A NEW UKRAINE: CATALYZING INVESTMENT IN FREEDOM, PEACE, AND PROSPERITY

April 13, 2023

A NEW UKRAINE: CATALYZING INVESTMENT IN FREEDOM, PEACE, AND PROSPERITY

April 13, 2023

Prepared by: The USAID Economic Development, Governance and Enterprise Growth (EDGE) Project, Contract Number 7200AA19C00055

Implemented by: International Development Group LLC (IDG)

This report is the result of partnership among USAID, U.S. Department of Commerce, and the American Chamber of Commerce in Ukraine. The report is informed by a survey conducted by the American Chamber of Commerce in Ukraine of 102 member businesses, in March 2023. Appreciation is expressed to the primary authors of this report: Declan Murphy, Mark Hellyer, Sergii Nerpii, Viktoriia Shyliuk, and Farhat Farhat; to IDG home office staff who provided support: David Morgan, Alex Rohozynsky, David Snelbecker, Luan Gashi, Elly Preotle, Saudamini Mohan, Lily Pourahmad, and Afua Owusu; and to colleagues at the American Chamber of Commerce in Ukraine. To connect with the report authors, please contact Oleksandr Rohozynsky, orohozynsky@internationaldevelopmentgroup.com. Electronic copies of the report in English and Ukrainian can be downloaded at https://www.usaid.gov/usaid-response-ukraine.

TABLE OF CONTENTS

Executive Summary **1**

Introduction **3**

Summary of Reforms **5**

Reform Area 1. Create a Goal-Focused Investment Policy Framework 7

Reform Area 2. Strengthen Institutions to Promote Investment 9

Reform Area 3. Create a Competitive Business Enabling Environment 11

Reform Area 4. Continue Anti-Corruption Reforms 13

Reform Area 5. Strengthen the Institutions and Regulatory Framework Governing Capital Investment Projects 15

Reform Area 6. Accelerate the Privatization Process 17

Reform Area 7. Accelerate EU Accession 19

Reform Area 8. Address Sectoral Issues 21

Annexes **24**

Annex 1: List of Acronyms 24

Annex 2: Organizations Consulted* 25

Annex 3: References* 26

Annex 4: Results of Survey of US Companies In Ukraine* 29

***These Annexes are only included in the online version of report.** (Available at https://www.usaid.gov/usaid-response-ukraine.)

EXECUTIVE SUMMARY

IMPACT OF WAR AND OPPORTUNITY FOR REFORMS

Rebuilding Ukraine as a modern economy after the Russian Federation's unprovoked war will cost over $400 billion, according to the World Bank. The reconstruction of Ukraine will be the largest and most comprehensive reconstruction effort since the Marshall Plan after World War II. In reconstruction, President Zelensky and the Government of Ukraine (GOU) have committed to not just rebuilding Ukraine's old post-soviet economy but, rather, to building back better – to building a wholly new economy – integrated into Europe and competitive in the 21st century's global economy and turning the vast war devastation into an opportunity to modernize Ukraine's economy. This will take a coordinated effort on a grand scale by numerous partners: the GOU, private sector, international partner countries, multilateral agencies, and international investors. A key factor for successful reconstruction will be to maximize the extent of involvement by the private sector and international capital in all aspects of investment and rebuilding, with as much reconstruction as possible driven by private investment and public-private partnerships.

A REFORM AGENDA TO CATALYZE INVESTMENT

This report presents a reform agenda to catalyze and enable the significant amount of investment that will be needed to rebuild Ukraine. The recommended reforms are based on research and analysis of Ukraine's investment enabling environment and institutions, including desk research, interviews with current and potential investors and with international development organizations, and a survey of businesses. The report team collaborated with the American Chamber of Commerce in Ukraine (AmCham) to survey its members, including US businesses (see Annex 4). Despite COVID-19 and huge war destruction, investors continue operations and seek to expand their businesses in Ukraine.

PRIORITY REFORM AREAS

Create a goal-focused investment policy framework: The policy framework should be developed in collaboration with investors to provide a blueprint for clarity and effective implementation. It should focus on vision, specific goals, constructive direction to institutions responsible for FDI, intended government actions, and measures for implementation of reform priorities.

Strengthen institutions to promote investment: Ukraine has to compete internationally for FDI. Assistance is needed to help the current Ukraine Investment Promotion Agency, UkraineInvest, to set a clear mandate with specific goals, improve private sector engagement, and increase essential budget, staff numbers and promotion skills.

Create a competitive business enabling environment: Progress in improving the business enabling environment has been achieved. Investors state much more is needed. To win new FDI, Ukraine must reduce the cost of doing business by reducing transaction costs and improve the environment for investors.

Continue anti-corruption reforms: Although real progress has been made in combatting corruption, much more remains to be done, addressing not only real corruption but also the perception of corruption, in order to become more attractive to new investors. Strengthening transparency and the rule of law and expanding digitalization are key for minimizing corruption risks**.**

Strengthen the institutions and regulatory framework governing capital investment projects: Ukraine needs to build government capacity to plan and manage large public investments and public-private partnerships (PPPs), appraising and managing projects, implementing procurements, collaborating with the private sector, granting concessions, and revising public procurement, PPP and concessions laws to be EU- and WTO-compliant**.**

Accelerate the privatization process: State Owned Enterprises (SOEs) in Ukraine are inefficient and perform poorly, but still present interest for foreign investment. The government should accelerate their privatization and ensure transparency, open competition, fairness, and realistic investor obligations.

Accelerate EU accession: The EU accession process serves as an engine for broad-based long-awaited reforms across a wide range of areas. Accelerating reforms for full compliance with EU *Acquis* should continue to be a top national priority.

Address sectoral issues: There are opportunities for investors in a broad range of sectors which have been identified as being of potential interest to US investors, including for agricultural inputs, high tech manufacturing, oil and gas, and renewable energy.

INTRODUCTION

The Russian Federation's destruction of Ukraine has been widespread, thorough, and deliberate. Much of the infrastructure damaged and destroyed was not simply collateral damage from military conflict but was rather an intentional effort by the Russian Federation to degrade Ukraine's infrastructure and economy to create miserable conditions for the population and to break the country's will to fight. While the Kremlin's efforts failed to dampen the will of Ukraine's people to defend themselves, the physical destruction to the economy and infrastructure has been massive. Turning the colossal devastation caused by the Russian Federation into an opportunity to modernize Ukraine's economy will take a coordinated effort on a grand scale by numerous partners: the GOU; Ukraine's private sector; international partner countries; multilateral agencies; and international investors.

A key factor in the successful reconstruction of Ukraine will be to emphasize the use of the private sector in all aspects of investment and rebuilding as much as feasible, with as much reconstruction as possible driven by private investment and expertise, and public-private partnerships, with government facilitation and oversight for each project as appropriate. How much of a role can be allocated to private investors will vary with each project, based on the extent to which private investors can accrue the returns on their investments.

Investments in which the returns entirely accrue to private investors can be designated to be private investments, with private investors fully driving these projects and the government playing a promotional and enabling role. Investments in which none of the returns on investment can accrue to private investors (for instance, a non-toll road) need to be designated as public investments, with the government appraising, financing, and managing projects and procuring private companies for construction and other services. Investments in which returns can be partially accrued to private investors are good candidates for PPPs, in which the government appraises projects, selects private-sector partners, and collaborates in financing and managing. The core principle of a modern, cutting-edge approach to Ukraine's modernization effort will be to steer investment projects as much as possible toward private investments and PPPs rather than over-relying on public investments.

Ukraine's Pre-War FDI Landscape

In the pre-war period, global investors were in recovery from the COVID-19 pandemic, economic decline, and reduced global FDI. As much as 60% of global investment projects originated and stayed within the Organisation for Economic Cooperation and Development (OECD) countries in 2020-21, thus crystallizing a trend that started at the beginning of the global financial crisis in 2008. In 2020, intra-EU cross-border investment reached $57.8bn, equivalent to 48% of the total. Historically, the European region has been the biggest recipient of global FDI projects. In recent years there has been a trend for FDI investors to increasingly locate eastwards in Europe. Investors continue to seek cost-competitive locations, access to regional markets, closer supply lines, and availability of productive labor and skills. Ukraine, with 320 FDI projects, accounted for 0.6% of FDI projects in Europe between 2009-2019. It ranked 26th among 52 countries in the wider European regions, just between Bosnia and Herzegovina (354 FDI projects) and Latvia (284 FDI projects), both much smaller countries in terms of population. About 158 U.S. companies have an active interest in Ukraine.

This report outlines reforms needed to catalyze a massive private-sector-led investment effort to rebuild Ukraine's economy. It is based on a review of over 30 reports undertaken in the last four years, a joint survey of 102 companies (March 2023) with AmCham, key informant interviews (KIIs) with 14 US investors and eight national and international organizations, and other inputs from experts on Ukraine's economy. US investors included in the survey and KIIs have combined investments in Ukraine valued at $6.75 billion. In general, these sources show a generally positive experience of investing in Ukraine, and plan to continue post war:

- Over 80% of those surveyed stated the initial investment in Ukraine was due to advantages of lower cost skilled labor and size of local market. This was backed up by the KIIs where most investors reaffirmed this point. Most stated that Ukraine is a competitive location, often more so than neighboring countries (though Ukraine's comparative record in attracting greenfield investment is not so good).
- Pre-war, 89% of US companies surveyed stated that their business was performing in line or above expectations and one third of survey respondents and half of the US investors interviewed stated they had plans to increase their investments post-war.
- The impact of the war has been hard on all, including US investors. Two thirds of US companies surveyed stated that the biggest impact has been the loss of sales, reporting an average fall of 60-70%. Some of this was due to damaged or destroyed facilities and around 50% of those surveyed reported damage to facilities limiting activities.
- Despite this, all US companies surveyed (see Annex 4), confirmed that they will continue business in Ukraine post war and 31% plan to increase investment (assuming a stable condition and returning citizens).
- Most respondents rate the EU *acquis* and its drive to reform as important to their business in Ukraine. Nearly 60% say future investment in Ukraine will hinge on access to EU markets. About 40% say EU product quality and standards are key to their business. A few US investors said its good for rule of law, especially with EU monitoring.

Ukraine's Inflows 2019-2021

Years	2019	2020	2021
FDI Total Inward Flows (million USD)	6,017	-36	6,549
FDI Stock (million USD)	54,210	52,091	62,131
Number of Greenfield Investments	48	45	77
Value of Greenfield Investments (million USD)	1,421	2,221	2,248

Source: UNCTAD, World Investment Report, 2022.

SUMMARY OF REFORMS

1. CREATE A GOAL-FOCUSED INVESTMENT POLICY FRAMEWORK

- Establish a stakeholder consultative group on foreign direct investment (FDI) policy.
- Establish a medium term FDI policy with clear vision.
- Establish clear goals and targets.
- Set limited number of priority sectors.
- Establish regular public - private dialogue.
- Benchmark and measure competitiveness and performance in FDI attraction.
- Track outputs, outcomes, and impact of FDI attracted.

2. STRENGTHEN INSTITUTIONS TO PROMOTE INVESTMENT

- Strengthen Ukraine's designated Investment Promotion Agency (IPA) with institutional independence in operations.
- Ukraine's IPA to develop and publish its own strategy for attracting FDI and specify goals.
- Establish strong links with the private sector.
- Benchmark with comparator countries.
- Ensure professional approach to all FDI promotion operational functions.
- Undertake outreach to existing and new investors.
- Ukraine should develop effective monitoring and evaluation tools and practice at IPA.

3. CREATE A COMPETITIVE BUSINESS ENABLING ENVIRONMENT

- Advance the deregulation process led by the Interagency Working Group on Deregulation (IWG) on the Accelerated Review of State Regulation of Economic Activity.
- Ensure the business taxes regime is rational, clear, consistent, predictable, and not onerously burdensome on labor.
- Facilitate access to land and infrastructure.
- Modernize Labor laws.
- Ease foreign exchange restrictions.
- Develop strong protection of property rights through strengthening legal frameworks and effective enforcement.
- Improve border procedures and border infrastructure.
- Align with EU *acquis* Directives related to business enabling environment (BEE).

4. CONTINUE ANTI-CORRUPTION REFORMS

- Expand digitalization to increase transparency and reduce physical interactions between investors and public sector officials.
- Continue to strengthen existing anti-corruption institutions.
- Strengthen anti-corruption legal framework, especially with reference to curbing oligarch influence.
- Strengthen the capacities and powers of existing oversight institutions.
- Promote an open approach and communication on corruption.
- Align with EU *acquis* Directives and accession requirements related to fighting corruption.

5. STRENGTHEN THE INSTITUTIONS AND REGULATORY FRAMEWORK GOVERNING CAPITAL INVESTMENT PROJECTS

- Broadly increase the capacity of the Government to drive and manage public investments and PPPs.
- Develop new strategies on PP and PPP.
- Strengthen the legislative framework governing PP, PPP, and concessions in line with EU and WTO.
- Increase and build capacity of human resources of PP and PPP authorities.
- Develop clear government policy of involving foreign companies in PPP.
- Build the capacity of the PPP Agency to train and support local and central Government Ministries and authorities.
- Strengthen supervisory and oversight of PPP and PP.

6. ACCELERATE THE PRIVATIZATION PROCESS

- Improve the privatization legal and policy framework.
- Develop a multi-year privatization strategy.
- Speed up corporatization and transfer of assets to State Property Fund of Ukraine (SPFU).
- Consider initial public offerings (IPO) on Ukrainian and reputable international stock exchanges.
- Establish an independent appeal process.
- Develop and implement an effective privatization communication strategy.
- Develop a strategy for demotivating and dis-incentivizing municipalities from keeping SOEs.
- Build the capacity of the SPFU.

7. ACCELERATE EU ACCESSION

- Prioritize and prepare adequately for the EU accession process.
- Prioritize alignment to the EU *acquis* in specific areas relevant to investment.
- Build capacity across government to undertake the accession process.
- Pay stronger attention to implementation of EU *acquis*.
- Establish strong mechanisms for monitoring, evaluating, and reporting EU accession progress.

8. ADDRESS SECTORAL ISSUES

AGRICULTURE, INPUTS AND FOOD PROCESSING

- Advance land reform.
- Remove the moratorium on foreign ownership of agricultural land.
- Further integrate with EU *acquis*, keeping in mind WTO commitments.
- Remove remaining tariff and non-tariff barriers for export to the EU and other countries.

HIGH TECH MANUFACTURING

- Encourage return of skilled Ukrainian population.
- Create risk insurance for foreign investors and business visitors.
- Provide Oblast level investment facilitators.

ENERGY SECTOR

- Revise and update legal framework to provide certainty.
- Address major financial imbalances in the energy sector.
- Address corruption and vested interests in the sector.
- Ensure that PP, concessions, and privatization are transparent, open, and free of corruption.

RENEWABLE ENERGY

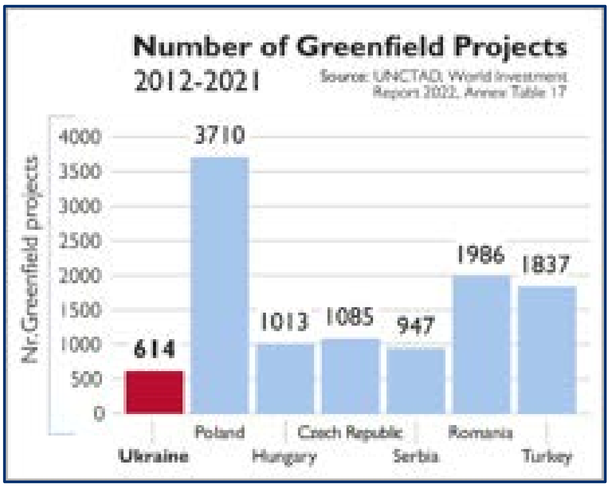
- Prioritize renewable energy projects in Ukraine's reconstruction plans.
- Create conditions for the development of the hydrogen, biofuels, and other renewable gases transmission industry.
- Progressively move from feed-in-tariffs in the renewable energy generation market.

REFORM AREA 1. CREATE A GOAL-FOCUSED INVESTMENT POLICY FRAMEWORK

Successful FDI attraction requires FDI policy, dedicated institutions, laws, regulations, business environment, and other related policies that enhance the investment environment. It equally demands a "whole of government" approach on the investment climate and business environment that will support investors in achieving competitive advantage in global markets. In this context, FDI policy should ideally establish national goals and expectations for FDI and specify the essential responsibilities, roles, and actions by the public and private sectors.

Challenges

Most countries seek to attract FDI and maximize its benefits, including: capital investment; annual direct economic contribution; new employment; exports; acquiring modern skills and technologies; and innovative sectors. Global competition for FDI is increasing. Competitiveness in attracting FDI is vital for success in winning new FDI. Central to that competitiveness challenge is effective FDI policy and promotion strategy. International experience shows that a range of countries have achieved a paradigm shift in their FDI levels and national development by establishing new FDI policies and innovative promotion. Stating FDI investment policy increases transparency and predictability, serves as a signal to investors and promotes the country as an investment destination.



- **Poor FDI performance compared to competitors**. Greenfield projects are the largest segment of global FDI. Ukraine has historically not performed as well as neighbors (see chart). Even comparing FDI as a share of Gross Domestic Product, Ukraine falls well below surrounding countries (averaging 2.9% over last five years compared to 5.6% across Central Europe and Baltics and below the 7.3% experienced by Serbia).
- **No published government approved FDI vision with specified goals.** A vision should chart Ukraine's plan of action for investors and public sector. Ukraine conducts a broad supportive policy towards inward FDI. However, Ukraine lacks a publicly stated national vision, policy, strategy, and concrete goals for FDI, and an effective policy evaluation process that measures the results of FDI annually (for example, jobs created, exports, economic impact, and FDI contribution to the economy). One US investor stated that Ukraine's FDI policy is like a "black box" and investors have nothing to study or understand in order to plan investments.
- **Limited role of private sector in developing FDI policy decreases its effectiveness and achievement of national goals.** Research shows significant public sector contacts with representative organizations (AmCham, European Business Association (EBA), etc.) but limited evidence of in-depth and ongoing consultation leading to action on implementation on specific policies and programs. Whilst the majority of existing foreign investors have seen improvements pre-war with consultations, especially through business representative organizations, there has been a reversal in the last year. Some existing investors interviewed complained of policies being introduced without any notice and no prior consultation or discussion.
- **Unclear responsibility for FDI policy**. It is not fully clear from research: (a) where responsibility for FDI policy and promotion lies in Ukraine; and (b) how well FDI policy is understood and driven, and by which public authorities. The respective roles and responsibilities of UkraineInvest and Advantage Ukraine need review and clarification for investors.
- **Ineffectiveness of FDI policies due to poor understanding and monitoring of FDI promotion and impact of FDI in Ukraine.** An essential element of effective FDI policy and promotion is ensuring systematic measurement of all promotion activity and the economic impact of FDI projects and investment. This is essential for effective policy development and assessment of performance.

Reforms

- ✓ **Establish a stakeholder consultative group on FDI policy.** Obtaining the views of relevant stakeholders, including industry and sector experts, is a crucial piece of the policy development process. This process will normally be led by the responsible Ministry and IPA. The objective of this group should be to build a sound plan of action with agreed performance indicators to measure implementation and provide expert consultation and guidance to develop an FDI policy. The indicators of performance should assess performance by measuring, for example, capital investment, number and quality of projects attracted, jobs created, exports, and direct economic contribution.
- ✓ **Establish a medium term FDI policy with clear vision.** The outcome of the above consultative process will lay the ground for elaborating an agreed policy with specific goals, actions and annual performance measurement. Combining this with effective execution can differentiate a country and its competitiveness. Equally, it can contribute to a unified effort across the government system to agree strategic areas of focus, and effective coordination to deliver clear stated goals.
- ✓ **Establish clear goals and targets.** This FDI policy and promotion and specified goals will be crucial foundations for improved performance. Ukraine should set targets that begin to match the performance of selected EU and non-EU countries, especially in projects from existing investors (many reported planned new investment) and linkages (more local suppliers). Examples of goals/targets:
  - o Ukraine to be best performer in number of greenfield projects attracted annually in non-EU countries in surrounding region.
  - o Ukraine to show annual advances in greenfield project numbers versus EU neighboring countries.
  - o Number of new greenfield projects per year from existing firms in Ukraine to be doubled by 2026.
  - o Research and Development (R&D) functions in existing FDI firms (increased technology and added value) to be encouraged and 10-20 new R&D functions per year sought over period of planning.

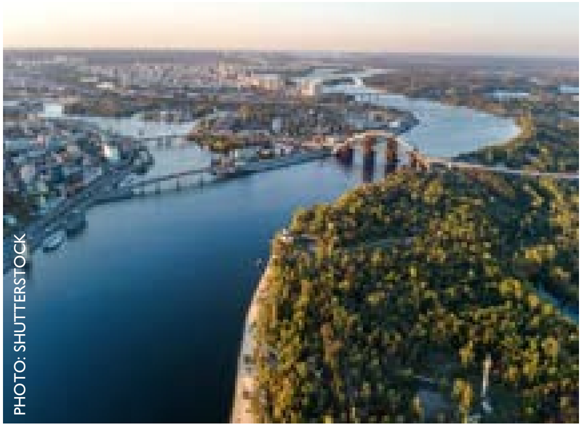


PHOTO: SHUTTERSTOCK

- ✓ **Set limited number of priority sectors.** FDI policy should confirm priority sectors and/or niche activities/functions for FDI attraction:
  - o Leverage particular competitive advantages of locations for select sectors and investors.
  - o Establish sector promotion strategies and unique selling propositions to investors.
  - o Focus on cluster formation and sectoral ecosystem development, driven by strong leadership and private sector partnerships with universities and research institutions.
  - o Work with existing/new investors and domestic companies to build more supplier linkage.
  - o Ensure methodologies to monitor and measure the progress of policy objectives and contribution of investment to sustainable national development.
- ✓ **Establish regular public - private dialogue.** Ukraine should strengthen communication and active partnership with the private sector in implementing FDI policy.
- ✓ **Benchmark and measure competitiveness and performance in FDI attraction.** To beat competition, Ukraine should set goals, allocate adequate resources, and track the performance for adaptive management of FDI attraction efforts, benchmarked against comparable countries and international best practice. This information should be publicly available and published on completion with Government and IPA commentary.
- ✓ **Track outputs, outcomes, and impact of FDI attracted**. Policy makers will often focus on evaluating the 'outputs' of IPAs, that is, the regular promotion activity and results achieved. This is important but equally important are the 'outcomes'. The GOU should calculate economic impact indicators for a better understanding of FDI's economic contribution based on assessment of the impact on capital investment, projects attracted, jobs, exports, and direct economic contribution. The impact analysis can provide grounds for maintaining and changing the priority directions set by policies in the area. It is equally vital for justifying budget allocations to investment promotion and IPAs.

REFORM AREA 2. STRENGTHEN INSTITUTIONS TO PROMOTE INVESTMENT

The scope of IPA structures and operational functions and successful practices are well-documented in research by OECD, World Bank, United Nations Conference on Trade and Development (UNCTAD), academia, expert consultants, etc. and in the practical experience of world leading IPAs. In planning and implementing IPA promotion strategy, it is vital to have distinct and clear plans of action for each function. While progress has been achieved, Ukraine's IPA does not appear to match this "best practice" profile.

Challenges

Over 500 national and regional IPAs now compete for FDI globally. The intensity of competition is increasing. Typically, ministries are responsible for FDI policy and IPAs responsible for FDI promotion strategy and implementation. OECD research (2020) on IPAs in Eurasia, shows that Ukraine IPAs have ambitious mandates, limited investor engagement, low budgets, and relatively low staff numbers. Their ability to implement "best practice promotion" is limited. Highly successful and competitive IPAs in the region: have clear government mandates within the FDI policy framework; are "one-stop-shop" for investors; have essential resources (people, skills, and budget) to reach out and build dialogue on investment plans; and are expert partners for investors. All eight functions (presented below) will have to be executed for an IPA to be successful in effectively attracting new investors and maintaining and expanding existing investments.

- **Poor performance and limited efforts to capture diverse sources of FDI.** FDI emerges from diverse sources – greenfield projects (including expansions), mergers and acquisitions, privatization, PPP projects, and international capital sources and infrastructure. The primary role of most IPAs is to focus on the largest segment, greenfield projects, but to also partner and liaise as appropriate with responsible ministries and agencies in dealing with other segments.
- **Ukraine lags behind competitors on FDI inflows, Greenfield Projects, and FDI stock.** Poland had nearly four times the level of Ukraine's FDI inflows and FDI stock at the end of 2021. Over the past 10 years Poland has achieved about six times more FDI greenfield projects than Ukraine. Hungary (population 37.8 million), the Czech Republic (population 10.5 million), and Romania (population 19.7 million) have all outperformed Ukraine. Serbia, a non-EU member (6.84 million), has achieved one and a half times the number of greenfield projects attracted to Ukraine from 2012 to 2021.
- **Investment promotion needs substantial strengthening in Ukraine.** According to the OECD Policy Framework for Investment (2015, 2016), investment promotion and facilitation can be a powerful means to attract FDI and maximize its benefits, in the context of broadly sound investment climates. Most foreign investors interviewed stated that they were motivated by private partners, not the government efforts. Their interest in Ukraine was based on the national market and/or natural resources. Once established, their facilities outcompeted sister facilities in neighboring countries. Current IPAs do not capitalize on promoting these and other competitive advantages of Ukraine, nor positive experiences of existing investors. UkraineInvest lacks a well elaborated and publicly stated strategy that informs investors and enables their support and participation in promotion.
- **Absence of a strong, single "one-stop-shop" and well-resourced promotion institution is needed if new FDI is to be achieved.** As competition intensifies, countries need to have a strong and competitive IPA, with a stable mandate and ideally with active private sector engagement and partnership in its structures that can undertake outreach campaigns and continuously build relationships with existing

and potential investors. Ukraine IPA has limited capacities with only 20-30 staff, which compares very unfavorably with competitor countries. For example, Poland, the Czech Republic, Hungary and even smaller countries like Serbia, Estonia, North Macedonia and Ireland all allocate substantially more resources to their IPAs.

- **Strategic goals are unclear to stakeholders.** Key features of highly successful IPAs are clear strategic targets and concrete goals (e.g. number of projects attracted, investment levels, employment, etc.) that are aligned with government objectives, and stated in FDI policy, which Ukraine currently lacks.

Reforms

✓ **Strengthen Ukraine's designated IPA with institutional independence in operations.** The most successful IPAs will have autonomous budgets, short reporting lines, and greater decision-making powers. Short reporting lines could also contribute to greater whole-of-government coordination in dealing with critical issues such as large, complex projects and policy barriers to investment (OECD research on IPAs, 2020). This will be achieved through:

PHOTO: SHUTTERSTOCK

- o Clarifying and coordinating missions and respective roles of UkraineInvest and Advantage Ukraine.
- o Strengthening the designated national IPA with new board structure, increased budget, and staff numbers, and streamlining, reorganization, and rationalization of organizational structure.
- o Appointing, for example, 3-4 CEOs of major FDI investors in Ukraine to an IPA governing board (pro bono) and benefiting from their business knowledge and sector expertise.
- o Having, in line with best international practice, at least 40-50 dedicated promotion staff (see OECD reports) with an adequate multi-annual budget, who are competitively recruited, selected, and supported for retention.

✓ **Ukraine's IPA to develop and publish its own strategy for attracting FDI and specify goals**. Goals may include doubling the number of greenfield projects, including new greenfield projects from existing firms in Ukraine, by 2026, and set capital investment inflows and sectoral targets. The IPA should also provide public annual performance reports.

✓ **Establish strong links with the private sector**. IPA links and direct contact and dialogue with investment decision-makers (in Ukraine and company/group headquarters) in the private sector are critical for success.

✓ **Benchmark with comparator countries.** As with policy, the IPA should systematically and regularly compare its performance/operations with neighboring and competitor agencies.

✓ **Ensure professional approach to all FDI promotion operational functions**. Best practice operations provide a checklist for action plans and monitoring performance. Building the image of a country, establishing direct contact and ongoing dialogue with key investors, acquiring new investments, and working with investors to obtain expansion investment are all essential.

✓ **Undertake outreach to existing and new investors.** Some feedback from existing investors in Ukraine reveals an absence of dialogue with UkraineInvest and potentially missed opportunities for new FDI. In most OECD and EU countries, existing investors source 50%+ of new investments. Regular dialogue and partnership with existing investors are vital for success. Winning investment projects, especially from existing investors is a major priority for all IPAs.

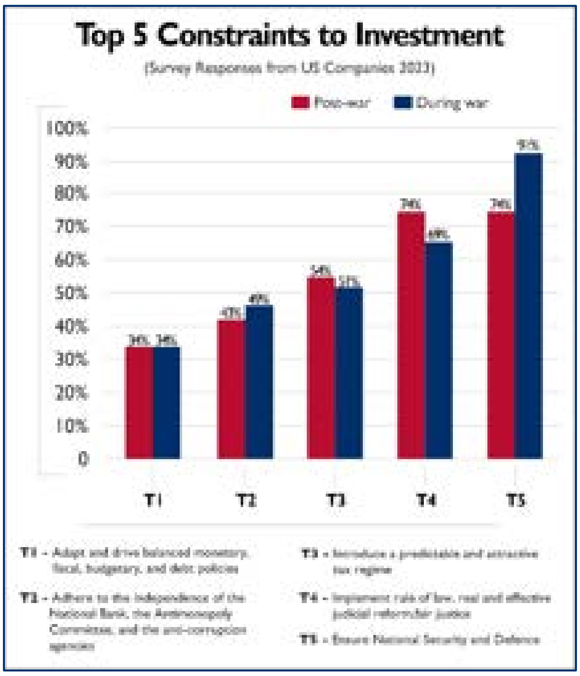
✓ **Ukraine should develop effective monitoring and evaluation tools and practice at IPAs.** OECD research shows Eurasia IPAs (including Ukraine) engage in monitoring and evaluation activities but tend to focus more on output (work activity) as opposed to outcome indicators (results and impact of investment). Professional data tracking and performance monitoring methods are needed within the IPA such as advanced Customer Relationship Management systems. Lack of effective systems to measure benefits of FDI makes it difficult for improving policy and for IPAs to argue for increased budgets.

REFORM AREA 3. CREATE A COMPETITIVE BUSINESS ENABLING ENVIRONMENT

There has been much progress in recent years in improving the BEE in Ukraine and moving up the World Bank "Ease of doing business rankings" from 142 in 2010 to 96 in 2015 and 64 in 2020. However, most foreign investors state that there is still a lot of room for improvement. Moreover, global perceptions have not changed. Therefore, if Ukraine wants to attract FDI and improve its competitiveness, it needs to strengthen the rule of law, provide legal protection to investors and property rights, streamline regulatory and administrative requirements, and harmonize these with international/EU standards to reduce transaction costs.

Challenges

The investment climate and prevailing BEE have a big impact on both the attractiveness of Ukraine in general (with taxation rates, labor laws etc.) and barriers to entry in the country. Improving the BEE will not only assist existing FDI and local companies to become more competitive but will also benefit the country's image as a destination for FDI.



- **Reform Process is ongoing.** Since 2016, there has been continuous implementation of reforms in such fields as deregulation, PP, bankruptcy procedures, and improving the institutional framework for business.
- **Progress in "Doing Business" indicators.** OECD and World Bank surveys have shown good progress in improving the business environment in Ukraine over recent years. For example, Ukraine moved in the Ease of Doing Business ranking from 142 in 2010, to 96 in 2015 and 64 in 2020. However, Ukraine scored low on "getting electricity", ranking 146 out of 190 and ranked 146 in "resolving insolvency."
- **Certainty in the tax regime is one of the biggest constraints to investment in Ukraine.** Both interviews with US investors and our survey (refer to Annex 4) show that the uncertainty in the application of taxes is one of the most important issues facing investors. Foreign investors are happy to pay taxes on time, but this should be based on clear, predictable, and fair systems. Based on investors experience, taxes in Ukraine are often ambiguous, unevenly applied, refunds are slow, and rules are changing frequently. High labor taxes also have been indicated as an impediment.
- **Legal framework and protection of investment rights is a major obstacle to investment.** In recent surveys and interviews with investors, the protection of investments and legal framework has been determined to be a major issue and is the second most important investment decision factor. Our survey and KIIs with US companies show that application of rules and creation of an even playing field is the most crucial factor after post-war security to attract new investment.
- **Operation of Business Ombudsman Council provides reassurance to investors.** The Business Ombudsman Council of Ukraine (BOC) provides a platform for businesses to file complaints about unjust treatment by government officials and SOEs. It also conducts extensive advisory sessions with state and the private sector. According to its annual report (2021), the Council receives over 1,500 complaints a year from entrepreneurs, and every seventh complaint comes from foreign investors. In the last seven years, the BOC has received almost 10,500 complaints and closed 70% of cases, demonstrating effective support to the business in the country.

Reforms

- ✓ **Advance the deregulation process led by the IWG on Accelerated Review of State Regulation of Economic Activity.** Recommendations to the Cabinet of Ministers to abolish a significant part of state regulation instruments (permits, licenses, declarations of approvals, etc.) under the Ministry of Economy would simplify regulations for investors. This should also address uneven enforcement of legislation which is often applied to imports and foreign investors (who follow designated rules) but are not always applied to national companies creating an unfair and uneven market.
- ✓ **Ensure the business taxes regime is rational, clear, consistent, predictable, and not onerously burdensome on labor.** Although the government states that its policy is to ensure a low tax regime to encourage business, there are cases where new taxes are imposed by Ministries, often at short notice without consultation. For example, the Ministry of Ecology sent the recent Sugar Tax directly to Parliament without any notice or discussions with business. Specific reforms would include:
    - Consult and explore/build Sugar Tax alternatives with the industry to not damage the sector.
    - Review income and social taxes on workers and employers, which are considered excessive.
    - Further clarification of the practical application of the existing regulations on controlled foreign companies whose different interpretations are unreasonably burdensome.
    - Limit manual interference with automatic tax payment systems.
- ✓ **Facilitate access to land and infrastructure.** Whilst industrial parks help small investors, especially national investors, foreign investors want to select the geographic locations best for their investment. Surveys and investors also report that the land buying process is both onerous and uncertain. "Location solutions" for investors are a vital part of competing for new investment and the GOU should provide these at the regional and central level.
- ✓ **Modernize Labor laws**. Labor legislation is based on the Labor Code (1971), meaning issues such as dismissal, business trips, vacation system, etc., are not properly regulated. The law should be aligned with the modern international business practices that protect both employees but allow flexibility in business decisions.
    - Simplify obtaining work permits and conclusion of labor contracts.
    - Deregulate trade unions' powers.
    - Improve the system of labor supervisory and controlling bodies.
- ✓ **Ease foreign exchange restrictions.** Currently there are issues around withdrawing dividends and international payments, including interest on hard currency loans. Whilst some of these were brought in as war measures, they are hampering foreign and local business and should be reviewed and applied equally. Notwithstanding these measures, investors have reported that even pre-war restrictions on foreign exchange limited and discouraged investment or additional investments.
- ✓ **Develop strong protection of property rights through strengthening legal frameworks and effective enforcement.** Judicial/court procedures and practices should be streamlined, and specialized bodies (e.g., Anti-Monopoly Committee) should be strengthened. Establish effective and independent administrative appeal procedures to reduce costly and lengthy court procedures, with access to international arbitration.
- ✓ **Improve border procedures and border infrastructure.** Customs procedures and facilities in seaports are outdated, including a considerable number of internal regulations which are still required in hard copies. These, together with shortages in equipment, facilities, and modern equipment, create corruption risks and slow the cargo turn-over down.
    - Fully implement the WTO Trade Facilitation Agreement including risk management, post-clearance audit, pre-arrival release, and authorized economic operators as well as modernization of Customs IT system and Electronic Single Window.
    - Ensure an effective customs appeal system for companies to resolve disputes.
    - Build awareness for full effectuation of the New Computerized Transit System.
- ✓ **Align with EU *acquis* Directives related to BEE.** Accelerate reforms to align with EU *acquis* in areas that will have impact on the business environment including the four EU Freedoms (movement of goods, services, capital, and persons), customs union, company law, intellectual property, competition policy, financial services, digital transformation, taxation, economic and monetary policy, social policy and employment, and enterprise policy.

REFORM AREA 4. CONTINUE ANTI-CORRUPTION REFORMS

Foreign investors cite corruption, particularly in the judiciary, PP, customs, and government services, as a key challenge in Ukraine. Despite recent Government steps and international donor support, there is still a widespread belief that "corruption is a norm." If investors believe they must contend with unscrupulous rent-seeking officials, compete on an uneven playing field, or rely on a flawed judiciary to protect their rights, they will be less likely to invest. Moreover, some investors state that due to the low international scoring on corruption in Ukraine, they have an extra burden of compliance with corporate anti-corruption measures, to prove they do not engage in such activities.

Challenges

Countries that have low levels of corruption and a functioning dispute and court structure perform better in attracting foreign investment by providing a clear and transparent system based on the rule of law, that protects existing and future investment and lowers the cost of doing business, particularly transaction costs. Effective legal and institutional safeguards against corruption sends a positive signal to investors and will encourage critical investments for enabling post-war reconstruction and economic recovery.

- **Corruption, perceptions of corruption, and an uneven playing field discourage investment.** Ukraine is burdened by perceptions of endemic corruption, as reflected by its persistently low score on Transparency International's Corruption Perceptions Index (CPI) and in 2022, Ukraine scored 33 points out of 100 and ranked 116 out of 180 countries. Since 2016, business has ranked widespread corruption and mistrust of the judiciary as one of the top two obstacles to foreign investment in Ukraine. A recent survey (2020) of investors also places corruption as the most important factor in investment decision making (ranked 7 out of 10). Ukrainian banks also lack confidence in the court system with fewer than 10% of the banks perceiving the court system to be fair and impartial, and no bank deems it to be quick and efficient. Existing US investors say that corruption in broader society creates unfair competition and uncertainty even when they do not themselves directly encounter corruption. Nevertheless, on the positive side, numerous US investors indicate that actual levels of corruption they encounter in Ukraine seem to be much lower than various reports would seem to indicate. Nonetheless, these negative perceptions need to be addressed just as much as the actual problems.
- **Oligarch influence and unstable institutions drive perception of persistent corruption.** Recent improvements have been made to strengthen the independence of anti-corruption bodies, but Ukraine still suffers reputational costs from the complicated history of gains and reversals with regard to these institutions. Further, oligarchic influence is seen by US investors as being used to create an uneven playing field in the national market, either through non-compliance with the rules or manipulating new laws in their favor through the Verkhovna Rada (Ukrainian Parliament). European auditors reported in 2021 that oligarchs and vested interests were the main obstacles to Ukraine's economic development.

PHOTO: SHUTTERSTOCK

- **Ukraine policy is addressing corruption.** In 2023, the Verkhovna Rada approved an anti-corruption program for 2023-2025 aimed at preventing corruption. The program continues and accelerates measures in the justice field, state economic regulation, customs affairs and taxation, public and private sectors, construction, land relations and infrastructure, the defense sector, health care, education and science, and social protection.

Reforms

✓ **Expand digitalization to increase transparency and reduce physical interactions between investors and public sector officials.** The Ministry of Digital Transformation should accelerate the process of simplification and digitalization of government services concerning business regulation. These include registrations, licensing, permits, certifications, and accreditations. This should be preceded by a systematic business reengineering process that would entail elimination of: (1) unnecessary administrative and regulatory requirements and procedures; and (2) duplicative and redundant authorities. Digitalization will minimize interface between businesses and authorities and dramatically reduce possibilities for corrupt practices. However, US investors have cast doubt on the effectiveness of these digitalization initiatives as there are always manual overrides that officials use so circumvent automatic processes and engage in face-to-face inspections. Moreover, a great deal of the bureaucracy is not centralized, and unnecessary paper approvals remain to be required by regional authorities. Therefore, to be effective, such digitalization of procedures needs to be expanded to regional and national governmental agencies.

- ✓ **Continue to strengthen existing anti-corruption institutions.** The GOU should ensure that these institutions are fully staffed and resourced, operate without political interference, and have required powers. Particularly, more support is needed for the Bureau of Economic Security and High Anti-Corruption Court of Ukraine, which as of September 2021, had sentenced 36 officials, including 10 judges for a range of corruption related offenses. Other institutions include the National Anticorruption Bureau, the Special Anti-Corruption Prosecutor's Office, the National Agency on Corruption Prevention, and the Asset Recovery and Management Agency. Specifically:
  - o Implement a selection process for constitutional judges that aligns with the Venice Commission.
  - o Complete the vetting of judges for the High Council of Justice and establish a qualification commission for judges.
  - o Appoint senior experienced leadership at Ukraine's anti-corruption agencies and protect decision making of officials without fear of future reprisals (unless breaking laws).
- ✓ **Strengthen anti-corruption legal framework, especially with reference to curbing oligarch influence.** Amend the Law on Prevention of Corruption (e.g., provisions related to plea agreement) and the Criminal Procedural Code to enhance investigative procedures. Strengthen the Anti-Money Laundering and Countering the Financing of Terrorism regulatory framework by developing effective secondary legislation. In addition, implement the anti-oligarch law to limit the excessive influence of oligarchs in economic, political, and public life. Capacity building is required throughout.

PHOTO: SHUTTERSTOCK

- ✓ **Strengthen the capacities and powers of existing oversight institutions**. In particular, strengthen the Accounting Chamber as the supreme audit institution with oversight of public revenue and expenditure and as a key player in anti-corruption. Similarly, the Antimonopoly Committee should be supported to vigorously investigate oligarch influence and break up Ukraine's monopolies and cartels, which disrupt the market and lead to an uneven playing field unfavorable to investors.
- ✓ **Promote open approach and communication on corruption.** It is important that Ukraine consistently alerts and admits immediately when corruption at elevated levels has been identified and follow due procedures in resolution, but this should be undertaken proportionally. These anti-corruption cases should be digitalized for tracking them. It is equally important to promote a more positive image of Ukraine on corruption. Although Ukraine scores low score on Transparency International's CPI, experts note that surveys do not provide an objective overview of corruption, and perceptions do not always match reality. Constant messaging and communications are needed to change perceptions.
- ✓ **Align with EU *acquis* Directives and accession requirements related to fighting corruption.** Much of the required transparency and legal frameworks are committed to within the EU-Ukraine Association Agreement (AA). The path to EU accession will include: the introduction of legal and institutional reforms, including compliance with chapters related to judiciary, PP, financial control over public funds, digital transformation, and media; and the fulfilment of accession preconditions related to anti-corruption, anti-oligarchs, Anti-Money Laundering, and aligning Ukraine's media law with EU standards to ensure a free and independent media sector. These will introduce additional safeguards against corrupt practices.

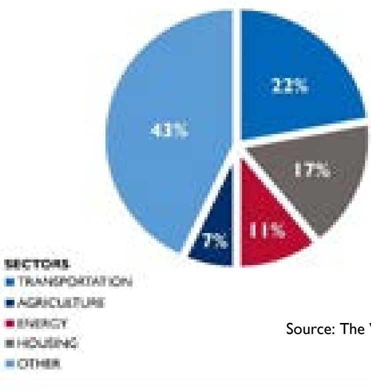
REFORM AREA 5. STRENGTHEN THE INSTITUTIONS AND REGULATORY FRAMEWORK GOVERNING CAPITAL INVESTMENT PROJECTS

To ensure a coordinated rebuilding effort with efficient use of scarce resources, the government needs to greatly improve its capacity to conduct appraisals of potential projects to identify the most promising projects. This should be based on calculations of their potential economic returns and best value for money to plan the correct role of private involvement in PPPs, to conduct procurements, and to soundly manage projects that involve substantial government participation. Open, transparent, and non-discriminatory institutional and regulatory framework for PP, PPPs, and concessions will be crucial in attracting foreign investors under national development plans, and the provision of quality public services at competitive prices for consumers.

Challenges

Rebuilding and modernizing Ukraine's economic and social infrastructure (particularly transport, energy, housing, and public schools and hospitals) will: enhance economic security, efficiency, and competitiveness; enable energy independence; improve transport connectivity and facilitate trade; promote private sector development; create employment opportunities; and contribute to economic growth. Massive investment will be needed of all types including private, public, and public-private. To enable this, Ukraine needs to address a wide array of issues in its current institutions and legal framework governing capital investment projects (CIP), build related capacity, and ensure fair and competitive award of contracts.

INVESTMENT NEEDS INCREASED FROM $350 BILLION (SEPTEMBER 2022) TO $411 BILLION (MARCH 2023)



Source: The World Bank

- **War created investment opportunities in reconstruction of public infrastructure of Ukraine.** There will be a massive program of reconstruction to rebuild Ukraine post-war. As of September 2022, the World Bank estimated that 40% of housing, 30% of power stations, and 33% of infrastructure have been damaged, including 305 bridges, 19 airports, 57 railway stations, and 24,000 kilometers of road.
- **The GOU has inadequate capacity.** At the central level, in line ministries, and at sub-national levels there are limited tools and capacity to conduct project appraisals and cost-benefit analyses of potential projects, run procurements, and manage projects.
- **PPPs will be needed to meet these costs alongside Government and international donor funds.** Based on a rapid assessment of immediate needs, Ukraine will need $14 billion for priority reconstruction in 2023, with Ukraine's capital budget for this year (2023) at $3 billion.
- **Capacity of PPP Agency is inadequate to meet the needs.** The goal of the PPP Agency is to promote the implementation of new projects, primarily in infrastructure. However, it has a team of three staff to provide services to central and local government agencies (advice on the PPP issues; training of the project teams; defining the idea; assisting in the preparation of necessary documentation; communicating with the market and promoting the search of investors; structuring of partnership contract; assisting in preparation of tender documentation; and advising during the tender process).
- **Processes in PPP are inefficient and slow.** The procedures and progress have been fairly slow even pre-war. This includes poor understanding and capacity of government authorities in Ukraine's regional, central, and regulatory bodies developing and regulating PPP projects. Investors commented that there is currently not one good example of a successful PPP in Ukraine. A new law (7505) is being presented to the Verkhovna Rada to speed up processes, including directly negotiating with investors for PPP contracts under certain conditions, but the efficacy and fairness of such an approach is unclear.
- **Wider legal framework for PPP is not encouraging for foreign investors.** The regulation and governance of areas covering PPP is not currently conducive to investors, and in some cases does not allow for foreign private or in some cases, national private participation. Other issues include ineffective or fixed tariff systems in public operations and inability to charge tolls on roads, making it unattractive or impossible (low fixed prices that do not reflect investment or return).

Reforms

- ✓ **Broadly increase the capacity of the Government to drive and manage public investments and PPPs.** To efficiently allocate hundreds of billions of dollars of investment in reconstruction will require an enormous increase in government capacity to: plan capital expenditures; appraise potential projects; conduct cost-benefit analyses; determine optimal PPP structures; conduct transparent procurements of private investors and implementing companies; negotiate transactions; monitor and manage projects; and evaluate results. Capacity needs to be improved at the central level (Ministries of Finance and Economy), within line ministries, and at sub-national levels.
- ✓ **Develop new strategies on PP and PPP** and a comprehensive and multi-year prioritized CIP plan, detailing all upcoming projects, costs, and intended type of contractual arrangements.
- ✓ **Strengthen the legislative framework governing PP, PPP, and Concessions in line with EU and WTO**. These should include:
    - Amend the PP Law to: eliminate wide exemptions from the law; enhance the provisions related to, inter alia, the use of the "most economically advantageous tender" criterion, dynamic purchasing, selection of economic operators, e-auctions, and innovation partnerships; provide for effective remedies; and eliminate overlapping authorities.
    - Elaborate sublegal acts and standard documents, particularly those related to framework contracts, simplified procedures, e-catalogues, and the rules on review procedures and available remedies.
    - Revise the PPP legal framework to shorten the process of competing and awarding PPP contracts; eliminate domestic content requirements which violate Ukraine's WTO commitments; and maintain fair competition, while allowing for transparent and justifiable direct negotiations in limited emergency cases using short-list under a framework arrangement.
    - Align the legislation on concessions and defense procurement with relevant EU directives.
    - Establish proposal evaluation mechanisms based on financial and qualitative criteria for identifying offers providing best value for money.
    - Revise resolution N. 169 (adopted based on the Martial Law) to limit the current wide scope on direct procurement to very special cases (e.g., defense and security sectors).
- ✓ **Increase and build capacity of human resources of PP and PPP authorities**. Build capacity of regulating and implementing bodies such as the PPP Agency and the Ministry of Economy, to ensure proper and effective oversight and optimal quality of control and enforcement.
- ✓ **Develop clear Government policy of involving foreign companies in PPP**. A clear signal is needed from government that it welcomes and actively encourages foreign participation in PPP projects in the reconstruction of Ukraine. This needs then to be effectively communicated and promoted to foreign businesses to generate a wide level of awareness and interest. This policy and the other reforms need to begin urgently, well before the end of the war so that the GOU and the international community are ready to deploy resources effectively in the reconstruction of Ukraine. Experience from post conflict reconstruction in Afghanistan and Iraq highlights the necessity for such processes to be in place prior to spending in order to improve economic efficiency.
- ✓ **Build the capacity of the PPP Agency to train and support local and central Government Ministries and authorities.** Specific skills in developing required PPP projects will be needed across government in order to attract the private sector. These include project management, project planning, and cost-benefit analysis. Moreover, the volume of PPP engagements that will be needed will require a strong set of advisers to both local and national authorities simultaneously and the PPP Agency will need to be expanded and resourced.
- ✓ **Strengthen supervisory and oversight of PPP and PP.** Strong independent oversight of the PPP processes is needed, both in the development and contracting of projects, and during implementation to resolve issues. It has been suggested by investors that for this to be effective and, given certain monies for the reconstruction of Ukraine will come from US and other international bodies, that some representation of key donors within the supervisory body is required to ensure trust and effective implementation. This could include selection and appointment of commissioners for the established commission under the Antimonopoly Committee of Ukraine in charge of handling complaints on violations of the PP Law. Enhance audit criteria and processes to include Verkhovna Rada and civil society oversight over PP and PPP.

REFORM AREA 6. ACCELERATE THE PRIVATIZATION PROCESS

SOEs in Ukraine are plagued with inefficiencies, poor performance, and a major source of corruption, political abuse, and malign influence. The current leadership is committed to accelerating privatization and is interested in the participation of foreign investors to transfer capital, technology, and know-how for: maximizing economic output and expanding exports; creating employment opportunities; generating proceeds for supporting a post-war reconstruction effort and social safety nets; fostering the expansion and share of the private sector in the economy; promoting competition; and completing the transition to a market economy. Foreign investors will not be interested to participate in a privatization process that lacks transparency, open competition, fairness, and certainty, and imposes unrealistic obligations on investors. Strong political will and sound privatization that is legal and institutional are crucial to attract FDI in Ukraine's privatization process.

Challenges

The State is the largest owner of assets in the economy of Ukraine. These assets are heavily concentrated in certain sectors (e.g., transport, energy, banking, agriculture, and machine building). Previous privatization processes have been challenging with many of the lucrative SOEs falling into the hands of oligarchs at initial stages of privatization. Privatization of large-scale SOEs has been stalled, and since 2018, a single large SOE was privatized. This has been caused by vested interests, ill-designed and constantly changing processes, poor execution of procedures and related disputes, and a misguided belief that first reforming SOEs and then privatizing might yield higher proceeds from privatization. Ukraine needs to resume privatization through an approach that increases investors' confidence.

The iconic Hotel Dnipro, privatized in 2020 with the assistance of the USAID/EDGE Project

- **The large number of SOEs in Ukraine reduces efficiency**. There are 3,358 registered SOEs (2021) and 1,600 are currently operating (remainder are dormant businesses). The US Department of State sums up the situation in Ukraine - "Some of the companies have significant environmental problems, legacy legal issues, or oligarchs as minority owners."
- **The privatization process is too slow to meet the needs of investors and GOU**. In 2020, Ukraine began a process to allow privatization of SOEs, including Naftogaz, MainGasPipelines, UkrTransGaz, and other companies involved in the energy sector. In 2021, Parliament clarified the law listing 659 exempt SOEs, mostly in the energy, defense, and aerospace sectors; the state railway; the postal service; and other entities determined to have "social value." In March 2021, Ukraine passed a law to facilitate progress towards large-scale privatization following a freeze on the process due to the COVID-19 pandemic. There is potential to rescue over 1,000 SOEs through private investment if they are privatized quickly.
- **Draft Law on rapid privatization adopted**. In 2022, the Verkhovna Rada adopted a law, which simplifies the privatization procedures and removed restrictions that previously prevented the sale of certain state assets. As a result, the SPFU continued privatization of a number of SOEs through auctions on the state electronic trading system "Prozorro Prodazhi" (Prozorro).
- **Suspension of audit requirements risks corruption.** The Martial Law of 2022 amended the Law on Privatization and cancelled the audit requirements and evaluation of large-scale SOEs subject to privatization. Suppressing essential information about SOEs to be privatized increases risk of financial abuse and corruption, reduces investors' interest, and affects the efficiency of the privatization process.
- **The capacity of the SPFU is not adequate to process potential increase in privatization**. The SPFU oversees the privatization process' technical aspects and provides catalogues of SOEs to be privatized. It defines small-scale privatization with less than or equal to UAH 250 million (currently cataloguing around 1,000 offers) and large privatization above this threshold (currently cataloguing around 26 offers). In October 2021, the SPFU auctioned the "First Kyiv Machine Building Plant" for $53 million. However, following the resignation of the SPFU head, future large-scale privatization plans were put on hold.

Reforms

- ✓ **Improve the privatization legal and policy framework.** Amend the privatization law to: (1) expand the scope of privatization to dramatically reduce the list of exempted SOEs not subject to privatization; (2) reintroduce provision for confirmation and disclosure of financial statements of large-scale privatization objects by authorized auditors; (3) prevent unreasonable requirements on investors such as keeping all or part of existing employees or management; (4) clarify and ensure proper implementation of rules on inheriting licenses of SOEs by privatized entities under full privatization or concession arrangement; and (5) streamline procedures and shorten the period for securing land plots of real estate objects to allow rapid utilization of the privatized object.
- ✓ **Develop a multi-year privatization strategy.** Develop a clear approach that outlines, inter alia, clear privatization methodologies and lists SOEs/state assets subject to privatization.
- ✓ **Speed up corporatization and transfer of assets to SPFU.** Transfer large SOE assets and the control and management authorities to the SPFU and engage reputable advisors to conduct valuation and corporatization for accelerating the privatization process.

PHOTO: SHUTTERSTOCK

- ✓ **Consider IPOs on Ukrainian and reputable international stock exchanges.** For existing corporatized SOEs (as per strategy e.g., Naftogaz, Ukrenergo, Gas Transmission System Operator, Energoatom, Ukrhydroenergo, Ukrzaliznytsia, and Ukrposhta; and state-owned banks: Privatbank, Oschadbank, Ukreximbank, and Ukrgasbank), develop IPOs on appropriate stock exchanges. Also allow the sale of shares of large SOEs through electronic platforms to increase transparency and reduce corruption risk and consider further development of Prozorro for this purpose.
- ✓ **Establish an independent appeal process.** It is essential to address privatization disputes/complaints without the need for costly and lengthy judicial proceedings, and this would require an independent appeal body.
- ✓ **Develop and implement an effective privatization communications strategy**. This strategy should target domestic and foreign investors as well as international investment banks and institutions.
- ✓ **Develop a strategy for demotivating and disincentivizing municipalities from keeping SOEs.** This should include removing state aid and subjecting SOEs to competition, as well as raising awareness among Municipalities on the benefits of privatization. This would include facilitating dialogue and sharing successful experiences from other countries.
- ✓ **Build the capacity of the SPFU.** Expand the resources, skills, and training of the SPFU to enable it to function properly, including developing technical, financial, and organizational profiles for large SOEs and posting them on the SPFU website along with planned privatization schedule and timely notifications for planned transactions.

REFORM AREA 7. ACCELERATE EU ACCESSION

One of the top national priorities for Ukraine's geopolitical and security objectives is to move toward European integration through forward progress with the EU accession process. Apart from these objectives, the EU accession process will serve as an engine for broad-based reforms across a wide range of areas (30+). Accession to the EU will help in, inter alia, strengthening the rule of law, increasing transparency, improving the investment climate and condition for economic and private sector development, and suppressing corruption. In addition to sustaining market access already granted under the EU-Ukraine AA, complying with the four EU Freedoms (the free movement of goods, services, capital, and natural persons) will provide guaranteed and easy access for investors to the EU market. Further, EU membership commitments will instill stability, predictability, and accountability which are all important to attracting FDI to Ukraine.

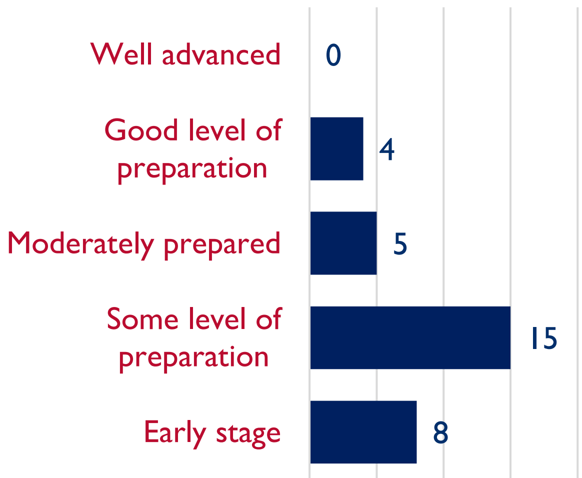
Challenges

EU membership requires deeper and far-reaching reforms for achieving full conformity with the EU *acquis communautaire*, which encompasses the full body of the EU legislative framework. In addition, the EU has imposed seven pre-conditions for launching negotiations. The GOU has strong political commitment for accelerating reforms, launching and undertaking negotiations, and rapidly securing EU membership. This effort is monumental and requires the drafting and enactment of hundreds of laws and secondary legislation, significant institutional reforms, and related capacity building for effective administration and enforcement. Whilst some of this had started under the AA, the lack of capacity and adequate resources within the GOU presents a major challenge in executing required systemic policy, legal, regulatory, and institutional reforms, and engaging in effective and productive negotiations. Ukraine needs to seize this window of opportunity for rapid accession and demonstrate reform progress to the EU and the international investment community.

- **Ukraine granted EU Candidate Status in June 2022 under certain preconditions.** The EU has set out seven pre-conditions for the initiation of negotiations. The most recent report by the New Europe Center provides an overall score of 5.86 out of 10 for current fulfillment, with reform of Constitutional Court and anti-oligarch law implementation scoring the lowest.
- **Much work remains to be done.** According to the European Commission Analytical Report dated February 1, 2023, the ability of Ukraine to assume obligations of the EU Membership was scored 2.15 out of 5, and the alignment with majority of the EU *acquis* chapters is either in early stages or just some level of preparation.

Acheiving Pre-conditions for EU Candidacy (2022)

Aligning Ukraine's Law with EU *Acquis* Chapters



Reforms

- ✓ **Prioritize and prepare adequately for the EU accession process.** It is important that the GOU quickly establishes a professional team to prepare for accession to the EU. Specifically, the immediate actions will include:
    - Complete expeditious reforms related to the seven pre-conditions.
    - Conduct a screening of Ukrainian legislation during the next few months to assess compliance with the *acquis*.
    - Develop a sequenced roadmap for undertaking negotiations and implementing reforms for conforming with EU directives and regulations.
    - Launch, in accordance with the roadmap, remaining reforms with the aim of completing them within two years.
- ✓ **Prioritize alignment to the EU *acquis* in specific areas relevant to investment.** As detailed in the relevant reform areas set out in this report, EU accession provides a mutually supportive mechanism to create a conducive investment climate and builds trust in systems that are being put in place to establish rule of law and certainty. These should be prioritized in the accession process, especially:
    - <u>BEE related chapters</u>: the four EU Freedoms (movement of goods, services, capital, and persons), customs union, company law, intellectual property, competition policy, financial services, digital transformation, taxation, economic and monetary policy, social policy and employment, and enterprise policy.
    - <u>Combatting Corruption related chapters</u>: judiciary, PP, financial control over public funds, digital transformation, and media.
    - <u>Capital Investment Projects related chapters</u>: PP, financial control over public funds, competition policy, transport, energy, Trans-European Network, environmental, and climate change.
    - <u>Sector specific chapters</u>: transport, energy, agriculture and rural development, food safety, veterinary, and phytosanitary, and fisheries.
- ✓ **Build capacity across government to undertake the accession process.** First, the Government Office for EU Integration, under the Secretariat of Cabinet of Ministers, will need capacity to negotiate and guide the EU accession process and reforms properly and effectively. It will also need to coordinate with all stakeholders. Secondly, the line Ministries will need support and capacity building to facilitate the implementation of necessary reforms and fulfil the obligations of EU membership.

PHOTO: SHUTTERSTOCK

- ✓ **Pay stronger attention to implementation of the EU *acquis***. The AA requires adoption of much of the *acquis*, and experience in Ukraine has shown good progress in legal adoption such as the quality infrastructure. However, many progress assessments criticize the lack of implementation and enforcement. Therefore, the GOU should identify institutional needs for complying with the implementation of the *acquis*, establish appropriate institutional mechanisms, and build related capacity for administering and enforcing new laws.
- ✓ **Establish strong mechanisms for monitoring, evaluating, and reporting EU accession progress.** The Government Office on EU Integration should monitor and report on the EU accession process and related reforms, and coordinate with stakeholders in the public sector, private sector, and civil society. It should also evaluate the economic impact of reforms, build awareness, and provide guidance to stakeholders for making necessary adjustments.

REFORM AREA 8. ADDRESS SECTORAL ISSUES

There are a wide range of opportunities for US investors in Ukraine for both reconstruction and for developing national and regional markets. Based on the current needs of Ukraine stated by the Government, current US investments in Ukraine, and stated interests reported by USG websites, the sectors of interest in Ukraine include agriculture, high-tech manufacturing, energy, transport and infrastructure, and services (IT and education).

Challenges

Whilst the general framework for investment reform set out in the previous sections will improve the attractiveness of all these sectors, four sectors were identified as aligned with current US investor interests but where specific barriers exist and further reforms are needed are specified below.

- **US interests are more in agricultural supply, not production**. Whilst Ukraine may be wishing to attract FDI in agricultural production, US interests appear to lie in production and supply of agricultural equipment, supplies, and infrastructure and in food processing. Specific identified sectors in food processing are starch sugars, yeast extracts, fuel ethanol, amino acids, carboxylic acids, biodiesel, animal fats, vegetable oil, and confectionary products.
- **In manufacturing, opportunities seem to be in high-tech areas such as machine building, pharma/clinical testing, medical devices, and security equipment**. US investors are interested in taking advantage of opportunities in Ukraine due to its proximity to Europe and other export markets (the Middle East), lower labor costs with high education, and reputation as a regional education and research hub. Defense also appears to be an ideal sector (recent investments from Germany in tank production are being considered).
- **Manufacturing opportunities could also exist in privatization of SOE in the manufacturing sector.**
- **Oil and gas.** Needs have been identified for specific equipment needed (rigs, casing pipes, drills, motors, and services) as well as services (side-tracking technology, upstream services, exploration, and Hydraulic fracture works).
- **Renewable energy**. Major US interests may be more in the traditional energy sector but there are already some US investments in this sector and there is much investment potential in green energy, with the aim of the GOU to focus on supplying the EU.
- **Need for more focus by UkraineInvest and Advantage Ukraine**. UkraineInvest refers to 13 sectors (with many sub-sectors) in its website and Advantage Ukraine has a similar list. Investment policy and promotion should ideally concentrate on a smaller list of priority sectors and especially existing investors in Ukraine.

Agriculture, Inputs, and Food Processing

- It is estimated that the post war cost of replacing agricultural machinery damaged or stolen during the War is $926.1 million. In addition, repairing grain storage could be $272 million, and there is also an urgent need to continue the pre-war irrigation and drainage construction program which also requires specific technologies.
- The majority of agricultural exports, with the exception of vegetable oils, are raw goods such as corn, wheat, rapeseeds, and soybeans and even vegetable oil is exported bulk. Therefore, opportunities exist in food processing machinery and production.

Reforms

✓ **Advance land reform**. Around 27% of agriculture land lacks clear title of ownership, which affects the ability of producers to secure short- and long-term financing, limiting ability to purchase inputs including modern equipment and inputs.

- ✓ **Remove the moratorium on foreign ownership of agricultural land.** Many foreign food processors need to secure supplies through their own production (at least in part as base inputs) so access to land is important.
- ✓ **Further integrate with EU *acquis***. Implement Sanitary and Phyto-Sanitary food safety standards and machinery and packaging standards that require specific technologies to be produced and purchased by producers.
- ✓ **Remove remaining tariff and non-tariff barriers for export to the EU and other countries.** To improve market access, include some tariff rate quotas and minimum pricing and tariffs, and recognize national competencies.

High Tech Manufacturing

- As a result of the war, it is estimated that 1,100 medical facilities have been damaged or destroyed, along with their equipment. These will not only need to be rebuilt but also re-equipped. And with proximity to EU markets and clear comparative cost advantages in high tech manufacturing, investors have a big opportunity in this sector.

- Post-war, security and defense equipment will be high on the agenda for many years. In security, manufacturing of alarm systems, fire protection equipment, explosives and drug detectors, and advanced video surveillance cameras with video analytic capabilities have been identified as specific needs for Ukraine.

Reforms

- ✓ **Encourage return of skilled Ukrainian population.** Post-war, it will be important for the GOU to ensure the return of displaced persons, especially skilled workers needed in the manufacturing sector to maintain its competitiveness (this is allied to quality of life in Ukraine post war).
- ✓ **Create risk insurance for foreign investors and business visitors.** New investors may see Ukraine as a high-risk destination for investment and will need risk insurance (which is now being provided on German investment in Ukraine). Similarly, travel restrictions imposed by foreign governments inhibit visits by foreign clients to Ukraine. An insurance program is needed to facilitate business-to-business contact in Ukraine (necessary for the manufacturing sector) and for new investments by US companies that limit or reduce exposure to potential future conflict or damage of facilities.
- ✓ **Provide oblast level investment facilitators.** A major constraint discouraging manufacturing investors is the complex regulatory and infrastructure issues at the local level, including connectivity to utilities, infrastructure, local permits, and regulatory administration. A single "go to" point in each oblast administration is important for clarity and to reassure investors that issues will be resolved. This could be from within existing administrations but should be linked to central investment facilitation such as UkraineInvest.

Oil and Gas

- Ukraine's oil and gas remains a large part of Ukraine's national energy security strategy, and more so now with the move away from Russian Federation sources.
- However, in recent years, domestic production has declined and so the GOU is seeking to significantly increase domestic production-providing opportunities.
- It is worth noting there are tariff exceptions for imports of technology and equipment for the oil and gas sectors.

Reforms

- ✓ **Revise and update legal framework to provide certainty.** To increase foreign investment, it is important the regulatory and legal framework is improved to provide certainty for investors based on rule of law and protection of property rights.
- ✓ **Address major financial imbalances in the energy sector.** Adopt policies that enable open competition between commercial and state-owned banks in the energy sector to enable commercial banks to finance energy infrastructure projects and greatly increase the amount of funding available for new investments.
- ✓ **Address corruption and vested interests in the sector.** As in other sectors, vested interests and lack of a level playing field adversely affect the willingness to invest, as well as trust in the government and judiciary. Policies are needed to make the oil and gas sector much more open and transparent with equal access and fair competition with adequate recourse to disputes.
- ✓ **Ensure that PP, concessions, and privatization processes in the whole energy sector are transparent, open, and free of corruption.** Linking to the thematic chapters on corruption and PP, it is important in this specific sector that liberalization of the energy sector and movement to a private sector environment is undertaken to ensure equal participation on a level playing field.

Renewable Energy

- Alongside increasing production and diversifying sources of fossil fuel power generation, Ukraine plans to rapidly expand its renewable sector and align with the goals of the EU (GOU is targeting 35% energy from renewables by 2035).
- It also plans to become a center of clean hydrogen power generation to supply to the EU in the coming years.
- In the previous decade, an estimated $12 billion was invested (domestic and foreign) in renewable energy in Ukraine, with pre-war capacity of 60 gigawatts of solar power, 320 gigawatts of onshore wind power, and 251 gigawatts of offshore wind power. As a result, solar and wind power currently accounts for around 5% of Ukraine's demand.

Reforms

- ✓ **Prioritize renewable energy projects in Ukraine's reconstruction plans.** As part of the build back better process and to ensure the sustainability of investment, use of renewables should be mainstreamed into major infrastructure development.
- ✓ **Create conditions for the development of the hydrogen, biofuels, and other renewable gases transmission industry.** To facilitate investments in renewable generation, especially focused on EU markets, amendments to the legislation on the Amendments to the Law of Ukraine "On Alternative Fuels" are required.
- ✓ **Progressively move from feed-in-tariffs in the renewable energy generation market.** It is important to ensure a more market-driven mechanism in the renewable energy generation market that is based on costs of production rather than state entities or government fixing arbitrary prices.

ANNEXES

ANNEX 1: LIST OF ACRONYMS

AA	Association Agreement between Ukraine and EU
AmCham	American Chamber of Commerce in Ukraine
B2B	Business to Business
BEE	Business Enabling Environment
BOC	Business Ombudsman Council
CEO	Chief Executive Officer
CIP	Capital Investment Projects
CPI	Corruption Perceptions Index (Transparency International)
EBA	European Business Association
EBRD	European Bank for Reconstruction and Development
EDGE	Economic Development, Governance, and Enterprise Growth
EU	European Union
FDI	Foreign Direct Investment
GOU	Government of Ukraine
IDG	International Development Group
IPA	Investment Promotion Agency
IPO	Initial Public Offering
IWG	Interagency Working Group on Deregulation
KII	Key Informant Interviews
OECD	Organisation for Economic Co-operation and Development
PP	Public Procurement
PPP	Public-Private Partnerships
R&D	Research and Development
SOE	State Owned Enterprise
SPFU	The State Property Fund of Ukraine
UAH	Ukrainian Hryvnia
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
USAID	United States Agency for International Development
USG	United States Government
WTO	World Trade Organization

For more information, you can locate the full report at:
https://www.usaid.gov/usaid-response-ukraine

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
1300 Pennsylvania Avenue, NW
Washington, DC 20523
Tel: (202) 712-0000
Fax: (202) 216-3524
www.usaid.gov

USAID
FROM THE AMERICAN PEOPLE