SAGSUR Report

TOWARDS A DECISIVE PACKAGE OF REFORMS IN UKRAINE

Proposals on key reforms for public discussion

Coordinators and Editors:
Leszek Balcerowicz
Ivan Mikloš

August/September 2016

CONTENTS

CHAPTER I INTRODUCTION

Leszek Balcerowicz, Ivan Mikloš

CHAPTER II TRANSFORMATION OF THE STATE

II.1 Structures and Operational Procedures of the State
Jerzy Miller, Mirosław Czech

II.2 Local Government and Decentralization
Jerzy Miller, Mirosław Czech

II.3 E-administration
Jerzy Miller

II.4 Justice System Reform
Luba Zimanova Beardsley

II.5 Anti-corruption
Luba Zimanova Beardsley

CHAPTER III PUBLIC FINANCE

III.1 The Budget
Leszek Balcerowicz, Pavlo Kuhta, Ivan Mikloš

III.2 The Tax System and Tax and Custom Administration
Leszek Balcerowicz, Pavlo Kuhta, Ivan Mikloš

CHAPTER IV MAJOR FACTORS OF ECONOMIC GROWTH

IV.1 Privatisation and Corporate Governance of State-owned Enterprises
Andriy Boytsun

IV.2 Deregulation and improvement of business climate in Ukraine
Alexander Škurla

IV.3 Demonopolisation
Andriy Boytsun

IV.4 Energy Reforms
Karel Hirman (with cooperation of Andriy Boytsun)

IV.5 Land market in Ukraine
Alexander Škurla

CHAPTER V THE HEALTHCARE SYSTEM

Jerzy Miller

CHAPTER I INTRODUCTION

Leszek Balcerowicz, Ivan Mikloš

Ukraine has suffered from the legacy of incomplete reforms after 1991, bad policies under Yanukovych government and shocks produced by the Russian aggression. The present authorities have prevented the collapse of the Ukrainian economy but it was impossible, given this legacy, to avoid a deep recession.

Despite important achievements of the new authorities (preventing the macroeconomic collapse, some structural reforms, some reform legislation):

- a serious loss of confidence in these authorities has taken place both at home and abroad;
- the early stabilization results and the beginning of economic growth can not be taken for granted.

This situation has been largely caused by the objectives factors – the legacy of the past and the Russian aggression. A certain role was also played by the excessively "incremental" approach to reforms, i.e. the lack of a decisive package. Finally – and related to the second factor - the communication of both the problems and of achievements was rather a weak spot and could and should be much improved. However, given the loss of confidence, the improved communication should refer to facts and precise plans and not to the general declarations.

The government has presented an action plan, which contains the correct priorities and many necessary steps, based on the previous programmes (especially President's 20-20). The plan has opened the way to a decisive and much more difficult phase: **the implementation**. It was not the lack of plans but their incomplete or defective implementation which was so far the main problem. This has to change which requires a decisive action and much improved cooperation between the President, the Prime Minister and the cabinet and, the Parliament, which in turn demands clear and better procedures.

The implementation should take the form of a rapid introduction of a package of key reforms: Such a strategy:

- Benefits from the various synergies between key reforms;
- Promises that positive effects especially economic growth will strengthen before the next elections. **Delaying the key reforms would be the worse economic and political strategy;**
- Creates the best chance (if communication is improved) to restore trust in Ukrainian authorities, both at home and abroad.

The Russian aggression against Ukraine has complicated the Ukrainian economic situation but it is an additional argument for decisive reforms and not-against them. For only in this way Ukraine can stabilize and improve its economic and political situation. And only trough decisive reforms can Ukraine strengthen its economic growth – the only source of financing the necessary military spending.

There are two aspects of the package of key reforms: its timing and its content the package. As to the timing the package should be launched as early as possible this year.

Without waiting for the package, the steps which have already long delayed should be introduced, especially those which are subject to conditionalities on the part of the EU and the IMF.

Measures, which contradict to the agreements with these institutions e.g. trade “irritants” in the relationship with the EU should be quickly eliminated. **Steps which would reverse of successfully started but not completed reforms should be avoided at all costs as they would fatally weaken the credibility of the Ukrainian authorities.**

The package of key reforms should contain the most important steps, which are necessary and – taken together – sufficient:

a. to strengthen the fiscal and financial stability of Ukraine
b. to increase decisively the scope of free market
c. to enhance the rule of law and to reduce corruption
d. to improve the structure and operation of the state apparatus

The most important reforms create **a win-win situation**. For example:

a. Radical and lasting **deregulation** would both enhance economic growth, especially of the SMS’s and reduce corruption. It would also increase the credibility of the authorities.
b. Strengthening the **fiscal stability** is necessary for stabilizing the value of hrywnia which in turn is critically important for restoring the trust in the authorities. It Is also an indispensable basis for a lasting economic growth
c. Visible **reduction of corruption** would strengthen economic growth as well as the confidence in the authorities.

In the following we will offer some comments on what is required and what should be prevented in order to make a decisive progress towards the respective strategic goals. These and other topics are developed in the respective chapters:

1. Ukraine has avoided the fiscal collapse but the job of achieving a lasting **fiscal stability is far from finished**.
   - Ukraine holds a sad world record among the poorer counties in the **social spending** to GDP ratio. With such fiscal burden a rapid and lasting economic growth is not possible.
   - There will be no lasting fiscal consolidation without **pension reform** (eliminating pension privileges, raising the retirement age)
   - The position of the Ministry of Finance should be strengthen in order to ensure the fiscal discipline
   - All the authorities should respect the requirements of sound budget. The present chaos is incompatible with the stability of Ukrainian economy.
   - The ongoing work on the **Public Finance Management (supported by the EU) should be accelerated**.

2. A good progress has been achieved by the central bank in stabilizing and cleaning **the banking sector** but the job is not finished. The best strategy here is to continue a good cooperation with the IMF.

3. A quick package of decisive reforms is needed in **the enterprise sector:**
   - **Privatization** has been hopelessly lagging and should be radically accelerated. This matters both for the economic growth of Ukraine, for the reduction of corruption and for increasing the **credibility** of the authorities abroad.
     Corporatization is not a substitute for privatization. Only in a few selected cases corporatization, if involving truly independent directors can shield a firm against the interference from the politicians and the bureaucrats
   - Massive and lasting deregulation is a must. Many proposals in this field have been prepared but not implemented.
   - The government should prepare **the complete list of monopolies, both state and private,** so that Ukrainian economy can be radically **de-monopolized**. Other privileges of the oligarchs should be eliminated, too.
   - It is a high time to abolish the moratorium on the sale of land which blocks an important market and thus the economic growth in Ukraine.

4. The present **size and structure of the state apparatus** is a burden upon the economy and society and a source of a deep dissatisfaction among the people. Therefore, a key reforms in this field have a strategic importance. Especially:
   - Tax and custom administration is reform should be accelerated
   - Unproductive or harmful inspections should be identified and restructured or eliminated.

5. Clear proposal for the decentralization together with the local finance reform are needed, and has been prepared (see chapter II 2.)

However, one should not wait for the key reforms until the whole public administration is restructured. Progress can be achieved by the reform ministers working with a competent and dedicated teams.

Besides identifying the key reforms which constitute the package, a list of proposed measures which are not necessary or are even harmful from the point of view of the strategic goals is being attached so as to stop them.

In general steps to be avoided include setting up new government organizations or new special funds and demands to support (trough regulations or budgetary spending) the selected branches projects or firms.

A key precondition for successfully preparing the reforms package and for achieving a lasting improvement in the policies, legislation and regulation are radically improved procedures of operation of the respective authorities and of the cooperation between them (i.e. between the President, the government and the Parliament).

***

The following chapters discuss the respective reforms. They have been written by the members of the SAGSUR in line with their specialization, but after a through discussion within the group and the consultation with its co-chairmans and ach chapter presents:

1. The situation in a given fields (the diagnosis)
2. The necessary reforms
3. The list of legal acts which have been already prepared and should be implemented to advance the respective reforms.

Besides the report contains a list of legal acts which – in the authors's opinion- are in conflict with the strategic reforms.

Even though the present report discusses most important fields for reform, it does not cover all of them. It does not cover national defence and security. Monetary policy and the banking sector are excluded, too. (NBU in cooperation with the IMF is doping a very good job).

CHAPTER II TRANSFORMATION OF THE STATE

II.1 Structures and Operational Procedures of the State

Jerzy Miller, Mirosław Czech

A. Law-making

Ukraine is legally over-regulated. The constitution, acts and executive acts regulate too many detailed issues. An example of this is the draft amendment of Articles 140-146 of the Constitution, which introduces the local government reform. Most of the proposed regulations should be incorporated into acts on local self-government and local state administration.

B. Cooperation between the highest state authorities

1. The most serious problem is the lack of a stable parliamentary majority and the lack of discipline among the deputies of the parties of the coalition government. It results in a low efficiency of the legislative work, because, for example, draft acts prepared by the government are being rejected.
2. It is a constant practice of the Parliament to submit draft acts, which are passed in spite of a negative opinion of the government, or even without such an opinion at all. Also some members of the governing parties do not consult their proposals with the government beforehand.
3. The legislative initiatives of the President are not coordinated properly with the government.
4. Other issues are: the way the government acts are proceeded in the Parliament, and also the working arrangements of the Parliament and of the government coalition related to acts that were not proposed by the government (especially such acts which affect public finances and the state budget). The parliamentary rules of procedure provide the right of the government to speak on draft acts during the plenary sessions and the work of parliamentary committees.

Removal of this pathological situation, which threatens the stability of state finances, legal order and authority of the state in society, does not require legal changes but rather the enforcement of existing procedural regulations. The responsibility of enforcing this elementary condition lies with the political leaders of Ukraine.

C. Government work

The work of the Cabinet of Ministers has significantly improved within the last five months. The quality of materials prepared for the meetings, the pace of work on draft decisions, participation of all members of the Cabinet of Ministers in the preparatory work due to the introduction of e-mail, have all contributed to facilitate the work of the Cabinet. However the following problems remain:

1. The government should be definitely relieved of detailed issues, which should be resolved at lower levels of authority.
2. The agenda of a meeting of Cabinet of Ministers and related materials should be delivered much earlier.
3. Expert analysis of the effects of the proposed decisions of the government before their adoption and assessments of these effects ex-post should be prepared.
4. The Cabinet of Ministers should take a position on the draft acts submitted to the parliament by groups of parliamentarians.

D. Procedures of establishment and implementation of the budget

1. The Budget Act is treated as a temporary decision, which can be changed at any time and even circumvented if one wants to spend money not included in the budget. This concerns both executive and legislative authorities. Therefore the decisions related to spending of public money shall be subject to special rules due to the impact of these decisions on the stability of the state.
2. It should be respected as an absolute rule that the Budget Act includes, on the revenue side, the planned level of budget revenue and, on the expenditure side, the upper limit of the planned expenditure. The Minister of Finance must have the right to limit expenditure when revenues are lower than planned. Nobody has right to increase spending, even if the revenues are higher than expected.
3. The Draft Budget Act can be presented only by the government. Therefore, any changes in the Budget Act can also be proposed only by the government. In order to maintain the financial stability, the Budget Act can not be changed in the first half of the year.
4. Changes in government spending introduced in any other way than the described above, should be automatically void.
5. The Draft Budget Act should include the new fiscal year and the next two subsequent years, so that multiannual expenditures have stable funding guaranteed.

The Public Finance Management reform strategy is currently being developed by the Ministry of Finance that will cover the institutional aspects of the budget process reform in more detail.

II.2 Local Government and Decentralization

Jerzy Miller, Mirosław Czech

A. Current state

Until 2015 the existing model and the related legal regulations in Ukraine essentially duplicated the system from the time of the Ukrainian SSR: rural and city councils, as well as district councils (rayon rada) and province councils (oblast rada), were the "representation" of the society in the respective administrative units, elected in general elections.

The legal basis for the local government is constituted by: the Constitution (chapter XI, Art. 140-146) and the Law on Local Self-Government (of 1997, as amended).

The executive power is exercised by local bodies of the state administration (mistsevi derzhavni administratsiyi) whose heads (holiv) are appointed by the President at the request of the Cabinet of Ministers.

In 2015, Ukraine started a reform of local government. A decision was made about the voluntary merging of city and rural councils into combined local communities (obyednanni terytorialni hromady).

In September 2015 the parliament began work on revising the Constitution. A draft amendment to Articles 140-146 of the Constitution was passed in the first reading. It introduces a three-tier model of local government - municipalities, districts and provinces.

Currently, during the transitional period, there are four levels of local governments: local communes, municipalities, districts and provinces. Local communes (misceva hromada), districts (rayon) and provinces (oblast) are continuations of the previous administrative units. A municipality is a town or a city (not all but only some of the largest in the district) or a combination of local communes.

A draft amendment to the Constitution maintains the state administration of the districts (rayons) and provinces (oblasts). The bodies of district and provincial administration will be headed by prefects, whose competences will include primarily:

a) controlling whether local government bodies comply with the Constitution and the acts;
b) coordinating the activities of local bodies of the state administration in, respectively, districts and provinces;
c) overseeing the implementation of government programmes;
d) managing the activities of the local bodies of the state administration and ensuring that they cooperate with the local government authorities in the case of martial law, state of emergency and environmental disasters.

B. Necessary changes and deadlines for their implementation

1. The most important task is to complete the creation of municipalities by merging neighbouring local communes. The current law requires a bottom-up initiative of

the commune to initiate the merger. Practice shows that this “democratic” method is ineffective. So far only 168 municipalities were created out of planned 983. The prolonged creation of municipalities slows down the decentralisation process, because one can not delegate tasks until there are entities to carry them out.

2. It is necessary to change the law so that creation of municipalities can be initiated by the government, while the local councils and the residents will be obligated to submit their opinions on the project.
   - **The best deadline to complete the creation of municipalities would be 1 January 2017.**

3. The draft law of 2015 provides that the boundaries of the municipalities are determined by the act of the parliament. Experience shows that changes in the boundaries of municipalities are relatively common (resulting from urbanisation, as well as demographic and economic changes) and their impact on the life of the country remains negligible. Therefore, to simplify and shorten the procedure of change, it should left to the competence of the Cabinet of Ministers.
   - **Completion date: December 2016.**

4. The municipalities which have been created so far are very diverse in terms of their size, population, and the presence of municipal institutions. This is why minimum indicators of the municipality’s size should be adopted, so that each municipality is able to independently execute the tasks which were delegated to it and to be financially self-sufficient.
   - **Completion date: December 2016.**

5. The areas which are immediately adjacent to cities should be treated in a special way. Cities develop more rapidly and they constitute poles of economic growth. Therefore a city has to have land available for building purposes. In addition, as a rule, a city is the seat of all or almost all municipal institutions carrying out the duties of the municipal government. Therefore:
   a) the boundaries of the municipality, which includes the city, should be set as far away from the city limits, as is indicated by the current and future places of residence of persons who use municipal services based in the city.
   b) particular attention should be paid to the educational services of schools, otherwise the city will provide and finance such services not only for the benefit of its own residents but also the residents of neighbouring municipalities. It always becomes the source of disputes between municipalities.
   - **Completion date: December 2016.**

6. Substantial own revenues are necessary for local governments if they are to be independent from the central government. Therefore, their sources of revenue should be determined in such a way as to ensure their ability to carry out all their own tasks. A list of own tasks to be performed by local governments should be created and the cost of their execution estimated

- **Completion date: for municipalities – November 2016, for provinces (oblasts) – March 2017.**

7. International experience indicates that the control of the financial management of local government is most effective when it is performed: during the planning of expenditures for the next year, at the moment of entering into long-term commitments, and when setting the terms of credit loans and issuing bonds. Otherwise, a significant number of local governments would find themselves in financial difficulties which will prevent them from executing their tasks. Therefore togehter with enlarging the financial authority at local government audit bodies should be created, which will give their opinion on those projects of the local government's decisions that may influence its financial stability. A negative opinion blocks automatically the decision in question.
   - **Completion date: second half of 2017.**

8. Local governments perform not only their own tasks, but also the tasks assigned to them by the government. Therefore, the government must control the quality and the cost of completion of the assigned tasks. The government should also require the use of uniform procedures throughout the country, to ensure the transparency and objectivity of their execution.
   - **Completion date: March 2017.**

9. Local self-governments are independent from the government. Nevertheless, their resolutions and decisions are subject to governmental control regarding the legality of local law-making. In order to ensure that local residents have trust in local legislation, the government must adopt a control procedure to verify the legality of the proceedings of the local governments.
   - **Completion date: June 2017.**

II.3 E-administration

Jerzy Miller

IT system in administration

There is no efficient state without efficient administration. There is no fair state without fair administration. And no administration is effective and resistant to corruption unless there is an easy access to the information about its activities.

Contemporary IT technologies make possible an introduction in Ukraine of the so-called e-administration (electronic administration) that will, among others, guard that administrative procedures are applied correctly and make itself transparent through the creation of "history" of all administrative proceedings and due to making its decisions public. It enables social control of the quality of the work of administration, including disclosures of cases of corruption.

Through the introduction of IT systems, Ukraine can make a breakthrough in the way the state functions and become a leading country in Europe in this area. Ukraine will be perceived as a modern state, open to new technologies, offering easy access to public information, with friendly and efficient administration. Ukraine has very talented IT professionals, as evidenced not only by their high places in the world ranking of IT staff, but also by their high rated IT products. For example, ProZorro system was awarded the title of the best program in Europe that supports public procurement. ProZorro showed how IT helps to develop competition in the market for goods and services, effectively reducing corruption and saving public money.

A. Current state

1. Administration, despite noticeable changes, is not the strength of Ukraine. One of its main weaknesses is the lack of information flow between different bodies of the state and the lack of databases gathering data concerning the most important processes occurring in the country. This is one of the reasons why important decisions are made without the preparation of preliminary analysis of problems and without a prognosis of potential effects of implementation of the proposed solutions.
2. Another problem for the administration is the high level of corruption. It is a result of, among other things, the possibility of making subjective decisions, regarding both their timing as the outcome. The source of this problem is either the lack of relevant administrative procedures or the failure to comply with them. This also applies to operational procedures concerning the control and inspection authorities.
3. Handling administrative matters usually requires a personal appearance in the relevant office, and very often also the submission of many documents to confirm the facts described in the application. Computers in offices are far too frequently only typewriters rather than "the guardians" ensuring the uniformity of procedures,

the source of the data needed for decisions or a means of on-line communication with parties to administrative proceedings.

4. The introduction of IT systems helps to improve the functioning of the state in the aforementioned areas. A good example of success is the system ProZorro for handling public procurement procedures which has been introduced this year. In just a few months of operation, ProZorro helped to save 3 thousand million UAH, but first and foremost, it increased the transparency of the process of procurement of goods and services, which greatly reduced the corruption previously associated with this area.

B. Necessary tasks to be carried out and deadlines for their implementation (assuming an ambitious but realistic plan)

1. IT systems organize the functioning of all institutions. Therefore, the first step in the introduction of e-administration must be an analysis of the existing administrative procedures and the development of further procedures in areas where so far there are no unified rules of conduct. This task should be performed with the help of all authorities of state administration and local government that participate in administrative proceedings. To do so, the procedures should be divided into homogeneous thematic groups (e.g. tax procedures, construction-related procedures) and for each of these a working group should be created, composed of representatives of all individuals and entities that take part in said procedures.
   - **Schedule: starting in September 2016**

2. The order in which the administrative procedures are to be analysed should not be accidental. I propose the following sequence, depending on whether procedure supports:
   a) activities that have the greatest impact on state revenues;
   b) activities that have the greatest impact on state expenditures;
   c) the most frequently performed administrative tasks for individuals and legal entities.
   - **Completion date: February 2017**

3. In the course of the analysis, the administrative procedure should be adapted to cooperation with IT systems, by elimination, as fully as possible, of:
   a) the requirement of the personal appearance of the parties;
   b) the need to submit any documents that is already in the possession of a state authority;
   c) issuing of a paper document, unless the party to the proceedings requests a paper document and not a digital copy;
   d) fees that need to be paid at the office counter;

   and adding to it automatic:
   a) updates of the central registers of the state, if such registers are maintained;
   b) updates of reports if such reports are prepared.
   - **Completion date, starting in September 2016**

4. Creation of central registers is another issue. Currently, in Ukraine, there are no central registers which are updated on-line. The construction of central registers should be carried out according to the following order:
   a) basic registers:
      - register of citizens and residents – completion date: December 2016;
      - register of legal entities – completion date: December 2016;
      - land and mortgage register – completion date: January 2017;
      - cadastral map – completion date: March 2017;
   b) registers that have the greatest impact on state revenues –completion date: April 2017;
   c) registers that have the greatest impact on state expenditures –completion date: June 2017;
   d) registers that have the greatest impact on the most frequently performed administrative tasks for natural and legal persons –completion date: September 2017.

   The completion dates indicated above specify the date of launching the said registers, together with the procedure of their automatic updating. To achieve the maximum usefulness of registers, it is also necessary to complement them with archival data by transferring that data from paper documents. Therefore, the construction of the central register must be accompanied by the preparation of a procedure for adding data to the database, which, depending on the size of registers, requires up to one year of work.

5. Building of e-administration facilitates the work of officials, shortens the wait for decisions, simplifies control, and makes it possible to work remotely, without actually “visiting” offices, 7 days a week, 24 hours a day. In addition, e-administration reduces corruption because the administrative procedures become transparent and deviations from the standard operating procedures are either impossible or automatically communicated to the supervisor and the auditors.

   E-administration provides easier access to information; it is an advantage to officials and parties to the proceedings, but it can also become a disadvantage if the registers are accessed by an unauthorised person. For the sake of protection of personal data contained in the registers, it is necessary to prepare software and hardware that supports control of authorizations of people who have the right to access the registers:
   a) in order to update data (active access)
   b) in order to retrieve data (passive access)
   - **Completion date – December 2016**

6. In order to make the introduction of e-administration a success, the centralised model of all the IT systems for civil service tasks should be adopted, whether the tasks are performed by central, regional or local authorities. Such a model is least expensive on the stages of construction, exploitation and modernisation,

guaranteeing at the same time that the implementation of the system will be uniform.

An alternative is a model comprising autonomous IT solutions, build independently by various state authorities, such as local governments, and connected by a common interface. However:

a) This solution is much more expensive and, above all, dangerous for the continuity of operations, especially when legislative changes necessitate software changes.
b) Moreover, the e-administration system should work on-line, and this requires high reliability of all its components.
c) The quality of the system is determined by its weakest link. Only a centralized model ensures a simultaneous launch of e-administration, within the scope of particular functionalities, throughout the whole country, and it is a necessary prerequisite for the operations of central registers.

- **The decision on this issue should be made in September 2016**

7. From the point of view of e-administration, the tasks of local government administration should be divided into two groups:
   a) tasks which affect the functioning of other local governments or the entire state, e.g. land-use planning
   b) internal tasks which have no impact on their environment., e.g. the setting of principles for social aid

   The former should be handled by centralized systems; the latter can be carried out individually by local governments, independently from other IT systems.

   - **The deadline to make the decision – October 2016**

8. Software and computer equipment should be prepared simultaneously for:
   a) all the officials implementing the administrative procedure;
   b) the central register/s;
   c) all users of the data stored in the central registers.

   The adoption of the principle of simultaneous launch of all three groups of users ensures that expenditures on IT systems will be utilized optimally and the effects of creation of e-administration will be obtained.

   - **Completion date – October 2016**

9. Software for accessing e-government should be prepared for individuals and legal entities. The possibility of contacting offices remotely via Internet connection brings the following benefits:
   a) savings in terms of time and money spent on travel to offices;
   b) a possibility to contact officials 7 days a week, 24 hours a day;
   c) a very large reduction of corruption:
      - there is no personal contact with officials and computers are not corruptible;
      - it ensures that all parties to the proceeding, all over the country, will be treated in the same way;

d) it brings savings in the administration, including the reduction in the number of employed officials, because the websites operate as front-ends to the relevant e-administration modules and do not require the support of officials.

This element of the e-administration construction is very spectacular, as it facilitates and simplifies the duties of individuals and legal entities towards the state. Therefore, it has a very positive impact on the assessment of the efficiency of the state

- **Completion date – December 2016**

The tasks of development of e-administration have been assigned to the Governmental Agency for e-Management, under the supervision of the Ministry of Economy and Trade. Contacts with the Agency, which have already taken place, enables us to predict great chances of success. As one of the conditions of success, Agency should invite to cooperation some representatives of cities that have experience in the implementation of IT systems supporting their own tasks.

An active involvement of the centre of the government is a condition for success of the e-administration reform.

II.4 Justice System Reform

Luba Zimanova Beardsley

A. BACKGROUND

1. Key Problems

In Ukraine, justice institutions do not enjoy the trust of the people. This is because of: (i) the long term "cozy relationship" of the courts and public prosecution with other branches of Government and interest groups; (ii) wide-spread corruption; (ii) ineffective and inefficient performance of justice institutions; and (iii) an often "arrogant" institutional culture.

There are strong indications of: suboptimal division of responsibilities; inadequate organizational designs; ineffective management; cumbersome and nontransparent decision-making procedures; and weak safeguards of independence and accountability (in the case of courts and public prosecution) that contribute to the picture of **the justice sector as the one which is incapable to respond to current societal needs.**

So far, little empirical evidence and knowledge has been collected and analyzed to: (i) fully understand the performance of justice institutions: and (ii) learn more about the results/impacts of the previous reforms. Even where such knowledge exists, it is used only selectively.

The management of the implementation of the justice sector reform is rather problematic. Reform master plans were adopted in 2015, but the plans miss the prioritization and sequencing of reform interventions. The implementation arrangement, which appears to be equally ambitious, is not functioning yet.

The justice sector reforms have been implemented on three separate tracks: court reform (overseen by the judicial authorities and JRC); reforms of legal services that are provided within the purview of the Ministry of Justice (MOJ) and overseen by the Cabinet; and the reform of pubic prosecution which is implemented by the Public Prosecutor's Office (PPO). There is no single place capable of providing timely, complete and reliable information about the progress or results of the justice sector reforms.

2. Policy and Legal Framework

The consolidated "*2015-2020 Strategy on Reforming Judiciary and Related Legal Institutions (Strategy)*"[1] is the justice sector reform masterplan. The overall goal of the justice sector reform is to increase access to justice by businesses and common people.

Sector's priorities and the content of the Strategy are influenced by: the Coalition Agreement (2014) and the Program of the Government; the Ukraine – European Union

[1] The related legal institutions include: public prosecution, public defense system; legal profession (attorneys); enforcement of civil judgments authorities; and penitentiary system.

(EU) Association Agreement[2]*; and the IMF's Extended Fund Facility*[3]. Each of these programs has its own goals and priorities.

On June 2, 2016, the Parliament of Ukraine adopted amendments to the Constitution, the Law on Courts and Judges and some other laws to facilitate the implementation of the above Strategy, namely in the areas of jurisdiction and organization of courts, the status of judges; powers of public prosecution; enforcement of civil judgments; and representation of defendants and litigants before courts. Passing the above legislation is a major achievement in building rule of law in Ukraine. The actual impact of the reforms, however, remains to be seen.

B. PROPOSALS FOR ACTIONS

1. Judicial Reform: Consolidation of the Court Organization

The recent amendments of the Constitution and the Law on the Status of Courts and Judges involves *changing a 4-pillar to a 3-pillar court structure*. This will be done by: consolidating the Supreme Court (SC) with the four High Specialized Courts and integrating the 1st and 2nd instance courts into circuit courts. The latter reform demands an immediate appointment of 200 judges of the SC through a new merit based competitive hiring method that involves sitting as well as non-sitting judges. The amendments also require the creation of an Integrity Council (IC)[4] and transformation (through a new law) of the current High Council of Justice (HJC) into an institution competent to perform the critical HRM functions and to steer the court system and reform process.

The above reforms could be characterized as *high risk – high reward-- reforms*. The key risks of the reforms include: insufficient understanding of possible impacts; extremely ambitious timeframe; lack of buy-in by the judiciary; and rather weak popular support. Save for drafting the Law on the HJC, the implementation of the reform is within the prerogative of the judicial branch. *The complexity and importance of the reforms call for the involvement of the executive branch (the Government) in the implementation of this reform*.

Proposed actions:

- The collaboration between the judicial sector and the Government should be formalized in a *memorandum of understanding* (MoU).[5] Information about the MoU and its implementation should be made publicly available.
- Concerned institutions should consider conducting additional *research on the factors which are relevant to the location, size and specialization of local courts*. The mixed results of the similar consolidation reform of the local prosecutorial offices

---

[2] The EU-Ukraine **Association Agreement was completely signed** on 27 June 2014. The signature was followed by **simultaneous ratification**by the Verkhovna Rada and the European Parliament on 16 September 2014.

[3]On 11 March 2015 IMF approved a four-year EFF worth $17.5 billion for Ukraine. Its first tranche of $5 billion was forwarded to Ukraine on 13 March 2015.[Its second tranche worth $1.7 billion was transferred to Ukraine on 4 August 2015.

[4] IC will be composed of non-judges and representatives of NGOs. It will be responsible for generating information about judges' and judge-candidates' integrity.

[5] The MoU/contracts is a tool used to lay down the obligations of judicial organization and courts with their partners without imposing an undue influence.

implemented by the PPO in 2014 reinforces this notion (see also section on reform of public prosecution). The Ukrainian reformers can build on *international good practice* which have been summarized, for instance, in the CEPEJ's[6] Guidelines on the Creation of Judicial Maps to Support Access to Justice within a Quality Judicial System (2013).[7]

- The reformers should also conduct a Public Relations (PR) Campaign to *raise awareness by stakeholders and the general public of the reforms and to seek their support*. Particularly in the case of local courts, the local PR campaign should be launched to inform users in advance about the organizational changes and their benefits.
- The local level consolidation should involve the *implementation of small locally grown improvements that would benefit to local users* such as: the creation of an information desk; providing a space that would allow confidential discussions between lawyers and their clients; complaint hot lines and so on.
- The reform envisions that NGOs, along with other representatives of civic society, will be members of an integrity council. The judicial institutions and the Government should consider inviting NGOs and other representatives of civic society to act as observers of the selection process or as members of working or evaluation groups. Such participation would further boost the credibility of the process and increase the likelihood of selection of judges who are acceptable to their communities.
- The judicial institutions and the Government should make sure that *the newly appointed judges* – many of whom will have no prior experience working in courts -- will *be represented in all judicial organs*. From this perspective, for instance, the introduction of *strict age or experience requirements for membership* in such organizations as the HCJ could *undermine* the achievement of one of the reform objective – *the diversification* the judicial workforce.

2. Reform of Public Prosecution: Unfinished Business -- Functional Review and Amendment of Prosecutorial Map

In 2015, the PPO embarked on a *radical institutional reform*. The goal was to reduce the scope of prosecutorial functions and powers so that they correspond with the needs of a contemporary democratic state; and to calibrate the sector capacities to the performance of these functions. The reform *aimed to achieve a 50 percent staff cut and corresponding 70 percent office reduction*. The 4-level competitive selection process for sitting prosecutors was implemented, followed by a competitive selection of the local chief prosecutors and their deputies. *The results of the above reform were rather disappointing*. The number of local offices was reduced from 639 to 178. But the overall staff cuts amounted only to 24 percent, most of which involved support staff. 76 percent of local prosecutors were reappointed. Not a single external candidate was appointed as a Chief Prosecutor, 2 candidates were appointed as the 1st Deputy and 20 as 2nd Deputy Chief Prosecutors.

The new PPO leadership appointed in May 2016 identified *new reform priorities: freeing the PPO of corruption and abuses of power; the establishment of a General Inspection Office; and speeding up stolen assets recovery. No specific plans have been made as in*

[6] European Commission for Efficiency of Justice
[7] http://www.coe.int/t/dghl/cooperation/cepej/quality/2013_7_cepej_Judicial_maps_guidelines_en.pdf

terms of continuation of the 2015 reform to the 2nd instance prosecutorial offices and PPO, although it is clear that these reforms are absolutely necessary.

The key benefits of the continued reform include a consistent and rational organizational structure supported by sufficient capacities and a positive culture. The key risks of the reform involve: the opposition to the reform by interest groups and prosecutors themselves; and inconsistent and/or uncommitted leadership.

Proposed Actions:

- The PPO and the Government need to *revisit the results of the first phase of the institutional reform and develop a plan for the corresponding reforms of the 2nd instance – regional offices and in the PPO*. The plan should build on the lessons learned from the first phase, it should be based on sufficient understanding of the key issues, and it should capitalize on international good practice.
- *A functional review* method is commonly used to address the challenge of a disconnect between the functions on one hand and capacity and culture of an institution on the other. The EU has already expressed its tentative agreement to (co-) finance a functional review.
- In addition, the PPO and the Government should engage in *correcting mistakes made by unjustified and uncoordinated (with other justice institutions) abolishment of local prosecutorial office*s. The PPO and the Government could take advantage of the reform of the judicial map (see the section on courts) and organize a joint research for both institutions. Such an approach would save resources, time and would be beneficial for the users.
- As is the case with courts, because of the level of dissatisfaction with the performance of public prosecution, the reforms should be *properly communicate both reforms to stakeholders*, including the general public. The PR campaign on the above reform is absolutely necessary.

3. Legal Aid Reform: Improving Targeting and Efficiency

In Ukraine legal assistance is a constitutional right. The law introduced two types of subsidized legal services: legal counseling (primary legal aid) and legal representation (secondary legal aid) for both, criminal and non-criminal cases. The MOJ's Coordination Center for Legal Aid Provision (CCLAP) is responsible for managing the legal aid. CCLAP delivers legal aid through in- house lawyers and paralegals and by subcontracting private lawyers.

In 2013, a 5- year legal aid program was designed. In 2013 regional (27) and local centers (100) have been established. The 2016 Government Action Plan anticipates the creation of 400 local offices (Legal Aid Bureaus) for, as said in the Plan, secondary legal aid provision; an expansion of eligibility criteria for users; and the increase of fee to be paid private lawyers for delivering legal aid. From 2014 to 2016 the legal aid budget grew 3.6 times from 79 (2.8 million Euro) to 287 million UHA.

The CCLAP explained that the newly created legal aid bureaus are financed through savings which occurred by the liquidation of other MOJ's local offices. They are supposed to be staffed by a pool of practicing lawyers whose work will be primary legal

aid; the facilitation of the secondary legal aid; and occasional secondary legal aid. The 2016 developments suggest: a dramatic increase of office and scope of legal aid; a shift toward primary legal aid and legal empowerment activities; increasing flexibility in using subcontracting arrangement for primary legal aid and in house lawyer for secondary legal aid; and increased provision of secondary legal aid for civil and administrative disputes.

The legal aid reform in Ukraine has achieved impressive results. The most recent policies and developments, however, raise two major concerns: radical changes in the scope and focus of legal aid supply were done without full understanding of legal aid needs and their trends (a legal aid needs assessment have not been done yet); and there a noticeable lack of sense of priorities.[8]

Proposed Actions:

- The MOJ has reached the point in which the quantitative growth of legal aid should be combined with an effort to improve the efficiency and performance of the system. The effort can be guided by the above mentioned EC Assessment of legal aid. This requires:
  - ✓ To improve targeting of those who really need legal aid by reviewing eligibility criteria: (i) such that they facilitate the provision of legal aid to those who cannot effort it as opposed to those entitled to it (e.g. on the ground military service); and (ii) the criteria reflect the realities of the Ukrainian public budget which is focused on the issues related to costs and quality of legal aid services.
  - ✓ Building stronger analytical/planning and performance monitoring and evaluation capacities in the current system;
  - ✓ Exploring, on a pilot basis, low cost high impact alternatives to the current delivery model; and
  - ✓ Addressing inherent abuse and corruption opportunities and incentives.
- The MOJ may want to use this opportunity to address the issue of the organizational independence of legal aid.
- The MOJ should proceed with the expansion of the legal aid based on the results of the needs assessment and efficiency review on a smaller pilot base.

4. Reform of Enforcement of Judgments

On June 2nd 2016 the Parliament passed the laws “On the authorities and officials performing enforcement of court rulings and mandatory resolution of other authorities” and “On enforcement procedures”. The first law initiates a mixed system of court rulings enforcement in which private enforcement agents state employed enforcement agents will have the same status and responsibilities. The laws will come into force in October, 2016 and the system of private enforcement agents should begin to work in January 2017.

[8] 2014 CEPEJ evaluation report indicates that even such countries as Czech Republic provide more than 90 percent of resources for secondary legal aid for criminal cases comparing to around 10 percent to administrative and civil cases. In Ukraine the budget for secondary legal aid for administrative and civil cases amounts to more 60 percent of the budget of criminal cases.

The above reform intends to address one of the most pressing problem of the justice sector with large impact on Ukraine economy – extremely low level of enforceability of civil and commercial rulings. In 2015 out of more than 5 million enforcement files worth of 550 billion of UAF only 3 million cases worth of 200 billion UAH were closed. Only 20 percent of all cases were actually enforced collecting about 3 percent of debts. The passage of the laws was one of the structural benchmark conditions for the IMF's support through its Extended Fund Facility. Enabling the system of private lawyers is of the utmost priority for Ukraine economic and social development. The reform is relatively simple, straightforward, low-risk & high-reward reform, at least at its initial stages.

The MOJ has done a lot of work to make sure that the system of private enforcers is ready to be launched as originally planned. The MOJ has signaled two possibly threats to the successful launch of the private. One has to do with a lack of resources for IT infrastructure to upgrade - upgrade the case management system (due to be operational on January 5, 2017); to develop Registers of Debtors and Enforcement Agents (due to be operational on October 5, 2016); and to develop and/or procure software for examination of enforcement agents. According to the law all procedural actions and decision of both, state and private enforcement agents are supposed to be entered into the new system (through case management). If not, they can be challenged and annulled via court rulings. The second obstacle relates to a remuneration system for Private Enforcement Agents. The MOJ has difficulty to reach an agreement with the MOF on the proposed system.

Proposed Actions:

- The Government should allocate missing funds and provide other assistance which is necessary to enable the creation of technology based infrastructure for case management, registries, and conducting testing of candidates.
- The Government should facilitate reaching the final decision on the remuneration system for private enforcement agents.

II.5 Anti-corruption

Luba Zimanova Beardsley

A. BACKGROUND: CHALLENGES

Ukraine updated its anti-corruption policy in 2011 and in 2014 and in 2015. An action plan(s) to implement the Strategy has not yet been developed. The top priorities include: (i) criminalization of corruption and building a strong anticorruption institutional infrastructure; (ii) deregulation of the economy (addressing corruption as an obstacle to growth); and (iii) reducing abuses in public administration.

The challenges of the implementation of Anticorruption Reform include: (i) ineffective tracking, evaluation and reporting on the progress and results; (ii) weak communication with the public and stakeholders; (iii) significant delays in implementing results.

The 2016 Action Plan promises to accelerate reform and deliver tangible results by the end of 2016.It is not clear, however, how the Action Plan intends to deliver on the promise as the sole focus of the 2016 Action Plan's anticorruption effort are the three specialized anticorruption institutions.[9] The 2016 Action Plan is overly optimistic in its estimates as to what and how long it takes to build an anticorruption system capable of producing results.

The fundamentally important part of the anti-corruption strategy is the reduction of opportunities for corruption through de-regulation, de-monopolization, privatization which are discussed un the part II of the report.

B. PROPOSAL FOR ACTIONS

1. Anticorruption Strategy 2018

By 2018 the Government needs to develop a new anticorruption strategy. The preparation work should start ASAP. The Government needs to also make sure that the strategy is realistic; based on societal consensus; and easy to understand by the Public.

Proposed Actions:

- The Government should consider conducting a national corruption survey. The survey would inform the Government about the perception as well as actual occurrence of corruption which, in turn, would help to improve the Government's response. Information generated through such survey could feed into broader public discussion and increase support for the future reforms.
- The reform requires top level leadership and credible and qualified staff which would manage/coordinate all reform activities The M&E system should allow to measure the outcomes (and not only the passage of laws and creation of institutions); it should stimulate speedy implementation; and encourage

[9] The National Agency of Ukraine for Prevention of Corruption; the National Agency of Ukraine for Investigation, Detection and Management of Assets derived from Corruption and other Crimes; and the State Bureau of Investigation.

complementary and/or joint monitoring and evaluation by/with civic society and private sector institutions. The system should be able to generate accurate and timely information about the progress, results and impact.

- The Government needs to make sure that the Implementation of the Strategy is based on action plans which reflect on realities on the ground.

2. Anticorruption Impact Assessment (CIA)

The purpose of CIA is to identify corruption risks on legislative and regulatory decisions and propose the changes in the legislation or mitigating measures. The approach is normally based on the following principles: proportionality; responsibility; consistency; transparency and public involvement. It is a part of or a form of regulatory impact assessment. Currently, an Anticorruption Committee of Parliament identifies and evaluates corruption risks and their mitigating measures as a part of debates about bills.

Proposed Action:

- The Government should introduce (at least on a pilot basis) more technically sound and consistent CIA. CIA should be done at early stage of the legislative drafting and should be expand to the most critical regulations. CIA should involve the communication of the results and possible solutions to the stakeholders and public. The approach could also be applied to laws and regulations which already in force. The initial phase of CIA could cover the assessment of consistency of Ukrainian laws and regulations with international standards and commitments.

3. On-line Publishing of Contracts Involving Public Funds

The recent procurement reform implemented in Ukraine (an E Procurement system ProZorro) has been one of the most impressive reforms. An online publication of all contracts involving public funds would complement this procurement reform. A biding publication of contracts involving public funds would further reduce corruption in management of public resources. No contract can become valid without the above publication. Experience from Slovakia (the first country to introduce this system) provides quite a few examples of corrupt practices pointed to by NGOs, MPs, citizens using information from the database. The 2016 Government Action Plan anticipate the introduction of this measure and some preparatory work has been already done.

Proposed Action:

- Prepare a bill which would introduce a binding open online publication of all agreements, where public funds will be used.

4. Anticorruption Court

June 2, 2016 Reform package (see above) have also anticipated the creation of the Specialized Anticorruption Court. No details, however, e.g. the jurisdiction of the court, a deadline for its establishment, have been given by the Constitution or the laws.

Proposed Actions:

- The Government, together with judicial institution, should quickly decide about the adjudication arrangement for major corruption cases and take necessary actions to implement this decision. In case they decide to establish an anticorruption court they should proceed with developing necessary legislation

CHAPTER III PUBLIC FINANCE

III.1 The Budget

Leszek Balcerowicz, Pavlo Kuhta, Ivan Mikloš

A. The current state

1. The public finance includes, by definition, the central government budget, those of local governments and various funds, especially the pension fund. In analysing the fiscal problems *one should always look at this integrated picture* (spending revenues, deficit, debt).

   By far the most important aspect of the fiscal stance is the *fiscal spending* as a percentage of GDP. It is because:

   - The level of fiscal spending determines the burden of taxation. If this burden is too heavy it is only because the fiscal spending is too high. Both act then as a barrier to growth.
   - During more difficult times (recessions, external shocks) a high level of spending in combination with the reduced tax revenues produce a surge in a deficit and/or chaotic spending cuts. The former may lead to a fiscal crises, the latter disorganizes the operation of the state and the economy.

2. **After the revolution significant fiscal consolidation has happened in Ukraine.** According to the IMF data, the share of general government revenues in GDP has fallen from 40.3% in 2014 to the expected 37.8% in 2016, while the share of general government expenditures has fallen from 44.8% of GDP in 2014 to expected 41.6% in 2016. Quasi-fiscal spending has dropped radically from 8.6% of GDP in 2014 to the expected 0.7% of GDP in 2016.*Overall, Ukraine is pursuing fiscal consolidation and is doing it in a correct fashion by reducing the share of government sector in the GDP.*However the progress will be fragile if not strengthen by structural reforms, especially the pension reform.

3. **The levels of government expenditure, particularly social expenditure, have become more normal as shares of GDP.** Pensions expenditure stood close to 18% of GDP in 2013 - highest in the world and possibly highest in history - and it is forecast at around 12% of GDP in 2016, close to the level of post-Soviet peers. Overall, social, education and healthcare expenditures have dropped from almost 36% of GDP in 2013 to a much more normal forecast level of about 26% of GDP in 2016.

   Government expenditure in Ukraine tends to be have low efficiency. For example: top 20% of households by income receive almost 15% of the state's social assistance, two thirds of schools are situated in rural districts contain less than a third of the country's pupils and at the same time these rural schools provide much worse education than city schools. Important reasons for spending inefficiency is the funding of excess capacity in education and healthcare systems (large number

of small rural schools instead of big hub schools, excess hospital network etc.) and low levels of means-testing in social assistance.

4. **The budget discipline is often violated:** Politically influential spenders often break their expenditure limits stipulated by the budget documents. This generates constant pressure to overspend and thus constantly endangers macroeconomic stability and confidence of economic agents in such stability. The violation of the budget discipline destroys incentives to use public money efficiently. To change the situation a decisive action by the political leaders is needed.

   Note: for recommendations on institutional strengthening of the budget discipline look at section 1 of chapter II of this Report.

5. Despite improvements since 2014:

   The state of public finance (the fiscal stance) in Ukraine:

   - acts as a systematic barriers to faster economic growth (the chronic disease),
   - and creates a risk of a sudden fiscal crisis which would endanger the stability of hrywnia and would have very negative consequences for those who govern.

The present fiscal stance is especially risky given the *external shocks*. Ukraine still has a very high level of fiscal spending relative to its GDP. At the same time it has very low GDP per capita. These two things related:

The lack of radical market reforms and the related corruption have blocked economic growth. And insufficient reforms on the spending side (especially in the social spending) has have maintained a high fiscal spending creating an additional barrier to growth and generating the risk of a fiscal crisis. To get out of this trap Ukraine needs the introduction of a package which would contain:

Market reforms which would release **entrepreneurship** and job creation. Fiscal reforms that would ease the fiscal burden and reduce the risk of the fiscal crisis.

B. Proposals

Draft laws to be prepared or already prepared by the Ministry of Finance and its partners

1. **Realistic and balanced (primarily, via expenditure cuts) draft budget for 2017.** A realistic and balanced budget will allow to give up the practice of continually overstating the planned revenue base year after year and, consequently, overestimating expenditures. This is a key factor for overcoming a permanent fiscal crisis and strengthening the macroeconomic stabilization. The key elements are:

   - The expenditures planned exclusively within revenues plus the deficit in compliance with the IMF program (3% of the GDP);
   - The verification of the forecast revenues by independent experts;
   - The budget consolidation at a minimum level of 70-80% due to a structural expenditure cuts;
   - Some members of SAGSUUR (L.Balcerowicz, I.Miklos, W. Pynzynyk, J. Miller, P.Kukhta) presented remarks and proposals on the budget during the meetings

with the Ministry of Finance and the Prime Minister. The proposals included reducing the increase of the spending on the wages and salaries in the budgetary sphere by linking them on the cuts in employment.

2. **Ensuring the openness of information on public finances.** At the moment, the implementation of the legislation on the openness of information on the use of public finance is very poor: 57% of administrators and recipients of budget funds (over 46 000 entities) and 87% of public utility enterprises (over 13 000 entities) fail to present reports of their activities and are not registered at an appropriate web portal. Registered entities present incomplete reports of low quality. There are no efficient mechanisms that allow to hold them responsible and the idea of mandatory online publication of contracts for them to become effective remains unrealized. Proposed actions:
   - *To write into law the mandatory publication of contracts at open online resources for them to become valid;*
   - To expand the effect of the Law On the Transparency of the Use of Public Finance on revenues of local and central budgets, state-owned banks, proprietary resources of legal entities subject to public law, political parties;
   - To consider the information official and such that may be used in court, to enhance the responsibility and accountability for the failure to abide by the Law, to authorize appropriate persons to supervise and ensure the implementation and enforcement of the Law.

   An appropriate draft law has been developed by civil society organizations – members of the Reanimation Reform Package (RPR) and registered in the Rada by the number 5061.

   Actions that may be taken without changes in the legislation

3. **The reform of primary healthcare (see: chapter V of the report).** To implement the principle of “money follows the person” at the primary healthcare level via communities. It may already be introduced in the fall, because the needed acts of the Cabinet of Ministers and the Health Ministry as well as one law are being developed by the team of the new acting *Health Minister Uliana Suprun.*

4. **An accelerated implementation of the system of large hub schools in rural areas.** The existing system of small-scale rural schools is very costly and, at the same time, very inefficient in terms of the quality of education services provided. If such small schools are replaced with large hub schools, it will allow to enhance the efficiency the school network, improve the quality of education in rural areas, thus making more efficient the cost of education as well as demonstrate to the public quick and obvious changes.

5. **It is important to continue the verification of pensioners and receivers of social assistance.** The verification is the process set up at the Ministry of Finance aimed at identifying fraudulent claims to social and pension payments. By conservative estimates (included into the 2016 budget calculation) it is supposed to generate 0.25% of GDP in savings in 2016 and double that amount in 2017. It is currently likely though that real savings would be at least twice larger - 0.5% of GDP in 2016 and 1% of GDP in 2017.The stability of the public finance in Ukraine requires a deeper pension reform.

III.2 The Tax System and Tax and Custom Administration

Leszek Balcerowicz, Pavlo Kuhta, Ivan Mikloš

A. The current state

1. **The tax and custom authority** consistently ranks as one of the most corrupt government entities in the surveys. Tax avoidance and tax evasion are still rampant, significantly skewing the playing field for honest taxpayers. In the Paying Taxes category of Doing Business ranking Ukraine occupies the 107 place, far behind even neighboring Belarus (63 place).

2. **The rate of Single Social Contribution has been almost halved with the reform passed in the end of 2015.** This move is a large step towards mitigating the problem of overly high labor tax rate that in Ukraine. Currently there is some evidence for increase in competitiveness and strengthening of the business environment due to the drop in tax rate, but so far there has been no clear evidence for the de-shadowing of salaries, which was one of the stated goals of the reform.

B. Proposals

Draft laws to be prepared or already prepared by the Ministry of Finance and/or the Ministry of Social Affairs

1. **The reform of the tax administration.** Tax administration reform is currently being developed by the government aimed at helping eliminate abuse within the system of tax administration and increase its quality. Important proposals are:
   - To transfer to the Ministry of Finance the right to define the tax administration methodology, the administration of databases, the right to provide written tax consultations;
   - To implement an electronic master-file for the taxpayers;
   - To move the audit functions to the oblast levels of tax administration, retaining only service functions at the regional level;
   - To dismantle the tax police and create a special financial investigations unit instead of it;
   - To implement a unified register of applications for the VAT refund that should be open to the public and a special transit account for the VAT balancing to guarantee the VAT refund to exporters;
   - To review the development of the plan of routine tax audits, including the criteria and rules used for it, as well as its openness to the public.

   The reform can also be used as an opportunity to review the tax system and get rid of unnecessary, but burdensome small-scale taxes. A good example is the 2% tax on currency exchange transactions, which yields a revenue of only 190 mln UAH, but creates strong incentives for the currency exchange market to go into shadow.

   An appropriate draft law is being developed by the working group under the auspices of the Ministry of Finance.

2. **The broadening of the Single Social Contribution (SSC) base.**This reform is important for creating a better level-playing field in the labor market as well as broadening the tax base. Key elements of the reform:
   - To broaden the unified social tax base at the expense of farmers and other entities currently exempt from the SSC;
   - To increase the SSC rate for small business entrepreneurs working within Groups 2 and 3 of the simplified tax system.

3. The reform of the simplified tax system, which in its present form is a source of pathology and tax avoidance. To level the playing field, make transition from small business to medium business more smooth and cut a lot of tax avoidance scheme it is necessary to reform the simplified tax system. It is important to conduct this reform in a gradual and transparent manner that would be painless for the small businessmen. A possible approach would be to return to a version of the reform proposed by the Ministry of Finance in 2015. Key elements of the reform should be:
   - To introduce the revenue tax, rather than the fixed tax rate, for small entrepreneurs under Groups 1-2 of the simplified tax system, which would make the tax burden more uniform between small businesses of various sizes operating in and outside of the simplified system;
   - To introduce mandatory cash registers, which would significantly help fight tax avoidance and curb the usage of the simplified tax system for selling goods in the shadow market;
   - To ban the use of the simplified system for legal entities.

CHAPTER IV MAJOR FACTORS OF ECONOMIC GROWTH

IV.1 Privatisation and Corporate Governance of State-owned Enterprises

Andriy Boytsun

A. Background

1. The Ukrainian state is the largest owner of enterprises and other assets in the country. Top-100 state-owned enterprises (SOEs) generated a total loss of UAH 117 billion in 2014 and UAH 16 billion in 2015. The total assets of these SOEs were some UAH 870 billion, with about 70 percent of the total assets concentrated in the energy sector (e.g., Naftogaz, Tsentrenergo, Energoatom) and 15 percent in infrastructure (e.g., Ukrzaliznytsia, Ukrposhta, airports and sea ports). The top-100 SOEs accounted for about 90% of the total assets of all SOEs.According to the Ministry of Economy, Ukraine has 3350 registered SOEs, out of which 1833 were operating SOEs, with a total workforce of more than 1 million employees (September 2014).

2. Like many other countries where politicians and bureaucrats are in control of public assets, Ukraine has been very inefficient in managing them. Considerable state ownership creates vast opportunities for politicians to misuse SOEs and other public assets in their interests, as well as for outright corruption. Rapid, massive, and transparent privatisation and reform of corporate governance in SOEs are the only remaining solutions to these problems.

3. In the past 11 years, no single major SOE in Ukraine was privatised. Most notably, during two and years after the Maidan Revolution, nothing has been done on this front. The state has typically set ambitious privatisation plans, which never get implemented, despite the vast apparatus involved in managing state property.
   The extent of that apparatus is enormous. First, the State Property Fund (SPF) alone employs over 2,000 people, and it is unclear what they do. Second, most SOEs are managed by line ministries which are also overstaffed, particularly because a lot of personnel is involved in SOE management.

4. The corporate governance reform in Ukrainian SOEs showed a promising start at Naftogaz in 2015. It generated very visible performance improvements. However, it has not been completed. In other SOEs, it has considerably slowed down (e.g., supervisory board at Ukrzalinytsia) or even regressed.

5. The recently adopted law on corporate governance in SOEs (Law 1405-VIII, dd. 02/06/2016) has introduced three major changes in SOEs, even when such enterprises are not corporatised: (i) increased disclosure requirements, (ii) mandatory audit, and (iii) supervisory boards, with a majority of independent directors. It is now a matter of putting this in practice.

B. Privatisation

1. According to the May 2015 Resolution of the Cabinet of Ministers,[10] 345 SOEs were to be privatised in 2015. The planned revenue from privatisation in 2015 was 17.1 billion UAH. In reality, privatisation only generated 0.15 billion UAH, or less than 1% of the planned revenue. In October 2015, the privatisation plan was, virtually in its entirety, carried over to 2016.[11]

   In August 2016, the Cabinet of Ministers extended the said Resolutionagain.[12]

2. Privatisation of the SOEs planned for 2015/2017 requires no intervention of the Parliament and can be achieved by the Cabinet of Ministers, the President, and the SPF. The major immediate targets are:

   - Odesa Portside Plant (OPZ);
   - Tsentrenergo;
   - Sumykhimprom; and
   - six regional electricity distribution companies (oblenergos).

   On this list, OPZ requires special attention because it was supposed to become a flagship case of privatisation. So far, it has failed, and it is crucial to draw appropriate lessons from that failure.[13]

3. On the updated privatisation list (that was amended by the recent CMU Resolution[12]), in our view, the priority companies to be privatised are:

   - Turboatom;
   - Elektrovazhmash;
   - United Mining Chemical Company (UGKhK);
   - State Food Grain Corporation of Ukraine (DPZKU);
   - Artemsil; and
   - The Agricultural Fund (Agragny Fond).

---

[10] Resolution No. 271 dd. 12 May 2015.

[11] Resolution No. 819 dd. 7 October 2015.

[12] Resolution No. 588 dd. 31 August 2016.

[13] First, it is necessary to revise the starting price of OPZ. The drastically lower starting price implies serious pressure on the part of populist politicians and political responsibility for the leadership of the country. On 31 August, the CMU made some amendments the privatisation methodology, which allow lowering the starting price in an easier way. It is now necessary to set a realistic price, which investment advisors estimated at a maximum of $100–150 million.

Second, it is absolutely imperative to solve the issue of the toxic debt to the DF Group before the privatisation of OPZ. Third, it is necessary to start the plant again (it has been stopped because of its deteriorating financial condition) and to update the vendor due diligence on OPZ. Fourth, it is necessary to give potential bidders enough time to prepare their bids (we propose 70–90 days instead of 45 days). Finally, the privatisation auction must be announced in manner making it clear that the government has responded to the problems, which led to the failure of the auction in July, and that the above essential privatisation conditions have been changed.

4. According to our estimates, there are at least 852 operating SOEs that are allowed for privatisation (i.e., are not excluded from privatisation by law).[14] They should be privatised, which requires no legislative changes.

   In particular, it is necessary to simplify the procedure for the privatisation of smaller enterprises in order to speed it up and make it transparent and effective.

5. Privatisation should include parts of large organisations in the infrastructure or their main assets (e.g., in railways, road transportation, gas etc.). It is necessary to allow SOEs that have subsidiaries to sell their non-core assets in order to operate efficiently.

6. We have warned about legal risks which may disqualify or, at least, discourage many bona fide buyers from participating in privatisation auctions. First, according to the privatisation law (as amended in February 2016), a company that has at least one share owned by an individual or entity from an aggressor country (such as Russia) cannot participate in privatisation in Ukraine.[15] In particular, listed companies cannot possibly control who owns their shares. This may disqualify such a company from the privatisation auction.
   Second, the law prohibits participation of companies that have a related party in an aggressor country (such as Russia).[15]Many international companies have subsidiaries in Russia. Although they are not controlled by these subsidiaries, they will fall under the definition of a related party of such a subsidiary, which is also likely to disqualify them.
   Technically, the legal changes required to solve this problem are very simple. It is now necessary to achieve an understanding with the Parliament in order to have them passed as soon as possible. In the immediate perspective, this is important for the privatisation of OPZ, as some of the desirable buyers are likely to be either a listed company or have a subsidiary in Russia. However, it is no less important for all other SOEs to be privatised.

7. The list of SOEs which are excluded from privatisation by law needs to be reduced sharply. This consists of two measures, both requiring changing the privatisation legislation.

   - The Government has already submitted Draft Law 4536 to the Parliament.

   - A further reduction of the list, requiring further legislative changes, is needed. Examples of major privatisation targets include Oschadbank, Ukreximbank, Ukrposhta, the rolling stock of Ukrzaliznytsia, Ukrgazvydobuvannia, and other SOEs of similar magnitude.

8. Today, the privatisation priorities and approaches of various ministries differ sharply. In order to proceed with privatisation efficiently, the government needs a single privatisation policy. In particular, the method of privatisation and

[14]The State Property Fund has provided updated statistics recently, which the Ministry of Economy is processing now. I have the most recent version of the file, but it is still work in progress. I am in touch with the team working on the statistics and offered our help if necessary. I will inform you as soon as the numbers have been updated.

[15]Law No. 2163-XII, Article 8.

involvement of privatisation advisors should be based on a logical grouping of companies. We propose the following grouping:

Group 1. SOEs that will not be privatised. For these SOEs, the state should formulate a clear ownership policy, with a convincing rationale for keeping them in state hands (such as natural monopoly considerations, social policy issues, or national security concerns). This group includes SOEs such as Naftogaz (which plays a vital role in transforming the energy market and performs a social policy function).

Group 2. Large companies that can be privatised, but need restructuring before privatisation process (such as large integrated energy companies and the like). For this group, the restructuring process should begin (or the obstacles for privatisation should be removed) as soon as possible, since the entire preparation for privatisation is a lengthy process (some 18–24 months). This group may include companies in the energy sector, such as UGV, UTG (excluding the gas transmission infrastructure), and Energoatom; banking, such as Oshchadbank and Ukreximbank; transport, such as rolling stock of Ukrzaliznytsia and sea ports; and services, such as Ukrposhta.

Group 3. Large companies that can be privatised and need no restructuring, but need advisors to support the privatisation process (such as large industrial companies). This group should be used for demonstrating that the privatisation process for large companies works efficiently. Examples of companies in this group include Odesa Port Plant (OPZ), Tsentrenergo, and Sumykhimprom.

Group 4. Smaller companies that can be privatised and need neither restructuring nor privatisation advisors. The most suitable privatisation mechanism for this group is the public auction, with price as the only criterion.

Group 5. The remaining companies, which cannot be privatised because they are of no interest to investors, should be liquidated. Their assets should be sold through a public tender, with revenues used to cover part of their liabilities.

9. Institutionally, two important changes are required:

   - The responsibility of the SPF should be made clear. We propose changing the incentives of the SPF so that failure to carry out privatisation implies clear responsibility. (Today, the SPF's officials have a greater incentive not to privatise in order to avoid criminal responsibility.) If this cannot be done quickly one should abolish the SPF altogether or narrow down its functions, making it a much smaller and more efficient privatisation office.

   - Clear deadlines (e.g., two months) should be set for the transfer of the SOEs from the privatisation list to the SPF.12If the respective line ministry does not perform the preparatory procedures for an SOE, it will automatically be transferred to the SPF, and the Fund will be responsible for completing those preparatory procedures. (Assuming that the SPF is quickly reformed or replaced by other structure.)

C. Corporate governance in SOEs

1. The process of CEO appointments in SOEs should be unblocked urgently. In particular, less discretion should be given to line ministers. (Today, they can sabotage the CMU Resolution appointing the CEO.)

2. The SOE's which for some reasons are not privatised should undergo a reform corporate governance. Unitary companies should be corporatised.

   The government can now set up full-fletched independent supervisory boards in major SOEs. The government should set up such boards in some 10–15 largest SOEs to improve oversight and operations in these companies.

   There is only one SOE in Ukraine, in which a full-scale corporate governance reform is underway and a full-fletched board of directors has been set up: Naftogaz. Overall, the reform at Naftogaz and, particularly, its subsidiary Ukrgazvydobuvannia has generated very visible improvements.

   However, even the first stage (out of three stages) of the Corporate Governance Action Plan of Naftogaz is still not completed. In particular, no ownership policy for Naftogaz has been adopted, no performance evaluation criteria for the Supervisory Board are in place, control mechanisms under the Supervisory Board are not yet implemented, etc. (At MGU, the new transmission system operator, the corporate governance systems needs to be simply created "from scratch"). This measure is within the competence of the Government.

   Other immediate targets for improved corporate governance include Ukrzaliznytsia, Ukrposhta, MGU (the new gas transmission operator to be set up), etc. Of these, Ukrposhta appear to be able to generate the quickest wins by the end of 2016 (in terms of popularity with the people) due to high visibility of the company, limited painful consequences for the population, and absence of serious vested interests.

   In state-owned banks, Oschadbank and Ukreximbank, improving corporate governance requires legislative changes (to separate the functions of the state as the owner and a policymaker, to insulate the banks from political influence, and to allow real boards of directors with truly independent directors). The government should submit these changes to the Parliament in September.

3. It is necessary to bring the corporate governance rules for SOEs in compliance with OECD standards of corporate governance. This requires developing legislative changes, which:

   - create a level-playing field for SOEs and private companies;
   - solve the issue of ownership rights to and supervisory boards in subsidiaries of SOEs;
   - solve the issue of dividends paid by subsidiaries of SOEs according to standard corporate practices;
   - ensure that financial plans of SOEs are approved by their boards of directors, not by the Cabinet of Ministers;

- forbid political intervention in the businesses of SOEs (a draft law on preventing SOEs from political intervention has been developed by EBRD’s consultants).

IV.2 Deregulation and improvement of business climate in Ukraine

Alexander Škurla

A. To lower quantity of controlling bodiesandto guarantee transparency of controlling process itself

1. Background:

Nowadays there are around 45 state controlling bodies workingin Ukraine, and often we see duplications and contradictions in their operations. Some functions are not in compliance with principles of market economy. Decree of the Cabinet of Ministers of Ukraine № 442 from 10 September 2014 cancelled only 2 controlling bodies, but this liquidation is still only formal. Some controlling bodies have been merged, but their functions have remained. Disorder in controlling bodies government settled throughmoratorium on controls(since 2009).

2. Proposals:

- To analyze functions of all state controlling bodies.
- To liquidate state controlling bodies with dublicated and contradicted functionsand with functions that are not in compliance with principle of market economy.
- To implement Decree of the Cabinet of Ministers№ 442 from 10 September 2014 „Onoptimisation of system of central organs of executive governance“ in full extent.
- To adopt draft Laws№ 3153„On specific aspets of state control regarding economic activities“,№2418a „On basic aspects of state control in economic activities regarding liberalization of state control“, № 2422a „On regulation of specific aspects of state control in economic astivities“,№ 2531a „On improvement of legislation in the sphere of state control“, **that** passed first reading in2015 and expect second reading. Draft Laws introduce implementation of risk criteria, lower amount of state controls including controls of State Fiscal Service, save time for entrepreneurs.
- To improve Decree of the Ministry of Economic Development and Trade of Ukraine from 30 September 2015 № 1553 (Plan of complex planned controls of state controlling bodies) in order to include into the Plan controls of all state controlling bodiesembracing State Fiscal Service**.**

B. To accelerate deregulation process of business environment

1. Background:

In the period of 2014 – 2016 some steps in deregulation in Ukraine have been done: amount of permitting documents have been lowered by 40% from 143 to 84; amount of economic activities needed licencing have been decreased from 56 to 30; quarentine certificatehas been cancelled (saved to businesses almost 2 blnUAH per year); compulsory certification has been cancelled regarding almost 90% of goods including new cars; more than 2 times terms of issuing phyto-sanitary certificates have beenshorten(from 5 daysto 2 days, around 5 billion UAH saved for businesses per year); almost 15 000 SovietGOST standards have been abolished. Decree of the Cabinet of Ministers № 615-phas been adopted on 23 August 2016„On action plan of economic activities deregulation“, that comprises 112 actions on deregulation in different sectors.

2. Proposals:

- To execute inventarisation and estimation of all legislative acts of the regulatory system of Ukraine.
  To adopt list of objective estimation criteria what regards all regulatory legislative acts (conformity to present legislation, conformity to constitution, conformity to international treaties, possibility to take sugjective decision etc.) and estimate all regulatory legislative acts based on those criteria.
- To adopt draft Law № 4958 „Onreduction of permitting procedures in the sphere of foreign economic activities“.
  Adoption of this draft Law would allow to cancel licences on export and import of ethanol, cognac and fruit spirit, alcoholic drinks tobacco products,to cancel requirement of reporting of retailers and financial fines fornon-compliance. Licences on export and import of above mentioned products for 5 years concentrated foreign-economic activity in sector among few big players. Cancellation of licencing would enable also small and medium sizedtraders to enter foreign markets.
- To adopt draft Law№ 4131 „On shortening of quantity of regulatory documents, including more active implementation of principle to declare.
  Big amount of permitting documents for processing of business activitiesharm the development of businessin Ukraine. This draft Lawmake regulatory procedures simpler in the spheres of:land protection, tradition medicine, determination of ownership right onobjecs of cultural heritage, estimation of real estate, insurance, labour protection, tour operating activities. For example this draft Law suggests to liquidate 18 regulatory documents and licences ontour operators.
- To adopt Decree of the Cabinet of Ministers of Ukraine on specification of application of the principle of „silent consent" while issuing regulatory documentsor to adopt draft Law „Onregulatory system in the sphere of economic activities".
  Present legal regulation of implementation of the principle of „silent consent“ is not sufficient (Law On regulatory system in the sphere of economic

activities, Decree of the Cabinet of Ministers № 77 from 27 January 2010), as many state organs and courts in Ukraine do not accept this principle as a tool of permitting economic activity, what make doing business more complicated. Solution could be automatic submission of information on issuing of regulatory document based on the principle of „silent consent“ into Single state register of legal bodies, physical bodies-entrepreneurs and public associations.

- To adopt draft Law № 4194 On usage of stamps of legal bodies and physical bodies-entrepreneurs.Draft Law suggests to cancel compulsory requirement to use stamps by entrepreneurs. The draft Law has been adopted on 8 September 2016 in first reading.

- To adopt draft Law № 4496 "On cancellation of administrative barriers on export of services".
  Draft Law reacts on decline of services export in 2015 by 17%, excessive administrative burden in the sector and simplifies procedure of contracting with foreign partners, accountancy and financing reporting as well as currency control in the sector of services (contracts could be concluded also in electronic form, banks should be banned to require translation of contracts into Ukrainian language if there is valid English version of contract, invoice should be acknowledged for accountancy and financial reporting, invoice could be signed by electronic signature). Draft Law has been adopted in first reading on 12 July 2016.

- To implement real control on creating newregulatory resolutions.
  Every new regulatory legislative act that is proposed to be implemented towards businesses, should undergo an analysis of regulatory influence on implementation while determining quantitative effects on businesses. This rule(M-test)should be compulsory for implementation according toDecree of the Cabinet of Ministers №1151.

C. To simplify the state regulatory system in the sphere of construction and allocation of land plots:

1. Background:

Construction is one of sectors of national economy with significant multiplication effectsinfluencing development of many other sectors of thenational economy of Ukraine. Unfortunatelly, untill todaydevelopment of construction in Ukraineis rather curbed by non-standardand toolong-lasting regulation procedures. Instead of securing the quality of construction, state regulation system slows down the whole construction processbeginning from allocation of land plots and finishing by issuing of permission onutilization of constructionobjectand connectionto electricity network.

2. Suggestions to resolve situation:

- To amend present legislation with the aim tomake the procedure of elaboration of land plots into private property or lease from sate or municipal property faster and quicker (the draft Law has been prepared).
  The aim of the draft Law is to make faster the process of allocation of land plots from lands of state or municipal ownership into private property or leaseby minimum of 2 months…to shorten the average terms to 6- 7 months. Draft Law cancels the duty to receivepermission on elaboration of project; cancels the duty to receive permission on elaboration of expert financial evaluation of land plot; allows to settle the process of elaboration of land plot in the framework of one meeting of municipal session; forms the final list of permitting documents, that are necessary for elaborating of land plot and also stipulates the final list of reasons for negative decisions on application.

- To amend present legislation regarding procedure of elaboration of land plot of state or municipal ownership for salein such a way, that detailed territory plans and normative-financial evaluation of land plots including ratios would become an open information for the public(draft Law has been prepared).
  Elaboration and allocation of land plot is very long-lasting and bureaucratic procedurein Ukraine. Since 1January 2015 based on the Law on regulation of construction activityfor elaboration of land plot it is necessary to have „Detailed plan of territory“(DPT, nowadays such official document in Kyiv is at the disposal only on around 10% of territoriesof the Cityof Kyiv and around 50% of territories in regions of Ukraine). Often municipalities are forced to arrange for such document using financial resources of private applicants. It´s not possible to see publicly what has already been done regarding DPT or has not been done. Procedure of „Change of targeted purpose“ of land plots is also quite bureaucratic and long-lasting. Process of land plot elaboration in Kyiv lasts in average from 2 to 3 years, requiresin average 17 meeting contactswithofficial representatives, arranging for 55 separatedocumentswhat creates broad space for corruption.Elaboration of land plots in the regions of Ukraine lasts in average 9 months. Normative-financial evaluation of land plotsin 2015 increased in average by 47% while implementing mechanism of indexation. Information on normative-financial evaluation of land plotsand methodology of calculation is so far not publicly open and creates space forcorruption. While arranging for„Construction permit“problems on receiving of construction conditions could appear, also while receiving state expertise for 4-thand 5-th categories.

- To implement singlesimplified procedureregarding the allocation of construction object mailing address (draf Law has been prepared).
  At present allocation of mailing address to construction object of finished construction iscomplicated procedure, that could last till 1 monthandcreates broad space for corruption.

- To merge State register of rights on real estate and Cadaster register in one.
  At present a lease right or an ownership right should go through the state registration process of the right on real estate either within the State register of rights on real estate(lease rights and ownership rights on objects of construction) or within the Cadaster register (land plots).
- To decrease requirement to pay „district development fee“ according to the Law on regulation of construction activities.
  Law on regulation of construction activities introduces for developers obligation to pay „district development fee“, that could reach up to 10% of the value of the wholeconstruction project what regards commercial real estate and up 4% what regards residential real estate.
- To optimize legislative acts regarding the state construction norms (SCN)by:1. liquidation of SCN; 2. harmonization with theEC norms; 3. liquidation of duplications based on other requirements.
  At present construction companies of 4 and 5 categories of construction works in Ukraine are oblidged to pass state control in construction called state expertise. When there is a new, modern construction project that do not comply with old Ukrainian state construction normsit is possible to settle the issue only through the Scientific-Technical Council working under the Ministry of Regional Development, Construction and Housing of Ukraine. Such procedure possesses significant corruption risks.
- To carry out preparation and adoption of the draft Law On implementation of electronic system in the sphere of land relations and construction.
  To arranfe for transfer from paper documentation regarding land relations and construction activities to electronic exchange of documents, aiming to increase effectiveness and lower corruption risks to minimal levelthanks tolowering the amount of contacts between order party or implementor of works / services and state or municipal institutions. Proposed electronic system is based on the principle of self-financing.

D. To simplify the state regulatory system in the sphere of natural resources exploitation

1. Background:

Ukraine possesses significant reserves of natural resources, but its extraction and utilization is hampered by state regulatory system. For example:extraction of natural gasfrom deposits, that are now not working because of the administrative process of land plots allocation including the procedure of change of targeted purpose, could reach1 billionм³ of gas yearlyin the whole gas industry in Ukraine. The administrative process of change of targeted purpose lasts in extraction business in average from 2 to 5 years. Company „Ukrhazvydobuvanna“is losing on getting special permission

onresources utilisation 440 thousandм³of gas every year(117,76 millionм³ of gas for the whole period), onallocation of land plots for extractionloses the company 1,78 millionм³ of gasevery year (1,6 billionм³ of gas for the whole period), on elaboration of land plots regarding equipping deposits and putting them in operationcompany loses 35 thousandм³ of gas every year (2,6 millionм³ of gas for the whole period).

2. Suggestions to resolve situation:

- To arrange for adoption of draftLaw №3096 „On simplification of aspets of extraction sector“.
  Draft Law stipulates simplified land utilisation for need of extraction industry; cancels requirement to get Act on mine measure for oil and gas companies(since 1994 Act on mine measure duplicates special permission on geological exploration/extraction); settles the problem of long-lasting arrangement of changing targeted purpose of land usage: enables possibility to use land plots based on agreement without duty to change targeted purpose of land usage; enables possibility to use right of „servitut“ in order to exploite oil and gas deposites and objects of pipeline transport without delay; cancels duty to register objects of extraction industry as objects of construction.
- To cancel all exceptions what regards access to auctions on sales of special permissions on utilisation of natural resources, that are determined in Decrees of Cabinet of Ministers № 594, № 615from 30 May 2011, № 277 from 6 April 2016**.**
- To amend Code on natural resources№ 132 from 1994
  There were attempts to amend Code on natural resources during last 10 years. AmendedCode has to give clear answers to the following questions: Who should agree uponthe rights to utilize natural resources(Regional Councils, Ministry of Ecologyand National Resources, Derzhirpromnahlad)? Which document confirms the right to utilizenatural resources(permission, agreement)? Would it be reasonable to have possibility to transfer the right to utilize natural resources to another subject?

E. To strengthen by legislative way the position of business ombudsman in Ukraine

1. Background:

Office of Business Ombudsman for more than one year since its establishment in Ukraine proved its positive impact on improvement od business environment in Ukraine: received 862 complaints from the side of businessmen working in Ukraine and 375 complaints helps to resolve, helping the businesses in Ukraine to save up to 3,5 billion UAH.

2. Proposals:

- To adopt draft Law№4591 „On establishment of Business Ombudsman ".
  Draft Law № 4591 has been supported by Committeeon industrial policy and entrepreneurshipof Verchovna Rada of Ukraine,despite the fact that Mainscientific-expertdepartmentof Administration of Verchovna Rada did not support adoption of such draft Law. In case draft Law№ 4591 would be adoptedstate organs of Ukraine would be obligated to cooperate with the Office of Business Ombudsman in Ukraine and to respond to its enquiries and complaints.

F. Deregulation of labour market

1. Background:

Labour market in Ukraine is regulated by Labour Code that is based on regulations of Soviet Labour Code adopted in 1971. Labour Code got obsolete and do not create stimuli for economic development and mobility of labour force. There were several attempts to amend present Labour Code(2008, 2011, 2015), but all of them did not find necessary compromise among different political forces of Ukraine. What regards labour market we suggest in the meantime to concentrate firstly on cancellation of excessive administrative barriers in area of labour lawand secondly on implementation of administrative responsibility of state servants as a tool toavoid violations and misuses from the side of state and public servants.

2. Suggestions to resolve situation:

- To cancel compulsory employee´s workbooks.
  Draft Law № 3507 from 24 November 2014 „On simplification of personal work of taxpayers" aims at cancelling the employee´s workbooksthat mean certain administrative burden for employers and could have negative impact on employees. Economic effect for businesses from abolition of employee´s workbookscould reach up to 500 mil UAH yearly. Instead of employee´s workbookselectronic data of labour activities of employees within the State register of compulsory state social insurance should be used.

G. Protection of private property rights of businessmen

1. Background:

Even if number of complaints on hostile takeovers according to the Ministry of Justice of Ukraine has decreased significantly in 2016 (1000) compared to 2015 (3000), hostile takeovers continue to exert strong negative impact on quality of business climate in Ukraine. It is necessary to adopt effective measuresonprotection of private property

rightsand on fight against state and private hostile takeovers in Ukraine. What appears as a problem is absence ofpersonal responsibility of state prosecutive and regulatory organs.

2. Proposals:

- To adopt draft Law on criminal responsibility of state registrators suggested by the Ministry of Justice of Ukrainein order to amend **present**Criminal Code of Ukraine with the aim to introducecriminal responsibility of dishonest registrators.
- To amend corporate lawwith elements of higher protection of ownership rights: for example signatures of chairman and secretary general on Protocol of general meeting of legal body should be confirmed by notarius.
- To change regulations on theCommission on dealing with complaintson hostile takeovers at the Ministry of Justiceof Ukraine. According to present rules it is possible to submit complaint on hostile takeovers only during first 30 days since the moment the hostile takeover starts. Suggestion is to prolong these terms.
- To secure that all court decisions, including permission to examinationinitiated by the Office of Prosecutor General or the State Fiscal Service, will be incorporated into the Register of court´s decisions.
- To adopt additional criminal responsibility for employees of state prosecutive organs onabuse of state servant´s responsibilities.

IV.3 Demonopolisation

Andriy Boytsun

A. Background

1. Although there are strong suspicions and abundant anecdotal evidence of limited competition and monopolisation in some of the Ukrainian markets, statistics and legal evidence are lacking, making it is difficult to describe the state of affairs precisely. In particular, the focus of the State Statistics Service is on collecting production data rather than markets and ownership data, which makes it impossible to use it for analysing market positions and misuse of privileges.

2. On the face of it, dominant market positions are sometimes related to oligarchs, but sometimes not. SAGSUR has commissioned an independent study to provide an inventory of the privileges that may systematically lead to dominant market positions, with the first results expected by the end of September.

3. Ukraine has no clearly defined competition policy aimed at promoting and developing competition rather than controlling monopolies.

4. Potential natural monopolies and related markets – such as energy markets – are the most likely candidates for market power abuse and misuse of privileges. This may proceed via regulatory capture (allowing the monopolist to set favourable tariffs/prices or limit market entry by new participants) or budget capture (allowing preferences for selected parties).

5. Ukraine has no institution of the market regulator (and no history of proper regulation), which is necessary for many markets that were historically controlled by the state (e.g., energy or transport markets). In addition, the Anti-monopoly Committee of Ukraine (AMCU) is often charged with tasks that are normally meant for sectoral regulators.

6. Overly regulation by the state in potentially competitive markets (e.g., food products) contributes to limited competition and monopolisation (see our section on deregulation).

7. Ukraine has been systematically failing to conduct any notable privatisation, as well as to create a level playing field for private companies and state-owned enterprises (SOEs). In addition, the reform of corporate governance in SOEs has not advanced in the past half a year. All of this contributes to a lack of competitive neutrality in Ukraine and maintains a fertile ground for misuse of privileges for private gain.

8. In many sectors, which were created and historically managed by the state (e.g., energy, railways, or roads), Ukraine is facing the challenge of separating the ownership function, the social policy function, and the regulatory function of the state. Establishing the institution of an independent regulator is especially challenging.

B. Energy markets

The Parliament should pass a law on the independent energy utilities regulator (Draft Law "On the National Commission for the State Regulation in Energy and Utilities"). The Energy Community (EC) also maintains that the energy regulator should be established by law. It is supposed to guarantee its long-term independence from the President, the Government, and the Parliament. This law also is one of the conditions for EU financial assistance of €600 million. The law has to be adopted in September–October 2016. According to the draft law, the regulatory office would be established be during the next six months after the law is passed (by spring 2017).

C. Gas market

1. Gazprom is pretty much the "elephant in the room". Gazprom allegedly misuses its dominant position in two major ways:

   - As a monopolist gas supplier, it appears to engage in price discrimination. In particular, it has been selling gas to European countries at a price lower than the price for Ukraine.
   - As a monopsonist buyer of gas transmission services from Ukraine. Ukraine cannot shut off access to its transmission system for Gazprom, because that would cut off Europe from Russian gas. If there were other buyers of transmission services, Ukraine would be able to choose who to work with.

2. Regional gas distribution

   - Available evidence suggests that one oligarchic group controls about 80% of the regional gas distribution companies (oblgases) and regional transmission operators. Despite some changes in the regulations, this allows these regional companies to prevent access to the system for new entrants.
   - In order to create trust in such sensitive markets, which are characterised by natural monopolies and regulation, high standards must be applied to the reputation of owners and transparency of ownership. If the oblgases' overdue debts of to Naftogaz persist:

     - the Government and Naftogaz can initiate their bankruptcy;
     - the regulator can take away their license;
     - they can be influenced through state-owned distribution networks.

D. Electricity markets and heat generation

1. According to the AMCU, the existing model of the wholesale market for electricity is based on the principle of a single buyer, making it prone to artificial monopolisation. At the same time, the potential for competition in electricity generation and supply is substantial.

   It is necessary to implement the EU's Third Energy Package (inter alia, by passing Draft Law "On the electricity market in Ukraine") to solve the problem. In

particular, it is necessary to make sure that no producers get a preferential treatment in any form.

2. The AMCU notes that the wholesale electricity price is formed by the energy regulator in an opaque manner. It is necessary to introduce transparent forecasting of electricity production by the Ministry of Energy, based on proportional and non-discriminatory treatment of producers/importers.

3. According to the AMCU, it is necessary for the energy regulator to introduce a transparent methodology according to which it determines the maximum prices for energy generation by heat power plants, depending on the type and cost of fuel. This will bring transparency to the heat power plants' tariffs and the wholesale market price.

4. Today, certain types of customer (such as household or metallurgic plants) enjoy preferential prices for electricity. These implicit subsidies are covered by other customers (such as industrial producers), including customers from other regions. We support the AMCU's proposal to abolish this cross-subsidisation.

5. The AMCU suggests that access to local electricity networks should be made possible, transparent, and effective. (Today, oblenergos can misuse their monopoly position to block access to energy suppliers due to the opaque procedures valid today.)

6. The AMCU notes that the procedure of obtaining electricity connection is opaque and complicated. In addition, the markets for electricity network construction are artificially monopolised (the contractor is chosen by the electricity distributor and requires no tender). We subscribe to AMCU's proposals on deregulating these procedures and making them competitive.

   It is necessary to pass Draft Law "On the electricity market in Ukraine" and Draft Law "On amending certain Laws of Ukraine" (regarding improving the connection to electricity networks)".

7. According to AMCU, it is necessary to introduce incentive-based tariff-setting for oblenergos, Ukrenergo, and other producers whose operations are not based on price bids.

8. Today, the market for thermal coal is effectively absent. The coal is sold within vertically integrated companies (the DTEK group uses the coal produced by DTEK mines; state-owned companies use the coal produced by state-owned coal mines and coal purchased from the state-owned company "Vuhillia Ukrayiny"). In addition, state-owned coal mines receive financial support from the state, which contributes to coal price distortions. All in all, this feeds into electricity price distortions. The AMCU proposes to:

   - introduce a market for thermal coal in Ukraine (by establishing a centralised trade platform for thermal coal);
   - abolish subsidies for the coal industry and to shut down loss-making mines.

E. Other markets

1. *Pharmaceuticals*. According to the AMCU, it is necessary to create competition in this market.

   - It is necessary to introduce reference pricing for all pharmaceuticals and medical products sold in Ukraine, as well as to create open registers of wholesale prices for these products.
   - The inefficient state regulation of the pricing for medicines should be replaced by a reimbursement-based system.
   - Mandatory medical insurance should be introduced (which can be done by adopting Draft Law "On mandatory social medical insurance").

2. *Air transportation*. According to the AMCU, the current regulations provide no mechanism for cancelling the rights to frequencies received by air carriers for international flights. Even if such frequencies are not used by the carrier, they cannot be used by other carriers, which blocks their access and limits competition. The international flight market appears to be dominated by one airline company.

3. *Transport*. Ukraine should establish a transport regulator in order to regulate natural monopolies and related markets in the transport sector.

4. *Sea ports*. Since there is no methodology for sea port tariffs, these can be set at arbitrarily high levels. The ports can also effectively discriminate prices by providing arbitrary discounts to selected customers. The Ministry of Infrastructure, which effectively regulates the industry today, should develop a transparent methodology for sea port tariffs.

5. *Oil processing and gas production*:

   - The oil produced by Ukrnafta (majority-owned by the state) appears to be processed by the Privat group, with the resulting products allegedly sold to the Privat group.
   - The gas produced by Ukrnafta is appears to be sold to DneprAzot, a company that appears to be related to the Privat group.

6. Many markets appear to be monopolised or oligopolised, but require a further analysis. These

   - gas production (appears to be misused by several oligarchic groups);
   - retail (appears to be dominated by one retail network);
   - telecommunications;
   - airports;
   - road construction and maintenance;
   - tobacco wholesale (appears to be monopolised by one supplier);
   - water supply and sewage (there are monopolies at the regional level);
   - banking retail: one bank appears to control about a third of the banking retail.

F. Draft laws that should be passed

- Draft Law "On the National Commission for the State Regulation in Energy and Utilities" - ПроектЗаконупроНаціональнукомісію, щоздійснюєдержавнерегулюванняусферахенергетикитакомунальнихпослуг (No. 2966-d, dd. 19.02.2016).
- Draft Law "On the electricity market in Ukraine" - ПроектЗаконупроринокелектричноїенергіїУкраїни (No. 4493, dd. 21.04.2016).
- Draft Law "On amending certain Laws of Ukraine" (regarding improving the connection to electricity networks)" - ПроектЗакону «ПровнесеннязміндодеякихЗаконів (щодовдосконаленняприєднаннядоелектричнихмереж)» (No.4310-1, dd. 28.03.2016).
- Draft Law "On mandatory social medical insurance" - ПроектЗакону «Прозагальнообов'язковесоціальнемедичнестрахування» (No. 2462a, dd. 30.07.2015).

IV.4 Energy Reforms

Karel Hirman (with cooperation of Andriy Boytsun)

A. Background

In the past two years, Ukraine has done more reforms in the energy sector than during the entire previous period since independence in 1991. However, gas and electricity market reforms have come to a halt and shown no significant dynamics during the last several months. Many legal principles based on EU legislation need to be implemented in Ukrainian legislation, but the laws required for this have not been passed or they are waiting for approval in the Parliament (see the list of the pro-reforms laws). In this crucial area, the energy sector reform has not yet taken off.

As of early September 2016, Ukraine has not established an independent energy regulator, nor adopted a Law on Electricity Market, nor amended the Law on Natural Gas Market. Hence, the legal regime of the gas market was not sufficient to trigger real liberalization. The government has decided to unbundle the transmission system operator and underground gas storages from Naftogaz. It is now a matter of implementing it, with the implementation complicated by the Stockholm arbitration proceedings between Naftogaz and Gazprom.

The state of communal heating energy is still very critical.

The most important achievements to date are:

- Diversification of the supplies of two key energy sources: gas and nuclear fuel.
- The decision of the Ukrainian government to set gas prices on the same market level, including all households, which reflects the principle of import parity and the actual cost of gas purchases abroad (decision No. 315 dd. 27.04.2016 on a single price of 6879 hryvna/thousand m3).
- According to forecasts, for the first time since 2006, Naftogaz will show profitability in 2016 and will require no financial assistance from the state budget to cover the losses from the sale of gas to households. The management expects a profit of about 16-18 billion UAH after tax in 2016. Most income and profit come from the transit of Russian gas to Europe, representing 2 billion USD.

The most urgent reform measures are:

- Creation of the independent regulatory office (see the list pro-reform laws),
- Creation of fundamental principels for transparent and liberal energy market (see the list pro-reform laws),
- For the heating season 2016-2017 is necessary to improve physical criteria for calculation of subsidies (relation of subsidies with the climate coefficient for every month and for every region based on valid construction standard),
- Restoring transparency in the payments for energy and creation of conditions for monetization of subsidies for population.

B. Heating and housing and utilities services (HUS).

Residential and public sector accounts for 60% of the total natural gas consumption in Ukraine. Industrial sector consumes only 40% of gas. The population is the main housing and utilities services (HUS) consumer and target group aimed by the state policy in this sector. The state and legal entities are also HUS consumers, but their share in total consumption is much lower and, for example, for central heating it makes up about 30%. The sector of residential and public buildings heating has one of the largest potentials for improving energy efficiency in Ukraine. The annual consumption of natural gas for heating purposes is estimated at 18 - 19 billion m³ with the maximum reduction potential (when reaching the current level of losses in the EU) of 11 billion m³ of gas[16].

- Centralized heating sector is one of the biggest natural gas consumers - 7.2 billion m³ in 2015,
- The sector has huge inefficiencies in terms of heat production and transmission (outdated District Heating Plants (DHP) and Thermoelectric Plants (TEP)) and in terms of consumption (large losses in buildings),
- In terms of investment efficiency to the modernization of supplies (isolation of networks and upgrading of boiler houses) has the greatest potential to reduction in gas consumption may be about 2.4 billion m³,
- The biggest saving potencial have buildings (public, residental - multiapartments and individual) to reduction in gas consumption about 7 billion m3,
- The system of mutual settlements for heat consumed by the population and relevant gas supplies has significant "gaps" in liquidity due to failure of the state to fulfill its commitments on housing and utilities services subsidy payment and difference in tariffs. By this, the burden of liquidity "gaps" falls on District Heating Companies (DHC).

Proposals:

- To restructure debts throughout the supply chain (population - District Heating Companies – Oblgases-Naftogaz-state budget) -the state budget for 2016 does not envisage subventions to pay debts for difference in tariffs, thus for 2016 there is no any mechanism to pay the debts that will continue growing in the future. Restructuring of existing debt is one of the necessary steps to financial recovery of the sector, which is a prerequisite for industry modernization,
- To review rules of the payment system (calculation and schedule of bills for heat), which is largely controlled by the state and creates significant "liquidity" gaps for market players (incl.system of subsidies for households) - cover District Heating Companies (DHC) cash gaps resulting from a delay between the increase in gas prices and the increase in tariffs for hot water, reducing DHC cash gaps as a result of disbalance between the timing of payment for gas and receipt of funds for heat, ensuring the timely receipt of payments from the budget,
- To review the tariff-making system (DHC can not include to tarrifs all necessarily costs for maintenance and modernization of grid system) that currently does not

[16] According data of Ministry of Regional Development, Building and Housing and Communal Services

motivate businesses to invest in facilities (average losses in the networks make up 16% according to the State Statistics Service of Ukraine. However, according to market operators, the real losses in some spots can reach up to 50% and need an immediate repair or replacement),

- To streamline the sectoral legislative framework and align it with the EU standards incl.technical standards,
- To review the governmental procedures for selecting and approving projects, which significantly slow down the implementation of investments (creation of an Energy Efficiency Fond)

C. Energy Efficiency

It has to Energy efficiency must be a top priority of energy policy of the Government. The Government has to should decide which member of the Government will be responsible for this area. This issue is relevant for all the sectors of the economy, (not only forthe energy sector,) and has a crucial impact on the social stability of households. The creation of an Energy Efficiency Found is not enough, and befor creating it:

Proposals:

- the Parliament has to adopt the necessary laws about measuringon measurement instruments, energy efficiency in buildings, the rules for calculation of public services (see the list pro-reform laws);
- the Government and the Parliament has to reinforce the position and rights of OSBB (Associations of Co-owners of flat buildings) with respect to utilities and institutions (see Draft Law "On the commercial accounting of utilities") .

D. Subsidies

Currently Ukraine has a system of the housing and utilities services (HUS) subsidies, which was developed in the middle of 90s of last century. The main principle of this system was minimizing consumer`s participation in the settlements. Today cost of services reached economically justified level, more than an half of households can become recipients of the system. Disadvantages of the current subsidy system:

- Blurred responsibility for timely and full payment for services between consumers and the state through numerous agencies involved in the settlement,
- No control between accrued and actually received subsidies amount,
- The system encourages netting that negatively affects the settlements and responsibility for the accuracy of determining the amount of payment.

Proposals:

- Restoring transparency in the payments and creation of conditions for monetization of subsidies for population,

- For the heating season 2016-2017 is necessary to improve physical criteria for calculation of subsidies (relation of subsidies on the climate coefficient for every month and for every region based on valid construction standard),
- Establishing direct relationship between supplier and customer of services for all types of payments.

E. Gas Market

1. **Unbundling of Naftogaz.** The Government has decided to unbundle the transmission system operator and underground gas storages from Naftogaz and make this new companies independent. This process is actually affected by the arbitration in Stockholm. The first preliminary decisions of the court are expected during 2017 year. The final decisions could be later.

   Proposals:

   - For this reason, it is necessary – before of unbundling – to implement changes in the statutes of Naftogaz in order to increase the independence of Ukrtransgas and to prepare conditions for creation of the international consorcium for operating of gas transit system

2. **Gas market reforms** demonstrated no significant dynamics during this year. Hence, the reform in this sector has not yet left the turning point.

   Proposals:

   - In particular, this concerns the implementation of the secondary legislation incl.the amendment of the Law to Gas Market, of the European network codes, the introduction of European gas transportation tariffs within Ukraine, etc. This measure is within the competence of the energy regulator and the Parliament,
   - This also applies to different governmental and ministerial acts affecting the responsibilities of the regulator. This measure is within the competence of the Government.

3. **Domestic gas production.** The Government wants to increase domestic gas production to 29 billion m3 by 2020 (from approximately 20 billion m3 today). This needs to be underpinned by attractive, competitive, and transparent taxation. The current fiscal regime in Ukraine does not incentivize new investment in gas production. One of the fundamental problems are gas and oil licences held by groups close to the Yanukovych establishment. They are blocking production on many fields with large production potential. Since gas production conditions differ from one deposit to another, it is necessary to differentiate the the payments for the rights to extract gas, optimally through acutions.

   Proposals:

- All gas and oil licences from the Yanukovych era, which had been granted in unfair manner and are not in exploitation today, have to be returned to the state deposit.
- Creation rules for competitive and transparent auctions for the exploration and exploitation licences. The geological data under control of state organizations made available on an equal and transparent basis to potential bidders in the auctions.
- Reduction of administration permits for exploitation of fields.
- Ukraine should introduce a flat royalty in compliance with production capacity and complexities of field. Furthermore, royalties should be paid on the basis of transparent European hub prices (similar to the principle of the single price for households) and on the standard European level.

F. Electricity market and coal industry.

Currently main problem for stable function of Ukraine grid system are supplies of energy coal (antracite group – A grade) from Donbass region (under control of separatists groups). On other hand state mines have long term problems with profitability of production and the state budget has been cover thier losses. Coal indrustry needs complex and deep reforms.

Proposals (the competence of Government):

- Privatisation of all state coal mines, incom from privatisation will use on covering of closing non-profit mines,
- To stimulate by tariffs of changing of boilers of power plants from A grade to G grade,
- Increasing energy production by nuclear power plants (base mode), which requires completing the construction of their infrastructure facilities,
- The reducing of coal thermal power plants of generation of electricity from the base mode to the peak.

G. Most important pro-reform energy laws in the Parliament (Verkhovna Rada)

- Draft Law "On the National Commission for the State Regulation in Energy and Utilities" - ПроектЗаконупроНаціональнукомісію, щоздійснюєдержавнерегулюванняусферахенергетикитакомунальнихпослуг (No.2966-d, dd. 19.02.2016).
- Draft Law "On the electricity market in Ukraine" - ПроектЗаконупроринокелектричноїенергіїУкраїни (No.4493, dd. 21.04.2016).
- Draft Law "On the commercial accounting of utilities" - ПроектЗаконупрокомерційнийобліккомунальнихпослуг (No.4901, dd. 06.07.2016).

- Draft Law "On the energy efficiency of buildings" - ПроектЗаконупроенергетичнуефективністьбудівель (No.4941, dd. 11.07.2016).
- Draft Law "On housing services and utilities" - ПроектЗаконупрожитлово-комунальніпослуги (No.1581-d, dd. 10.12.2015).
- Draft Law "On amending certain legislative acts of Ukraine" (regarding bringing them in conformity with the Law of Ukraine "On the natural gas market") - ПроектЗаконупровнесеннязміндодеякихзаконодавчихактівУкраїни (щодоїхприведенняувідповідністьзЗакономУкраїни "Проринокприродногогазу") (No.4868, dd. 24.06.2016).

IV.5 Land market in Ukraine

Alexander Škurla

A. Background:

In 2001 long-awaited **land reform** in Ukraine took place: 7 million of citizens of Ukraine got the property rights to 28 million haof land plots.But afterintroduction of moratoriumon sales of agrarian landsince 1 January 2002 owners of the land plots cannot fully dispose with their land until today. In November 2015Verchovna Rada of Ukraine prolonged moratorium until 1 January 2017. Populists threaten the citizens by sell-out of Ukrainian land, and hinder the potential of Ukraine´s biggest asset already for 15 years.

Prolongation of present moratorium would support continuation of „shadow“land market. It is supposed nowadays, that in shadow space around 7 millionhaof agrarian lands are cultivated, and state and municipal budgets do not receive at least 2 billion UAHevery year, that means 1/3 part of allbudgetary incomes from agrarians. Officially in Ukraine around 21,3 million haof agrarian land is being cultivated, but in fact up to 28,3 million hais being cultivated.

Ministry of Agrarian Policy and Trade of Ukraine prepared draft Law on land turnover that would prolong the moratorium onsales of agrarian land. What is more dangerous, the Ministry suggeststo prolongtermsof land leasefrom 7 yearsto 49 years.President Petro Porosehkoin his speech to Verkhovna Rada on 6 September 2016 advised PMs to work hard in order to open land market in Ukraine.

State institution "Derzgeocadaster"under the Ministry of Regional Development, Construction and Housing of Ukraine in principle supports cancellation of moratorium on agrarian land sales if thetask will be settled as a complex solution(introduction of financing program for buying of agrarian land by farmers, adoption of compulsory consolidation of land plots, introduction of agreed restrictions on agrarian land sales, support of farmers). "Derzgeocadaster" admits start of the land marketalready in 2017, prefers to start fromsales of state agrarian landduring first 2 yearsafter moratorium cancellation and later would allow sales of private argarian land.

B. Proposals:

1. Do not adopt draft Law on land turnover of the Ministry of Agrarian Policy and Food in version where prolongation ofmoratorium on sales of agrarian landafter 1 January 2017 is suggested.
2. Agree on reasonable land market restrictions for the transition period based on agreement of all main stakeholders: state, local administrations, land owners and farmers.
3. Finish inventarisation of all state agrarian land of Ukraine and also to arrange for full inventarisation of private agrarian land. Consequently arrange for effective utilisation of free agrarian land by means of cultivation, lease, sale or transfer to municipal ownership of regional territorial administrations.

CHAPTER V THE HEALTHCARE SYSTEM[17]

Jerzy Miller

A. The current state

1. The healthcare system in Ukraine is inefficient and highly corrupt.

Healthcare is divided among various bodies of the state. Most of it belongs to the Ministry of Health, but other ministries have also their own healthcare units, e.g. the Ministry of Defence, the Ministry of Internal Affairs, the Ministry of Infrastructure (Ukrzaliznycia units).

The units of healthcare are financed from the state budget through the budgets of „their" respective ministries. The amount of the annual budget depends on the resources of the units, for example for hospitals on the number of beds and not on the number of patients nor on treatment costs. Therefore the resources are not being adjusted to the actual treatment needs.

According to the Constitution, medical services are free of charge; in practice almost all of them are paid. It is estimated that the total of informal under-the-table payments to medical staff is comparable with the annual budget of the healthcare system and amounts to approximately 60 thousand million UAH. Of course these payments are not registered and therefore not taxed.

Opinion polls show that 92% of the population feels threatened by the fact that in the case of sickness they will not be able to afford treatment or medicines.

2. In February 2016, the Ministry of Health has completed work on the concept of the healthcare reform, work done with the participation of international advisors. As far as its model is concerned, the concept is correct. It stipulates that:

a) medical services will be financed from the budget (all citizens are entitled to free healthcare), but only in a limited range of services adapted to the current financial capacity of the state;
b) remaining medical services will be wholly or partly paid;
c) every citizen will be able to get a health insurance from private companies, in case of an illness requiring paid services;
d) healthcare units will not receive money just for their existence, but for treating patients. In short, the money will follow the patient;
e) the state will order medical services through a competitive process, from public and private entities, in four groups:
   - services of a family doctor, first aid services;
   - specialist medical services;
   - general hospital services;
   - specialist hospital services;
f) the patient will be able to choose – from all units contracted by the state - the unit where he wants to be treated

[17] This note benefits from the participation of its author in the working group in the Ministry of Health.

g) the state will set up a commission setting the prices of medical services, uniform for the whole country, on the basis of evaluation the ratio of treatment cost to medical effects.

B. Expected changes

1. The most important change is the liberation of residents from the administrative assignments to medical units where they are to be treated. Free choice of doctors and healthcare units by the patient is a fundamental principle of the new system. It creates a market of medical services, where the patient, by his selection of the place of treatment, decides where the state payment for his treatment goes.
2. Doctors, nurses and other health professionals will change their attitude towards the patient because a dissatisfied patient will change the place of treatment and another unit of healthcare will get the payment.
3. The state will order medical services for citizens through a competition in which public and private medical units will compete on the same terms. This change will force the state units to increase the quality of their services to match the level of private units.
4. Competition between the private and public healthcare units will improve their management and reduce the cost of treatments.
5. The introduction of IT systems – encompassing all healthcare units that want to have their services paid with the money from the state budget - will allow statistical and scientific research in the field of epidemiology, on the effects of treatments with various medical procedures, on the impact of prevention on the health of the population, in the field of managements and economics.

C. Necessary tasks to be carried out and deadlines for their implementation

1. The reform requires organizational changes in the Ministry of Health, that is the creation of a team which will be dedicated to the preparation and implementation of the reform. The team should be granted sufficient competences for its operational activity.
   - **Completion date: September 2016.**

2. The reform of the healthcare system is very complicated and risky because of its direct impact on the security of the country's inhabitants. Moreover, the reform concerns a public service which is a very large financial burden for the state budget. Therefore, the reform must be implemented in stages over several consecutive years. The most rational scenario seems to involve the reform being applied gradually to various levels of medical services:
   - 1.01.2017 - the level of a general practitioner
   - 1.01.2018 - the level of a specialist MD and general hospital services
   - 1.01.2019 – the level of a specialist hospital
   - **Completion date: September 2016.**

3. The reform of the healthcare system applies to all residents of the country and all health professionals. In addition, it affects the tasks of many state authorities. This is why regular meetings with representatives of the interested groups are necessary. The information about the proposed changes should be made easily available for the country's inhabitants and healthcare professionals in media and on the website of the Ministry of Health
    - **Completion date, systematically, starting from September 2016.**

4. The reform requires changes to the act Fundamental Principles of the Health Care Legislation of Ukraine. The act should cover only the general principles of the new relationship between the state, patients and public and private healthcare units. All the details concerning the conditions for cooperation should be moved to the level of execution acts in order to maintain the maximum flexibility at the later stages of the reform.
    - **Completion date: adoption of the draft by the Cabinet of Ministers, October 2016;**
    - **Adoption of the act by the Supreme Council, November 2016.**

5. The reform must increase the importance of the flow of information in the healthcare system. It is necessary to build an IT system that includes adequate tools to support all those functions of circulation of organizational, legal, financial, and healthcare-related information, which are essential to the functioning of the healthcare system and necessary for the Ministry of Health to supervise the operations of the system. Due to the fact that the reform will be implemented gradually, in stages, the IT system should have a modular structure, designed and built in sufficient time before the start of the next stage of the reform, so as to ensure the flow of information from the first day of the implementation of the next stage of the reform.
    - **Completion date of first modules, December 2016.**

6. The success of the reform will depend primarily on the people involved in the process. Therefore, it is necessary to raise the qualifications of those who are needed to achieve the objectives of the reform, including, in particular, the healthcare professionals
    - **Completion date, continuously, starting from January 2017.**

7. Implementation of the first stage of the reform relating to services of family doctors
    - **Completion date, January 2017**

All these tasks can be carried out within the planned deadlines only if their implementation starts in late August or early September 2016.