



ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT



EU/TACIS PROGRAM

## ***ROUNDTABLE ON ENTERPRISE DEVELOPMENT AND INVESTMENT CLIMATE IN UKRAINE***

*Kiev, 13 June 2006*

### ***MAIN FINDINGS AND RECOMMENDATIONS***

## Introduction

The Roundtable is organised within the OECD-EC project on “*Improving the conditions for enterprise development and the investment climate for domestic and international investors in Ukraine*”, financed by the EC-TACIS programme. The meeting is co-hosted by the UNDP. The objective of the roundtable is to discuss policy recommendations, based on main findings of the activities carried out in 2004-2006 within the three components of the project, i.e.

- Legal framework for business operations
- Financial markets and their role in creating favourable investment climate
- Investment and regional development.

The purpose of this paper is to summarise main findings and highlight policy recommendations for the three areas of the projects.

### Session 1: Legal framework for business operations

This part of the project has aimed at engaging discussions with the public and private sector in Ukraine on the improvement of the legal environment for doing business and attracting foreign investment. A first workshop held in May 2004 resulted in the set of recommendations subsequently incorporated into the OECD publication “*Legal Issues with regard to Business Operations and Investment in Ukraine*” (October 2004). A second workshop was organised in April 2005 in Kiev to review progress achieved and discuss remaining gaps.

OECD work and other available studies, in particular the UNDP Blue Ribbon Commission for Ukraine’s “Proposals for the President: A New Wave of Reform” and the report by the European Business Association on Barriers to Investment, agree that Ukraine’s current legal system for business operation is inadequate and hinders market developments in the country. The government should therefore act rapidly in close co-operation with the business and investment communities.

#### *Main recommendations*

Several directions for future government actions are proposed:

- Improve existing legislation, in particular the Civil and Commercial Codes, which took effect on 1 January 2004. Whereas the Civil Code, covering relations among both individuals and legal entities, is generally market-oriented, the Commercial Code, applicable to relations among legal entities and the State, contains anti-market provisions. The Commercial Code thus should be abolished and market orientation of the provisions of the Civil Code improved.
- Corporate and anti-monopoly legislations: Ukraine needs to introduce a Law on Joint-Stock Companies and a Law on Limited Liability Companies. The current antimonopoly legislation is unnecessarily broad, imposing extremely low monetary thresholds for transactions requiring prior approval.
- Reduce unnecessary obstacles and hidden charges: main proposed measures to overcome the bureaucratic red tape, which remains a major problem in Ukraine, are: (i) cancellation of all unnecessary notarisation requirements; (ii) reducing notary fees for all remaining notarisations; (iii) returning to a simple power of attorney system and (iv) reintroducing a possibility for giving broad authorisations. The outdated 90-days rule, introduced allegedly to prevent capital flights, should be removed. Similarly, the outdated requirements regarding the form of contracts should be simplified.
- Regulatory governance and the permits system: Ukraine’s current “permits system” (or regulatory governance) covering various forms of state regulations of business activities remains arbitrary, excessive, costly and overregulated. Recent efforts to eliminate several thousands regulatory acts in 2005 have not been successful.

As the first step to make the system more transparent and its implementation predictable, the OECD proposed to adopt a framework Law on Fundamentals of the Permits System.

## **Session 2: Financial markets and their role in creating favourable investment climate**

This component of the project has focussed on the role of the financial sector in attracting foreign investment. A conference was organised in October 2005 in Kiev to demonstrate the contribution of financial liberalisation in conducting business activities, also taking into account the experience of transition economies in this area. Participants discussed the issues of capital movement liberalisation and the stability of the financial sector as well as the regulatory and institutional framework for a modern banking system and capital markets in an open economy.

There are three principal domains critical to attract foreign investors, i.e. building an adequate legal framework, achieving macroeconomic stabilisation and developing business friendly environment. Although Ukraine has realised certain progress, much work remains to be done in all three areas. As evidenced by frequent complaints by domestic and foreign firms, in particular regarding high interest rates and prohibitive collateral requirements, Ukraine's largely bank-based financial system is underdeveloped and insufficiently diversified. The development of the financial sector and capital markets is hindered by inadequate regulations and supervision mechanism.

### *Main recommendations*

- Improve legal environment of the banking sector and financial markets to a level similar to that in force in the European Union. In particular, legal enforcement of collateralized obligations should be smoother and faster and bankruptcy law strengthened.
- Designing an adequate regulatory basis and supervision system for the financial sector in line with international standards, in particular establish the limits on large credits and connected lending and require banks to classify their loan portfolio based on European standards.
- Create a strong and effective banking sector, in particular through re-capitalisation and its diversification, especially by opening it to foreign partners.
- Devote high importance to the education of professionals, the formation of professional bodies and the education of public.
- Encourage liberalisation of capital markets, in particular by promoting their transparency and integrity, including through greater participation of institutional investors.
- Promoting good corporate governance in both corporate and financial sectors, disclosing information to the stakeholders and the public; protecting more efficiently the rights of minority shareholders; strengthening the responsibility of boards. .

## **Session 3: Investment and regional development**

FDI can and should play a major role in driving regional economic growth and creating employment in Ukrainian regions. It brings important multiplier effects resulting from local procurement of materials and services and local spending of salaries. Other potential benefits include technology transfers, upgrading of the efficiency of local suppliers, competitors and customers, contributions to local infrastructure and improved labour force skills.

Within this part of the OECD/EC initiative, several activities have been undertaken at regional level in Ukraine to analyse current practices and provide policy recommendations to local and regional administrations and central government authorities in the following fields:

- FDI and regional development: the case of Lviv region;
- Industrial restructuring and enterprise development at regional level: the case of Kharkiv region;
- Investment and entrepreneurship development in the tourism sector: the case of the Republic of Crimea.

## *Main recommendations<sup>1</sup>*

Ukraine regions should develop coherent, integrated development strategies based on an in-depth understanding and knowledge of local assets, competitive advantages and opportunities, which are aligned and co-ordinated with national growth objectives. Regional investment promotion and entrepreneurship development efforts must result from and help achieve national and regional economic and social development goals. To attract, retain FDI and fully exploit its potential, a number of more specific policy recommendations are proposed, based in particular on the study of Lviv region:

- a) *Develop and implement a coherent FDI attraction policy*, building on the general economic development strategy, but specific and focused on the FDI market opportunities and region's competitive positioning. The following steps can be undertaken:
  - *Identifying directions for FDI strategy*: Develop an overall FDI strategy jointly with all concerned stakeholders; Identify realistic FDI objectives; Inform the public about the strategy.
  - *Setting targets for FDI attraction*: Analyse and monitor key FDI indicators on competitor locations, key source markets, and potential foreign investors; Evaluate the region's competitive position; Identify sector, market and company targets.
  - *Organising FDI attraction*: Set up a "one-stop-shop" for FDI attraction; Plan and allocate necessary resources for FDI attraction;
  - *Implementing FDI attraction strategy*: Improve the business environment for FDI, including human resources development, infrastructure and property development; Launch effective marketing and promotion tools; Undertake company targeting.
  
- b) *Design an FDI aftercare policy* to bring the maximum net economic benefits to the host region in the long run. The most appropriate focus for aftercare should be on types of strategic FDI which are mobile and contestable across national borders and whose economic impacts are strongly additional and whose displacements effects are minimal.
  - At regional level, first focus on supporting the bedding down of the initial investment projects to ensure that full project roll-out is achieved efficiently and to schedule and the planned number of jobs is fully realised.
  - Respond to the key concerns of strategic investors related to the consistency and transparency of the application of Ukrainian regulations. These concerns relate to customs and excise; tax and social security; building and land approvals; anti-competitive practices; improvements in transport, telecommunications and utilities.
  
- c) *Support FDI embedding in the local economy by*:
  - Stimulating inter-firm alliances and networking between firms and research institutions in order to stimulate diffusion of new technologies and innovation.
  - Promoting entrepreneurship and SME development to build or strengthen the supplier industries in the host region.
  - Strengthening linkages between business and research by modifying the academic curriculum of local universities in accordance with the changing needs of the economy.
  - Supporting the development of specialised clusters including the infrastructure and supply of trained human resources.

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<sup>1</sup> Discussions during the Roundtable and recommendations mainly focus on FDI and regional development issue based on the results of the study on Lviv regional FDI policy. Materials on the other two themes will be available for information to participants of the Roundtable.