

## A Review of the Development of the Private Sector in Ukraine since 1998, and an Evaluation of the Contribution of DFID

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Revised March 2007

## 1 Introduction

1.0 1.1 The aim of this report is to attempt to:

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- a. measure the changes to the contribution of the private sector to the economic growth of Ukraine since 1998, at both a national and a regional level;
- b. evaluate the contribution of the Department for International Development, if any, to these changes;
- c. ensure that lessons learned can be identified, disseminated and embedded into Ukrainian practice;
- d. ensure that lessons learned can be identified, disseminated and embedded into DFID, and other donor, thinking and practice worldwide.

1.2 The report has been produced as part of the process of DFID graduating from Ukraine after some 16 years of work, initially under the Know How Fund and from 1999 the Department for International Development (DFID). The development of the Ukrainian private sector has been an important focus of our work throughout this time, but more particularly since 1998. A dedicated Private Sector Development (PSD) adviser was recruited in September 1999, and has continued to this date, with full support from the cadre of enterprise advisers in DFID London, and latterly from Policy Division.

## 2 Background

2.1 The Department for International Development (DFID) commenced a specific programme of private sector development in Ukraine in 1998. This operated within the framework of the 1997 White Paper <sup>1</sup> and the strategy: "Support for Transition Countries : A New Strategy", also published in 1997. The latter laid down priorities for DFID assistance, which included, inter alia:

- To develop the enabling framework for economic growth
- To promote an inclusive approach to economic management
- To integrate these countries into the global economic and political framework.

2.2 The 3 Year Country Strategy for Ukraine (CSP), published in October 1998, added detail to the Transition Country Strategy, and identified the following priority needs for the development of the private sector:

- Better economic and business management and good governance in the private sector

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<sup>1</sup> Eliminating World Poverty: A Challenge for the 21<sup>st</sup> Century" (Cm 3789)

- Key structural reforms & improved administration at central and local level
  - A better enabling environment for private sector development
  - The removal of trade barriers impeding relations with the EU, and accession to the World Trade Organisation (WTO).
- 2.3 In the light of this policy guidance, and the indication in the Country Strategy Paper that up to £1 million a year would be allocated to private sector development, a Private Sector Development strategy was finalised in June 2000 to define a framework for future UK assistance to the development of the private sector in Ukraine for the period to 2003. This considered that “future DFID support for PSD should concentrate upon:
- Improving the competitiveness of Ukrainian firms by developing a range of services to support business growth;
  - The development of an enterprise culture amongst young people;
  - Improving the availability of smaller sums of finance for PSD, especially via micro credit and credit unions;
  - Providing support to regulatory reform and enterprise development at the national and local level;
  - Developing good governance in the private sector
  - Assisting Ukraine to take advantage of EU accession of the CEE countries.”
- 2.4 The strategy continued : “future UK support will focus not just on individual projects, but will seek to influence the wider policy and institutional framework. In this regard, we will work very closely with the EU, in the early part of 2000 so that, in the first instance, the TACIS SME and PSD strategy for Ukraine for the years 2000 - 2003 will complement this strategy. We will aim to work more closely with the World Bank too.
- 2.5 “Our support will usually take the form of strategic and detailed technical assistance, at national and local level to tackle and remove some of the key constraints to PSD outlined above. However, it is likely that most of our work will be at the local level - at Oblast or Municipality level, in the following focal Oblasts : Donetsk, Lviv and Kharkiv. If necessary, we will consider making available the capital for micro credit as well as the technical assistance required to successfully lend it.”<sup>2</sup>
- 2.6 A full copy of this strategy, which has framed DFID’s PSD work in Ukraine since that date, is attached at annex 1.
- 2.7 DFID continues to view the development of the private sector as a key task in achieving the Millennium Development Goals.<sup>3</sup> In December 2005, a

<sup>2</sup> Kharkiv was removed as a focal Oblast – due to the high level of USAID work there – and Luhansk added in 2002

<sup>3</sup> Described in full at [www.un.org/millenniumgoals](http://www.un.org/millenniumgoals)

strategy paper commented that “the poorest people in our world are living in, and working in and sustaining a bustling, often unnoticed private sector....nine out of ten jobs in the developing world are in the private sector. DFID believes that improving the prospects for these millions of businesses is an essential route to eliminating poverty.”<sup>4</sup> This document emphasised three separate programmes to support private sector development: improving the business and investment environment, improving business capacity and improving the impact of investment on the poor (Corporate social responsibility).

2.8 1998 is the starting point for this review, coinciding with the launch of a number of PSD projects and the engagement of a Private Sector Development Adviser with specific country responsibility for Ukraine.<sup>5</sup> These projects included technical assistance:

- to the State Committee for the development of Enterprise established in 1997 (later to become the State Committee for the Regulatory Policy and the Development of Enterprise);
- to the Licensing Chamber of Ukraine (incorporated into the State Committee for Regulatory Policy and Entrepreneurship in 2000) on company registration and licensing;
- to the City of Lviv for the development and implementation of tourism policy;
- in Donetsk to support coal sector restructuring , and to help redundant miners start their own business;
- to support the development of enterprise education in Lviv Oblast;
- to the development of re-employment policies by the Ministry of Labour and Social Affairs in Lviv and Kharkiv, and later at a national policy level.

### 3 Structure of the Report

3.1 This report will firstly outline the economic changes in Ukraine at a national and regional level in the DFID focal Oblasts between 1998 and 2005 and then look at the evolving situation in respect of the key policy areas that were the focus of the 2000-2002 PSD Strategy as updated. These are:

- Regulatory reform and the business environment;
- Business support infrastructure;
- The availability of credit for micro and small firms;
- The development of an enterprise culture amongst young people;

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<sup>4</sup> Working with the Private Sector to eliminate Poverty DFID December 2005

<sup>5</sup> Much of the SME programme prior to 1998 focused on the development of business centres, starting in Luhansk, as a result of a programme of cooperation with its twin city Cardiff, and developing to Kyiv and five centres in Western Ukraine; other major donors, especially IFC took over their development. The real impact of such work has been limited, due to lack of a strategic lead and local support, and as a result of the more fundamental constraints to PSD.

- Taking advantage of EU accession for Central and Eastern European countries;
- Good Governance in the private sector;

3.2 The subject of improving international trade is beyond the competency of this author. However, it may be worth adding a section to this report to cover this area.

3.3 Finally the report will then attempt to draw out some policy lessons from our work and its contribution to the development of policy in Ukraine, for the Ukrainian Government into the future, for DFID in its policy and practice in other parts of the world and for other donors, both in Ukraine and elsewhere.

#### 4 The Economy of Ukraine 1998 - 2005

4.1 Ukraine has the second largest landmass of any country in Europe (602,000 square kilometres) and a population of some 46.6 million people (2006). The present administrative structure of the country comprises of 24 regions (oblasts), two Oblast level cities and one autonomous republic, Crimea. Kyiv, the capital, is the largest Ukrainian city, (and formerly the third largest city in the USSR), with more than 3 million inhabitants. For many years the country struggled to adjust to life as Europe's largest newly independent state and a market economy. Post Soviet transition was much harder than many thought in the early nineties, and whilst much has changed, much in reality actually remains the same.

4.2 Private business was not welcome in the Soviet Union and any kind of entrepreneurial drive was treated with suspicion, even in the days of *glasnost*. Much of Ukraine had no history of capitalism prior to its development as a centrally planned economy and so there is, naturally, considerable ignorance of ways to stimulate and support business which have become common place tasks of the public sector in the EU or the USA.

4.3 Since independence from the USSR in 1991, the country has suffered economic and social collapse on a scale rarely experienced anywhere else in the world in peacetime. GDP was estimated at 424 billion Ukrainian Hyrvna (UAH) in 2005 (\$81.66 billion (approximately one tenth of Russia), having doubled since 2001. 2005 GDP per capita was estimated at \$1520. However, this figure was still estimated at only 85 per cent of the 1990 figure. These official figures may overstate the fall in output; the informal economy has been expanding beyond the reach of government regulations, taxes or statistics and even official estimates suggest that half of actual total GDP comes from the informal economy - it could be higher.<sup>6</sup> Table 1 below details GDP growth per annum since 1996.

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<sup>6</sup> World Bank suggests 53% for 2005 – see [www.worldbank.org/ukraine/dataandstatistics](http://www.worldbank.org/ukraine/dataandstatistics)

Table 1 GDP per annum 1996 - 2006

	Nominal GDP (Bn UAH)	Real GDP Annual change Percentage		Nominal GDP (Bn UAH)	Real GDP Annual change Percentage
1996	81.5	-10	2001	204.2	9.2
1997	93.4	- 3	2002	225.8	5.2
1998	102.6	- 1.9	2003	267.3	9.6
1999	130.4	- 0.2	2004	345.1	12.1
2000	170.1	5.9	2005	424.7	2.6
2001	204.2	9.2	2006 est	466.8	4.0

- 4.4 Clearly to all observers the private sector - and the number of small firms - has expanded enormously between 1998 and 2006, yet the task is to demonstrate this statistically. It would also be of considerable interest to compare the size of the private and small firms sectors in Ukraine with the UK, for example. Such an exercise is complicated by a variety of factors. The most important of these is a mutual understanding of what a small firm is. In the United Kingdom, for example, in 2005, it was estimated that there were 4.3 million businesses, of which fewer than 25% were formally registered as limited companies - 1.08 million. The remainder are unregistered.<sup>7</sup>
- 4.5 Further, 72% of the 4.3 million had no employees and only 42% (1.83 million) were registered for Value Added Tax - i.e. had a turnover of more than £60,000 per annum.
- 4.6 In 1999, USAID and the State Committee for the Development of Enterprise (later to become SCORPE) carried out a survey of businesses and households which suggested that, using the same definitions and understandings as the UK data above, there were 3.073 million businesses in Ukraine, of which 2.651 million (86%) had no employees. Comparing the official figures of small firms (with fewer than 50 employees) suggested that over 80% of these 2.651 million - 2 million businesses - were unregistered and informal; strictly speaking in Ukrainian terms illegal.
- 4.7 The estimated numbers of businesses in Ukraine is included in table 2 below, together with a comparison with the situation in the UK, for 1998 and 2004. The figures for Ukraine are taken from UkrStat publications supplemented by the USAID Household and Employment Survey referred to

<sup>7</sup> This is why the 4.3 million is an estimate. There is no actual figure for the number of businesses in the UK

above.<sup>8</sup> UK figures are taken from Department of Trade & Industry (DTI) statistics for 1998 and 2004.<sup>9</sup>

- 4.8 For Ukraine, clearly the figures for 2004 are available, but not broken down by employment size, see [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua). However, the key finding in the 1998 Ukraine figures is the information about informal self employment contained in the USAID survey, which indicated the levels of persons were trading informally. Such figures are not available for 2004; however, given the changes that have been introduced since 1999, in particular the simplified tax rate, and the improvement in the economic fortunes of the country with business creating many, many more jobs it can be assumed that the figure of informal self employment in Ukraine is lower, and it has been estimated that at 2004 this figure has been reduced to 1.35 million.
- 4.9 In many ways this is a fair basis for comparing the two economies, which are, in terms of the population, of a broadly similar size. In the eyes of many Ukrainian officials, many of the 3.1 million businesses in the UK with no employees would be trading informally. Indeed many are actually part-time businesses, whose owners also have a paid job. The annual income of many of these sole traders is less than the British average wage.
- 4.10 It must be recognised that many of the informal self-employed in Ukraine at the 1999 survey were barely trading ; however, in the process, their entrepreneurial skills are being well tuned, and they are all making a real contribution to the national economy and some of them will create real businesses.
- 4.11 In Ukraine, the numbers of business per 1,000 population was 52.5 in 2004, having fallen from 61.6 in 1998. Reasons for these changes could include the fact that the employment situation had improved, so encouraging those who were in self employment because there was no alternative to resume paid employment. It has to be said that one factor in this change - although operating in the opposite direction - is the significant fall in the population from 49.9 million to 47.3 million over that seven year period.
- 4.12 For the UK over the same period the comparable figures are: 62.6 in 1998 (a population of 58.4 million) to 72.8 in 2004 with a population of 59.8 million.
- 4.13 In terms of direct comparison<sup>10</sup>, there were 1.108 m entities in the Unified State Register of Enterprises and Organisations of Ukraine on 1 July 2006.

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<sup>8</sup> Some Aspects of Functioning of the Informal Sector of the Economy of Ukraine. Kyiv International Institute of Sociology 2000 (Contained in A Strategy for assistance to SMEs and Entrepreneurship – Peter Fortune and Hans Martens TACIS Ukraine April 2000) and Entrepreneurship in Ukraine USAID January 2000

<sup>9</sup> See [www.sbs.gov.uk/SBS\\_gov\\_files/researchandstatistics](http://www.sbs.gov.uk/SBS_gov_files/researchandstatistics)

<sup>10</sup> Direct comparison is difficult as the Ukrainian basis for registering business has changed substantially between the two years and the latest figures may be far more accurate estimates of entities which are actually trading. Note that 16,000 of the 1.108 million entities are political parties.

This figure can be compared to the figure of 952,000 in 1999. 5% of the entities in the State Register in July 2006 were public sector businesses.

Table 2 Distribution of Business in Ukraine and UK by Size 1998 and 2004

Employment Size	Businesses - Ukraine				Business - UK			
	Number 1998	%	Number 2004	%	Number 2004	%	Number 2004	%
None - Informal	2,121*	49	1,350**		2,340	64	3,126	71.2
None - Formal	532	37						
1-5	149	4.9			922.6	25	808.5	19
6-10	104.6	3.4			204.3	6	218.7	5
11 - 50	123.8	4.0			160.1	4.4	170.7	4
51 - 250	33.2	1.2			24.6	0.7	27.1	0.6
250 +	10.9	0.5			6.66	0.2	6.5	0.2
<b>Total</b>	<b>3,073</b>	<b>100</b>	<b>2,462</b>	<b>100</b>	<b>3,658</b>	<b>100</b>	<b>4,358</b>	<b>100</b>

Notes on the above table 2

\*This figure includes all informal, unregistered businesses in the grey sector and was estimated by the Entrepreneurship in Ukraine Study published by USAID in January 2000. It can include individuals trading or selling flowers from their dachas, for example, in subways or on streets.

\*\* This figure is an estimate by the author based upon a number of factors since 1998, including the fact that it is now easier to start a formal business, the increase in employment opportunities resulting from the rise in production from large enterprises and the overall increase in wage levels since 1990

- i) the total numbers of businesses employing no people in the UK is an official estimate in both years - it includes both formal and informal categories.
- ii) There has clearly been a decline in the number of businesses in Ukraine from the table between 1998 and 2004. This will be due to the unreliability of the data for 1998. The figure for formal businesses for Ukraine for 2004 is taken from the Entities in the Unified State Register of Enterprises and Organisations and relates to 1 July 2005. It is conceivable that the total number of businesses in Ukraine declined between the two years.
- iii) The numbers of respondents in IFC Surveys claiming unofficial or undeclared sales has declined since 2000.

4.14 Notwithstanding the notes above, it is felt that the table has enough accuracy to make some general comparisons between the two countries, showing that the number of small firms in Ukraine and enterprise activity is higher than many commentators suppose: 52.5 per 1,000 people compared with 72.8 in the UK.

4.15 However, even after seven years of reform of the environment for business the development and growth of new and existing private business remains hindered by :

- Over regulation and an administration
- Limited access to bank finance, and even then at high cost and with excessive security cover;
- An unstable business environment;
- Lack of information about business in general and about business opportunities at home and overseas;
- A negative public image of business especially in the regions and a widespread lack of understanding of the concept of profit, the basis of any market economy.

4.16 It must be said, in conclusion, however, that there has been a 12.7% growth in the numbers of businesses formally registered in Ukraine in

the six years between 1998 and 2004 and a 52.7% real increase in Gross Domestic Product.

## 5 The Business Enabling Environment

5.1 Since 1999, a considerable amount of effort has been made by both the Government of Ukraine and international donors, including DFID, at national and regional level, to improve the business environment, the greatest efforts being made between 1999 and 2001 and from 2005. This does appear to have had results, although the evidence base for this - IFC Surveys and anecdotal project evidence from the ground - is patchy and in the case of the formal data only extends to 2004, prior to the latest period of activity.

5.2 Nevertheless, given that enabling environment reform appears to be incredibly difficult to achieve in practice<sup>11</sup>, there do appear to have been positive results. These include:

- the introduction of simplified tax regimes for micro, small and medium sized enterprises;
- business registration, following the Law of Ukraine on State Registration of Businesses - Legal Entities and Individuals in 2004, which created the unified State register of enterprises, and particularly where one-stop shops have been introduced.<sup>12</sup> This has simplified the actual business registration process and reduced the number of days taken to an average of 3 days in 2004 compared to 12 days in 2001.<sup>13</sup> There still remain, however, numerous pre-registration and post-registration formalities, which still take a considerable time, although it is estimated that the total time to complete all the processes for registering a business dropped from 8 weeks in 2003 to 4.5 weeks in 2004.<sup>14</sup> However, it is estimated that registration still costs entrepreneurs an average sum equivalent to 15% of per capita GDP although this figure is much better than the estimated 30% in 2002.<sup>15</sup> In the UK, comparable costs for legal companies are an average of 0.01% of GDP per head in 2002;<sup>16</sup>
- licensing and permits, after the enactment of the Law "On Licensing Certain Types of Business Activities"<sup>17</sup> and following instructions in 2005 to all Oblast State Administrations to

<sup>11</sup> See, for example, World Development Report 2005 (World Bank Group November 2004) and A Review of Business Enabling Environment Work Supported by DFID - Policy Division DFID September 2004.

<sup>12</sup> It has to be said, however, that it was not possible to implement the law fully for some time due to the limited technical capacity of some of the registration authorities - the lower level of government - especially in rural areas and areas suffering from significant industrial decline.

<sup>13</sup> Ukraine: An Assessment of the Business Enabling Environment, IFC, Kyiv October 2002, page 83

<sup>14</sup> IFC 2005 op.cit, page 12

<sup>15</sup> The Enabling Environment for Business in Ukraine : A Case Study. Small Enterprise Development Working Group, June 2004

<sup>16</sup> The Enabling Environment for Business in Ukraine : A Case Study. Small Enterprise Development Working Group, June 2004

<sup>17</sup> No. 1775-III dated June 1, 2000

thoroughly review all permits and licences required for business.

- 5.3 Inspections are still the biggest problem faced by Ukrainian business, but the problem appears to be decreasing slowly. In 2001 94% of firms were inspected at some time during the year (a figure which had declined by 20% since 2000) with the average firm receiving 11.7 inspections.<sup>18</sup> In 2004 78% of firms surveyed were inspected.<sup>19</sup> The typical small firm spent 22 days dealing with inspections in 2001, compared to 27 days in 2000.<sup>20</sup> There is no comparable figure for 2004.
- 5.4 In 2001, 40% of all firms surveyed made unofficial payments to inspecting bodies, and 28% in 2002.<sup>21</sup> In 2004, this figure appeared to have dropped to 20%.<sup>22</sup>
- 5.5 IFC attempts to measure annually the share of a Ukrainian business manager's time spent on regulatory matters. This averaged 14% in 2002, slightly lower than the 16% reported in 2001.<sup>23</sup> In 2004 this figure appeared to have increased again to 20%.<sup>24</sup> In the UK, a comparable figure would average 5%.<sup>25</sup>
- 5.6 Both the IFC Surveys and the first Cost of Doing Business Survey produced in 2002 for the World Bank, as part of the Private Sector Development Loan<sup>26</sup>, show that there are clear regional variations in the enabling environment for business. In 2002, the Enterprise Manager Time Tax varied from 8% in Chernivtsi and 9% in Chernihiv to 21% in Zaporizha and Odesa.<sup>27</sup> In 2004, using a different measure, it was estimated that 94% of firms in Sumy and Poltava found dealing with tax inspectors a serious obstacle, and only 51% in Mykolaiv and 60% in Odesa (average for Ukraine = 75%). Further, permit procedures were considered more complicated in Zhytomyr (93% of respondents) and Crimea (84%) and less complicated in Zaporizha and Dnipropetrovsk (27%) - average for Ukraine = 65%.<sup>28</sup>
- 5.7 It follows from this that it is possible to make significant changes to the environment for business at the regional and particularly local level. Examples abound from across Ukraine of good steps being made by reform minded Mayors on the ground, usually in self-governing municipalities. Such examples show clear evidence at the local level

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<sup>18</sup> IFC 2002 op.cit. page 32

<sup>19</sup> Business Environment in Ukraine 2005, IFC, Kyiv October 2005. Page 40.

<sup>20</sup> IFC 2002 op.cit. page 39

<sup>21</sup> Ibid, page 40

<sup>22</sup> IFC 2005, op.cit. pages 39 and 75

<sup>23</sup> IFC 2002 op.cit. pages 17 and 18

<sup>24</sup> IFC 2005 op.cit. page 64

<sup>25</sup> Small Enterprise Development Working Group 2004, op.cit. page 57

<sup>26</sup> Cost of Doing Business Survey Report, Andrii Palyanitsa for the World Bank, Kyiv 2002

<sup>27</sup> IFC 2002 op.cit. page 18. The Enterprise Manager Time Tax is defined as the time that enterprise managers spend dealing with government regulatory activities.

<sup>28</sup> IFC 2005 op.cit. pages 68/69 and 71

of direct attribution of increases in economic activity and revenue to reform efforts, sometimes within three months. One-off increases of 150% or more, from 50% reductions in taxes, have been common.<sup>29</sup>

- 5.8 Enabling environment reform work in Ukraine over a period of 7 years to date, confirms that such reform is a long-term, time-consuming process, with many successes and reverses - possibly taking more than 10 years. Such work involves deep involvement with local agencies, and the political agenda, and must be continuously monitored. Such work, at least in its early stages, needs champions: strong, visible leaders of change, at a senior level. In Ukraine these have been Mayors or Regional Governors. In addition, reform efforts in Ukraine were successful in the cases where issue areas were not too complex, reform solutions were simple and practical and there was adequate preparation of documents and argument, most frequently done with high quality technical assistance.
- 5.9 Often, there have been simple, yet challenging, issues of language and understanding in the implementation of reform efforts. Many policymakers in Ukraine, especially at local level, do not understand - or are even suspicious of - the complex world of business, and small business in particular. Such an understanding is a fundamental prerequisite of reform; this lack of understanding leads to a basic ignorance of how to proceed with reform.
- 5.10 The involvement of DFID and other Donors has been effective in bringing the issue to the top of the agenda, at national level, in 1998 and keeping the issue there during times of difficulty. It has also been useful in offering support and knowledge on the ground. However, it was most effective when:
- The focus was on the internalisation of work and on creating local ownership for outputs, with minimal emphasis put on the role of international actors;
  - Resources were concentrated on building sustainable technical and organisational capacities in Ukrainian organisations;
  - The donor work was matched by continuous long-term involvement of reform minded representatives from governmental agencies to create a critical mass of beliefs and ideas there;
  - Measurable outcome-based monitoring and evaluation systems were an integral part of technical assistance projects.
- 5.11 In many ways these comments echo comments made in the SIGMA Report on Ukraine<sup>30</sup> which comments that "that governance in Ukraine continues, broadly speaking, to operate according to inherited modes of organisation, practice and thinking. These modes derive from the former communist system practices, modified by the

<sup>29</sup> Small Enterprise Development Working Group 2004, op.cit, annex 3

<sup>30</sup> Support for Improvement in Governance and Management Report on Ukraine - SIGMA March 2006

practices of the Kravchuk and Kuchma regimes (often described as “kleptocracies”). During the last 15 years, established ways of thinking and doing business - stable “institutions” in the sociological sense - have formed; and these, more so than formal institutions, are resistant to change. Recent events have illustrated that, if reforms are unsupported by an underlying consensus, embedding them in law does not provide stability...it is questionable if the time is ripe for fundamental change in Ukraine - donors may see a need, but real change will only happen when it is driven from within.”

- 5.12 Key achievements of DFID’s work in this period have included our support to the State Committee for Regulatory Policy and Entrepreneurship (SCORPE) since 1998, often during periods when it was abandoned by other donors and having a difficult time within Government (for example during 2003 and 2004). The Committee, formed in 1997 as the State Committee for the Development of Enterprise, was re-created as SCORPE in 2000, at the same time absorbing the formerly independent Licensing Chamber, which at the time was an important partner of the Company Registration project.
- 5.13 The role of the Committee is to formulate and implement state policy on entrepreneurship development and support and to remove legal and administrative hurdles to business investment and growth. It has played an important role during the post 2004 efforts to deregulate, notwithstanding weaknesses in certain areas and at local level<sup>31</sup>, and continues to receive support from DFID via the Private Sector Development project, both at national level and in Odesa, where the local office is a key partner in the Cluster and Benchmarking components of the project - see below.
- 5.14 Other DFID work in this area has included:

- **Company Registration Project**

Launched in 1998 and completed in 2000, the aim of this project was to support the Government of Ukraine in the completion and operation of a unified state register of business. The project was implemented by Companies House in the UK. It is interesting to note that the results of the project finally became clear in the contents of the Law on Registration in 2004.

- **Social & Economic Regeneration in the Donbas**

One component of this integrated project was the improvement of the enabling environment in Donetsk and Luhansk, but particularly the latter. This work has included the achievement of an understanding at both Oblast and Rayon level within Luhansk of the

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<sup>31</sup> See, for example, comments included in the Back to Office Report from the Mission to Review the Lviv Development Project, October 2006.

need for, and the benefits to be gained from a supportive environment for business (developed by an intensive process of the development of a Social & Economic Development Strategy). Detailed work has concentrated upon the establishment of One Stop Permit Shops, and support for the physical creation and operation of such a One Stop Shop for Permits and Registrations in Krasnodon.

An extension to this project, starting in April 2007 will support the growing network of One-Stop-Shop offices (set up by both DFID and other donors in the Luhansk Oblast) that give permits to new businesses by the creation and development of the budgeted Oblast Permit Giving Centre, which will continue to provide them with regulatory training and methodological support beyond the end of the project in 2008.

Recent project research from Donetsk suggests that the introduction of such one-stop-shops may have increased business registrations by up to 30%<sup>32</sup>

- **Support for Chambers of Commerce**

This project commenced in 2001 providing support to the Donetsk Chamber of Commerce and latterly the Luhansk Chamber, in partnership with the Donbas project. Key aims were the development of an infrastructure to support small and medium sized businesses and the harnessing of private sector support for changes to the enabling environment. This latter aim has been successfully introduced in Luhansk where the concept of the inspection log was pioneered - with project advice and support - in 2002; the 2005 IFC Business Environment Survey proposes the widespread usage of such an Inspection Checklist.<sup>33</sup>

- **Lviv Development Project**

A key part of this project is the development of a better enabling environment for business within Lviv Oblast for both Ukrainian and international investment. The work of the project has concentrated upon assisting the Oblast State Administration in the development of a Welcome Investors programme and on the development of One Stop Permit Shops, in response to a national initiative. Annex 2 contains a minute from the Economic Adviser to DFID Ukraine on the details of the latter work and some lessons learned.

- **Private Sector Development Project**

This four-year project originally started in April 2003 to provide support to the World Bank Private Sector as part of DFID's strategy to partner multilateral donor institutions world wide in order to gain

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<sup>32</sup> The system only allows registrations either where the firm operates or the registering person lives

<sup>33</sup> IFC 2005 op.cit. page 46

greater effectiveness towards the achievement of the Millennium Development Goals. The project was originally designed to provide the Bank with support in the development of clusters and a Ukrainian Benchmarking Index - both important business management and economic development tools in the development of a good environment for business.

The late start to the Loan, problems with its effective implementation and its eventual cancellation in early 2006 created some identity problems with this project. However, the cluster and benchmarking work are progressing well, especially in an environment where cooperation between businesses is not well developed. Both of these two tools depend fundamentally on such cooperation for their success. The Benchmarking Index is due to be launched in January 2007. The project has been extended to 31 July 2007.

5.15 Other donors providing support to the Government of Ukraine since 1999 have included:

- **International Finance Corporation** from 1998 - via annual series of surveys of the business environment, attempting to show the sheer complexity of the regulatory climate for business in Ukraine, especially SMEs. The surveys - already referred to extensively above - provide a useful role in showing the marked regional variations in the business climate from Oblast to Oblast;
- **World Bank**, which initially launched the Private Sector Development (PSD) Loan programme in four Oblasts in the west of Ukraine in 1999, specifically focusing on the improvement of a number of indicators reflecting the enabling environment<sup>34</sup>. The Loan became operational from April 2004 in two Oblasts but was cancelled in early 2006 due to lack of progress on the Government's side. An important planned component of the PSD Loan was a Cost of Doing Business Survey, launched in July 2003 and planned as a six-monthly measure of the change in the regulatory climate at the oblast level. No further survey has yet been published;
- **USAID**, initially from 1996 via the Newbiznet programme, which, in its latter stages focused on the development of business associations as pressure groups for change at the regional, and particularly local, level, and from 2000 via the BIZPRO programme, which has continued the work with administrations at the regional and local level in eight focal oblasts, largely in the west of the country. USAID reports success from many of its 32 focal rayons and municipalities (local level administrations) - in some, increases in budget receipts have reached hundreds of per cent, largely from a relaxation on permits for local businesses - taxis, kiosks etc. Much of this is based on legitimisation of activities from the grey economy. General economic growth has also increased.

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<sup>34</sup> For example, the time taken to register a new business, the number of bodies able to physically inspect a business

- 5.16 It is widely agreed that the biggest issue for the regulatory environment for Ukrainian businesses is its unpredictability. Regulations are often confusing or unclear, many regulatory activities lack a comprehensive legislative basis, information is lacking and procedures are unnecessarily complex. Rules change frequently - for example there were 34 amendments to key tax laws in 2004.<sup>35</sup>
- 5.17 The lack of clear and accurate information for businesses on the current state of the law assists rent seeking behaviour by corrupt officials. A simple, but important policy has been to develop intermediaries such as the Chambers of Commerce - such as our project in Donetsk and Luhansk, to provide such good information, often via hot-lines.
- 5.18 A fuller summary will be made in the conclusions, but it must be said here that Ukraine has made considerable positive strides in the improvement of its enabling environment for business, and that in the IFC Survey for 2005 52% of respondents felt that the business environment would improve in the next 12 months and only 18% felt it would get worse. The fact that there are still so many negative factors about the Ukrainian business environment shows, in part, how difficult it is in any country in the world to make such changes.

## 6 Business Support Infrastructure

- 6.1 Any market economy depends on an infrastructure - private or public - of business support organisations to provide advice, information, training or consultancy. In many developed economies, some of this role is taken by business membership and representative organisations, usually Chambers of Commerce. In Ukraine, in the absence of significant private sector input, there has been a major drive to create business centres, with donor monies replacing the private and public sponsorship usually available in the West. Most of these deal with the micro and small business sector and some, but by no means all, have a good reputation. Few if any would be sustainable without continuing donor support.
- 6.2 Much of the early work of the Know How Fund in Ukraine was concerned with the establishment of Small Business Centres. In fact the first project in the country was the creation and development of Enterprise Luhansk in 1992 in partnership with Luhansk City Council and with support from Cardiff City Council, its sister city in the UK. This closed in 1996 due to lack of support, having been part of a Know How Fund supported IFC project to develop business centres across the country. A parallel project was launched by USAID - the Newbiznet project - in 1995 and many of the centres so created have developed into sustainable operations.

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<sup>35</sup> IFC 2005 op.cit. page 8

- 6.3 Where possible, DFID has supported the development of these centres, for example in Kharkiv, a partner in the 1999-2002 Re-Employment project and Lviv, which has played an important role as a partner of DFID since 1998, with its participation in the first Cross Border project, aiming to support Lviv Oblast State Administration take the fullest advantage of the accession to the EU of Poland. Newbiznet Lviv Business Support Centre continues to play an important role as a partner of the current Lviv Development Project, and is supporting the establishment and growth of Local Development Agencies in some of the larger rayons of the Oblast.
- 6.4 Chambers of Commerce are key parts of the business support infrastructure in many developed economies, especially in the EU. Chambers of Commerce in Ukraine occupy a similar role to those in Western Europe and the UK, providing a variety of services and information to support business growth. They had a key role during the Soviet period and they have adapted to their new role in a market economy with varying degrees of success. Some are very successful, having taken the opportunities of the new economy, whilst some have barely changed their attitudes since Soviet times. This success has been based on a number of factors at a local level, including a positive attitude by the Chambers management and a good relationship between the management and the senior Oblast staff. Our project work in Lviv for example has been unable to develop a good working relationship with the local Chamber of Commerce.
- 6.5 In Ukraine, where the market economy is just developing, Chambers do have a key role in :
- Developing associations of entrepreneurs, which are groupings of those self employed businesses - the smallest and the poorest entrepreneurs - which are striving to succeed. In Donetsk, the Chamber includes five such Associations;
  - Working closely with the local Oblast and Rayon administrations to reduce the barriers to business, in particular the regulations and inspections, which bear most heavily on those poorest entrepreneurs;
  - Disseminating information on how to manage successful businesses - often totally unavailable to Ukrainian entrepreneurs - and promoting better business practices, important where the predominant role models are often characterised by corruption.
- 6.6 DFID provided support to two Chambers of Commerce in Eastern Ukraine from 2001 to 2005, both to assist them to become champions of the private sector and to assist in the development of business infrastructure. A useful by-product of this project was that the Donbas Social & Economic Regeneration project was then able to further develop the Luhansk Chamber of Commerce as a partner in its efforts to deregulate the business environment and to establish

business centres, which have successfully been developed in four pilot rayons of the Luhansk Oblast: Krasnodon, Severodonetsk, Kremenaya and Perevalsk.

## 7 The availability of credit for micro and small firms

- 7.1 American, European and German aid has provided extensive investment in loan and equity funds, and at the same time provided technical assistance (TA) to attempt to create a mature banking network, which is once again a feature of all successful market economies. Much of this has been aimed at medium to large businesses. TACIS, inter alia, has attempted to create small credit funds, but has had real difficulty finding suitable fund management bodies. USAID and Canada are providing extensive TA to credit unions in Ukraine.
- 7.2 In the year 2000, USAID and the EU, plus four other partners, established the Ukrainian Micro Credit Bank, now successfully trading as the Procredit Bank with ten branches across the country. As the country's banking system is maturing it is attracting interest from outside; for example, the Austrian Raffeisen Bank commenced operations in Ukraine in 1998. In September 2005, it acquired Joint Stock Post Pension Bank Aval (Bank Aval), previously one of Ukraine's key business banks. In commenting on this acquisition, the Chief Executive of the Bank commented that "Ukraine is one of the most important markets for us. With this acquisition Raffeisen becomes the Number 1 in the country. Bank Aval has a sound economic basis and an outstanding branch network throughout the country." Together both banks will form the largest banking group in Ukraine, their combined share in the market's total banking assets amounted to 11.9 per cent at 1 July, 2005.
- 7.3 However, whilst the banking sector is beginning to flourish, the availability of loans and overdrafts for micro and small businesses is still difficult. Loans still cost typically 18% per annum or more and demands for collateral can often exceed the sum of the loan and be restrictive in terms of the types of collateral demanded. Further, loan periods can be one year or less. With retail price inflation currently averaging 10% - a high figure in recent history<sup>36</sup>- the real rate of interest on the loan is high. Whilst interest rates have been reducing over the previous 6 years, they now remain stable. One of the reasons for the high lending rate is the high rate that banks have to pay to obtain savings deposits especially from individuals, around 10-12%. One of the key reasons for this is the National Bank of Ukraine discount rate which has been 8.5% since June 2006, having then reduced from the 9.5% figure that had been current since June 2005. In actual terms this 8.5% rate is one of the lowest rates since independence, a rate of 7% having been achieved throughout 2003.

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<sup>36</sup> In part due to internationally high commodity (and especially oil) prices

- 7.4 The aim of providing support for micro-finance predated the creation of the Procredit Bank and, given DFID's relatively small country budget, a decision was taken to create a microfinance fund within the Donbas project, to operate within the four pilot rayons of Luhansk Oblast (defined in para 6.6 above). This eventually commenced operations in 2005, due in part to internal delays within DFID, hosted by the UkrcommunBank, headquartered in Luhansk and with offices in each of the rayons and cities. The total fund is just under \$1 million and loans are lent at 18% to start up and expanding small firms (maximum loan sizes \$5,000 and \$10,000 respectively: 25,000 and 50,000 UH). Repayment periods vary between 18 and 24 months. As of the end of 2006, all the funds had been lent and there have been very few defaults. The total portfolio of loans now significantly exceeds the sum made available by DFID.
- 7.5 Clearly the DFID monies made available to Luhansk Oblast for microfinance have made an impact on the availability of finance for micro and small businesses in the four pilot areas of the Oblast. Further, the six credit unions established in the pilots which have already made over 1,000 small loans of less than \$500. Virtually all these loans from the Credit Unions and two-thirds of the loans from the Microfinance Fund have been for trading businesses.
- 7.6 All these credit unions, plus the 10 established in Donetsk Oblast under the Community Development project, have started taking deposits from local savers as well as making loans - the taking of deposits is a key step in the mature development of microfinance institutions.
- 7.7 It is interesting to note that there was considerable opposition within the Luhansk Oblast State Administration to the establishment of the Micro Finance Fund, based upon the widespread view that meaningful economic growth would only come from the growth of larger businesses, a view commonly held in the UK prior to 1980. This led to their view that funds should therefore be made available only for the expansion of larger firms.
- 7.8 One interesting by-product from this intervention is that at least four banks which are also operating within the Luhansk Oblast are now offering micro loans.

## **8 The development of an Enterprise Culture amongst Young People**

- 8.1 Our work on the introduction of enterprise education started in 1998 with a project to introduce enterprise education into the curriculum of secondary schools in the Oblast. Our goal was to tackle the poor image held by most people in Ukraine of private business in general; many in parliament and the public service share this view. Our strategy in 2000 was to seek to build a positive image of private

business amongst the young, by the introduction of a wide range of support, for example:

- Enterprise education in schools, vocational schools and further and higher education - introducing active learning methods and subjects into the curriculum with the immediate aim of increasing business and economic awareness, and developing skills needed to get work in a flexible labour market.
- The expansion of enterprise education into the curriculum of technical schools in Donetsk Oblast, a project which started in 2001 and which led to the development of a Centre for the development of Enterprise Education (CEE) established within the Donetsk State Institute of Post-diploma Education of Engineering and Pedagogy;
- The continuation of support for the small Enterprise Europe programme of placements for young business men and women from Ukraine with British SMEs, a project which DFID ceased to support in December 2002.

8.2 In 2002, the Donbas project, which has been referred to above, commenced its programme of building on the Lviv experience, which project had already been completed by then, to introduce enterprise education into each secondary school in the Oblast. The Luhansk Oblast Education Department now fully owns the Enterprise Education programme. Over 2 full academic years, some 30,000 students have attended classes. About 80% of educational establishments have continued to provide classes in this discipline into a third academic year. For the past 3 years (apart from the provision of one full set of academic material) all costs have been met from the Oblast education budget.

8.3 These small efforts have had a considerable and continuing impact on the schools within the areas concerned, but there is little evidence that the efforts have been replicated by the Ministry of Education across Ukraine as a whole. However, other donors have also been supporting the Ministry with the development of more enterprising thinking within schools in other Oblasts.

## 9 Taking advantage of EU accession for Central and Eastern European countries

9.1 DFID provided considerable support for development at the local & regional level in Western Ukraine in the 1990s, and as part of this in 1999 it initiated an evaluation of the impact of EU Accession upon this area. In particular, this study looked at the likely effects that Polish entry to the European Union would have upon development patterns in the border areas, and especially Lviv Oblast. Whilst there was a focus on effects on economic development and cross-border

trade, the wider social and political dimension of the accession process were also examined.

9.2 Whilst it was accepted that the entry of Poland to the European Union would provide certain potential benefits to the Ukraine, it is also clear that the current level of development of the Ukrainian border regions meant that there is a real risk in the short- to medium-term of the negative effects outweighing the benefits. Changes anticipated included:

- the introduction of visas
- the strengthening of the border regimes on the Polish eastern border
- the introduction of the European acquits within Poland
- Increased levels of investment in pre-accession Poland.

Taken together these could, without further support, exacerbate the existing gaps in standards of living and economic competitiveness between Polish and Ukrainian neighbour regions.

9.3 What was also shown by the study was the lack of preparedness of the regions on both sides of the border for the future changes, but far more so in the Ukrainian side. The reasons behind this are complex, but DFID considered that a key task in improving this was to support common structures for strategic planning at the regional level, and to facilitate operational arrangements to enable common development of priority projects.

9.4 It should also be noted that the current development of capacity at the regional level in Poland in the late 1990s and early 2000s provided an opportunity for Ukrainian regions to benefit from the increasing expertise and capability for regional development on the Polish side of the border. Many of the financial instruments for pre-accession deal with generic issues of regional development, and via strengthening co-operation across the border this work can be used to also provide spin-off benefits for Ukrainian regions.

9.5 In 2001 a Cross Border project was launched whose approach was based on proposals from the Ukrainian and Polish regions at the DFID joint seminar held in Lviv in March 2000. The project proposed that a jointly developed Polish-Ukrainian strategy for regional cross-border co-operation be prepared, and that a Cross Border Agency for Social and Economic Development be created. The project also included the Oblast of Volyn.

9.6 The work of the project was absorbed into the Lviv Development Project in September 2003. Poland, of course, became a member of

the European Union with effect from 1.01.04 together with Slovakia and Hungary, the other CEEC countries which border Ukraine.

- 9.7 A further part of our strategy to encourage business in Lviv Oblast to take advantage of opportunities in a Poland within the EU was our business competitiveness project which worked with 20 medium sized companies to support them towards the international quality standard ISO9000. This project commenced in September 2000 and was working satisfactorily until it was suspended, and eventually closed, due to serious deficiencies of management by the international consultants engaged by DFID to achieve project outcomes.

## 10 Good Governance in the Private Sector

- 10.1 From 1998 to 2001, DFID funded an IFC project whose aims were to improve the standards of corporate governance, accounting standards and shareholders rights in the pilot Oblast of Kharkiv. Funding for the project was stopped as there was no prospect of the project becoming locally sustainable, in line with DFID policy. Since then the project has developed into a Corporate Development project and has been funded since 2003 by the Canadian International Development Agency (CIDA) and the State Secretariat for Economic Affairs of Switzerland (seco). Building on the Corporate Governance Project, it expands its advice to local companies to address a broader set of issues that hinder Ukrainian companies seeking outside investment. In addition to corporate governance, the Partnership advises companies on financial management, asset management, and investor strategies to help them become viable businesses able to attract outside investment. This project continues to work with government officials on legislative reform and with educational institutions to improve post-secondary programs on corporate governance.

## 11 Policy lessons and conclusions to be drawn

- 11.1 Between 1998 and 2006 it is estimated that a total of £7 million has been invested by DFID in the development of the private sector in Ukraine, via 17 separate projects<sup>37</sup>, this figure including:
- The provision of technical advice and assistance to national, Oblast and local officials;
  - The professional and technical development of more than 40 Ukrainian experts in Luhansk, Lviv and Donetsk to an international level of expertise;
  - Investment of £500,000 in a microfinance fund in Luhansk;
  - The publication of educational texts on enterprise;
  - The costs of management internships for 60 young Ukrainians within British small firms between 1998 and 2002;

<sup>37</sup> Some projects were cross cutting – for example the Social & Economic Regeneration in the Donbass – and some included PSD components as a marginal part of their purpose and aim.

- Project administration and monitoring costs by UK and increasingly since 2003 Ukrainian staff and advisers.

11.2 Over this time, the role of the private sector within the Ukrainian economy has expanded and the numbers of private firms increased. The Ukrainian small business sector can bear comparison with that in the UK, in that there appears to be a large number of informal sole traders in Ukraine - as there are in the UK; key differences between the two include include a far lower number of small businesses employing between 1 and 25 people in Ukraine than in UK, clearly indicating the very low numbers of micro business growing to the next stage and employing people.

### Investment Climate

11.3 In particular, the environment for business in Ukraine has improved substantially over the period in part due to our support from donors, including DFID. Whilst business, especially small firms, continue to encounter problems with official interference in their work, to such an extent that they spend four times longer than those in the UK on dealing with formal and unofficial inspections and bureaucracy, the fact that the position is still difficult is more a testimony to how difficult it is worldwide to reform the investment climate for business.

11.4 The following extracts from an internal review of the activities of DFID on enabling environment reform<sup>38</sup> outlines some of the problems encountered by DFID reform projects worldwide.

11.5 "Some of the projects examined review have found, or are finding, implementation more difficult than planned. For example, it is proving to be more challenging, in practice, to engage with Governments, at all levels, on both the whole principle of deregulation and on detailed implementation than originally thought." One reason for this is the sheer workload of any reforming government and the lack of cabinet time (for example, the 2003 OPR of the Uganda Deregulation Project indicates that a 'well considered cabinet information memorandum on regulatory best practice has yet to be discussed by cabinet'), and "legislative overload at all levels".<sup>39</sup> This has also been a problem within Ukraine from 2005 onwards with government officials coping with the reforming zeal of the Yuschenko Government in terms of regulatory reform.

11.6 "Projects have also encountered embedded opposition from individual civil servants, sometimes at junior levels, well after

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<sup>38</sup> Review of DFID activities in the enabling environment for business - DFID Policy Division  
ICEE Team assisted by Simon White and Peter Fortune – September 2004

<sup>39</sup> DFID Bosnia Business Registration Project (MIS 315 540 021) OPR December 2003

agreement on action has been reached with their superiors.”<sup>40</sup> Often such opposition is based on opinions which can be summarised as ‘fighting bureaucracy vs. fighting crime’;<sup>41</sup> the tension between facilitating business registration—and thus economic growth—and assisting law enforcement. An equally difficult tension on the ground can stem from the important source of revenue that business regulation provides for local authorities, and the very real difficulties that will result from any reduction, at least during the lag until the increases in taxation that flow from increased economic growth are received. Our Lviv Development project has found many examples of this on the ground, especially in smaller, more rural rayons, and the Donbas project has found it also in Kremenaya.

- 11.7 “The OPR for the Umbrella Project to Improve the Enabling Environment in Kenya (June 2003) indicates that it has been difficult to get project managers to move from research, albeit high quality, to implementation. Others report that actually moving from agreement about the nature and effects of the problems to actual implementation on the ground can be challenging.
- 11.8 “The same project also highlights the widely reported point that getting the private sector engaged in policy dialogue with government is a slow process and requires ‘carefully targeted inputs to ensure that their self interest is recognised adequately at all levels. It is less of a resource intensive activity as a process and time intensive one’.<sup>42</sup>
- 11.9 “The work of the two DFID country case studies (Bangladesh and Ukraine) indicates that successful reform of the enabling environment requires donors and the implementers of donor projects to engage politically and to understand what motivates and hinders political actions: ‘Political will determines the pace of reform in this most politically sensitive of sectors’.<sup>43</sup>
- 11.10 “Also, given that the work inevitably links in with the political processes, on some occasions the wrong people are recruited both internationally and locally. On one project (in Bosnia) two local lawyers chosen to work on legislative drafting were from different political backgrounds and they could not agree to work together.”
- 11.11 Enabling environment work requires some new skills, especially in what many call the ‘hearts and minds agenda’: ensuring that

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<sup>40</sup> See especially Social & Economic Regeneration in the Donbass (Ukraine) MIS 283-559-020

<sup>41</sup> Bosnia Business Registration Project OPR op cit, December 2003

<sup>42</sup> DFID Umbrella project to improve the enabling environment for the private sector in Kenya (MIS 031-540-033) OPR, June 2003

<sup>43</sup> DFID Legal sector reform programme, Kenya (MIS 031-542-088) OPR September 2002

successful enabling environment implementation ensures all key policy makers and policy implementers are fully involved in the development of, and fully agree with, regulatory best practice. This can also be time consuming.

- 11.12 It is now widely accepted that enabling environment reform in any country is an enormous task. The enabling environment agenda, particularly the need for deregulation, is very broad and the initial focus of interventions can easily be lost. Many projects start with the complex problem of over-regulated business registration procedures, but have found their attentions diverted as other regulatory issues are put on the table for attention, especially when the business community has been consulted. In Kenya, for example 'the original focus of the project was deregulation which later extended to broader enabling environment concerns'.<sup>44</sup>
- 11.12 As one experienced authority suggests, "it is essential to determine exactly what should be done at any given time, and clear sequencing of project actions being very important. Priorities in enabling environment work must be carefully identified and there must be a sharp focus on specific reforms that are manageable and capable of implementation. Quick wins are often important in cementing local goodwill."<sup>45</sup>
- 11.13 Projects can also get bogged down in local debate on what determines the enabling environment for business, which can provide ample opportunity for those seeking to delay change; the Ukraine Case Study gives examples of the State Tax Administration using every opportunity to frustrate attempts to reform tax legislation.<sup>46</sup>
- 11.14 Implementation difficulties can also be caused by sheer lack of experience on the part of policy makers, difficulties in finding local project staff who are apolitical and the limited influence of donors and donor projects on certain governments. The efforts of the Government of Ukraine to establish one stop permit shops has certainly been less effective due to the lack of competent and experienced local staff - or staff who are senior enough within the local administration hierarchy to implement change.
- 11.15 A further difficulty can be that reforms are introduced at national level - sometimes to 'headline' reform - but that resources are not

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<sup>44</sup> DFID Umbrella project to improve the enabling environment for the private sector in Kenya (MIS 031-540-033) OPR, June 2003

<sup>45</sup> See Gamser, M. (2003) "Kenya deregulation project: improving the business trade licensing reform environment". In) A contribution to the WDR 2005 on investment climate, growth and poverty; case studies commissioned by the Department for International Development. London, Department for International Development. 2004

<sup>46</sup> Small Enterprise Development Working Group 2004 op.cit

made available at the local level to implement them. Again this has been found in the work of the LDP.

- 11.16 DFID experience to date emphasises that enabling environment is a long-term process, and requires interventions, which are much more intensive, detailed and lengthy than previously.
- 11.17 Although indications are that DFID's support for enabling environment reform does have positive outcomes and impact<sup>47</sup> (see Box 4), and the World Development Report 2005 confirmed this, the monitoring and evaluation of the DFID's enabling environment work to date has not generated clear or comprehensive results. This is not a problem confined to DFID: a joint evaluation of enterprise growth initiatives by USAID and the consultancy company DAI states that 'the lack of systematic monitoring and evaluation in existing programmes makes it much harder than it should be to assess and construct these initiatives'.<sup>48</sup>
- 11.18 An internal case study of Enabling Environment Reform in Ukraine published for the Small Enterprise Working Group in 2004 contained many examples of reform in Ukraine at the local level where resulting improvements in time taken to obtain licences or permissions and income to local authorities raised as a result of freeing up the market place can be measured in excess of 150%.<sup>49</sup>
- 11.19 As this review emphasised there is much to support the dissemination of the working experiences of our projects in Ukraine across a worldwide stage.

### Foreign Direct Investment

- 11.20 A key part of our Donbas and Lviv projects - the latter founded within the framework of ensuring Western Ukraine can effectively compete with a Poland within the EU - has been to ensure that the environment for investment, especially foreign investment, is as attractive as other countries worldwide. This is within the development context that foreign capital flows are now greater on an annual basis than development aid.
- 11.21 Much FDI is now globally mobile, not just within Europe, although it has to be said that much manufacturing investment from Western

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<sup>47</sup> See Review of DFID Activities in the enabling environment for business op.cit. Box 4 page 42

<sup>48</sup> See Snodgrass, D. R. and J. P. Winkler *Enterprise Growth Initiatives : Where Now? What Next?* Enterprise Growth Initiatives : Where Now? What Next? Bethesda, MD, USA, Development Alternatives International 2004

<sup>49</sup> Small Enterprise Development Working Group 2004 op.cit annex 3

Europe is moving to central Europe to seek out cheaper labour, and other costs. Poland and Slovakia have benefited from this trend over the past decade. Such investment has, however, yet to seriously consider Ukraine, outside of Kyiv city. Results of our work and that of other donors, here have been disappointing. It has been difficult in both east and west Ukraine to encourage Oblast officials to see FDI from the investors' (the customer) viewpoint, notwithstanding considerable efforts via advice and study tours to regions of the old and new EU which have successfully attracted foreign investment. Officials cling doggedly to supply-side models in which opportunities for investment (sometimes in Soviet-era manufacturing plants) are offered with little apparent understanding of the need to compete in a global market place. Much FDI into Ukraine is currently coming from Russia, or from Cyprus which is merely capital that fled Ukraine in the early 1990s returning; it may well be, taking the argument of the SIGMA study referred to earlier<sup>50</sup> that this is the path that Ukraine will take, in which the market economy is heavily influenced by the State and that investment will be dominated by flows from other countries of the former Soviet Union.

- 11.22 Instability is also a negative here - continual changes in legislation can affect, and have affected existing international investors, for example the changes in tariffs affecting sunflowers and the Cargill investment in Donetsk Oblast, and the termination (and then re-activation) of the Special Enterprise Zones (SEZ) in 2005 - in theory the right course, but one which caused a number of problems for existing investors.
- 11.23 A further problem is the view of many Ukrainian officials that foreign investment can be treated differently and somehow sheltered within a cocoon, isolated from any external, Ukrainian influences. In some ways this was the thinking behind the SEZ. Whilst this can work, it means that Ukraine will not reap the benefits from embedding FDI into the local economy and encouraging the investors to use local suppliers. It is from this process that foreign firms become a core part of the local economy and it is from this that the real benefit of the FDI spreads to other businesses within the local economy. It has to be said, however, that this does not prevent the investor moving out after periods as long as 30 years.<sup>51</sup>

### Timescales

- 11.24 International development is a long-term process. Comments above show how long it takes to change detailed processes within the

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<sup>50</sup> See footnote 30, page 12

<sup>51</sup> See, for example, the case of Sony UK in South Wales, one of the best examples of developing third or even fourth tier suppliers which has closed completely after 27 years operation, due to global market trends

enabling environment for business. Our experience of the Company Registration project (1998-2000) also demonstrates this - results on the ground did not follow until the Act of 2004 and the outcomes arrived in early 2006 once most of the rayon and lower level administrations had received the necessary investments in computer and internet equipment and the trained staff.

- 11.25 Many of the PSD project interventions in Ukraine were small, totalling less than £500,000, and short-term - less than 24 months, although some were extended. They were designed during the early days of DFID and many were conceived in the days of the Know How Fund, when short, sharp action on the ground was the aim. Only post 2002 did DFID Ukraine PSD project work follow evolving DFID strategic guidelines and become part of larger, longer strategic projects - for example the Donbas project - or support larger multilateral projects, for example the World Bank PSD Loan.<sup>52</sup>
- 11.26 Even then four years is still a short time in development, but this is a problem shared by all international donors.
- 11.27 In many ways the message here is that it may still be too early to measure the success of our PSD work, and that a formal review in five years time may be more worthwhile.
- 11.28 One of the problems of shorter, smaller projects is that there is much less margin for error in implementation. The Business Competitiveness project (ISO9000)<sup>53</sup> in Lviv in 2000 and 2001 suffered problems of implementation, firstly in terms of an unsuitable lead expert and then significant project mismanagement in the first half of 2002. Some useful outcomes had already been achieved from this work, which was important in the context of EU accession of Poland and Slovakia, but there was just no room for recovery given project size and duration.

### Sustaining Capacity

- 11.29 Our project work has successfully sustained the capacity of Ukrainian business infrastructure over a period of four to five years giving them an excellent chance of surviving in the market place that had developed over that time. Our work in Lviv has, since 1999, utilised the capacity of Newbiznet Lviv which has now grown into a

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<sup>52</sup> This was of course a most unfortunate experience, actually becoming effective in early 2004 at a difficult time politically in Ukraine and at a time when SCORPE - the host - was enduring considerable uncertainty. The loan was withdrawn in 2006, an unusual action for the World Bank. Our project to support the Loan suffered considerably from this uncertainty in spite of excellent consultancy support on the ground.

<sup>53</sup> Only an 18 month £200,000 project in any case

substantial and successful business support organisation. Our work with Donetsk Chamber of Commerce in 2000 and 2001, and then subsequently, enabled them to embed themselves into the local SME community and to cement their relationship with the Oblast Administration, a key relationship within eastern Ukraine. Luhansk Chamber of Commerce was a less strong organisation in 2001 when our project work started but has grown to a sustainable body as a result of opportunities provided by the Donbas project. The Kharkiv business centre was also used extensively by our Re-employment project from 1999-2001, providing considerable support, although it has to be said that this centre (also one of the Newbiznet 'family' created by USAID in the mid 1990s) was well established anyway.

- 11.30 Further, in Lviv, we have supported both the development and creation of the Agency for Regional Development & European Integration (ARDEI) and the European Business Information Centre (EBIC), launched in 2005.
- 11.31 Many of these are business centres. These are key institutions in PSD, as they provide business advice, information and consultancy; however, they are often difficult to sustain once donor support has been withdrawn. Our work here has ensured that four have strong foundations into the future at a time when Ukraine's economy is expanding.
- 11.32 At the same time, our project work can expand the market for services, services which may have been unknown in the days prior to independence. This applies to business advice and consultancy as well as other areas. One of the outcomes of the Lviv Tourism Project (1999-2001) was the Lviv Tourist Information Centre. Whilst this has never really prospered - for many reasons - 2005 has seen a number of private businesses establishing information centres for tourists within hotels and shops and restaurants.
- 11.33 A further example here relates to micro finance. In Luhansk Oblast we have, by the launch of the micro finance fund via one of the locally based banks encouraged at least three other banks to come into this new market sector.
- 11.34 One common theme in this section is that all of our successful partners have been managed and led by excellent capable individuals, individuals who were already in post and whom we have supported rather than advised.
- 11.35 In some cases, the lack of sustainable local capacity has constrained further achievements. In Luhansk Oblast, the expansion of credit unions could have proceeded, and demand for loans was present

further but local capacity on the ground in the four pilot rayons was insufficient to support such an expansion sustainably.

## Conclusions

11.36 During the period under review the private sector expanded significantly, both as a result of the privatisation of state enterprises and the growth in the economy. Real GDP has increased by more than 50% and the number of businesses has also grown. DFID has spent some £7 million on initiatives to sustain and expand the private sector of the economy, at the national and the regional and local level, in pursuit of our aim to reduce poverty in Ukraine. Our contribution over this period has included:

- (i) continuous technical assistance, advice and support to the State Committee for Regulatory Policy & Enterprise at national level, and in Luhansk and Odesa Oblasts, to enable the Committee to play its part in the improvement of the business environment of Ukraine and the Oblasts concerned;
- (ii) the development and embedding of social and economic planning within Luhansk & Lviv Oblast State Authorities, the process and the plans providing the framework for the launch of initiatives to improve the environment;
- (iii) at local level, support for the creation of a One Stop Shop in Krasnodon and in Lviv Oblast in Sokal and Radehiv and the publication of Guides for businesses, to assist them with compliance with the regulatory environment;
- (iv) technical advice and assistance to support the expansion of the work of Donetsk and Luhansk Chambers of Commerce for small firms, including their work at the local level in towns within Donetsk Oblast;
- (v) financial support and technical assistance for the development of business centres in four pilot rayons and cities in Luhansk Oblast, centres which are now operating sustainably as area offices of the Chamber of Commerce;
- (vi) the successful operation of the micro finance fund in the four pilot centres of Luhansk Oblast, lending over 300 separate loans totalling nearly £600,000 with less than 10 defaults;

- (vii) the successful operation of a stone cluster and the emergence of the wine cluster in Odesa together with the integration of clusters as a key economic development tool of the SCORPE;
- (viii) the development of a Ukrainian benchmarking index;
- (ix) management internships for 62 young Ukrainians within British small firms between 1998 and 2002, under the Enterprise Europe programme;
- (x) the integration of enterprise within the curriculum of all secondary schools of Luhansk Oblast and within the professional and technical schools of Donetsk Oblast, and the creation of a Centre for Enterprise Education with the Donetsk State Institute of Post-diploma Education of Engineering and Pedagogy;
- (xi) the sustainable operation of 10 credit unions in Donetsk Oblast and 6 in Luhansk Oblast, all of them now taking savings deposits as well as making small loans. Further, considerable numbers of credit unions were also launched under the Rural Livelihoods projects in Donetsk, Luhansk and Kyiv Oblasts;
- (xii) the professional development of 43 Ukrainian staff in economic development, as a result of their work on the Donbas, LDP, Private Sector Development and SCORPE projects;
- (xiii) the opening and development of the Lviv Tourist Information Centre;
- (xiv) technical assistance and hands on help from UK Companies House to the Licensing Chamber and then SCORPE to create the Unified State Register of Enterprises in Ukraine;

### Policy Lessons

11.37 Policy lessons to be learnt from our work include:

- (i) Reform of the enabling environment is a long term process, which can often fail due to the lack of senior staff and management support for them on the ground. Further, constant institutional changes shift responsibilities for this sector from one government agency to another;
- (ii) There are often simple, yet challenging, issues of language and understanding in the detailed implementation of reform

efforts. Many policymakers in Ukraine do not understand - or are even suspicious of - the complex world of business, and small business in particular. Such an understanding is a fundamental prerequisite of reform; this lack of understanding leads to a basic ignorance of how to proceed with reform;

- (iii) Reform is essentially an issue of governance. Much of the problem on the ground is due to lack of budget funds for the regulators;
- (iv) Such work, at least in its early stages, needs champions: strong, visible leaders of change, at a senior level. In Ukraine these have been Mayors or Regional Governors;
- (v) In addition, reform efforts in Ukraine were successful in the cases where issue areas were not too complex, reform solutions were simple and practical and there was adequate preparation of documents and argument, most frequently done with high quality technical assistance providing support to trained local staff;
- (vi) Our work was most effective when:
  - The focus was on the internalisation of work and the development of Ukrainian professionals and on creating local ownership for outputs, with minimal emphasis put on the role of international actors;
  - Resources were concentrated on building sustainable technical and organisational capacities in Ukrainian organisations;
  - Our work was matched by continuous long-term involvement of reform minded representatives from governmental agencies to create a critical mass of beliefs and ideas there;
  - There was a focus on achieving positive project outcomes rather than advertising international consultants involvement in reform.

## ANNEX 1

## DFID PRIVATE SECTOR DEVELOPMENT STRATEGY 2000

**DEPARTMENT FOR INTERNATIONAL DEVELOPMENT  
UKRAINE**

PRIVATE SECTOR DEVELOPMENT STRATEGY 2000 - 2002

## 1 Background

1.1 The Government's priorities for the transition countries were set out in the White Paper "Eliminating World Poverty: A Challenge for the 21<sup>st</sup> Century" (Cm 3789), and in "Support for Transition Countries: A New Strategy", both published in 1997. The latter stated that " we will continue to support the process of transition in the region, seeking to ensure that its benefits are sustainable and spread through all levels of society" and laid down priorities for our assistance, which included :

- ◆ To develop the enabling framework for economic growth
- ◆ To promote an inclusive approach to economic management
- ◆ To integrate these countries into the global economic and political framework.

1.2 The 3 Year Country Strategy for Ukraine (CSP), published in October 1998, added detail to the Transition Country Strategy, and identified the following priority needs for the development of the private sector :

- ◆ Better economic and business management
- ◆ Key structural reforms & improved administration at central and local level
- ◆ A better enabling environment for private sector development
- ◆ Good governance in the private sector
- ◆ The removal of trade barriers impeding relations with the EU, and accession to the World Trade Organisation (WTO).

1.3 In the light of this policy guidance, and the indication in the Country Strategy Paper that up to £1 million a year will be allocated to private sector development, this strategy defines a framework for future UK assistance to private sector development (PSD) in Ukraine for 2000 - 2002 inclusive<sup>54</sup>.

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<sup>54</sup> This strategy has been prepared following four missions to Ukraine by DFID and British Embassy Know How Fund (KHF) staff between April 1998 and October 1999.

1.4 This PSD strategy is structured as follows :

- ◆ DFID Policies & Objectives for Private Sector Development
- ◆ An overview of the factors constraining PSD in Ukraine;
- ◆ A summary of national and local measures in Ukraine to support PSD
- ◆ Support for PSD from other donors
- ◆ Past DFID (via KHF) support for PSD in Ukraine
- ◆ A framework for future support to PSD

Annex A summarises, in tabular form, the strategy and the ways that it attempts to achieve the CSP priorities for PSD, including existing and proposed projects.

1.5 This strategy must not be read in isolation. PSD is a cross cutting sector and new and existing work in other sectors, in particular, the financial sector and agriculture, will contribute to achieving the goals of the PSD strategy. The key adviser taking forward this strategy will be the PSD adviser, but there will be a close involvement in its implementation & continuous review from the financial, agricultural, economic and social development advisers. It is essential that the effectiveness of DFID support be maximised by this strong liaison.

1.6 The **goal** of the PSD strategy is to increase the level of income amongst the population of Ukraine, so reducing the incidence of poverty. The **purpose** is to generate private sector growth, specifically from micro, small and medium sized businesses, (MSMEs), which will create jobs and increase the numbers, and sustainable incomes, of people employed by the private sector.

## 2 *Private Sector Development: DFID Policies & Objectives*

2.1 PSD everywhere involves an array of measures that can assist a range of targets within the private sector, from micro enterprises through to small and medium sized businesses, as well as measures to develop a wider understanding of the role of the private sector in a developing and expanding market economy. In all cases, however, the purpose of all the programmes is to reduce vulnerability, increase incomes and generate employment (at the business and the household level. Table 1, below, describes the process by which PSD can contribute to DFID priority objectives of poverty reduction.

Table 1

**Private Sector Development in Ukraine is hampered by a number of constraints,  
Including an unstable business environment, a lack of business and management skills, high tax rates, over regulation and corruption and lack of access to financial and non financial services**

Overcoming these constraints requires that :

The enabling environment for PSD in Ukraine is improved, and the performance of governmental and non governmental organisations servicing PSD be improved

In turn, this requires that :

*The capacity of both public and private sector institutions is enhanced*

This leads to :

*Positive change in business practices, capacity and performance*

Which, in turn,

*Enhances efficiency and economic growth*

Resulting in :

*Higher employment and incomes at an aggregate level*

From which

Poorer people benefit, via new jobs created in MSMEs, higher self employment among the poor & the spending from higher incomes

2.2 Whilst table 1 is, of course, highly simplified, it does highlight some core beliefs, including :

- ◆ Whilst poor people can do a considerable amount to help themselves, they are not the sole agent of their economic development, and experience from all over the world has shown

us that there are distinct limitations to what can be achieved by working directly with them alone;

- ◆ Significant dynamism in any economy comes from emerging small and medium sized businesses, most of whom are established by non poor people;
- ◆ The successful development of the private sector produces benefits wider than for the entrepreneur alone, including the poor;
- ◆ Given the overall socio economic situation in Ukraine, virtually any private sector development will have a positive impact on levels of poverty.

2.4 In no economy, whether in transition or not, will the poor self develop out of poverty through their own self-employment. Although economic growth is not sufficient in itself, it is a necessary precondition for poverty reduction. In economies which have successfully achieved reductions in poverty, economic growth, generated through a variety of means, has been at the heart of that process.

### 3 An Overview of the Factors Constraining PSD in Ukraine

3.1 The role of the private sector in the economy of Ukraine remains relatively small, and the contribution of the informal economy could account, on some estimates, for 50% of the total. Barter is widespread, especially when dealing with former or existing state owned enterprises, and there is a culture of non-payment, which inhibits the development of MSMEs, in particular.

3.2 The current numbers of businesses in Ukraine by size band, is included in table 2 below, together with a comparison with the situation in the UK. The figures for Ukraine are taken from an extensive USAID Household and Employment Survey conducted in the earlier part of 1999. UK figures are taken from Department of Trade & Industry (DTI) statistics for 1998.

3.3 Given that Ukraine and UK are of approximately similar size, these figures show a much healthier private sector in Ukraine than many have earlier imagined. The total number of businesses is similar, the major differences being the much larger numbers of self employed and the corresponding fewer businesses employing between 1 and 10 people, and to a lesser extent, between 11 and 50.

3.4 It must be recognised that many of the self-employed are barely trading; however, in the process, their entrepreneurial skills are being well tuned, and they are all making a real contribution to the national economy and some of them will create real businesses.

Table 2

## Distribution of Business in Ukraine and UK by Size

Employment Size	Businesses - Ukraine			Business - UK		
	Number	%	Nos Employed	Number	%	Nos Employed
None (self employed)	2,651,430	86	2.7 m	2,339,645	64	2.3 m
1-5	148,975	4.9	0.5 m	922,585	25	2.4 m
6-10	104,610	3.4	0.9 m	204,290	6	1.4 m
11 - 50	123,760	4.0	3.2 m	160,100	4.4	3.1 m
51 - 250	33,170	1.2	4.2 m	24,610	0.7	2.5 m
250 +	10,850	0.5	9.8 m	6,660	0.2	9.4 m
Total	3,072,795	100	21.3 m	3,657,890	100	21.1m

Notes: 1 Ukrainian figures for employment do not include informal jobs

2 Ukrainian figures for no of firms do not include small & micro businesses in the agricultural sector.

3 Figures for number of Ukrainian firms do include unregistered firms

3.5 Notwithstanding the above, the development of new and existing private business continues to be hampered by :

- ◆ Over regulation and corrupt administration, for example, an excessive number of inspections and overly bureaucratic procedures;
- ◆ High (in many cases, very high) tax rates;
- ◆ Very limited access to finance, and even then at high cost and with excessive security cover;
- ◆ An unstable business environment, especially at a macro level, and a poorly formulated legal framework for settling business disputes;

- ◆ Lack of information about business in general and about business opportunities at home and overseas;
  - ◆ A lack of business and management skills;
  - ◆ A negative public image of business and an almost universal lack of understanding of profit.
- 3.6 There is much evidence to suggest that these problems bear much more heavily upon MSMEs than larger businesses, which in effect are former state owned enterprises in decline. In many locations micro, small and medium sized businesses are misunderstood, and understanding of business extends to large (very large) factories, and to manufacturing. Many, especially outside the capital, and other large cities, see no need for the service sector, which, coincidentally, is the sector which has been fueling economic growth and MSME growth in Western market economies.
- 3.7 Foreign direct investment (FDI) has been very limited, especially into existing Ukrainian enterprises. This is due to an unfavourable environment for investors, compared to other destinations for FDI - including massive bureaucracy, macro economic instability, the inclination to change laws and regulations often at a whim, heavy tax rates and a lack of structural reform. The west of Ukraine has been more attractive but much of the investment has been Polish.
- 3.8 As a result of much of the above, the competitiveness of Ukrainian businesses has been falling compared to other Central European states (CEEC); taking 1990 as a base figure of 100, competitiveness of Polish and Hungarian business in 1998 was over 150, in Ukraine it had fallen to 50. Further, the average productivity of Ukrainian businesses is 20% of that of comparable US firms, and in many sectors this drops to 10%. These problems are being exacerbated by the strong efforts in many of Ukraine's neighbours to become members of the European Union (EU), and the financial support these countries are receiving from the EU to prepare for accession.
- 3.9 The accession issues are exacerbating an already difficult relationship with EU over trade and the accession of Ukraine to the World Trade Organisation (WTO) is desirable but distant, in the face of apparent reluctance on the part of the Ukrainian side to act against clear breaches of international trade agreements, especially as concerns "pirated" goods.
- 3.10 No social or political consensus exists about reform and its nature. Attitudes range from a strong wish to pursue a transition agenda, and that the problem has been too little reform, on the one hand, to a feeling that reform to date has been responsible for the substantial falls in standard of living. For reform to succeed, and the fear of change to diminish, the mind-set of a substantial part of the Ukrainian people still needs to alter radically.
- 3.11 Whilst all the above is clearly true, it must be remembered that there are still significant numbers of private businesses which are trying to grow, and are succeeding in their efforts. Such businesses are managed by people who want their firms to grow, who realise

that to achieve this, profits must be reinvested and who are willing to learn from international and Ukrainian best practice in order to succeed.

#### 4 *A Summary of National & Local Measures to Support PSD in Ukraine*

- 4.1 The policy climate for PSD appears to have been improving throughout 1998 and 1999, with slow, but increasing, recognition amongst Government that the private sector is the only option for economic growth in Ukraine. The October 1999 election showed only modest support for a return to more state involvement in business and industry, and the action taken to improve the enabling environment for PSD seems likely to continue. There are many reports from different parts of the country of a marked reduction in the number of inspections in the last year, and during 1999, many taxes on business and on profit did decline, at the instigation of the President, although they are still at relatively high levels.
- 4.2 In many ways, activity since the election has indicated, if anything, a more determined attempt to develop the private sector and to create the right economic and governmental conditions for its growth. The new government that is being formed following the election of President Kuchma in November 1999 appears, so far, to be far more reform minded than previous ones and there are real prospects for reform to be tackled with renewed vigour
- 4.3 In 1998 a State Committee for Enterprise Development was established to support the process of regulatory reform and to create an environment across the whole country that would be more supportive of enterprise development. In January 2000, this was re-created as the State Committee for Regulatory Policy & Enterprise. It has made some progress under the drive of its leader, but it is constrained by a lack of finance, an apparent absence of internal management and strategic direction and a fear of driving change too fast.
- 4.4 At a regional and local level, there are programmes to attract investment in some, but by no means all, locations. Often these include, for example, free enterprise zones and investment funds, but many in Ukraine are sceptical of these, seeing them as political and declaratory, frequently failing to materialise. Further, there is distrust amongst local and foreign investors about the durability of projected tax breaks on offer. Some local authorities claim to be trying to create business friendly environments, but in practice, these rarely exist in practice. There exist many business centres across the country, some started by local enthusiasm, invariably private, many by foreign donors, but very few receive financial - or indeed other - support from the public sector at local or national level, and few are actually sustainable, without continuing donor support, in one form or another. This lack of local support is often due, not to a lack of will, but simply a lack of money, and too many competing demands on the public purse.

- 4.5 The issue of Poland and Hungary's accession to the EU, and its impact on Ukraine, and especially on its businesses, and on the ability of the informal sector to travel at will and without visa, appears to have simply not been considered, at either national level or at local level in the west.

## 5 Current Support for PSD from Other Donors

- 5.1 A summary of current support for PSD by other international donors, and by subject area, is as follows :

### Business Support Infrastructure

- 5.2 Any market economy depends on an infrastructure - private or public - of business support organisations to provide advice, information, training or consultancy. In many developed economies, some of this role is taken by business membership and representative organisations, usually Chambers of Commerce. In Ukraine, in the absence of significant private sector input, there has been a major drive to create business centres, with donor monies replacing the private and public sponsorship usually available in the West. 28 have so far been formed, in part by earlier DFID actions, and by Tacis, USAID and IFC using other donor funds. Most of these deal with the micro and small business sector and some, but by no means all, have a good reputation. Few if any would be sustainable without continuing donor support.
- 5.3 The needs of larger SMEs have been dealt with in part by the four TACIS Post Privatisation Centres, one of which, in Lviv has succeeded well and is sustainable, as the west Ukraine Management Centre, although others not failed. There appears to be little attempt to develop business consultancy skills in other businesses, either of the consultant or, as a demand, among the clients. The USAID cited survey, above, found that less than 10% of businesses questioned had received help from a management consultant or training course - the comparable figure for UK would be 40%. The German Transform Programme, USAID (via Barents) and World Bank are also involved in enterprise restructuring.

### SME Finance

- 5.4 American, European and German aid has provided extensive investment in loan and equity funds, and at the same time provided technical assistance (TA) to attempt to create a mature banking network, which is once again a feature of all successful market economies. Much of this has been aimed at medium to large businesses. TACIS, inter alia, has attempted to create small credit funds, but has had real difficulty finding suitable fund management bodies. World Bank SECAL has had at least \$1 million available for micro credit (i.e. \$50 to \$5000, unsecured) for some time, and has recently requested TA from DFID to create a reliable and trustworthy

organisation to lend this. USAID and Canada are providing extensive TA to credit unions in Ukraine.

- 5.5 EBRD, after many years of trying to work via local banks is establishing during 2000, the Ukrainian Micro Credit Bank, which will operate initially from Kiev, but then from 8 other centres. This will lend from \$5,000 to \$125,000.

### *Enterprise Restructuring*

- 5.6 Enterprise restructuring is very important to Ukraine with many enterprises still owned by state, or Oblast and Municipal Councils, who are unable to manage or supervise them. A large number, however, have been privatised and restructured and much donor support is being, and has been, made available in an attempt to get them to trade profitably. Corporate governance practice is weak and examples of what would be regarded as totally unacceptable practice in any Western economy are weekly occurrences. IFC has been working in this area for some time, lately with KHF support, and others.
- 5.7 The TACIS Post Privatisation Centres have also been active here, with varying results, see above.

### **Regulatory Framework**

- 5.8 This is an important area, albeit a difficult one and one which has received much attention from donors. Donor strategies have included widening the horizons of policy makers through study visits, analysis of legislation, strengthening business lobbies and funding policy advisers. USAID are working with a Committee on Regulatory Reform, and have provided help to the State Committee for Regulatory Policy & Enterprise (SCORPE) as have TACIS, and, now DFID. DFID's company registration and licensing project is tackling a key area of necessary reform. Many donors have tried to support truly representative business representative organisations in order to strengthen them into an effective business lobby. Both TACIS & German Transform aid has gone into strengthening the Chamber of Commerce network.

### **Cultural Change**

- 5.9 A key barrier to change in Ukraine is a lack of public understanding of a market economy and of the positive contribution made by business, operating legitimately. Various donors have tried to work with the media in order to try to feature positive stories of entrepreneurship. A further means to improve this situation is by the education and training of school children, via enterprise education projects, which have been very popular and very useful in other CEE countries. Clearly this is an important area for Ukraine as a transition economy, since long term reform will only be successful if

the young have the necessary knowledge and understanding of business. However, no donor has developed anything other than small scale or pilot programmes in this area, and DFID has just launched an enterprise education project in Lviv, which is to form the basis of a national system.

## 6 Past DFID Support for PSD

- 6.1 DFID has not previously had a PSD strategy, but has provided support to SME development and to agriculture and finance, all of which have contributed to private sector development.
- 6.2 Much of the SME programme has focused on the development of business centres, in Luhansk, Kyiv and five centres in Western Ukraine; other major donors have now taken over their development. The real impact of such work has been limited, due to lack of a strategic lead and local support, and as a result of the more fundamental constraints to PSD.
- 6.3 In the financial sector, technical assistance is being provided on company registration and licensing, and rural livelihoods projects in both Donetsk and Odessa are adopting a holistic approach to farm restructuring, including support via rural centres to rural enterprise development and small agribusiness. In the social sector, work is being done in Donetsk to support coal sector restructuring and to help redundant miners start businesses.
- 6.4 Recently, a project to support the State Committee for Regulatory Policy and Enterprise has been started, as has a tourism development project and one to develop enterprise education, both in Lviv.

## 7 A Framework for Future Support to PSD

- 7.1 The PSD strategy will aim to meet its goal by reducing some of the above identified constraints, whilst at the same time, complementing other donors work, rather than duplicating. The DFID budget for PSD in Ukraine is relatively low - at £1 million - and it is important that our effectiveness and results, on the ground, are clear. For this reason it is unlikely that we will participate in co-funding projects with a multiplicity of donors, where our input is not completely clear.
- 7.2 At the same time, we will seek to reduce any confusion, which might exist as a result of lack of donor coordination, and will strive to avoid creating any additional confusion.
- 7.3 The experience of transition in CEEC, especially Poland, Hungary and the Czech Republic, is of relevance to the achievement of the goal of the strategy and we will encourage the involvement of consultants from these countries in our Ukrainian projects.
- 7.4 Our projects under this strategy will average £450,000 in value, without us losing the opportunities to respond rapidly to needs and

requests as they arise. All projects will be strategic, in that they will focus on issues at a scale larger than just the local; will be designed to be sustainable after the project finishes, and will contain resources to enable widespread dissemination to take place across Ukraine, and seminars and round tables to exchange experiences of our work in Ukraine with other Former Soviet Union (FSU) and CEE countries will be arranged regularly.

- 7.5 It is considered that future DFID support for PSD should concentrate upon:
- ◆ Improving the competitiveness of Ukrainian firms by developing a range of services to support business growth;
  - ◆ The development of an enterprise culture amongst young people;
  - ◆ Improving the availability of smaller sums of finance for PSD, especially via micro credit and credit unions;
  - ◆ Providing support to regulatory reform and enterprise development at the national and local level;
  - ◆ Developing good governance in the private sector
  - ◆ Improving Ukrainian international trade practices
  - ◆ Assisting Ukraine to take advantage of EU accession of the CEE countries
- 7.6 Future UK support will focus not just on individual projects, but will seek to influence the wider policy and institutional framework. In this regard, we will work very closely with the EU, in the early part of 2000 so that, in the first instance, the TACIS SME and PSD strategy for Ukraine for the years 2000 - 2003 will complement this strategy. We will aim to work more closely with the World Bank too.
- 7.7 Our support will usually take the form of strategic and detailed technical assistance, at national and local level to tackle and remove some of the key constraints to PSD outlined above. However, it is likely that most of our work will be at the local level - at Oblast or Municipality level, in the following focal Oblasts: Donetsk, Lviv and Kharkiv. If necessary, we will consider making available the capital for microcredit as well as the technical assistance required to successfully lend it.

## PSD Themes

### 7.8 *Improving the Competitiveness of Ukrainian Firms*

Much donor support has gone into restructuring large former state owned enterprises, or via the development of the business centre network, into assisting the creation of micro and small firms. In spite of all the problems detailed above, there are a significant number of strong Ukrainian firms, which have the potential to grow, and whose management has the desire to grow. These businesses are uncompetitive compared with their Polish and Hungarian competitors and with others on the world stage, and this gap is widening.

All market economies need a strong core of medium sized businesses, and there is a need in Ukraine to assist the development of these, by the development of management skills, by the use of the international quality standard ISO 9000 to improve the internal organisation of the business and at the same time to internationally accredit the business and by the provision of detailed management information, based upon international best practice.

We will support the development of this sector by strengthening the capacity of those organisations, in the private or public sector, which have the potential to deliver such services. It is our aim to develop the market for these services in Ukraine, and our support will be provided to organisations charging medium sized firms for this service, albeit at a much subsidised price. Delivering the services for free would hinder the creation of a market for business services within the country.

This support will be launched in Lviv but will eventually be made available in our other focal oblasts, including Donetsk and Kharkhiv.

### *7.9 The development of an Enterprise Culture amongst Young People*

Private business in general has a poor image amongst the people of Ukraine, and many in parliament and the public service share this view. It is a view founded in no small part on the beliefs of socialism, with its views about "profiteering" and "racketeering". Unfortunately, the behaviour of many so called businessmen and women, and politicians, since independence has reinforced this view. We will seek to build a positive image of private business amongst the young, by the introduction of a wide range of support, for example:

- ◆ Enterprise education in schools, vocational schools and further and higher education - introducing active learning methods and subjects into the curriculum with the immediate aim of increasing business and economic awareness, and developing skills needed to get work in a flexible labour market. This will build on our pilot project in Lviv Oblast, in co-operation with Ministry of Education, launched in September 1999;
- ◆ Specific support to institutions to provide support for young people who wish to set up their own business;
- ◆ The continuation of the Enterprise Europe programme of placements for young business men and women from Ukraine with British SMEs.

Via this support, we will contribute to building a new skills base and helping to change attitudes towards business.

A second strand of this strategy will work with the media sector, to harness the undoubted power of the media to help promote a positive image of business, via the inclusion of business success stories, nationally and locally within focal oblasts. Further, all future projects will require contractors to promote the positive outcomes of DFID supported work, and to report regularly to DFID on the results of this promotion.

### *7.10 Improving the Availability of Micro Credit*

While much work has been done in the country to develop small business, the availability and cost of credit for emerging businesses is very poor and is hindering the growth and maturity of the small and micro sector. Whilst much has been done to create the right conditions and to provide money for lending to larger firms, there is a lack of understanding in banks of the needs of smaller firms and to how to lend to smaller business, a similar problem existed in UK in 1980, of course. Macro economic policy in Ukraine drives up the cost of credit of course, but security requirements can be excessive, often up to 3 times the value of the loan.

This problem if worst, of course, for micro and small firms, who wish to borrow sums between \$100 and \$10,000, sometimes for short periods of time, unsecured. Donor policy in other parts of the developing world is focusing on support to create specific institutions to lend micro credit, a route widely accepted as necessary if the policy is to successfully develop sustainable institutions, and to provide such organisations with the specific skills needed to evaluate the borrower's application and to monitor closely the business once it has started.

We will provide technical assistance to create such organisations, where appropriate, complementing an organisation which can provide the funds, for example the World Bank. In certain circumstances, we will consider making the funds available ourselves. The availability of micro credit in this way will of course assist other sectors, for example the development of rural livelihoods.

We will also provide technical assistance for the growth of credit unions, which would appear to offer an innovative role for financing smaller firms in certain parts of Ukraine.

This work will build heavily on DFID experience in other parts of Central & Eastern Europe, as well as other parts of the world, especially in terms of the structure of the models to be used.

#### *7.11 Providing Support to Regulatory Reform of the Enabling Environment for PSD at the National & Local Level*

We will support the process of regulatory reform and the creation of an environment more supportive of private sector development. We are currently working with The State Committee for Regulatory Policy & Enterprise, which was established in 1998 to improve the enabling environment for PSD. It is currently receiving DFID support, having also received USAID and TACIS funding in the past. We are also supporting attempts to improve the licensing and registration framework, both via SCORPE and directly with the Licensing Chamber and others.

In addition, our work on the LARGIS project, in Lviv and in the centre, has a key focus on private sector (economic) development, and we will look for ways to improve the enabling environment for PSD within the evolving results of this project.

We will provide additional support to reforms at both national and local level, to help to develop a better enabling environment for the private sector, as long as it is clear that such support will eventually lead to clear and tangible outcomes. In particular, we will provide support for the development of policies to encourage and stimulate SME growth at the local level, by working with, and training, officials in the Oblast and Raion governments in our focal oblasts.

### *7.12 Developing Good Governance in the Private Sector*

It is essential that Ukrainian business develops transparent and legal business practices in particular relating to its shareholders, investors and employees, as well as the Government at local and national level. We are currently supporting an IFC project - jointly with the Canadians - aimed at improving good governance in the private sector, in Kharkhiv, and we will examine the results of this work in detail in mid 2000 in order to determine our future work in this respect.

### *7.13 Improving Ukrainian International Trade Practices*

"It is critically important that Ukraine should follow the right policies to tackle its economic and financial problems."<sup>55</sup> This is particularly true of its international trade practices, which are viewed by many as currently being below internationally acceptable standards. For example, EU receives the largest number of complaints concerning Ukraine of any Country in Central Europe and the FSU. We will attempt to influence at the highest level and to use UK expertise, including at Government level, to bring about improvements, the eventual aim being to see Ukraine admitted as a member of the WTO. Our Economic Adviser will lead on this.

This work clearly links closely with our work to support Ukraine to take advantage of the opportunities from the accession of the CEE countries into the EU - see below.

### *7.14 Assisting Ukraine to Take Advantage of EU Accession of the CEE Countries*

The process of accession of some CEEC into the EU has been in progress for some time, notwithstanding the fact that, whilst the target date for accession for Poland and Hungary is expected to be between 2003 and 2005, it has not yet been fixed. DFID commissioned some research into the effects of this process of accession on the Lviv Oblast, and it found that:

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<sup>55</sup> CSP para E4

- ◆ A lack of understanding, at both national and regional level, of the process and its economic and social effects on Ukraine - in some ways a refusal to accept the existence of the process;
- ◆ Consequently, a lack of preparedness and policy to deal with the effects;
- ◆ Almost certainly, there will be a cessation of the present visa free access by Ukrainian citizens into Poland and Hungary, for example, which will have a severe effect on informal trade and, therefore, on the livelihoods of many people, especially in Western Ukraine;
- ◆ Ever reducing competitiveness of Ukrainian business, a process likely to get worse as EU funds are allocated to the Western provinces of Poland and Hungary, as the new border regions of an enlarged EU;
- ◆ A shortage of project design and development skills in Western Ukraine, as in many other CEEC, skills which will be needed if the fullest benefit is to be had of any EU cross border assistance to Ukraine to tackle the above problems.

We will provide support to institutions in West Ukraine, to ensure that Ukrainian businesses do not suffer from and are in a position to take advantage of the accession of many CEE countries into the EU.

In many ways a strong regional development agency (RDA) is required in the Lviv region to tackle these issues, an initiative which is not possible in the current state of local and regional government in Ukraine. Against the context of our LARGIS project, we will work towards the creation of such a RDA over the next three years.

### Partners

- 7.15 We will continue to collaborate with other international donors, for example World Bank and TACIS, where DFID technical assistance plays a clear role in improving the effectiveness of a project, and where the DFID contribution is clear. We will strive also to develop joint initiatives together. In the past some support has been provided to projects where there has been a multiplicity of donors, for example IFC and other bilateral donor funds, and in these cases it is sometimes difficult to identify the actual contribution our funds have made. It is unlikely that we will co-fund projects in such circumstances in the future.
- 7.16 We will work with the Oblast and Municipal authorities which demonstrate a commitment to reform and the development of the private sector within our focal Oblasts, which are, to reiterate, Lviv, Donetsk and Kharkhiv. We will always ensure that there is a strong local demand for, and ownership of, our projects. Other focal Oblasts will be considered seriously, but we will always focus our work on a maximum of 4 focal oblasts.
- 7.17 We will continue to work with business development organisations, in the public or the private sector, and where appropriate with NGOs

who can help us achieve our goal and aims. All of our partners must behave in an ethical manner in all matters, at all times, and demonstrate a commitment to the goals and policies of DFID as set out in the 1997 White Paper, and any subsequent amendments. Evidence that our contractors are not behaving in such a manner, or are acting in any way that could bring DFID or HM Government policy into disrepute, could lead to suspension or cessation of projects.

### Impact

7.18 The PSD strategy will pay considerable attention to impact assessment, in particular, to monitor the detailed impact of projects developed within this strategy, and to understand as much as possible about their income and employment effects, whether they be on the development of business or on individuals, and the impact of the projects on the goal and purpose of the PSD strategy.

7.19 Various options for such impact assessment could include :

- ◆ Assessing the impact on a strategy wide basis;
- ◆ Using consultants to assess the impact on a project by project basis;
- ◆ Assessing impact on particular client groups, via market research;
- ◆ Collaborating with other donors to agree common indicators for assessment, so reducing the overall costs.

### ANNEX A

#### THE RELATIONSHIPS BETWEEN COUNTRY STRATEGY PAPER PRIORITIES FOR PSD IN UKRAINE & PSD STRATEGY PRIORITIES

CSP Priorities <sup>56</sup>	PSD Strategy Priorities	Projects (Actual or Proposed)
1 Better Economic & Business Management	Improve Competitiveness of Ukrainian Firms	Improving the Competitiveness of Mid Sized Ukrainian Business (proposed 2000 - 2002)
2 Key Structural Reforms & Improved Administration at Central and Local Level	Providing Support for Regulatory Reform to Better Support PSD at	Support to State Committee for Regulation & Enterprise

<sup>56</sup> CSP priorities distilled from paras E2 and E14 of the CSP (pages 7 and 8)

	National & Local Level	<p>Development CNTR 98 6967A (1999 - 2000; extension 2000 to 2002 )</p> <p>Company Registration &amp; Licensing Project CNTR 98 5481A 1998 - 2000</p> <p>LARGIS - Local &amp; Regional Government Strengthening (1999 - 2002)</p> <p>Support to Reinforce State Measures and Local Initiatives for Re-employment (CNTR 99 8130) 1999 - 2002</p> <p>Possible project to assist local administrations to take advantage of the July 1999 Law on Concessions (To be investigated within the framework of LARGIS - possible start 2001)</p> <p>Possible project to assist Lviv City &amp; Oblast Government to develop a Regional Development Agency (To be developed from LARGIS - possible 2001-2002)</p> <p>SME Policy Development in Lviv Donetsk and Kharkhiv Oblasts (proposed 2001-2003)</p>
3 A Better Enabling Environment for PSD in	Providing Support for	Placements for Ukrainian Entrepreneurs in SME

<p>Ukraine including overcoming constraints to PSD, including :</p> <ul style="list-style-type: none"> <li>◆ Excessive regulation</li> </ul> <p>3 A Better Enabling Environment....Continued</p> <ul style="list-style-type: none"> <li>◆ Lack of information <ul style="list-style-type: none"> <li>◆ Shortage of management skills</li> <li>◆ Lack of credit</li> </ul> </li> </ul>	<p>Regulatory Reform to Better Support PSD at National &amp; Local Level</p> <p>Improving Competitiveness of Ukrainian Firms</p> <p>Improving the Availability of Smaller Sums of Finance for PSD</p> <p>The Development of an Enterprise Culture Amongst Young People</p>	<p>sector CNTR 98 4993A - 1998-99; Phase II 1999-2000 Phase III 2000 - 2001</p> <p>Tourism Development in Lviv CNTR 99 7753A 1999 - 2001</p> <p>Improving the Competitiveness of Mid Sized Ukrainian Business (Proposed 2000 - 2002 Possible extension 2002 - 03)</p> <p>Improving Services of Chamber of Commerce, including Donetsk, Kharkhiv and Lviv (Proposed - 2000 - 2002)</p> <p>Support to Develop a Micro Credit Agency in Donetsk (Possible project in collaboration with World Bank) 2000 - 2002</p> <p>Development of Ukrainian Credit Unions as Sources of Business Finance (Possible 2000 - 2002)</p> <p>Enterprise Education Ukraine CNTR 99 7766A 1999 - 2002</p> <p>Enterprise Education in Further Education in Donetsk (Proposed project 2001 - 2003)</p> <p>West Ukraine &amp; EU Enlargement (1999 - 2001)</p>
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DFID UKRAINE

	Assisting Ukraine to take advantage of EU Accession of the CEE countries	
4 Good Governance in the Private Sector	Good Governance in the Private Sector	Ukraine Corporate Governance Project (IFC) 1999 - 2000
5 The Removal of Trade Barriers impeding relations with EU & accession to WTO	Improving International Trade Practice  Assisting Ukraine to take advantage of EU Accession of the CEE countries	Ukraine - EU Trade Policy Development Project (In design - projected 2000/01)  Ukrainian Regions & EU Enlargement CNTR 99 7229 (1999 - 2000) Possible extension/enlargement of project 2000 - 2001

## ANNEX 2

ONE STOP PERMIT SHOPS IN LVIV OBLAST : FINDINGS FROM DFID WORK  
A MINUTE FROM THE ECONOMIC ADVISER TO DFID UKRAINE

## Reference

**FROM:** Katya Maynzyuk**DATE:** 12 April 2006**CC:** John Stuppel  
Peter Fortune  
Adrian Campbell  
Krzysztof Herbst  
Alexandra Zayarna  
Olga Sandakova**To:** Olga Mrinska**One-stop shop permit offices in Lvivska oblast: findings from LDP work**

This note summarises the information we received during the monitoring mission to LDP project in March 2006 regarding the work conducted by the project to support the development of one-stop shop permit offices in Lvivska oblast. We are grateful to project experts, Olena Bey and especially Ms. Tatiana Lukashenko, for this valuable work and insights. A large portion of this note is based on the information they have provided during our meeting. The note also contains our recommendations for cross-reading with other DFID work in the area.

**Background**

The work on one-stop shop permit offices (OSSPOs) in cities and rayons of Lvivska oblast was launched relatively recently in response to a specific request from the oblast administration and as an example of a vertical operational programme to support the strategic priority of the oblast for improved business environment. To a large extent, this suggestion was a reaction to the recent national initiative to develop one-stop permit oblasts at all levels, including rural rayons. At that moment and until now, streamlining permit procedures remained a big unresolved issue, especially in rayons (where decision-making responsibilities are scattered between the various levels of government) and we had no knowledge of a practical example of a successful and operational OSSPO in rural rayon. Therefore, the DFID has seen this LDP work very much as an exploratory exercise.

After the mission, we see that this kind of exploratory approach proved very productive. It differs considerably both from the national approach and from how this task was tackled in other oblasts, and, in particular, in the other DFID pilot region Donbas, where attention is concentrated on actual creation of the OSSPOs. The LDP, on the other hand, started from detailed investigation of

the current legal frameworks for permit provision, in order to take stock of the existing regulations and arrive at a clear agreed list of necessary procedures approved by the authorities and understood by the businesses. In other words, because of the complexity of the current system, the idea is to understand and officially clarify this complexity first before trying to orchestrate it through one-stop shops.

### **The national initiative and the complexity of the current system**

Although the need for streamlined permit procedures was realised for a long time, during the last year the central government actively declared it a priority and in October it issued a new law which requested authorities at all levels to “ensure provision of business registration services according to the principle of organisational unity”. Local and regional authorities were urged to quickly adopt the new approaches (sometimes under the danger of dismissal\*).

This resulted in formal opening of one-stop shops for receiving permits in almost all Ukrainian cities and rayons, even though they rarely became operational. In most cases, the new offices simply became mailboxes for the submission of permit applications from new businesses, and this additional link in the chain of the decision making process was often making it even slower. Majority of businesses in the oblast are not even aware about the new law and those who are aware often prefer the system to remain as it was without additional intermediaries.

The current version of the law suffers from a number of weaknesses, which makes it difficult to practically introduce it in the regions.

- First of all, it does not specify which regulations should be subject of unifications. The LDP experts estimate that the total number of currently acting permits is around 150 and about 30 of those could be usefully unified for one-stop shop provision.
- Secondly, it does not spell out administrative procedures for establishing OSSs, including staff numbers etc.
- But most importantly, the law makes only a vague reference to the fact that all the currently existing regulations do not imply organisational unity. Quite contrary to that, existing regulations are complex, chaotic and widely scattered among various decision-makers. Each permit and each regulatory decision is covered by a different legislative act, and often differs from one region to another. In order to streamline the system, all those individual legislative acts would also have to be amended, but there is no clarity about what has to change and no agreement to changes among stakeholders involved. The October law gives one year for amending the legislation but does not set a direction.

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\* Soon after the new government came to office in early 2005, President Yushchenko requested all Ukrainian oblasts to adopt unified systems for business registration by summer, calling for the resignation of the governors in case the deadlines would be broken.

## The work in Lviv oblast

In response to the national initiative, all cities and rayons of the oblast have opened positions of OSSPO administrators whose task is to organise collective work of the offices involved in issuing the permits. Because of the lack of space and equipment, authorities could not bring the representatives of all the relevant regulators in one room to establish a permanent OSSPO, but chose to appoint a flexible administrator instead.

The work of the LDP concentrated on the following tasks:

- Establishing and maintaining close operational contact with the OSSPO administrators; provision of training to the key people involved in the process through half day regional seminars. The idea of this cooperation and training was to set a forum for joint discussion about the possible approaches to OSSPO organisation and on the details of certain problematic regulations.
- The project has prepared a comprehensive package of all legal requirements to receive the key permits, with concrete procedures to follow and typical forms / documents to fill in. This was an amazingly useful and revealing work, since it turned out that even agreeing the typical forms officially with the authorities was not always easy.
- The project also prepared manuals and guidance on how to fulfil the existing procedures in a business-friendly format.
- Apart from analysis of the current legislation, the project prepared proposals for new regulations which would clarify and streamline the cooperation between the various authorities and departments. Some of these recommendations are already applied in practice.
- The project established operational links with the State Committee on Regulatory Policy and Entrepreneurship (SCORPE) (as well as with 4 working groups working on these issues in Kyiv) and submitted a number of ideas for regulatory changes at the national level. These submitted proposals were rather modest as the project as trying to stay realistic. In particular, this included suggestions on amendments to the one-stop shop permit application form. The current form is addressed to the OSSPO administrator, while at each post-administrator stage the application would have to be addressed to higher level officials.
- Certain concrete improvements were made with assistance of LDP experts to specific regulatory requirements. As a result, the 140 steps which businesses had to take for full registration are now decreased to 70. Needless to say that this number still remains very high.
- The LDP notes that submitting proposals to SCORPE and other central agents only makes sense if it is made in the form of concrete draft legislative acts; any general policy ideas usually do not survive, mostly because of lacking legal drafting capacities at the national level. My personal comment is that this circumstance represents an extremely unfortunate gap in the policy process, which is also present in other areas

of DFID involvement in Ukraine (in particular, the FRSSU project has researched it in detail). The policy formulation process often does not start with policy discussion and stakeholder coordination but from legislative drafting which considerably diminishes the quality of the final outcomes and its practical applicability.

### **The key problems remaining**

- Current legislative frameworks. As already mentioned, it remains complex, confused and scattered.
- No recognition of the need to provide a significantly strong institutional role to the OSSPO administrator. The “October law” does not specify the rank and the status of the potential OSSPO administrators, which de facto leaves this assignment to regular civil servants. At the same time, in most of the areas regulated by permit legislation, the hierarchy of decision making goes beyond the rank of administrator, and so he or she does not have enough power to influence the process. According to the LDP and the general expert consensus, for the OSSPO to act effectively, the rank of the administrator should be comparable at least with deputy head of rayon administrations or deputy city mayors. The LDP experts have developed addresses to the national regulators and even to the President of Ukraine explaining this problem and received a favourable comment promising the necessary changes in the preparation of the 2007 budget.
- Equipment and material base (which is currently lacking). This pragmatic aspect is critical for OSSPO because effective coordination of registration processes requires access to legal databases, email connection to quickly communicate with other regulators and authorities, photocopying facilities to work with various forms and registration documents.
- Unwillingness of many regulatory authorities to cooperate. LDP experts reckon that additional work (and requirements) is needed to make authorities like fire inspection, architectural supervision, sanitary safety service etc. redirect their services to work through the OSSPO administrator.
- Ideological confusion. The principle behind OSSPO should be to separate businesses from civil servants in the process of registration: to the extent possible, the civil servant should work with the document, not interact with business representatives.
- Insufficient efforts to promote OSSPO among the business community and raise their awareness in the issue. As we discovered and described before, not many businesses know about the new law. Moreover, even the existing (uncoordinated) procedures are not clearly defined and explained to the businesses at the moment.
- The role of stakeholders who have de facto powers to issue permits but no legal obligation to follow the newly established law. These stakeholders include various non-governmental agencies such as oblast energy companies who have regulatory roles in their sectors but yet formally remain outside the national regulatory system.

- We discovered striking facts about such regulatory powers of non-governmental agents. Apart from issuing permits, such agents sometimes have opportunity to levy (in cooperation with governmental authorities) specialised local taxes, whose rates are established by local governments but whose proceeds are shared between local budgets and the non-governmental agents. For example, each investor considering a new construction in a city, has to pay a certain percentage of the (estimated construction costs?) to the local budget which shares it with infrastructure support companies (the idea is that new construction requires new infrastructure – both physical and “social” – which brings additional costs both to such companies and to the budget). In the city of Lviv, the total current size of this percentage is at the level of 25%. We were also told about the most innovative approach of the city of Illichivsk which brought the rate of such payment down to zero to attract new investors.

### **Cooperation with other DFID projects**

As we understood during the mission, there is a difference in approach to OSSPO between LDP and Action Donbas, with the latter been more concentrated on the actual establishment of the OSSPO rather than on the analysis of the existing procedures. We should explore this difference in more detail and share the results of the investigations conducted by the LDP as widely as possible. If there is indeed any comparative advantage in the LDP exploratory work, communication with AD could help to identify it clearly and disseminate this work more effectively both to other regions/donors and to the national level.