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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 3 April 2008

SEC(2008) 402

COMMISSION STAFF WORKING DOCUMENT

**Accompanying the
Communication from the Commission to the Council and the European Parliament**

‘Implementation of the European Neighbourhood Policy in 2007’

Progress Report Ukraine

{COM(2008) 164}

{SEC(2008) 391}

{SEC(2008) 392}

{SEC(2008) 393}

{SEC(2008) 394}

{SEC(2008) 395}

{SEC(2008) 396}

{SEC(2008) 397}

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{SEC(2008) 401}

{SEC(2008) 403}

1. BACKGROUND AND OVERALL ASSESSMENT

Ukraine and the EU first established contractual relations in 1994 by signing the EU- Ukraine Partnership and Cooperation Agreement, which entered into force in 1998. On this basis, the EU-Ukraine Action Plan was adopted in February 2005 for a period of three years. Since then, implementation has been guided and monitored on the basis of annual implementation tools, which set out comprehensive yearly sets of priorities and timelines, based on the priorities agreed jointly by the EU and Ukraine. A first progress report was adopted in December 2006. In addition, overall evaluations have been carried out in November 2005, March 2006 and May 2007.

Intensive cooperation through the EU-Ukraine Summit, the EU-Ukraine Cooperation Council, the EU-Ukraine Cooperation Committee, and seven sub-committees, has enabled both sides to progress with the implementation of the Action Plan. Negotiations on a New Enhanced Agreement (NEA) that is to be the successor agreement to the PCA started in Brussels in March 2007.

This document reports on overall progress made on the implementation of the EU – Ukraine Action Plan between 1 November 2006 and 31 December 2007 although developments outside this period are also considered when deemed relevant. It is not a general review of the political and economic situation in Ukraine.

Ukraine continued to make progress in most areas, although the pace of progress stalled somewhat compared to the previous years, in particular as regards economic and structural reforms, also due to the political instability which characterised most of 2007. Ukraine's positive record in the conduct of democratic elections of 2006 was broadly confirmed during the 2007 early parliamentary elections, and the freedom of the media further consolidated. Other major achievements during the reporting period have been the launch of negotiations on an EU-Ukraine New Enhanced Agreement (NEA), the finalisation of Ukraine's WTO accession process, the start of negotiations on a deep and comprehensive Free Trade Area as a core element of the NEA, the entry into force of agreements on visa facilitation and readmission, and the positive cooperation with the EU Border Assistance Mission (EUBAM). Co-operation on CFSP matters has significantly increased in scope and in substance. Ukraine has continued to work towards the objectives set by the Agreement on Conformity Assessment and Acceptance of Industrial Products, and has taken further positive steps in areas such as the protection of intellectual property rights. Overall good progress has also been achieved in, for example, the fields of energy and transport.

Constitutional reform to establish the necessary checks and balances between the main state institutions remains a key priority for Ukraine, as do further steps towards consolidating the rule of law through judicial reform, stepping up the fight against corruption, and significantly improving the business and investment climate. While Ukraine has benefited from robust economic growth over the reporting period, reducing inflation and creating the conditions for sustained growth remain the main macro-economic challenges.

2. POLITICAL DIALOGUE AND REFORM

Political dialogue

The political dialogue between the EU and Ukraine has further intensified. Regular consultations are held at the EU-Ukraine summits, meetings of the EU-Ukraine Cooperation Council, EU-Ukraine Ministerial Troika meetings and Troika meetings of the EU-Ukraine Political and Security Committee, Political Directors, and Council working groups.

Democracy and the rule of law

Objectives in this area include: strengthening institutions guaranteeing democracy and the rule of law; judicial and legal reform; and the fight against corruption

The September 2007 pre-term parliamentary elections in Ukraine were observed by an International Observer Mission under the leadership of the OSCE/ODIHR. The mission concluded that the elections “were conducted mostly in line with OSCE and Council of Europe (CoE) commitments and other international standards for democratic elections”. The international observers found that the elections took place in an open and competitive environment for the conduct of elections processes. The field of contestants offered voters a diverse choice of 20 political parties and electoral blocs, which were registered in a generally inclusive and transparent process. Ukraine’s positive record in the conduct of democratic elections of 2006 was confirmed. However, certain shortcomings were registered with regard to the legal basis, such as the poor quality of voter lists, possible disenfranchisement of voters who crossed the borders, and the lack of possibilities for absentee voting. The adoption of the unified election code was once again recommended. An additional concern was the removal of legal provisions safeguarding the integrity of homebound voting”. In February 2007, the Parliament passed a law on the State Voters’ Register whereby a centralised computerised nation-wide register is to be established. The law entered into force in October 2007, too late to play a role in the parliamentary elections.

In January 2007, the Parliament adopted the law on the Cabinet of Ministers of Ukraine after having overridden the President’s veto and without taking any of his proposed amendments into account. The law was criticised by the Venice Commission for introducing through an ordinary law changes that amount to constitutional amendments, as well as for endangering the principle of separation of powers. Outside the reporting period, in January 2008, the President submitted a new draft law on the Cabinet of Ministers which envisages the increase of the President’s powers.

In addition, the Venice Commission pointed out that the constitution lacks an efficient system of checks and balances. Therefore, the two centres of power currently competing in the executive impede the implementation of sustainable reform policies. The Constitutional Court, which barely functioned during most of the year and saw its independence compromised during the political crisis in 2007, has often failed to address issues of constitutional relevance, such as the interpretation of the constitutional provisions related to the powers of the President. In December 2007, the President established the National Constitutional Council, charged with revising the Constitution. Concerns have been expressed regarding the inclusiveness and transparency of the process.

The Venice Commission has also recommended reforming and limiting the excessive powers of the prosecution service, which would require relevant amendments to the Constitution. In addition, the draft law on prosecution reform has not yet been adopted by the Parliament. Training of judges and human rights experts took place throughout 2007 and was provided

through joint cooperation programmes between the EC and the CoE. A number of draft laws on the judiciary, including a draft law on the status and recruitment of judges and a new code of criminal procedure, mainly in line with the recommendations of the CoE, were introduced to the Parliament by the President in November 2007. Amendments to the law on the bar, which envisage equal access to the bar profession for both Ukrainian and foreign citizens, were adopted in November 2006. Nevertheless, further efforts to improve the court reform and to ensure the independence, impartiality and efficiency of the judiciary remain to be done, as well as decisive steps to reform law enforcement bodies.

Towards the end of 2006, efforts were made to initiate **anti-corruption** legislation. The OECD pointed in a report of December 2006 to a number of shortcomings in Ukraine's fight against corruption, notably to the need to reform the criminal legislation to meet international standards and to close loopholes which allow allegedly corrupt persons to escape jurisdiction, to strengthen prosecution of corruption and to address the problem of immunity of senior officials. Political corruption and corruption in the judiciary need special attention. The Council of Europe's Group of States against Corruption (GRECO) adopted its peer review report on Ukraine in March 2007.

The adoption of anti-corruption legislation was halted by the political crisis following the April 2007 presidential decree on early elections and dissolution of the Parliament. An anti-corruption action plan in August 2007 was adopted to address a number of recommendations provided by GRECO. In its present form, the action plan has not been endorsed by GRECO, and not all the recommendations from the CoE experts have been taken into account. The UN Convention on Anti-Corruption remains to be ratified alongside the CoE's Criminal Law Convention on Corruption. Though the problem has been publicly addressed at political level as a priority, no real progress has been made, since the effective implementation of the initiatives still remains to be undertaken.

In line with the objective of reform of the civil service, and as recommended by the OECD, efforts should be continued to improve the standard of the civil service. A new draft law on civil service is presently under consideration by the Parliament. Its main objective is to create a professional, politically impartial civil service in accordance with European standards. Two more draft laws dealing with the accountability of civil servants were the object of regional public consultations during September – November 2007.

EUBAM's activities help the customs, border guard and law enforcement services to develop further their professionalism which, in the long run, will contribute to the respect of the rule of law in these agencies. Although the border between Ukraine and the Republic of Moldova, in particular at its Transnistrian section, is not properly controlled, illegal cross-border activities are more and more adequately combated. At the same time, due to some inconsistencies in the relevant Ukrainian legislation and the high level of existing corruption, in particular also in the judiciary, promising actions of law enforcement services are often wrecked.

Human rights and fundamental freedoms

Objectives in this area include: ensuring respect of human rights and fundamental freedoms, in line with international and European standards; fostering the development of civil society;

ensuring respect for the freedom of the media and expression; ensuring respect for rights of persons belonging to national minorities; prevention of ill-treatment and torture; ensuring equal treatment; ensuring respect of children's rights; ensuring respect for trade unions' rights and core labour standards; and ensuring international justice.

The citizens of Ukraine enjoy wide-ranging pluralism in both electronic and print media. At the same time, a few outstanding issues still need to be addressed. Further progress is needed with regard to the introduction of a public service broadcaster and the development of pluralism in the regional and local media.

Despite positive steps, cases of **torture and ill-treatment** continue to be reported, in particular in pre-trial detention and prison facilities. Investigation into complaints of torture and ill-treatment and prosecution of the perpetrators remain insufficient. Ukraine is cooperating with the CoE's Committee for the Prevention of Torture (CPT), whose latest visit to Ukraine took place in December 2007. However, a number of the CPT recommendations have yet to be implemented. The establishment of the National Preventive Mechanism required under the Optional Protocol of the Convention against Torture remains under discussion. Positive developments were noted regarding cooperation with civil society in the monitoring of detention facilities. An order from Ministry of Internal Affairs was issued in April 2007 requesting that all detainees must be informed of their rights. However, the police have not subsequently received instructions on how to carry out the order. Detainees in pre-trial detention continue to be subjected to harsh conditions, and cases of harassment of persons belonging to sexual minorities by the police continue to be reported. Transfer of responsibilities over the penitentiary to the Ministry of Justice is underway but remains to be completed. Ukraine has ratified the 2nd Optional Protocol to the International Covenant on Civil and Political Rights, aiming at the abolition of death penalty.

Ukraine still has to ratify the Rome Statute of the International Criminal Court which requires constitutional amendments.

Regarding the fulfilment of core ILO obligations, the authorities have increased their efforts in the area of **trade union** rights and core labour standards, notably by setting up an Economic and Social Council, facilitating new trade union registration and implementing the 2006-2007 decent work country programme of policy dialogue with technical assistance from the ILO.

Introduction of a **juvenile justice system** is envisaged in the draft law on the state programme "National Plan of Action on Implementation of the UN Convention on the Rights of the Child". However, a system of juvenile justice remains to be put in place.

Ukraine has taken further considerable steps in improving the development of **civil society**. In January 2007, the registration fee for NGOs was significantly lowered, and trade unions are now exempt from paying any such fee. In November 2007, the Cabinet of Ministers endorsed a concept paper on government support for the development of civil society.

A number of positive measures were taken with respect to **rights of persons belonging to national minorities**, such as the ratification of the European Convention on Nationality in December 2006, and the appointment of an Ambassador at large to combat racism, xenophobia and discrimination in November 2007. However, a number of measures are still

needed to comply with CoE standards, such as the strengthening of the criminal legislation against hate speech and racially motivated crimes and the improvement of the anti-discrimination legislative framework. The situation of the Roma remains problematic. An upward trend of violence apparently motivated by racial intolerance has been observed.

The state programme on gender equality, which was adopted in December 2006, led to the adoption of supporting decrees and regional programmes. However, the enforcement of the 2006 framework law on equal rights of **women** and men is weak. Women still suffer from the current pay gap and the lack of training opportunities at work. Domestic violence is still a concern. Further awareness activities, an increase in shelter capacities as well as a better implementation of the related provisions of the criminal code at judicial level are therefore needed.

Regional and international issues, cooperation on foreign and security policy

Objectives in this area include the strengthening of political dialogue and cooperation on foreign and security policy issues, regional and international issues, conflict prevention and crisis management and the development of cooperation in addressing common security threats, including combating terrorism, non-proliferation of weapons of mass destruction and illegal arms exports.

Ukraine aligned itself with nearly all of the EU CFSP declarations open for alignment. Informal policy planning talks between the Council Secretariat Policy Unit and the Ukrainian Ministry of Foreign Affairs took place, along with the enhancement of other diplomatic contacts, including the EUSRs. The secondment of five officers from the Ukrainian Ministry of Interior to the EU Police Mission in Bosnia has been temporally halted. Ukraine ratified the EU-Ukraine Agreement on the Security Procedures for the Exchange of Classified Information which entered into force in February 2007. Executive arrangements were concluded within the framework of the agreement. However, Ukraine has not yet ratified the Agreement Establishing a Framework for Participation in EU Crisis Management Operations.

Following a joint request from the Ukrainian and Moldovan President, the EU Border Assistance Mission to Moldova and Ukraine (EUBAM) is in place since December 2005. EUBAM operations are based on a memorandum of understanding signed between the governments of Ukraine and the Republic of Moldova and the European Commission. It has been agreed between the parties to extend the mandate of the EUBAM until end-November 2009.

Ukraine continued to be fully committed to the work of EUBAM and co-operated actively with the EUBAM and the Republic of Moldova. With the support of EUBAM, the professional capacities of the Moldovan and Ukrainian customs and border guard services were enhanced and inter-agency cooperation within Ukraine as well as between Ukraine and the Republic of Moldova was increased. Overall, good progress has been made in the implementation of the cooperation for the settlement of the Transnistria conflict.

3. ECONOMIC AND SOCIAL REFORM

Macroeconomic framework and functioning market economy

In 2007 economic **growth** is estimated to have stayed robust at 7.3 % in real terms, supported by strong domestic demand. **Inflation** accelerated throughout 2007, reaching 16.6 % (year-on-year) in December 2007.

In the medium-term, the National Bank of Ukraine's declared strategy is geared towards adopting an inflation-targeting monetary policy framework and some flexibility on the exchange rate. In 2007, no steps were taken in this respect, and more emphasis is needed on communication efforts on future policies. With regard to perceptions on central bank independence, the participation of the Bank's Governor in the September 2007 parliamentary elections was a setback.

As a result of stronger than expected economic growth, the government allocated additional revenues to expenditure programmes in two supplemental budgets and had no difficulty in keeping the **fiscal deficit** at below 2 % of GDP in 2007. Public and guaranteed debt has stabilised at a low level of about 15 % of GDP which has boosted Ukraine's creditworthiness. The overall prudent fiscal stance over the reporting period has not yet been entrenched with equal improvements in the quality of public finances. The recent reform commitments in **public finance management** (supported by the EC and other donors) are timely, and the challenge of organising the EURO 2012 football championships highlights inter alia the urgency of improving capital budgeting. The pace of social spending (including pension outlays), a rationalisation of subsidies, and a reduction in tax burden are other main issues yet to be addressed in a medium-term fiscal framework.

International surveys on the ease of doing business did not show tangible improvements in 2007, therefore raising questions on the prospects for more broadly-based growth in the longer term. According to these surveys, Ukraine is lagging considerably behind the regional peers, in particular in the areas of paying taxes, dealing with licences and protecting investors. The 2006 law on a business permit system is not fully implemented, because, mainly, of the lack of implementing regulations. The 2007 law on inspections reflects understanding of the need to reduce the administrative burden on companies but it has not yet deployed its effects, partly due to divergences in interpretation by different State bodies. Tax inspections and, generally, the intricate tax system represent a considerable barrier to business development, which should be tackled through a comprehensive tax reform. The developing financial services sector requires particular attention, with action aimed at improving prudential supervision, and moving towards risk-based supervision, given its determinant role in the recent economic growth.

Employment and social policy

In January 2007, the government endorsed the state programme of economic and social development for Ukraine for 2007 which envisages a number of priorities concerning social insurance and the pension system. Four per cent of the population still lives below the **poverty** line.

While the overall **unemployment** rate has decreased to 6.8 %, Ukraine still faces major challenges to thoroughly improve its labour market, such as the shortage of qualified workers and the large share of the informal economy. The adoption of a new modern labour code, widely discussed with the social partners, is still pending. Ukraine benefits from an ILO project to train labour inspectors. Further efforts are nevertheless needed to reinforce the

administrative capacities of the Ministry of Labour and Social Policy as well as the State Employment Service.

The draft law on **social dialogue**, elaborated with EC and ILO experts, is not yet in force. It should further align with the requirements of ILO Convention 87 on freedom of association and the right to organise conventions in particular as far as representation of social partners is concerned. Once adopted, the law on social dialogue will need to be complemented by legislation on collective agreements and employers. As regards **pensions**, Ukraine is facing the problem of demographic ageing and is working towards postponing the retirement age.

On gender equality, see section 2

In 2007 progress on **regional development** was hindered by the re-organisation of competences between the concerned ministries (Ministry of Economy and Ministry of Regional Development) and by political changes. Ministries had to prepare their work plans by the end of January. Real work on strategy update will only start after the approval of the work plan.

In September 2007 the Cabinet of Ministers approved the programme of social and economic development for 2008. The programme envisages the creation of a specific body for the modernisation of the communal economy that will attract resources from international financial organisations under state guarantees. This would mean considerable progress as the main problem for upgrading networks, utilities and buildings' common parts is the lack of finance.

Some progress was made on **sustainable development**. The Ministry of Environmental Protection has proposed a law to the Rada to establish a sustainable development strategy up and including the year 2020, covering economic, social and environment aspects.

In the framework of a structured dialogue on agriculture several meetings on different subjects have been held.

4. TRADE-RELATED ISSUES, MARKET AND REGULATORY REFORM

Similar to previous years, total Ukrainian **trade** with the EU has increased in 2007. EU imports from Ukraine grew by 25.2 %, while exports grew by 22.4 %. EU-Ukraine trade in services is still very limited in value terms but increases steadily. A significant proportion of Ukrainian goods entering the EU market benefits from the EU GSP.

The bilateral textile agreement with the EU was tacitly renewed until end 2008, and the bilateral agreement on steel was concluded for 2007 with tacit renewal from 2008. Both agreements will end automatically with Ukraine's accession to the WTO.

Since 2006, Ukraine has taken measures to restrict export of grains several times, including a *de facto* export ban at the end of 2006 and in June 2007. This created unpredictability and disruption in the functioning of the market. More generally, the use of export restrictions as a means to control prices on the domestic market remains of concern.

Ukraine made significant progress in the area related to **WTO accession**. In November 2006 and May 2007 the two legislative packages necessary to fulfil Ukraine's bilateral and multilateral commitments in WTO context were approved, including removing the ban on exports of non-ferrous scrap and laying down new conditions for the supply of banking and insurance services in Ukraine. As regards export duties, Ukraine committed to the gradual reduction of export duties for different types of commodities, in accordance with a reduction calendar to be implemented once Ukraine joins the WTO. Moreover, Ukraine has successfully completed market access negotiations with all members of the WTO in the Working Group. Negotiations with the EU continued with a view to resolving the export duties issue on which agreement was found in January 2008. After the reporting period, the WTO General Council approved Ukraine's accession to the WTO in February 2008. Accession will become effective after ratification of the accession instruments by the Ukrainian Parliament. Regarding the future of Ukraine's trade relations with the EU, the draft negotiating directives for an EU–Ukraine Enhanced Agreement include an FTA component providing for deep yet gradual convergence with the EU in non-tariff and regulatory areas. Several sessions of exploratory talks concerning the format and scope of the negotiations took place in 2007. Negotiations were launched in February 2008.

On **customs** some progress was made regarding the legislative approximation, the adoption by Ukraine of international customs standards and the upgrading of the capacity of the customs service and improving relations with businesses. The regulation for the adoption of the Single Administrative Document entered into force on 1 January 2008. The law amending the customs code allowing for *ex-officio* action of the customs authority as regards pirated and counterfeit goods was adopted in November 2006 and an implementing regulation was adopted; however the excessive financial guarantees required from right holders is a matter of concern. Ukraine became a member of the revised Kyoto Convention on the Simplification and Harmonisation of Customs Procedures. The State Customs Service (SCS) prepared a first draft of the new customs code. The 2002 Harmonised System (HS) is in force since January 2008. Some work has been carried out to determine the criteria to benefit from a more favourable customs treatment - the so-called “white list of economic operators” - but so far the results are not entirely satisfactory. The Cabinet of Ministers approved in July 2007 a resolution on a new statute for the SCS. It reinforces among other the investigation powers of the SCS in areas such as on smuggling. Cooperation with EUBAM continued and contributed to upgrade border management and to strengthening the rule of law, increasing barriers to criminal activity, and at the same time facilitating legal trade. In November 2006, Ukraine and the Republic of Moldova signed a Protocol on the Exchange of Information between the Customs Services on the cross-border movement of goods which includes the establishment of an automated system for exchanging pre-arrival information on cargos.

In April 2007 the Ukrainian Cabinet of Ministers endorsed the agreement on the extension of EUBAM's mandate until November 2009. The agreement entered into force in May 2007.

In order to improve and facilitate border operations and to move towards the adoption of a single-window approach, an inter-institutional agreement authorizing customs to carry out preliminary documentary ecological controls at the border entered into force in the first semester of 2007. In terms of remaining challenges, Ukraine will need to enhance the level of enforcement in areas such as risk analysis, simplified customs clearance, customs valuation, and fight against corruption.

On **free movement of goods and technical regulations**, Ukraine continued to work on the implementation of its Action Plan towards an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA). In 2007, the Ukrainian Standardisation Body (DSSU) established a working group for the preparation of the draft law on market surveillance, which was registered in the Parliament in January 2008. The wide scope of application of the DSSU's draft could pose problems as non-food and food products require completely different infrastructures, expertise, methodologies and practices of surveillance. Another draft law on market surveillance has been developed by the Secretariat of the President of Ukraine and is already registered in the Parliament. While in general being better aligned with the EU practices on market surveillance than the DSSU's version, this draft cannot be considered either as the one providing for an effective system for market surveillance. It includes many restrictive provisions for authorities, which could render ineffective any market surveillance authorities and activities.

No progress can be reported regarding the reform of the infrastructure for quality, including the establishment of an independent national standardisation body and the separation of conformity assessment and market surveillance functions. On the other hand, the transposition of the sectoral legislation started in all the priority sectors. The adoption of new national standards aligned with those of the EU continued although the speed of preparation of the new standards is slower than envisaged. The voluntary application of standards is discouraged by, among others, the practice of compulsory certification. Ukraine should ensure that old standards are automatically repealed when new standards are adopted.

Ukraine made some progress on **sanitary and phyto-sanitary** issues, although practices and controls are not yet such as to allow exports to the EU of most animal products, Ukraine adopted a law on veterinary medicine, several pieces of implementing legislation and an action plan to advance the national programme for approximation with EU legislation. Ukraine reorganised the state veterinary department into a central governmental body, the State Committee of Veterinary Medicine. Some Ukrainian food establishments started to implement strengthened hygiene rules. Ukraine restructured the central state laboratory of veterinary medicine into the State Research Institute of Laboratory Diagnostics and Veterinary/Sanitary Testing. It continued the accreditation process of veterinary laboratories. The European Commission's Food and Veterinary Office assessed Ukraine's residue control systems regarding animals and animal products. The Community added Ukraine, for the first time, to the list of countries with approved residue monitoring programmes for milk and eggs. This is an important step towards the authorisation of exports to the EU. Honey export is already allowed. Ukraine continued to address the challenges resulting from multiple outbreaks of rabies in wildlife and domestic animals. Ukraine participated in workshops under the European Commission's "Better training for safer food" programme.

Little progress can be noted as regards the elimination of barriers to the **establishment** of companies. In November 2006, the Parliament adopted a law that allowed access of foreign bank branches to the Ukrainian market after Ukraine's WTO accession. Amendments were also adopted to the insurance law to bring the law into compliance with Ukraine's WTO commitments, in particular regarding the access of non-residents to the national insurance market. The number of permits and licenses required in most economic sectors impedes business and constitutes a huge cost factor for the companies.

No progress can be reported as regards the establishment of a modern **company law** framework as the new draft law on joint stock company has not yet been adopted. This draft

law was submitted to Parliament in spring 2007 and it went successfully through the first reading. However, consideration of this draft was affected by the early parliamentary elections of September 2007. Furthermore, the draft law is not fully in line with EU legislation and best practices in the field of corporate governance.

As regards **financial services**, progress achieved during the reporting period was essentially linked to the adoption of WTO-related banking and insurance legislation. There was however no progress as regards the adoption of crucial rules on the introduction of disclosure rules regarding the real ownership of banks and non-bank financial institutions. These rules are fundamental to ensure appropriate supervision over the financial services sector. In the insurance sector, the two legislative WTO packages included amendments to the insurance law to bring its provisions into compliance with Ukraine's WTO commitments, in particular regarding the access of non-residents to Ukraine's insurance market. At the same time, several acts aiming at improving the regulatory as well as supervisory framework for non-bank financial institutions were issued by the State Commission on Regulation of Financial Services Markets in 2007, covering among others rules on insurance reserves for life and non-life insurance or amendments to rules for the placement of reserves for life insurance payments. A more unified approach to the drafting of the new law "on insurance" would certainly contribute to its quality and conformity with relevant European and international rules and commitments. Finally, in November 2007 the Cabinet of Ministers approved the "concept for the state target programme for the modernisation of capital markets" which aims at addressing the deficiencies in the capital markets infrastructure through consolidating stock exchange, establishing of a central depository and a central payment and settlement system. There are however concerns about a possible duplication of existing infrastructure.

There has been no progress in the area of freedom of **capital movements**. Administrative and sometimes tax problems with the repatriation of foreign investments still exist.

Other key areas

There was no significant progress in the area of **taxation**. A resolution reintroducing tax privileges for the importation of car parts for internal automobile production, was adopted in May 2007. A new tax code, which is supposed to replace and consolidate more than 200 regulations in force, is still to be approved by Parliament. Ukraine still has to improve and simplify its VAT administration system, as no long-standing solution was found for the issue of reimbursement of VAT refunds. In terms of remaining challenges, Ukraine will also need to reinforce the administrative capacity of the Tax Administration, in particular by moving towards a more focused risk-based system for tax control and audits. Contacts have been established with the European Commission services for an exchange of views on the principles of the code of conduct for business taxation.

Concerning **competition policy**, a draft law amending certain elements of the Ukrainian law on the protection of economic competition, including state aid aspects, has been rejected by the Parliament. There has been no progress with regard to the transparency and independence of the competition agency, the Anti-Monopoly Committee of Ukraine. Staffing problems have been further aggravated by the wide range of its responsibilities which also cover the public procurement area. Ukraine agreed to an OECD peer review of its competition policy, which took place just after the reporting period in the beginning of 2008. The draft report contained

many recommendations for improvements in legislation and practice. In the area of state aid, no progress is to be reported.

On **intellectual property rights**, the EU and Ukraine have engaged since April 2006 in an in-depth dialogue. Ukraine is in the process of thoroughly revising its legislative framework as a consequence of the ongoing WTO accession negotiations. Effective implementation and progress on issues such as geographical indications, registration of medical products, copyright obligations and deterrent penal sanctions are required. The revised customs law, which entered into force in February 2007, provides for *ex-officio* actions (see *customs*). However, weak enforcement of IP rights, including at the borders, remains an issue of concern as there is still a widespread circulation of counterfeited and pirated goods, including medicines. Ukraine is listed in category 2 of the EU enforcement survey¹. Ukraine has not yet set up a national coordination council to focus on enforcement activities.

The **public procurement** legislation is not yet in line with international and EU practices and does not provide for enough transparency and stability. The significant increase of the role and power of the tender chamber without adequate mechanisms of public control on its activities is a source of concern. The institutional structure of the procurement system is unclear, creating overlaps in terms of function and control positions. It should however be noted that Ukraine is currently working on a revised legislation to address the above-mentioned shortcomings. As regards e-procurement, the 2007 budget allocated funds for establishing the public procurement portal.

Regarding **statistics**, Ukraine is implementing the TACIS 10 programme, which is a continuation of TACIS 8 and is oriented towards further harmonisation of the Ukrainian statistical system with EU standards. The programme provides for, inter alia, supporting Ukraine in designing a strategy for developing a sustainable and modern statistical system until 2012 and further improvement of data quality, especially in the field of trade statistics. Special attention will be devoted to reconciling EU-Ukraine foreign trade statistics. The new strategy is to be based on a global assessment of the national statistical system conducted in 2007, which indicated the priority areas for development.

On **public internal financial control (PIFC)**, a twinning project started in October 2007 with the Ministry of Finance (Control and Audit Department - KRU) on improving the internal control system through the gradual introduction and implementation of PIFC principles. A Central Harmonisation Unit for internal audit was established in KRU August 2007 and a decision was taken to transform the KRU into a public audit body during the course of 2008.

Although Ukraine has confirmed its intention to establish an **enterprise policy** dialogue with the European Commission, based on the adoption and implementation of the European Charter for Small Enterprises, no real progress in this area can be expected unless Ukraine takes up a government-wide political commitment to proceed, as implementation of the Charter requires action from several different parts of government in particular the Finance Ministry. The State Committee of Ukraine for Regulatory Policy and Entrepreneurship was

¹ Countries with high level of production, transit and/or consumption of infringing goods, with which the EU has a preferential relation, including a commitment to adopt the highest standards of IPR enforcement but which need to considerably step-up their efforts and tackle serious deficiencies.

appointed to lead this work, but has only limited power to take action without the commitment described above. An Interdepartmental Working Group involving representatives of all stakeholders was also set up in order to define the format and mechanism of adoption the Charter or elaboration of a national SME strategy based on principles of European Charter, although so far this has not produced tangible results.

5. COOPERATION ON JUSTICE, FREEDOM AND SECURITY

The EC – Ukraine visa facilitation and **readmission** agreements entered into force on 1 January 2008 after the appropriate procedures had been completed on the EU side and in Ukraine in 2007. Both sides cooperated closely in view of improving infrastructure and making procedural standards for irregular migrants in custody compliant with EU standards.

Ukraine remained a major transit country for irregular **migrants** from Asia, the Arabic countries and Africa and the number of migrants is increasing. In order to address this issue more adequately, the State Border Guard Service (SBGS) continued, with the help of the EC, implementing a reform strategy towards an EU-compliant law enforcement service. A concrete result in this regard was the out-phasing of the conscript system in 2007. As of 2008, personnel will be recruited by using objective and transparent entry examinations and receive contracts. This is a major step forward towards professionalism in the SBGS. The Warrant Officer's Education and Training System was reformed in 2007, which is now compliant with the EU Core Curriculum for Border Guard Services. Moreover, reform steps were initiated to make the service's career development system more transparent and based on merits. The creation of an employees' representation body is also under preparation. Amendments to a number of laws have been prepared in order to approximate to EU norms and standards. The SBGS also established, with the help of EUBAM, risk analysis units which will pave the way towards risk-based border controls (selectivity methodology).

In June 2007, the Cabinet of Ministers adopted a Resolution "On approval of the state special-purpose law enforcement programme 'organisation and reconstruction of the state border' for the period until 2015". According to this programme, the government will allocate – until 2015 – up to about € 133 million for improvement of border infrastructure, including equipment. However, it remains to be seen whether the government will allocate sufficient funds annually to implement the programme.

The **asylum** system deteriorated in 2007. In the period from mid-March to mid-November 2007, no asylum authority was appointed to take positive decisions on asylum applications. This led to a remarkable backlog in the processing of asylum claims. Also continuous reorganisations in the competent authority, exacerbated by frequent changes in management and limited financial resources allocated by the state budget have led to problems of access to asylum and substantive procedures, and have negatively impacted on the quality and speed of asylum decisions. The refugee law also has several shortcomings, in particular as regards the accelerated procedure that it establishes, which is frequently used to reject claims without considering the substance of the claim. In addition, the refugee law has no provisions on non-discrimination of refugees on grounds of their race, religion or country of origin.² It does not provide access for legal specialists of non-governmental organisations (NGOs) or UNHCR to

² This is important for the ethnic Chechens from the Russian Federation who are generally not recognised.

refugees' individual files, or for refugees to have legal representation during refugee status determination (RSD) interviews with the Migration Services. In addition, the refugee law does not establish a timeframe within which asylum applications of persons who have entered Ukraine irregularly should be referred from the State Border Service and the Ministry of Interior (MOI) to Migration Services' bodies.

A lack of national funds for the creation of adequate refugee reception and integration programmes as well as the fact that asylum seekers were frequently victims of xenophobia have resulted in a highly inhospitable asylum environment in Ukraine. Asylum-seekers consistently face problems with access to territory, access to asylum and access to substantive RSD procedures. They are often subject to police harassment, arbitrary and protracted detention as well as a serious risk of *refoulement*, while refugees face serious obstacles to the enjoyment of their rights and to integrate in Ukraine.

The UN Convention on **Trans-national Organised Crime** is being implemented in the context of regional cooperation, particularly trafficking in persons. In this regard, further attention needs to be given to prevention as well as the reintegration of victims and protection of witnesses in cooperation with civil society groups. The necessary legislation to enable Ukraine to adhere to the Third Protocol on Firearms has also been drafted.

Work in the fight against **drugs** continued apace in line with Ukraine's international commitments with an additional focus on cooperation with other countries in the Black Sea region. Progress in the area of prevention would be assisted through enhanced cooperation with civil society groups.

Legislation approximating the EU standards on **money laundering** as well as the FATF recommendations on terrorism financing has been adopted, enabling Ukraine to ratify the relevant CoE conventions. A national anti-money laundering strategy until 2010 was adopted as well as an action plan for cooperation between the government and the National Bank of Ukraine in this sphere. In addition, Ukraine is a member of the Council of Europe's Moneyval group and its Financial Intelligence Unit has become a member of the Egmont Group. However, few money laundering cases have been brought to trial, with hardly any convictions rendering the implementation of the legislation questionable.

Draft legislation on the implementation of the CoE Convention on the Protection of Personal Data was prepared and a cooperation agreement was concluded with Eurojust. Concluding a cooperation agreement with Europol remains a priority. The implementation of personal data protection and ratification of the CoE Convention are prerequisites for the conclusion of the agreement and for cooperation with these organisations.

6. TRANSPORT, ENERGY, ENVIRONMENT, THE INFORMATION SOCIETY, RESEARCH AND DEVELOPMENT

In May 2007, Ukraine adopted a "Concept of national sustainable **transport** policy for the development of all modes of transport for 2007-2013", but the implementation of the Ukrainian transport policy still faces numerous challenges in particular in the land transport sector. Ukraine identified a list of priority investment projects covering all modes of transport

(including rolling stock and bus fleet renewal) and is negotiating their implementation with International Finance Institutions.

As regards road transport, Ukraine still faced the challenge of developing a road safety action plan and needs to adhere to and implement a number of fundamental international transport conventions governing the sector. As regards passenger transport, Ukraine has still not adhered to the Interbus Agreement. In the rail sector, Ukraine introduced a common consignment note.

Negotiations on a comprehensive aviation agreement with Ukraine started in December 2007. In a gradual process giving the administrations and market operators the necessary time to prepare and adjust, such an agreement will bring together the Ukrainian and the EU aviation markets and allow for the extension of the EU aviation standards and regulations to Ukraine. A number of irritants concerning the practical operation of air services between Ukraine and EU still need to be resolved though, in particular as concerns the non-discriminatory access to aviation infrastructure. Ukraine needs urgently to increase efforts and resources in order to achieve the required level of aviation safety and the administrative capacity of the Aviation Administration in order to ensure efficient safety oversight (at the end of 2007, two Ukrainian airlines were subject to operational bans imposed at the Community level). Ukraine should accelerate its efforts in order to implement EU standards and legislation in order to prepare for the implementation of the future comprehensive aviation agreement. A first important step in that context will be the adoption of a new air code.

The restructuring of the state-owned port sector (separating operational and commercial functions) is still progressing very slowly. However, the commitment of Ukraine to bring maritime transport in Ukraine closer to international and European standards (including the transposition, enforcement and implementation of EU maritime legislation) has had the positive result of removing Ukraine off the black list of the Paris Memorandum of Understanding on port state control.

Ukraine is a key **energy** transit country for the EU, in particular for Russian gas and oil. The EU and Ukraine further enhanced their energy dialogue. Ukraine made good progress in the sector including through the ongoing implementation of the Memorandum of Understanding on Energy. The EU-Ukraine Summit adopted the second progress report regarding this MoU. Ukraine is in the process of securing funding from International Financing Institutions for priority projects enhancing energy security and hydrocarbons transit. A preliminary audit of the gas transit network was completed, which identified investment needs approximately € 2.5 billion. Ukraine continues to work towards the extension of the Odessa-Brody oil pipeline to Gdansk in Poland and agreed with Georgia, Azerbaijan, Poland and Lithuania to cooperate on this project. This might open possibilities to increase significantly Caspian oil supplies. The Boyarka Natural Gas Metrology Centre, established with EC assistance, was inaugurated. It will contribute to increasing transparency and reliability of gas supplies in the region and to the EU.

Ukraine adopted a sector reform plan 2007-2011, which complements the energy strategy. The Energy Community initiated the process of Ukraine's accession to the Energy Community Treaty, which entails progressive convergence with the internal energy market acquis. Ukraine strengthened the regulator and further adapted energy prices towards cost recovery levels, but much more needs to be done. The UCTE (Interconnected Electricity Networks of Continental Europe) established a working group, following Ukraine's and the

Republic of Moldova's joint membership application. The group will consider the required measures for synchronous operation with UCTE networks.

Ukraine pursued preparations towards an emergency oil stocks mechanism, based on Community practice. It continued coal sector restructuring, but much more needs to be done including to improve the safety of mines. In the context of the energy MoU the EU and Ukraine have finalised a roadmap on energy efficiency and renewable energy sources. Ukraine adopted legislation aiming at promoting energy efficiency and the use of renewable energy sources. It adopted a programme to develop biofuel production and established a biomass energy service company.

In the area of nuclear energy, the European Commission and Ukraine launched a joint project, with involvement of the International Atomic Energy Agency, on the evaluation of the safety of Ukraine's nuclear power plants. Ukraine pursued the upgrading of nuclear power plants in the context of an updated "Integrated Upgrade Package". The EC disbursed the first tranche of the EURATOM loan for the upgrading of the Khmelnytsky-2 Rivne-4 nuclear reactors. Ukraine further strengthened the Nuclear Regulatory Authority. In Chernobyl, the stabilisation works of the existing shelter have been completed and the contract for the construction of the New Safe Confinement - a major part of the whole Chernobyl rehabilitation programme - has been signed with the contractor. Substantial progress has been achieved regarding the completion of the spent fuel storage facility as well as the interim storage for solid waste. Ukraine continued preparations towards a nuclear waste strategy and took steps to strengthening the safety and security of radioactive sources including the adoption of relevant legislation.

Regional dialogue continued through the "Baku initiative" for EU-Black Sea/Caspian energy cooperation. Under this initiative ministers agreed a roadmap aiming at market convergence, security of supply, sustainable energy development and regional cooperation.

Key **environment** issues concern threats related to climate change, air quality, water quality, waste management, nature protection and radiation contamination in the north-east of Ukraine. Ukraine made further progress on climate change, as altogether 157 joint implementation projects have been prepared, even if only one has so far been registered at the UN level. The EU-Ukraine working group on climate change met three times during 2007 and has agreed its terms of reference, i.e. to focus on Kyoto Flexible Mechanisms, promotion of research as well as international action on mitigation and adaptation. A seminar on Post-2012 action was organised in Kiev in July 2007. Ukraine supports the EU initiative to reach a global and comprehensive Post-2012 agreement by 2009, as agreed in Bali. Ukraine participates actively in the Danube - Black Sea Task Force (DABLAS). Three of the 50 priority DABLAS investments concern Ukraine³. Ukraine also participates in activities undertaken under the EU Water Initiative, within which it has signalled an interest to start a national policy dialogue. A cooperation agreement was signed in May 2007 between Ukraine and the Community Civil Protection Mechanism. This mechanism was mobilised in November 2007 to prepare a first assessment of the environmental damage and needs for pollution remediation efforts in Kerch Strait, which is being followed up through a Post-Disaster Damage Needs Assessment.

³ Kherson (approved in 2004), Mykolaiv (negotiations ongoing), Saki/Gurzf/Yalta/Kersh (feasibility stage)

The 1998–2008 national environment strategy continues to require attention. The Ministry of Environmental Protection adopted its strategic priorities until 2011. An inter-ministerial assessment of environmental situation in the regions was finalised. Work is ongoing to implement existing strategies and plans, but continued attention is required. Overall, framework legislation and sectoral legislation is in place in most areas, but require further development, in particular implementing legislation. The National Agency for Environmental Investments started its activities in 2007. A major challenge continues however to be to strengthen administrative implementation capacity at all levels of the country, including coordination between authorities. There are some ongoing activities to integrate environment considerations into other policy sectors such as energy. Monitoring as well as enforcement require special attention. Ukraine has not published state-of-the environment reports since 2003, but continued to consult with stakeholders on regular basis. Access to information and involvement of the public require nevertheless continued attention. There is only limited progress as regards environmental impact assessments.

Ukraine has ratified relevant international and regional conventions and protocols, except the following protocols of the UNECE Convention on Long-Range Trans-boundary Air Pollution: Protocol on Persistent Organic Pollutants; Protocol on Heavy Metals; Protocol on Further Reduction of Sulphur Emissions; Protocol concerning the Control of Emissions of Volatile Organic Compounds or their Trans-boundary Fluxes. Ukraine participates actively in the International Commission for the Protection of the Danube River as well as the European Commission on the Protection of the Black Sea against Pollution. It signed in December 2007 a joint declaration with the Republic of Moldova and Romania to co-operate more closely to achieve a good ecological status of the Danube delta aiming at the objectives of the EU water framework Directive, and to prepare a Danube Delta Analysis Report in 2008. The agreement with the Republic of Moldova on use and protection of water resources within the Dniester River has been revised, but not yet formally adopted.

Implementation of the Convention to the Protection of the Black Sea against Pollution is becoming increasingly important, in view of the environment pressures of the region. Ukraine has already expressed support to the objective of the European Community to accede to the Convention as included in the Black Sea Synergy. In so far as Bystroe Deep Water Channel is concerned, Ukraine has committed itself to comply with the recommendations of the multilateral environmental agreements (Espoo Convention, Aarhus Convention, Bern Convention, and Ramsar Convention), and to share the results of environmental impact assessments with the international community and take responses into account before proceeding with works. The European Commission and Ukraine have further enhanced cooperation and information exchange, including on climate change, water, waste management and Black Sea environmental collaboration as well as sustainable integrated land use of Eurasian Steppes. Other topics such as modelling of energy use and emissions abatement options have been identified for possible closer cooperation. Exploratory talks will be launched at a technical level to re-establish the Regional Environmental Centre (REC) in Ukraine.

With reference to the **information society**, Ukraine started to implement the “national concept for the development of telecommunications up to 2010”, by preparing a draft law on universal service and by issuing a new numbering plan. Furthermore, a plan was adopted for the use of frequencies for advanced e-communications services; this was necessary in order to issue the tender for a second licence for third generation mobile services, expected to be

published by mid-2008. Concerning online services, Ukraine has adopted two new laws on the “principles of information society development 2007-2015” and on the “state programme for the use of e-signatures in electronic documents”.

There remains a persistent need to strengthen the independence and the capacities of the National Commission for Communications Regulation (NCCR). The problems concerning the appointment and dismissal of the NCCR’s Board Members during 2007 must be solved in order to ensure the implementation of a comprehensive regulatory framework for electronic communications.

In the **audiovisual** sector, the European Commission and the CoE have been implementing a joint programme Ukraine which has dealt extensively with media regulation issues. This project comes to an end in April 2008. The OSCE has also carried out considerable work over the last 18 months to bring Ukrainian media legislation into line with European standards. Ukraine has still to ratify the UNESCO Convention on the Protection and Promotion of Diversity of Cultural Expressions and the CoE Convention on Transfrontier Television.

Ukraine is currently revamping its **research and innovation** policy with more direct relevance to the sustainable and equitable economic development policy objectives of the country. There is still a need for the Ukraine to take over more fully into its own economic and scientific policies more elements of the EU best practises including some of the Lisbon strategy concepts. For instance, Ukraine needs to increase its level of investment in research and pursue the reform of its research sector in order to increase Ukraine’s research capacities.

Ukraine has not increased its low level of investment in research and there is a need to pursue the reform of the research sector in order to increase Ukraine’s research capacities. Although the FP7 for Research has introduced a provision for bilateral country cooperation with in particular Ukraine, it has not been able to take full advantage of this despite the establishment of a structured EU-Ukraine dialogue on science and technology. There remains a need for an increased participation of Ukraine in the FP7.

7. PEOPLE-TO-PEOPLE CONTACTS, EDUCATION AND HEALTH

Convergence in higher **education** proceeded through the generalisation of ECTS (European Credit Transfer System), a focus on quality assurance and modernisation of accreditation in accordance with the principles of the Bologna Process. Consultations continued with employers on the development of a national qualifications framework while education reform proceeded in line with national policy with a focus on lifelong learning, relevance and equal access to quality education.

Ukraine initiated a policy dialogue with the European Commission on improving efficiency and labour-market relevance of education and **training** provision to promote productivity and innovation with the support of the World Bank and ETF, opening possibilities for a future sector programme. The financing and governance of vocational education and training in the context of decentralisation remains a key policy concern as well as equity, responsiveness and skills enhancement. Closer cooperation between all stakeholders at all levels and, in particular, with social partners, is required in order to ensure the sustainability of education and training sector reform and to benchmark the Ukrainian system with those of EU Member States. A greater number of students had access to the **Erasmus Mundus** programme while

significant benefit accrued to Ukrainian students, academics and higher education institutions through participation in the Erasmus Mundus External Cooperation Window programme, the Jean Monnet programme and from scholarships to the College of Europe. The **Tempus** programme continued to underpin reform of higher education by promoting voluntary convergence with EU developments deriving from the Lisbon Agenda and the Bologna Process. Tempus enabled the development of many new courses and curricula that respond to labour market needs and contributed to the establishment of sustainable international research partnerships.

By contrast, the area of **culture** remains an area of future potential cooperation. In the area of youth, Ukrainian young people, youth workers and youth organisations continued benefiting from the opportunities offered by the Youth in Action programme with participation rates on the rise. Further efforts aimed at promoting intercultural dialogue through youth exchanges and informal education would be welcome.

Ukrainian **civil society** organisations continue to benefit from possibilities under various ENP programmes with adequate provision of regional and national support to people-to-people initiatives in the context of CBC programmes. The new ENPI CBC programmes offer additional opportunities in this regard.

Ukraine continued its **health** sector reform, which it will pursue in order to address, inter alia, inefficiencies, inequalities in access, maternal health, child mortality, the financing of the health care system, HIV/AIDS and tuberculosis. Ukraine participated in the TAIEX seminar “Health in all policies” jointly organised by the European Commission, the WHO and the European Health Observatory. The European Commission invited the Ukraine to the EU Network of competent authorities in health information and knowledge. The country participated in the European Commission’s HIV/AIDS Think Tank. The European Commission selected the Ukrainian Network of people living with HIV/AIDS as member of its civil society forum HIV/AIDS. The Ukrainian Presidential adopted a decree aiming at the establishment of a coordination council on this disease, tuberculosis, and drug abuse and the development of a new national HIV/AIDS prevention and treatment plan 2009–2013.

8. FINANCIAL COOPERATION – 2007 KEY FACTS AND FIGURES

Since the adoption of the ENP Action Plan with Ukraine, EC assistance has been increasingly geared towards supporting the achievement of key policy objectives as outlined in the Action Plan. With the entry into force of the European Neighbourhood and Partnership Instrument (ENPI) the strategic, policy-driven character of EC assistance was strengthened and allocations generally increased. The introduction of new cooperation instruments such as twinning and TAIEX (Technical Assistance Information Exchange) also strengthened the EC’s ability to provide financial and technical support in key regulatory areas and reforms.

The indicative financial envelope for Ukraine under the National Indicative Programme for the period 2007-2010 is € 494 million. The programme finances the implementation of three priorities: support for democratic development and good governance (public administration reform, public finance management, rule of law and judicial reform, human rights, civil society development and local government, education, science and people-to-people contacts); regulatory reform and administrative capacity building (trade, improving the

investment climate, social reform, regulatory aspects); infrastructure development (energy, transport, environment, border management).

The 2007 ENPI Annual Action Programme for Ukraine had an original allocation of € 120 million in the framework of the bilateral cooperation. This amount was increased to € 142 million by an additional € 22 million allocation from the Governance Facility, which resulted from Ukraine's good performance in Governance. Funding was provided to support the implementation of Ukraine's energy policy, to twinning and technical assistance activities, to improve the capacity to deal with irregular migrants and to reduce migration flows through Ukraine as well as on integrated border management with a particular emphasis on the EUBAM operations on the Ukraine – Republic of Moldova border.

Support in the area of nuclear safety continued amounting to € 39 million within the framework of the Action Plan 2007 under the new Instrument for Nuclear Safety Cooperation.

Ukraine also benefits from cooperation activities financed under the ENPI multi-country and regional programmes and is eligible under the ENPI Cross Border Cooperation component.

EC assistance has moved towards a sector approach, using budget support to implement sector reforms. Efficient delivery of Budget Support relies upon effective medium-term budget forecast system coupled with the development of strong, coordinated sector reform strategies. Some progress has been made by Ukraine in this respect, but it should be accelerated.

Aid coordination has also progressed to some extent, but there remains a need for a single, high-level co-ordinator for all donors.