

# ICPS newsletter

## Economic legislation of 2002: were there any changes for the better?

***The lack of a common vision regarding public policy in the Verkhovna Rada, along with the executive government's failure to provide analytical support for policy, prevented a number of laws from being adopted that would have been important for the business community, first of all, the Civil Code and the Tax Code. Entrepreneurs have no possibility to forecast legislative developments, and thus are prevented from designing or implementing their own long-term development strategy. Among the positive results achieved this year we can cite the adoption of the Land and Customs codes, as well as improvements made to financial and agricultural legislation***

Experts of the International Centre for Policy Studies and the Coordination and Analysis Centre for Ukrainian Business Associations evaluated changes in the economic legislation of Ukraine over 2002<sup>1</sup>. The research was conducted with financial support from the Centre for International Private Enterprise (CIPE, Washington, DC) under the framework of the "Evaluation of Changes in Economic Legislation" project. Its results are published in a new issue of Policy Studies.

During October 2001–November 2002, the Ukrainian government continued to adopt inconsistent normative acts in its effort to regulate certain market relations. However, framework legislation adopted under the centrally planned economy regime (namely, the 1963 Civil Code, 1970 Punitive and Labour Code, 1971 Code of Labour Laws, 1983 Housing Code, and 1984 Code of Administrative Offenses, 1991 Economic Procedural Code) were not superseded. The President of Ukraine vetoed new Civil and Economic codes, which were to be enacted starting on 1 January 2003. The impact evaluation of the implementation of these codes indicates that it would be advisable to finalise and adopt the Economic Code, in view of the changes narrowing the sphere of state interference. Concurrently, the Ukrainian business community has been long anticipating for a competent legal resolution of such issues like equality of all legal entities, regardless of the form of ownership, the right of individuals to engage in entrepreneurial activity, protection of intellectual property rights, and identification

<sup>1</sup> The research employed results of enterprise opinion polls carried out in 2002 by the Ukrainian Marketing Group, commissioned by the International Finance Corporation.

of the legal status of securities, hence, the Verkhovna Rada should focus its efforts on elaborating and adopting a new Civil Code.

### Ownership relations

The current outdated legislation in Ukraine fails to rise to today's market needs, and often contradicts new normative and legal acts. Under such circumstances, legislative uncertainty has increased, particularly in terms of protecting private ownership rights; and as a result, the risks of doing business escalate. Furthermore, obsolescent laws stifle the development of new financial instruments.

Over this period, no systemic changes took place in terms of legislation on corporate governance; the Verkhovna Rada has not yet approved a new Law of Ukraine "On joint-stock companies". In the meantime, only fragmentary changes have been made to the legislation regulating this sphere. We believe that such a situation is due to the fact that national industrial and financial groups have sought to preserve non-transparent rules, since such conditions permit them to gain control over enterprises at a lower price.

None of the necessary legislative changes have happened in the state property management sector, either; laws "On the management of state property" and "On the State Property Fund of Ukraine" have not been adopted, even though they could perceptibly boost the quality of state property management.

### Judicial reform

At the same time, judicial reform has been underway; on 7 February 2002, the Verkhovna Rada adopted a new Law of Ukraine "On the judiciary in Ukraine", which superseded the laws "On the judiciary", "On commercial

courts", and "On bodies of judicial self-government". The law sets forth the legal frameworks to organise judicial bodies and administer justice; boosts the specialisation of courts and judges, which will provide for the more competent review of cases; and regulates the procedures for supporting court activities, which will give them more independence and thus enhance the protection of entrepreneurs' rights. However, the effects of these judicial reforms will only show with time.

### Tax policy

Tax system reform in Ukraine was cramped by the opposition between taxpayer and government interests; businessmen first of all seek to alleviate their tax burden, while the government endeavours to keep budget revenues from any sizable shrinking. The Verkhovna Rada failed to pass the Tax Code; instead, certain tax laws were considered, with the Law of Ukraine "On the corporate profit tax" amended (the tax rate was cut, depreciation norms raised, and administration simplified) and the excise rate for certain commodities raised. However, the effects from these changes will be felt no earlier than 2004. In November 2002, the process of amending legislation on personal income taxation was initiated—the Verkhovna Rada passed in first reading a relevant law envisaging mitigation of the tax burden upon Ukrainians.

### Regulation of economic activity

The government's policy aiming to support entrepreneurship was for the most part declarative. The number of adopted normative and legal acts that would simplify the regulation of entrepreneurial activity was insufficient. In the meantime, administrative and normative pressure upon entrepreneurs has hardly abated. We believe that the excessive number of normative and legal acts passed every year<sup>2</sup>

<sup>2</sup> Over three thousands of laws, Presidential decrees, and governmental resolutions alone are adopted annually. There are even more normative and legal documents of departments and local government bodies.

is the virtual equivalent of an administrative tax on business, since they consume extra time and money of entrepreneurs in their efforts to track all the changes in the legal domain. Intricate and frequent changes in the legal domain are one of the key problems for doing business in Ukraine.

## Open economy

The Verkhovna Rada and Cabinet of Ministers of Ukraine hardly undertook any measures to adjust Ukrainian legislation to the norms of the World Trade Organisation (WTO). The chief accomplishments became the adoption of the new Customs Code, the Law of Ukraine "On the particulars of state regulation of economic entities' activity related to the production, export, import of CDs for laser data-reading systems", and amendments to the Law of Ukraine "On the quality and safety of foodstuffs and food raw material". Furthermore, in its desire to tighten protectionism of the national automobile and ferrous metallurgy industries, the Verkhovna Rada adopted laws contradictory to WTO norms. We believe that this was possible due to (1) the disinterest of influential stakeholders in acceding to this organisation; and (2) the lack of a mechanism for monitoring conformity of draft laws and governmental decisions to WTO norms.

A positive achievement in terms of the market's openness to labour migration became the lifting of all restrictions on employment terms for foreigners and stateless individuals in Ukraine. On the other hand, an earlier decision of the Constitutional Court regarding changes to the requirement of registering/terminating the domestic residence permit—i.e., from "by permission" to "optional/voluntary"—has remained only declarative, since Ukrainians are still asked to show a stamp in their passport indicating permanent residence when concluding civil acts.

## Financial sector

The most important legislative changes in the financial sector had to do with the regulation of activity of non-banking institutions. During this period, the Verkhovna Rada passed the following key laws: "On credit unions" and "On amending the Law of Ukraine "On insurance". Nonetheless, delaying the creation of the State Commission on Financial Services Market Regulation has stifled the development of the non-banking financial sector.

In addition, the Ukrainian government undertook measures to cope more efficiently with money laundering; the Verkhovna Rada

**Table 1. Summary evaluation of changes in Ukrainian economic legislation**

Changes stimulating business	Changes hampering business
<ul style="list-style-type: none"> <li>– mitigation of the tax burden on enterprises in the new version of the Law of Ukraine "On the corporate profit tax" (decreased corporate profit tax rate, increased depreciation norms, simplified administration)</li> <li>– demonopolised market for confirming compliance services</li> <li>– adoption of framework laws on insurance and credit unions, and formation of financial market regulation agencies, which fostered the institutionalisation of the non-banking financial sector</li> <li>– regulation of the activity of joint investment institutions (mutual funds), which permitted to start granting licenses to asset-managing companies</li> <li>– adoption of a new Customs Code, which will allow to curtail operating costs for agents of external economic activity thanks to simplified and more transparent customs procedures</li> <li>– approval of the Land Code, which heralds the formation of a free land market</li> <li>– unlimited employment term for foreigners, which lowered barriers to labour migration</li> </ul>	<ul style="list-style-type: none"> <li>– accumulated VAT reimbursement debts to exporters, making it even more unpredictable to do business in Ukraine and putting exporters on unequal footing</li> <li>– abandoning single licensing procedures, which tightened administrative pressure over business</li> <li>– delaying the creation of an authorised executive body to regulate the financial services market, which stalled the development of the non-banking financial sector</li> <li>– uncertainty in the adoption of a new version of the Civil Code, which was detrimental to the investment climate and the protection of private ownership rights</li> <li>– delaying the adoption of the law on money laundering which resulted in the FATF imposing counter-measures</li> <li>– approval of decisions to support agriculture that are not backed by budget financing</li> </ul>

Source: ICPS.

adopted the Law of Ukraine "On the prevention and counteraction of legalisation (laundering) of incomes acquired by criminal means", while the NBU tightened its control over foreign subsidiaries of Ukrainian banks. However, despite the measures undertaken, the FATF classified Ukraine as a country not cooperating in combating money laundering.

## Agriculture

During October 2001–November 2002, the Land Code was a hugely important legislative act in agriculture approved by the Verkhovna Rada. Its adoption heralds the creation of a new free land market, which will transform land into capital. Nonetheless, the Ukrainian government has still to promulgate a great number of normative and legal acts required by the code; this makes it highly unlikely that a free land market will emerge before 2005.

The Ukrainian government resorted to a number of measures to support agriculture over the evaluated period, including the introduction of obligatory crop insurance. We disapprove of this measure, since we believe that it discourages enterprises from independently diversifying risks and can unreasonably drive up their expenses. Another mechanism introduced in order to

support grain prices at a stable level were pledged and interventionary purchases. However, given that the budget does not allocate any money to finance these mechanisms, they are only declarative at this point.

## Communications

Major problems in the communications sector include the lack of mechanisms to finance social needs and non-regulated interaction between operators. Postponing the resolution of these problems will result in: (1) escalating opposition between the Ukrtelekom OJSC and private operators; and (2) a sluggish pace for the development of the telecommunications network and telephone penetration level. Therefore, all market participants should be interested in the adoption of a new Law of Ukraine "On telecommunications". Indeed, the Verkhovna Rada has registered such a draft, which entails its attempt to adjust the activity of this corresponding sector in Ukraine to comply with European Union directives. However, vaguely defined norms of the draft can spawn rent seeking and increase operators' operating costs, as well as administration expenses on the part of the government. ■

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