electronic commerce generally.

⁹ This development of cooperation is also requested by the European Parliament (report of Mme. Mann, December 1995).

¹⁰ A 15% tax on foreign firms' turnover imposed when Air Ukraine does not operate the same route has already made several European companies cease activities in Ukraine. Besides the discrimination which goes against the principles of international air transport such a policy cannot be said to help Ukraine's integration with the world economy.

- **Industrial cooperation** (art. 53 of the PCA) is a sine qua non for the modernization of industry. Areas where cooperation with the private sector is practical will be identified. Industrial sectors with high value-added potential (the farm-produce industry, engineering, consumer industries) should be given priority, countering the current position which tends to preserve heavy industry by maintaining state intervention in sectors considered to be strategic ¹¹. The latter are inappropriate to Ukrainian market demand : they stem from the structure of the former USSR with its military connotations. The interest of the private sector in industrial cooperation operations hinges on the effective privatization of enterprises and the potential for restructuring them.

- **Agriculture** (art. 60 of the PCA) is a sector of high potential ¹². The current yields of the main products (wheat, sugar, sunflowers), are half as large as those of a comparable European country. Taking account of the agricultural tradition and the quality of the soil in Ukraine, this country could achieve a spectacular and rapid increase in its yields and become again a big exporter to world markets, subject only to an effective policy of privatization, opening up to foreign capital and modernization. This applies also downstream to the food-product industry which, together with agriculture, constitutes one of the main potential areas for rapid wealth creation and export revenue for Ukraine.

- **Tourism** (art. 72 of the PCA) is another sector in which there is a considerable potential for rapid development, with a notable advantage : it involves the creation of substantial numbers of new jobs. Again, what is needed is a policy of privatization and the modernization of accommodation, communication and transport infrastructure.

This applies particularly to Crimea ¹³, which has substantial assets in this sphere.

- **The environment** (art. 63 of the PCA) has particular importance in Ukraine and not only because of the crucial nuclear aspect. The latest research confirms the existence of air, water and ground pollution exceeding currently accepted international standards by far. This situation is due to an obsolete industrial infrastructure, excessively hungry for energy and other raw materials, and to a lack of investment in anti-pollution processes. The Community intends to promote measures of a horizontal type in this sphere, as well as more specific measures.

¹¹ The share of heavy industry in industrial production increased from 39% in 1993 to 58% in 1996 in the general context of reduction of overall industrial production. The Ukrainian authorities are rightly preoccupied about the insufficiency of domestic production of consumption goods.

¹² The farm-produce industry delivers 1/4 of Ukraine's GNP and provides employment to 1/4 of the active population. The significant reduction of agricultural production recorded in 1996, generally attributed to drought but also due to structural problems (particularly, the system of ownership is almost unchanged, and there is chronic under-investment).

¹³ Even before 1917, the Crimea was the favourite tourist spot for Russians. In 1996 4 million tourists were attracted to the area, against 8 to 10 millions before 1991. The conversion from mass tourism, with limited purchasing power, to a modern tourist service industry requires : (i) the reconstruction of communication and public service infrastructures, (ii) the privatisation of hotel and tourist facilities, and (iii) the assurance of maintenance of law and order. (For the current situation, see the OSCE report of August 96 on tourism in Crimea).

- **Scientific and technical cooperation** (art. 58 of the PCA). Ukraine has a high potential for Research and Development, but there are two main obstacles to its development : a lack of resources which is severe enough to compromise even the maintenance of the potential for research and is a source of isolation among researchers; and inadequate scientific training for the requirements of a modern economy.

The opening of European research programmes under the Fourth Framework Programme (participation in specific programmes; INCO-Copernicus calls for tender and INTAS) and Community membership of the Ukraine Science and Technology Centre (USTC) will help address the first problem. The second is dealt with in the framework of the training measures listed under point 2.

- **The battle against organized crime and money laundering** (arts. 68 and 79 of the PCA), has to be the subject of intense cooperation between the Community and its Member States and Ukraine. This is a matter of vital concern both for these national institutions and for their people. Beyond the effects which impinge on it directly, the Union must be very concerned at the development in Ukraine of organized crime and the weakening of government institutions due to the development of a black economy and the power of clans on the administration and the economy.

The PCA provides for cooperation in the control of illegal migration (art. 27) and the fight against drugs (art. 79). The implementation of this cooperation involves consultation with the Ukrainian side, and comes under Titles V and VI of the Treaty on European Union. The potential of the Round Table of the Stability Pact may be used. The technical assistance of the Community could contribute to regional cooperation in these areas and in strengthening the capacity for action of the Ukrainian administration. Some research has already been started to draw up means of action in this sphere.

b) Development of bilateral trade : although trade with the Community has grown substantially, Ukraine is still highly dependent on the CIS market.¹⁴ Ukraine is also concerned about its increasing trade deficit with the Community.

The existence of a trade deficit is a normal phenomenon with economies in transition which have to import many capital goods and which lack products which are competitive in foreign markets.¹⁵ The effect of the Community's anti-dumping policy on trade should not be overestimated; it actually affects less than 1% of bilateral trade. Anti-dumping policy is an integral part of the rules of multilateral trade and as long as Ukraine is not recognized as a market economy the rules applicable remain those of reconstitution of real value, corresponding to state-run economies. The Commission reminded the Ukrainian authorities in May 1996 of the possibility of individual treatment for producers able to prove that they were producing without state intervention.

¹⁴ The EC is the Ukraine's principal trading partner outside the CIS, with 15% of its trade and a positive balance of 700 Mecu in 1995. However in 1995, 45% of its product exports and 65% of its imports were still carried out within the CIS; see Annex IV

¹⁵ Ukrainian exports outside the CIS consist mainly of metallurgic products (over 40%), iron ore and transport equipment, all these being products for which demand is stagnant and where competitiveness relates first and foremost to the prices.

In the short term, EU action will relate to :

- the establishment of a joint working party on trade which will carry out a comprehensive examination of the trading situation between the EU and Ukraine. In particular, it must identify the causes of the unfavourable balance linked with the current economic transition. It must seek methods of balancing trade, by identifying the various types of existing obstacles, acting as a monitoring and early warning unit regarding potential obstacles and difficulties, and following up decisions made in this connection, particularly by the Joint Committee:

- assistance to Ukraine within the framework of its membership of the WTO will be continued with a view to adapting its commercial legislation to international standards as well as to the principles of the Interim Agreement, particularly in the spheres of standards, certification and intellectual property.

- an easing of quantitative restrictions will be sought within the current steel negotiations. The Community is proposing a gradual liberalization of access to the European market in return for effective restructuring and liberalization of the Ukrainian system of production (particularly the abolition of government grants).

The entry into force of the PCA will confirm the date set in Article 4, namely consultations in 1998 to see whether circumstances, in particular headway made by Ukraine with its reforms on the way to a market economy, and the state of the economy at the time, will allow the beginning of negotiations on the establishment of a free trade area. This outlook underscores the importance of continued economic reform.

In the longer term, trade expansion and an improvement in the Ukrainian balance will above all be achieved by enterprise modernization, increased competitiveness and a more dynamic presence on world markets.

c) growth of investments : foreign investments form the principal source of long-term capital, taking into account the low lending capacity of the Ukrainian banking sector and the limited borrowing capacity of enterprises. However foreign investments remain limited¹⁶

- The development of an appropriate legislative framework in addition to its implementation procedures is a prerequisite for the growth of investments. In this respect the Ukrainian government must itself take the initiative : only a clear and committed policy of liberalization and privatization, including the introduction of legislation ensuring that foreign companies do not receive discriminatory treatment (as provided for in Article 30 of the PCA) is likely to attract foreign and national investors. Additionally, effective protection of intellectual property is an essential condition - although not sufficient in itself - for the encouragement of direct foreign investment and the transfer of technology.¹⁷

¹⁶ \$150 - 200 million flow of funds per annum and \$950 million in stock since 1989 against \$3.9 billion in Russia.

¹⁷ As a general rule, these rights under private law belong to private organisations which make their own decisions regarding their availability. Nevertheless the public authorities can encourage the transfer of technology by the use of appropriate measures. Although Ukraine is not yet a member of

Beyond privatization, conditions for the private sector are still very difficult (high levels of complicated and discriminatory taxation, administrative complexities, mafia payments).

- The Community will supplement measures taken by the Ukrainian authorities in this sphere by the transfer of knowledge and discussions relating to the establishment of an investment fund (revolving fund). Such an instrument, specific to Ukraine, could stimulate investment and provide a cover for certain risks. The experience of the Jopp programme will be developed to finance SMEs, but it is not enough to provide a significant stimulus. The EBRD will be encouraged to develop its activities in Ukraine, in liaison with the Community.¹⁸

The Member States could study formulas for guaranteeing investments in addition to the development of a bilateral network for the encouragement of trade through linking the Chambers of Commerce.

6. The reform of the energy sector : since 1992 one of the Community's priorities has been the reform of the energy sector and the improvement of nuclear safety in Ukraine. This will be continued, with the objective of reducing Ukraine's dependence and increasing the safety of its nuclear plants (35% of electrical energy is of nuclear origin). This initiative will take the form of a restructuring of the energy market in Ukraine, the encouragement of energy saving and a search for alternative sources of energy, the continuation of the effort to improve nuclear safety, particularly through implementation of the MoU relating to the closure of Chernobyl in the year 2000.

a) Assistance from the EC in restructuring the energy sector : the Commission's objective is the promotion of an efficient energy sector, based upon the principles of the market economy and ensuring security of supply.

Although these reforms are well under way, significant effort will still be required. In particular, it is necessary to speed up the process of privatization and the introduction of an appropriate legislative framework : in this sphere as in others, these factors influence the access to foreign investment. Ratification of the Treaty on the Energy Charter by Ukraine and the Community will ease the introduction of the plan of action.

Various types of action will be intensified : (i) support for the implementation of an overall energy saving strategy, for the restructuring of the coal industry, relating in particular to social problems and the liberalization of the energy market; (ii) assistance in finding reliable sources of fuel supplies in addition to searching for other forms of renewable energy, (iii) the integration of Ukraine into regional working parties on the restoration of gas and oil pipelines; (iv) preparatory studies and measures accompanying loans made by the

the WTO, the effective implementation of measures modelled upon those of the ADPIC (TRIPS) should ensure sufficient protection of intellectual property to encourage foreign companies to invest in the country and to ease the transfer of technology

¹⁸ The EBRD committed ECU 150 million in Ukraine in 1995; it should be ECU 200 million in 1996, chiefly in the private sector. It is participating in the financing of G7 Plan measures for Chernobyl and is managing the \$ 200 million Nuclear Safety Fund (NSA).

international financial institutions, with regard to the implementation of investments which are economically viable and which respect the environment; (v) industrial cooperation, particular through the promotion of joint ventures between traders and component manufacturers.

The importance of points (i) and (ii) should be emphasized, in that removal of the constraints imposed by Russia upon Ukrainian supplies is a priority. Coal can obviously not fulfill this function. Energy saving and the search for independent gas supplies must be contributory factors.

b) **nuclear safety constitutes a priority**¹⁹ within the context of the overall reform of the energy sector in Ukraine. It is centered upon two fundamental factors : the improvement of nuclear safety and the closure of the Chernobyl nuclear power station. This agreement provides inter alia for the following commitments : to implement projects for decommissioning the Chernobyl nuclear power plant, to cooperate in the development of a cost-effective and environmentally sound approach to the shelter for Chernobyl 4, to develop an action plan for addressing the social impact of the closure of Chernobyl.

- Assistance in improving nuclear safety essentially relates to power stations of the VVER type which are in operation, through the programme of assistance on the sites, reinforcement of the body responsible for safety, and help on the Chernobyl site.

- **The EC contributes actively to the implementation of the agreement of December 1995 (MoU) relating to the closure of Chernobyl, with the firm intention of respecting the deadlines set.** Preliminary studies financed by the Community should enable decisions to be taken within the framework of the G7 in 1997, regarding the additional financing to be anticipated, project by project. The contribution of Ukrainian resources which is stipulated in the MoU must also be carried out.

The closure of Chernobyl has **long term and short term aspects.**

- **The long term aspect** is related to the in depth restructuring of the energy sector. Investments are needed for the rehabilitation of the existing thermal power plants and for additional hydro-electric power plant. The MoU includes a comprehensive package of measures which go well beyond the year 2000, until the full restructuring of the energy sector will have been achieved.

- **The short term aspects** concern safety risks associated with the present situation at the Chernobyl site (operation of reactors and status of sarcophagus) and the need to find **replacement electricity** for the reactors to be shutdown. In the view of the Ukrainian authorities, the completion of two nuclear reactors under construction at Rovno and Khmelnytsky (the R4K2 project), could bring by the year 2000 the compensating electricity capacity for the two Chernobyl reactors.

- **Two measures are of particular importance for the Community over the period up to mid 1997, in order to support the decision of Ukraine to close the Chernobyl plant by the year 2000.** These measures relate to the financing of the completion of the two reactors under construction, the implementation of the necessary measures to assure the safety of the sarcophagus.

For the **completion of the two reactors** 70% of the investment (about 1000 Mio\$) should be paid by loans from Euratom (up to 400 mecu) and from the EBRD. The preparation of these financing decisions is under way. Safety, economic, environmental and financial **due diligence** has to be demonstrated. The EBRD and the Commission have agreed to entrust a **panel of independent experts** with a new least cost investment analysis in the context of the MoU requirement to "identify least cost power supply investments to meet Ukraine's future national power requirements". The financial due diligence will depend on Ukrainian

¹⁹ See the Commission's Information Note of November 1996 on this subject.

decisions in the nuclear power sector, which should ensure that the borrower will be able to reimburse the loans. The current planning is to submit the loan decisions to the Commission and to the EBRD board by mid-1997.

Although the funding of the sarcophagus as such is not part of the MoU, it is considered essential by The Ukrainian President and, as agreed by the G7 Heads at the Moscow Summit, the G7 and Ukraine will begin to discuss this issue in December 96.

The financing modalities for both the completion of R4K2 and for the sarcophagus require therefore urgent attention.

c) The economic and social aspects connected with the accident and with the closure of Chernobyl also constitute an important part of the Community's overall assistance regarding Chernobyl. The social aspects of the closure of the power station form an integral part of the MoU and the EC must endeavour to contribute to an analysis of the problem of rehabilitation of the occupational groups which will be affected by the closure of the plant, the problem of the economic, social and environmental restoration of the regions affected by radioactive fallout, and medical assistance for the development of specific treatment (for example for cancer of the thyroid).

AVAILABLE INSTRUMENTS

This document, addressed to the Member States as a general guideline also includes information regarding concrete projects. These are set out in the last part in a thematic order which corresponds with the priorities set out above. However, whilst the Union's strategy with regard to Ukraine constitutes a coherent whole, the legal bases of the concrete initiatives are various. The projects mentioned could give rise to (i) assistance initiatives under the responsibility of the Community, covered by the Tacis Regulation, (ii) initiatives under the responsibility of the Community in implementation of the Interim Agreement, (iii) initiatives under joint responsibility in implementation of the PCA when this has been ratified, (iv) initiatives under Titles V and VI of the Treaty on European Union, (v) initiatives under the exclusive responsibility of the Member States for which the latter will take any decisions.

1. At Community level : the Community has introduced a set of measures for assistance to Ukraine (see Annex II), some of which are open to all the NEI (Tacis) or others such as the macro-financial assistance which has been in progress since 1994, or the Euratom loan instrument for the improvement of nuclear safety which is only granted to a very limited number of countries.

The priority objectives are defined by the Tacis Indicative Programme, signed in September 1996 for the period 1996-99 (the reform of the legislative and statutory framework, enterprise reform and the development of the private sector, the reform of the energy sector and the environment), covering very broadly the objectives set out in this document and making it possible to embark upon initiatives without delay. A quarter of the budget which is available for the NEI over the period 1996-99 is allocated to Ukraine, of which an initial installment of approximately 110 Mecu will be committed before the end of 1996.

It will be advisable to study the possibilities of developing additional instruments in the infrastructure projects in Ukraine (particularly the trans-European networks), and of encouraging cooperation with the EBRD in order that the latter can increase its activity in Ukraine alongside the Community and the other principal partners.

2. Cooperation under Titles V and VI of the Treaty on European Union (CFSP and Third Pillar): developments relating to security in addition to initiatives for the control of organized crime and illegal immigration, necessitating an increased level of cooperation between the Commission, the Council and the Member States and Ukraine, and undoubtedly the development of specific instruments.

3. At the level of the Member States, there is a significant level of potential which calls for a higher level of synergy between Community initiatives. The establishment of the Ukrainian Centre for Legal and Political Advice, in addition to a large German project, is in this respect a model to be followed. Some Member States are very committed with regard to Ukraine in a bilateral capacity, and all are through their contributions to international institutions such as the World Bank or the EBRD.

Some spheres are suitable for **decentralized initiatives** : for example teaching and training, where the Member States should be encouraged to increase initiatives (secondment of teachers, giving study grants in Europe, support for the teaching of European languages in Ukraine, networks of information exchange, university sponsorship), industrial and scientific cooperation.

CONCLUSION

Ukraine has clearly demonstrated its ambition to become integrated into the European area and the new geopolitical scene will place this large country immediately adjacent to the Union. This is a quite new situation both for the Union and Ukraine. Until 1991 the Union had in this region only a single negotiating partner, which was geographically distant; it now has a new partner, geographically close, which is diplomatically demonstrating its dissimilarity as well as its readiness to contribute to the stability of the region. Ukraine has for the first time in its history a choice other than that of allegiance to one of its two powerful neighbours.²⁰

Ukraine has also given pledges of its wish and ability to move closer to Europe and to reform its economy and its society. These pledges are of even greater value in that they have been produced from a situation of extremely severe constraint, which is described in the first part of this document.

However, this country is still only in the middle of the river crossing and will not be able to continue without international support. This support must naturally be practical with the following **immediate priorities**: (i) the transformation of society by all the measures available under the PCA (ratification by the Member States and entry into force); (ii) support for the reform of the economy (decision regarding new macro-financial assistance for 1997); (iii) the reform of the energy sector, and in particular the closure of Chernobyl (financing and implementation of the agreement between the G7, the EC and Ukraine, including the financing of the sarcophagus); (iv) the search for improvements in bilateral trade (working party on trade); (v) the introduction of a framework conducive to private investment in Ukraine.

These initiative priorities are developed within the operational section which follows.

This support should also offer the authorities and the Ukrainian people a political perspective which will be substituted for any possible return to the former ways and will loosen the grip of dependence upon their powerful neighbour.²¹

The Union has a unique opportunity of contributing to the emergence of a large democratic country, which can contribute to the stability of the region, which has obvious economic potential and with which it would be linked by a solid partnership.

²⁰ It is worth recalling that Ukrainian independence has twice hung fire (1648-1654 and 1918-1921), through a failure to find support and an anchorage point outside its two powerful neighbours.

²¹ Whilst the Ukrainian authorities are resolute in searching for anchorage within Europe, public opinion within the country provides a figure of 54% representing those who still see the future of the country linked with Russia. (Eurobarometer March 1996)

CONCRETE MEASURES

1. SUPPORT FOR ECONOMIC STABILIZATION AND REFORM

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---|--|--|
| <p>Tacis : Action Programmes during the period 1991-1995 have supported numerous projects in the areas of <i>privatization, post-privatization, financial services, development of the SME sector, military conversion, and food production, processing and distribution</i>. Tacis assistance in privatization has been a combination of institutional support, mostly to the State Property Fund (SPF) and the Small and Medium Enterprises' Development Agency (SMEDA), as well as support for the privatization of specific enterprises.</p> | <p>Tacis : priorities set out by the Tacis Indicative programme for the period (<i>support for the development of institutional cadre of officials, reform of the legislative and regulatory framework, enterprise reform and development of the private sector, reform of the energy sector and of the environment</i>), corresponding to the shaping of the reform of the Ukrainian colony.</p> | 1996-1999 |
| | <p>- 1996 Action Programme approved by the Commission</p> <p>- 1997 Action Programme in preparation - Expected decision:</p> <p>Creation of the Ukrainian Centre of Legal and Political Advice, which will provide legal and economic policy for the use of the Parliament, the President and the Prime Minister (a complementary measure to that implemented by bilateral German assistance).</p> | <p>October 96</p> <p>March 97</p> <p>Start of 97</p> |
| <p>Macro-financial assistance: disbursement of balance of payments aid of ECU 85 million in 1995 and first tranche of ECU a maximum of 100 million of a maximum 200 million for 1996, in support of the programme of stabilization and of economic reforms, also linked to the registering of progress on Chernobyl.</p> | <p>Macro-financial assistance: <i>payment, where possible, of the 2nd tranche of the loan of ECU 200 million decided on in 95;</i> a request for 1997 is under examination.</p> | <p>End 96</p> <p>January 97</p> |

2. TRANSFORMATION OF UKRAINIAN SOCIETY

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|--|---|---|
| <ul style="list-style-type: none"> • <i>legal advice</i> activities on parliamentary procedures, banking legislation, and <i>advice on economic policy</i> in liaison with a German project of the Federal Ministry of the Economy. • <i>joint programme with the Council of Europe</i> on adapting Ukrainian legislation to <i>democratic criteria</i>. • <i>training project</i> for Ukrainian Members of Parliament. • <i>support for NGOs</i> (Democracy, poverty alleviation, LIEN). • policy advice for the <i>strengthening and reorganization of public employment services</i>. • other activities have been carried out in education, retraining, vocational guidance and building social dialogue structures for effective policy making. | <p><u>Community :</u></p> <ul style="list-style-type: none"> • in conformity with the objectives of the implementation of the PCA the <i>modernization and reform of state institutions will be a major objective</i> for the period. • further support for the <i>development of a free civil society</i> and for democracy through the instruments developed for this purpose (Democracy, LIEN, City Twinning, TEMPUS, etc.) with particular stress on education and training issues. • <i>furtherance and deepening of cooperation with the Council of Europe</i>. • Continuation of <i>support for the development of an active employment policy</i>. The assistance over 1996-99 will focus more in-depth on (i) general policy support, (ii) promotion of active labour market measures, and (iii) institution-building. | <p>1996-1999</p> <p>1996-1999</p> <p>1st half 97</p> <p>1996-1999</p> |
| | <p><u>Member States :</u></p> <ul style="list-style-type: none"> • provision of instructors, the providing of study grants in Europe, support for the teaching of European languages in Ukraine, information exchange networks and sponsorship of university institutions. | |

3. UKRAINE'S PLACE IN EUROPE'S SECURITY ARCHITECTURE

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---|--|------------------|
| <p>cooperation of Ukraine with the <i>Stability Pact</i>, the <i>NEAP and PjP</i> and also with the <i>WEO</i> , support for <i>regional cooperation</i> efforts.</p> | <p><u>CFSP :</u></p> <ul style="list-style-type: none"> • strengthening of political meetings at <i>various political levels</i> with the possibility of organizing summit meetings where necessary; <p>1. security questions:</p> <ul style="list-style-type: none"> • <i>strengthening of the political dialogue on security matters</i>, and provision of information for Ukraine on the Union's policy in this area; • <i>development of existing cooperation</i>, and of contacts with specialists (particularly on the questions of illegal trafficking in nuclear materials); • <i>development of joint action</i> with Ukraine <i>in the sphere of international relations</i>, and association of Ukraine on a case by case basis of the steps taken by the Union (on questions such as the CTBT, mines and non-proliferation); • <i>promotion of the ratification of international treaties</i> by Ukraine; • <i>further consideration within the Council on the position of Ukraine in the European architecture of security</i>; • <i>further support in the development of OSCE</i> and its work on a European security model, in cooperation with Ukraine. <p>2. foreign policy questions:</p> <ul style="list-style-type: none"> • <i>strengthening of political dialogue</i>; • <i>consultations with Ukraine prior to particular events</i> (such as UNGA); • <i>specialist consultations with the CFSP group</i>, and on an ad hoc basis. <p><u>Community (Takis) :</u></p> <ul style="list-style-type: none"> • with respect to regional cooperation, strengthening of assistance by <i>the improved coordination of the existing assistance programme and the development of synergetic links</i> (Takis, Phare, Meda, Black Sea cooperation, relations of Ukraine with countries of Central and Eastern Europe). | |

4. SUPPORT FOR REGIONAL COOPERATION

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---|--|----------------------------------|
| <p>a) Black Sea <u>Tacis</u> : various projects for the environment.</p> | <p><u>Community</u> :</p> <ul style="list-style-type: none"> • further <i>consideration within the Council</i> on the development of this region; • <i>better coordination of existing assistance programmes and development of synergetic links</i> (Tacis, Phare, Meda, Black Sea cooperation, relations of Ukraine with countries of Central and Eastern Europe). • <i>development of cooperation with the IFIs</i> in spheres such as transport, the environment, energy and tourism. | |
| <p>b) Cooperation with Central Europe</p> | <p><u>Tacis</u> : utilization of the programme of trends-frontier cooperation to develop cooperation between Ukraine and its neighbours to the west, particularly with respect to:</p> <ul style="list-style-type: none"> • the development of regional and local cooperation, • the environment, • the management of frontier posts, • transport (TENs). <p>For the TENs :</p> <ul style="list-style-type: none"> • <i>support for the organization of a conference in Ukraine</i> on transport corridors, • <i>assistance to the preparation of Ukraine for the Pan-European transport conference.</i> | <p>May 1997</p> <p>June 1997</p> |
| <p>c) Cooperation with the NIS <u>Tacis</u> : cooperation since 1992 on networks, the environment, agriculture.</p> | <p><u>Tacis</u> : utilization of the "inter-state" programme for the development of joint projects particularly regarding the environment, energy, transport and telecommunications. Development of joint projects with the NIS on telecommunications.</p> <ul style="list-style-type: none"> • <i>support to the participation of Ukraine in the NIS work group for the rehabilitation, modernization, and the rationalization of oil pipelines (transport of oil and gas);</i> • <i>development of transport corridors II and IX</i> of the TEN; | <p>Under way</p> |

5. THE DEEPENING OF CONTRACTUAL RELATIONS

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---|--|--|
| <p>5.a) achievement of the potential of the PCA</p> <ul style="list-style-type: none"> • ratification of the PCA by five Member States and the European parliament; • assistance in the adapting of Ukrainian legislation to the principles of the PCA, • development of the spheres of cooperation enshrined in the PCA. <p>Tacis : until now, the assistance for the environment has mainly covered regional projects, particularly the Black Sea.</p> | <p><u>Member States :</u></p> <ul style="list-style-type: none"> • <i>ratification of the PCA</i> | 1st half 97 |
| | <p><u>Community + Member States :</u></p> <ul style="list-style-type: none"> • <i>advance implementation of aspects of the PCA to the extent this is possible;</i> • <i>further assistance in the adapting of Ukrainian legislation to the principles of the PCA,</i> • <i>and to the development of the spheres of cooperation enshrined in the PCA, particularly:</i> | Immediate |
| | <p>5.a.1 The environment</p> <p>In line with the new Tacis regulation, more environment-related activities will be incorporated in the annual programmes. Projects related to: <i>waste water, solid waste management, industrial pollution control, district heating, hazardous waste management and biodiversity</i> will be developed and supported <i>in addition to horizontal measures.</i></p> | |
| | <p><i>Given the pan-European Ministerial Conference on the Environment in Aarhus, Denmark, which is expected to focus largely on the NIS environment, the EC will promote the cooperation of Ukraine with central Europe and the NIS, more specifically in:</i></p> | June 1998 |
| | <ul style="list-style-type: none"> • <i>further developing both the Ukrainian National Environmental Action Plan (NEAP) and local environmental plans, on the basis of the principles enshrined within the Environment for Europe process and its Environmental Action Programme for Central and Eastern Europe;</i> • <i>strengthening of the environmental centre in Kiev as part of a NIS-wide network of the "New Regional Environmental Centre (NREC)" project, from 1996 onwards;</i> • <i>continuing to support Ukrainian participation in the Black Sea Environment Programme, established in 1993, particularly in implementing its obligations of the Black Sea Strategic Action Plan signed in Istanbul on 31 October 1996, centered upon the Regional Activity Centre for special Pollution Monitoring at the National Scientific Centre of Sea Ecology, in Odessa.</i> • <i>supporting environmental projects developed by local and regional actors of Ukraine with the local and regional authorities on the other side of Ukraine/CEEC border.</i> | 1996-97 1997 1997 1997-98 |

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|--|--|------------------|
| <p>Member States : Under bilateral assistance, five²² EU Member States are implementing activities in the Agriculture sector in Ukraine, of which three with significant extended activities (Germany, United Kingdom, the Netherlands).</p> | <p>5.a.2 Agriculture</p> <ul style="list-style-type: none"> • <i>increased coordination to be insured with major donors</i> involved in this sector. • <i>Various measures will address the need for post privatization restructuring and development of enterprises, support the development of credit facilities for private farmers, as well as of agro-industrial and agro-services enterprises in general.</i> | 1st half 97 |
| <p>Tacis : The Programme grant financed 25 projects to the sector under the annual Action Programmes for more than 31 MECU. 16 projects already completed and 9 still under implementation. Ongoing projects will be completed in September 1997.</p> | <p>5.a.3 Industrial cooperation</p> <ul style="list-style-type: none"> • Industrial Policy Dialogue : constitution of a working group to identify areas where cooperative action is feasible with the private sector. Sectors with high added value (food products, engineering, consumption industries) are to be given priority. • The Commission will pursue its local cooperation with business circles, particularly its participation in the "Euro-business club"; • Organization of round tables with the heads of Ukrainian enterprises to exchange experiences, give advice and initiate joint initiatives • Creation of a network of advisors for sectors of the economy ("Advisory business councils"), offering the Commission and the Ukrainian government their experience on the policies to be implemented with respect to investment, industrial policy, technology policy... | Immediate |
| <ul style="list-style-type: none"> • <i>productivity initiative</i> supported since 1995; | <p>Community (Tacis) :</p> <ul style="list-style-type: none"> • A Tacis project on the restructuring of the iron and steel industry (ECU 1 million) is going to start. This could lead to subsequent assistance on drawing up projects for restructuring enterprises; • the new Tacis regulation provides for the promotion of industrial cooperation and support for the establishment of joint ventures through the funding of equity investment in small and medium-sized companies. (JOPP) <i>A specific initiative for Ukraine could be developed on the basis of local needs;</i> | 1997 |
| <ul style="list-style-type: none"> • Ukraine enjoys the benefits of the Business Cooperation Centre; | | |

²² Germany, the Netherlands and the United Kingdom ,France and Sweden

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---|--|--------------------------------|
| <p><u>Commission :</u> R&D cooperation with Ukrainian participants started in 1992 with the International Agreement on Scientific Collaboration between the EC and the Ministry for Chernobyl Affairs. Research was carried out on health issues, the environment and emergency management. In 1993 in the framework of the International Association for the promotion of cooperation with the scientists of the New Independent States (INTAS) started and was expanded in 1994 with participation in 5 specific programmes of the 3rd Framework programme (PECO) and promotion of joint projects and networks (COPERNICUS). 35 projects were financed under PECO for a total amount of 521.750 ecu (environment, non-nuclear energy, nuclear fission safety, biomedicine and health, human capital and mobility). 12 projects were financed under COPERNICUS for a total amount of 332.600 ecu (information technology, communication technologies, telematics and language engineering, manufacturing production, processing & materials, measurement and testing).</p> <p>Ukrainian scientists can take part in all EU RD projects under the <i>4th Framework Programme</i> (1994-98).</p> | <ul style="list-style-type: none"> • link-up of Ukraine to the BC-Net of the SME; • continuation and <i>strengthening of coordination of action with EBRD</i>; • activities over the next years will focus on know-how transfer, feasibility/viability studies and pro-active consultation with Ukrainian operators; • <i>la training of staff and managers for industry</i> under the "Productivity Initiative" programme. <p>5.a.4 Scientific and Technical Cooperation</p> <p><u>Community :</u></p> <ul style="list-style-type: none"> • cooperation programmes in RD should be actively encouraged, mainly through <i>increasing support for the USTC</i>²³, exchange of young scientists, information exchange networks; • <i>obtaining of mandate to participate in USTC</i>; • <i>implementation of programmes as foreseen in the PCA</i>, like Copernicus, CEEC countries, etc.); • possible <i>Information Seminar in Kiev</i> to be explored if the Ukrainian side signals an interest in this. <p>5.a.5 Battle against organized crime and money laundering</p> <p><u>Commission + Council + Member States (2nd and 3rd pillar)</u></p> <ul style="list-style-type: none"> • the developments in the field of security, the measures involved in the battle against organized crime and illegal migration require <i>increased cooperation by the Commission and the Member States and also by the Ukrainian side</i>. • <i>a regional study on the 3rd pillar is to be launched</i> as the start of the necessary cooperation between the EU and the NIS in this sphere. | <p>1997</p> <p>1st half 97</p> |

| | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|--|--|---------------------------------|
| | <p>5.a.6 Transport</p> <p><u>Community :</u></p> <ul style="list-style-type: none"> • priority in <i>assistance for the trans-European networks programme</i>, in particular with respect to the multi-mode connection of Ukraine's national transport systems with those of the rest of the continent; importance of the improvement of border crossings in this context; • legal and technical advice for the <i>adoption of more transparent legislation on calls for tender, the reorganization of the road transport sector, privatization of transport</i>; • <i>development of the preparatory stage of investments in infrastructures in close coordination with EBRD.</i> <p><u>Community + Member States :</u></p> <ul style="list-style-type: none"> • action aimed at ensuring non-discriminatory treatment of air carriers flying to Ukraine • assistance in the <i>organization and training of officials</i>; <p>Possibility of including Ukraine in such multi-lateral events/conferences as the next EU/CEEC Information Society Forum, which will take place in Brussels. It would be helpful if Tacis could meet the costs of Ukrainian participation in this (or an equivalent meeting) in the same way as Phare has done for CEEC countries.</p> | <p>Autumn 97</p> <p>Nov. 96</p> |

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---|---|---|
| <p>5.b) Development of bilateral commercial exchange</p> <ul style="list-style-type: none"> assistance to Ukraine in the matter of its gaining membership to the WTO with the intention of <i>adapting its commercial legislation to international practice and also to the principles of the Interim Agreement</i>, particularly in the sphere of standards and of the registration of intellectual and industrial property. anti-dumping policy: the position of the Commission, spelt out during the Joint Committee of May 1996, rests on the following elements : antidumping rules are an integral part of the rules governing the multilateral trade system, actual anti-dumping measures affect a very limited share of EC trade with Ukraine, amounting to less than 1% of Ukrainian exports in 1994. Eight products are affected. Two seminars on antidumping policy already took place in Ukraine. | <p>Community :</p> <ul style="list-style-type: none"> creation of a <i>joint working group (EC + Ukraine.)</i> responsible for identifying causes of imbalance: study of measures to achieve trade balance, identification of various forms of obstacles, an alert system and following up decisions; <i>entry into force of the PCA will confirm the date set in Article 4. This prospect underlines the importance of continuing the economic reform process.</i> steel trade : <i>the Commission will start negotiations on 28-29 November in Kiev for a new ECSC agreement.</i> The directives foresee a longer 5 years agreement, seeking improved market opening in the Community with the possible eventual abolition of quantitative restrictions for Ukrainian steel products, in exchange for the achievement of appropriate market conditions within the Ukrainian economy, namely "the application of disciplines no less stringent than those applied in the Community, concerning competition and state aids". This offer will be a major prospect of market opening. textiles: <i>during 1996-99, gradual forthcoming liberalization of the Community regime towards Ukrainian products in accordance with the PCA.</i> membership of WTO : <i>further assistance in the adapting of commercial legislation to international standards, in accordance with the PCA and with a view to the membership.</i> anti-dumping : <i>organization of seminars for officials;</i> <i>Commission available to examine the granting of individual treatment to producers in non-market economies that provide evidence that they operate without state interference.</i> | <p>November 96</p> <p>1998</p> <p>November 96</p> |

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---------------------------------|---|------------------|
| 5. c) development of investment | <p><u>Community (Takis) :</u></p> <ul style="list-style-type: none"> • assistance in <i>developing the secondary market of shares of privatized companies</i> (assistance to the Stock Exchange related to the setting up of custodians, the control and supervision of capital markets and staff training). • support to financial sector for the <i>introduction of international accounting standards by Ukrainian banks.</i> <p><u>Member States :</u> the promotion of investment under the auspices of the PCA (art. 54 of the PCA), requires the Member States to intervene. Research into investments guarantee systems, <i>development of a system for promotion of trade/ bilateral Chambers of Commerce.</i> Germany announced the establishment of a German-Ukrainian fund for SMEs, as a preliminary stage for a bank providing credits to SMEs.</p> | |

6. ASSISTANCE TOWARDS REFORM OF THE ENERGY SECTOR

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|--|---|------------------|
| <p>6. a) restructuring of the energy sector</p> <ul style="list-style-type: none"> • The Community has put aside ECU 55 million for the 1991-96 period, i.e. 35% of its technical assistance to Ukraine, to energy and 24% to nuclear safety?. <p>Principal guidelines :</p> <p>(i) support for the implementation of the decentralized, competitive structure of production and distribution, based on prices reflecting costs;</p> <p>(ii) support for measures of energy savings and improvement of energy efficiency, particularly in industry;</p> <p>(iii) support for the modernization of production equipment.</p> <ul style="list-style-type: none"> • The EBRD committed ECU 150 million in Ukraine in 1995; it is to commit ECU 200 million in 1996, chiefly in the private sector. | <p><u>The Community</u> : will continue to develop a global approach for progress across all areas of energy production and usage, including energy efficiency:</p> <ul style="list-style-type: none"> • create a structured dialogue with Ukraine on energy policy, to revitalize the sector within a competitive market focus and to ensure security of supply and energy diversification for both the EU and Ukraine; • define co-operative schemes, reinforced by exchanges of institutional experience and technological know-how; • promote funding of selected schemes through collaboration with appropriate financing institutions, especially the EBRD; • continue support to the restructuring of the power sector according to sound economic principles (least-cost options, cost-based tariffs and efficient system of bill collection); • continue efforts to implement energy efficiency policies and programmes in all sectors of the Ukrainian economy; • promote a global approach to the restructuring of the coal sector, taking into account the social dimension in Ukraine, especially in the Donbass region; • secure transit arrangements for oil and gas, which is important both in meeting European Union energy import needs and in providing a source of revenue to Ukraine: support to the participation of Ukraine to NIS working groups on rehabilitation, modernization and rationalization of oil and gas pipelines; • encourage the development of legislative and financial frameworks within which industrial co-operation and joint ventures in the energy field can be established. • ratification of the Energy Charter Treaty to achieve these objectives. | <p>1996-1999</p> |

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|--|--|--|
| <p>6. b) nuclear safety</p> <p>The EC plays an essential role in the implementation of the EU/G7 Plan formulated in Naples in 1994 for the restructuring of the nuclear sector and particularly the closure of Chernobyl.</p> <p>As a member of G7's Working Group for Nuclear Safety, the Community participated in the elaboration of the action plan and the negotiations.</p> <p>The Community is financially committed to assist Ukraine in the implementation of the Plan.</p> <p>The Community has <i>financed research</i> in the following areas:</p> <ul style="list-style-type: none"> * <i>phasing out of reactors 1, 2 and 3 of the Chernobyl power station</i> * <i>ensuring the safe condition of the damaged reactor (sarcophagus)</i> * <i>completion of the Rovno 4 and Khmel'nitsky 2 reactors (project management, on-site inspection, engineering with a view to obtaining of loan)</i> <p>The Community participates in the <i>financing of the new installations necessary for the phasing out of Chernobyl.</i></p> <p>The EBRD is participating in the financing of G7 Plan measures for Chernobyl and is managing the \$ 200 million Nuclear Safety fund (NSA)</p> | <p>Community :</p> <ul style="list-style-type: none"> • contribution to the <i>implementation of the agreement providing for the closure of Chernobyl in 2000.</i> • <i>decision within the G7 of supplementary funds to be provided project by project.</i> <p>(i) the granting of the Euratom loan to finance the completion of the two reactors at Rovno and Khmel'nitsky if the current study confirms that this is the least cost solution as required in the MoU,</p> <p>(ii) the Community, together with its G7 partners, will have to take important political decisions regarding the necessary measures to assure the safety of the shelter (Chernobyl unit 4).</p> <p>(iii) The provision of Ukrainian funds planned under the MoU will also have to be confirmed.</p> <ul style="list-style-type: none"> • <i>Continuation of ongoing programmes</i> in order to insure an increased level of protection and safety of existing nuclear power stations. | <p>Mid-1997</p> <p>Mid-1997</p> <p>Mid-1997</p> <p>1996-1999</p> |

| <u>Measures implemented :</u> | <u>Measures to be implemented :</u> | <u>Timetable</u> |
|---|--|------------------------------|
| <p>6. c) economic, social and environmental regeneration and secondary medical effects of Chernobyl</p> <ul style="list-style-type: none"> The Joint EU-Ukraine-US project to <i>develop an action plan to address the social impact of closing Chernobyl Nuclear Power Plant (CNPP)</i> commenced in October 1995, in response to the request from Ukraine to include this topical issue in the G7-Ukraine MoU. A number of project activities have been initiated at a local level, i.e. in the Slavutich region and the CNPP. They have resulted in a cooperative working environment with the key local actors who will be most affected by the closure. <i>Clean-up and secondary medical effects of the Chernobyl accident</i> were already tackled through the Tacis Nuclear safety programme from 1991 to 1995, concerning in particular studies on the use of contaminated soil, radioactive waste treatment, development of thyroid cancer and its treatments, abstraction of ground water for domestic potable supply, use of contaminated forestry waste. | <ul style="list-style-type: none"> the EC will further contribute to the <i>establishment of a programme aimed at alleviating the major social consequences of closing CNPP</i> and an appropriate structure to administer the initiatives contained in the "closure package" through ways of training schemes, surveys (on population, labour mobility, compensation mechanisms), information campaigns to inform population on the ways it will be affected by the closure. There shall be a <i>continuation of past activities</i> through the Tacis programme at a regional level, involving in particular the main contaminated populations and areas of Ukraine, Belarus and Russia, with the objective to try and <i>define an overall long-term strategy</i> to tackle these issues. | <p>1996/1997</p> <p>1997</p> |

Annex I : THE TACIS PROGRAMME FOR 1996-99 IN THE CONTEXT OF THE NEW TACIS REGULATION

The new Tacis Regulation, adopted in June 1996, does not alter in any respect the general approach of the previous regulation, i.e. it still focuses on the transfer of know-how in key sectors of reform. There are however some important innovative elements that allow the Tacis programme to have a broader set of instruments to assist the New Independent States in their reform process towards an open market economy with democratic institutions. These elements are particularly relevant for a country like Ukraine and they are mainly the following:

- assistance may cover costs related to *small-scale infrastructure projects* in the context of border-crossing facilities;
- the programme shall support the *establishment of joint ventures* through the funding of equity investment in small and medium-sized companies;
- due regard shall be taken of the *promotion of equal opportunities for women* in recipient countries and of *environmental considerations* when designing and implementing programmes;
- particular attention will be paid to *border-crossing facilities on borders between the New Independent States and the Union, and the New Independent States and central Europe*, as well as to measures on the Finnish-Russian border;

Moreover, the Regulation encourages once again coordination and cooperation with the international financial institutions along these lines.

The Tacis Indicative Programme for Ukraine for 1996-1999 has been prepared, negotiated, approved and signed on September 11, 1996. It will concentrate on three priority areas: institutional reform and development, support for economic reforms and private sector development, energy and environment. Within the first priority, the measures foreseen will aim at implementing the PCA provisions and adapting the institutional framework conducive to a democratic and market based society, forming the administration and developing the civil society. Within the second priority, three objectives will be pursued: the transfer of existing economic activities from the public sector to the private sector, the restructuring and development of privatized companies, the start-up and development of new economic activities by the private sector. Under the third priority area, assistance shall concentrate on the support of an overall sectoral reform policy while reducing the energy dependence of Ukraine, and envisage activities in the field of environment at horizontal as well as vertical level, within the scope of the Regulation, starting from projects aimed at increasing public awareness in this area.

The Tacis Programme for 1996-1999 for projects benefiting Ukraine has duly taken into account these innovative elements of the new Tacis regulation. Indeed, environment issues will be considered in the development of projects at national and regional level; the programme JOP will, hopefully successfully, be developed in Ukraine for developing joint ventures based on specific local needs; cross-border cooperation and measures promoted at decentralized level by local and regional actors of Ukraine will be supported in the regional programmes for common environment projects as well as management of border posts and the development of the TENs all over Europe. In this latter context, extensive use could be envisaged of small-scale infrastructure projects.

The Commission shall therefore make technical assistance and small-scale infrastructure facilities for border crossings available to Ukraine for 1996-1999. Efficient and optimal use of these instruments will very much depend on the reform path that Ukraine will have followed all along this period.

Annex II : INTERNATIONAL AID TO UKRAINE

| International aid 1991-1995 : | Grants | loans | Total |
|--------------------------------|------------|-------------|-------------|
| European Union (mecu) : | 871 | 1436 | 2744 |
| of which : | | | |
| Community : | 340* | 815 | 1155 |
| Member States : | 556 | 1033 | 1589 |
| USA : (\$ in mecu) | 558 | 494 | 1052 |

1. Aid from the Union : the EC has implemented a series of instruments to assist Ukraine in its transition to a market economy and a democratic society. The technical and financial assistance may be calculated, including all instruments, at **ECU 2.8 billions**, of which 1215 comes under the Community: Tacis: ECU 400 million (grants); loans for the balance of payments: up to ECU 285 million for 1995-96, the rest coming from the Member States (ECU 1589 million of which ECU 556 million are grants and ECU 1033 million are loans). Some Member States are very involved in Ukraine on a bilateral basis and all of them are through their contributions to international institutions such as the IMF, the World Bank and the EBRD.

a) technical assistance: the Tacis programme represents **ECU 400 million over 1992-95** of which 105 million was for nuclear safety and ECU 62.5 million constituted the EU's contribution to the G7 Plan for Chernobyl. About **ECU 538 million are planned for 1996-99** with the following priorities: support for the legislative and regulatory institutions and the retraining of staff, enterprise reform and the development of the private sector and the reform of the energy sector and the environment.

The total Tacis undertakings which will benefit Ukraine under the 1996 budget are estimated at about ECU 108 million in the form of grants. The national allocation (ECU 38.5 million) is already committed, as is the 1996 Tacis contribution under the EU/G7 Plan for the closure of Chernobyl (ECU 37.5 million). To this is added the measures provided as topic programmes, such as the Democracy, Nuclear Safety, Inter-state ... programmes, estimated at **ECU 32 million**.

b) aid in the restructuring of the energy sector has constituted a priority of Community assistance since the beginning. This position is enshrined in the approach of G7, which has established a link between the measures for the closure of Chernobyl and the long-term reform of the energy sector in Ukraine. The Community's aid has been concentrated on the **reorganization of the energy sector**, the improvement of the efficiency of the production process in the oil, gas and coal sectors, and also in energy savings, for a total of **ECU 55 million**.

For nuclear energy, the EC participated in the G7 Plan decided on in Naples in 1994. This provided overall measures for the restructuring of the nuclear sector and, in particular, the closure of Chernobyl, in the framework of the MoU signed on 20.12.95 with Ukraine. The financing will comprise grants, loans and local funding. The European Community has committed itself to put ECU 500 million in this action over three years (100 million from Tacis, 400 million of Euratom loans). The actual contribution of the EC has already been determined: 1994; ECU 25 million; 1995; ECU 37.5 million; 1996; ECU 37.5 million, of Tacis credits.

c) macro-financial assistance: the EC paid Ukraine in 1995 a first loan to the balance of payments of ECU 85 million. The Commission is currently implementing the decision of the Council of October 1995 to grant a second loan up to a maximum of ECU 200 million. This aid is linked to the registering of progress on the nuclear question and to the furtherance of economic reforms. It is granted under particularly favourable financial conditions and is subject to a condition of the sharing in the settlement of the aid between the international donors.

d) humanitarian aid - ECHO has financed humanitarian measures in Ukraine of a total amount of 1994; ECU 3.3 million; 1995; ECU 0.5 million; 1996; ECU 0.8 million. These measures, intended to deal with the consequences of the Chernobyl nuclear accident, have mainly consisted of the sending of equipment and medicines for detecting and monitoring of cancer. Ukraine has also benefited from programmes covering several countries (Russia, Ukraine, Belarus), for an amount of ECU 0.9 million in 1994, ECU 1.4 million in 1995 and ECU 0.5 million in 1996.

2. Aid from the USA: \$1405 million between 1991 and 1995 mainly to the support of democracy, the restructuring of the economy, the private sector, energy and financing linked to nuclear non-proliferation (\$403 million between 1992 and 96). To this is added \$400 million of commercial credit between 1992 and 96. Aid of \$225 million is planned for 1997.

3. Other sources of aid (international aid)

- **aid from the World Bank and the IMF:** \$3.500 million of loans since 1994 of which \$2 billions were in 1996; planned for 1997: a balance of payment loan of \$550 million and loans of \$200 million linked to projects; discussions in progress with the IMF for a loan of \$3.1 billions over 3 years, and also a stabilization fund of \$1.5 billions linked to the introduction of a new currency.
- **aid from the EBRD:** ECU 150 million was committed to Ukraine in 1995 and this should amount to ECU 200 million in 1996, mainly in the private sector. The EBRD participates in the financing of the measures of the G7 Plan for Chernobyl and also through the Nuclear Safety Fund of \$200 million (NSA) administered by the bank.
- **loans linked to the reform of the energy sector and to nuclear safety,** approved or under negotiation for 1996-97: World Bank, \$1,409 million; EBRD, ECU 975 million, (pm : Euratom, ECU 400 million).
- **loans linked to disarmament:** \$234 million promised in November 1994 by several European countries (conversion of defence industry, training of personnel, etc), \$350

million committed by the USA and \$1 billion promised by the USA and Russia in the form of compensation (mainly nuclear fuel).

Annex III : THE ECONOMIC SITUATION OF UKRAINE

1. The economic situation

a) the Ukrainian economy is faced by considerable challenges: transformation from a planned economy heavily centered on heavy and military industries, controlled from abroad, to a market economy; an energy price crisis greater than that facing the West in the 1970s; a reshuffle of its trade markets. These challenges were aggravated by the absence of reforms between 1991 and 1994, a period of marked recession (economic activity had fallen in 1994 to half the level of 1990), hyper-inflation (over 10,000% in 1993), and budgetary deficit.

The success of the economic transformation is a necessary condition for the maintenance of independence. It also constitutes the main preoccupation of the population.

b) the policy of macro-economic stabilization implemented since October 1994 has given impressive results : reduction of inflation to 0.1% per month in July 1996, reduction of the budget deficit to 4.2% in the first half of 1996, relative currency stabilization. However, a serious crisis of budgetary liquidity has developed (1.5 billion of unpaid public salaries in August 1996).

c) micro-economic liberalization has been taken on (liberalization of internal and external trade and prices, and the reduction of state intervention). **Structural reforms** (privatization and conversion of enterprises, reform of the state administration and of the tax system) have begun.

The EU recognized in May 96 that Ukraine was an economy in transition. In fact, with respect to the liberalization of the economy and of the share of the private sector, Ukraine is in the last group among countries in transition, according to World Bank figures ("From Plan to Market"). In practice **the transformation of the economy is colliding against strong political resistance**, a conservative parliament, vested interests of the former nomenklatura in the economy and the administration, the low level of the standard of living of the population and of capital available for investment.

d) the economic situation is uncertain: GDP in real terms is 42% of the 1989 level, production is still falling (currently less than 35% of the 1990 level in industry and 65% for agriculture). However this does not record the dynamism of the underground economy, which is estimated to be 50% of GNP and of services.

e) investment is insufficient : (foreign investment: about \$200 million in flux for 1995, \$950 million in stocks since 1989, against \$3.9 billions in Russia), the liberalization of the economy and privatization being incomplete, and the treatment of foreign enterprises being perceived as uncertain (instability of the legal framework, arbitrary behaviour by the administration, absence of reliable commercial courts). This situation has up till now deprived the Ukrainian economy of an essential backing of economic dynamism.

f) the population is affected, which substantially reduces the room for maneuver of economic policy. Real wages are 35% of their 1990 level (the average wage is \$78 per month, below the estimated minimum requirement of \$100). A "glimmer of social security"

was introduced in March 1995 and pensions doubled in April 1996 in order to partly compensate for the introduction of market mechanisms for the most destitute.

The regular payment of wages constitutes a prerequisite to restoring confidence in the government's economic policy.

2. The state of implementation of reforms :

- **macro-economic stabilization: reduction of budget deficit** (this fell from 23% of the GNP in 1992 to 4.2% in the first half of 1996. Public expenditures were reduced from 58% of GNP in 1992 to 40% in 1996); establishment of a **restrictive monetary policy** (limitation on money creation, freezing of bank credits to the private sector); **tax reform** (introduction of VAT law on the taxation of companies).
- **price liberalization**, particularly of publicly set prices, rents and charges (80% of the actual price is invoiced), of energy and of basic living goods, is complete for enterprises, still partial for individuals. Since January 1996 the government has stopped covering payment defaults by consumers. However, since these, in particular the enterprises, are still not paying their energy bills, the suppliers are accumulating a large debt.
- **the liberalization of foreign trade and exchange** is well advanced, in spite of the persistence of administrative obstacles. Negotiations for membership of Ukraine to the WTO are progressing. The relative stability of the currency has enabled a new national currency, the Hryvnia, to be introduced in September.
- **the privatization of enterprises** has been delayed due to the complexity of the procedure adopted and the political opposition of the parliament. The latter has, for the fourth time (in July 1996), adopted a draft law which is unfavourable to the privatization of the food-product industry.

"Small privatization" is well advanced: 33,000 small enterprises had been privatized by 1 July 1996 (out of 45,000) and 2,100 medium and large enterprises (out of 8,000). There has only been limited privatization of land (33,000 private farms, representing 1.8% of the agricultural land of the country).

Access to foreign investors is restricted: although in principle it is guaranteed by law (treatment as for nationals), in reality it is subject to numerous restrictions (priority given to employees, some shares are reserved for the state, reduced periods of publication, land is excluded). There is no secondary market and the law on bankruptcies is defective. One thousand enterprises are excluded from the privatization process.

Beyond privatization, **the operating conditions of the private sector** remain very **difficult** : high, complex and discriminatory taxation, restrictive attitude by the administration, Mafia payments.

3. The government has announced a huge reform programme for 1997 centering on micro-economic liberalization, the return to growth and the integration of the underground economy into the legal one. However, this programme still has to be accepted by Parliament. The measures under way or envisaged include: **administrative reforms** - simplification of the government organizational structure, and development of the rule of

law in economic matters (establishment of a bankruptcy law and of a reliable system of commercial courts); **tax reform** of the taxable base, the rates and the methods of collection, so as to improve the budget balance and reduce the share of the underground economy; **restructuring of the state budget**, particularly with a reduction of grants to the economy and a better allocation of resources in favour of health and education costs, reform of the pension system (particularly, the creation of autonomous pension funds, independent of the state budget); **reform of the financial system** (consolidation of the independence of the central bank, introduction of a reliable mechanism of regulation and supervision of banking activities), development of a stock (and bond) exchange to mobilize domestic savings and foreign investment; **further privatization** (large enterprises, land, commercial assets), closing of loss-making mines; **further trade liberalization**, improvement of access to the Ukrainian market for foreign products and investments, implementation of the legislative and regulatory conditions for joining the WTO.

4. Various figures on the Ukrainian economy:

GDP : \$44.3 billions in 1996. The GDP in real terms has fallen since 1989 (-40% between 1989 and 1993, -24.3% in 1994, -12% in 1995, -8% predicted for 1996). The black economy is estimated at 50% of GDP. The IMF predicts a recovery in 1997 (+3%).

Production : consistently falling since 1990. Real industrial production is at 35% of the 1990 level, agricultural production at 65%.

Inflation : clearly improved, **2% monthly in September 1996**. The rate of annual inflation has decreased from 375% in 1995 (the first year without hyper-inflation) to 45% in 1996.

Foreign trade : CIS 61%; EC 14.9%; USA 5.7%. See annex IV.

Balance of payments : deficit of \$5.7 billions in 1995, due to energy imports; deficit of \$3.2 billions predicted for 1996 and \$3.6 billions in 1997, before international financing. Foreign debt linked to energy: \$4 billion with Russia (rescheduling agreement concluded in February 1995), \$500 million with various creditors under Year 1995.

Employment : low official unemployment rate (1%). A recent study by the ILO calculated hidden unemployment at 34% (unpaid holidays, reduced working hours). Survival is widely obtained by a second job. Employment structure: agriculture, 20%.

Annex IV : TRADE & INVESTMENT ISSUES BETWEEN THE EC AND UKRAINE

1. Distribution of Ukrainian foreign trade : CIS 61 %; EC 15%; USA : 5,7%. Ukraine has significantly reoriented its trade relations since 1991. It increased its exports towards Western countries and now reaches a positive balance with the West in general, but not with the EC. However it remains very dependent on CIS countries, with a substantial deficit (- \$2.8 billions in 1995, \$ 4.5 billion in 96), due mainly to energy imports.

The EC is already Ukraine's main trading partner outside the CIS, with a share of 15% of Ukrainian foreign trade. Although the EU's increasingly positive balance, is a problem for Ukraine, **EC imports from Ukraine are also increasing** (+35% in 1994, +15% in 1995). They amount to four times those of the USA. Trade with the EC comprises mainly machine-tools, electrical machinery (EC exports), steel and metal, mineral, chemical and textile products (EC imports).

Trade data should be taken with caution as they only reflect part of the reality. There is a substantial amount of unregistered trade and barter trade (about 30%).

Latest EC-Ukraine trade data (in million ecu, 12 Member states) :

| | 1993 | 1994 | 1995 |
|-------------------|--------|--------|------------------|
| EC Imports: | 934.6 | 1253.6 | 1452.6 (+ 15,6%) |
| EC Exports: | 1474.8 | 1667.7 | 2061.8 (+23,6%) |
| EC Trade Balance: | +540 | +414 | +609 (+ 47%) |

15 Member States (1995) : imports : 1518.7 million ecu; exports : 2214 million ecu; balance : +695.2million ecu;

2. Regulatory framework : Ukrainian trade was in principle liberalized (no more state trading, withdrawal of tariff measures and quotas on exports, withdrawal of quotas on imports). However there are strong pressures by various ministries for a strategy based on support for exports and substitution for imports, in order to protect domestic products. Therefore administrative intervention is generally intent on preventing free trade.

Concrete obstacles remain such as **indicative prices for exports, import licensing regimes** for some products, which entail cumbersome and often arbitrary administrative control. **Export tariffs** were even recently reintroduced on some products namely ferrous scraps, non ferrous metals; following an EC request, the Ukrainian authorities promised to them rapidly. Such export restrictions create an unfair competitive advantage for domestic manufacturers as they get access to subsidized raw materials, and they may delay the process of industrial restructuring. They are against WTO rules and they are against the condition of the EU macro-financial loan that "no reversal shall be permitted in the liberalized trade and price regime".

The Community's objective is to eliminate these restrictions to trade, and it would deem a reversal from liberalization very negative.

3. Issues at stake in bilateral trade relations :

- There are recurrent complaints from the Ukrainian authorities that EC trade is not open enough. Complaints refer to the EC positive balance, to areas of trade which are subject to quantitative limitations like steel, textile, agriculture, as well as to the antidumping policy.

- The EC is concerned about unsatisfactory market access conditions in Ukraine for EC products and services, as European enterprises face numerous market access difficulties such as : tariff protection, discriminatory excise taxation regimes, technical barriers like non-transparent or discriminatory testing and certification requirements, pure discrimination by legislation, like the new law on public procurement which excludes foreign suppliers.

These issues were discussed in depth and arguments were exchanged at the May Joint Committee meeting, and the Commission agreed in September 96 to set up a joint working group in order to look for ways and means to improve trade relations.

4. detailed description of the bilateral trade issues.

i) market access issues in the EC for Ukrainian products :

a) the EC positive balance : the increase in EC import figures indicates that Community market access is not so restrictive. The existence of a trade surplus is a normal phenomenon with economies in transition as the latter still lack products which are competitive in western markets. The constantly falling trend of Ukrainian industrial production since 1990 indicate that this is largely an industrial problem.

Moreover the EC has made substantial trade concessions (most favoured nation treatment, General System of Preferences).

b) steel products : the current agreement on trade in steel products, signed in January 1995 (for two years, extended to June 97), has set up an increase in steel quotas of 35% in 1995 and 15% in 96. Quotas for 1995 have been fully used by Ukraine on flat products, but not on long products. The Commission had a first exchange of views on the new agreement with the Ukrainian authorities in October 96, in the framework of the ECSC contact group; it will start negotiations for a new ECSC agreement on 28-29 November (see last part of the main document).

It should be noted that the Interim Agreement already entails an obligation to remove state aid which are detrimental to mutual trade.

c) textile products : the new agreement concluded with Ukraine in November 1995 maintains existing quantitative limitations, except for five categories of textile imports where they are suppressed. The quota level was raised by 20%. This seems to be a satisfactory deal for Ukraine.

Textile trade with Ukraine has increased strongly in 1994, leaving a small surplus for the EC : EC imports = 117.8 million ecu, exports = 124 million ecu; surplus = 6.2 million ecu, reduced from 15.5 million ecu in 1993.

d) GSP : criticisms of GSP mainly stems from a lack of understanding of the Ukrainian authorities regarding the functioning and opportunities of the GSP system. Therefore the Commission has proposed at the Joint Committee to organize an information seminar. As regards the substance, a proposal for a revision of the preference levels was addressed to the Council, it foresees a 50% reduction of preferences for products of chapter 12, with the exclusion of these products in 1999. No change is expected as regards industrial products.

e) antidumping policy : antidumping is a recurrent political issue for the Ukrainian authorities who keep stressing the "adverse" effect of the ad. policy in relation with EU trade opening. The position of the Commission was spelt out during the May 1996 Joint Committee: Anti-dumping policy is an integral part of the rules of multilateral trade and as long as Ukraine is not recognised as a market economy the rules applicable remain those of reconstitution of real value, corresponding to state-run economies. The Commission reminded the Ukrainian authorities in May 1996 of the possibility of individual treatment for producers able to prove that they were producing without state intervention.

ii) market access issues in Ukraine for EC products and services :

This is a main issue for the EC, as European enterprises face numerous market access difficulties. A comprehensive note on barriers to trade in Ukraine was handed over to the Ukrainian authorities during the May Joint Committee meeting.

This problem of market access for EC products is interrelated with the issue of access for foreign investments. They have similar causes, namely misconceptions regarding the rationale of a free economy, reluctance to allow competition, and contradictory regulatory decisions. The consequences are also interrelated : they act as disincentives to potential foreign investors and the lack of competition and foreign investment delays the take-off of the Ukrainian economy.

The Commission considers that the removal of these obstacles is in the interest of the Ukrainian economy itself, as they hamper its integration into the world economy. Moreover they are contrary to the PCA and the WTO rules and Ukraine will have an obligation to remove them. The Community offered support for this through its technical assistance, as it

is already the case for standards with Tacis assistance to Derzstandardt, as well as for the WTO accession process.

Main obstacles :

§ **tariff protection** : a number of tariffs have been increased in recent months, whereas a standstill would be appropriate during WTO access negotiations, and information of the EC would be desirable;

§ **discriminatory excise taxation regimes**. Many excise rates are discriminatory to the detriment of imported goods. This is against national treatment for goods (Interim Agreement).

§ **technical barriers**, like non-transparent or discriminatory testing and certification requirements. Separate certification of car spare parts for already certified types of motor vehicles is an example. This is uncommon and useless, it is also against national treatment for goods (I.A.).

§ **discrimination by legislation**, like the new law on public procurement which excludes foreign suppliers. This is against national treatment for companies' operation (art.30 of PCA when ratified) as well as against WTO rules. The Ukrainian delegation at the Joint Committee indicated that the new law on public procurement is being revised so as to include foreign suppliers.

Another case is **air services taxation**. Ukraine imposes a discriminatory tax when a foreign carrier operates a route to or from Ukraine, which is not operated by the Ukrainian carrier. This tax is against commonly accepted international air policy principles and is imposed to the detriment of the development of air services with Ukraine;

The Ukrainian Delegation at the Joint Committee referred to the "Plan of priority measures regarding the accession of Ukraine to the WTO", approved by the Cabinet of Ministers on 18 March 1996, which foresees in particular to bring the Ukrainian legislation in conformity with WTO rules, regarding import licensing, public procurement and intellectual property; but no deadline was given for implementation.

iii) WTO : prospects for Ukraine's application :

The accession process of Ukraine to the WTO is going on, with the support of Tacis technical assistance. Problems raised by WTO members last year included the country's heavy dependence on barter (currently 30% of Ukrainian foreign trade), especially for agriculture, the rôle of state monopolies, export restrictions and high import barriers.

A WTO working party was set up in December 93 to define Ukraine's terms of entry, and has met for the 3 rd. time in June 1996 to examine Ukraine's trade policies.

This last meeting discussed the **customs tariffs** structure of Ukraine, as well as **market access in Ukraine** for goods and services. On the former issue, Ukraine made an offer with a fairly high tariff levels, liable to decrease to 14% on a weighted average basis until 2005.

5. Investment review : evolution of investment flows and current legal framework for investment in Ukraine :

This is a main issue for the EC, and it should also be for Ukraine, as foreign investment is essential to foster restructuring of the economy. (Investment promotion and protection is mentioned in art. 54 of the PCA). The Commission is concerned that foreign investment remains low in Ukraine, (an inflow of direct foreign investment last year in the order of between \$ 150 - 250 million), as privatisation has done little progress and the legislative and tax framework is still perceived as unpredictable. This brings the cumulative FDI since 1989 to between \$950 million), of which about 80 % are in the form of equipment, and quite a substantial part had been undertaken by Ukraine - G7 countries joint-ventures.

The new law concerning the "Regime for Foreign Investments" approved by the Werchowna Rada in March 1996, apparently does not give the adequate framework and guarantees liable to attract foreign investment. Too many exceptions written into this law raise doubts about the reliability and trustworthiness of its rules concerning national treatment to FDI, tax and customs duties privileges, long-term protection of FDI and repatriation.

Some improvements can be expected from the proposed establishment of the "National Agency for Foreign Investment promotion" and political pressure from outside like, for instance, by Western business groups, including the Kiev based European Business Club.

Without a radical change of mind translated into new transparent legislation, the insider and monopolist mentality will continue to discourage foreign investors and so delay considerably the necessary restructuring and modernising of the Ukrainian economy.

Annex V : NUCLEAR SAFETY IN UKRAINE

This is a priority for the Community as part of overall reform of the energy sector in Ukraine Assistance for improving safety chiefly concerns: functioning VVER-type power stations en fonctionnement, via programmes to provide on-site assistance, strengthening the safety authority and aid for the Chernobyl site.

i) The Memorandum of Understanding (MoU) on the closure of the Chernobyl Nuclear Power Plant signed on 21 December 1995 is a political agreement between the G7 and Ukraine in support of the decision of President Kuchma to close the Chernobyl NPP by the year 2000.

- **The elements for cooperation laid down in the MOU relate to : power sector restructuring, energy investment programme, nuclear safety, social impact plan. The MoU includes a list of specific projects which are to be implemented, namely the sarcophagus, short term upgrading of Chernobyl unit 3, preparation of decommissioning of units 1-3, new generating capacities to replace Chernobyl.**

- **The MoU also contains provisions concerning financial resources. The agreed principles for possible Western financial assistance necessary to supplement domestic Ukrainian resources are : revenue generating projects should be financed through loans, non revenue generating projects can be considered for grant financing. The MoU figures for Western financial support are : 1809 Million \$ as loan financing, 498 Million \$ as grant financing. These figures reflect loans and grants which were - at the time of the signature of the MoU -either firmly committed or likely to become available from the G7 members (including Tacis and Euratom), from the World Bank and from the EBRD for areas covered by the MoU. These figures do not include any provisions for the sarcophagus.**

- **At the Moscow G7 summit on 26 April 1996, the G7 Heads and President Kuchma confirmed that the MoU should be implemented in all its terms. They also agreed that specific discussions would be held on the sarcophagus once the EC Tacis financed study would be finished (before end 96).**

ii) The European Community actively contributes to the implementation of the agreement and has a firm intention of respecting the time periods envisaged. Preliminary studies financed by the EC at the cost of 100 million ecu (1994 : 25 million ecu; 1995 : 37.5 million ecu; 1996 : 37.5 million ecu), will enable the projected supplementary financing to be determined in the G7, project by project. The contribution by Ukraine specified in the MoU has also to be finalised.

Two measures are of particular importance for the Community over the period up to mid 1997, in order to support the decision of Ukraine to close the Chernobyl plant by the year 2000.. These measures relate to the financing of the completion of the two reactors under construction, the implementation of the necessary measures to assure the safety of the sarcophagus.

- **For the completion of the two reactors 70% of the investment (about 1000 Million USD) should be paid by loans from Euratom (up to 400 Mecu) and from the EBRD. The preparation of these financing decisions is under way. Safety, economic, environmental and financial due diligence has to be demonstrated. The EBRD and the Commission have agreed to entrust a panel of independent experts with a new least cost investment analysis. The financial due diligence will depend on Ukrainian decisions in the nuclear power sector, which should ensure that the borrower will be able to reimburse the loans.**

The current planning is to submit the loan decisions to the Commission and to the EBRD board by mid 1997.

- As far as the **sarcophagus** is concerned, a Tacis study by EC and Ukrainian experts with participation of US and Japanese experts will provide proposals for short and long term measures by the end of 1997. On the basis of the results of this study, the G7 should discuss possible solutions with Ukraine. It is expected that the cost of these measures will amount to several hundreds of million ecus over the next 10 years. There is at present **no identified financing source** available. This will however become a subject for consideration by the G7 within the next months, in particular in 1997 when the G7 chair will be held by the USA.

FINANCIAL STATEMENT

This document has no new budgetary implications.

The proposals relating to Community assistance are covered by line B7.52 : Technical Cooperation with the Independent States of the former USSR (the Tacis Programme). The amount of credits in the line for Ukraine for the year 1996 is ECU 38.5 million and the 1996 Tacis contribution to the EU/G7 Plan for the closure of Chernobyl is ECU 37.5 million. To this has to be added the measures specified under the heading of thematic programmes such as the Democracy, Nuclear Safety and Inter-state Programmes, estimated at ECU 32 million.

The financing of the Chernobyl dossier is yet to be decided within the G7 in 1997.

The final macro-financial assistance for 1997 will be the subject of a Council decision (15% of the amount to be established must be guaranteed from the budget).

ISSN 0254-1475

COM(96) 593 final

DOCUMENTS

EN

11

Catalogue number : CB-CO-96-608-EN-C

ISBN 92-78-11837-0

Office for Official Publications of the European Communities

L-2985 Luxembourg