BUSINESS ENVIRONMENT IN UKRAINE

Ukraine SME Survey and Policy Development Project
with the financial support of the Ministry of Foreign Affairs of Norway

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INTRODUCTION

The International Finance Corporation (IFC), established in 1956 as a member of the World Bank Group, promotes sustainable private sector investment in emerging economies. When Ukraine became a IFC member country in 1993, as the size of the country’s private sector precluded direct investment, IFC began its work by delivering technical assistance projects, first to help create the private sector and later to assist in its further development.

In 1996, under its Business Development Project, IFC began to conduct annual surveys of the SME sector in Ukraine, to analyze the state of the business enabling environment for these firms. The surveys have been effective in promoting policy reform on private sector development issues, and have been used as a tool to monitor the progress of various reforms and changes in the business environment.

This report, the seventh in a series, was written in the summer of 2003. This report has as its goal a clear and factual representation of the issues that face Ukrainian entrepreneurs in starting and developing their business. In this sense, it is not an exhaustive examination of, or an attempt to catalog, all the issues related to business development and regulation of private sector activity in Ukraine. Rather, the purpose is to allow the government, NGOs and international organizations to understand the policy decisions that are most strongly influencing the growth of small business in Ukraine, as these policy decisions are seen by entrepreneurs.

The authors would like to thank those who have given comments and suggestions on various drafts of this report. From the IFC, special thanks to Elena Voloshina, Tania Lozansky, Yana Gorbatenko and Garland Boyette for their comments, corrections, and suggestions. Our thanks are also due to Yuri Oliynyk, Sergei Szyzenko, and Oksana Sydoruk for their translation work, as well as to Svetlana Dorosheva for the design and Vladyslav Zakharenko for the layout of this report. The authors and research team consisted of Volodymyr Buny, Yuriy Kuzmyn, Sergiy Kysil, Dina Nicholas, Bogdan Senchuk and Natalia Shevchuk. The survey fieldwork was carried out by the Ukrainian Marketing Group (UMG). The Government of Norway has provided funding for this survey through its Trust Fund with the IFC.

This report has been published in English, Russian and Ukrainian. Although all efforts have been made to assure that the Ukrainian and Russian versions of this report correctly represent the original, the English version will prevail in the event of any ambiguity. The views expressed herein are those of the authors and do not necessarily represent the views of the International Finance Corporation or the Norwegian Government.

This report, in both hard copy and electronic format, can be obtained at the following addresses:
Over the past ten years, small and medium enterprises have taken on an increasingly important responsibility in creating employment opportunities, developing competition and encouraging economic growth in Ukraine. The economic restructuring process that has occurred in the country is no small accomplishment, and despite setbacks which have restrained reform, the reader of this report should recall that most of the issues discussed within simply did not exist a decade ago. Methods for assuring equal treatment, compliance, and predictability of administrative and regulatory procedures applicable to private enterprise are still in development.

The SME sector, which has existed in Ukraine for just over a decade, plays a vital role in established market economies. In Europe, SMEs employ three quarters of the labor force and account for about two thirds of the GDP of the European Union. In Ukraine, accurate figures for the SME sector simply do not exist, as the sector is not separately defined by official statistics. It is not possible to obtain a figure of any exactitude on the number of SMEs in the country, let alone verifiable estimates for the share of the labor force working in small and medium sized enterprises, or their share of the country’s GDP.

However, the estimates which do exist are unanimous in considering Ukraine’s SME sector to be smaller and less productive than that of the European Union. The issue of contention is rather how much smaller and less productive it is. Without entering the debate on exact figures, it is nevertheless well understood that the growth of small enterprise should be further encouraged and assisted, if Ukraine is to join the ranks of developed nations with modern economic systems. Perhaps a beginning can be made by defining the sector officially, and providing clear and updated information on its most important indicators. This would encourage more effective policy development by allowing the government to monitor and evaluate its own policies towards the private sector.

This report concentrates on a number of issues affecting the business climate in which SMEs operate, based on the findings of an independent survey of over 2000 enterprises, conducted in 23 oblast centers of Ukraine and the cities of Kyiv and Simferopol in the Spring of 2003. The issues of focus include the availability of competitive external financing, the system of taxation, and a number of regulatory processes: state inspections of enterprises, import and export operations, obtaining permits for business activities, certification, licensing and business registration. In considering the extent to which administrative and regulatory processes, as well as the method of their implementation, create so-called “barriers to business”, the intent of the report is to display the effect of government policies on entrepreneurs, as a starting point for constructive dialogue between the public and private sector.

Main Survey Findings

- Many of the general improvements in the Ukrainian business environment seen between 2000 and 2001 have suffered setbacks in 2002. In particular, firm assessment of difficulties raised by political instability, anti-competitive practices, corruption, and unwarranted state interference in business activities have each increased by 10 or more percentage points year-on-year. While assessments of the majority of other business environment issues have also deteriorated, this change has been less significant.

- Firms rate the system of taxation as the main barrier to business activities, with 70% citing taxation as an obstacle to growth and development. Ukrainian firms see the key difficulties of taxation as: high tax rates, unstable tax legislation, and the overall number of taxes, each of which was cited as a barrier by more than three quarters of all surveyed companies. On the other hand, survey results show that the simplified tax has significantly decreased the barriers involved in taxation for small firms, which rate all aspects of the tax system as less of a burden than their larger counterparts.

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2 Here, SMEs are referred to by European standards: enterprises with less than 250 employees as well as the self-employed.
3 The State Statistics Committee only keeps records on small enterprises, defined as legal entities with up to 50 employees, and experts estimate that small firms (less than 50 employees) accounted for 82% of all enterprises in the country in 2002. While the state Tax Administration keeps records on all legally operating enterprises as well as on individual entrepreneurs, this information is not made available, even as summarized statistical data.
4 A summary of results is presented in the Business Environment section of this report. The full list of potential barriers surveyed, displaying all results from 2000-2002, is presented in Annex 3.
Over half of surveyed firms cited frequent changes to legislation, anti-competitive practices of other firms, political instability and corruption as serious barriers to business activities.\textsuperscript{5}

Ukrainian enterprises have rated criminal pressure as last on the list of possible barriers to their operations. These results coincide with the previous survey findings: firms have consistently rated criminal pressure as the least serious barrier to operations and growth over the past three years.

While most enterprises are relatively satisfied with the work of central authorities, Ukrainian enterprises remain much more critical of their local business climate. Less than a third of firms believe that the actions of local authorities do not impede business operations. A quarter of firms consider the business environment in their city as conductive to investment and growth, while under one in five believe that local authorities strive to create equal opportunities for entrepreneurs. Overall, SMEs are less satisfied with their local business environment than are large enterprises.

External financing options are limited for Ukrainian firms, and bank financing is rare. Only 17\% of surveyed firms obtained a bank loan in 2002. Loans for a period of three years or more account for less than 5\% of all loans obtained by surveyed firms in 2002. Moreover, nearly one in two firms with a need for external financing did not apply to a bank, with half of these enterprises citing high interest rates or prohibitive collateral requirements as the key reasons for not having turned to a bank to meet investment needs.

The regulatory climate in Ukraine was cited a barrier to business development by 43\% of surveyed firms, which is an increase from the result of 38\% obtained in 2001, and presents a return to levels seen in 2000.

\textbf{Regulatory Climate in Focus}

The majority of this report will concentrate specifically on the regulatory climate in which Ukrainian firms operate. In order to assess which specific regulatory issues are most acute for entrepreneurs, surveyed firms were asked to rate each regulatory procedure separately, based on the level of difficulty that it presents for their company’s operations. A total of six regulatory procedures were covered by the survey. Figure 1 presents survey findings.

\textit{Figure 1 Specific Regulatory Issues as Barriers to Business Development in Ukraine} \textsuperscript{6}  
(\% of firms)

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{regulatory_climate_bar_chart.png}
\caption{Specific Regulatory Issues as Barriers to Business Development in Ukraine \textsuperscript{6}}
\end{figure}

\textsuperscript{6} Throughout this report the term “barrier” refers to the share of firms citing the procedure as a major or significant obstacle.
Inspections were cited as the most significant regulatory barrier to business, with 48% of firms considering the procedures to cause major or significant obstacles to operations. In 2002, the typical surveyed firm was inspected a total of 14 times. Firms report that the total duration of all inspections averaged 17 working days in 2002.

Customs procedures, which presented problems for 38% of firms involved in foreign trade, were ranked second in order of difficulty.

Obtaining permits, meanwhile, was cited as a barrier to operations by just over a third of all firms. Survey findings show that the share of firms obtaining permits in Ukraine, including obligatory permits to start operations, has been declining over the past three years. At the same time, firms report that the difficulty of receiving each of the most-commonly issued permits for business operations has increased significantly between 2000 and 2002.

Time tax estimates averaged 14% in Ukraine in 2002 – a drop from an average 16% in 2001. Time tax measures the amount of time that enterprises spend dealing with state regulatory and administrative issues.

Table 1 shows that the negative trend seen in attitudes towards the overall business environment in Ukraine does not affect the appraisal of specific regulatory procedures. When each regulatory issue is considered separately, firm opinion has shown improvement over the past three years. The single exception is inspections procedures, which surveyed companies have consistently rated with increasing severity.

| Table 1 | Regulatory Barriers to Business Development, 2000-2002 (% of firms citing each procedure as a major or significant obstacle) |
| --- | --- | --- |
| Issue | 2002 | 2001 | 2000 |
| Inspections | 48 | 46 | 42 |
| Customs procedures | 38 | 46 | 49 |
| Obtaining permits / approvals | 35 | 41 | 44 |
| Licensing procedures | 32 | 35 | 42 |
| Certification procedures | 30 | 40 | 42 |
| Firm registration/ Re-registration procedures | 19 | 21 | 22 |

When these results are analyzed by size of enterprise, it is clear that in 2002, large firms are relatively more severe in their assessment of procedures which are rated to be the most difficult overall, such as inspections and customs. SMEs on the other hand, tend to have more difficulty with registration, permits, certification and licensing.

| Table 2 | Regulatory Barriers to Business Development by Firm Size in 2002 (% of firms citing each procedure as a major or significant obstacle) |
| --- | --- | --- | --- |
| Issue | Small | Medium | Large |
| Inspections | 46 | 47 | 57 |
| Customs procedures | 37 | 34 | 41 |
| Obtaining permits/ approvals | 36 | 34 | 33 |
| Licensing procedures | 32 | 34 | 29 |
| Certification procedures | 32 | 32 | 25 |
| Firm registration/ Re-registration procedures | 21 | 18 | 13 |
Regulatory “Time Tax”

An estimate of time tax refers to the amount of time that firm management spends dealing with state officials and completing the requirements of regulatory agencies. While it is clear that such procedures are vital for the protection of the health and safety of company employees as well as the public at large, the time that enterprises spend completing such procedures obviously takes away from their typical business activities. It is therefore expected that a regulatory time tax should be as low as possible, and in this sense, time tax estimates allow an appraisal of the efficiency of government officials in carrying out regulatory procedures. They also point towards the clarity, stability and predictability of the regulatory base — the fewer changes to regulations, the less management time spent gathering information and advice on how to comply with official requirements.

In 2002, enterprise managers estimated that the average share of their time spent on regulatory matters was 14%, which is lower than the 16% cited in 2001 and 2000. This tax remains under 20% for firms operating in all cities of Ukraine, with the exception of Khmelnytsky. In 2002, as had been the case in 2001, Uzhgorod, Odesa, Kirovograd and Kherson remain amongst the most “taxed” cities across Ukraine. Meanwhile, results show that the time that firms are asked to allot to regulatory questions is similar for all sizes of business and remains level across most industries.

**Figure 2** Enterprise Manager Time Tax: Regional Variations in 2002

(% of firm time spent on regulatory matters)
Conclusions

Survey results over the past three years show that a number of issues in the overall business environment are becoming increasingly acute for firms in Ukraine, such as political instability, corruption, anti-competitive practices and official interference in business activities (Table 6).

Nevertheless, firms continue to experience difficulties with the regulatory environment, with 43% of surveyed companies citing the regulatory climate in Ukraine as a barrier to their operations. Moreover, each of the specific procedures covered in this report remains problematic for a significant portion of Ukrainian companies. It should also be underlined that, despite the legislative progress mentioned above, many regulatory processes continue to operate outside of a clear legislative framework, and lack the benefit of unifying legislation to define their goals, procedures, terms and conditions, or all of the agencies involved in the process.

Most regulatory procedures also have in common other important deficiencies: including a lack of clarity in regulations that do exist and a lack of availability of information, to allow entrepreneurs to become familiar with a regulatory process and its requirements. The requirements prescribed in normative acts are often either incomplete or so general as to be open to a number of interpretations. Even in cases were clear information exits, it often remains inaccessible for entrepreneurs. Between 10% to 50% of entrepreneurs claim that they had difficulty in obtaining information necessary to complete the regulatory procedures covered in this report, depending on the procedure. In many cases, results show that the lack of access to information directly increases the costs and timeframes required for a firm to complete procedures. This also creates the conditions for rent seeking behavior on the part of state officials allowed to “monopolize” access to information. Given this situation, survey findings document that it is often the practice of implementation of procedures lacking transparency, and open to a number of interpretations, which is problematic, rather than the intent of the procedures themselves.

Unofficial Payments

Close to quarter of surveyed firms stated that unofficial payments are likely required of the average Ukrainian company when completing each of the regulatory procedures covered in this report. The single exception is obtaining permits and approvals, a procedure for which fully 40% of firms claimed that the typical Ukrainian enterprise is likely to pay unofficially (Table 3).

Table 3 The Unofficial Cost of Regulatory Procedures (% of firms citing unofficial costs as likely required for a typical enterprise to complete each regulatory procedure)

<table>
<thead>
<tr>
<th>Procedure</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtaining Permits and Approvals</td>
<td>42%</td>
<td>38%</td>
<td>33%</td>
<td>40%</td>
</tr>
<tr>
<td>Customs Procedures</td>
<td>26%</td>
<td>28%</td>
<td>31%</td>
<td>27%</td>
</tr>
<tr>
<td>Licensing Procedures</td>
<td>27%</td>
<td>26%</td>
<td>23%</td>
<td>26%</td>
</tr>
<tr>
<td>Certification Procedures</td>
<td>24%</td>
<td>23%</td>
<td>23%</td>
<td>24%</td>
</tr>
</tbody>
</table>

Firms stating that the average company usually pays only the “official fee” to complete a given regulatory procedure ranged between 24% for customs to 57% for registration. A significant portion of firms, between 15% for permits and 50% for customs, had difficulty in answering this question. Figure 1 in Annex 3 displays responses of all surveyed firms.

These issues are covered in the Business Environment section of this report.

This process began with the adoption of the Law on Licensing in 2000. Encompassing legislation was passed in 2001 on certification and standardization procedures, although the technical specifications needed to enforce the legislation are yet to be adopted. In January of 2004, the Law on Registration will come into effect, while a Tax Code is currently with Parliament.
Structure of the Report

This report will examine a number aspects of the administrative and regulatory environment in Ukraine, by first summarizing firm assessment of the current business environment, then discussing in more detail access to external finance and the system of taxation. Finally, attention will be turned to six specific regulatory processes: state inspections of enterprises, import and export operations, obtaining permits for business activities, certification, licensing and business registration, and the practice of their implementation.
The methodology and the sample selection used for this survey is similar to that of IFC business environment surveys conducted since 2000. The sample is not set proportionally to all firms operating in Ukraine, and is constructed in order to allow for comparison between firms of different sizes, operating in all sectors of business, in each of Ukraine’s oblast centers. Details on methodology and sample selection can be found in Annex 1 of this report. A profile of survey respondents is presented in Figures 3-7 and Table 4.

**REACH**

2,014 companies operating in 23 oblasts centers of Ukraine, and the capital cities of Kyiv and Simferopol.

**TIMING**

Fieldwork carried out in April 2003.

**METHOD**

Three questionnaires presenting a total of 160 questions. Face to face interviews with firm managers for two sections of the questionnaire, and one self completed section of the questionnaire. Questions covered included the general, administrative and financial aspects of firm activities.

**SAMPLE**

Manufacturing firms, representing 46% of all surveyed companies, are proportionally distributed amongst cities, based on information on active enterprises from the State Tax Administration.

**Sector**

For all other sectors of business activity, quotas were set in order to allow comparison between cities. Other sectors include transportation, construction, trade, public catering, financial sector and service firms. Agricultural firms are not covered by the survey.

**Firm Size**

The survey has applied the following breakdown for size of enterprise: small – up to 50 employees; medium – between 51 and 250 employees; large – over 250 employees. Individual entrepreneurs are not covered by the survey.

**Figure 3** Respondents by Sector of Business Activity (% of all firms)

- Financial Sector: 3%
- Transportation: 4%
- Construction: 5%
- Public Catering: 6%
- Trade: 16%
- 46% Manufacturing
- 18% Services

**Figure 4** Respondents by Firm Size (% of all firms)

- Small: 15%
- Medium: 63%
- Large: 22%

**Figure 5** Respondents by Legal Status (% of all firms)

- State enterprise (50-99 % state-owned): 6%
- Other: 20%
- Collective enterprise (founded with property of enterprise workers’ collective): 17%
- Closed joint-stock company: 24%
- Open joint-stock company: 32%
- Limited liability company: 17%
- Private enterprise (founded with individual property): 32%
**Table 4** Respondents by Region

<table>
<thead>
<tr>
<th>City</th>
<th>Share of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kyiv</td>
<td>9.3%</td>
</tr>
<tr>
<td>Donetsk</td>
<td>5.9%</td>
</tr>
<tr>
<td>Dnipropetrovsk</td>
<td>5.8%</td>
</tr>
<tr>
<td>Kharkiv</td>
<td>5.7%</td>
</tr>
<tr>
<td>Odesa</td>
<td>4.9%</td>
</tr>
<tr>
<td>Simferopol</td>
<td>4.6%</td>
</tr>
<tr>
<td>Lviv</td>
<td>4.3%</td>
</tr>
<tr>
<td>Zaporizhia</td>
<td>3.9%</td>
</tr>
<tr>
<td>Lugansk</td>
<td>3.8%</td>
</tr>
<tr>
<td>Vinnytsia</td>
<td>3.5%</td>
</tr>
<tr>
<td>Mykolaiv</td>
<td>3.4%</td>
</tr>
<tr>
<td>Cherkasy</td>
<td>3.3%</td>
</tr>
<tr>
<td>Kherson</td>
<td>3.3%</td>
</tr>
<tr>
<td>Lutsk</td>
<td>3.3%</td>
</tr>
<tr>
<td>Chernigiv</td>
<td>3.2%</td>
</tr>
<tr>
<td>Chernivtsi</td>
<td>3.2%</td>
</tr>
<tr>
<td>Ivano-Frankivsk</td>
<td>3.2%</td>
</tr>
<tr>
<td>Khmelnytsky</td>
<td>3.2%</td>
</tr>
<tr>
<td>Poltava</td>
<td>3.2%</td>
</tr>
<tr>
<td>Rivne</td>
<td>3.2%</td>
</tr>
<tr>
<td>Ternopil</td>
<td>3.2%</td>
</tr>
<tr>
<td>Kirovograd</td>
<td>3.2%</td>
</tr>
<tr>
<td>Uzhgorod</td>
<td>3.2%</td>
</tr>
<tr>
<td>Zhytomyr</td>
<td>3.2%</td>
</tr>
<tr>
<td>Sumy</td>
<td>3.1%</td>
</tr>
</tbody>
</table>

**Figure 6** Respondents by Management Level

- CEO: 4%
- CFO: 4%
- Chief Accountant: 8%
- Chief Economist: 15%
- Other: 18%
- Deputy Director: 48%
- General Manager / Director: 48%

**Figure 7** Respondents by Gender

- Female: 55%
- Male: 45%
Main Findings

- Many of the general improvements in the Ukrainian business environment seen between 2000 and 2001 have suffered setbacks in 2002. This year, surveyed firms have rated most aspects of the overall business climate in Ukraine as more problematic than they had in 2001. Firm assessment of difficulties raised by issues such as political instability, anti-competitive practices, corruption, and state interference in business activities has jumped by 10 or more percentage points year-on-year.
- Firms rate taxation as the main barrier to business activities, with 70% citing the system of taxation as an obstacle to growth and development. More than half of all firms also cited frequent changes to legislation, anti-competitive practices of other firms in the market, political instability and corruption as serious barriers to business activities.
- Ukrainian enterprises have rated criminal pressure as last on the list of possible barriers to their activities. These results coincide with the previous survey findings: firms have consistently rated criminal pressure as the least serious barrier to operations over the past three years.
- While most firms are relatively satisfied with the work of central authorities, Ukrainian enterprises remain much more critical of their local business climate and the actions of local authorities. Less than a third of firms believe that the actions of local authorities do not impede business operations. A quarter of firms consider the business environment in their city as conductive to investment and growth, while under one in five believe that local authorities strive to create equal opportunities for entrepreneurs.
- Overall, survey results show that SMEs are less satisfied with the local business environment than are large enterprises.

The SME Sector

Any analysis of the Ukrainian SME sector must be expressed in terms of estimates. The State Statistics Committee, which keeps records of all registered firms, does not employ a distinction between medium and large enterprises. Consequently, all official statistics in Ukraine consider SMEs as firms with less than 50 employees, and even more significantly, individual entrepreneurs are not included in these statistics. At the same time, official data does not of course take into account the level of shadow sector activity, which is estimated to represent about 50% of Ukraine’s GDP.

By contrast, in Europe, SMEs are defined as enterprises with 250 or fewer employees, and include the self-employed, which make up the greater share of SMEs in many of these countries. Shadow sector activity, while not absent, is estimated to account for less than 10% of sales of firms in the European Union.

SMEs make up 99% of all enterprises in the European Union, employ three quarters of the labor force and account for nearly two thirds of GDP. In Ukraine, these indicators, when established by official sources, are significantly lower (Table 5). However, given the variance in definitions of SMEs, any detailed analysis comparing Ukraine’s official statistics with those of Europe, including Eastern Europe, is rendered effectively irrelevant.

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1The full list of business environment issues, as rated by firms in 2002, can be found in Annex 3 of this report.
2A Ukrainian individual entrepreneur is between the status of the self-employed and a micro enterprise by European standards. In Ukraine, individual entrepreneurs may have up to 50 employees and a turnover of under UAH 1 million (US $189,000). Often, this form is preferable for tax purposes - individual entrepreneurs with less than 10 employees (a European micro-enterprise) and turnover of less than UAH 500,000 (US $94,000) pays between UAH 20 and UAH 200 (US $3.8 and $38) per month in taxes, plus an additional 50% for each employee. It is estimated that there were about 1.7 million individual entrepreneurs in Ukraine in 2001.
Business Environment in Ukraine

For purposes of estimation, if individual entrepreneurs are added to official statistics on the number of small enterprises, the number of SMEs in Ukraine per 1000 people is roughly comparable to showings in Europe (Figure 8). At the same time, estimates on employment and GDP share for individual entrepreneurs and enterprises with between 50 and 250 employees are so unreliable as to prevent assigning verifiable figures to the SME sector as a whole, and effectively precludes discussion of the contribution that the sector makes to employment and productivity of Ukrainian enterprises.

**Table 5** Varieties in SME Definitions Hinders Comparative Analysis

| Country    | Definition of SMEs by # of Employees | # of SMEs per 1000 population | SME % of GDP | SME % of employment | CPI 2002  

<table>
<thead>
<tr>
<th>Country</th>
<th>UK</th>
<th>Germany</th>
<th>EU</th>
<th>USA</th>
<th>Japan</th>
<th>Poland</th>
<th>Czech Republic</th>
<th>Russia</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td># of SMEs</td>
<td>46</td>
<td>37</td>
<td>45</td>
<td>74</td>
<td>50</td>
<td>n/a</td>
<td>n/a</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td># of SMEs</td>
<td>50-53</td>
<td>50-52</td>
<td>63-67</td>
<td>50-52</td>
<td>52-55</td>
<td>49</td>
<td>34</td>
<td>12</td>
<td>7</td>
</tr>
<tr>
<td># of SMEs</td>
<td>49</td>
<td>46</td>
<td>72</td>
<td>54</td>
<td>78</td>
<td>61</td>
<td>44</td>
<td>16</td>
<td>19</td>
</tr>
<tr>
<td># of SMEs</td>
<td>8.7</td>
<td>7.3</td>
<td>7</td>
<td>7.7</td>
<td>7.1</td>
<td>4.0</td>
<td>3.7</td>
<td>2.7</td>
<td>2.4</td>
</tr>
</tbody>
</table>

For Ukraine and Russia statistics are for small enterprises only, and do not include individual entrepreneurs. Sources: The Resource Center for Small Business (http://docs.rcsme.ru/rus/RC/Statistics); UN Economic Commission for Europe; Russian State Statistics Committee; Szabo, A. (2000): Development of the SME Sector in the Visegrad Countries; Institute for Economic Research and Policy Consulting (IER).

**Figure 8** The Number of SMEs and Individual Entrepreneurs in Ukraine is nearly the same as in Developed Market Economies (number of SMEs per 1000 people)

For Ukraine and Russia statistics are for small enterprises only, and do not include individual entrepreneurs. Sources: The Resource Center for Small Business (http://docs.rcsme.ru/rus/RC/Statistics); Russian State Statistics Committee; Ukraine State Statistics Committee; Institute for Competitive Society.

**SME Policy in Ukraine**

In the early 1990s, the Government of Ukraine established the State Committee on Promotion of Small Enterprises and Entrepreneurship, displaying its understanding of the importance of the role of SME development in the process of transition. The Committee has since undergone several transformations, and now forms the Committee on Regulatory Policy and Entrepreneurship, under the Cabinet of Ministers of Ukraine. The key tasks of the Committee include:

- Participation in the development and implementation of a unified state policy in the field of entrepreneurship;
- Coordination of executive branch activity on development and implementation of unified regulatory policy for private enterprise, licensing of entrepreneurial activity and state registration of enterprises;
- Contribution to the formation of a system for financial, credit, consulting and informational support for entrepreneurs.
SME activity, however, depends not only upon the work of the Committee, but also upon decisions taken by a number of other institutions working within central and local government, as well as on development of regulatory policy, on infrastructure, on criminal activity and corruption, quality of labor and the climate of competition. All of the above define how and to what extent Ukraine’s SMEs will grow and develop. Encouraging the growth and development of SMEs, furthermore, is not simply a policy debate. As the European example shows, in a modern economy, SMEs play a determining role in reducing unemployment, increasing competition, and supporting economic growth.

The creation of a coherent government policy on SME development must nonetheless be seriously impeded by a lack of reliable statistical information on the sector. Small and medium enterprises, as a separate sector of the economy, remain undefined, and data on SMEs remains difficult to obtain, hampering statistical analysis and monitoring of enterprise activity by size of enterprise. Such a situation prevents not only effective and targeted policy development, but likewise significantly complicates the government’s ability to evaluate its policy decisions.

**Barriers to Enterprise Development**

For this report, entrepreneurs were asked to separately rate the significance of a set of 16 factors, based on the level of difficulty that these present for the operations of their firm. The results are presented in Figure 9. This overview will take a look at a number of these selected factors in turn, and further, the report will concentrate on three issues that are generally considered critical for the development of SMEs: the availability of external financing, the system of taxation, and the overall regulatory environment for private enterprise.

![Figure 9](image-url)

**Figure 9**  
Key Barriers to Business Development in 2002  
(% of all firms)
Over the past three years, taxation has regularly topped the list of barriers to business development in the opinion of Ukrainian firms. In 2002, the tax system is followed closely by the lack of stability in legislation, with each of these factors cited as a major or significant obstacle to operations by about 70% of all surveyed enterprises. Unfair competition, corruption, and political instability are causes of concern for more than half of Ukrainian companies. Over 40% of firms then cite the regulatory environment, lack of external financing and the business climate at the local level as serious obstacles. The actions of the central government are considered to be an obstacle by 35% of firms, while criminal pressure is last on the list, with a quarter of companies citing it as an obstacle to their operations and development.

This year, firms have rated the vast majority of the issues presented in Figure 9 more severely than they had in 2001. The two exceptions are firm assessment of taxation and external financing – the former remains unchanged while the latter has reduced by a single percentage point. All other factors have been judged significantly more severely in 2002. Especially poignant is the jump in acuteness of government intervention in business activities. The work of both central and local government institutions were considered to cause serious impediment to over a third of all surveyed firms (Table 6). Enterprise appraisal of the full list of potential barriers covered by the survey, with comparative results over the past three years, is available in Annex 3 of this report.

<table>
<thead>
<tr>
<th>Issue</th>
<th>2002</th>
<th>2001</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxation</td>
<td>70</td>
<td>70</td>
<td>83</td>
</tr>
<tr>
<td>Unstable Legislation</td>
<td>69</td>
<td>63</td>
<td>n/a</td>
</tr>
<tr>
<td>Anti-Competitive Practices</td>
<td>56</td>
<td>45</td>
<td>53</td>
</tr>
<tr>
<td>Political Instability</td>
<td>51</td>
<td>40</td>
<td>n/a</td>
</tr>
<tr>
<td>Corruption</td>
<td>51</td>
<td>39</td>
<td>46</td>
</tr>
<tr>
<td>Inflation, Economic Instability</td>
<td>48</td>
<td>45</td>
<td>65</td>
</tr>
<tr>
<td>Regulatory Environment</td>
<td>43</td>
<td>38</td>
<td>44</td>
</tr>
<tr>
<td>Obtaining External Financing</td>
<td>41</td>
<td>42</td>
<td>24</td>
</tr>
<tr>
<td>Lack of Skilled Labor</td>
<td>41</td>
<td>41</td>
<td>n/a</td>
</tr>
<tr>
<td>Local Authorities Interference in Business Activities</td>
<td>40</td>
<td>23</td>
<td>24</td>
</tr>
<tr>
<td>Central Government Authorities Interference in Business Activities</td>
<td>35</td>
<td>19</td>
<td>n/a</td>
</tr>
<tr>
<td>Criminal Pressure</td>
<td>26</td>
<td>13</td>
<td>15</td>
</tr>
</tbody>
</table>

Legal Awareness and Information on Legislative Change

According to survey results, the rate of legislative change in Ukraine is cited as an obstacle to business operations by over two thirds of surveyed companies. Nevertheless, Ukrainian firms have a relatively high awareness of their legal rights, as well as of laws covering their business activities (Figure 10). On average, more than 85% of respondents indicated that they have good knowledge of legislation related to business activities. Moreover, as larger firms have better possibilities of recruiting legal specialists, it is natural that large enterprises have a somewhat higher level of legal awareness than SMEs.
The high level of firm awareness of new regulations covering their activities was further highlighted by firm responses to a specific question on knowledge of laws on private enterprise, which were adopted in 2002-2003. Only 5% of enterprises indicated that they were unaware of any of the laws or amendments listed in Figure 11.

Media remain the most cited source of information for businesses of all sizes, while lawyers and law firms are in second place. The use of commercial services such as lawyers, consulting firms and accountants as sources of information increases as firms get larger and subsequently can employ them more often. Results show that legal information is also provided by authorities to firms of different sizes, while business associations and trade unions play a relatively minor role. The use of the internet is equally popular across firms of all sizes. For small firms, survey results show that friends and colleagues are also an important source of information on legislative change. Their role is by and large replaced by law firms and consulting companies as firms grow and can afford to employ such services regularly.
Competition and Anti-Competitive Practices

About 7% of surveyed companies claimed to be market monopolies in 2002. Another 2% share the market with one competitor and 6% of companies have two or three rivals. It may therefore be assumed that the vast majority of firms in Ukraine are working in a relatively competitive environment. Yet, over half of surveyed firms considered the business environment in Ukraine to be discriminatory: the issue of unfair competition was rated to be one of the key barriers to business operations, with over half of all enterprises judging it to be a major or significant obstacle to their firm (see Figure 9).

These companies declare that the overall environment in which they work is inequitable due to the influence of a number of supplementary factors. Nearly half of surveyed firms believe that the illegal dissemination of confidential information is a significant or major obstacle to business. For every second firm, collusion of competitors on the market is a serious obstacle, while for 40% a serious issue is competitors providing falsified information on goods registered at customs. About 38% of companies are seriously hampered by competitors illegally using their trademarks, while over a third believe that competitors can influence customs officials to purposely delay their goods at customs, thus putting significant or major obstacles in the way of their business activities.
It was found that customs officials are not the only authorities involved in uncompetitive activity. Among the barriers established by state officials, more than half of firms cited the creation of favorable conditions for competitors by city authorities to be a major or significant obstacle. The provision of privileged access to clients was an issue for over 40% of firms, as were state subsidies and special tax provisions, as well as privileged access to land plots and buildings. Privileged access to infrastructure for competitors is cited as an obstacle by more than a third of all companies.

### Figure 14
Many Firms Believe an Uncompetitive Business Environment is Created Through the Actions of Local Authorities
(% of all firms rating each factor as a barrier to business, 2002)

![Bar chart showing the percentage of firms rating each factor as a barrier to business, 2002.](image)

<table>
<thead>
<tr>
<th>Factor</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Favourable conditions created by decisions of authorities (including issuing of permits)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Privileged access to clients</td>
<td>40%</td>
<td>50%</td>
<td>60%</td>
</tr>
<tr>
<td>State subsidies (including tax breaks)</td>
<td>35%</td>
<td>45%</td>
<td>55%</td>
</tr>
<tr>
<td>Privileged access to credits</td>
<td>30%</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Privileged access to land plots and buildings</td>
<td>25%</td>
<td>35%</td>
<td>45%</td>
</tr>
<tr>
<td>Privileged access to infrastructure</td>
<td>20%</td>
<td>30%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Economic and Political Stability

At a macro level, recent years have seen a level of relative stability economically as well as politically, if conclusions are drawn from basic macro indicators (Table 7).

### Table 7
Indicators of Stability at the Macro Level, 2000–2002

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer Price Index</td>
<td>28.2%</td>
<td>12%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Producer Price Index</td>
<td>20.9%</td>
<td>8.6%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Exchange Rate UAH /US $</td>
<td>5.4</td>
<td>5.4</td>
<td>5.3</td>
</tr>
<tr>
<td>Political</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of high state officials dismissed</td>
<td>311</td>
<td>173</td>
<td>71</td>
</tr>
</tbody>
</table>

Note: CPI and PPI indicate year on year change, as an average of the period

However, according to the survey, in 2002 a larger portion of firms were worried about instability at the macro level than in 2001 (Figure 15). As economic indicators in Ukraine have remained relatively stable over the past two years, firm unease with the situation developing at the macro level in 2002 is most likely associated with political uncertainty. Moreover, the share of firms for which political instability is a serious obstacle for business grew substantially between 2001-2002, placing this factor in front of economic instability in the minds of businesses.
Labor and Employment

Several years after completion of small scale privatization, and in the aftermath of the privatization of large enterprises, a significant portion of firms in Ukraine still have difficulties with labor and employment. Over two thirds of small firms and four of five large enterprises cite a lack of skilled labor to be a relevant concern. Of these firms, nearly half of small firms and about 60% of medium and large enterprises perceive this issue as a major or significant obstacle to their business.

While many international experts recognize that Ukraine has a large pool of relatively inexpensive skilled labor, responses of surveyed firms suggest continuing problems with the efficiency of Ukraine’s labor market. However, responses to this question depend significantly on the extent to which the typical firm is currently able to invest in the development of skilled labor, and offer the salaries, work environment and incentives that highly skilled workers require.

Criminal Pressure

Surveyed firms have considered criminal pressure as the least significant barrier to business of the options that they have been asked to rate over the past three years (see Figure 9). Nevertheless, this issue remains important, as every forth manager considered criminal pressure as a serious problem to his or her business in 2002.

Figure 14

Lack of Skilled Labor Remains a Problem for Many Companies

(% of firms citing a lack of skilled labor as relevant, and as a barrier to business)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 15

More Firms View Economic and Political Instability as Serious Impediments to Their Business

(% of firms rating each factor as a barrier to business, 2001 – 2002)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political instability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Macroeconomic instability</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 16

Criminal Focus Shifted Towards Medium Firms, While Intensity Increased

(% of all firms rating criminal pressure as a barrier to business, 2001 and 2002)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
It should be noted that the situation has deteriorated from 2001 and 2000, when 15% or less of respondents had viewed pressure from criminal elements as a serious impediment to their operations. Along with a general increase of criminal pressure, the attention of criminals looks to have become more selective over 2002 and shifted from large firms towards entities of a medium size. One possible explanation of this change is that large firms were able to create their own security service, whereas smaller firms usually rely on external services. In general, as can be seen from Figure 17, a greater share of SMEs view criminal pressure as a barrier to their operations than do large firms.

Enterprise Attitude Towards Central Government Institutions

There are two main ways of forming entrepreneurial opinion on the quality of work of central government bodies. On the one hand opinion is formed through direct interaction with representatives of central authorities at the local level. Examples include the State Tax Administration, State Automotive Inspection, Ministry of Internal Affairs, etc. On the other hand, when no local representative is envisaged or when the law does not require such interaction, opinion is formed mainly through the media. Opinions on the Ministry of Foreign Affairs, National Bank of Ukraine, Cabinet of Ministries, and to some extent Parliament, are formed in this way.

The power of a governmental body depends on the extent of its authority. In particular, for firms, this can often be reduced to the frequency of contacts they are obliged to have with an agency, as required by law or other regulations. Therefore, it is quite natural that the more often firms come into contact with representatives of central authorities, the more often they cite the activity of these authorities as counteractive to their business operations.

In addition, frequent contacts with representatives of an agency create the necessary prerequisite for potential rent seeking behavior on the part of governmental employees, and contribute to the negative opinion of firms on the authorities which they encounter most often.²

For agencies with which firms do not come into daily contact, the recent improvements in the economy and an increase macroeconomic stability must clearly be key factors positively influencing the opinions of entrepreneurs. In general, survey results show that about one in five firms consider the actions of central authorities as impeding business development. Moreover, the change in opinion that occurred between 2000 and 2002 has been positive in the main (Figure 18).

² The relationship between contact with regulatory agencies and requirements for unofficial payments is documented in various sections of this report (see for example, Inspections). Corruption is cited as a barrier to business operations by half of surveyed companies.
Figure 18  Perceptions of Government Agencies is Improving, 2000 – 2002
(% of firms stating that an agency impedes business development)

- State Tax Administration
- Sanitary and Epidemiological Service
- Road Police
- Customs Committee
- State Committee on Energy Conservation
- Parliament
- State Construction Committee
- Cabinet of Ministers
- Presidential Administration
- Ministry of Internal Affairs
- State Standardization Committee
- Ministry of Finance
- Ministry of Ecology
- National Bank
- Antimonopoly Committee
- Ministry of Labor
- Ministry of AgriPolicy
- State Committee of Statistics
- Ministry of Justice
- Ministry of Health Care
- Ministry of Transportation
- State Committee of Communication
- State Committee on Regulatory Policy
- Ministry of Economy
- Ministry of Foreign Affairs
- Higher Arbitration Court
- State Committee on Information Policy

2002
2000
--- average 2002
--- average 2000

%
Local Authorities and the Regional Business Climate

About a quarter of survey respondents believe that local authorities apply their efforts to promote business development in their city or region. Moreover, the share of firms positively assessing the work of local authorities has decreased over the past three years (Figure 19).

This is a sharp divergence from the trend in firm appraisal of the work of central government agencies, which has not only improved but remains roughly comparable to results obtained in established market economies, where about two thirds of firms claim to be satisfied with the work of both central and local authorities.⁹ In this sense, Ukraine’s showing is somewhat surprising – the sharp variance between enterprise evaluation of the quality of central and local government is noteworthy.

In 2002, the sharpest criticism leveled at local authorities was their promotion of unfair competition: less than one in five firms agreed with the statement that local authorities strive to create equal opportunities for all firms. The greatest change of opinion over the past three years, however, was on the question of the extent to which local authorities precisely and accurately implement the laws and regulations of central government agencies, which dropped by nearly 15 percentage points. The share of companies agreeing that the decisions of local authorities do not impede business development dropped by 6%, and represents the opinion of less than a third of all firms surveyed. Of all questions posed of the actions of local authorities, this was the most positively assessed.

Figure 19 The Business Environment at the Local Level Deteriorated Between 2000 and 2002 (% of all firms agreeing with the statement)

---

Figure 20 below displays firm assessment of their local business climate, by oblast. As can be seen, firms in Khmelnytsky, Ivano-Frankivsk, Cherkasy, Kirovograd and Simferopol are quite critical of local authorities insofar as they assist the development of business in the region. Meanwhile, in Sumy, Poltava and Rivne firms are relatively satisfied with the work of the local government.

Overall, large firms are less critical towards local authorities, while the perceptions of SMEs do not differ significantly between small and medium firms (Figure 21). This suggests that it is not only relative financial strength (or volume of taxes paid to local budgets, which is assumed to be proportional to size), but other factors that matter. On one hand, local authorities may be less demanding towards large firms due to the strong relationship between city authorities and management of large enterprises, which in Ukraine, as in many countries, develops as a matter of course due to the importance of such enterprises to the regional economy and to local employment. In Ukraine there are some additional factors however, for example, in many cases large firms directly subsidize a number of social services such as schools and kindergartens, hospitals and theatres, which are important factors of social stability in regional cities.
Services provided to businesses at the local level are most often related to either the carrying out of government regulatory functions, or the provision of communal services which are potentially commercial.

On questions concerning execution of government functions, firms assess the State Automotive Inspection, the Architecture Department and the Land Resources Department more critically than other state service providers (Figure 22 left).

When firms are asked to assess the quality of communal services provided in their city (Figure 22 right), results show that the Road Maintenance Department, government health care institutions and the provision of heating and energy were rated as less than minimally satisfactory across Ukraine. It should be remarked that, overall, no regulatory authorities or state service providers had a rating above that of minimally satisfactory.

It should be noted that all of the services covered in Figure 22 (right) are either fully or partially covered from the state budget. Budgetary problems and insufficient financing naturally lead to a decrease in quality. At the same time, being municipally owned, these service providers are monopolies and thus cannot provide services of an adequate quality without substantial levels of regulation and oversight.
Local Investment Climate

Respondents were asked to evaluate the extent to which the entrepreneurial climate in their city encourages investment and the further development of their business. Figure 23 displays firm attitudes towards possibilities for investment and business expansion in their city, amongst the regions of Ukraine.

**Figure 23**  The Business Environment in my City Encourages Investment and Enterprise Growth

(% of firms agreeing with the statement)
Obtaining External Financing as a Barrier to Business

In 2002, obtaining external financing was cited as a barrier to operations and development by 41% of surveyed firms. This situation has not changed significantly over the past two years, in 2001 nearly the same share of firms had rated external financing options as a barrier to their business activities. The real change occurred between 2000 and 2001, when the share of firms considering obtaining financing as a barrier nearly doubled.

Ukraine’s economy has been growing since the year 2000, and results suggest that an increasing portion of local firms are now looking to develop and further expand their activities. In this situation, as will be seen in this report, Ukraine’s banking sector is lagging behind the trend. Consequently, the difficulty of obtaining external financing is an issue which has increased in importance in the eyes of entrepreneurs over the past three years.

Specific Difficulties in Obtaining External Financing

High interest rates and high collateral requirements remain the two key difficulties for firms looking at external financing options. At the same time, results displayed in Figure 25 show that most of the specific difficulties associated with obtaining financing have become more acute for firms between 2001 and 2002.
High interest rates were cited as a difficulty by 57% of surveyed firms. Although the average commercial interest rate for bank credits in local currency had decreased to 22% by the end of 2002, this figure represents an interest rate of nearly 2% a month. For many firms considering bank financing as an option for expanding operations, this remains an excessive figure, especially if long term financing is being considered. High collateral requirements, meanwhile, were also considered to present serious difficulties for more than half of surveyed companies.

**Figure 25**  **Key Financing Difficulties, 2001 - 2002**

(\% of all firms)

<table>
<thead>
<tr>
<th>Difficulties</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rates</td>
<td>50</td>
<td>45</td>
</tr>
<tr>
<td>High collateral</td>
<td>40</td>
<td>35</td>
</tr>
<tr>
<td>Availability of long term credits</td>
<td>30</td>
<td>25</td>
</tr>
<tr>
<td>Access to information on financial resources</td>
<td>20</td>
<td>15</td>
</tr>
<tr>
<td>Norms of amortization</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Requirements on credit history</td>
<td>5</td>
<td>2</td>
</tr>
</tbody>
</table>

**Overview of the Ukrainian Banking System**

At the end of 2002 the banking system of Ukraine consisted of the National bank of Ukraine (NBU) and 157 additional banks which had obtained licenses from the NBU to conduct banking operations. Out of these, 136 were registered as joint-stock banks (94 public corporations, 2 state owned banks, 42 closed stock banks, 20 limited partnerships, 1 bank was registered as a cooperative).

The total credit portfolio of banks in Ukraine was about UAH 46.7 bn. (US $8.8 bn.). Credits provided to business comprised 82% of this portfolio (an increase of 46% over 2001 figures). Long term credits (over 3 years) accounted for 28% of all credits provided, which is an increase of 92% over 2001. Over 2002, the quality of the credit portfolio has improved: the share of prolonged credits has decreased from 7% to 5%, the share of bad credits has decreased from 6% to 5%. Deposits of firms make up 37% (UAH 20,021 million) of bank liabilities, and the deposits of individuals - 35% (UAH 19,088 million).

In general, the current problems of the Ukrainian banking system are related to (a) lack of trust on the part of the population, (b) high credit risk, (c) high operational costs and (d) limited use of capital.

The last three years have seen a period of macroeconomic stability (low inflation and a stable exchange rate), which has brought significant increase in deposits of natural persons (68% increase in 2001 and 70% in 2002 compared to the previous year). Yet despite this, the general trust of population in the banking system is low. According to a recent GFK-USM survey, 80% of households do not trust banks.

The high risk associated with commercial banking activities is based in a situation of poor legal protection for creditors. The most cited problem in this area are ineffective procedures for pledging assets. In addition, in Ukraine the ‘Moratorium for compulsory sale of property’ put a ban on the sale of assets of enterprises in
which the government stake is more than 25%. This law effectively prevented the release of bank credits to a significant portion of enterprises starting at the end of 2001, as no other viable ways of pledging are available to many firms. In such a situation, high risk premium inevitably contributes to high interest rates in the system.

Despite the fact that the National Bank of Ukraine has decreased its discount rate (from 45% in 2000 to 7% currently) and reservation requirements (from 17% to 8%) considerably over recent years, commercial rates on credits did not decrease accordingly – from 40% to 18% as of mid 2003. According to experts, the major reason for high interest rates are the high costs of capital formation. Data also suggests that high operational costs, not related to banking activities, are another major contributor to high rates for credit.

Many of the above difficulties induce banks to set high interest rates and high collateral requirements, thereby limiting enterprises’ chances of borrowing money for day to day activities and investments.
External Financing Needs

Just under 40% of interviewed firms stated that they needed to draw financial resources from external sources in 2002. Results predictably show that the need for external financing increases with the size of the firm.

The relationship between size of firm and need for external financing grows with the size of the firm across all sectors of the market, with the single exception of financial services firms, where capital formation is part and parcel of business. Firms in which the state is a minor shareholder (up to 25%) showed the same need for external financing as private firms. However, firms with larger government stakes more often indicated need for money from the outside.

Uses of External Financing

The major reasons for which enterprises seek additional financing are twofold: working capital and investments. According to survey results, about 26% of firms needed external financing to increase working capital, while for the majority of firms financing was required for direct investments, and a much less significant share needed financing for marketing activities.

A detailed breakdown of responses shows that businesses needed external financing to develop their core activities: working capital was required for enterprises in trade, means of transportation for transportation firms, technology and equipment for manufacturing companies, building renovation and construction for firms in the public catering & hotels sector (Figure 28). In general, the most popular types of potential investments across sectors were new technology & equipment (33% of firms wanting to invest), major repairs of buildings (19%) and acquisition of new transportation (15%). Marketing efforts, meanwhile, were of some importance to service firms as well as to enterprises involved in trade, manufacturing and public catering.
Survey results show that bank loans play a relatively minor role as sources of enterprise investment. For SMEs requiring external financing in 2002, bank credits constituted about 18% of all sources of investment. Internal resources (such as amortization and retained earnings), remained the major identified sources of investment for companies of all sizes in 2002.

For small firms, the second most common form of investment, after internal sources, were private savings, cited by a third of respondents. The popularity of private savings as a source of investments is an indicator of the extent to which SMEs, and especially small enterprises, are reluctant or simply unable to obtain bank financing for their projects. As firms grow, however, these private savings are largely replaced by bank credits, as can be clearly seen from the figure above.
A portion of surveyed companies also cited having used ‘other’ sources to finance their activities in 2002. These include such resources as outside domestic or foreign investors (7% of these firms), non-bank loans (4%), leasing agreements (2%), state funds (2%), and other unspecified sources (4%). The relatively low share of firms citing these resources, which amounted to 18% of all firms, is an indicator their lack of availability or accessibility. This is especially important in the case of leasing, which can be a viable and affordable alternative to bank financing for SMEs looking to grow their business. The box “Leasing” at the end of this section looks at some of the issues which have been hampering the development of the leasing industry in Ukraine.

Banks as Sources of Financing

According to the survey, nearly half of all firms (45%) citing a needing for external financing did not apply to a bank for credits. Firms needing financing, yet which did not apply for bank loans, made this decision on a number of grounds. The key reasons cited were high interest rates, named by over a third of respondents, and high collateral requirements, identified by another fourth. One in six firms was uncertain in its ability to repay the loan, while banking bureaucracy and unavailability of long term credits were each cited by around 10% of firms not turning to banks. Unofficial payments as well as other reasons were named in just 2% of cases.

In looking at responses by size of firm, noteworthy is the fact that unavailability of long-term credits and the need to make unofficial payments were mentioned equally often by firms of different sizes. ‘Banking bureaucracy’ (which also includes lengthy legalization of collateral) was less of an obstacle for large firms than for smaller ones, as transaction costs per borrowed hryvnia decrease with size of credit. On the other hand, somewhat unexpectedly, a greater share of large and medium firms cite high interest rates as an obstacle to bank financing than do small firms. While the scope of operations of small firms allows them to rely on private savings, this is not the case for many larger firms, thus making the latter somewhat more sceptical towards financing terms.
These results indicate that three quarters of firms do not apply to banks because of obstacles which are outside of their direct control, and which are related to high risks that lie at the lender’s side. High collateral and significant banking bureaucracy are direct consequences of the lender’s wish to secure repayment of credit. Interest rates are strongly affected by a high risk premium. The limited availability of long term credits, meanwhile, is a factor of the uncertainty associated with the future.

While firms tend to underestimate the risk of credit non-payment, the survey has shown that about 80% were confident of their ability to repay. Thus it can be assumed that these firms would apply for bank credits if perception of risk in the economy was adequate, and the lending terms stipulated by Ukrainian banks were at a level acceptable to firms.

**Obtaining Bank Credits in Ukraine**

Not very surprisingly, large firms have better chances of receiving credit than smaller ones. This characteristic is not only common to Ukraine. Among the reasons for this are lower transaction costs and better choices of assets to serve as a collateral. On the other hand, large enterprises often do not have sufficient savings to finance their working capital needs. Therefore the higher popularity of credits to increase working capital, coupled with a higher need for working capital cited by large firms, contribute to improved chances for receiving bank credits.

As can be seen from Figure 33, firms looking to increase working capital have the highest chances of having their credit application approved. As working capital requirements are usually short-term financing solutions, this result is not surprising. Firms looking to invest in assets have a slightly lower than average chance of receiving the loans that they request. Marketing activities, meanwhile, have the lowest chances of success, as they are non-material and cannot serve as collateral, and the return is usually uncertain, making them on average less ‘interesting’ for banks.
Reasons for non-repayments of bank credits
About 14% of firms ran into problems with timely repayment of bank credits. The major reasons for non-payments cited by respondents were typical business-related problems: failure to carry out contracts by business partners or alteration of the state of the market, while policy-related problems, such as change in taxation or currency risks were cited less often.

Reasons for refusal of bank credits
On average, 24% of firms applying for bank credits did not receive them in 2002. Figure 34 shows that the main reason most firms did not obtain the bank credits that they were seeking was insufficient collateral.

In general, previous findings support the view that the probability of receiving credit is higher for projects with better collateral - large firms are more likely to receive credits and banks find new equipment slightly more attractive than repaired. Yet it should be noted that collateral is not the only way for a bank to insure repayment of credits. Banks naturally see projects which are underpinned by additional sources of financing, including financing which comes from the company itself, as less of a risk. Not surprisingly, the second most commonly cited reason for not receiving bank credits was a lack of personal resources to invest in the project.

Other common reasons for failure to obtain bank credits were: ‘low priority of project’, ‘not a worthwhile project’, and ‘lack of documentary support for the project’, which can be generalized as problems relating to the quality of the petition submitted to the bank. In 16% of cases, companies were not able to receive bank credits due to such factors. The existence of this ‘quality’ problem indicates, at least, a need for training firms to prepare projects and apply for bank loans with a greater chance of success.
Long term Credits

Figure 35 shows that long term credits in Ukraine are still the exception. While only a quarter of firms receiving bank loans obtained credits for a period of more than one year, less than 5% of firms obtained credits for more than three years.\(^1\)

![Figure 35 Long Term Loans Are Rare](image)

This phenomenon stems from the unwillingness of banks to provide long term credits, as well as from a reciprocal unwillingness of enterprises to take such loans. The reasons which preclude long term crediting by banks have been discussed above. For firms however, this unwillingness may be based in a number of factors.

While nearly half of surveyed firms stated that the lack of long term financing poses difficulties for them, it should be noted that less than one in ten cited the unavailability of long term credits as a key reason for not applying for bank loans (Figure 30). Therefore, the simple unwillingness of banks to take the risk of providing such loans is not a key issue for firms. Instead, results suggest that at current rates of interest, firms are unwilling to turn to banks to finance long term activities, and that most see the lack of extended financing options as inseparable from the problems of high interest rates and significant collateral requirements in Ukraine. At the same time, in order to obtain long term credits, firms are required to display the ability to plan their activities on a long term horizon, to credibly present banks with viable projects for financing, and to build confidence in a project by agreeing to also invest in the activities for which they seek to obtain financing.

Conclusions

Banks remain a relatively unpopular source of financing for Ukrainian firms. Of all firms surveyed, only 17% received a bank loan in 2002. Results of the survey show that half of surveyed firms which needed external financing were unwilling to turn to banks. Meanwhile, for SMEs needing external financing, bank credits accounted for just 18% of all investment sources.

Firms cite high interest rates as the key barrier to effective bank financing in Ukraine. Interest rates are also the main reason for firms to look for sources other than banks to finance their investment activities. In 2001, the average commercial lending rate (for credits in national currency) in Ukraine was 32%, compared to 9% in the US and 7% in Germany in the same year.\(^2\) Although the lending rate in Ukraine had dropped to about 22% by the end of 2002, this remains a figure for firms looking for financing to contend with. A recent survey\(^3\) posed questions on access to finance to firms in 80 countries across the world, and allows comparison of the situation in Ukraine with that of a number of other countries. Table 8 shows that firms in Ukraine were amongst the most severe when assessing the difficulties related to access to financing in their country.

### Table 8 Business Assessment of Difficulties in Obtaining Financing\(^4\)

<table>
<thead>
<tr>
<th></th>
<th>High interest rates</th>
<th>Collateral</th>
<th>Lack access to long term bank loans</th>
<th>Inadequate credit information on customers</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
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<td>7</td>
<td>8</td>
<td>9</td>
<td>9</td>
<td>8.3</td>
</tr>
<tr>
<td>Poland</td>
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<td>9</td>
<td>4</td>
<td>4</td>
<td>6.5</td>
</tr>
<tr>
<td>Slovakia</td>
<td>6</td>
<td>3</td>
<td>8</td>
<td>8</td>
<td>6.3</td>
</tr>
<tr>
<td>Turkey</td>
<td>8</td>
<td>5</td>
<td>7</td>
<td>5</td>
<td>6.3</td>
</tr>
<tr>
<td>Russia</td>
<td>5</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>5.8</td>
</tr>
<tr>
<td>Hungary</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>4.0</td>
</tr>
<tr>
<td>Germany</td>
<td>3</td>
<td>7</td>
<td>3</td>
<td>2</td>
<td>3.8</td>
</tr>
<tr>
<td>Spain</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>7</td>
<td>2.8</td>
</tr>
<tr>
<td>US</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1.5</td>
</tr>
</tbody>
</table>

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\(^1\)According to the National Bank of Ukraine (‘On Crediting’, September 28, 1995, #246), long term credits are defined as credits for a period of more than three years.

\(^2\)In 2001 real interest rates were correspondingly 10% in Germany, 7% in the US and 15% in Ukraine.


\(^4\)This table presents nine countries, selected from 80 available, and ranks them according to the share of respondents for whom certain parameter of financing were a significant major obstacle to business.
Ukraine’s economy is improving and the inflation which characterized much of the 1990s has been brought under control. However, with economic growth has come an increasing maturity of outlook on the part of Ukrainian enterprises. Firms looking to grow and expand their activities are progressively recognizing the role that viable external sources of financing can play in stimulating private sector development. Consequently, the continuing deficiencies in the banking sector in Ukraine have become more acute in the eyes of entrepreneurs.

Meanwhile, the population, as a general rule, continues to avoid using banks to deposit private savings. This explains the substantial level of private savings and internal resources that many firms have on hand to finance their investments, and also suggests that the majority of banks simply have a lack of cash to profitably lend to business. In 2002, the total credit portfolio of Ukraine’s banks was US $8.8 billion or about 21% of GDP. (This figure is around or over 100% of GDP in most established market economies)

For SMEs, leasing is a viable option, which is especially attractive in countries where access to finance is limited and collateral requirements are high. However, results of this survey show that only 2% of firms turned to leasing companies for investments in 2002. This is symptomatic of the current legislative basis in this field. Due to an unsettled legal framework, activities that are typical to well-developed banking systems such as leasing, microcrediting, or even mortgage loans remain unavailable for profitable use by banks and other financial institutions in Ukraine.

Leasing

Leasing is a mechanism by which an enterprise makes a small upfront payment to secure the right to use an asset, and then makes the remaining payments from cash flows generated from the use of the asset. The asset itself effectively serves as the collateral for the transaction, with the leasing company retaining ownership of the asset until it has been paid off. In OECD countries, leasing currently accounts for approximately 15-30% of all investment in capital assets, while in developing countries, this figure is lower, in the range of 0-15%. As survey results have shown, in Ukraine about 2% of respondents stated that they had used leasing mechanisms to purchase assets in 2002.

In countries were few enterprises have the resources to buy capital intensive equipment outright, and where collateral requirements are high while long-term, large scale loans are not available from banks, the value of a financial instrument such as leasing is felt all the more strongly. SMEs, in particular, benefit from leasing development as they tend to have more difficulties in qualifying for bank financing and often lack the capital to purchase fixed assets to grow their business.

Currently, only a handful of financial intermediaries in Ukraine are operating as leasing companies. Leasing development in Ukraine has been hampered by the difficulties that are present in many of the countries of the region, including:

- Problems in legal and tax treatment of financial lease transactions;
- Poor understanding among potential lessors and lessees of both the advantages and the mechanics of leasing;
- Lack of access to long-term financing.

The current legal environment includes significant disincentives to financial leasing. Contradictions and serious ambiguities in the legislative base make tax treatment and rights of parties to a lease difficult to comprehend. These difficulties have been hampering the active development of the leasing industry in Ukraine, and leasing remains unavailable to the majority of SMEs looking for external financing to develop their business.
Taxation and its Legal Basis

The tax system remains the number one barrier in Ukraine. There has been no change in firm perceptions of the relative level of difficulty caused by the tax regime: in 2002, as in 2001, 70% of firms cited taxation as a barrier to business.

In enterprise appraisal of the taxation system, Ukraine is similar to OECD countries, where firms are also quite critical of national tax regimes, with nearly 60% of firms in OECD countries citing taxation as an obstacle to their business. However, in Ukraine the difficulties of the tax system are magnified, as these stem not only from firm perceptions of current tax rates and the number of taxes for which a company is liable, but equally from the administrative burden involved in filing and calculating taxes as well as the frequency of changes to taxation legislation. The following examples serve to illustrate the rate of legislative change in the sphere of taxation in Ukraine: the law «On the Value Added Tax» was changed 5 times in 2002, and an additional 4 times as of mid-2003; the law «On Corporate Profit

Main Findings

- The system of taxation remains the key barrier to enterprise growth and operations according to Ukrainian firms. In 2002 as in 2001, 70% of firms cited taxation as a barrier to business.
- Ukrainian firms see the key difficulties of taxation as: high tax rates, unstable taxation legislation, and the overall number of taxes, each of which was cited as a barrier by more than three quarters of all surveyed firms.
- In 2002, nearly three quarters of eligible Ukrainian firms had switched to the simplified taxation system. Survey results show that the simplified tax has significantly decreased the barriers involved in taxation for small firms, which rate all of the aspects of the tax system as less of a burden than their larger counterparts.
- The typical surveyed firm paid an average of 8 different taxes in 2002, which is a reduction from the 10 total taxes firms reported paying in 2001. Due to the level of small firm participation in the simplified tax system, this number depends on size of enterprise: large firms paid an average 11 taxes, medium firms 10 and small 7. For firms of all sizes however, the number of taxes paid has reduced over the past two years.
- The share of sales that enterprises report paying to the budget in taxes has not changed between 2002 and 2001, and remains an average 28%. This result does not differ significantly by firm size: small firms report paying 27% of sales as taxes, medium 32% and large 31%.
- Firm managers estimate that the average company hides 21% of its sales from taxation. This figure is between the 26% reported in 2001 and 16% cited in 2000.

In enterprise appraisal of the taxation system, Ukraine is similar to OECD countries, where firms are also quite critical of national tax regimes, with nearly 60% of firms in OECD countries citing taxation as an obstacle to their business. However, in Ukraine the difficulties of the tax system are magnified, as these stem not only from firm perceptions of current tax rates and the number of taxes for which a company is liable, but equally from the administrative burden involved in filing and calculating taxes as well as the frequency of changes to taxation legislation. The following examples serve to illustrate the rate of legislative change in the sphere of taxation in Ukraine: the law «On the Value Added Tax» was changed 5 times in 2002, and an additional 4 times as of mid-2003; the law «On Corporate Profit

Figure 36 Perceptions of Taxation as a Barrier to Business Development, 2000-2002 (% of all firms)

Taxation was altered 6 times in 2002, and 5 times as of mid-2003; the Law «On the System of Taxation» was amended 3 times in 2002 and already 3 times by mid-2003.

This lack of consistency and stability in legislation begins with the overall legislative base: the Ukrainian tax system continues to operate without a single unifying law on taxation, although a draft Tax Code has been in Parliament for a number of years. Such a Code is needed to provide legislative stability, as the document would not only clearly define tax rates for some period of time, but also stipulate the procedure for accrual of taxes and as well as set a framework for the methods of their payment.

In addition to frequent changes to tax legislation, there are a number of administrative issues which make Ukraine’s system of taxation more demanding than that of many European countries. These include the administration of taxes and the terms of their calculation, as well as the deductions that firms are allowed to make from their taxable income base. In Ukraine, deductions remain far fewer than in many western European countries, and are accompanied by relatively large mandatory rates of returns to a number of social funds. Some of the additional key issues of the Ukrainian tax system, which set it apart from that of many western countries include:

- Depreciation rates for deducting investment in fixed assets;
- Lack of tax privileges for SME investors;
- Lack of tax allowances for R & D;
- Lack of significant tax breaks for start ups.

While the foundations of these problems are in some sense specific to the development of this region, the results are equally so: most experts estimate shadow sector activity to be equal to nearly half of official GDP figures. Many of these firms not only do not contribute to the government budget through any kind of formal relationship, but are equally not regulated by agencies which are responsible for the health and safety of the public. Moreover, findings for this report show that even for firms operating legally, firm managers estimate that the typical Ukrainian firm hides about 21% of sales from taxation.

**Specific Tax Aspects as Barriers**

While overall, the tax regime presents difficulties for nearly three in four Ukrainian firms, the specific aspects of the tax system which cause the majority of difficulties are high tax rates, changes to legislation, and the overall number of taxes, each cited as a barrier to business by between 75-80% of entrepreneurs.

Furthermore, businesses have rated all of the specific aspects of taxation more critically in 2002 than they had in the previous year, and overall results are closer to those obtained in 2000. Each of the issues displayed in Figure 37 was cited as a barrier by over half of all surveyed companies.

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2 Depreciation rates for fixed assets used for accounting purposes are higher than those which may be used for deducting the cost of an asset from taxation. This in effect prevents firms from ever writing off the full cost of an asset.

3 The simplified method of taxation (unified tax) does indeed simplify tax calculation, filing and reporting – however, as will be seen in this report, the share of sales that small firms pay as taxes is not significantly impacted by the unified tax.
At the same time, as will be shown throughout this section, there are significant differences of opinion between firms with less than 50 employees on the one hand and their larger counterparts on the other. It should be stressed that small firms cite the various difficulties inherent in taxation as less of a difficulty across the board (Figure 38). For a considerable portion the country’s small firms, therefore, the simplified taxation regime has decreased the burden associated with the leading administrative barrier for operating a business in Ukraine – the system of taxation.

### Figure 38  Specific Tax Issues as Barriers to Business Development by Firm Size in 2002 (% of all firms citing the issue as a major or significant obstacle)

#### Tax Rates

In 2002, 38% of enterprise managers claimed that of all taxes, paying the profit tax, at a rate of 30%, is the most troubling for their business. The relative level of discontent varies greatly by firm size, with around 50% of large and medium sized enterprises having difficulty with payment of profit tax, compared to less than a third of small firms.

It should also be noted that, for small firms, the most common response to the question of most troubling tax in terms of payment was «none of the above», given by 44% of enterprises with less than 50 employees.

Payment of VAT is the second most common hurdle for firms in Ukraine, with about a third of all surveyed firms having difficulty with the process. This is another problem which is accentuated for large and medium firms, with 38% of these firms claiming that they have difficulties with payment of VAT.

The difficulties with VAT payment center on a number of issues: on its accrual when accompanied by high levels of inter-enterprise arrears; on VAT exemptions for certain sectors and firms; and the on the continuing problem of the government’s backlog of VAT refunds for exporters. For business in Ukraine, these difficulties combine to construe an image of the VAT as a second corporate income tax rather than the consumption tax that it is meant to be. An additional, and purely administrative difficulty with VAT is the current requirement for most firms to file VAT returns based of their records with tax authorities each month, which for the majority of firms means visiting the tax office in person.
Calculating Tax Liability

In 2002, just under a third of enterprises claimed that calculating the profit tax for their firm was a difficulty (Figure 40). This assessment once again depends strongly on size of firm, with about 40% of all medium and large firms citing calculation of profit tax liability as a difficulty for their business. For small companies this was much less of an issue, with about a quarter having problems evaluating the profit tax liability of their firm.

The accounting system is less of an issue with VAT – an average of 17% of businesses had difficulty, although this figure ran to just under a quarter (23%) of large firms, which remains a significant share in absolute terms. Nearly half of all small firms claimed that no serious difficulties were caused during calculation of tax liability, which can be attributed to the comparative clarity and transparency of the simplified tax system.
A breakdown of the types of taxes, fees and duties that are applicable to enterprises in Ukraine is presented in Table 9.

<table>
<thead>
<tr>
<th>National</th>
<th>Local</th>
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<tbody>
<tr>
<td>Value Added Tax</td>
<td>Advertising Fee</td>
</tr>
<tr>
<td>Excise Tax</td>
<td>Communal Tax</td>
</tr>
<tr>
<td>Corporate Profit Tax</td>
<td>Hotel Fee</td>
</tr>
<tr>
<td>Customs Duty</td>
<td>Parking Fee</td>
</tr>
<tr>
<td>Government Duty</td>
<td>Open-air Market Fee</td>
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<tr>
<td>Real Estate Tax</td>
<td>Hippodrome Fee</td>
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<tr>
<td>Land Tax</td>
<td>Fee on the Use of Local Government Symbols for Commercial Purposes</td>
</tr>
<tr>
<td>Fee for Transportation of Natural Resources</td>
<td>Fee on Television or Movie Filming</td>
</tr>
<tr>
<td>Tax on Owning Transportation Vehicles</td>
<td>Fee for organizing auctions, competitive sales and lotteries</td>
</tr>
<tr>
<td>Fee for the Use of Natural Resources</td>
<td>Fee on the issuance of permits to set up trade or services outlets (kiosks)³</td>
</tr>
<tr>
<td>Fee for Geological Surveys Conducted through the State Budget</td>
<td>Fee for passing through an oblast for transportation vehicles travelling across the border of Ukraine</td>
</tr>
<tr>
<td>Fee for Environmental Pollution</td>
<td></td>
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<tr>
<td>Fee to the Fund for the Liquidation of the Effects of Chernobyl</td>
<td></td>
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<tr>
<td>Fee to the State Pension Fund</td>
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<tr>
<td>Fee to the State Innovation Fund</td>
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<tr>
<td>Patent Fee</td>
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<tr>
<td>Fixed Agricultural Tax</td>
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<tr>
<td>Tax on the Cultivation of Vines, Fruits and Hops</td>
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</tr>
<tr>
<td>Fee for Crossing the Border into Ukraine</td>
<td></td>
</tr>
<tr>
<td>Fees to the Fund for Insuring Bank Account Deposits of the Population</td>
<td></td>
</tr>
<tr>
<td>Additional Fee to the Tariff on Electrical and Heat Consumption</td>
<td></td>
</tr>
</tbody>
</table>


³As this permit fee is collected yearly, and is thereby considered a tax.

In 2002, the typical surveyed enterprise paid a total of 8 taxes. With 72% of surveyed small firms filing with the unified tax method, this number strongly depends on firm size. While small firms averaged 7 taxes in total, large firms paid an average of 11 taxes in 2002, while medium firms are not far behind with 10 total taxes. These figures represent a decrease from last year, where the average large enterprises had reported paying a total of 13 taxes, medium firms 12 and small firms 8 taxes.
Results of Figure 42 show that in 2002, manufacturing, construction and financial sector firms paid the greatest number of total taxes, an average 9 taxes per firm. As can be seen, however, the average number of taxes paid by firms in Ukraine has declined over the past two years for all firms except those working in construction and the financial sector, which showed no change.

**Taxation as a Share of Sales**

The share of sales that firms pay to the state budget is the clearest direct indicator of the financial burden that taxation creates for an enterprise. In 2002, Ukrainian firms reported paying an average 28% of sales as taxes. Figure 43 shows that this average has undergone no significant change over the past year. In 2001, firms had reported paying an average of 29% of sales in taxes, while in 2000 the average had been 24%.

Although survey results had shown meaningful variations in the number of taxes paid by firms of different sizes, with small firms paying significantly fewer taxes, the percentage of sales that firms report paying to the budget as taxes does not differ substantially by firm size. Large enterprises report paying an average 31% of sales in tax, medium firms 32% and small firms 27%. Results therefore show that the unified tax, while entailing a significant simplification of accounting and reporting procedures for small firms, does not significantly lessen their financial obligations to the government budget.

The share of sales that SMEs report paying in taxes has decreased somewhat between 2001 and 2002, while large firms have experienced a steadily increasing tax burden over the past three years.
TAXATION

Looking at this question by sector of enterprise activity, results show that in 2002, construction firms paid an average 40% of sales in taxes, making construction the most highly taxed sector in Ukraine, and constituting a jump of nearly 100% in year on year terms. Public catering firms also reported paying a comparatively higher share of sales as tax (33%) than firms in the remaining sectors. At the other end of the scale, trading firms paid an average 22% of sales in taxes, the lowest showing across all sectors of business activity. Public catering, meanwhile, is the only sector to show a constant increase in taxes as a share of sales over the past three years (Figure 44).

Unregistered Economic Activity

Firms operating in any number of countries report taxation to be a difficulty for their operations, just as most individuals consider the personal income tax to be an unfair deduction from their «actual» salary. This point is quite obvious and firm assessment of difficulty is consequently mitigated in the mind of the reader.

However, as has been discussed, the reasons for the low level of tax culture in Ukraine stem from a number of factors that combine to make the system of taxation a difficulty for entrepreneurs. Some of these factors originate in the particular problems caused by the system of taxation in Ukraine, and the demanding administrative and fiscal burden which is not reflected in formal tax rates. Still other factors are historic: in the Soviet Union «evading» government regulations was a way of life for its citizens, and avoiding payment for goods or services was considered a privilege the practice of which was by far more pervasive than relevant examples from developed countries. At the same time, it should be stressed that companies, even more than individuals, like to see a return on investment. The level of services provided by the government in Ukraine, as in all of the countries of the region, cannot be compared to western standards, while at the same time, assessment of official corruption, whether real or perceived, is an equally sensitive issue which cannot be discounted when assessing firm behavior.

According to this report, 60% of Ukrainian firms consider the privileged treatment of the shadow sector as a problematic aspect of the tax system. The term privileged treatment refers to the unfair competition that results from some firms operating in the shadow sector, hiding a share of sales from taxation or otherwise not paying taxes on their activities.

\[\text{Figure 44} \quad \text{Tax Burden as a Share of Sales by Sector, 2000-2002}^1\]

\[\text{(% of sales paid in taxes)}\]

<table>
<thead>
<tr>
<th>Sector</th>
<th>2002</th>
<th>2001</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Transportation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade</td>
<td></td>
<td></td>
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At the same time, such behavior is not always illegal: some enterprises and sectors in Ukraine are allowed tax privileges by the government, having their tax debts written off or being officially excluded from the payment of certain taxes, including VAT. The remaining firms then make allowances for competing on such terms.

Sales Hidden From Taxation

In 2002, over half of Ukrainian entrepreneurs thought that enterprises hide a portion of sales from taxes, estimating that the average share of sales retained is about 21%. Over the past three years this estimate has ranged from 16% in 2000 to 26% in 2001. It is important to note that answers to this question do not necessarily reflect on the operations of a particular enterprise – rather they are an estimated share of sales hidden by the average company, as reported by enterprise managers in Ukraine.

In looking at 2002 data by firm size and sector, results show that perceptions of the share of sales hidden from taxation do not depend greatly on firm size. This year SMEs believe that their peers are holding back a relatively larger share of sales than do large firms, but this perception was the reverse in 2001.

Although a detailed analysis of this question by firm size, sector and region displays discrepancies which do not allow for broad conclusions, there is a tendency for responses to vary around the 20% mark over the past three years.
TAXATION

Simplified Tax for Small Business

More and more eligible firms are switching to the simplified method of tax filing, accounting and reporting (unified tax), which was introduced in Ukraine by Presidential Decree in July of 1998. In 2002, 72% of qualified survey respondents had already switched, compared to 61% of eligible firms in 2001.

The simplified system of taxation, accounting and reporting is available to firms which employ less than 50 people and have a turnover of less than UAH 1 million (US$187,000). This system allows qualified firms to pay a majority of taxes as one tax with one report – and replaces the following taxes and mandatory fees for enterprises:

- Corporate Profit tax;
- VAT (if the enterprise has chosen the 10% rate – in such a case excise duty is paid separately);
- Land Tax;
- Communal Tax;
- Road Tax;
- Fee for the Use of Natural Resources;
- Patent Fee;
- Mandatory Social Insurance Fund Fee;
- Fee on the issuance of permits to set up trade or services outlets (kiosks);
- Social Fund for Disabled Persons Fee;
- State Pension Fund Fee;
- State Employment Fund Fee;
- State Innovation Fund Fee;
- Fee to the Fund for the Liquidation of the Effects of Chernobyl.

Figure 46  Enterprise Assessment of Sales Hidden from Taxation in Ukraine by Firm Size, 2000-2002

(average estimate of share of sales hidden by the typical firm)

Figure 47  Participation in the Simplified Taxation System, 2002 and 2001

(% of firms eligible for simplified taxation)
VAT can be included in the list of taxes that the unified tax replaces – firms opting to pay through the simplified system can choose a rate of 10% of turnover, which covers payment of VAT. If companies choose to pay VAT separately, they qualify for a unified tax rate of 6% of turnover. Enterprises are able to choose to switch from regular to unified tax once per year, and under the unified tax are required to file quarterly.

**Conclusions**

In Ukraine, entrepreneurs cited tax rates, frequent changes to tax legislation and the aggregate number of taxes as the key impediments in the main barrier to their operations and growth: the system of taxation. Ukrainian firms have rated these difficulties much as do entrepreneurs in neighboring countries. In Russia, a recent report has found the issues of tax rates, frequent changes in taxation legislation and number of taxes are cited as problematic by 58% of polled entrepreneurs. These issues are therefore common to the tax systems of the region, where methods for assuring equal treatment, compliance, and predictability of the system are still in a stage of development.

Aggregate results of this survey have shown that generally, in Ukraine, the regulatory environment is less favorable to small firms. Taxation is one of the few areas in which small firms are less stringent in their assessment of government regulations, and where small firms rate the procedures involved in the issue as less of a barrier than their larger counterparts. These positive results for small enterprises must be attributed to the benefits of the simplified system of taxation. The clearest measure of its value is its popularity, with survey results showing that nearly three quarters of eligible firms have switched to the simplified tax. At the same time, small firms report that the share of sales that they pay to the government budget through taxation does not vary substantially from the share that medium and large firms contribute. This leads to the conclusion that simplified tax reduces the administrative difficulties inherent in the tax system, without affecting the level of funds available to the budget.

In Europe, a number of countries have tax regimes which are geared towards the development of small business, including France, Great Britain, and Holland, which all employ various incentives to encourage SME growth. The United States, meanwhile, employs a progressive corporate profit tax rate as well as a number of tax exemptions available to small businesses and small business investors. Yet the sheer number of small businesses in these countries cannot reasonably be compared with Ukraine’s showing, while it is clear that the tradition of small business development in such countries is at odds with the experience of former Soviet countries, where the very conception of private enterprise, not to mention small business, did not exist ten to twelve years ago.

In comparing the tax system of Ukraine with that of established market economies, it is also important to note that most of these countries are not dealing with a significant level of tax evasion and perceived official corruption, the results of which cannot be overemphasized. Ukraine, similar to the other countries of the region, is in a situation where the government needs to find mechanisms to encourage firms to pay taxes. This situation is radically different from that of western countries, and therefore the solutions to the problem may also need to be reevaluated on similar terms. Yet for the present, the government continues to assume that enterprises are hiding sales from taxation, and this assumption has a non-negligible effect on the sheer amount of taxes and regulations firms are subject to, as well as on actual tax rates. Firms, meanwhile, consider taxes and their rates excessive and continue to hide a share of their activity from the state budget.
Main Findings

- The typical Ukrainian firm spent 17 days undergoing inspections in 2002. This number is the continuation of a significant downward trend: in 2000 the typical firm was inspected an average of 27 days per year, and in 2001 this average had dropped to 23 days.
- Although inspections duration is decreasing, the number of times that a firm is inspected has risen back to 2000 levels. In 2002, the average company was inspected 14 times, as had been the case in 2000. The number of inspections a firm undergoes depends on its size: in 2002, small firms received an average 12 visits from all inspecting agencies, while large firms were inspected 23 times over the course of the year.
- The two agencies most actively conducting inspections are the Fire Department and the Tax Authorities, each covering nearly three quarters of surveyed firms in 2002. Moreover, the typical firm was inspected three times by each of these agencies over the course of the year. These are also the two agencies which were reported as most often soliciting unofficial payments, by 18% and 23% of firms, respectively.
- Nearly three quarters of firms experienced difficulties during inspections. The main causes of such difficulties, as reported by enterprises, are the number of documents requested, lack of transparency in complicated procedures, and unclear demands on the part of inspectors.
- Just under half of surveyed firms claimed that it was either difficult or extremely difficult to obtain clear and factual information on the inspections process.
- Over the past three years, fines have become the most common form of negative consequences after an inspection. In 2002, 42% of surveyed firms suffered negative consequences, of these, 86% paid a fine.

In 2002, 48% of Ukrainian firms have judged the inspections process as a barrier to their business activities. This figure is slightly higher than the 46% of firms which considered inspections as a barrier in 2001. Three years of economic growth leading to increased opportunities for enterprises have softened firm assessment of every regulatory issue, save one: inspections. The situation with inspections is in fact the reverse: findings for this report show that the inspections process is the single regulatory issue that firms in Ukraine have judged with increasing severity for each of the past three years (Figure 48).

The Inspection Process and its Legal Basis

The legal basis for inspections in Ukraine is quite complex, without unified legislation to consolidate the process and stipulate standard procedures. The inspections process is based on the authorization of ministries and central regulatory agencies in Ukraine to control compliance to the legal acts they issue. This authorization consolidates the inspections process, which is further regulated only by the separate legislative acts which define the functions and existence of central regulatory agencies in Ukraine. For example: The Laws «On Fire Safety», «On Labor
Protection», «On Sanitary and Epidemiological Safety of the Public», «On Prices and their Derivation», «On National Employment», «On the Protection of the Environment», etc. These laws stipulate the existence of specific regulatory agencies, and thereby maintain their right to conduct inspections of enterprises, without providing further definition of the limits or scope of such inspections.

The following agents have inspection powers in Ukraine:

1. 31 central government agencies, the Council of Ministers of the Autonomous Republic of Crimea, the regional administrations of Ukraine’s 24 oblasts, and the city administrations of Kyiv and Sevastopol;
2. all fiscal bodies with respect to tax, duty and other budget payments at all levels;
3. agencies which regulate environmental safety and protection of human health;
4. local government bodies;
5. other bodies in cases stipulated by current legislation.

Regulating Inspections

The current amalgamated collection of legal documents covering the inspections process does not:

- fully define types of inspections, or the goals of the inspections process;
- designate all of the agencies empowered to conduct inspections, nor the scope of their authority;
- clearly indicate the reasons for which an inspection of an enterprise may be initiated;
- set any guidelines for the number of times that an agency may visit a firm, or the procedures which should be followed during a site visit.

Out of this legal basis arises a system of often overlapping regulatory functions and non-transparent procedures, in which a firm may be inspected any number of times by a particular agency, for reasons which are not communicated to the company.

Types of Inspections

A defined or exhaustive list of types of inspections is currently lacking, yet two particular types of inspections are defined in the Presidential Decree «On Some Measures for Deregulation of Business Activities», dating from 1998. This Decree specifically grants four state agencies the ability to conduct planned and unplanned inspections of a firm’s financial and business activities. These agencies are the State Tax Authorities, Customs Officials, State Treasury Officials, and the Central Control and Auditing Department (the latter both under the Ministry of Finance).

Scope of Inspections

In practice, most inspections are carried out by tax authorities, social protection agencies and the regulatory agencies which give out permits and licenses to businesses to conduct operations. The operations of a firm reviewed during any particular inspection are intended to be aspects of its financial and/or business operations, which fall generally within the realm of the authority granted to the agency conducting the inspection. However, it must be stressed that current legislation does not set any explicit parameters for the scope of the vast majority of inspections, or the procedures which should be followed during a site visit to a company.

Procedural Requirements

By the Presidential Decree «On Some Measures of Deregulation of Business Activities», inspecting agencies are allowed to issue normative acts defining procedural regulations for conducting enterprise inspections, with the approval of the State Committee on Regulatory Policy and Entrepreneurship. The ramifications of this Decree, however, unfortunately include the absence of such normative acts, with two or three exceptions enacted before the Decree came into force.

Therefore, virtually no regulations on the inspections process exist apart from those which standardize particular aspects of planned and unplanned inspections of business and the agencies empowered to conduct them. However, as will be shown in this report, of the four agencies that may conduct planned and unplanned inspections, only one – the Tax Inspectorate, carries out a meaningful share of the total inspections firms undergo yearly in Ukraine.
Frequency of Inspections

In 2002, the average business in Ukraine was inspected 14 times over the course of the year, which is a slight increase, year-on-year. In 2001, firms had reported being inspected an average of 12 times, down from 14 times in 2000.

In 2002, the large firms were inspected most often – a total of 23 times. For large firms, this figure is higher than results obtained in 2000, and much higher than the 12 yearly visits reported for large companies in 2001. Medium firms were also visited by inspecting agencies more often in 2002 than in 2001. For small firms however, there has been little change in inspections frequency over the past three years.

When looking at results by sector of business activity, firms working in the fields of public catering, manufacturing and trade were inspected more often than firms in other lines of business. Public catering firms were inspected an average 21 times over the course of 2002, which is a significant increase on 2001 figures. A higher rate of inspections for public catering is to be expected however, given the issues of public health and safety involved in the services that these firms offer.

As can be seen from Figure 50 below, the only sector to show a constant decrease in the number of inspections over the past three years is the transportation sector. For all other sectors inspections frequency has increased between 2001 and 2002.
The number of inspections that the typical firm undergoes varies significantly amongst Ukraine’s oblast centers. The average firm in Donetsk was inspected 23 times, which is 9 inspections above the Ukrainian average. Zaporozhia, Chernivtsi and Rivne, by contrast, display the lowest average number of inspections in the country, with the typical firm being inspected a total of 7 times over the course of 2002.

### Most Common Agencies Conducting Inspections

As can be seen from Figure 52, the Fire Inspectorate and the Tax Authorities covered nearly three quarters of all firms surveyed, making these the agencies most frequently conducting inspections of businesses in Ukraine. The Sanitary and Epidemiological Service covered 58% of all surveyed firms, while the State Pension Fund covered nearly half, and the Labor Protection Department covered just over a third of firms in 2002.

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**Figure 51 Annual Number of Inspections: Regional Variations in 2002**

(average number of inspections per year)
Between 2002 and 2001, there has been a reduction in the number of firms undergoing inspections by the State Pension Fund, the Unemployment Fund, and the State Committee of Standards, Weights and Measures. Although these were the only agencies to demonstrate more than a 10% drop in activity, 2002 witnessed an overall decrease in the share of Ukrainian firms visited by each of the agencies listed in Figure 52. Table 10 below summarizes inspections agency activity in 2002, as reported by surveyed enterprises.

### Duration of Inspections

The average duration of inspections of surveyed firms has been steadily dropping over the past three years. In 2000, the typical firm spent 27 days on inspections, while in 2001 this dropped to 23 days. In 2002, we see the lowest results yet, with an average figure of 17 days for duration of all inspections per firm.

There has been a sharp decrease in the duration of inspections for small firms – a drop of 9 days between results obtained in 2001 and 2002. Medium firms have also experienced a decrease in inspections duration, although this drop is much less significant – 4 days between 2001 and 2002 results. Large enterprises however, have experienced an opposite effect, with inspections at large firms increasing by 9 days year-on-year, to 34 total days in 2002.

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**Figure 52** Top 10 Organs Visiting Firms Nationally, 2001 and 2002 (% of firms visited)

<table>
<thead>
<tr>
<th>Agency</th>
<th>Share of firms visited</th>
<th>Average Number of visits per firm</th>
<th>Average Duration per visit (working days)</th>
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<tr>
<td>Tax Inspectorate</td>
<td>74%</td>
<td>2.8</td>
<td>8.1</td>
</tr>
<tr>
<td>State Fire Department</td>
<td>74%</td>
<td>2.5</td>
<td>1.8</td>
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<tr>
<td>Sanitary and Epidemiological Service</td>
<td>58%</td>
<td>3.4</td>
<td>2</td>
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<tr>
<td>Pension Fund</td>
<td>46%</td>
<td>1.5</td>
<td>1.7</td>
</tr>
<tr>
<td>Labor Protection Department</td>
<td>36%</td>
<td>2.5</td>
<td>2.3</td>
</tr>
<tr>
<td>State Agency for Energy and Energy-Related Resources</td>
<td>35%</td>
<td>4.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Social Insurance Fund</td>
<td>32%</td>
<td>1.4</td>
<td>1.6</td>
</tr>
<tr>
<td>Unemployment Fund</td>
<td>32%</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Consumer Rights Protection Department</td>
<td>29%</td>
<td>1.9</td>
<td>1.6</td>
</tr>
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</table>
The typical small firm consequently spent half a month being inspected, medium firms just under a full month, while large firms spent a month and a half of 2002 undergoing inspections. Such results again serve to emphasize the constraining impact that inspections produce on the operations of any business in Ukraine, when data is considered in absolute terms. Yet, survey results for inspections duration have shown some positive developments: not only is the average duration of inspections dropping for SMEs year on year, but inspections duration seems to also be taking on a more logical character: SMEs are being inspected less often and over fewer days than their larger counterparts.

Looking at inspections duration by sector of business activity, in 2002 Ukraine’s manufacturing firms and financial services firms spent the largest amount of time on inspections. The typical financial services firm was inspected over a total of 21 days, while manufacturing firms spent a total of 20 days being inspected. Service firms and public catering companies, on the other hand, come in at the low end of the scale, averaging 12 and 13 days spent on inspections respectively.

Of firms across Ukraine, those in Donetsk, Vinnytsia and Poltava spent the largest number of days being inspected. In Donetsk, the average figure for all firms is 29 days spent on inspections, while in both Vinnytsia and Poltava it is 28 days. Considering that these figures are reported in working days, in all cities with average durations of 22 days or higher, the typical firm spends over a calendar month under inspection.\(^9\)

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\(^8\)Firms were asked to report inspections duration in working days. The average number of working days per month is 22.

\(^9\)Although the sample does not allow for statistically significant analysis of data by firm size and region concurrently, it should nevertheless be taken into account that the survey looks at a majority of small firms, which have shown a substantially lower average duration of inspections nationwide.
Comparing Regional Inspection Characteristics

When data on number and duration of inspections is combined, the cities of Donetsk and Poltava display two of the most stringent inspections regimes in the country. Not only did firms in these cities present two of the highest averages for inspections duration, but they also displayed the highest averages for annual number of inspections nation-wide in 2002. Cities such as Chernovtsi, Cherkasy and Simferopol, however, show the opposite trend – enterprises in these cities were inspected fewer times than the national average, while duration of inspections was also below the average showing for Ukraine.

Entrepreneurs and the Inspections System

Lowering the Number of Inspections

Survey respondents were asked their opinion on the best way of lowering the number of inspections that their firm undergoes in the typical year. The most popular response, regardless of firm size, was switching to simplified tax, given by 42% of all surveyed firms. The clarity of the accounting methods used in the simplified method of taxation is considered an advantage by firms of all sizes.

Fully a quarter of respondents said that nothing could lower the number of inspections, while another 25% opted for the creation of better relations with inspections authorities. Seventeen percent stated that local authorities should use their influence with inspections bodies to lower the number of inspections, while only 12% thought that lodging formal complaints would be the most effective method.
Looking at this question by size of firm, results show that nearly half of small firms chose the option of switching to unified tax. This is an encouraging sign, showing that those firms who are able to use the simplified method of taxation, accounting and reporting see benefits that go beyond the number of taxes paid and simplified filing. On the other hand, the results of Figure 57 also display the advantages of size: a significantly greater portion of large enterprises believe that official methods, such as formally contesting the actions of inspectors and regularly using the inspections registration book\textsuperscript{11} are effective techniques for lowering the number of inspections, than do SMEs.

Legal Awareness
Some of the consequences of the complex inspections regime in Ukraine, where most firms are visited on a regular basis by one or another of the country’s inspecting organs, extend to the rather high level of legal awareness of her entrepreneurs. Ninety-one percent of respondent firms claimed that they are either very familiar or generally familiar with legislation covering the inspections regime. Only 8% claimed that they know the legislation poorly, and less than 1% that they do not know it at all. Results do not differ significantly by firm size, although as is clear from Figure 58, small firms tend to be slightly less familiar with the legal basis for inspections.

\textsuperscript{11}The inspections registration book was introduced by Decree of the President No. 817/98 of 23 July 1998, «On Some Measures of Deregulation of Business Activities.» Inspecting agency representatives are required to sign off on each inspection that they conduct at an enterprise. If an inspector refuses to sign, the firm has the right to refuse to admit the inspector onto its premises. It should be noted that its lack of popularity among surveyed firms likely rests on the fact that there is no legislation limiting the number of inspections that may be conducted at an enterprise by the vast majority of agencies, thereby circumventing much of the efficacy of such a book.
Obtaining Information

Ukrainian firms were almost evenly split in rating the difficulty of receiving complete and accurate information on the inspections process. Nearly half (51%) said that it is either not at all difficult or rather not difficult to receive such information from inspections authorities. However, as can be seen in Figure 59, only 12% of firms stated that it was not at all difficult to obtain this information. To further highlight this point, firm size had almost no effect on responses to this question.

Problems Experienced During Inspections

Just under a third of surveyed firms (31%) claimed to have had no difficulties during inspections of their enterprise. For the remaining 69% that did, the most common problem was the number of documents demanded by agencies conducting inspections. In addition, just over a quarter of entrepreneurs cited the conflicting or unclear demands made on the part of inspections authorities, while another 23% cited complex, entangled and non-transparent procedures as having caused difficulties during the process.

The issues that affect large firms and SMEs tend to differ. Large firms are most concerned with the bureaucracy of the process: the number of documents required, as well as with the frequency and duration of inspections. While the number of requested documents remained the most common difficulty for SMEs, they were relatively more concerned with unclear demands on the part of inspectors and the lack of transparency of the procedures involved in inspections.
It is interesting to note that less than 10% of either SMEs or large firms claimed that significant difficulties were caused by the need for unofficial payments during inspections. This figure is actually less than the share of firms claiming that unofficial payments were solicited for inspections (Figure 63). Considering that firms are unwilling to directly acknowledge requirements for unofficial payments, it is usually assumed that the true level of unofficial payments remains underreported, and that a significant portion of firms are affected. Given this combined information, one reaches the conclusion that unofficial payments are part and parcel of owning a business in Ukraine, and moreover, on a relative scale, the system does not present overwhelming difficulties for the typical firm.

Interesting also is the relatively small share of firms, either large enterprises or SMEs, which cited the lack of information on inspections procedures as one of the main obstacles in the inspections process. By comparing this data with the 49% of total firms who claimed that it is difficult to obtain information on the inspections requirements from inspecting authorities, it is clear that firms do not necessarily think that increased information on inspections will strongly improve the process. This suggests that either implementation is such an issue that increased access to information could have little effect, or that the current difficulties with implementation stem directly from the legal basis – simply increasing access to information on a confusing legislative base would not lessen the burden of the inspections process.

Inspection Consequences

A full 42% of surveyed firms reported experiencing negative consequences as a result of inspections in 2002, which is nearly the same share as in 2001 (41%). Of these firms, 86% were fined in 2002, which is significantly higher than the 61% in 2001. This significant increase in the share of firms paying a fine as a result of violations can be seen in Figure 61, and is the continuation of a process which began last year, with the repeal of the ‘kartoteka’ system. This system, abolished in early 2001, had allowed inspecting bodies finding violations at a firm to directly debit any arrears owed to the state from bank account of the company in question. The rise in the share of firms paying fines has correspondingly lead to a significant decrease in other types of consequences as shown in Figure 61.

12Less than half (42%) of firms in this survey stated that «the average Ukrainian company» pays «the official fee» to complete regulatory procedures (average for all procedures given in Figure 1 in Annex 3 of this report). At the same time, significantly fewer firms admit that they were required to make such payments during any given procedure.
The average reported fine paid by surveyed firms amounted to UAH 2,758 (US$ 520), ranging from a reported maximum of UAH 402,000 (US$ 75,140) to the minimally established fine in Ukraine, UAH 17 (US$ 3). Figure 62 displays the average fine paid by surveyed firms, by size of enterprise.

Unofficial Payments

In 2002, the agencies which most frequently asked for unofficial payments to complete inspections procedures were those which were most active in conducting inspections. The Tax Authorities were cited as soliciting unofficial payments from 23% of firms that they visited, while the State Fire Inspection required unofficial payments from 18% of firms. The Sanitary and Epidemiological Service was also cited by another 12% of companies. The Pension Fund and the Consumer Rights Protection Bureau each reportedly required unofficial payments from 6% of firms, while the Labor Protection Department required them of another 5% (Figure 63).

Conclusions

Ukrainian firms cite inspections as the key regulatory barrier to business operations and growth. In 2002, nearly half of all surveyed firms claimed that the inspections process was either a major or significant obstacle to business. The inspections process is also the single regulatory issue covered in this report which has not been more favorably assessed by enterprises over the course of the past three years.

Yet although inspections still occupy a significant portion of company time, inspections duration has been steadily decreasing between 2000 and 2002. Inspections duration is one of the most significant hurdles for business in the inspections process, and year on year results display a clearly positive trend in this regard.

The number of inspections that the average firm encountered in 2002, however, is the same as that of the year 2000 – a total of 14 yearly inspections. When three quarters of firms state that they are visited an average of three inspections.
times in one year by the Fire Department, or for that matter a third of firms receive five yearly visits from authorities regulating energy consumption, this should be cause for reflection, at the very least.

Inspections agencies continue to operate without the benefit of clear or unified legislation on the inspections process, specifying the scope of their authority, regulating inspections procedures, or stipulating the reasons for inspecting a firm or the number of times that a firm may be inspected over the course of a year. The Ukrainian legislative base would profit from a normative act which would clearly introduce and define:

1. an exhaustive list of types of inspections and the agencies authorized to conduct them;
2. the legal basis for initiating an inspection of an enterprise;
3. timeframes for conducting inspections;
4. documents confirming the right of a specific agency/official to conduct inspections;
5. regulations stipulating the procedures to be followed by a regulatory agency during an inspection of an enterprise;
6. a system of formally recording the results of inspections and communication of results to the inspected firm such as an inspection registry, (including the name of inspectors, reason for inspection, fees & fines charged, signed by each inspector and inspectee for each inspection);
7. methods and channels for feedback/reaction from entrepreneurs on the actions of inspections agencies;
8. terms and conditions for firms to challenge the results of an inspection and/or the decisions taken by regulatory agencies based on these results.

In the meantime, the consequences of employing an inadequate legislative base to direct a regulatory procedure which is key to insuring the health and safety of the public are displayed in this report. Over 40% of firms experienced negative consequences as a result of inspections at their enterprise, while at least 23% reported that unofficial payments were solicited by inspecting authorities. A quarter of firms claimed that the demands made by inspecting authorities during the course of an inspection were unclear or conflicting, and that significant difficulties are caused by the complex and non-transparent procedures involved in inspections of their enterprise.

Meanwhile, nearly half of all firms say that it is difficult to receive clear and complete information on the inspections process and on the responsibilities of either the agency conducting the inspection or of the firm which is being inspected. The combination of these characteristics produces an unfortunate perception that many regulatory agencies consider inspections, much like permits, to be a solution to problems generated by recent decreases in allocations from the state budget.

**Figure 63 Relationship Between Agency Activity and Requirements for Unofficial Payments**
Main Findings

- Nineteen percent of surveyed firms were involved in foreign trade operations in 2002. Of all firms, 38% consider customs procedures to be a barrier to business operations and development.
- The share of firms involved in foreign trade differs substantially by firm size. Over half of surveyed large firms either import or export goods, for medium firms this number is about 20%, while less than 10% of small firms are involved in foreign trade.
- Forty three percent of companies importing goods and half of exporting companies consider it difficult to obtain complete and factual information on required procedures from custom authorities.
- Survey results show that firms citing a lack of information on customs procedures consider customs procedures as more of a difficulty and are more likely to make unofficial payments.
- A quarter of firms completing import or export procedures claimed that unofficial payments were solicited by customs officials.
- Violations of legally established timeframes for completing customs procedures during import and export operations occurred in around 12% of cases, on average. The most common violations of mandated timeframes are for receiving VAT refunds, cited by over a quarter of exporting firms.

Thirty eight percent of all firms considered customs procedures to be a barrier to their growth. The share of Ukrainian firms considering customs to be an obstacle, however, has decreased significantly over the past three years, as shown in Figure 64.

Firm Involvement in Foreign Trade

Nineteen percent of surveyed Ukrainian companies are involved in foreign trade operations. About 8% of companies carry out both import and export operations, while 11% are involved in either importing or exporting goods. Large firms dominate foreign trade, with nearly 60% citing import or export operations as applicable to their business activities. Somewhat predictably, the share of firms involved in foreign trade falls significantly for SMEs, as can be seen in Figure 65.
Foreign trade operations are conducted by just under one third of enterprises working in the manufacturing sector, and by 15% of firms in the financial sector, 14% of trading companies and 12% of transportation firms (Figure 66). Less than one in ten firms is involved in foreign trade amongst construction and services firms and public catering companies.

**Figure 66** Foreign Trade Operations by Sector of Business Activity in 2002 (% of all firms)

Markets for Foreign Trade

Following a drop in demand from CIS countries, Ukraine made some efforts to diversify its trade towards the West. Despite this, the majority of surveyed companies which conduct foreign trade operations still cite the CIS as their major market. About half of surveyed exporting companies sell their goods to Russia, about one quarter sell to other CIS countries, 20% to Europe and 4% to the rest of the world. Russian companies are also the main foreign partners for over half of Ukrainian enterprises which conduct import operations. Nine percent of domestic companies import from other CIS countries, while just under a third of surveyed firms cited European countries as their major partners for imports, while 6% cited other nations.

**Figure 67** Markets for Firms Involved in Foreign Trade in 2002 (% of firms involved in foreign trade)

These results, when compared to official statistics on trade volume, suggest that a small portion of firms are responsible for a significant portion of Ukraine’s foreign trade. Firms exporting goods to non-CIS countries deserve particular mention, as they are responsible for three quarters of Ukraine’s export volume, yet according to survey results, represent less than a quarter of enterprises. This may be an indication of the extent to which foreign trade operations, and especially exports to non-European and non-CIS countries, are dominated by a relatively small number of large enterprises.

**Figure 68** Volumes of Foreign Trade in 2002 (% of foreign trade volume)

Source: State Statistics Committee of Ukraine
Difficulties During Import Procedures

The most frequent customs procedures that surveyed firms completed while importing goods were drawing up of customs documentation (80% of firms), customs inspections (74%) and payment of import duties (60%). During the survey, firms were asked to rate the level of difficulty that each specific customs procedure presented during import operations. Overall, the greatest share of firms stated that difficulties occurred during the most common customs procedures: drawing up customs documentation and passing customs inspections.

Unofficial Payments During Import Procedures

On average, unofficial payments were requested of firms in about a quarter of cases during customs procedures for importing goods. About half of the companies of which unofficial payments were requested claimed that they had paid in order to facilitate the procedures.

Survey results present an interesting trend: firms which made unofficial payments consider import procedures as a barrier to their business more often than companies which were not required to pay. This relationship holds for all mentioned stages of imports, with the exception of veterinary inspections (Figure 70).¹

¹ The number of importing firms which passed veterinary inspections was smaller than necessary to make statistically significant conclusions.
Violations of Terms During Import Procedures
Ukrainian law regulates customs procedures, and government officials are charged with completing procedures within a given timeframe or according to other specifically stated requirements. During the survey, companies were asked whether they had identified violations during customs procedures. Figure 71 shows that violations of terms are not very common, and occur in less than 20% of cases during each procedure. Firms reported that the most common violation during import operations took place during consideration of applications for import licenses, which in 19% of cases took more than the 15 days established by law. Seventeen percent of firms reported violations in timeframes for obtaining import quotas and 14% for the carrying out of veterinary inspections.

Obtaining Information on Import Procedures
Overall, 43% of respondents regard obtaining complete and factual information on the procedures for importing goods into Ukraine as difficult. Survey results show a relationship between accessibility of information and violations taking place during import operations – firms which found information difficult to obtain were more likely to experience violations of legally established timeframes during import operations. Similarly, firms which have difficulties with accessing information make unofficial payments more often than firms which have no problems with obtaining full and factual information on import procedures (Figure 72).

Figure 71  Frequency of Violations of Terms During Import Operations in 2002 (% of importing firms)

Figure 72  Unofficial Payments are More Common for Firms Lacking Information (% of importing firms)
Difficulties During Export Procedures

As with imports, the most frequent procedures exporting firms have to complete is drawing up of customs documentation (80% of firms) and customs inspections (73%). Half of companies that export applied for a VAT refund and another half obtained a certificate of origin from the Chamber of Commerce of Ukraine.

In rating the difficulty of each step of the process, firms cited the VAT refund procedure as presenting the most significant barriers to export operations. Overall, about half of surveyed firms had difficulty with the VAT refund, which is a significantly larger portion of firms than for other export procedures. The VAT refund is followed by the passing of customs inspections and drawing up customs documentation, with 30% of firms having problems during each of these two procedures.

Unofficial Payments During Export Procedures

Results for unofficial payments during export procedures show a trend similar to that seen with imports: firms which made unofficial payments consider export procedures as barriers to their business more often than companies which have not (Figure 74). Overall, in 27% of cases, unofficial payments were solicited of companies exporting goods, while about half of firms which were requested to pay unofficially did so.

![Figure 73] Export Procedures as a Barrier to Business in 2002

![Figure 74] Unofficial Payments Increase Difficulties During Export Procedures in 2002
Violations of Terms During Export Procedures

Violations of stipulated timeframes during export operations occur with about the same frequency as during import operations. The exception is of course the VAT refund procedure, which is applicable to exporting firms and was delayed in over a quarter of cases. This is followed by violations of the terms stipulated to receive licenses for export procedures, experienced by one in five exporting firms, and violations during the passing of customs, which were reported by 10% of firms surveyed.

Figure 75 Frequency of Violations of Terms During Export Procedures in 2002 (% of exporting firms)

- VAT refund
- > 15 days to consider application for an export license
- Drawing up customs documents
- Customs inspections
- Obtaining a certificate of origin
- Obtaining quotas
- Sanitary inspections
- Passing of state frontier
- Veterinary inspections

Obtaining Information on Export Procedures

Half of surveyed exporting companies consider it difficult to obtain complete and factual information on export procedures from customs authorities. Despite the fact that reported access to information is slightly lower for exporters than for importers, the results allow a relationship between access to information and violations of timeframes taking place during export operations (Figure 4B in Annex 3). Moreover, firms which have difficulties in accessing information tend to make unofficial payments more often than firms which have no problems with obtaining satisfactory information on export procedures (Figure 76).

Figure 76 Unofficial Payments are More Common for Firms Lacking Information (% of exporting firms)

<table>
<thead>
<tr>
<th>Unofficial payments</th>
<th>How difficult is it to obtain information?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simple</td>
<td>0%</td>
</tr>
<tr>
<td>Difficult</td>
<td>100%</td>
</tr>
</tbody>
</table>

Conclusions

Results of the survey show that the share of companies assessing customs procedures as barrier to operations has dropped by 11 percentage points between 2000 and 2002. Yet, as is the case with many regulatory procedures covered in this report, when firms are asked to rate the difficulty of particular customs procedures results show that a significant portion, in some cases over half of all respondents, continue to experience serious problems during customs. Survey results also show a relationship between the share of firms citing customs procedures as problematic and the frequency of unofficial payments. Unofficial payments also tend to increase as firm access to information on the customs process declines. These results suggest that a significant step forward in simplifying customs procedures, which have legislative guidelines stipulating their terms, can be made by increasing access to information on the customs process, its conditions and requirements.
Permit Procedures and their Legal Basis

A permit is a document which allows an entrepreneur to begin a specific activity, usually in a particular location, building or office. In Ukraine, permits are required before a firm can begin operations, utilize building space for commercial purposes, initiate renovation works in an office, begin construction, set up a kiosk, etc.

The permits issued to begin these activities stipulate that, as the case may be, the construction or renovation plan and the works to be conducted, the construction site or the building to be renovated, the office to be utilized for commercial purposes, or the kiosk and its proposed location adhere to certain norms. These norms are established either directly by the Cabinet of Ministers, by local government authorities, or by regulatory agencies such as the Fire Department, the Architecture Committee, the Housing and Municipal Services Department, the Sanitary Service, etc.

Although permits number in the dozens, there are some difficulties that prevent an exact estimate of the number of permits that exist in Ukraine. First, while most permits issued by regulatory agencies are applicable across the country, in practice, local governments may implement additional permits for activities which would not require permits.

Main Findings

- Fifty seven percent of surveyed firms obtained permits over the course of 2002. Survey findings show that the share of firms obtaining permits in Ukraine, including obligatory permits to start operations, has been declining over the past three years.
- Businesses report that the difficulty of receiving all of the most-commonly issued permits for business operations has increased significantly between 2000 and 2002. This year, as in the previous year, the permits most difficult to obtain were those for land allocation, construction and renovation of premises. Each of these permits was cited as difficult or extremely difficult to obtain by more than half of the firms receiving them in 2002.
- Perceptions of the permit process vary significantly amongst the regions of Ukraine. This indicator of regional control of the process is linked to the ambiguity of the current legislative base, which fails to define the procedures that a firm must complete to obtain a permit, or all of the standards which must be met to receive it. Additionally, it is important to note that the cost of the overwhelming majority of permits and their corresponding approvals is not stipulated by law.
- The main obstacles faced by firms obtaining permits are linked to the bureaucracy of the process: a large number of required documents and the time implications of obtaining all necessary permits and approvals.
- Unofficial payments were most often required of firms obtaining the permit for renovation of premises and the Fire Department for start-up of operations, cited by respectively 27% and 19% of entrepreneurs.
- Twelve percent of firms that applied for permits in 2002 had not obtained them as of the Spring of 2003. The most commonly cited explanations as to why permit applications had not been approved were the following:
  - the documents were still being considered;
  - the time required to process the application was so lengthy that it had been rescinded;
  - the application was dismissed without an explanation.

1 In this section, the word “permit” applies to both permits and the approvals required to obtain them. In addition, included in the term “permits” are a number of additional regulatory documents that businesses must obtain for their day-to-day operations from government agencies, and which are therefore seen as permits by entrepreneurs (such as documents which regulate access to infrastructure). The list of proposed permits is in Table 4, Annex 3.
2 In the best cases, regulations stipulate the cost of 1 hour of work per employee of the regulatory agency assessing whether a firm may receive a permit or approval. How many hours (or days) of work and how many agency employees are involved in the process however, is a matter left to negotiation.
them in another region or city. Secondly, the difference between a permit, an approval, and an expert assessment is not always clearly stipulated. Thirdly, it can generally be said that two different types of permits exist, namely:

- a permit granted by a specific agency, usually when the procedure is administered by one body;
- a complex of permits granted as a result of interaction among several agencies as part of a single legal procedure.

In the first case, before such «single agency» permits can be issued, companies are required to obtain a number of preliminary approvals and/or expert assessments, which are obligatory subsets of the permit in question. These approvals and expert assessments are carried out either by the agency in question, or, as is more common, are delegated to other agencies or even to private firms.

In the second case, which is much more the norm, the term «permit» really applies to a complex of permits, each granted by an agency having no connection with the others, and each separate permit having equal weight in the process. Each of these permits has no value alone, yet combined they create the necessary conditions for a firm to, for example, begin renovation of premises. Furthermore, each of these permits is also usually made up of a number of corresponding approvals, which must be obtained before each specific permit can be granted. When a firm speaks of receiving a «permit to begin renovation» in practice this permit is made up of a range of permits issued by each of the separate agencies involved in the «renovation» process. Which agencies are involved depends on the location, historical status, infrastructure etc. of the building in question as well as the works to be carried out.

In the second case, which is much more the norm, the term «permit» really applies to a complex of permits, each granted by an agency having no connection with the others, and each separate permit having equal weight in the process. Each of these permits has no value alone, yet combined they create the necessary conditions for a firm to, for example, begin renovation of premises. Furthermore, each of these permits is also usually made up of a number of corresponding approvals, which must be obtained before each specific permit can be granted. When a firm speaks of receiving a «permit to begin renovation» in practice this permit is made up of a range of permits issued by each of the separate agencies involved in the «renovation» process. Which agencies are involved depends on the location, historical status, infrastructure etc. of the building in question as well as the works to be carried out.

It is therefore simpler to speak of a permit as a set of conditions which must be met, or even signatures which must be received, before an entrepreneur can begin a particular process at a specific location - whether this is setting up a kiosk, renovating an office, or constructing a building. The number of «signatures» that must be received cannot be generally summarized, as this depends significantly on the particular location which has been chosen. Consequently, a firm may discover that it needs to obtain an additional approval or expert opinion only during the process of obtaining the permit.

This situation exists due to the fact that whereas a number of laws and regulatory acts have been adopted prescribing the specific activities for which permits must be obtained, or which bodies are authorized to grant permits in a particular field, there is no clear definition of permits, or of all of the conditions which must be met in order to obtain them. There can be in such circumstances be no exhaustive list of permits in Ukraine.

The current permit system is an opaque and complex process, with no unifying legislative framework and often overlapping functions allocated to numerous agencies, effectively deregulated to the local level. The confusion thus created leads to a number of consequences. First, survey results show that the incidence of unofficial payments during the permit process is higher than that for all other regulatory procedures, with the possible exception of procedures, the relative difficulty of obtaining permits depends significantly on the willingness of local authorities to develop enterprise in their region.

Some communities have taken the initiative, and set up «one-stop shops» (OSS) for permits, where entrepreneurs can either obtain many of the most commonly-issued permits, or obtain comprehensive information on and assistance in receiving them. However, such offices are currently operating in very few cities across Ukraine, at the initiative of the local administrations. Furthermore, such one-stop shops are most often set up in small industrial or agrarian communities. One stop shops for permits are difficult to create in large cities as most permits are allocated by district authorities in larger towns. Gathering together all of the district branches of even some of the agencies involved in the process of obtaining permits and approvals is not feasible without a clear endorsement from national authorities, which hold, in the end, responsibility over the vast majority of agencies involved in the permit process. Action on the part of the central government has so far been lacking.

The Permit Process as a Barrier to Business

The share of survey respondents citing obtaining permits as a major or significant barrier to business declined from 41% in 2001 to 35% in 2002 (Figure 77). While this is undoubtedly a positive development, as is discussed further in this report, the share of firms obtaining permits has declined significantly over the past three years.
Given the significant decision-making authority which is conferred to local agencies during the permit process, it is not surprising that opinions of enterprise directors on the difficulty of obtaining permits differ significantly by region. The range of answers to the question of to what extent the permit process is a barrier, varies by about 50 percentage points, from a high of 66% in Khmelnytsky to a low of 17% in Kherson.

Figure 77  Perceptions of the Permit Process as a Barrier to Business Development, 2000-2002
(% of all firms)

Figure 78  Perceptions of the Permit Process as a Barrier to Business Development: Regional Variations, 2002
(% of all firms citing permits procedures as a major or significant obstacle)
More than half of firms in each of Dnipropetrovsk, Khmelnytsky and Kirovograd cited the permit process as a barrier to operations and growth, as did 47% in each of Ternopil and Chernivtsi. By contrast, substantially fewer firms viewed the permit process as a barrier in Lviv, Kherson and Sumy, where only every fifth enterprise cited the permit system as a barrier for business development.

In looking at survey results by sector of activity, the share of companies citing the permit process as a significant or major barrier is significantly lower among enterprises providing transportation and financial services, and averages around 21%. Yet, while some variation exists amongst sectors, responses did not vary significantly when analyzed by firm size.

**Number of Permits Obtained**

In 2002, 57% of surveyed firms applied for permits and approvals. This represents a decline from the 64% applying in 2001 and 86% in 2000. Of entrepreneurs applying for permits in 2002, the number of permits obtained per company averaged 3.9, dropping from 4.1 permits in 2001 and 4.4 permits in 2000. This is a result of a sharp drop in the share of enterprises applying for four or more permits and a respective increase in the share of firms applying for three permits or less per year. As can be seen from Figure 79, the majority of surveyed firms received three or less permits for their operations in 2002. As three permits are obligatory in Ukraine to launch operations at a particular site, these results suggest a progressive reduction in business expansion, while the reduction in the share of firms obtaining other permits points to reduction of investment in infrastructure.

**Figure 79** Number of Permits Obtained per Enterprise, 2000 - 2002 (% of firms obtaining permits)

<table>
<thead>
<tr>
<th>Year</th>
<th>3 or less permits</th>
<th>More than 3 permits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>59</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>54</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>45</td>
<td></td>
</tr>
</tbody>
</table>

**Most Commonly-Issued Permits**

As can be seen from Figure 80, the share of firms applying for each of the most commonly issued permits has decreased over the past three years. In fact, the only permit which was obtained by a greater share of firms in 2002 than in 2001 was the permit to occupy premises.
Obligatory Permits

Three types of permits are obligatory for all firms to begin operations. These include permits issued by the Fire Department, Sanitary and Epidemiological Service, and the Labor Protection Department. Between 27% and 41% of survey respondents applied for each of these permits in 2002 (Figure 80). In line with the trend for all permits across Ukraine, these permits are also showing a decline in the share of firms obtaining them. As these permits are obligatory, this decline is an indication that fewer new firms are beginning operations in Ukraine, year-on-year.

Data of the State Statistics Committee on the number of firms registering yearly in Ukraine confirms the findings of this report. Figure 81 shows a substantial drop in the number of small firms registering in Ukraine per year, over the past 6 years.

Experts estimate that in 2002, small firms accounted for 82% of all legal entities in Ukraine, and it can be assumed that the overwhelming majority of all newly registered firms are small enterprises.

Figure 80  Most Commonly-Issued Permits, 2000 - 2002
(% of firms obtaining each permit)

Figure 81  Newly Registered Small Firms in Ukraine, 1997-2002
(number of firms)

Source: Ukraine State Statistics Committee
Difficult of Obtaining Permits

An analysis of responses from firms which obtained permits over the course of 2002 shows that receiving permits has become more difficult. As can be seen from Figure 82, the difficulty of obtaining permits in Ukraine has been steadily increasing over the past three years, and has increased sharply between 2001 and 2002.

In 2002, land allocation and construction permits remained the most difficult to obtain, and were cited as such by about two thirds of firms applying for each. The other permit which over half of all businesses cited as difficult or extremely difficult to obtain was the permit for renovation of premises.

Interesting is the fact that the top four permits listed as most difficult to obtain are the same four which have the highest incidence of unofficial payments – land plot allocation, construction, renovation of premises and the Fire Department permit to begin operations. The three listed as most difficult to obtain also require the longest waiting period before they are issued.

Obligatory Permits by Region

When comparing the difficulty of receiving obligatory permits in Ukraine’s regions, survey results show that process of obtaining required permits in Ivano-Frankivsk has improved significantly in 2002, and the city now shows the lowest rate of difficulty for obtaining permits to start operations across Ukraine. Sumy and Vinnytsia also show positive results for 2002. Cherkasy, Khmelnytsky and Dnipropetrovsk however, fall at the other end of the scale, with obligatory permits cited as particularly difficult to obtain in these cities.

Figure 83 presents regional variation in the difficulty of receiving the obligatory permit from the fire department to launch operations, as assessed by firms receiving in 2002. It should be noted that the assessments of the difficulty of receiving each obligatory permit are quite similar. A detailed table comparing the difficulty of obtaining each obligatory permits in each of Ukraine’s oblast centers is provided in Table 5 of Annex 3 to this report.
Duration of the Permit Process

The direct relationship between the time required to obtain a specific permit and the share of firms citing it as difficult to obtain is confirmed in 2002. The timeframe for obtaining a permit is longest for land allocation, and averages 46 working days, while firms reported that the permit to begin construction works averages 32 days to receive. In 2001, enterprises had reported that it took about 27 working days to obtain the land allocation permit, while it took an average 17 days to be issued a permit to begin construction. This increase in duration, year on year, confirms enterprise sentiment on the increasing difficulty of obtaining permits. Overall in 2002, entrepreneurs cited four permits as typically taking over a month to obtain: land allocation, construction, renovation, and placing of trade and services outlets. The maximum response given for the duration of receiving each of these permits was over a year. Table 6 in Annex 3 presents timeframes for obtaining obligatory permits as reported by firms, with a breakdown of responses by size of enterprise.

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Fig. 83 Difficulty of Obtaining the Fire Department Permit to Launch Operations: Regional Variations in 2002

*Results for Zhytomyr may not be statistically significant.*

11 Timeframes are reported as the duration for receiving the final permit, once all necessary approvals and documents have been submitted to the issuing agency.
Permit Costs

Permits costs vary in Ukraine. In current legislation, a clear indication of whether a permit may be issued free of charge or whether firms should pay for the procedures required is the exception rather than the rule. The typical situation is that normative acts which regulate the issuing procedure for a permit do not contain any indication of its official cost.

At the same time, the law allows permit-issuing agencies to charge a fee for their services (carrying out expert assessments, site appraisals, etc.). In the majority of cases, receiving a permit is linked to obtaining such services from regulatory agencies. The tariffs for these services, as a rule, are defined as the cost per one hour of work per agency employee. In each concrete case therefore, the final cost of the service rendered, as well as the amount of hours an employee spends delivering the service in question, may differ significantly. This directly affects the cost of the permit for the entrepreneur.

For this reason, when respondents were asked to cite the price that they paid for obtaining specific permits, answers varied widely. This range of answers went up to UAH 20,000 (US $3,750) for the permit to install small architectural forms and UAH 15,000 (US $2,800) for a permit to begin operations from the Sanitary Service. Table 7 in Annex 3 displays firm responses for costs of obligatory permits, by size of enterprise.

Obstacles in the Permit Process

Firms obtaining permits in 2002 were asked which specific issues during the procedures caused them the most significant difficulties. The main problems in the permit process are the large number of documents required and lengthy timeframes for obtaining permits and their corresponding approvals.

These results do not differ greatly by size of firm. Large firms tend to be less satisfied with the bureaucracy of the process, while small firms cite requirements for unofficial payments and the lack of information on obtaining permits and approvals as relatively more problematic.

![Figure 84](image-url)
Information On Permits and Issuing Procedures

Survey respondents reported that it was most difficult to obtain a complete list of permit requirements from the Land Resources Department, Architecture Department, from local authorities and from the Department of Housing and Municipal Services. All of the agencies listed in Figure 85 were cited by over 30% of respondents as bodies from which it was difficult or very difficult to obtain necessary information on permit procedures.

Figure 85  Obtaining Information on Permit Requirements: Ranking the Transparency of Government Agencies in 2002
(% of firms rating obtaining information as quite difficult or very difficult)

<table>
<thead>
<tr>
<th>Agency</th>
<th>Very Difficult</th>
<th>Quite Difficult</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land Resources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Architecture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Authorities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Department of Municipal and Housing Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sanitary and Epidemiological Service</td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Deparment of Ecology</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fire Department</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Road Police Department</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity Supplier</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labor Protection Department</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Permits Not Obtained

Twelve percent of surveyed firms could not obtain necessary permits in 2002. Of these permit applications, almost every third (28%) was for land allocation, followed by permits for the installation of «small architectural forms» (14%), and 13% for the start-up of operations form the Fire Department and another 13% for beginning construction.

Figure 86  Top 5 Permits Firms Were Unable to Obtain in 2002
(% of firms not able to obtain each permit)

<table>
<thead>
<tr>
<th>Permit</th>
<th>% of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land plot allocation</td>
<td>28</td>
</tr>
<tr>
<td>Placing small architectural forms</td>
<td>14</td>
</tr>
<tr>
<td>Starting construction work</td>
<td></td>
</tr>
<tr>
<td>Fire Department</td>
<td>13</td>
</tr>
<tr>
<td>Construction</td>
<td>13</td>
</tr>
</tbody>
</table>

Over a third (38%) of firms not able to obtain necessary permits in 2002 said that their documents were still under consideration with permit issuing agencies. Another quarter had not obtained needed permits because the timeframe for considering documents was too long. The next most common answer, given by 17% of firms not receiving required permits, was that the application was denied without any documented justification. Interestingly, nearly the same share of firms claimed that either the «unofficial» price was too high, or that the official price was too high.
Unofficial Payments

The survey asked respondent firms to assess how much the typical firm pays to complete a number of regulatory procedures. Permit procedures topped the list for perceived incidence of unofficial payments, with over 40% of all firms citing unofficial costs as likely to be required to receive permits for business activities in Ukraine.

A separate, specific question on unofficial payments was also posed only to those firms who had obtained permits over the course of 2002. Respondents were asked which agencies had required unofficial payments to complete permit procedures. Results show that unofficial payments were solicited from between 10% to 27% of firms, depending on the permit in question. Unofficial payments were most often made to obtain permits for renovation of premises, for start-up of operations from the Fire Department, as well as for land plot allocation and for construction. The share of enterprises citing unofficial payments as required to obtain specific permits in 2002 is shown in Figure 88.

The causes of the incidence of unofficial payments during permit procedures can be linked to the complexity and duration of the procedures and the number of agencies involved in the process. Other issues, such as the lack of transparency of the process, as well as a lack of clarity in the official cost of a number of permits for which prices are not stipulated by law, add to the confusion.
Conclusions

Survey results show that the share of firms receiving permits in Ukraine has declined significantly over the past three years, while the difficulty of obtaining permits, as perceived by firms involved in the process, has increased substantially over the same period. The share of firms obtaining permits is a direct indication of the number of entrepreneurs who are starting their business, expanding operations, improving and upgrading premises, and investing in infrastructure. The reduction in the share of firms obtaining permits suggests a crucial suspension in the rate of development of enterprise in Ukraine. Furthermore, official data on the share of firms registering and launching operations supports the findings of the survey. While the causes of such a decline must be many-sided, it should be recalled that the majority of firms believe that the business environment in their city is not conducive to enterprise growth (Figure 23). The reported increasing difficulty of obtaining permits, which are required to expand business operations, does little to induce firms to invest in their activities.

Permits are documents issued to firms to conduct business activities, in order to standardize enterprise compliance to certain set regulations covering these activities. Given this definition, the government should not attempt to receive direct financial benefits from the issuing of permits to regulate business operations. The advantage received by the government during the process is information on the number of firms working within a certain regulated sphere of business activity, and the corresponding ability to control firm compliance to regulations covering that activity. In attempting to make the issuing of permits a difficult procedure of high prestige and elevated value for firms, the state loses more in taxes than gains through the cost of the permits it issues.

With this in mind, any process of simplifying permit procedures should aim to:

- Shorten the list of activities for which firms must receive a permit from central or local authorities;
- Develop and implement clear, simple and transparent procedures for the issuing of permits;
- Separate the responsibility of agencies which at once issue permits and also have corresponding oversight over their rules and regulations;
- Provide entrepreneurs with realistic access to information on permits and their procedures.

In order to accomplish these goals, the following steps should be implemented:

1. Carry out a thorough analysis of the economic and social benefits and risks which justify the existence of specific permits.
2. Carry out a legislative analysis of the procedures for issuing the remaining permits in order to locate shortcomings and flaws, including:
   - Stipulate an exhaustive list of documents required;
   - Reevaluate and bring into line with contemporary requirements norms, regulations and standards;
   - Separate the responsibilities for issuing permits between central agencies of the executive branch, local representatives of these agencies, and local government authorities;
   - Reconsider the current timeframes and costs involved in the permit process;
   - Stipulate a process for coordinating the actions of the separate agencies involved in issuing a particular permit of set of permits;
3. Introduce the application principle for obtaining permits in cases where the requirements which need to be met are simple to fulfill, and the share of firms obtaining the permit is sufficiently large.
4. Create a system of monitoring adherence to regulations and standards, which distinctly separates responsibility for issuing permits from that of compliance control.
5. Prepare and distribute official documents which contain comprehensive information on the permit process, written in clear and accessible language. Assure that these are updated regularly and easily available for entrepreneurs.
Licensing and its Legal Basis

Licensing of business activities is one of the main regulatory procedures of the government, and aims to ensure the protection of rights, legitimate interests, public safety and health, and the environment. A system of government-issued licenses is also intended to ensure the equality of rights and lawful interests of all companies during the licensing process, as well as to counteract the use of licensing to restrict competition.

In Ukraine, licensing is required for operating a business in a number of fields, 62 of which are specified in the Law «On Licensing Certain Types of Business Activities.» Licenses may be issued either by federal agencies or by authorized local authorities, which are clearly specified in a Resolution of the Cabinet of Ministers. In Ukraine, therefore, the licensing process is an example of one of the few regulatory procedures which operates within a relatively clear and unified legal framework.

A license is an official document which confirms the right of a firm to conduct business activities for a specified length of time and in compliance with particular regulations. A license issued directly by a central executive agency is valid across Ukraine. A license issued by a local office of a central executive agency or by an authorized local authority is valid only in the area of the appropriate administrative and territorial unit.

Most licenses in Ukraine are issued for a set three year term, except for those which allow a firm to provide radio communication services (10 years), telephone communication (15 years), and technical maintenance of television, radio, and wire broadcasting for industrial purposes (5 years).

Main Findings

- In 2002, the progress in licensing that had been made after the enactment of the Law of Ukraine «On Licensing Certain Types of Business Activities» was secured. Thus, only 32% of surveyed firms considered licensing to be a barrier to their business, down from 35% in 2001 and 47% in 2000.
- Fewer firms experience difficulties during the licensing process than during most of the regulatory procedures covered in this report. Thirty two percent reported difficulties with the amount of documents required to submit an application, 23% with the timeframes for reviewing licensing applications, and 16% with the complexity and lack of transparency of the procedures involved in the process.
- The licenses most frequently obtained by firms in Ukraine are for trade in alcoholic beverages and in tobacco products, which together amounted to 41% of all licenses issued to surveyed firms in 2002. The next most common licenses are for construction work and transportation services, which each accounted for less than 10% of licenses obtained in 2002.
- Just 14% of companies obtaining licenses in 2002 reported violations of established deadlines for processing license applications. This figure has dropped sharply from the 41% who cited violations of license issuing terms in 2001.
- Twenty-four percent of business entities receiving licenses in 2002 were required to make unofficial payments during the process. This figure is similar to results obtained in the previous year, 22%.

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1 No. 1775-III dated June 1, 2000
2 As is discussed below, licenses in some fields are covered by separate legislation, specific to the activity in question.
3 Resolution #1698 adopted by the Cabinet of Ministers on November 14, 2000 specifies the list of licensing bodies, and includes 31 federal agencies, the Council of Ministers of the Autonomous Republic of Crimea, 24 oblast administrations, and city administrations in the cities of Kyiv and Sevastopol.
4 License fees are set out in Resolution #1755 of the Cabinet of Ministers adopted on November 29, 2000, “On License Terms for Certain Types of Business Activities, Amounts and Procedure for Calculating Issuance Fee.”
License fees are stipulated by the Cabinet of Ministers and are set at 20 non-taxable minimum incomes, when the license is issued by a central executive agency (UAH 340 or US $64), or 15 non-taxable minimum incomes if it is issued by local representatives of a central executive agency (UAH 225 or US $48). The law also sets clear terms for issuing licenses, and divides the issuing process into three distinct stages: ten working days for considering and approving a licensing application; three working days for sending a notice of approval/dismissal to the applicant; and three working days for issuing the license, once proof of payment of the license fee is received by the issuing agency. The legal basis for licensing also provides an exhaustive list of documents to be attached to an application for obtaining a license for a specific type of business activity.

In addition to the 62 types of business activities that are subject to licensing in accordance with general legislation, a number of specific laws regulate licensing in such fields as banking, provision of financial services, foreign economic activity, broadcasting, power generation and use of nuclear power, education, intellectual property, production of and trade in ethyl alcohol, cognac and fruit spirits, alcohol and tobacco products.

This year’s report shows that 65% of all surveyed companies were required to obtain licenses, a drop of 2% and 5% as compared to results obtained in 2001 and 2000, respectively. Firm managers in Ukraine ranked licensing fifth out of seven potential regulatory barriers to business development. Meanwhile, just under a third of companies cited the licensing process as a barrier to business activities, which represents a slight decrease from the results of 35% obtained in 2001 and 42% in 2000. These findings suggest that some legislative stability has been reached in regulations covering the licensing process, and point towards a positive trend in state regulation of enterprise in the field of licensing. However, the 32% of business owners that still find licensing an obstacle to business represent a large share in absolute terms (Figure 90).

The significant variations that exist in the perception of licensing among entrepreneurs in Ukraine’s oblast centers are an indication of the continued influence exerted by local governments on the licensing process. Since legal regulation of licensing is concentrated at the national level, the problem here lies mainly in enforcement. In other words, regional data may suggest the degree of compliance or non-compliance with existing legislation in the regions, rather than the effectiveness of procedures prescribed by the legislation itself.

When compared to survey results obtained in the year 2001, licensing at the regional level is characterized by considerable improvements in attitudes towards the process in Lviv, a major setback in Khmelnytsky and some regress in Lutsk, Ternopil, Simferopol, Kyiv, and Odesa.
Survey results show that the business activities for which licenses were obtained most frequently has remained unchanged. Most often, company owners obtain licenses for trade in alcohol and tobacco products, transportation, construction, and tourism.

However, there are a number of differences in licensing activity between 2001 and 2002. Results for 2002 display:

- an almost two-fold decrease in the number of licenses issued for passenger and freight transportation services;
- a nearly six-fold increase for licenses issued to conduct educational activities;
- and a more that two-fold increase in the amount of licenses issued to conduct medical practice.
The Most Significant Obstacles in Licensing

More than half of firms obtaining licenses in 2002 experienced difficulties during the process. According to survey results, 32% of respondents receiving licenses cited the large number of documents required with an application as the most significant difficulty encountered. Nearly another quarter of firms cited the long waiting period involved in receiving a license as a problematic issue. As the terms for issuing licenses are clearly stipulated in legislation, and given the relatively small share of firms which cited official violations of the term required to receive a license on the part of government authorities (Figure 92), this assessment of licensing terms as creating a difficulty may be due to respondents implying the term required for completing all documentation necessary for submission, rather than specifically the term required for consideration of the documents by government agencies.

Firms reported that fewer problems were encountered with other issues in the licensing process. Between 16% and 11% of firms had difficulties due to complex and non-transparent procedures, vague or unclear requirements made by licensing authorities, and frequent changes to licensing legislation. Less than 10% of firms had difficulty with the lack of available information about licensing procedures or the need for unofficial payments (Figure 91).

Difficulty of Obtaining Information on Specific Licenses

According to firms applying for licenses in 2002, it is most difficult to acquire complete and accurate information on obtaining licenses in the fields of education, with 72% of applicants citing the procedure as problematic, as well as medical practice, foreign economic activity, and construction, which were each cited by about half of respondent firms. Enterprise representatives had the fewest difficulties obtaining information on licenses for trade in tobacco and alcohol products, which were cited as difficult to obtain by less than 30% of respondents.
Violations of Terms Required to Issue a License

Existing legislation in Ukraine prescribes three distinct stages to the licensing process, and sets the terms for each step in the process:

- 10 working days to consider and pass a decision on a license application;
- 3 working days to send a notice of application approval/dismissal to the applicant;
- 3 working days to issue a license following the receipt of proof that the license fee has been paid.

Fourteen percent of company managers participating in the survey reported violations of the above deadlines for receiving a license. This data shows that considerable progress has been made since 2001, when 41% of survey respondents cited numerous violations of established terms.

Of the three steps in the licensing process, businesses faced the largest amount of problems at the stage of consideration of a license application. According to survey data, fewer entrepreneurs had difficulties with violations of the term required to issue a license, reported by 8% of respondents, and violations of the timeframe for sending an applicant a notice of approval/dismissal of the application, cited by 5% of firms obtaining licenses in 2002.

Nevertheless, it should be taken into account that personal perceptions of survey respondents may have influenced the results to a certain extent. In particular, to obtain a license for a number of specific business activities, it is necessary to complete certain preliminary licensing procedures. For example, a firm wishing to obtain a license for teaching must submit the findings of a preliminary inspection from the Sanitary Service as well as a conception of the type and directions of the teaching activity proposed, which also needs to be first approved by the appropriate government agency. All of these steps require more time. Some respondents may have mistakenly regarded the time spent on obtaining such documents as part of the 10-day term for considering the license application.

Figure 92 Frequency of Violations of Licensing Terms in 2002 (% of firms obtaining licenses)
Survey respondents may have also been mistaken in taking the three-day term for sending an approval/dismissal notice for the three-day term for receiving it. The three-day term required to issue a license may have been violated if business owners presented the appropriate licensing body with a copy of a bank order to transfer the license fee (a payment document appropriately noted by the bank), while the licensing body may have required proof of the arrival of the money to the budget, which is issued by local offices of the State Treasury.

Unofficial Payments in Licensing

According to survey results, 24% of firms were asked to make unofficial payments during the licensing process in 2002. This is similar to the result obtained in 2001, when 22% of business participating in the survey did not deny that they had made unofficial payments when obtaining licenses.8

Conclusions

Licensing appears to present fewer problems than other regulatory procedures, showing that the attention given to the licensing process by agencies of the Ukrainian government has had a positive effect. Surveys performed in the years 2000 and 2001 noted a reduction in the number of business activities that are subject to licensing, as well as in the number of licensing bodies. This year’s survey has confirmed that improvements have been made in government regulation of licensing.

However, even though considerable progress has been achieved in improving licensing procedures, the existing situation is still imperfect. First, almost one third of firms (32% of survey respondents) still view licensing as a barrier to business development. Secondly, more than 25% of firm representatives applying for licenses in 2002 had difficulties with the amount of documents required for submission in order to obtain a license. Thirdly, 14% of company owners cite complex and non-transparent licensing procedures as an obstacle, while 12% named vague and unclear requirements on the part of state agencies as presenting difficulties during the process. At the same time, the considerable discrepancies in assessment of licensing procedures amongst the regions of Ukraine display the continued influence exerted by local authorities on the process.

Proposals

Results of the survey confirm the consolidation of positive trends in the sphere of licensing, since the enactment of the Law of Ukraine «On Licensing Certain Types of Business Activities» in 2000, which solved or simplified a number of previous difficulties in this sphere of state regulatory activity. However, this survey has also revealed that deficiencies in the licensing process remain, both in the sphere of regulations covering licensing procedures, as well as in the practical implementation of regulations which are currently prescribed by law.

Further steps in the improvement of the licensing process should be the following:

- Gradually delegate licensing responsibilities from central government agencies to local authorities -- with the simultaneous introduction of effective procedures for continued oversight of the licensing process by central authorities. Retaining national level oversight of the process would provide a means of countering possible restriction of competition, and limit likelihood of protection of certain local businesses.
- Improve control of licensing at the regional level to standardize the procedure for enforcing existing licensing legislation across the regions of the country.
- Make changes to normative acts, by setting forth lists of documents required to obtain each license, making them as short as possible and clearly specifying the features that such documents are required to have.
- Create local information services to provide comprehensive and complete information on: agencies which have authority to issue licenses; documents that are required to obtain licenses; legally prescribed terms for receiving licenses; license costs, and so forth.

8 Responses for 2001 include firms which considered all information on unofficial payments as “confidential.” In 2002 confidential was no longer an option for this question. Similarity in result between 2002 and 2001 suggests that firms answering “confidential” in previous years did in fact mean “yes”.
Main Findings

- Thirty eight percent of respondent firms reported that their products are liable for mandatory certification. Thirty six percent, meanwhile, cited standardization procedures as relevant to their business activities.
- The process of certification and standardization is one of the least significant barriers to business in Ukraine. Although just over 30% of firms for whom certification or standardization procedures were relevant cited them as a barrier to business in 2002, this represents a substantial drop of 10 percentage points from results obtained in 2000 and 2001.
- Nearly 58% of firms encountered problems while completing mandatory product certification procedures. Ukrainian enterprises singled out the bureaucracy of the process as well as the lack of transparency and simplicity in certification procedures as key difficulties.
- Over half of firms going through the process of standardization in 2002 also experienced difficulties. These firms also cited bureaucracy as the main issue, although they underlined the high cost of obtaining standards as well as the lack of conformity between Ukrainian and international standards as additional key problems.
- Almost a fifth of all firms were required to make unofficial payments while completing certification (22%) and standardization procedures (19%).
- Only 4% of firms have introduced a quality management system, while another 7% opted for voluntary certification.

The Certification and Standardization Process

With the recent passage of the new laws “On Conformity Assessment”, “On Standardization”, and “On the Accreditation of Conformity Assessment Bodies”, which were adopted in 2001, Ukrainian enterprises have been paying more attention to conformity assessment regulations. Conformity assessment refers to activities aimed at ensuring that products, quality assurance systems, environmental management systems, and company personnel meet standards established by law.

Although the laws mentioned above were passed in 2001, firms are still waiting for them to come into force. Conformity assessment is currently still conducted on the basis of the Cabinet of Ministers Decree “On Standardization and Certification”, adopted in 1993. This is due to the fact that as of mid-2003, central authorities responsible for drafting new technical specifications prescribed by these laws and coordinating them with Ukraine’s conformity assessment agency have not completed their task and the specifications have not yet been submitted to the Cabinet of Ministers for approval.

Certification is one particular regulatory aspect of conformity assessment. During the certification process, a government-appointed body confirms that a product, quality or environmental management system, and personnel of a firm meet legal standards. Certification can either be mandatory or voluntary. In the mandatory process product requirements and terms of putting such products into circulation are regulated by applicable legislation. Voluntary certification, on the other hand, is practiced by companies who choose to certify products in order to, for example, distinguish the quality of their goods from that of other producers or service providers.

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1 This figure represents respondents who cited certification or standardization procedures as either a significant or major obstacle to business operations.
Mandatory certification is performed in accordance with conformity assessment regulations. Based on the approval of an authorized certification body, the applicant obtains a certificate of conformity, the standards of which are approved by the national executive body in charge of conformity assessment. In August of 2002, the State Committee for Standardization, Measurements and Certification issued a list of 39 types of products subject to mandatory certification in Ukraine.²

This section analyzes firm attitudes towards the process of mandatory certification of imported and domestically manufactured products as well as firm assessment of the process of standardizing production methods.

Perceptions of Certification and Standardization as Barriers to Business Development

In 2002, 30% of firms who cited certification as relevant to their activities rated the procedures involved as a barrier to business operations and growth. This result represents a drop of 10 percentage points from results obtained in previous years. In 2000, 42% of firms had cited certification procedures as a barrier, while in 2001 this figure had been 40% (Figure 93).

Analysis of these results revealed discrepancies amongst the regions of Ukraine. Thus, certification is viewed as a barrier by just 10% and 11% of firms engaged in the process in Kherson and Sumy, respectively. However, every second respondent firm in Dnipropetrovsk, Cherkasy, Khmelnytsky and Chernivtsi reported that certification is a significant obstacle to their business.

²This list is included in Table 8, Annex 3 of this report.
Table 9 in Annex 3 shows the dynamics of change in the perception of the certification process as a barrier from 2000 through 2002. Firm attitudes toward the certification process have improved the most in Lviv and Kirovograd while firms in Khmelnytsky and Chernigiv have experienced a sharp rise in negative perception of certification.
Mandatory Certification

Thirty-eight percent of survey respondents reported that the products of their firms were subject to mandatory certification. According to the survey, 62% of all surveyed large firms are obliged to certify their products, while this figure is 47% for medium firms and only 29% for small enterprises (Figure 95).

A breakdown of results by sector shows that every second manufacturing firm, every third trading company, and only every seventh transportation firm is required to complete mandatory certification procedures.

Problems in Certification

Of firms who are subject to mandatory certification, just over half, 58%, identified problems during the procedures. A breakdown of these results, by sector of business activity, is presented in Figure 97.
For firms working in such sectors as transportation, services and manufacturing, the share of companies identifying problems during mandatory certification was higher than for other sectors.

Respondents were asked to state which specific problems they encountered while completing mandatory certification procedures. Figure 98 reflects the most frequent problems encountered during mandatory product certification. No significant variations were observed when analyzing this data by firm size or by sector of business activity.

**Figure 98** Problems in Obtaining Certificates of Conformity in 2002
(% of firms citing the issue as a difficulty in certification procedures)

- Number of documents requested
- Long waiting period for obtaining certificates of conformity
- Complex/non-transparent procedures
- Need to obtain several certificates of conformity
- Frequent changes in certification procedures
- Ambiguity of demands made by officials
- Ukrainian certificates of conformity not recognized abroad
- Inaccessibility / Lack of information on certification procedures
- Unofficial payments

Ukrainian enterprises singled out bureaucracy, long waiting periods and the complexity and lack of transparency implicit in certification procedures as the main problems in the certification process.

Enterprise assessment of the difficulty caused in attempting to obtain complete and accurate information on the terms and conditions of product certification in Ukraine are shown in Figure 99. Almost a third of SMEs, and 28% of large companies completing mandatory certification procedures claimed that the process of obtaining full and accurate information about necessary documents, the cost and timeframe of the procedures poses a serious problem.

**Figure 99** Difficulty of Receiving Complete and Accurate Information on Certification Procedures by Firm Size in 2002
(as a % of firms citing certification as relevant to their activities)

- Small
- Medium
- Large

Very Difficult  Quite Difficult  Not too Difficult  Not at all Difficult
Unofficial Payments During Certification

Twenty two percent of company managers reported that they were asked to make unofficial payments during the certification process. When asked to specify the amounts of such payments, the majority of respondents reported that it was within 25% of the official cost of the procedure, and another quarter claimed that the amount of additional payments was between 26% and 50% of the official cost. Only 10% of firms citing the amounts of unofficial payments stated that these amounts exceeded 50% of the official cost of the procedure.³

Standardization

More than a third (36%) of all firms participating in the survey have implemented standardization processes at their company. As can be expected, standardization requirements differ significantly by size of firm. In 2002, 65% of large companies stated that standardization is relevant to their business, while nearly half of medium firms and only a quarter of small firms need to obtain standards for their activities.

When looking at standardization requirements by sector of business activity, survey results show that a greater number of manufacturing and construction companies standardize their products, when compared to firms operating in other lines of business.

Although the majority of enterprises adhere to national standards, a third of all firms implementing standardization procedures developed the technical specifications independently. International ISO standards are applied by just 14% of firms employing standardization processes.
Problems in Standardization

Fifty-six percent of firms reported specific problems with the standardization process. The most common problems encountered during standardization procedures are shown in Figure 102. The bureaucracy of the process was cited as a difficulty by over a quarter of firms. Another problem which stands out are the costs related to obtaining and updating standards in Ukraine. Fifteen percent of firms also cited discrepancies between Ukrainian legislation and international standards as presenting serious difficulties.

Figure 102  Problems Experienced During the Standardization Process in 2002

(\% of firms experiencing problems with standardization procedures)

- Number of documents requested
- High cost of obtaining / updating of standards
- Long waiting period for standardization
- Ukrainian standards not harmonized with international standards
- Complex / non-transparent procedures
- Ambiguity of demands made by officials
- Frequent changes in standardization procedures
- Inaccessibility / Lack of information on standardization procedures
- Unofficial payments

Applying for complete and accurate information about documents, fees, and waiting periods with regard to standardization procedures was cited as an obstacle in the process by over a quarter of all firms citing standards as relevant to their activities. The share of small firms (34\%) which suffer from lack of access to information on standardization is significantly higher in comparison to medium (25\%) and large companies (24\%).
Unofficial Payments During Standardization

Nineteen percent of company managers claimed that unofficial payments were required in order to complete standardization procedures. The cost of unofficial payments is similar to those required for certification. Two thirds of respondents agreeing to indicate the costs involved stated that the amount of unofficial payments was within 25% of the official cost of the procedure. Only 11% of responding firms indicated that the amount of unofficial payments exceeded 50% of the official cost of the procedure.  

Conclusions: Quality Assurance and Quality Management

The strategic restructuring of companies in Ukraine, by formulating new business strategies, investing in modern technology, developing new products, and adopting competitive business practices is critical to enhancing the competitiveness of Ukrainian economy.

Firm representatives participating in the survey were asked to report which steps were taken in the years 2000 through 2002 to increase the level of competitiveness of their enterprise, with a special stress on two specific activities - quality management and voluntary product certification. Survey findings show that just 4% of the entire survey sample, and 6% of industrial enterprises, have introduced ISO-based quality management.

Voluntary product certification is another option for companies wishing to promote their products on the market. According to survey results, 7% of surveyed firms, and 11% of industrial enterprises, have adopted such practices. The percentages shown above are rather low, suggesting a low level of competitiveness of Ukrainian enterprises. Such issues will become more acute with the upcoming expansion of the European Union and the progressive integration of Ukrainian firms into the world economy, when local firms will be required to compete not only with foreign firms across the border but also with multinational enterprises.

In order to gain real benefit from WTO membership, the economic policies of Ukraine should be directed towards speeding up innovation in potentially competitive sectors, and creating a favorable business environment in the country. Adjustment of national legislation in the areas of taxation, customs, as well as certification and standardization to WTO standards and regulations is necessary to increase the volume of sales of Ukrainian goods and services entering foreign markets. Without enhancing the innovative capacities of local companies, and assuring that certification and standardization processes meet or exceed western standards, Ukraine cannot rely on the advantages of global trade in the future.
Main Findings

- Firms rank the registration process as the lowest regulatory barrier to business development in Ukraine.
- According to entrepreneurs, business registration is nevertheless quite an expensive procedure. In 2002, the average cost of registering a company in Ukraine was approximately UAH 788 (US $148) for self-completed registration procedures.
- The average company spends 46 days on registration procedures, a result which shows that formal deadlines for completing registration procedures are not always met.
- Nineteen percent of respondents who registered their companies in 2002 claimed that they were required to make unofficial payments during the process.
- One-stop shops (OSS) significantly reduce the barriers to registration in Ukraine. As results from the Ivano-Frankivsk OSS show, in 2002 both the cost and duration of registration were half the Ukraine average, while firms report zero corruption and increased access to information on registration procedures.
- The Law "On Registration" will come into force in July of 2004. The law is a significant step towards simplifying registration procedures, not least of all because it will introduce a complete list of documents that entrepreneurs need to submit in order to register a company. At the same time, the law will make many "post-registration" procedures automatic for registering firms.

Registration and its Legal Basis

This section analyzes the process of registering companies in Ukraine. In accordance with the terminology used in this report, the registration process is conditionally divided into three stages:

1. Pre-registration, including collection of information and preparation of necessary documents;
2. State registration, which is completed once the certificate of state registration is obtained and a business entity has emerged;
3. Post-registration procedures,^ which follow receipt of the state registration certificate and include obligatory registration with:
   - the local office of the State Tax Administration;
   - the State Statistics Department;
   - the Unemployment Insurance Fund;
   - the Accident Insurance Fund;
   - the Temporary Disability Fund;
   - the Pension Fund;
   - the Ministry of Internal Affairs (to have the company stamp and seal made);
   - The process of opening a bank account is also part of post-registration procedures.

It is important to note that in Ukraine, completing the process detailed above is not in fact sufficient for a firm to begin operations. All entrepreneurs, once they have registered a company, must receive separate and obligatory permits from three additional state agencies before they can begin running their business. Effectively, this process is linked to firm registration, and adds to the costs, duration and complications involved in the procedure of launching a firm in Ukraine.

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^It is impossible to open a bank account without a proper proof of such registration. In addition, sanctions may be imposed for failure to register with the above agencies.

^ Each of these obligatory permits is separately issued by the Fire Department, the Sanitary and Epidemiological Service, and the Labor Protection Agency. Additional permits may also be required for a firm to begin operations.
Overall, state registration of business entities in Ukraine is governed by the Law of Ukraine “On Entrepreneurship” dated February 7, 1991. To enforce the Law and to specify some of its provisions, the Cabinet of Ministers of Ukraine adopted Resolution #740 on May 25, 1998 entitled “Regulation on State Registration of Business Entities”. In addition, the Cabinet of Ministers determines the procedure for maintaining business entity registers and the cost of state registration.

The Parliament of Ukraine has recently adopted the Law “On Registration”, which will come into effect on July 1, 2004. The main distinctions of registration procedures according to the new law will be:

- an increase in the official fee for receipt of the state registration certificate from the equivalent of 7 (UAH 119) to 10 (UAH 170) non-taxable minimum incomes;
- reduction of the time needed to receive a state registration certificate from 5 to 3 days. Additionally, the option of accelerated registration (1 day) will no longer be provided;
- a complete list of documents which entrepreneurs need to submit with their registration application will be provided within the legislation.
- the grounds for completing registration procedures at the State Statistics Office, State Tax Administration, Pension Fund and Social Insurance Fund will be an official notification from the State Registrar that the firm has received a state registration certificate. The registrar will also directly communicate other necessary data on the new firm to these agencies.

The new Law also stipulates the additional documents which should be supplied to registering authorities in addition to those in the generally established list. These additional documents depend on the chosen legal form of the registering company. The fact that this additional information will be clearly set out in the law will reduce the amount of hassle and guesswork registering firms are subject to while completing registration procedures.

Registration as a Barrier to Business

As was the case in 2001, in 2002 registration was ranked as the regulatory procedure presenting the least significant barriers to business development. In 2002, only 17% of respondents who registered their companies found the registration process to be an obstacle to starting a business, down from 21% in 2001 and 25% in 2000.

Figure 104 Perceptions of Registration Procedures as a Barrier to Business Development, 2000-2002

(% of all firms)
Registration Procedures

Sixty-five percent of all respondents who registered their companies in 2002 did it alone. In 2002, 19% of entrepreneurs used the services of intermediaries providing “turnkey registration”, similar to the result of 18% received in 2001.

When asked to assess difficulties of obtaining complete and accurate information on terms of registration, such as lists of documents required, costs, deadlines and procedures which need to be completed, from government agencies, nearly 63% of respondents claimed that obtaining such information is not difficult.

Given the small share of firms completing registration procedures, it is not possible to analyze all of the difficulties in the process, yet survey results show a distinct trend: the difficulties in obtaining information faced by the remaining 37% of firms caused many of the delays and increases in the cost of registration for firms, and often resulted in some form of unofficial payments.

Although enterprise registration was cited as the least significant regulatory obstacle to the development of business, only 19% of respondents said they had had no difficulty in registering their companies. In answering the question about what had caused the most difficulty in the registration process, entrepreneurs ranked the large number of documents required first, cited by 30% of respondents, and unofficial payments last, with 7% of all respondents citing this as a difficulty.
The level of service at agencies involved in the registration process is another cause of concern for companies. Thus, 22% of respondents complained about long lines and the limited number of work days at the Unemployment Insurance Fund, while fully 41% were dissatisfied with the level of client service at the State Registration Department (Figure 108).

Time Required to Complete Registration Procedures

The duration of the registration process in Ukraine has changed very little over the past year. In 2002, firms required an average of 46 working days to complete all registration procedures, as compared to 42 working days in 2001.

To obtain a registration certificate, almost 85% of respondents chose the regular procedure in 2002, which takes five working days, while only 15% of enterprises opted for the fast-track procedure, completed within one working day. With the new Law on State Registration, this one day procedure will be eliminated. Although only one in seven
surveyed companies used this expedited service in 2002, this is not an insignificant number and it will be useful to watch how the new law will affect registration times.

Although the law clearly sets the time required to receive a registration certificate at five days, this procedure averaged 15 working days for surveyed firms across the country in 2002.

Cost of Registration

Survey results show that completion of all registration procedures costs firms an average of UAH 788 (US $148) if they do it alone, or UAH 1,120 (US $211) if they hire an intermediary or an external consultant to complete either some or all of the necessary steps for them. These reported amounts include all official and unofficial payments, as well as costs inherent in pre-registration formalities. This cost factor goes towards explaining why 65% of respondents registered their companies alone, and only 35% hired intermediaries.

Unofficial Payments

Many companies in Ukraine claim that they often have to make unofficial payments in the course of day-to-day business activities. The case does not change with the registration process.

In responding to a question which asked them to rate the sum that most businesses pay to complete registration procedures, 30% of all firms surveyed claimed that companies are asked to pay the official cost of registration procedures and to make additional unofficial payments. At the same time, only 19% of businessmen who registered their companies in 2002 confirmed that unofficial payments had indeed been required during the process. The number of responses confirming the existence of the practice of unofficial payments, given the rather small amount of surveyed firms registering in 2002, makes it impossible to draw a statistically correct conclusion about the amounts of such payments.

Conclusions

Survey results show that registration procedures have not undergone any considerable changes or improvements in year-on-year terms. Just like in 2001, the registration process does not represent a major obstacle to an enterprise entering the market. Neither the time nor the cost of registration have undergone any radical changes in the last two years. Despite the absence of any negative tendencies, a number of problems remain unresolved, such as the availability and transparency of information, adherence to official deadlines for completing registration, and the practice of unofficial payments.

The official cost of obtaining a state registration certificate is set by current law at UAH 119 (US$23). Despite its name however, this certificate is not enough to register a company in Ukraine. In order to complete the entire process of registration, including registration with all mandatory agencies after receiving a state registration certificate ("post-registration" procedures), Ukrainian entrepreneurs reported paying an average of UAH 788 (US$148) in 2002. In addition, all start-ups in Ukraine must obtain at least three separate permits before they can begin operations. The costs and times involved in these additional procedures are discussed in detail in the Permits section of this report.

In July of 2004, the new "Law on Registration" will take effect. This legislation, in its current form, will be a positive step towards simplifying the registration process. However, Ukraine’s entrepreneurs will need to wait for the normative acts which will underpin and result from this general framework, to see if the process and procedures for registration in Ukraine will be greatly improved with the new legislation.

Meanwhile, results of the work of the Registration Chamber in Ivano-Frankivsk demonstrate the efficiency of a one-window approach to registration, and are detailed in Box “One Window Registration”. As can be seen from the results of this survey, most obstacles to the registration process in Ukraine have either been significantly reduced or outright eliminated in Ivano-Frankivsk, with the help on the One Stop Shop approach.
'One Window' Registration (One Stop-Shop)

In May 2002, a one window registration chamber began operations in Ivano-Frankivsk. Its main advantages include:

1. Full registration of firms with all obligatory agencies is performed through a "one-window", one-stop-shop procedure
2. Time required to complete registration procedures through the one-stop-shot does not exceed 10 working days

This survey included 25 entrepreneurs who had registered their enterprises at the Registration Chamber in Ivano-Frankivsk. Survey results for the registration one stop shop demonstrate that:

- **Registration time is significantly reduced.** On average, complete registration takes less than 18 working days (11 days for pre-registration (document preparation), and 7 days for state registration and post-registration procedures combined). For comparison, the average for Ukraine is 46 working days (19 days for preparation and 27 days for the state registration and post-registration procedures);
- **Registration cost is significantly reduced.** The average cost of registration for firms going through the one-stop shop in Ivano-Frankivsk amounted to UAH 265 (US$50). For comparison, the average for Ukraine as whole in 2002 was UAH 788 UAH (US$148).
- **Unofficial payments are not demanded at the Ivano-Frankivsk OSS.** At the same time, in Ukraine as a whole 19% of respondents have confirmed the need for unofficial payments during registration.
- **Eighty-seven percent of respondents registering through the OSS claimed that it was not difficult to receive complete and reliable information on registration requirements** from the government agencies involved. This figure is 24% higher than the average for Ukraine.

These findings demonstrate the efficiency of the work of the Registration Chamber in Ivano-Frankivsk and should serve to provide impetus for creation of similar agencies across Ukraine, thereby eliminating many of the barriers to a regulatory procedure which all enterprises must undergo.
Sample and Methodology

Timing of the survey
The field work for this survey was carried out by Ukraine Marketing Group, an independent market-research firm in April 2003.

Structure of the questionnaire
Questionnaires were prepared in Ukrainian and Russian. To ensure that questions would be correctly understood and clearly interpreted by respondent firms, the questionnaire was tested at 30 companies in Kyiv. These companies represented a variety of sectors of business activity, in order to be able to spot sector-specific issues at an initial stage.

Questioning was conducted on the basis of three separate questionnaires covering a number of aspects of the commercial activities of each enterprise. Two sections were based on personal interviews, while respondents were asked to complete one questionnaire individually. The questionnaire covered a total of 160 questions.

Sample selection
Sample parameters were obtained from State Tax Administration. The sample had two basic requirements (1) it should allow comparisons with surveys conducted in 2000 and 2001; and (2) it should be representative of business in Ukraine. As samples used in previous years had focused on both SMEs and large enterprises located in the oblast centers of Ukraine, the 2002 sample retained this structure.

Selection of firms was random, based on a specific number of firms per sector per city without regard to the size or origin of an enterprise. Manufacturing firms were selected proportionally by region, while selection of all other firms was based on fixed quotas established for each sector of business activity.

The final sample consisted of 14 enterprises randomly selected from a list based on printed and electronic databases of enterprises in Ukraine. When necessary, these were amended by information from regional representatives. The selection was made with regard to the quotas mentioned above.

The sample consisted of small (up to 50 employees), medium (51-249 employees) and large (over 249 employees) enterprises. Individual entrepreneurs and micro-enterprises were intentionally excluded from the sample.

A sectoral breakdown of the sample is as follows:

Table 1  Sectors of Business Activity

<table>
<thead>
<tr>
<th>Sector</th>
<th>Firm Types</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>Heavy and light industry, food processing, energy industry and industry of construction materials</td>
</tr>
<tr>
<td>Construction</td>
<td>Construction service companies</td>
</tr>
<tr>
<td></td>
<td>Producers of construction materials are covered under manufacturing</td>
</tr>
<tr>
<td>Trade</td>
<td>Wholesale and retail</td>
</tr>
<tr>
<td>Public Catering</td>
<td>Restaurants, canteens and cafes</td>
</tr>
<tr>
<td>Transport</td>
<td>Freight services, passenger transportation and public transportation</td>
</tr>
<tr>
<td>Financial Sector</td>
<td>Commercial banks and insurance companies</td>
</tr>
<tr>
<td>Services</td>
<td>Hotels, travel agencies, and domestic service firms</td>
</tr>
</tbody>
</table>

1 Due to the lack of separate statistical information available on firms in Ukraine with between 51-249 employees.
The sectors noted above were selected in order to encompass a broad selection of business in Ukraine, while following the sectoral breakdown used by the State Statistics Committee of Ukraine when compiling national statistics. Firms were selected based on their self-stated primary line of activities. Agricultural enterprises were intentionally excluded.

### Table 2
**Sample Structure by Firm Size**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>435</td>
<td>256</td>
<td>244</td>
<td>935</td>
</tr>
<tr>
<td>Construction</td>
<td>58</td>
<td>34</td>
<td>15</td>
<td>107</td>
</tr>
<tr>
<td>Transport</td>
<td>45</td>
<td>24</td>
<td>13</td>
<td>82</td>
</tr>
<tr>
<td>Trade</td>
<td>282</td>
<td>42</td>
<td>6</td>
<td>330</td>
</tr>
<tr>
<td>Public Catering</td>
<td>115</td>
<td>12</td>
<td>1</td>
<td>128</td>
</tr>
<tr>
<td>Financial Sector</td>
<td>32</td>
<td>19</td>
<td>16</td>
<td>67</td>
</tr>
<tr>
<td>Service</td>
<td>303</td>
<td>50</td>
<td>12</td>
<td>365</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>1270</td>
<td>437</td>
<td>307</td>
<td>2014</td>
</tr>
</tbody>
</table>

### Table 3
**Sample Structure by City**

<table>
<thead>
<tr>
<th>Region</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cherkasy</td>
<td>45</td>
<td>16</td>
<td>5</td>
<td>66</td>
</tr>
<tr>
<td>Chernigiv</td>
<td>43</td>
<td>13</td>
<td>9</td>
<td>65</td>
</tr>
<tr>
<td>Chernivtsi</td>
<td>43</td>
<td>18</td>
<td>4</td>
<td>65</td>
</tr>
<tr>
<td>Dnipropetrovsk</td>
<td>66</td>
<td>21</td>
<td>29</td>
<td>116</td>
</tr>
<tr>
<td>Donetsk</td>
<td>52</td>
<td>22</td>
<td>44</td>
<td>118</td>
</tr>
<tr>
<td>Ivano-Frankivsk</td>
<td>50</td>
<td>10</td>
<td>5</td>
<td>65</td>
</tr>
<tr>
<td>Kharkiv</td>
<td>82</td>
<td>22</td>
<td>10</td>
<td>114</td>
</tr>
<tr>
<td>Kherson</td>
<td>34</td>
<td>23</td>
<td>9</td>
<td>66</td>
</tr>
<tr>
<td>Khmelnytsky</td>
<td>50</td>
<td>5</td>
<td>10</td>
<td>65</td>
</tr>
<tr>
<td>Kirovograd</td>
<td>39</td>
<td>16</td>
<td>9</td>
<td>64</td>
</tr>
<tr>
<td>Kyiv</td>
<td>103</td>
<td>54</td>
<td>31</td>
<td>188</td>
</tr>
<tr>
<td>Lugansk</td>
<td>47</td>
<td>12</td>
<td>17</td>
<td>76</td>
</tr>
<tr>
<td>Lutsk</td>
<td>38</td>
<td>19</td>
<td>9</td>
<td>66</td>
</tr>
<tr>
<td>Lviv</td>
<td>58</td>
<td>12</td>
<td>16</td>
<td>86</td>
</tr>
<tr>
<td>Mykolaiv</td>
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<td>14</td>
<td>5</td>
<td>69</td>
</tr>
<tr>
<td>Odesa</td>
<td>56</td>
<td>30</td>
<td>12</td>
<td>98</td>
</tr>
<tr>
<td>Poltava</td>
<td>43</td>
<td>13</td>
<td>9</td>
<td>65</td>
</tr>
<tr>
<td>Rivne</td>
<td>45</td>
<td>12</td>
<td>8</td>
<td>65</td>
</tr>
<tr>
<td>Simferopol</td>
<td>59</td>
<td>20</td>
<td>13</td>
<td>92</td>
</tr>
<tr>
<td>Sumy</td>
<td>39</td>
<td>18</td>
<td>6</td>
<td>63</td>
</tr>
<tr>
<td>Ternopil</td>
<td>50</td>
<td>12</td>
<td>3</td>
<td>65</td>
</tr>
<tr>
<td>Uzhgorod</td>
<td>50</td>
<td>8</td>
<td>6</td>
<td>64</td>
</tr>
<tr>
<td>Vinnitsia</td>
<td>36</td>
<td>19</td>
<td>15</td>
<td>70</td>
</tr>
<tr>
<td>Zaporizhia</td>
<td>52</td>
<td>15</td>
<td>12</td>
<td>79</td>
</tr>
<tr>
<td>Zhytomyr</td>
<td>40</td>
<td>13</td>
<td>11</td>
<td>64</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>1270</td>
<td>437</td>
<td>307</td>
<td>2014</td>
</tr>
</tbody>
</table>
Permit for Transferring Residential Premises to Commercial Use

1. Receive the list of required documents:
   - Application Form 1a
   - Copy of Company Charter 1b
   - Copy of Certificate of State Registration 1c
   - Copy of proof of ownership of premises 1d
   - Copy of architectural plan of premises 1e
   - Copy of document stipulating that no one is registered in the premises 1f

2. Fill out Application Form 1a for the City Executive Committee for getting a permit to transfer residential premises to commercial use.

3. Receive information on documents required for receiving document stipulating that no one is registered in the premises 1f.

4. Receive document stipulating that there are no arrears in communal services payments for the premises.

5. Submit document stipulating that there are no arrears in communal services payments for the premises.
   Receive document stipulating that no one is registered in the premises 1f.

6. Request a copy of the architectural plan of premises 1e.

7. Receive a copy of the architectural plan of premises 1e.

8. Make Copies of:
   - Application Form 1a
   - Company Charter 1b
   - Certificate of State Registration 1c
   - Proof of ownership of premises 1d
   - Architectural plan of premises 1e
   - Document stipulating that no one is registered in the premises 1f

9. Notarize
   - Copies of Company Charter 1b
   - Copies of Certificate of State Registration 1c
   - Copies of proof of ownership of premises 1d

10. Submit
    - Application Form 1a
    - Copy of Company Charter 1b
    - Copy of Certificate of State Registration 1c
    - Copy of proof of ownership of premises 1d
    - Copy of architectural plan of premises 1e
    - Copy of Document stipulating that no one is registered in the premises 1f

11. Wait for 30 days
    For official notification that the City Executive Committee met and made a decision
    If the application is not rejected and there are no requirements for additional documents to be submitted, the City Executive Committee sends its application to the Inter-Department Commission for consideration.
Business Environment in Ukraine

Provide
- Copy of Application Form 1a
- Copy of Company Charter 1b
- Copy of Certificate of State Registration 1c
- Copy of proof of ownership of premises 1d
- Copy of architectural plan of premises 1e
- Copy of document stipulating that no one is registered in the premises 1f
Set up meeting with officer at the premises for a preliminary inspection

Premises Inspection by Sanitary and Epidemiological Service Officer

Receive approval for the transfer of residential premises to commercial use

Provide
- Copy of Application Form 1a
- Copy of Company Charter 1b
- Copy of Certificate of State Registration 1c
- Copy of proof of ownership of premises 1d
- Copy of architectural plan of premises 1e
- Copy of document stipulating that no one is registered in the premises 1f
Set up meeting with officer at the premises for a preliminary inspection

Premises Inspection by Fire Department Officer

Receive approval for the transfer of residential premises to commercial use

Provide
- Copy of Application Form 1a
- Copy of Company Charter 1b
- Copy of Certificate of State Registration 1c
- Copy of proof of ownership of premises 1d
- Copy of architectural plan of premises 1e
- Copy of document stipulating that no one is registered in the premises 1f
Set up meeting with officer at the premises for a preliminary inspection

Premises Inspection by Communal Services Department Officer

Receive approval for the transfer of residential premises to commercial use

Submit approval for the transfer of residential premises to commercial use from Sanitary and Epidemiological Service, Fire Department and Communal Services Department

Wait for 14 days
Decision is positive only if all three approvals from Sanitary and Epidemiological Service, Fire Department and Communal Services Department were obtained. If there are no requirements for additional documents to be submitted, the Inter-Department Commission sends its decision to the City Executive Committee for consideration

Wait for 14 days
During a regular meeting the City Executive Committee makes its decision on the transfer of residential premises to commercial use
Receive the official document, confirming approval for the transfer of residential premises to commercial use
### Table 1

<table>
<thead>
<tr>
<th>Issue</th>
<th>Firm Size 2002</th>
<th>Firm Size 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Small</td>
<td>Medium</td>
</tr>
<tr>
<td>Inspections</td>
<td>46</td>
<td>47</td>
</tr>
<tr>
<td>Requirements to make &quot;voluntary&quot; contributions</td>
<td>40</td>
<td>39</td>
</tr>
<tr>
<td>Customs procedures</td>
<td>37</td>
<td>34</td>
</tr>
<tr>
<td>Obtaining permits/ approvals</td>
<td>36</td>
<td>34</td>
</tr>
<tr>
<td>Licensing procedures</td>
<td>32</td>
<td>34</td>
</tr>
<tr>
<td>Certification procedures</td>
<td>32</td>
<td>32</td>
</tr>
<tr>
<td>Registration/ Re-registration procedures</td>
<td>21</td>
<td>18</td>
</tr>
</tbody>
</table>

### Figure 1

The Cost of Regulatory Procedures - Official vs. Unofficial Payments in 2002

(\% of all firms)
Figure 2: Perceptions of Main Barriers to Business Development in Ukraine in 2002 (ranked by % of firms citing the procedure as a significant or major barrier)
### Table 2: Comparison of Barriers to Business Development, 2000 - 2002 (ranked by % of respondents citing the issue as a major or significant obstacle in 2002)

<table>
<thead>
<tr>
<th>Issue</th>
<th>2002 %</th>
<th>2001 %</th>
<th>2000 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxation</td>
<td>70</td>
<td>70</td>
<td>83</td>
</tr>
<tr>
<td>Unstable Legislation</td>
<td>69</td>
<td>63</td>
<td>n/a</td>
</tr>
<tr>
<td>Cost of Energy Resources</td>
<td>65</td>
<td>65</td>
<td>n/a</td>
</tr>
<tr>
<td>Anti-Competitive Practices</td>
<td>56</td>
<td>45</td>
<td>53</td>
</tr>
<tr>
<td>Insufficient Purchasing Power</td>
<td>56</td>
<td>59</td>
<td>70</td>
</tr>
<tr>
<td>Political Instability</td>
<td>51</td>
<td>40</td>
<td>n/a</td>
</tr>
<tr>
<td>Corruption</td>
<td>51</td>
<td>39</td>
<td>46</td>
</tr>
<tr>
<td>Inflation, Economic Instability</td>
<td>48</td>
<td>45</td>
<td>65</td>
</tr>
<tr>
<td>Regulatory Environment</td>
<td>43</td>
<td>38</td>
<td>44</td>
</tr>
<tr>
<td>Obtaining External Financing</td>
<td>41</td>
<td>42</td>
<td>24</td>
</tr>
<tr>
<td>Lack of Skilled Labor</td>
<td>41</td>
<td>41</td>
<td>n/a</td>
</tr>
<tr>
<td>Local Authorities Interference in Business Activities</td>
<td>40</td>
<td>23</td>
<td>24</td>
</tr>
<tr>
<td>Contract Fulfillment by Partners</td>
<td>40</td>
<td>26</td>
<td>n/a</td>
</tr>
<tr>
<td>Central Government Authorities Interference in Business Activities</td>
<td>35</td>
<td>19</td>
<td>n/a</td>
</tr>
<tr>
<td>Underdeveloped Infrastructure</td>
<td>29</td>
<td>25</td>
<td>39</td>
</tr>
<tr>
<td>Poor Supply of Goods from Firms Working in Related Sectors</td>
<td>28</td>
<td>25</td>
<td>35</td>
</tr>
<tr>
<td>Criminal Pressure</td>
<td>26</td>
<td>13</td>
<td>15</td>
</tr>
</tbody>
</table>

### Table 3: Comparison of Barriers to Business Development by Firm Size, 2002 (ranked by % of respondents citing the issue as a major or significant obstacle)

<table>
<thead>
<tr>
<th>Issue</th>
<th>Small %</th>
<th>Medium %</th>
<th>Large %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxation</td>
<td>66</td>
<td>78</td>
<td>83</td>
</tr>
<tr>
<td>Unstable Legislation</td>
<td>66</td>
<td>76</td>
<td>75</td>
</tr>
<tr>
<td>Cost of Energy Resources</td>
<td>60</td>
<td>72</td>
<td>75</td>
</tr>
<tr>
<td>Anti-Competitive Practices</td>
<td>55</td>
<td>59</td>
<td>57</td>
</tr>
<tr>
<td>Insufficient Purchasing Power</td>
<td>53</td>
<td>58</td>
<td>64</td>
</tr>
<tr>
<td>Political Instability</td>
<td>46</td>
<td>59</td>
<td>58</td>
</tr>
<tr>
<td>Corruption</td>
<td>50</td>
<td>54</td>
<td>51</td>
</tr>
<tr>
<td>Inflation, Economic Instability</td>
<td>46</td>
<td>49</td>
<td>52</td>
</tr>
<tr>
<td>Regulatory Environment</td>
<td>44</td>
<td>41</td>
<td>38</td>
</tr>
<tr>
<td>Obtaining External Financing</td>
<td>38</td>
<td>47</td>
<td>49</td>
</tr>
<tr>
<td>Lack of Skilled Labor</td>
<td>36</td>
<td>47</td>
<td>50</td>
</tr>
<tr>
<td>Local Authorities Interference in Business Activities</td>
<td>38</td>
<td>45</td>
<td>41</td>
</tr>
<tr>
<td>Contract Fulfillment by Partners</td>
<td>35</td>
<td>46</td>
<td>47</td>
</tr>
<tr>
<td>Central Government Authorities Interference in Business Activities</td>
<td>34</td>
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<td>34</td>
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<tr>
<td>Underdeveloped Infrastructure</td>
<td>28</td>
<td>30</td>
<td>27</td>
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<tr>
<td>Poor Supply of Goods from Firms Working in Related Sectors</td>
<td>27</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>Criminal Pressure</td>
<td>26</td>
<td>32</td>
<td>22</td>
</tr>
</tbody>
</table>
Figure 3  Regional Differences in Firm Perceptions of the Quality of State Communal Services and State Regulatory Functions (weighted average by region)
Figure 4A Violations of Terms Usually Go Along with Difficulties to Obtain Information (% of importing firms)

Figure 4B (% of exporting firms)
## Table 4  
**Full List of Permits Proposed for Respondent Evaluation**

| Permit from Sanitary and Epidemiological Service to start operations |
| Permit from Fire Department to start operations |
| Permit from Labor Protection Department to start operations |
| Land Plot Allocation Permit |
| Placing Small Architectural Forms Permit |
| Right to Occupy Premises |
| Permit to Renovate Premises |
| Permit for Construction |
| Placing Trade/Services Outlets Permit |
| Gas Supply Permit |
| Water Supply Permit |
| Electricity Supply Permit |
| Permit for Marginal Industrial Emission |
| Permit to start Construction Work |
| Road Police Approval to Place Trade/Services Outlets |

## Table 5  
**Difficulty of Obtaining Obligatory Permits in Oblast Centers, 2001-2002**  
(% of firms citing each permit as difficult of very difficult to obtain)

<table>
<thead>
<tr>
<th>City</th>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SES^1</td>
<td>Fire^2</td>
</tr>
<tr>
<td>Cherkasy</td>
<td>66.7</td>
<td>78.6</td>
</tr>
<tr>
<td>Khmelnytsky</td>
<td>50.0</td>
<td>70.8</td>
</tr>
<tr>
<td>Dnipropetrovsk</td>
<td>67.2</td>
<td>35.5</td>
</tr>
<tr>
<td>Chernivtsi</td>
<td>55.6</td>
<td>40.0</td>
</tr>
<tr>
<td>Kirovograd</td>
<td>40.6</td>
<td>50.0</td>
</tr>
<tr>
<td>Kyiv</td>
<td>42.3</td>
<td>65.5</td>
</tr>
<tr>
<td>Simferopol</td>
<td>40.0</td>
<td>44.8</td>
</tr>
<tr>
<td>Kherson</td>
<td>45.2</td>
<td>42.5</td>
</tr>
<tr>
<td>Lutsk</td>
<td>36.8</td>
<td>43.3</td>
</tr>
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<td>Donetsk</td>
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<td>Ivano-Frankivsk</td>
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<td>16.0</td>
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<tr>
<td><strong>Ukraine Average</strong></td>
<td>39.3</td>
<td>42.2</td>
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^1 Permit from Sanitary and Epidemiological Service to start operations  
^2 Permit from Fire Department to start operations  
^3 Permit from Labor Protection Department to start operations
### Table 6  Average and Maximum Waiting Period for Obtaining Obligatory Permits in 2002  
*(working days)*

<table>
<thead>
<tr>
<th>Service</th>
<th>Small Average</th>
<th>Small Maximum</th>
<th>Medium Average</th>
<th>Medium Maximum</th>
<th>Large Average</th>
<th>Large Maximum</th>
</tr>
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<tr>
<td>Sanitary and Epidemiological Service</td>
<td>8</td>
<td>80</td>
<td>10</td>
<td>130</td>
<td>11</td>
<td>80</td>
</tr>
<tr>
<td>Fire Department</td>
<td>9</td>
<td>250</td>
<td>8</td>
<td>129</td>
<td>9</td>
<td>50</td>
</tr>
<tr>
<td>Labor Protection Department</td>
<td>9</td>
<td>260</td>
<td>7</td>
<td>43</td>
<td>7</td>
<td>43</td>
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</table>

### Table 7  Average and Maximum Cost of Obligatory Permits in 2002  
*(UAH)*

<table>
<thead>
<tr>
<th>Service</th>
<th>Small Average</th>
<th>Small Maximum</th>
<th>Medium Average</th>
<th>Medium Maximum</th>
<th>Large Average</th>
<th>Large Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sanitary and Epidemiological Service</td>
<td>210</td>
<td>7500</td>
<td>1016</td>
<td>15000</td>
<td>1403</td>
<td>15000</td>
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<td>Fire Department</td>
<td>300</td>
<td>10000</td>
<td>653</td>
<td>8000</td>
<td>180</td>
<td>10000</td>
</tr>
<tr>
<td>Labor Protection Department</td>
<td>203</td>
<td>5000</td>
<td>482</td>
<td>3500</td>
<td>482</td>
<td>3500</td>
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<tr>
<td></td>
<td>Products Subject to Mandatory Certification in Ukraine</td>
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<tr>
<td>---</td>
<td>-----------------------------------------------------</td>
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<td></td>
</tr>
<tr>
<td>1.</td>
<td>Electrical household and analogous appliances, accessories</td>
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</tr>
<tr>
<td>2.</td>
<td>Lighting production and accessories</td>
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</tr>
<tr>
<td>3.</td>
<td>Hand-powered mechanical machines, portable machines, machine hoisting tools with insulated hand-knobs</td>
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</tr>
<tr>
<td>4.</td>
<td>Radio-electronic home appliances</td>
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<tr>
<td>5.</td>
<td>Computers and calculating machines</td>
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</tr>
<tr>
<td>6.</td>
<td>Special self-defense facilities</td>
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</tr>
<tr>
<td>7.</td>
<td>Production equipment for food, dairy and meat industries, trade and public catering enterprises, food processing enterprises</td>
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<td></td>
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</tr>
<tr>
<td>8.</td>
<td>Medical equipment</td>
<td></td>
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</tr>
<tr>
<td>9.</td>
<td>Toys</td>
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<td>10.</td>
<td>Detergents</td>
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<tr>
<td>11.</td>
<td>Small-size tractors</td>
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</tr>
<tr>
<td>12.</td>
<td>Engines for tractors and agricultural machines</td>
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<tr>
<td>13.</td>
<td>Metal-working and wood-working equipment</td>
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<tr>
<td>14.</td>
<td>Welding equipment</td>
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<tr>
<td>15.</td>
<td>Electrical machines</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td>Bicycles, baby carriages</td>
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<tr>
<td>17.</td>
<td>Security facilities and equipment</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>18.</td>
<td>Communication facilities</td>
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<tr>
<td>19.</td>
<td>Film and photo technology</td>
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<tr>
<td>20.</td>
<td>Glass- and china-ware, faience, ferrous and non-ferrous metal dishes and utensils</td>
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<tr>
<td>21.</td>
<td>Automation and mechanization facilities for cash operations and office equipment</td>
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<td>22.</td>
<td>Oil-, solid- and gas-fuel-operated household appliances</td>
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<td>23.</td>
<td>Production designated for firefighting purposes</td>
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<tr>
<td>24.</td>
<td>Transportation vehicles, and their additional parts and components</td>
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<td>25.</td>
<td>Agricultural technology, machines and equipment</td>
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<tr>
<td>26.</td>
<td>Cranes and hoisting equipment</td>
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<td>27.</td>
<td>Welding materials</td>
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<td>29.</td>
<td>Food production and raw food stuffs</td>
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<td>Petrochemical products</td>
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<td>31.</td>
<td>Building materials and their products</td>
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<td>32.</td>
<td>Pipes and containers</td>
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<td>33.</td>
<td>Hotel services and public catering services provided by travel operators</td>
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<td>34.</td>
<td>Health and safety equipment</td>
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<tr>
<td>35.</td>
<td>Chemical sources of electrical current</td>
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<td>36.</td>
<td>Radiation technology</td>
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<td>37.</td>
<td>Paper products designated for school and office use</td>
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<td>38.</td>
<td>Sporting and hunting guns</td>
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<td>39.</td>
<td>Household pyrotechnic goods</td>
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### Table 9
Perceptions of the Certification Process as a Barrier to Business, 2000-2002
(% of enterprises citing certification as a major or significant obstacle to business)

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<th>City</th>
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