

Ukraine.



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Investment Profile

2001



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Foreword



The recovery of economic activity in late 1999 developed into broadly based economic expansion in 2000. External debt to the private sector has been successfully rescheduled, the exchange rate has remained stable, and the international reserves position was strengthened.

On the structural front, a number of important measures were taken, including the improvement of payments discipline in the energy sector, major reforms in the agricultural sector, the elimination of non-cash revenue offsets and significant reduction of discretionary tax exemptions, the drastic reduction of payment arrears on government wages and social benefits and the virtual elimination of pension arrears, the increase of communal tariffs to cost-recovery levels practically all over Ukraine, a streamlining of the public administration, and the passage of a privatisation law.

Despite the improvements outlined above, further progress is required to consolidate Ukraine's financial position and create a solid base for sustainable economic growth. The annual inflation rate rose from 19 per cent in 1999 to about 27 per cent in 2000, reflecting increases in administered prices, notably communal tariffs, higher prices for energy imports and some staples, and the impact of purchases of foreign exchange by the National Bank of Ukraine (NBU).

Looking ahead, Ukraine sees its greatest need for further action in reforming the banking sector (especially with regard to Bank Ukraina), ensuring the transparency of privatisation operations, further improving the payments discipline in the energy sector, rationalising financial relations between the central and local governments, and further reducing distortions in the tax and foreign trade systems.

Ukraine is determined to consolidate the progress made by tightening fiscal and monetary policies, and by accelerating key structural reforms necessary to ensure sustained growth. The fiscal policy aims to further consolidate the government finances, improve the tax structure and widen the tax base, and better target public expenditures in line with priorities for structural reform. Building on good progress in 2000, the 2001 budget law prohibits netting and non-cash operations and government loan guarantees other than for loans from multilateral organisations. The reforms being undertaken in the financial sector aim at strengthening banking legislation and accelerating the restructuring of the major problem banks.

The government of Ukraine will continue to give high priority to rationalising government expenditures, and to ensuring that no new payment arrears on wages, pensions and benefits emerge. To improve transparency and accountability and to reduce opportunities for corruption, the fiscal programme aims to promote cash operations.

The government of Ukraine will continue to attach high importance to further streamlining the public administration. A major focus for the government in the future will be on improving transparency and governance, and on reducing opportunities for rent seeking and corruption. Progress in this area is essential to encourage private activity and to ensure an efficient use of public resources.

Ihor Mityukov

Minister of Finance of Ukraine
EBRD Governor for Ukraine



Introduction

The growth of the Ukrainian economy in 2000 was not only stronger than expected, but also represented the first full year of positive GDP growth since transition began. This success reflects the strong response of industry to the earlier decline in the exchange rate, but also the government's determination to promote reform, as well as the emergence in parliament of a broad alliance more likely to support reform than before. The improved political situation and the better performing economy have enhanced prospects for structural reforms. Long-awaited legislation on privatisation, taxation, and land reform has been submitted to parliament. A zero-deficit budget for 2001 (if privatisation revenues are included, or a 3.0 per cent deficit if, as per international norms, they are excluded) was approved by parliament in December. While property rights legislation including land ownership is being developed and administrative reform initiated, sustainable economic growth in the coming years will depend on further commitment to structural reforms.

During the 1990s Ukraine's economy did not live up to the expectations held at the onset of transition, despite its considerable potential. Instead, the recorded economy contracted continuously as a result of obstacles to the development of a market economy. Successive governments were unable to gain a consensus for a clear reform agenda, which delayed progress with economic transition. At the end of 1999, however, after the re-election of President Leonid Kuchma, a new reform-minded cabinet was appointed, committed to accelerating structural economic reforms. Moreover, the emergence of a pro-government majority alliance in the Verkhovna Rada (parliament) enabled the government to pass and begin to implement long-delayed legislation.

The improved political situation and the recovery of industrial output since 1999 offered better prospects for structural reforms in 2000 than ever since independence, which resulted in some major achievements. The rescheduling of most commercial debts in early 2000 was an important success for the government, removing the earlier prospect of default. Besides, new accords were reached with Russia and Turkmenistan over energy debt rescheduling. Important legislation on privatisation, taxation, and land reform was submitted to the Verkhovna Rada. The amounts collected in cash in both the fiscal and power sectors improved as the government implemented measures to ban non-monetary means of payment. All these positive developments were supported by the favourable macroeconomic climate in 2000, with a stable hryvnia exchange rate, higher than expected GDP growth, and a tighter fiscal policy, although inflation was higher than expected.

The challenges ahead

Liberalisation of the trade sector is one of the major challenges. In accordance with EU and WTO guidelines, Ukraine has been making moves towards liberalisation by gradually

eliminating export quotas and licences. At the beginning of 2000 the temporary 2 per cent import surcharge was removed and some preferential import duties were lowered, but high tariff and non-tariff barriers are still a significant obstacle to trade. Several sectors remain protected and benefit from higher duties. Further trade liberalisation and negotiations on accession to the WTO should be accelerated. WTO negotiations continue, but the tendency to resort to certification procedures and other non-tariff barriers to protect domestic industry has slowed progress.

Attracting more foreign investments is a key priority for the Ukrainian authorities. While the renewed large-scale privatisation programme can create investment opportunities, attracting more foreign direct investment also depends on an improvement in the business environment, including comprehensive tax reforms. Some investment-related legislation was in fact improved in 2000, and the privatisation process accelerated. The Tax Code is in the process of being revised. The law on national treatment for foreign-owned enterprises with respect to tax and currency regulations was adopted in February 2000, a National Bank regulation in May 2000 enhanced the credit situation for both domestic and foreign investors, and new regulations to protect minority shareholders against dilution of their stakes took effect in October. The new proposed Tax Code, still in discussion in the Verkhovna Rada, is more investor-friendly than the current regime. (See *Investment climate* below).

Sustaining the recent improvement in cash collection rates is the main challenge in the power sector, which would lay the basis for renewed investment and effective organisational reforms in the sector. In 1999 less than 9 per cent of the total payments by the distributors to the power market were made in cash. In July 2000 a law took effect to improve cash payments in the wholesale power market, which required power

distribution companies to pay cash for the electricity they have contracted to purchase from the energy market, while the regulator determines the proportion of the receipts that will be paid to the generating companies. In August 2000 the collection ratio had reached 80-90 per cent. Besides, new legislation enabled the government to accelerate the privatisation process of the regional energy distribution companies.

International relations

Since independence, Ukraine's foreign policy has been balanced between strengthening ties with the west while avoiding tensions with Russia, its largest trading partner and supplier of much-needed energy imports. The logic of this bifurcated stance stems from concerns over Russia's sensitivities towards Ukraine's ties to western institutions, particularly NATO, as well as from Ukraine's ethnic, religious and cultural divisions. A friendship treaty with Russia and Ukraine's decision to join the CIS inter-parliamentary assembly in 1999 paved the way for improved bilateral relations.

The issue of payments for energy imports remains contentious. Since coming to power in early 2000, Russian President Vladimir Putin has presided over a toughened stance on gas debt negotiations, while raising oil and gas export tariffs and imposing tariffs on other goods. Ukraine, however, continues to control the transit pipelines for Russian gas exports to Europe. While both countries have intensified efforts to reduce their mutual dependence, both have faced difficulties. To reduce reliance upon Russia, Ukrainian foreign policy has sought to keep some distance from Russian-dominated structures, such as agreements between Belarus and Russia for closer political and economic integration, in favour of closer partnerships with countries to the south. A trade bloc of Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova (GUUAM) has been one such vehicle.

Ukraine's relations with the west have generally strengthened since independence. Ukraine was the fourth largest recipient of US bilateral aid in 1994. The country signed a partnership and cooperation agreement with the EU in 1994 that came into effect in 1998, and joined the Council of Europe in 1995. Ukraine is an active participant in NATO's Partnership for Peace programme, under which it frequently joins in exercises with NATO troops. President Kuchma's re-election in 1999 and the appointment of the Yushchenko cabinet have ensured the further entrenchment of Ukraine's western-oriented foreign policy.

With obligations reduced by almost US\$ 2 billion and with considerable progress made in resolving the gas debt problem with Russia, Ukraine's international financial position in 2001 looks better than in previous years. With continued GDP growth on the back of improved export performance and a resurgence in domestic demand and investment, commitment to further reforms is the key to a better investment climate. The main areas the government needs to focus on include privatisation, legal reform, deregulation, combating corruption and continuing the progress made in 2000 to approve and implement the Tax, Civil, and Land Codes. Only in this way, building on the improved economic performance, can Ukraine lay the foundations for sustainable growth for the coming years.



Economic summary



The year 2000 was Ukraine's first full year of economic growth since the onset of transition. GDP growth was much higher than expected. Inflation was also considerably higher, but is expected to come down in 2001. Strong export growth ensured an increase in the trade and current account surpluses. FDI was still at a low level, but the target for privatisation revenues was more than 80 per cent met. The exchange rate held firm and even appreciated somewhat towards the end of the year. The budget for 2000 provided for a deficit of just 1.8 per cent of GDP and the out-turn was estimated at a deficit of 0.5 per cent of GDP. A balanced budget for 2001 (including privatisation revenues) was approved in December, the first time in recent years that a budget has been approved on time. The successful rescheduling of most commercial debts removed the earlier prospect of default. The prospects for 2001 depend on the successful implementation of structural reforms.

GDP growth

GDP growth was estimated at 6.0 per cent in 2000, much higher than expected. The recovery reflects the strong response of industry to the earlier decline in the exchange rate, but also the government's determination to promote reform, as well as the emergence in the Verkhovna Rada of a broad coalition more likely to support reform than before. The growth of the economy was driven by light industry, the food and paper sectors and heavy industry. The year 2000 was the first year of positive growth since the transition began. In 2001 a growth figure of 3.5 per cent is forecast, reflecting a continuation of demand for exports and stronger domestic demand.

Inflation

Inflation has been higher than expected, at an estimated 28 per cent annual average, partly because of the National Bank of Ukraine (NBU)'s policy of buying foreign exchange to meet external debt commitments, higher oil prices and increases in utility tariffs. Inflation is forecast to come down to about 16.0 per cent in 2001, which would still be higher than the 13.6 per cent projected by the 2001 budget.

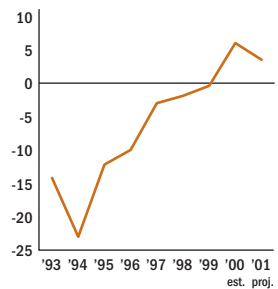
Current account and trade balance

Exports have grown substantially. Ukraine's key trading partners – Russia, the EU and the US – recorded economic growth that contributed to the success of the local economy. Strong export growth ensured an increase of the trade balance surplus to an estimated US\$ 779 million and of the current account surplus to some US\$ 1.48 billion or 5.2 per cent of GDP. In 2001, the trade surplus is forecast to turn into a deficit (-US\$ 300 million) and the current account surplus is expected to narrow (to US\$ 510 million) as domestic demand and import growth pick up.

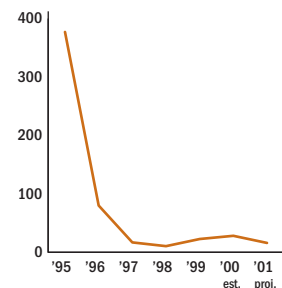
Foreign Direct Investment

Cumulative FDI per capita stood at US\$ 78 at the end of 2000. Net FDI inflows in 2000 stood at an estimated US\$ 594 million, about 19 per cent more than in 1999, but less than in 1998. The figure is very low for a country the size of Ukraine and is expected to increase only slightly in 2001, reflecting the persistently difficult investment climate. While FDI was low, the State Property Fund has proceeded with privatisations of enterprises via tenders and auctions and raised UAH 2.1 billion (US\$ 386 million) in revenues for the budget in 2000, some 84 per cent of the UAH 2.5 billion (US\$ 460 million) targeted. The sale of the Mikolayiv bauxite plant alone brought over UAH 1

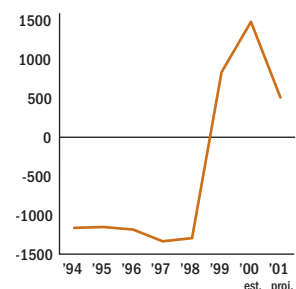
GDP
% change



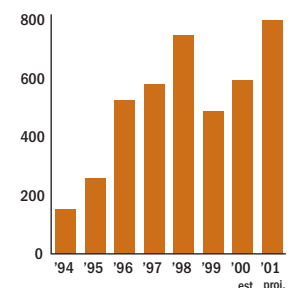
Consumer prices
Annual average, % change



Current account
US\$ millions



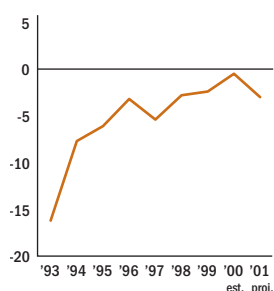
Total FDI
US\$ millions, cash receipts, net



Source: EBRD, March 2001

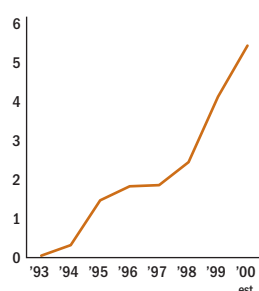
General government balance

% of GDP



Exchange rate

Annual average, hryvnias per US\$



Source: EBRD, March 2001

billion (US\$ 184 million) into the budget, more than the total previous two years' privatisation receipts. The 2001 target is UAH 5.9 billion (a little over US\$ 1 billion at the current exchange rate).

Government balance

Following the collapse of the domestic securities market after the financial crisis of 1998 as well as the uncertainties surrounding the provision of external finance, the government became very dependent on the NBU for funding the budget deficit. It was therefore essential to reduce the deficit, and the budget for 2000 provided for a (revised) deficit of just 1.8 per cent of GDP, to be almost fully financed by privatisation revenues. The budget included a number of measures to boost revenues, including limits on tax offsets and reductions to tax exemptions, and also aimed to bring off-budget expenditures into the budget. A tight fiscal policy contributed to an estimated budget deficit of 0.5 per cent of GDP. The Verkhovna Rada approved a zero-deficit budget (including privatisation revenues) for 2001 in December 2000, the first time it has managed to approve a budget in time in recent memory.

Exchange rate

Since the currency corridor was abandoned and the exchange rate allowed to float in February 2000, the NBU has ensured that the rate remained stable, despite the absence of official funding for most of the year. In practice the NBU purchased sufficient foreign exchange to meet its external debt obligations, while maintaining reserves at around US\$ 1 billion for most of the year 2000. The NBU was also assisted in this policy by the larger than expected external surplus. The consequence of this prolonged stability was, however, a loose monetary policy and some appreciation of the real exchange regime. The annual average and end-year exchange rate in 2000 is estimated at UAH 5.44 to the US dollar.

Relations with the IMF

The IMF suspended the Extended Funding Facility (EFF) in September 1999 when certain targets were missed. Negotiations were seriously delayed by the NBU's admission that it misreported reserve levels to the IMF in 1997-98 to secure funding under the EFF. However, following a decision to repay US\$ 100 million to the IMF in August 2000, the IMF decided that the matter was closed. Following agreement between the government and the IMF on the budget deficit for 2001, on the amount of privatisation revenues that was realistic to expect this year and the need to pass a law on commercial banks (and especially to bring Bank Ukraina under NBU control), the IMF approved the resumption of the EFF in December, extending its term to September 2002. However, the IMF delayed the first-quarter disbursement pending further progress in reform.

Relations with the World Bank

The World Bank approved a new Country Assistance Strategy (CAS) for Ukraine in September 2000, aimed to assist the government and civil society in obtaining sustained growth and poverty reduction. The World Bank granted Ukraine the last tranche of the current financial sector adjustment loan (SAL) at the end of January 2001, after its board had decided to cut the allotment from US\$ 100 million to US\$ 60 million following its December mission which found that Ukraine had not implemented the credit agreement in full.

Debt restructuring

From January 2000 Ukraine suspended debt payments to official creditors as well as the holders of its two main eurobonds with the intention of rescheduling to overcome the very urgent debt service profile. The latter was the result of the high cost and short maturity of much of the commercial debt that Ukraine had contracted. In April the government announced that it had been successful in securing the agreement of the vast majority of creditors to the rescheduling of US\$ 2.6 billion of commercial debt. Arrears to official creditors mounted throughout the year as the failure to secure an agreement with the IMF (until December) prevented negotiations with the Paris Club of official creditors. However, the government commenced negotiations in March 2001.

The finance ministry has chosen international investment bank Lazards out of six participating banks in a tender to advise it in its debt restructuring talks with the Paris Club. Apart from the US\$ 0.5 billion due to the Paris Club in 2000-01, Ukraine has to make payments on debts to IFIs as well. Total debt servicing obligations are US\$ 1.8 billion in 2001, compared with US\$ 2.1 billion serviced in 2000. Debt service will remain in excess of US\$ 1.5 billion per year for most years until 2007 when the new eurobonds are to be repaid.

Selected economic indicators

	1993	1994	1995	1996	1997	1998	1999	2000 est.	2001 proj.
GDP (% change)	-14.2	-23.0	-12.2	-10.0	-3.0	-1.9	-0.4	6.0	3.5
Consumer prices (annual average % change)	4,735	891	377	80.0	16.9	10.5	22.7	28.2	16.0
Current account (in US\$ millions)	na	-1,163	-1,152	-1,185	-1,335	-1,295	834	1,481	510
General government balance (% of GDP)	-16.2	-7.7	-6.1	-3.2	-5.4	-2.8	-2.4	-0.5	-3.0
Trade balance (in US\$ millions)	-2,500	-2,575	-2,702	-4,296	-4,205	-2,584	-482	779	-300
Total FDI (in US\$ millions, cash receipts, net)	na	151	257	526	581	747	489	594	800
External debt stock - official debt (US\$ millions)	na	7,167	8,013	8,837	9,553	11,483	12,437	10,544	na
Unemployment (% of labour force)	0.3	0.3	0.5	1.3	2.3	3.7	4.3	4.2	na
Exchange rate, annual average, hryvnias per US\$	0.05	0.32	1.47	1.83	1.86	2.45	4.13	5.44	na
Gross reserves, excluding gold (end-year, US\$ millions)	162	651	1,051	1,960	2,375	782	1,090	1,016	na

Source: EBRD, March 2001



Investment climate

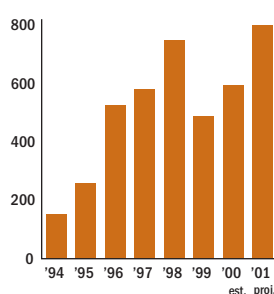
With its market of almost 50 million people and substantial industrial base, Ukraine offers considerable opportunities for investors. Yet throughout the 1990s the economy has not lived up to its potential, reforms have been slow, and the investment climate has been difficult. The appointment of a reform-minded government and the emergence of a pro-government parliamentary majority have enhanced the achievements in 2000. Investment-related legislation has been improved, the privatisation process has been accelerated, and the fiscal system is in the process of being revised. With a resurgence in domestic investment, an improved financial balance, substantially reduced inflation, a growing economy and restructured international debts, the prospects for investors in 2001 look more promising than ever since transition began.

Foreign direct investment

According to EBRD statistics, net foreign direct investment (FDI) amounted to an estimated US\$ 594 million in 2000, up from US\$ 489 million in 1999. According to the State Statistics Committee, FDI in Ukraine rose 18.4 per cent year-on-year to US\$ 588.4 million in the first three quarters of 2000, including US\$ 17.2 million (2.9 per cent) from the former Soviet Union (CIS and Baltic states) and US\$ 571.2 million (97.1 per cent) from the rest of the world. The government target for 2000 was US\$ 750 million, while for 2001 the target is set at US\$ 800 million. Both targets and actual figures are very low for a country the size of Ukraine.

The cumulative FDI stock since 1994 totalled an estimated US\$ 3.865 billion at the end of 2000, or US\$ 78 per capita. FDI came from 109 countries. The US remains the country with the largest FDI amount, contributing almost 17 per cent of the

Total FDI
US\$ millions, cash receipts, net



Source: EBRD, March 2001

total, followed by Cyprus (9.6 per cent) and the Netherlands (9.4 per cent). Other major investing countries were Russia, the UK and Germany.

The sectors receiving most cumulative FDI were the communications sector, the food industry, domestic trade, engineering and metalwork, finance, and the fuel industry. Companies from the US invested mostly in domestic trade and the food industry. The great majority of FDI from the Netherlands went into the food industry. The bulk of FDI flows from Cyprus were directed towards domestic and foreign trade and the food sector, while most Russian FDI was made in the fuel industry.

Investment policy and incentives

The Law on Foreign Investment Regime (1996) generally provides for the equal treatment of foreign businesses. There are some sector-specific restrictions on foreign investment, especially in banking, insurance and telecoms. Other sectors, such as armaments or alcoholic spirits, are completely closed to foreign investment. Licences are required in certain "sensitive" sectors, such as import licences for agricultural

Top 10 sources of cumulative FDI as at 1 January 2001

Country	FDI, US\$m	% of total FDI
USA	635.8	16.45
Cyprus	372.6	9.64
Netherlands	361.8	9.36
Russia	314.3	8.13
UK	299.4	7.75
Germany	237.9	6.15
Virgin Islands	176.8	4.57
South Korea	170.4	4.41
Switzerland	169.3	4.38
Other	1,127.2	29.16

Source: Ministry of Finance, March 2001

Sectors attracting most cumulative FDI as at 1 October 2000

Sector	FDI, US\$ '000	% of total FDI
Communications	898,865.53	24.2
Food industry	768,779.98	20.7
Domestic trade	687,543.40	18.5
Engineering & metalwork	340,475.11	9.2
Finance	226,895.96	6.1
Fuel industry	207,719.98	5.6
Ferrous metals	145,602.64	3.9
Chemicals	133,661.98	3.6
Transport	129,676.43	3.5
Construction	123,646.35	3.3
Other	53,432.64	1.4

Source: State Statistics Committee, January 2001

chemicals, pharmaceutical products, veterinary medicines, cosmetics and hygiene products. The main forms of foreign participation are a full partnership, a limited partnership, a joint stock company, or a limited liability company. Foreign investors are guaranteed the right to repatriate profits in foreign currency, as well as the original investment, unimpeded, if they have registered with the authorities.

The hryvnia is not yet fully convertible. Of total hard-currency receipts, 50 per cent generally need to be converted into hryvnias through the interbank currency exchange. However, most current-account transactions can be made through the Ukrainian banking system without authorisation. Approval from the NBU is required for capital account transactions, such as loans abroad or loans from foreign sources. The NBU's Regulation No. 602 (May 2000) provides Ukrainian residents with an avenue for obtaining foreign currency loans and building their creditworthiness on international markets. At the same time, foreign investors no longer need to invest large amounts of cash into the charter funds of their Ukrainian joint ventures. Instead, they may contribute the minimum statutory amount to their business venture's authorised capital and provide loans/credit for the expansion of the Ukrainian business venture's activities on the international market.

Recent legislation aims to improve the investment climate. The passage in 1999 of the laws on production sharing and on concessions aims to provide investors with incentives to invest in natural resources and in infrastructure respectively. In addition, in February 2000 a law was adopted introducing the concept of national treatment for foreign-owned enterprises with respect to tax and currency regulations. New regulations to further protect minority shareholders against dilution of their stakes, issued by the securities market regulator, took effect in October 2000 (see *Financial sector* below). Legislation in the field of industrial property and copyright is making good progress.

The extent of regulation, the tax burden, difficulties in enforcing contracts, and corruption remain the main obstacles for business in Ukraine, according to most surveys. An IFC survey of SMEs, conducted in the three months to February 2000, indicated that government interference (especially inspections), a high tax burden and difficulties in gaining access to credit are among the main obstacles. However, the earlier introduction of a simplified tax system for SMEs has reduced the costs of tax compliance.

The new proposed Tax Code is more investor-friendly than the current regime. The bill, which is still in discussion in the

Verkhovna Rada, proposes tax cuts, such as the reduction of corporate tax from 30 to 20 per cent and of VAT from 20 to 15 per cent, simplification of the system by considerably reducing the number of taxes, and extension of rights to appeal (see *Taxation and social expenditure* below).

Special Economic Zones (SEZs)

Special (free) Economic Zones (SEZs) have been increasingly applied as a vehicle for generating investment. The 1992 law on the framework and principles for SEZs was made redundant by a series of case-specific laws establishing separate tax holidays for individual zones. In 1999 the government decided not to establish any more new zones until a review of the entire process had been completed.

In spring 2000 the government approved regulations governing the new Interport Kovel SEZ near the Polish border, which came into being on 1 January 2000. The new regulations detail the documentary and other requirements for investors who want to set up in the SEZ, and also set out the way in which it will be managed. The zone's administration will report to a council for its development, to include representatives of the economy and transport ministries and of the customs and tax services. Other SEZs in operation include Zakarpatska, Lviv (Truskavets and Yavoriv SEZs), Kyiv (Slavutich SEZ), Poltava (Kremenchuk SEZ), Odessa, Donetsk/Lugansk and the Crimean Autonomous Republic (Sivash SEZ).

Typical incentives granted to enterprises located within a SEZ are likely to include exemption from customs duty (and sometimes VAT) on goods and services brought into Ukraine, lower corporate profit tax, a reduction of tax on non-resident profits from investment activity, the abolition or reduction of payments and fees into social security and pension funds, and exemption of all foreign currency revenues from sale of goods and services produced in the SEZ from mandatory currency sale to Ukrainian banks on the interbank currency exchange. For establishing a business within an SEZ investors are generally obliged to invest a designated sum (from US\$ 200,000 to US\$ 1 million), to build specific infrastructure elements, and to ensure employment of local labour (50 per cent of the jobs created). All investment-related business projects would typically have to be aimed at job creation, the introduction of new technologies and environmental protection. The life of an SEZ ranges from five to 60 years.

In autumn 2000, the President signed a decree on additional measures to strengthen the war on corruption and other illegal actions in the socio-economic sphere. The Cabinet of Ministers and other central bodies of executive power were instructed to take additional effective and concrete measures to fight

corruption, bribery and illegal actions linked with them.

The cabinet has been authorised to work out a detailed set of measures, which would provide, in particular, for the creation of a special body and its local departments to regulate licensing activities, remove red tape and artificial obstacles to the issuing of licences and permits.

Privatisation and restructuring

Voucher-based mass privatisation was concluded in 1999. Initial attempts to sell shares of larger enterprises via open tenders were less successful owing to a lack of transparency. The winners of some tenders also failed to pay, so the state property fund (SPF) increasingly resorted to sales through stock exchanges. In 1999 over 1,930 enterprises were more than 70 per cent privatised, although the budget proceeds were less than the target of UAH 800 million (0.6 per cent of GDP). Fiscal pressures and the need to promote large-scale privatisation led the government to propose a more radical approach to privatisation for the period 2000-02, which was approved by the Verkhovna Rada in May 2000.

The emphasis would now be on sales of state shares in some of the largest enterprises in major sectors of the economy, including metallurgy, energy and chemicals, as well as some of the main utilities. The sales would be to strategic investors and for cash – the programme was intended to raise UAH 2.5 billion for the 2000 budget (an estimated 1.5 per cent of GDP), and substantially more in each of the following two years. By mid-2000 a number of sales had materialised owing to the greater effectiveness of tenders, with the SPF selling controlling blocks of shares. At the end of the year, following the sale of further smaller stakes, the target for the year was 80 per cent met.

There have been very few sales to western strategic investors. Russian companies have been especially active in buying up share packages. Some privatisations completed in 2000 and early 2001 included the sale of share packages in some large metallurgic and chemical companies, such as Azovstal, the Mikolayiv Alumina Plant, the Zaporizhzhya Aluminium Plant, and the Oriana chemical concern. The sale of Mikolayiv to an affiliate of Siberian Aluminium (SibAl, Russia) alone brought over UAH 1 billion in the budget, more than the previous two years' privatisation receipts. (See *Major sectors of the economy: Intermediate goods and heavy industry* below.)

On 12 January the State Property Fund ratified the proposed list of companies whose stakes are to be privatised in 2001. The highlights are the planned sale of a 49.9 per cent stake in Ukrtelekom (the fixed-line telephone monopoly), which is hoped to generate at least UAH 3.286 billion (US\$ 600 million), and blocking minority stakes in the regional energy distribution companies ("oblenergos"; see *Major sectors of the economy: Energy* below). The 2001 target is UAH 5.9 billion (a little over US\$ 1 billion at current exchange rates). One problem with this ambitious target could be that the valuation of the companies is too high.

The sale of the oblenergos, originally scheduled for late February and early March, was postponed until April on the advice of the financial advisor to allow the government more time to address some of the issues of concern to strategic investors.

The forthcoming sale of Ukrtelekom follows numerous occasions in the past when the Verkhovna Rada voted against the privatisation, including a government bill introduced in early 2000. The government will sell 25 per cent plus one share to a strategic investor via open tender. The winner of the tender will have the right to have management control of an additional 25 per cent from the state's total share of 50 per cent plus one. The sale is scheduled to take place at the end of 2001. The EBRD is considering assisting in the pre-privatisation, including the selection of an advisor and the provision of a loan. Minister of economy Vasyl Rohovy heads the commission for the privatisation (See *Major sectors of the economy: Telecommunications* below.)

Privatisation is proceeding in the agrarian sector. A Presidential decree of December 1999 allows former members of collective farms to leave with their share of land and property. In July the Verkhovna Rada approved the Land Code at first reading. If adopted, the Code would allow farmers to trade land and use it as collateral, which should lead to an increase in finance for agriculture.

Markets and trade

According to the State Statistics Committee, Ukraine's foreign trade turnover totalled US\$ 25.368 billion in January-November 2000, an increase of 22.6 per cent year-on-year. The country's trade surplus for 11 months of 2000 increased to US\$ 528 million, up from US\$ 394.7 million on 1 October 2000. Ukraine's trade deficit with Russia dropped US\$ 340 million from the previous year to total US\$ 1.8 billion on 1 October 2000. As usual, Russia was by far Ukraine's main trading

partner in the first 11 months of 2000, accounting for 24.1 per cent of exports and 41.7 per cent of imports, mainly gas. The second and third largest export volumes were shipped to Turkey and the US respectively, while other leading sources of import included Germany and Turkmenistan.

Exports in January-November rose 24.8 per cent to just over US\$ 13 billion, largely due to a 50 per cent increase in the export of chemicals and a 40 per cent increase in the export of metals and equipment. The most exported goods were ferrous metals (36 per cent of all exports), chemicals (11 per cent), machinery and mechanical equipment (9 per cent), and fuel and oil products (5.5 per cent). Imports rose by 18.3 per cent to US\$ 12.359.9 billion. Gas imports, which make up a quarter of overall imports, rose by 9 per cent, while machinery and mechanical equipment imports went up 40 per cent. Machinery and mechanical equipment account for 6 per cent of overall imports, oil for 6.5 per cent, electrical goods and automobiles for 3 per cent.

In accordance with EU and WTO guidelines, Ukraine has been making moves to liberalise its trade sector by gradually eliminating export quotas and licences. Upper tariff limits on imported industrial goods have stood at 30 per cent since 1996, although the overall level of tariff protection is between 5-8 per cent, except for certain agricultural products. Despite some recent reductions in tariff barriers, licensing requirements still hamper foreign trade. The trade-weighted average tariff on non-energy imports rose to over 12.5 per cent in 1999. However, at the beginning of 2000 the temporary 2 per cent import surcharge was removed and some preferential import duties were lowered.

Major trading partners, January-November 2000

Country	% of total export	Country	% of total import
Russia	24.10	Russia	41.67
Turkey	6.08	Germany	7.85
USA	5.24	Turkmenistan	6.96
Germany	5.17	Belarus	4.53
China	4.24	Kazakhstan	2.83
Italy	4.23	USA	2.55
Poland	2.95	Italy	2.43
Bulgaria	2.63	Poland	2.21
Hungary	2.32	Switzerland	1.64
Belarus	1.89	France	1.64
Other	41.15	Other	25.69

Source: State Statistics Committee, January 2001

Despite some progress in lowering import duties last year, several sectors remain protected and benefit from higher duties. At the Council for Cooperation between Ukraine and the EU in May 2000, some progress was also made on specific trade issues, including tax privileges in the automotive sector and the registration of pharmaceutical imports. Negotiations on Ukraine's application to join the WTO continue, but the tendency to resort to certification procedures and other non-tariff barriers to protect domestic industry has slowed progress. The maintenance of the export duty on sunflower seeds and a recent presidential decree on intervention in the grain market have also raised concerns that production will be adversely affected.

Taxation and social expenditure

Foreign residents (foreigners spending 183 days or more of the calendar year in the country) are subject to the same tax laws as Ukrainian citizens. **Personal income tax** rates increase progressively, based on a tax-free minimum, and are generally high. Foreign entities based in Ukraine are taxed on the share of their activities derived from operating in Ukraine. Representative offices with headquarters elsewhere can claim a reduction for expenses for operations elsewhere. Most expenses are deductible, including exchange rate losses. Foreign investors are liable for **corporate tax** (30 per cent, with reductions in SEZs), **capital gains tax** (30 per cent), **withholding tax** (15 per cent), and **VAT** (20 per cent, but reduced or exempted in SEZs).

The proposed new Tax Code aims to simplify the tax system and reduce certain tax rates. The significant tax burden on enterprises arises from a combination of the large number of taxes (there are 22 central taxes and 16 different local taxes, although six main taxes account for most of the revenues), and high tax rates, accentuated by restrictive depreciation allowances. In addition, following the decision to end the *kartoteka* system in 1999, whereby the tax authorities could freeze the bank account of a company suspected of tax evasion, legislation on a tax collateral system to replace it has been approved by the Verkhovna Rada, although it has not yet come into effect.

The new code will reduce the number of taxes to 25, and will reduce the corporate tax rate from 30 to 20 per cent and VAT from 20 to 15 per cent. While being investor-friendly in its tax cuts and simplification of the system, above all the new Tax Code aims to bring revenue out of the huge grey economy. Legislation on untaxed revenues aiming to legalise shadow

capital inside and outside Ukraine and thus strengthen the official economy was proposed in August 2000. In September 2000 the Ukrainian cabinet adopted Resolution No. 1397, suspending Resolution No. 825 (18 May), which established the procedure of exemption/reduction from taxation of non-residents' income received from sources in Ukraine. Under Resolution 825, international double tax treaty relief, if any, could be applied up front, unless the relevant double tax treaty provided otherwise. According to Resolution No. 1397, the relevant state bodies have been requested to make suggestions for improving the procedure of exemption/reduction from taxation of non-residents' income received from sources in Ukraine.

Employers are generally obliged to contribute 32 per cent of their employees' salaries to a **pension fund**, and 4 per cent to **social insurance**. These tariffs are reduced or exempted in the SEZs. Reform of the pension system is a key government objective. The low basic pension and pension arrears continue to accentuate social deprivation among pensioners. The existing state scheme is affected by the number of privileged pensioners, by the need to meet other social security payments and by the size of the shadow economy which limits the revenue base. Some changes have been introduced, and more fundamental reforms are being considered including the promotion of private savings for funded schemes under draft laws. However, this would depend not only on adequate records of contributions, but also on effective regulation of pension funds and the development of the capital market.

The Country Promotion Programme

thanks

Taipei China

The Taipei Technical Cooperation Fund

United Kingdom

The Know How Fund

Switzerland

The Swiss Technical Cooperation Fund

Canada

The Atlantic Council of Canada

Major sectors of the economy



Most sectors of the economy recorded growth in 2000. In the service sector, mobile telecommunication was the star performer with about 300 per cent growth. Since the financial crisis of 1998 manufacturing has benefited from the hryvnia depreciation and especially light industry and food processing have successfully substituted expensive import products. The troubled energy sector is finally undergoing restructuring and privatisation. Agriculture is likely to benefit from the land reform that is in the process of being implemented.

Agriculture

Agribusiness has traditionally been an important sector and has a major role to play in Ukraine's economic development and transition. The country was once known for its agricultural traditions and for the extremely fertile black earth, *chernozem*, unique to this part of Europe, which earned Ukraine renown as the "bread basket" of the Soviet Union. At the onset of independence in 1991, agriculture still accounted for almost 25 per cent of GDP, against about 11 per cent today.

Land reform

One of the main problems for agriculture has been the very slow pace at which land privatisation has proceeded. Privatisation is now proceeding, although not smoothly. A presidential decree of December 1999 allowed former collective farm workers to leave with their share of land and property. From January to May 2000, about 6.4 million Ukrainians each received on average 4.1 hectares of land and created new agricultural structures. Their investments exceeded even the state loans. One of the remaining problems is the slow registration of legal ownership rights. The delay in registration has created an untransparent situation in land ownership. As at early November 2000 an estimated 10 to 20 per cent of land title holders had sold their title deeds at bargain prices despite the absence of a law regulating such transactions. The president asked parliament to limit the maximum size of private land plots to 100 hectares until 2010 in order to prevent speculation on the land market. On 3 November the Verkhovna Rada placed a moratorium on all deals involving the purchase and sale of title deeds. The debts of the collectives to the budget (over UAH 6 billion or 3.6 per cent of GDP) have been written off. An issue still to be addressed is the creation of a mortgage land bank for long-term loan programmes. The main condition for the further development of agrarian and land reform, however, is the immediate adoption of the new edition of the Land Code, transforming land into a commodity, which is an essential condition for reform. In July 2000 the Verkhovna Rada approved the Land Code at first reading. If the Code is adopted it would allow farmers to trade land and use it as collateral, which should lead to an increase in finance for agriculture.

Apart from some sub-sectors, however, agribusiness does not meet its full potential, although realising the sector's full potential is one of the government's key objectives. Agriculture is an important sector in terms of employment.

Many crops, especially grain, recorded a low harvest in 2000. Exceptions were sunflower seed, with a record harvest of 3.5 million tonnes (an increase of 23.8 per cent of gross yield), and corn, with 3.7 million tonnes. The average yield per hectare increased, compared with 1999. Export of sunflower seed, however, decreased sharply due to a 23 per cent export duty. The crop is important for the food industry, as Ukraine is a major exporter of sunflower oil (see *Food processing* below). On average, Ukrainian agricultural production grew by 2 per cent: crop farming increased 7 per cent, but output in livestock farming fell 5.4 per cent.

In November 2000 the government adopted the "Grain of Ukraine 2001-2004" programme, which provides for the doubling of grain harvests. The grain harvest for 2001 is expected to be over 35 million tonnes. Production in 2004 should be 40 million tonnes, which is realistic as in the past 25 years the grain harvest 12 times exceeded this amount. Increasing production should be achieved through resource-saving technologies, improved crop structure, better seed quality and plant protection measures. Ukraine will need approximately US\$ 1.5 billion annually to fully implement the programme.

Food processing

In view of the role of agriculture within the economy, food processing is one of Ukraine's most important industries, but like most other sectors it is short of investment. It is estimated that the agri-industrial sector (from primary processing of agricultural commodities, through food processing and packaging to agri-equipment manufacture) could potentially absorb € 5-10 billion of immediate investment. In practice, however, actual investment opportunities have been constrained by slow progress on fundamental sector reform and the generally difficult business environment. However,

the food industry increased output in 2000, the second consecutive year of growth, as a result of greater reliance on domestic production rather than no longer affordable imported food products in the wake of the 1998 Russian financial crisis. There was growth in most sub-sectors: brewing was the best performer as usual, with the sunflower oil industry coming a close second.

Case study: Boryspil Cerealia

Boryspil Cereal Plant (BCP), a breakfast cereal manufacturer located in Boryspil near Kyiv, started to operate in the late 1980s. As a result of Soviet planning, large investments in state of the art production equipment were made, while the need for development of the market, brands and competent management was neglected. In 1997 BCP was privatised when venture capital company ATS Development Capital (US) acquired 98 per cent of the shares, with the residual shares held by employees and other individuals. BCP is the market leader in Ukraine with a market share of about 40 per cent. The company's main brand name is "Start", with a range of 20 types of products, the main groups being corn flakes, frosties, loops, pillows and shreddies. The raw material and packaging are sourced locally. The products are consumed as a breakfast meal, but primarily as snacks. The UK-manufactured APV production equipment is well maintained. The company has 120 permanent employees and 50 temporary staff. Cerealia AB is a Scandinavian breakfast cereal, flour and bread manufacturer with annual turnover of US\$ 640 million. In early 1999 Cerealia came in contact with the owners of BCP and started the due diligence process for the potential acquisition of BCP's shares. The acquisition, finalised in February 2000, fitted into Cerealia's strategy of expansion eastwards and allowed it to gain a stronghold in an important market which offered operational synergies with its other east European operations, most notably in the Baltic states. Cerealia saw its investment as a window into the Russian market, as there are no tariffs between Ukraine and Russia. Ukraine offers low transportation and production costs, enabling corn flakes to be produced at about half the cost of production in Sweden. BCP is further improving its marketing strategy. There was a need for comprehensive advertising and promotional campaigns. The products still need improvement, particularly in terms of quality, in order to become competitive internationally. The Russian market will be targeted as a priority for the new owners, including finding Russian partners for sales and distribution in southern Russia. BCP will need to increase the existing distribution network to strengthen its geographic reach, achieve economies of scale and have a stronger presence at the retailers.

To support the expansion of BCP, in June 2000 the EBRD acquired a 37 per cent equity stake in the plant and committed to participate in future capital increases. The proceeds will enable BCP to expand its operations, have access to much-needed working capital, and increase its marketing and sales in Ukraine and elsewhere in central and eastern Europe. The investment will help to develop BCP as well as a number of SMEs that supply the company or distribute its products. With the support of Cerealia and the EBRD, BCP has an opportunity to become the leading breakfast cereal company in the region, providing high-quality, locally produced products sold at competitive prices throughout Ukraine and Russia.

Brewing

The brewing industry has been the best performing sub-sector in the food industry for some years and again recorded growth in 2000. Ukraine's three largest breweries are Obolon (Kyiv), Rohan (Kharkiv) and Slavutych (Zaporizhzhya). Market leader Obolon, based in Kyiv, has benefited from EBRD financing worth € 40 million since 1997. Ukrpyvo is an association of around 40 beer-brewing and bottling companies, including Rohan and Slavutych, but excluding Obolon. Ukrpyvo breweries increased output in 2000 by 18.8 per cent. The fastest growers within the association were Kolos (Lviv, 52 per cent) and Slavutych (41.5 per cent). Rohan increased output by a third. Ukrpyvo and Obolon together represent 95 per cent of the beer market.

Foreign investment in the brewing industry is considerable and still increasing. Sun Interbrew, set up in 1999 by Sun Brewing and Interbrew (Belgium) for operations in the Russian and Ukrainian markets, already controlled 20 per cent of the Ukrainian brewing industry, including the fourth, fifth and seventh largest breweries Desna (Chernihiv), Yantar (Mikolayiv), and Krym (Simferopol), when in 2000 the Ukrainian Antimonopoly Committee allowed it to purchase the controlling interest in Rohan Brewery. Rohan is the youngest and one of the most dynamic breweries, which launched production in 1993 and almost doubled its annual output in the past five years. The deal was worth about US\$ 30 million. However, the Antimonopoly Committee permitted the acquisition of the 81 per cent of Rohan only on the condition that Interbrew sell its interest in one other brewery. Sun Interbrew pledged to sell all the shares of the Krym brewery and soft drinks mill to a competitor in 2001.

Baltic Beverages Holding (BBH), a joint venture owned by Pripps-Ringnes (Sweden-Norway) and Hartwall (Finland), owns

50 per cent of the Slavutich brewery, and 42 per cent of Kolos, the eighth largest. Norway's Orkla owns half the shares in BBH, established in 1991. In May 2000 Orkla announced a merge with Carlsberg Breweries (Denmark), which also owns one fifth of Hartwall. Thus, Carlsberg became a major player on the Ukrainian beer market.

The Odessa-based Chornomor brewery has founded a joint venture with Efes Breweries, which is owned by Efes (Turkey). Chornomor contributed assets into the statutory capital in exchange for 49 per cent of shares, and Efes Breweries paid for its 51 per cent stake through delivery of industrial and commercial equipment. The cooperation provides Chornomor with an opportunity to resolve the issues involving its accumulated debts.

Sunflower oil

The production of vegetable oil increased again in 2000. The sunflower oil industry is one of the best performing food processing sub-sectors with increasing exports. The largest crushing plant in Ukraine is the Dnipropetrovsk Oil Extraction Plant (DOEP), the first fully integrated edible oil processing plant in the CIS. DOEP has a 260,000-tonne crushing capacity and a 100,000-tonne refining capacity and produces and sells branded bottled edible oil in Ukraine and Russia under the name of Oleina. The plant's geographic position and proximity to Russia gives it the logistical advantage of being both close to its raw material supply and to its most important export market.

Since 1998 DOEP has been majority owned by Eridania Beghin Say (EBS), a Swiss agri-business company. With EBS's support DOEP has modernised and expanded its refining and bottling line and obtained greater access to west and central European markets. The plant's management has improved considerably since EBS took control. The EBRD has been involved in DOEP's operations for more than five years. Its current loan facility, agreed in December 1999, builds on earlier funding activities and is helping to pay for the raw materials necessary to produce 45,000 metric tonnes of refined edible sunflower oil per year.

The First Ukrainian International Bank has opened two credit lines worth US\$ 5 million to the Polohy vegetable oil refinery in the Zaporizhzhya region in early 2001. One credit line worth US\$ 2 million was opened for a year within the credit line of the EBRD. Another line worth US\$ 3 million was launched for the 2001-02 farming season. Polohy's facilities are designed

to process 1,080 tonnes of sunflower seeds and refines 450-460 tonnes of oil a day.

The Ukrainian-Russian company KMT intends to buy the Vinnytsia oil and fat plant in 2001. The State Property Fund had announced the sale of the state's 50 per cent stake in early 2000. The Vinnytsia plant has the capacity to process 120,000 tonnes of oil-bearing crops to obtain about 60,000 tonnes of oil, but only produced 20,000 tonnes of rapeseed and sunflower oil in the 1999-2000 season and is on the verge of bankruptcy. KMT already owns the Chernivtsi oil and fat plant, having acquired 65 per cent of it from Raelin (US) in addition to the 28 per cent it already owned.

Tobacco

The tobacco sector has been among those attracting most FDI in recent years. Ukraine has 13 tobacco plants, five of which belong to large international tobacco companies Reemtsma (Germany), Philip Morris (US) and British American Tobacco (BAT), which have made large investments. Reemtsma, the largest cigarette manufacturer in Ukraine with 42 per cent market share, has two factories in Kyiv and Cherkasy, and accounts for a large share of the country's cigarette exports to CIS countries such as Russia. Philip Morris owns a plant in Kharkiv and has the second largest market share with 24 per cent.

BAT Ukraina, which holds 12 per cent of the market, has completed the construction of a new tobacco workshop at its factory in Pryluky in 2000. In 2000, BAT and Japan Tobacco International, which owns a plant in Kremenchuk and also has 12 per cent market share, have increased their presence in the Ukrainian tobacco market at the expense of Reemtsma – JSC Kyiv-Reemtsma's production fell by 23.4 per cent – and the small 100 per cent Ukrainian tobacco factories (4.8 per cent market share), while Philip Morris' market share remained stable. The tobacco factories put out 57.85 billion cigarettes in 2000, a 7.7 per cent increase from 1999.

The small Ukrainian tobacco factories have seen an output decline, especially in filterless cigarettes, since 1998 which continued in 2000. In 2000, the tobacco factories produced only half the amount of filterless cigarettes produced in 1999. The factories have suffered from competition from cheap Russian cigarettes, many of which are imported illegally. Due to the huge losses, operations have been closed at the Dnipropetrovsk, Odessa and Monastyrshchenka cigarette plants. The Feodosi plant has practically stopped producing

filterless cigarettes, and in Lviv a production facility has been standing idle for some time.

Intermediate goods and heavy industry

The metal processing, machine building, chemical and petrochemical industries are major contributors to Ukraine's GDP. The combined sector accounts for about 50 per cent of total industrial output and is a leading hard currency generator, with mining and metallurgy (base metals and roll products) contributing more than 40 per cent of total exports, 30 per cent of industrial output, and 44 per cent of the aggregate profits of the economy. The profitability of the mining and metallurgical complex rose by 18.3 per cent in 2000, and the share of barter operations dropped from 30 per cent in 1999 to 11 per cent in 2000. The growth of the sector was impressive in 2000, albeit starting from a low base in 1999.

Privatisation in the sector finally started to move more rapidly in 2000, although mostly minority stakes have been sold off to investors. Some heavy industrial enterprises, especially in metallurgy, have been revitalised and commercialised in the past two years and are now successfully competing in international markets, to such an extent that some markets, especially the US and the EU, are taking measures to curb steel imports from Ukraine, which could have a serious impact. The introduction of import duties on steel by Russia would deal a severe blow to the Ukrainian pipe industry, which is largely export-oriented. Up to 70 per cent of Russia's imports of steel pipes are from Ukraine.

Ferrous metallurgy

The steel industry, built up in the Soviet era, remains the fifth largest in the world, with almost 200 enterprises involved in some aspect of metal manufacture. Many of them require considerable investment before they can be brought up to western standards, but some have been privatised and restructured and are performing fairly well on international markets. In 2000 the sector increased output for the second consecutive year, by about 16 per cent. Base metal, rolled products and steel pipes are the most successful products.

Metal exports increased by an average 40 per cent in 2000, although exports of pig iron and rolled stock made of alloyed steel were on the decline. South-east Asia and the Middle East are the main export markets, worth 27 and 20 per cent of total exports respectively. Exports to the US and Canada account for 11 per cent of the total, but the US has been

requesting commitments from Ukraine to limit exports which threaten the domestic steel industry, and has set quota and indicative prices for rolled metal.

The Metallurgiya consortium was established in June 2000 by companies operating on various commodity exchanges, including the Zaporizhzhya Ferroalloy Works, the Frunze Machine Building Scientific Production Association, Dniprospetsstal (see below), energy distributor Poltavaoblenergo and commercial bank Zevs. Metallurgiya has been set up as a counter-balance to prevent Russian structures such as Russian (Siberian) Aluminium from dominating the Ukrainian market in strategic areas. Metallurgiya regularly bids for shares in Ukrainian enterprises, and has acquired shares that formerly belonged to the Zaporizhzhya Aluminium Works in the company Porshen and in the Preobrazovatel R&D Institute, plus shares in the Zaporizhzhya Cable Factory.

Some successful Ukrainian steel companies

- **Dniprospetsstal**, one of the participants in Metallurgiya, was one of Ukraine's first privatised steel-producers. The company exports half of its output to Germany, Italy, Austria, Belgium, the UK, the US, Canada and south-east Asia. Dniprospetsstal is Ukraine's only producer of special steels. Production increased by about 30 per cent in 2000. A group of offshore companies related to the Ukrainian-Irish European Trading Group has a controlling stake in Dniprospetsstal, which has opened two representative offices in Russia and Germany.
 - **ISTIL-Ukraine** is a subsidiary of International Steel and Tube Industries Ltd in Donetsk. The company produces bars and sheets, casting sections made of ordinary, structural and alloyed steel, welded pipes and metal furniture, and exports 50 per cent of products sold. The plant has recently been modernised, with a new electric arc furnace and ladle-furnace set and a continuous casting machine. Due to the investments it recorded some losses in 2000, but returned to profits from September 2000.
 - **Azovstal** in Mariupol is considered one of the most efficient steel producers. Donetsk-based company Keramet Invest has purchased a 20.56 per cent stake in Azovstal on the Donetsk Stock Exchange, the biggest deal in the history of the Ukrainian stock exchange. Keramet was the only bidder and bought the stake for Azovstal Trading House, which now holds a controlling stake in the plant. The state still holds 25 per cent of the company.
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Non-ferrous metallurgy

The largest alumina producer in the CIS is the Mikolayiv Alumina Plant (MAP). Russian Aluminium (a holding company of Siberian Aluminium and oil company Sibneft), Russia's largest aluminium group, now controls the MAP through its subsidiary, Ukrainian Aluminium. Russian Aluminium has rapidly acquired the majority stake in 2000 and in September officially earmarked US\$ 40 million for a two-year investment programme in the MAP.

The plant's output in 2000 reached a record high, producing 1.115 million tonnes of alumina, 0.4 per cent over target.

Ukrainian Aluminium has bought an unfinished construction site in Pervomaisk in the Kharkiv region on which it will build a new aluminium plant. The government selected Pervomaisk as the site for the plant because this location would allow it to receive electricity supplies from the Russian grid. Construction of a new aluminium plant of at least 100,000 tonnes a year was one of the commitments taken on by Ukrainian Aluminium when it bought its first shares in the MAP in March 2000. It is expected that the new plant will use as raw material at least 200,000 tonnes of alumina produced by the MAP. Ukrainian Aluminium must start building the plant no later than 2002.

In September 2000 the State Property Fund announced a tender to sell 68.01 per cent of shares of the Zaporizhzhya Aluminium Plant, Ukraine's sole primary aluminium manufacturer with an annual capacity of 100,000 tonnes of primary aluminium and a processing capacity of 16,000 tonnes of foil. The tender appears to have been won by AvtoVAZInvest, the investment arm of Russian car producer AvtoVAZ, which paid US\$ 70 million for the stake and pledged to pay off US\$ 76.5 million of debts by mid-2001 and invest US\$ 200 million within five years. However, the deal has yet to be concluded.

Chemicals

Ukraine produces mainly mineral fertilisers (nitric, phosphate), chemical pesticides, synthetic tars, plastic materials, and chemical fibres and threads. The chemical industry increased production by about 5 per cent in 2000. The production of fiberglass, potash, caustic soda, methanol, cord and titanium dioxide increased most, by about 40 per cent, while petrochemical production dropped 12 per cent.

Oriana, in Kalush in the Ivano-Frankivsk region, is Ukraine's largest petrochemical enterprise. It integrates 10 independent factories and a number of auxiliary workshops and services and produces more than 100 commodities, such as olefin, hydrochloric acid, caustic soda and antistatic. Oriana incorporates a potassium fertiliser factory, as well as ethylene,

propylene and benzene factories. By 2000, the enterprise had not been profitable for two years and had heavy debts to German banks.

A tender to privatise 50 per cent of Oriana was announced in August 2000. In October, Kyiv-based Lukoil-NaftoKhim, an affiliate of Lukoil (Russia), won the tender to manage the assets of the chemical complex in a 50:50 joint venture with the government. Lukoil promised to transfer UAH 100 million (US\$ 18.39 million) to the joint venture's statutory fund, pay UAH 4 million (US\$ 0.74 million) of wage arrears, and restructure and repay foreign debts. Lukoil-NaftoKhim is obliged to supply Oriana with 75-80,000 tonnes of oil (chemical raw material) per month, maintain the size of the workforce for a period of two years, search out new sales markets, and invest US\$ 37 million into reconstructing production capacities.

Lukoil's investment will focus on turning around the loss-making petrochemical facilities and especially the 10,000 tonnes-per-year magnesium plant, which has been closed since the start of 1999 for lack of funds. An investment of US\$ 15-18 million is needed to upgrade the magnesium works and start production. It is planned to begin selling shares in Oriana by October 2001, when the company begins stable operations. At the end of December 2000, JSC Lukor, founded by Oriana and Lukoil-NaftoKhim renewed polyethylene production.

Styrol, based at Horlivka in the Donetsk region, is one of the biggest chemical companies in the CIS. Its products include pharmaceuticals as well as ammonia, carbamate and ammonia saltpeter. In August 2000 Styrol increased its shareholding in the Trypillia biochemical plant in the Kyiv region 63.22 per cent. Trypillia's main product is lysin, a component used in the production of drugs. Styrol has proposed to the Okean shipyard in Mikolayiv (see *Transport* below) to create a facility at the yard to transship Styrol's styrene products on sea-going vessels. The projected capacity of the facility is 60,000 tonnes annually and will be situated at Okean's idle burner oil depot. A rail trestle will be built to handle deliveries.

Automotive industry

Ukraine has an extensive automotive industry, although problems such as under-investment, over-staffing and high levels of indebtedness have burdened it for many years. Under the 19 September 1998 law on stimulating car manufacturing in Ukraine, investors are exempt from import duty on goods used in car manufacture and spare parts until 1 January 2008. They are also exempt from VAT on car sales to Ukrainian residents.

Car producer **AvtoZAZ** in Zaporizhzhya recorded losses of more than US\$ 5 million in the first half of 2000. In October the government offered a 31.58 per cent stake for sale, while retaining 50 per cent plus one share until 2004. The tender failed for a lack of bids. Joint venture AvtoZAZ-Daewoo (with Daewoo of Korea), set up in 1998 with US\$ 300 million charter capital, was the largest investment project ever in Ukraine, with an estimated value of US\$ 1.2 billion. AvtoZAZ-Daewoo currently operates at 15 per cent of capacity and assembles Daewoo cars on prepay terms now that bankruptcy proceedings have been initiated at the Daewoo parent company. Although assembly could be suspended, there are still shipments of Nubira and Legansa component sets. The joint venture assembled 12,000 cars in 2000, against 6,045 in 1999. In 2001 the joint venture plans to assemble at least 17,840 cars, 13,340 for domestic consumption and 4,500 for export. AvtoZAZ-Daewoo is negotiating with Russia's AvtoVAZ on long-term cooperation.

AvtoKRAZ (Kremenchuk, Poltava) is one of the largest producers of heavy-duty trucks in the CIS. The company produces mine dump trucks, onboard vehicles, timber lorries, truck tractors, concrete mixers, chassis for oil and gas output equipment and all-terrain vehicles for the army. Currently 50 per cent of shares belongs to the Ukrainian-German joint venture Mega-Motors, and 27.33 per cent to the State Property Fund. AvtoKRAZ increased sales by 69 per cent year-on-year in the first three quarters of 2000.

KrimAvtoGaz is a subsidiary of GAZ (Russia) that assembles cars from components supplied from Russia. The plant has the capacity to assemble 25,000 Gazelle, Volga and Sobol cars and trucks a year in 60 different modifications. KrimAvtoGaz assembled 50 per cent more cars in 2000 than in the previous year. The company opened the first part of a new Haden-3 paint shop in December 2000. KrimAvtoGaz, Haden Group International (US) and GAZ are financing the new facility, which will be able to paint 70,000 cars and trucks a year. Haden and GAZ are supplying US\$ 38 million worth of equipment. In 2001, the company will increase the share of Ukrainian parts to 60 per cent from the usual 30 per cent, which will lower the price of vehicles by 15 to 20 per cent.

Energy

Ukraine is a critical transit centre for exports of Russian oil and natural gas to central and western Europe, as well as a major energy producer and consumer in its own right. Ukraine's energy

needs are considerable; it is the world's third largest gas-consumer, reflecting its fuel-inefficient industry, a legacy of the Soviet-era. The government's national Energy Programme up to the year 2010 anticipates greater use of energy saving technology and falling consumption of energy resources, with overall consumption decreasing from 353 million tonnes of fuel in 1990 to 326 million tonnes in 2010. According to this programme, annual domestically produced fuel resources are to rise from 179 million to 216 million tonnes. The programme intends to use foreign investment to meet at least half of the country's oil and gas needs. However, Ukraine's energy sector has been troubled since independence and throughout the 1990s by dependence on barter deals, lack of funds, failed privatisations, and consumer non-payment, all of which have contributed to a continued energy crisis.

Power generation

Thermal power plants account for about 50 per cent of the electric power produced in Ukraine. The country has 17 major thermal-fired plants with 104 power units. Ukraine has 27 large combined heat and power plants associated with regional power distribution companies ("Oblenergos"), with 4,014 MW of installed capacity. Most of these thermal power plants are old with obsolete equipment and technology. Although Ukraine produces more electricity than it consumes, it is not a net exporter. Much of the electricity the country produces is lost in the inefficient transmission and distribution network, increasing dependence on Russian fuel imports. Since natural gas accounts for 44 per cent of the primary fuel consumption of the thermal power plants and 20 per cent of fuel consumption by all electricity generators, reliance on Russian gas and related debt problems have affected the electricity sector. Ironically, Ukraine has enough power plants to produce twice its electricity needs, but most of them have worked below capacity because of fuel shortages, caused by the payments crisis.

As part of continuing international support for Ukraine's energy sector reforms (Task Force on Energy Sector Reform in Ukraine), in October 2000 the EBRD provided a US\$ 100 million Fuel Purchase Working Capital Facility as seasonal financing for four state-owned thermal generating companies. The proceeds were used to purchase fuel stock (coal and crude oil) for the winter. The loan was made on the condition of the successful fulfilment of the government's immediate reform programme, which includes the privatisation of seven Oblenergos and substantial and lasting increases in cash collection at all stages of the power cycle (see *Power distribution* below).

Oil and gas supplies

Russia currently exports about 125 billion cubic metres of gas to western Europe and 90 per cent of the gas export goes through Ukraine. Rather than receiving cash for transit fees, Ukraine has received free gas from Russia as payment. In recent years, however, Ukraine has been unable to keep up with its payments for gas which it imports from Russia or for the transport fees for gas imported from other countries through Russia. The two countries have been at odds over the amount of Ukraine's debt. Ukraine's non-payment of debts has prompted Russia at various times in recent years to disconnect the country from its electricity grid, cut off gas and oil supplies, investigate ways for gas transit to by-pass Ukraine, and even ask it to pay its energy debts by handing over state-owned enterprises in lieu of cash. High world oil prices have enticed Russian oil exporters to sell elsewhere, leaving Ukrainian refineries short of supplies.

In December, matters were settled and agreements were signed on Russian gas deliveries for 2001 and the transit through Russia of Turkmen gas exported to Ukraine. The agreement is a strong signal for foreign markets, in particular for possible investors in Ukraine's gas transportation system. The countries specified that Ukraine will receive 30 billion cubic metres of gas from Russia as payment for transit, 30 billion from Turkmenistan and will produce 18 billion cubic metres itself in 2001. Russia ensured the transit of Turkmen gas and offered Ukraine an eight-year grace period in its repayment of debt.

Power distribution

Lasting improvements in the power sector depend on the successful sale of the remaining state shares in the Oblenergos to strategic investors. Seven of the 27 Oblenergos were already sold in 1998 and eventually came to be controlled by offshore companies widely believed to be financial investors rather than strategic investors. The sales of the remainder were to proceed via tenders in 2001, following the appointment of a financial adviser, Credit Suisse First Boston (CSFB), the first time a western advisor has been engaged to run a privatisation tender in Ukraine. The Oblenergos' privatisation with advisor assistance was a requirement of the IMF. From 51 to 75 per cent stakes of seven Oblenergos were on the privatisation list in 2000. One of the seven sales, of a 70 per cent stake in Mykolayivoblenergo, was postponed by a court dispute.

CSFB recommended restructuring of the Oblenergos' debt to creditors, adopting more flexible tariff-setting rules and cutting a long list of investment requirements for would-be buyers.

The tender was announced in late October. The government wanted to sell the six Oblenergos to western investors instead of (offshore) local business groups, as with the first seven back in 1998, and therefore decided to ban offshore firms from taking part in energy privatisation. The law "On the Procedures for Holding Tenders on Sale of Shares of Energy Companies" was approved in September 2000. The successful sale of four out of the seven Oblenergos was one of the terms of the EBRD's granting loans for completion of the construction of the power units at the Rivne and Khmelnytsky NNPs (see *Nuclear energy* below).

The deadline for applications for Sevastopoloblenergo, Khersonoblenergo, Kirovohradoblenergo was 8 December. The six oblenergos were to be sold on 22 February and 1 March but the sale was postponed until April on the advice of the financial advisor to allow the government more time to address some of the issues of concern to strategic investors. The State Property Fund issued a tender in January 2001 to select a financial advisor to assist in privatisation of the next 12 Oblenergos.

The government's immediate reform programme also included substantial and lasting improvements in cash collection of payments for energy bills. Low cash payments have limited the ability of the generators to purchase fuel, have affected the efficiency of the wholesale market and have also contributed to the problems of non-monetary payments in the economy. In 1999, while total payments by the distributors to the power market were about 80 per cent, less than 9 per cent were in cash. Cash collection ratios rose, however, in 2000. In July 2000 a law took effect to improve cash payments in the wholesale power market, which required power distribution companies to pay cash for the electricity they have contracted to purchase from the energy market, while the regulator determines the proportion of these receipts that will be paid to the generating companies. In August 2000 the collection rate was 70 per cent, the highest rate ever, as opposed to 10 per cent in January.

Regional power distribution companies offered for sale in 2000

Company	Per cent of shares offered for sale	Starting price (UAH millions)	Equivalent in US\$ millions
Kyivoblenergo	75	174.03	31.99
Rivneoblenergo	75	100.61	18.49
Zhytomyroblenergo	75.56	95.17	17.49
Sevastopoloblenergo	70	35.35	6.49
Khersonoblenergo	65	111.49	20.49
Kirovogradoblenergo	51	87.02	15.99

Nuclear energy

Subject to four main conditions, the EBRD on 7 December 2000 approved a loan for the completion and safety upgrade of two nuclear power plants (NPPs) in Ukraine, known as Khmelnytsky 2 and Rivne 4 (K2 and R4). The US\$ 215 million loan to Energoatom, the Ukrainian state-owned company responsible for nuclear power generation, is to be guaranteed by the government of Ukraine. The approval will become effective once the following conditions have been met:

- Confirmation that the Chernobyl NPP has been closed permanently (from 15 December 2000);
- A number of important safety assurances, including a report from international nuclear regulators that the Ukraine Regulator has the necessary independence and resources to assure operations of Ukrainian nuclear facilities according to western safety standards, a commitment from the G-7 and European Commission to provide technical assistance, and a commitment from the Ukrainian government to provide the necessary independence and resources to the country's nuclear regulator;
- Approval by the IMF's Board of the Extended Fund Facility to Ukraine (which occurred in late December 2000);
- Commitments by the other institutions expected to provide funds for the project.

The project's total cost is US\$ 1.48 billion, to be covered by EU Euratom (US\$ 585 million), export credit agencies (US\$ 348.3 million), EBRD (US\$ 215 million), Russia (US\$ 123.7 million), Energoatom (US\$ 158.6 million) and Ukraine (US\$ 50 million). Conditions of the loan and the loan guarantee would also require enhancement of the safety, not only of K2 and R4, but of the other 13 nuclear facilities owned by Energoatom, and implementation of electricity-sector reform, particularly privatisation of energy distribution companies and increases in tariff collections.

In 1995, the G-7 countries, the European Commission and the government of Ukraine had signed a memorandum of understanding regarding the closure of the Chernobyl NPP. The EBRD was asked to play an important role in a possible financing of the completion of K2 and R4 to replace the generating capacity of the Chernobyl NPP.

The EBRD was also asked to administer about US\$ 1 billion in grant funds for Chernobyl. Since the inception of the Nuclear Safety Account (NSA) and the Chernobyl Shelter Fund (CSF) more than 25 countries and the EU have contributed to the funds. The NSA provided grants to improve the safety of the Chernobyl NPP in the short term prior to the closure. Two major decommissioning facilities, Spent Fuel Storage and Liquid Waste Processing, are also being financed from the NSA. Both are under construction and scheduled for completion in 2003.

The CSF is assisting Ukraine in conversion of the deteriorating "sarcophagus" around the wrecked Chernobyl reactor into a stable and environmentally safe system for a period of one hundred years. This project, which will cost about US\$ 760 million and is known as the Shelter Implementation Plan (SIP) is currently scheduled for completion in 2007. Most of the engineering work and the most critical emergency repairs have already been implemented, however the condition of the Shelter requires that the remaining stabilisation measures and the new environmental barrier, the confinement, are realised with a sense of urgency.

Oil and gas

Both oil and gas production in Ukraine meet only 20 per cent of domestic demand. The country has proven oil reserves of 395 million barrels, the majority of which are located in the Dnieper-Donetsk basin, the major oil- and gas-producing region in the eastern part of the country. Domestic oil production declined during the 1990s and now stands at less than 80,000 barrels per day (bbl/d). Although Ukraine's oil consumption has also more than halved in that decade, consumption still outstrips production capacity by far. The country currently imports nearly 80 per cent of its oil, almost all from Russia. Ukraine has natural gas reserves of more than 1 trillion cubic metres, but for the other 80 per cent of domestic demand it relies heavily on imports, again primarily from Russia.

To reduce its dependence on imports, Ukraine is giving priority to developing its own oil and natural gas resources. Naftohaz Ukrainy (NGU), a state-owned holding company established by Presidential decree in 1998, is responsible for the whole oil and gas sector. It has three subsidiaries: UkrHazDobichia (exploration), UkrHazTransit (transport) and Haz Ukrainy (trading). Almost all national gas production is run by companies incorporated into NGU, such as UkrNafta, UkrHaz-Vydobuvannia and ChornomorNaftoHaz. The highest output of oil is from joint ventures with NGU, such as Poltava gas-oil company (with JKC of the UK), and Plast (with Maru Consulting, part of the Greek industrial group Sanfo Hellas Holding, and Expoinvest of Cyprus). Although there are plans for the eventual privatisation of NGU itself, reform in the oil and gas production sector has been slow and foreign investment negligible.

Oil transit

A key component of Ukraine's strategy to reduce its dependence on Russian oil is the US\$ 300 million Yuzhny oil terminal near Odessa. The terminal, with a throughput capacity

of 800,000 bbl/d, should be capable of supplying all six of the country's oil refineries (see *Oil refining* below), as well as opening up export capacity. The terminal is expected to handle oil supplies from Kazakhstan, Azerbaijan, and the Middle East.

Ukraine is eager to be included in the Caspian Sea's vast untapped oil potential. Today the only way for extracted oil in the Caspian region and Kazakhstan to get to Europe is from Black Sea ports by tanker across the Bosphorus and the Dardanelles to the Mediterranean Sea, and from there via the Atlantic Ocean to the ports of the North Sea countries. By completing the construction of the Odessa-Brody (Lviv region) oil pipeline, as well as the Yuzhny terminal, which started in 1994 and 1996 respectively, Ukraine hopes to make itself an attractive transit country for Caspian Sea oil to markets in the west and North Sea oil going from Europe to Asia.

Oil refining

Ukraine, the second-largest oil refining country in eastern Europe after Russia, has six refineries: Kremenchuk (capacity of 361,000 bbl/d), Lysychansk (320,000 bbl/d), Kherson (236,000 bbl/d), Odessa, Drohobych (both 78,000 bbl/d), and Nadvirna (74,000 bbl/d). The Ukrainian refineries refine all Ukrainian crude oil, plus oil from Russia's Volga-Ural, west Siberian and Mangyshlak regions and some from Turkmenistan. The Lysychansk refinery is fed by west Siberian crude oil arriving from Kuybyshev by pipeline. The refineries' products are mostly consumed by the domestic market.

Three of the refineries were already partly owned by Russian oil companies in early 2000: Kremenchuk by Tatneft, Odessa by LUK-Sintex Oil Ltd (part of the Lukoil group), and Nadvirna by Alfa-Nafta (also part of Lukoil). Watford Petroleum Ukraine Holding Ltd (UK) holds 30 per cent of the Nadvirna refinery (officially called Naftokhimik Prykarpattia), and the 26 per cent government shareholding is managed by Alfa-Nafta, which itself owns 14 per cent. Sentoza, which is affiliated to Privatbank, holds around 10 per cent.

In June 2000, the State Property Fund named Tyumen Oil Company (TNK, Russia) the winner of the investment tender for 67.41 per cent of the Lysychansk oil refinery (LINOS). According to the terms of the investment tender, the winner has to invest € 60 million for modernisation of the refinery and to repay € 18 million of the company's debt. The winner undertook to supply the refinery with 4 million tonnes of crude per year.

In November, the State Property Fund declared Ukrainian trading house UkrNaftoProdukt the winner of a bid for 60 per

cent in the Kherson refinery (KhersonNaftoPererobka). The majority owner of UkrNaftoProdukt is KazakhOil (Kazakhstan), which now controls Kherson. In fact, Kherson refinery is managed by Russian Alliance Group, with whom UkrNaftoProdukt/KazakhOil has signed a management agreement.

Transport

At the international conference of transport complex donors held in Kyiv in December 2000, Ukraine submitted a package of investment proposals worth about US\$ 5 billion. Investment projects for the construction of a sea and river fleet and port infrastructure are estimated at US\$ 2.356 billion, for the construction of concession highways at US\$ 771.95 million, for the development of the railway complex at US\$ 705 million, for the retrofitting and renewal of the air fleet at US\$ 363.6 million, and for the development of the car service infrastructure at US\$ 11.7 million.

Railways and roads

Ukraine has 22,630 kilometres of railway, all 1.524 metre broad gauge, of which 8,600 kilometres are electrified. There are 247,300 kilometres of road, of which 172,565 kilometres are highways. Both railways and roads are in urgent need of modernisation. While economic ties with western Europe are intensifying, upgrading of the rail and road transport infrastructure is becoming essential. The need for organisational reform in the sector and revised policies has been recognised, but presents major challenges.

Within the Trans-European Networks (TEN) system, the system of EU-sponsored Pan-European Transport Corridors, Corridors V and IX are important for the development of Ukraine's road and railway system. Corridor V connects Venice and Trieste with Koper in Slovenia, running on to Ljubljana, then Budapest, and then the Ukrainian cities Uzhhorod and Lviv. Corridor IX runs from Helsinki via St. Petersburg, Pskov and Moscow, to Ukrainian cities Kyiv and Ljubasevka, then on to Chisinau in Moldova, Bucharest in Romania and Dimitrovgrad in Bulgaria to Alexandroupoli in Greece.

Ukrzaliznytsia, the State Administration for Railway Transport of Ukraine, was established in 1991 following the break-up of the state-run Soviet railway monopoly. In December 1999 the EBRD signed a loan agreement to provide a credit of US\$ 51.9 million to Ukrzaliznytsia to support the company's modernisation and restructuring and to finance a track renewal programme for the main line from Kyiv to Lviv, as well as the

purchase of modern track maintenance equipment. This loan enables Ukrzaliznytsia to improve the efficiency and profitability of its freight business and offer competitive domestic and international transport services.

The EBRD will lend € 75 million to rehabilitate key sections of the M06 motorway between Kyiv and the western border. The funds will also enable the Ukrainian State Corporation for Road Construction, Repair and Maintenance (Ukravtodor) to buy urgently needed maintenance equipment, as well as improve road sector financing, planning and budgeting. The project will strengthen the vital link between Ukraine and its natural trading partners in the eastern regions of Poland, Slovakia and Hungary and is a huge boost to the Ukrainian transport sector. It will remove bottlenecks, and enable Ukraine to expand trading activities with its closest western neighbours and the EU. This is the first involvement of an IFI in the Ukrainian road sector.

Airports and aviation

Ukraine's principal airport near Kyiv is Boryspil. Odessa, Lviv and Kharkiv are the second, third and fourth international airports. They are now in the process of being refurbished with the assistance of IFIs. With the help of a US\$ 25.4 million EBRD loan, the Ukrainian State Air Traffic Services Enterprise is financing the installation of modern air traffic control equipment. The project will help to ensure aviation safety in Ukrainian air space and to attract additional overflight traffic, which will generate increased revenue.

State-owned Air Ukraine, one of the successor airlines to Aeroflot, is the national carrier with mostly Soviet planes and serving a number of cities in Russia and elsewhere in the CIS. Since 1996 Air Ukraine has had a joint venture with an Israeli company, Aerosvit, the leading private airline in Ukraine. Aerosvit is expanding its service with the introduction of new international and domestic flights. From November 2000 it started new regular services from Kyiv to Bucharest, Prague and Warsaw and additional flights to Israel.

Ukraine International Airlines (UIA), established in 1992, makes 85 flights per week to and from airports in 12 countries. UIA is 68 per cent owned by the state, while minority shareholders include Austrian Airlines/Swissair (19 per cent), and international leasing company AirFl (13 per cent). Besides Austrian Airlines and Swissair, UIA is a partner

to Sabena (Belgium), Iberia (Spain), KLM (Netherlands) and Blue Panorama Airlines (Italy). In 2000, the number of passengers increased by 12 per cent and the company carried 1.4 million passengers. UIA started complex servicing of international-class aeroplanes in Ukraine last year. Such repairs were previously performed abroad. The project is part of a development programme implemented with ATC Lashen (UK). Two planes were overhauled in 2000.

The EBRD is investing US\$ 5.4 million into UIA to upgrade the fleet of aircraft and to improve the ecological performance of aircraft engines. The airline currently has five Boeing 737s and 10 Antonov 24s. The investment is also being used to support a programme for the development of flight routes between Ukraine and western Europe, to support market development, and to expand competition between UIA and west European airlines. The investment was made into UIA's basic capital through the purchase of preference stocks, the EBRD's share in the statutory fund being 9.9 per cent.

Ports and river transport

Ukraine has well-developed sea and river transportation systems. The largest ports are on the Black Sea (Odessa, Ilyichevsk and Mikolayiv) and handle bulk cargo and container traffic. Regular ferry services run between Odessa and Novorossiysk and Sochi ports in Russia and Batumi and Sukhumi in Georgia. Recently, a ferry service was established between Ilyichevsk and the Georgian port of Poti, to link up the EU sponsored TRACECA (Trans Central Asia Caucasus) corridor for rail and road transport with the Trans-European Networks (TEN), and in particular Corridor IX. The rail ferry terminal was inaugurated in April 1999.

In 2000, Ukrrihflot, a fully privatised river-sea operator from Kyiv, received a US\$ 17.1 million loan from the EBRD to build two new ships. The total value of the project is some US\$ 46 million. In 1999 the EBRD had disbursed € 1.9 million under a medium-term facility to Ukrrihflot. This money was used to purchase two dry cargo vessels from shipyard Societatea Comerciala Navol S.A. (Romania), and assisted in the upgrading of the company's fleet.

A 78 per cent stake in shipbuilder Okean in Mykolayiv was auctioned in September 2000 for a starting price of US\$ 4.8 million, the winner of the tender being obliged to pay off debts and salary arrears. Damen Shipyards Group

(Netherlands) signed the purchase agreement with the State Property Fund in October and changed the name of the shipbuilder into Damen-Okean. The shipyard plans to return output volumes in 2001 to the level of 1991. Okean now employs 5,300 workers.

Telecommunications

The government started the process of restructuring the telecommunications sector in 1993 when it separated telecommunication services (Ukrtelekom) from the main postal entity (Ukrposhta). Within the Ukrtelekom structure each region had its own local telephone company, and long-distance telephone services were provided by a separate company, Utel. Utel was privatised at an early stage, when AT&T (US), Deutsche Telekom (Germany) and KPN Telecom (Netherlands) all bought stakes, with Ukrtelekom retaining 51 per cent.

The privatisation of Ukrtelekom is an integral part of a national development programme aiming to bring Ukraine up to average European telecommunication standards by 2005. Large investments in Ukrtelekom are required for this purpose, to be attracted through privatisation. For a long time, however, the Verkhovna Rada has opposed Ukrtelekom's privatisation for security reasons. Ukrtelekom was on the "negative" list of strategic state-owned companies that could not be privatised. An additional obstacle was the government's wish to buy back the foreign shares in Utel, in order to make Ukrtelekom more attractive to foreign investors. The foreign shareholders were eventually persuaded to sell back their stakes.

Following repeated parliamentary rejection of bills to privatise it, the law on privatisation of Ukrtelekom was adopted on 13 July 2000. The government will sell at least 25 per cent of shares to an industry investor at an auction open to domestic and foreign investors at the end of 2001 aimed to raise at least US\$ 600 million. More shares can be sold, but the state plans to keep a 50 per cent plus one share stake in Ukrtelekom. The EBRD is considering assistance in the pre-privatisation, including the selection of an advisor and the provision of a loan. A part of the loan is to be channelled directly into Ukraine's budget, whereas the largest part of the financing is to be channelled by Ukrtelekom into implementation of several projects. The funds will also be spent on the introduction of services to provide a computer-aided financial document flow system, the Internet, ISDN, and frame relay.

Mobile telecommunications

Given the obsolete condition of the telephone system and waiting times of more than five years for a phone line, it is not surprising that mobile telecommunications companies have rapidly become operational in Ukraine and are doing good business. The market has grown by 300 per cent in 2000 to about 700,000 subscribers, the most dynamic year in terms of growth, and is expected to double to 1.5 million subscribers in 2001 as operators engage in a battle to lower bills and improve services. Penetration is still low, however, at 1.2 per cent. Seven licences have been issued and there are currently five operators in the mobile market operating six networks. Two companies, Astelyt and Telesystems Ukrainy, have licences but do not yet provide mobile communications services.

Ukrainian Mobile Communications (UMC) was set up as a joint venture between Ukrtelekom (51 per cent), KPN (Netherlands, 16.33 per cent), TeleDanmark (Denmark, 16.33 per cent) and Deutsche Telekom (Germany, 16.33 per cent). UMC has so far invested around US\$ 300 million in the development of its NMT-450 and GSM-900 networks. The NMT-450 network covers more than 170 cities and the GSM-900 covers around 40 cities. UMC has invested US\$ 50 million in the GSM-900 in 2000 and will invest the same amount in 2001 to expand the network and offer new services, such as WAP services to pre-paid customers. UMC will also start providing GSM-1800 services in 2001, for which it received a licence in autumn 2000. UMC had about 450,000 subscribers at the end of 2000, a market share of about 52 per cent.

Kyivstar is owned by two Ukrainian companies (Storm – 31 per cent, and Omega – 20 per cent), investment fund Sputnik (US, 14 per cent), and Telenor (Norway, 35 per cent). In January 2001 Telenor announced it would buy an additional 6.8 per cent stake to increase its total to 41.89, to be finalised in April 2001. Kyivstar has already invested US\$ 240 million in launching its GSM-900 network in Ukraine and is currently investing heavily into development of the network to cover most of Ukraine's regional centres. The company expects to invest US\$ 150 million to expand its network and launch new products before the end of 2001. In March Kyivstar launched a GSM-1800 network in Kyiv. Kyivstar had about 300,000 subscribers at the end of 2000. (See case study overleaf.)

Golden Telecom operates a DCS-1800 MC network in the Kyiv and Odessa regions. At the end of 2000, it had a market share of about 7 per cent, represented by about 38,000 subscribers. The company has so far invested about US\$ 60 million, including US\$ 35 million in cellular communications, and will invest US\$ 21 million to expand services to other major cities in Ukraine in 2001. Golden Telecom is part-owned by Global TeleSystems (US). Golden Telecom has been the first entrant in the CIS Internet access and content mass market, providing services in Russian and English. Its development priority is convergence in order to provide all available types of communication services.

DCC provides cellular network services in D-AMPS standard of 800 MHz frequency and has some 40,000 subscribers.

WellCom GSM-900, the trademark of Ukrainian Radiosystems, began operation in October 1998. The company has about 30,000 subscribers.

Case study: Kyivstar

ZAO Kyivstar GSM was founded in August 1997 as a closed joint stock company involving local shareholders Storm LLC and Omega Company Ltd, and the Sputnik Funds. Following an international tender held by the Ukrainian authorities in 1997, Kyivstar, UMC (the existing NMT 450 operator), and URS were awarded national GSM frequency allocation. Since then, Kyivstar holds five licences for telecommunications services: the use of GSM radio frequencies, the provision of GSM 900 mobile services and the provision of international and long distance, data and local communications services. The licence for the use of frequencies is for 15 years and the other licences are for 13 years. Kyivstar started operations with a soft launch in Kyiv in December 1997 and a full commercial launch in 1998.

Telenor Invest AS (Norway) became a shareholder in Kyivstar with a 35 per cent stake in March 1998. Telenor Invest is a fully owned subsidiary of Telenor AS and is responsible for the group's growing international project activity, including extensive investments in the CIS and central and eastern Europe, in places such as St. Petersburg, Moscow, Stavropol, Kaliningrad, Lithuania, and Montenegro.

By the end of 2000 Kyivstar had positioned itself as the second largest mobile operator in Ukraine with a share of 35 per cent of the mobile phone market (about 300,000 subscribers) and its network covered most of the major cities in the country including Kyiv, Dnipropetrovsk, Odessa, Lviv, Kharkiv and Zaporizhyya. The mobile phone sector still leaves substantial room for growth, with mobile phone ownership in Ukraine representing less than 1 per cent of the population in 2000, compared with 8 per cent in Poland and over 12 per cent in the Czech Republic, and an average of over 30 per cent in west European countries. Kyivstar's strategy is to expand the national GSM 900 network and to improve customer service. Ericsson Radio Systems AB, part of the Ericsson Group (Sweden), is providing Kyivstar with US\$ 54 million long-term supplier credits.

In June 2000 the EBRD signed a US\$ 34.2 million (€ 36.8 million) investment package, consisting of a US\$ 30 million (€ 32.3 million) loan and a quasi-equity investment of US\$ 4.2 million (€ 4.5 million). The EBRD had already worked with Telenor Invest on the North-West GSM network in St. Petersburg. The EBRD financing will support Kyivstar's twin objectives of expanding the national network and improving customer service. This will help develop an efficient, reliable and user-oriented telecommunications infrastructure in Ukraine. Due to the currently low access to fixed line services, cellular technology is all the more important.

By supporting Kyivstar, the EBRD hopes to trigger effective competition by an experienced operator into the mobile communications market. This should lead to more customer-tailored tariff plans, more rapid network expansion and improved coverage across Ukraine. The project will have a strong demonstration effect for foreign and local investors by attracting significant foreign capital and know-how.

Financial sector



Ukraine's financial sector is dominated by five large Soviet-era banks, two of which remain state-owned. While the banking system is relatively healthy by regional standards, financial intermediation remains weak. The impact of foreign banks on the market remains limited. At the end of 2000 a new banking law was adopted by parliament. In the securities market, market capitalisation in 2000 stood at more than double the 1999 level. The insurance market's volume remains low, but the sector is growing rapidly.

Banking sector

The Ukrainian banking sector comprised 153 licensed operating banks at the end of 2000, but the eight largest (the "Big 8 system banks group") collectively accounted for the majority of the sector's assets. These eight banks are Prominvestbank, Bank Ukraina, Ukreximbank, Ukrsotsbank, Oschadnybank, Avalbank, Privatbank and First Ukrainian International Bank. The first five of these existed before independence, two of which remain state-owned (savings bank Oschadny and foreign trade bank Ukrexim). First Ukrainian International Bank joined the league of big banks at the end of 2000. Many of the small and medium-sized banks are so-called "pocket banks", which were established in the 1990s mainly to fund their enterprise-owners. Some previous pocket banks, however, have developed into large recognised banking institutions, such as Privatbank. The largest banks provide services in all parts of Ukraine, but there are regional banks which are becoming national players, such as First Ukrainian International Bank and West Ukrainian Commercial Bank.

The banking sector has been developing relatively steadily. Banking was the first sector in the country to convert to international accounting standards, and Ukraine has arguably the best electronic fund payment system in the CIS. While the sector is relatively healthy by regional standards, financial intermediation remains weak. At the end of 2000, the sector's total assets were equivalent to about US\$ 5.5 billion, and total banking capital was reported to stand at around 30 per cent of total liabilities. Both the National Bank of Ukraine (NBU, the central bank) and the Association of Ukrainian Banks (AUB) consider this to be a positive level, given that in other transitional economies banking capital generally represents only 16 per cent of banks' liabilities.

Bank lending

Total bank lending is estimated at around 10 per cent of GDP. The volume of total credits is rising, and the share of bad loans

has fallen. However, the spread between lending and deposit rates is high and most loans to the real sector are very short-term. On average, short-term lending (three to six months) accounts for 75 per cent of the loan portfolio. According to the World Bank, only 5 per cent of enterprises use medium or long-term bank loans to finance their operations. Bank profits remain relatively low, while the share of interest profits has declined from 65-75 per cent to 55-65 per cent. Interest income is mostly generated by loans to legal entities (60 per cent), while loans to natural persons remain insignificant (4 per cent). Although the average lending rate and banking fees have slightly declined over the past two years, most banks continue to operate with exceptionally high costs.

New banking law

The Verkhovna Rada in early December 2000 adopted the Bill of Banks and Banking, outlining the structure of the banking system, economic, organisational and legal grounds for reorganisation and liquidation of banks, as well as of finance and credit institutions. The bill determines, among other things, the procedure for securing licences for banking services. The bill introduces a differentiated approach to the definition of the minimum required level of authorised capital of a commercial bank, depending on the scope of territory on which it operates. In particular, the minimum size of authorised capital at the moment of registration of a regional corporate bank cannot be less than € 1 million, for commercial banks operating on the territory of a certain region € 3 million, and for those working on the whole territory of Ukraine € 5 million. One of the articles in the bill makes it incumbent on the banks to identify the legal entities and individuals carrying out large-scale or so called "doubtful" operations. Adoption of the banks and banking law was one of the IMF conditions for resumption of credits to Ukraine under the current EFF programme. The prime minister met another important condition in December when he approved plans to stabilise crisis-ridden Bank Ukraina.

Banking consolidation

Fragmentation has been a major concern for the NBU, owing to the resulting lack of risk diversification and supervising difficulties. A gradual process of consolidation is under way. More mergers and more effective procedures by the NBU for the liquidation of banks contributed to a decline in the number of banks from 205 (total) at the end of 1999 to 153 (licensed) banks at the end of 2000. The new banking law incorporates international experience and provides for increased NBU regulatory framework powers. The president has acknowledged the importance of developing the sector. These developments could lead to a more rapid consolidation through a more determined enforcement of licensing and other regulations.

In 2000, six out of 38 commercial banks were closed, which had been registered as being in a state of liquidation since 1994.

Ukraine Micro Finance Bank (MFB)

In early 2001 the Ukraine Micro Finance Bank (MFB) started operations, the only newly registered bank in Ukraine during the last two years. MFB provides financial services to Ukrainian private micro enterprises. Shareholders include the EBRD (20 per cent), the IFC (20 per cent), the German-Ukrainian Fund (20 per cent), the Western NIS Enterprise Fund (20 per cent), IMI (Germany, 10 per cent) and DOEN (Netherlands, 10 per cent). In addition to their € 10 million equity contribution, the shareholders will provide debt finance, including an EBRD credit line of up to € 10 million. MFB is offering loans of up to US\$ 125,000 in foreign currency, and smaller loan amounts are provided in local currency. The bank also provides other banking services such as deposit and current accounts, money transfer and international payments. MFB is currently operating in Kyiv and Slavutych, but will soon open branches in Kharkiv, Donetsk and Lviv.

Foreign investment in the banking sector

Ukraine has one of the most liberal sets of regulations for foreign bank participation in the CIS. Foreigners are permitted to participate fully in the domestic banking sector, although they must establish a resident office a year before applying for a licence. Of the total 31 banks with foreign capital, only seven are 100 per cent foreign-owned. While foreign penetration is

taking place, it remains slow. On 1 January 2001, foreign capital accounted for 14.47 per cent of the Ukrainian banking system, but only for 5 per cent of the banking sector assets. Foreign banks service both their multinational clients and Ukrainian blue chips. Since 1997 foreign banks such as Credit Lyonnais (France), Raiffeisenbank (Austria), ING (Netherlands), Kreditanstalt (Germany) and Citibank (US) have established full subsidiaries. Apart from western banks, banks from neighbouring countries such as Russia (Alfa Bank, National Reserve Bank) and Poland (Kredyt Bank, PEKAO) are also entering the market.

Non-bank financial institutions

Securities

The Ukrainian securities market, which was created mainly to facilitate post-privatisation enterprise restructuring in the early 1990s, has gradually evolved to feature more or less the same range of institutions and instruments as more developed markets. However, the securities markets are still under-developed and over-regulated, not transparent and mainly markets for consolidation of "strategic" enterprises. The Law on Securities and the Stock Exchange (1991) provides for the use of such instruments as shares, municipal bonds, corporate bonds, treasury bills, saving certificates, promissory notes and privatisation papers. In 1996, new regulations (On State Regulation of the Securities Market in Ukraine) established the State Securities and Stock Market Commission (SSMSC), with administrative and disciplinary powers over brokers and trading activities. The Law On the National Depository System and Electronic Circulation of Securities was adopted in 1997. In 1999, the SSMSC tightened controls on so-called "non-organised" trading, aimed at improving transparency on the market. While the SSMSC has made strides in the past few years to begin to fulfil its assigned functions, it still lacks the financial and human resources to regulate Ukraine's market effectively.

Minority shareholders have gained some more protection against dilution of their stakes with the approval of new regulations prohibiting companies from issuing "phantom shares". Although the ban was in theory already present in

existing company law, it was so vague that companies were regularly able to violate it. Companies would issue shares and sell them to outsiders without first offering them to shareholders. The new regulations, issued by the SSMSC with effect from October 2000, provide that managers now have to notify shareholders of new emissions, after which shareholders have 15 days to exercise their priority right to buy. Whether these new regulations are effective enough remains to be seen. Further legal changes to protect shareholders against asset stripping and profits skimming will need to be approved by parliament, and a bill on these is currently being drafted.

Market capitalisation in 2000 stood at more than double the 1999 level. The capitalisation ratio was less than 10 per cent, as compared to around 25 per cent in Russia. Since the latest Ukrainian International Stock Exchange (UISEX) was registered in December 2000, a total of seven stock markets and two trading information systems are now registered. About two-thirds of all trading on the primary markets and 99 per cent of all secondary market transactions are executed through an over-the-counter system called First Stock Exchange Trading System (PFTS). There are more than 100 listed companies, of which only 30 are more or less regularly traded. Shares account for around 60 per cent of all trades, while trading in promissory notes and treasury bills account for 32 per cent and 6 per cent respectively. Corporate debt instruments such as bonds are almost non-existent, for reasons of perceived currency risk and unfavourable taxation. An estimated 80-90 per cent of trade in securities is settled offshore.

Insurance

There are about 283 insurance companies operating on the Ukrainian market, of which 29 have foreign capital and the 12 largest firms account for 51 per cent of the premium base. While the market is growing, the sector is still in its early stages of development. Market volume remains low, but the sector is growing by 60 to 70 per cent a year. The sector is dominated by voluntary property insurance, which accounts for 70 per cent of the market. Voluntary casualty insurance, non-state and state mandatory insurance and personal insurance lag far behind (7 or 8 per cent each), with life insurance undeveloped and marginal at 1 per cent.

On 7 March 1996 the Verkhovna Rada adopted a law "On Insurance" with the purpose of bringing the legislative regulation of the insurance industry in line with European requirements. At the same time a range of government regulations created a backbone for the programme for the development of the insurance market up to the year 2004. As part of the programme, all insurance companies had to re-register their authorised capital and bring it to the required levels of € 500,000 by January 2000 and € 1 million by the beginning of 2003.

As many Ukrainian insurers are not able to raise such amounts, this creates an opportunity for joint ventures and foreign companies to establish a presence in the local market. A requirement for foreign insurers to work through local partners was lifted in June 1999. However, the law "On Insurance" sets a limit on foreign ownership in Ukrainian insurance companies. ASKA, one of Ukraine's largest insurers, has approached Raiffeisen (Austria) to help it find a western partner for further expansion. ASKA has more than 100,000 retail and corporate clients. American International Group (AIG, US) has started to operate as a general insurance company in Ukraine, AIG Ukraine. The company is marketing a range of property and casualty products to corporate and retail customers.



EBRD activities in Ukraine

As at 31 December 2000 the European Bank for Reconstruction and Development (EBRD) had signed (net of completed and restructured) 38 projects in Ukraine totalling € 1.2 billion, of which 27 are in the private sector. Investments have been made in a broad range of sectors, including food processing, the financial sector, oil and gas extraction, transportation, agricultural services, telecommunications and municipal infrastructure.

The EBRD acts as administrator of the Chernobyl Shelter Fund, which was established in December 1997 to help Ukraine transform the existing Chernobyl sarcophagus into a safe and environmentally stable system. The Chernobyl Shelter Implementation Plan (SIP) is being carried out under the Fund, which is administered by the EBRD on behalf of the G7 and other contributing countries. A dedicated project team within the Bank is managing the SIP. The EBRD role is very similar to that already undertaken as administrator of the Nuclear Safety Account (NSA) and follows similar procedures.

EBRD key objectives and projects under consideration

The EBRD is placing a high priority on the development of its private sector portfolio through increased financial resources to private small and medium-sized enterprises (SMEs), direct private corporate financing, private bank development support and private financing for infrastructure development, particularly in sectors such as power and telecommunications.

Particular attention is being focused on the energy sector, including helping to privatise the sector and making the country more energy efficient via projects in conservation and efficiency, nuclear safety and new technology for power generation. Special attention is also being paid to developing the vast potential of the agricultural sector. The EBRD is also active in the upgrading of key infrastructure, including transport and municipal services. The Bank's main operational objectives are as follows:

- **Support of private sector development** through credit lines and equity funding for SMEs, and through direct financing of both joint-venture and local private companies. Opportunities for direct financing of joint ventures are limited by the low number of foreign investors, but the EBRD continues to be responsive to demand for project financing resulting from privatisation and foreign investment.
- **Support for privatisation** by providing financing and technical services for the most promising newly privatised enterprises. The Bank is actively participating in the preparation for privatising major companies in the energy and

telecommunication sectors. This work includes procurement of technical assistance for regulatory and investment banking advice, as well as potential pre-privatisation financing.

- **Support for the strengthening of the financial sector, with special emphasis on financing micro, small and medium-sized business.** In the banking sector, this means close monitoring of the SME credit lines to ensure efficiency and to coordinate the implementation of institution-building programmes in participating banks; consideration of credit lines for, and equity participation in, leading private banks; bringing more Ukrainian banks into the Trade Facilitation Programme; and consideration of support for the most promising private banks.

To help meet growing demand for new equity financing, the EBRD has contributed to a capital increase for the Ukraine Fund, and has capitalised a post-privatisation fund, Euroventures Ukraine.

- **Promote private investment in food processing and develop the agricultural sector.** The EBRD will invest in market-oriented and private sector projects that support private sector initiatives which contribute to the opening up of the agribusiness sector. The Bank plans to work in areas where such initiatives are under way, in cooperation with private entrepreneurs, and to support the development of distribution, marketing and processing programmes. The EBRD will also consider ways to broaden its activities in line with the latest reform measures in land ownership and their implementation provided that its "sound banking" objectives can be achieved.
- **Rationalisation of the energy sector.** The EBRD focuses on renovation of thermal power generation capacity, and also on improving the efficiency and environmental performance of the thermal power stations. It also aims to develop privately sponsored power generation schemes, to improve gas transportation efficiency, support reform of the power market, and make investments to improve energy efficiency by increasing district heating network efficiency and creating energy service companies.

- **Rehabilitation and reform of key infrastructure sectors.**

With respect to municipal and environmental infrastructure, the Bank is focusing on a priority investment programme to finance critical investments in the water supply and waste management sector in two large industrial cities. Other initiatives involve pre-investment studies for similar programmes in other cities, and assistance to local governments in commercialising and increasing private sector involvement in their municipal services

Sample of current projects as at 31 December 2000

Private sector

Dnipropetrovsk Oil Extraction Plant

In May 1999 the EBRD provided a three-year revolving credit facility of US\$ 35 million to Dnipropetrovsk Oil Extraction Plant (DOEP), Ukraine's leading sunflower oil extraction company and the first edible oil processing plant in Ukraine to be fully privatised. The financing modifies earlier projects signed by the EBRD in December 1995 and September 1997. In addition, the Bank's US\$ 8.5 million existing preference share issue was replaced by a US\$ 8.5 million senior, subordinated debt issue maturing on 31 December 2002. The loan proceeds will be used for the purchase of sunflower seeds from local producers in Ukraine and for refinancing an earlier preferred share issue.

Micro and SME II credit lines

In August 2000 the EBRD launched an US\$ 88 million credit line to finance micro, small and medium-sized enterprises in Ukraine. The project aims to continue the efforts started under the first line of credit to assist promising Ukrainian private banks in their efforts to become effective financial intermediaries.

SME I credit line

In December 1994 the EBRD signed an agreement for a US\$ 121.2 million credit line designed to assist private SMEs in Ukraine. The funds are being provided in four tranches to the National Bank of Ukraine (NBU) for on lending to Ukrainian companies via eligible participating banks. An autonomous Project Monitoring Unit (PMU) was established within the NBU to monitor the credit line. The SMEs eligible for financial assistance are those seeking hard currency denominated financing for investment, export/import activities and leasing.

The participating banks are benefiting from technical assistance, which provides institutional development programmes and strengthens credit assessment skills. The banks participating in the SME Line of Credit represent the best private financial intermediaries in Ukraine in terms of prudential requirements, balance sheet strength, and management quality. The line began disbursing in April 1995. As of the end of September 1999, over US\$ 120 million had been disbursed for 150 SME projects in a broad range of sectors across the country.

Obolon

Ukraine's first privatised brewery, Obolon, signed a US\$ 40 million loan in December 1997 with the EBRD. The funds are being used to modernise its operations, increase its production capacity and install a financial accounting system to provide reports according to International Accounting Standards.

FUIB credit facilities

In August 1995 the EBRD granted credit of US\$ 13 million to First Ukrainian International Bank (FUIB), a leading private commercial bank. This financing has allowed FUIB to expand its medium-term lending to the private sector Ukrainian enterprises for projects satisfying specific lending criteria. Customers are mostly private enterprises, although state-owned enterprises currently in the process of being privatised are also eligible. In November 2000 the EBRD provided a US\$10 million credit facility to FUIB aimed to increase the supply of medium and long-term finance to the Ukrainian corporate sector. This is the first financing under the EBRD's Enterprise Support Program for Ukraine.

Ukraine Fund

The Ukraine Fund is a venture capital fund established in 1992 with a subscribed capital of US\$ 11.8 million, of which the EBRD contributed US\$ 3.5 million. The Fund makes equity investments in SMEs in Ukraine, including privatised enterprises, with high-quality management and exceptional profit prospects. Most of its capital is used for investments in the production of consumer goods and services for the local market. With a large pipeline of future investments, the Ukraine Fund received a capital increase of US\$ 10.7 million from the EBRD, which was signed in December 1995.

Multibank equity financing facility

There is no single client. Client banks joining the programme will be located in Ukraine and will be suitably qualified private sector financial institutions that can demonstrate a need for capital strengthening, together with a satisfactory level of creditworthiness and capable management teams. The first bank accredited to this framework is Lviv based West Ukrainian Commercial Bank (WUCB).

The basic terms and conditions of framework operations will consist of equity injections into client banks generally not exceeding about 20 per cent of the enlarged share capital bases of such banks. In some cases equity investments may be accompanied by convertible debt facilities. Where possible, a strategic investor will be invited alongside the EBRD, with the combined stakes not intended to exceed 50 per cent of the share capital of investee banks. Total programme cost US\$ 20 million

Subordinated Credit Facility to Raiffeisenbank Ukraine

The loan will be subordinated to other creditors of RBU and will have a maturity of seven years. In accordance with the Basle Accord, part of the loan (around US\$ 5 million) will be qualified as Tier 2 capital of RBU. The remaining part will be disbursed against credit applications to finance sub-projects selected in accordance with standard EBRD criteria. The total project cost is € 9.9 million

Natural gas compressor station construction (Gastransit closed JSC)

Financing of US\$ 50.0 million from the EBRD will allow Gastransit, a closed joint-stock company in Ukraine, to build a gas compressor station in southern Ukraine. Costing a total of US\$ 78.0 million, the new compressor will help to overcome the bottleneck in the gas transportation system in Ukraine. The project is the first phase of a programme that will further increase the delivery of Russian gas to Turkey and other south European countries.

Ukrichflot II

In October 2000 the EBRD lent US\$ 16.8 million to Ukrichflot, a limited liability company incorporated in Ukraine. The proceeds will be used in part to finance the acquisition of two 3,800 dwt general cargo new building vessels from the Navol Shipyard in Romania, with delivery in September 2001 and

June 2002. The project aims to increase Ukrichflot's efficiency, reduce its fleet's average age and expand its capabilities in the international shipping market.

Ukraine Microcredit Bank (UMB)

UMB will be a newly established institution devoted to providing financial services to micro and small enterprises. It will be a joint-stock limited liability company, incorporated and operating in Ukraine. EBRD funding under the project is equity investment of € 2.0 and a further credit line. The total project cost is € 32 million. By providing reliable access to financial services for micro and small enterprises throughout Ukraine, the project will give direct support to private sector development. Other shareholders are the International Finance Corporation (IFC), the Western NIS Enterprise Fund, the German Ukraine Fund and the Dutch Doen Foundation.

Iveco Ukraine

Iveco Ukraine is to be involved in the automotive industry in Ukraine and controlled by Iveco SpA, a leading European manufacturer of commercial vehicles ultimately fully owned by Fiat SpA. EBRD finance is US\$ 21.12 million ordinary equity investment in Iveco Ukraine. The total project cost was US\$ 85.4 million. The project aims to strengthen the local production of commercial vehicles and to help it expand into the manufacturing of diesel engines, gearboxes and vehicle components.

Cerealia BCP

The project consists of a US\$ 3 million equity investment in one of the largest Ukrainian cereal breakfast producers, Boryspil Cereal Plant (BCP), to finance permanent working capital needs and the company's growth. The proceeds from the capital increase will enable BCP to expand its operations, have access to much-needed working capital, and increase its marketing and sales in Ukraine and elsewhere in the Bank's region of operations.

Ukraine International Airlines

Purchase of a 9.93 per cent stake in Ukraine International Airlines (UIA) totalling US\$ 5.4 million (€6.5 million). The investment will help the Ukrainian airline to meet market demand and to offer a credible alternative to west European airlines.

Public sector

Ukraine energy service company

A sovereign loan of US\$ 30 million provided by the EBRD in May 1998 will finance the establishment of Ukraine's first energy service company. UkrEsco will identify and implement energy-saving investments in SMEs and public sector institutions.

Starobeshevo Power Plant modernisation

In December 1996 a loan agreement was signed with Donbasenergo Genco, one of Ukraine's four state-owned thermal power generators, for a credit of US\$ 113 million to finance the replacement of an old coal-fired boiler with a more efficient and less polluting unit. The project will contribute to a significant improvement in energy efficiency, as the new boiler will use a waste product, replacing expensive local coal and imported gas and fuel oil.

Refurbishment of Borispil Airport

Borispil is Ukraine's largest international airport, situated about 40 kilometres from Kiev. In December 1993 the EBRD granted a loan of US\$ 5.1 million to help finance renovation of the airport. The total project cost was US\$ 14.8 million, financed by a loan from the Ukrainian government and the First Ukrainian International Bank. The financing paid for refurbishment of the passenger terminal, which has helped the airport handle growing numbers of passengers and increasing international air traffic. These renovations also created facilities for commercial activities, such as duty-free shops and restaurants, which generate revenue for the airport. The renovations were completed in May 1994.

ITUR Telecommunications

ITUR (Italy-Turkey-Ukraine-Russia) is the name of a trans-border project funded by 26 international telecommunications operators and banks. The involvement of the Ukrainian Enterprise for International and Interurban Telecommunications and Broadcasting (UKRTEC) was made possible by a loan of US\$ 52.8 million from the EBRD, granted in June 1994. The project provides Ukraine with modern telecommunications links with Europe, neighbouring Black Sea countries and the rest of the world. The ITUR consortium is constructing an under-water cable, and constructing and operating a "land link" fibre optic cable, which links the ITUR landing station at Odessa to Kiev and connects the ITUR terminating station to Palermo, Italy, and

the rest of the world. The EBRD is also providing technical co-operation financing for the project.

Zaporizhzhya water utility development and investment programme

An EBRD loan of US\$ 28 million was extended in May 1999 to Vodokanal, the municipal water and wastewater enterprise in Zaporizhzhya, to help reduce pollution in the Dnieper River. The project will finance critical investments in the water supply and wastewater sector and will enhance the financial and operational performance of Vodokanal. The financing will improve the efficiency and quality of water and wastewater services, bringing cleaner and safer water to the citizens of southern Ukraine.

Railway commercialisation and track management

An EBRD loan will assist Ukrzaliznytsia (UZ) to improve track maintenance. As a result UZ will be able to offer faster, more reliable rail freight transport services at lower cost, and track maintenance costs will be reduced substantially. Policy reforms will promote improved financial performance, better management and commercialisation. The operation involves an EBRD finance loan (sovereign guaranteed) of US\$ 51.6 million with a 15-year term. The total project cost is US\$ 110.9 million.

M06 Highway Rehabilitation

EBRD has granted a €75 million loan to rehabilitate key sections of the M06 motorway between the capital, The Kyiv, and the country's western border. It is the first involvement of an international financial institution in the Ukrainian road sector. The funds will also enable the Ukrainian State Corporation for Road Construction, Repair and Maintenance (Ukravtodor), to buy urgently needed maintenance equipment, as well as improve road-sector financing, planning and budgeting.

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Signed projects (net of completed and restructured), as at 31 December 2000 (in € million, exchange rate as at 31 December 2000)

Operation name	Sector	EBRD debt	EBRD equity	EBRD total
Private				
Obolon Brewery	Agribusiness	45.4	0	45.4
IVECO Ukraine	Automotive	0	20.4	20.4
DOEP II	Food processing	5.9	0	5.9
DOEP (Amended)	Food processing	27.8	0	27.8
SME Line of Credit	Finance	137.5	0	137.5
SME Credit Line II	Finance	50.8	0	50.8
Integrated Agricultural Services	Agriculture	0	15.7	15.7
Ukraine Fund (plus capital increase)	Finance	0	7.8	7.8
FUIB Agribusiness Credit Facility	Banks	15.0	0	15.0
Ukrichflot I	Water transport	9.5	0	9.5
Ukrichflot II	Water transport	6.6	0	6.6
Poltava Oil & Gas	Oil & gas	9.0	0	9.0
AD-Zarya	Glass container production facility	0	12.8	12.8
Radisson SAS Kyiv	Tourism	7.38	6.19	13.6
FUIB under MBEFF (Share Purchase)	Finance	0	4.92	4.92
Procter & Gamble Distribution	Logistics	0	17.4	17.4
Agribusiness Industrial Complex	Agribusiness	58.7	0	58.7
Cerealia BCP	Agribusiness	0	3.5	3.5
Kyiv Star GSM	Telecoms	39.4	0	39.4
Multi Bank Equity Finance – WUCB	Finance	0	4.6	4.6
Ukraine Microcredit Bank (UMB)	Finance	10.0	2.0	12.0
Ukraine Subordinated Credit Facility to Raiffeisenbank Ukraine	Finance	11.5	0	11.5
FUIB under ESF	Finance	11.5	0	11.5
Hudson Asset Management	Agribusiness	0	2.5	2.5
P5 Communications	Telecoms	0	1.1	1.1
Ukrainian International Airlines	Transport	6.5	0	6.5
Ista Centre	Manufacturing	11.3	0	11.3
Subtotal		512.9	98.9	611.8
Public				
Starobeshevo Power Plant	Energy	130.4	0	130.4
ITUR	Communications	61.1	0	61.1
Balkan Gastransit project	Oil & gas	47.3	0	47.3
Ukraine Fuel Purchase Loan	Energy	115.2	0	115.2
State International Airport Borispol	Airports	5.9	0	5.9
Eurovision – TV Ukraine	Communications	1.2	0	1.2
Air Navigation System Upgrading	Transport	30.1	0	30.1
Zaporizhzhya – Water Utility Development and Investment Programme	Infrastructure	32.3	0	32.3
Ukraine Energy Service Company – UkrEsco	Energy	34.0	0	34.0
Railway Development Project	Transport	59.8	0	59.8
MO6 Highway Improvement	Transport	75.0	0	75.0
Subtotal		592.3	0	592.3
Signed projects total				1204.1
of which private				51%
of which public				49%