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Implementation of the European Neighbourhood Policy in Ukraine Progress in 2012 and recommendations for action

Accompanying the document

JOINT COMMUNICATION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

European Neighbourhood Policy: Working towards a Stronger Partnership

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1. OVERALL ASSESSEMENT AND RECOMMENDATIONS

This document reports on the progress made in implementing the EU-Ukraine Association Agenda between 1 January and 31 December 2012. Developments outside this reporting period are also taken into consideration where deemed relevant. This is not intended to be a general review of the political and economic situation in Ukraine. For information on regional and multilateral sector processes, readers should refer to the Eastern Partnership report.

In March 2012, the EU and Ukraine initialled the text of the Association Agreement and its Deep and Comprehensive Free Trade Area (DCFTA). There was a common understanding that Ukraine's performance, notably in relation to respect for common values and the rule of law, will be of crucial importance for the speed of its political association and economic integration with the EU, including in the context of conclusion of the Association Agreement and its subsequent implementation. Ukraine stepped up its efforts to implement the priorities of the Association Agenda, as evidenced by the Joint Committee's report of November 2012¹. However, much remains to be done by Ukraine, for example the fight against conflict of interest and corruption in the judiciary, and the stabilization and consolidation of its public institutions so as to enable it to benefit fully from the Association Agreement's potential.

Overall Ukraine presented a mixed picture of developments on deep and sustainable democracy. There were some positive developments in the field of legal reform, including the judiciary, where some important laws were enacted (entry into force of a new Criminal Procedure Code, the new legislation on the Bar, the establishment of a National Preventive Mechanism against torture), and in the area of freedom of association. It was decided to launch the preparation for *constitutional reform*: a Constitutional Assembly was established to act as an auxiliary and advisory body to the President. At the same time, these developments remained over-shadowed by the matter of selective justice and the conduct of parliamentary elections which showed deterioration in several areas compared to standards previously achieved. The perception of corruption remained high, and Ukraine continued to occupy a lowly position in international rankings. This was also due to lack of progress in improving the anti-corruption system and even regression in budget transparency and in terms of legislation on public procurement. Ukraine took only at a late stage initial measures to start removing EU's concerns related to public finance management. This led to delays in planned disbursements under EU sectoral budget support.

Progress was achieved in the energy sector, notably with the adoption of legislation enabling the unbundling of Naftogaz. At the same time, Ukraine's notification of wishing to renegotiate its World Trade Organisation commitments under Article XXVIII of the General Agreement on Tariffs and Trade (GATT) raised commercial concerns and posed a challenge to the integrity of the multilateral trading system.

¹ The Association Agenda will be updated in 2013 to reflect the priorities of the finalised Association Agreement.

In the framework of the first (legislative) phase of the Action Plan on Visa Liberalisation, Ukraine continued to pursue the adoption of the requisite legislation and strategic and policy documents in such areas as the legal status of foreigners, border and migration management, asylum, trafficking in human beings, drugs and mutual assistance in criminal matters. The agreement amending the Visa Facilitation Agreement between Ukraine and the EU was signed on 23 July 2012. Instances of *refoulement* and of denial of access for United Nations High Commissioner for Refugees (UNHCR) representatives to asylum seekers were observed with concern by the EU.

In 2012, the risks to Ukraine's economy increased markedly as growth stalled and the balance of payments deficits widened, partly as a consequence of sluggish external demand. Foreign direct investment remains at a low level as a result of the deteriorating business climate. International reserves decreased significantly as Ukraine attempted to stabilise its currency, contrary to the recommendation of the International Monetary Fund (IMF). Negotiations with the Fund on a new standby arrangement started in January 2013.

Ukraine continued to cooperate with the EU on several regional and international issues. At regional level, it adopted a positive stance in the 5+2 Transnistria settlement talks, and its cooperation with the EU on all questions related to this matter was constructive.

The Council Conclusions of 10 December 2012 reaffirmed the EU's commitment to signing the Association Agreement, including the DCFTA, as soon as Ukraine demonstrates determined action and tangible progress in three areas - actions to remedy the shortcomings noted in the October 2012 parliamentary elections; progress in addressing the issue of selective justice and preventing its recurrence; and action to implement the reforms set out in the jointly agreed Association Agenda, possibly by the time of the Eastern Partnership Summit in Vilnius in November 2013. It indicated that signature could be accompanied by opening for provisional application of parts of the Agreement. At the 16th EU-Ukraine Summit which took place on 25 February 2013 in Brussels Ukraine confirmed its determination to comply with those areas/elements specified by the Conclusions to that end.

In 2012, Ukraine did not address most of the key recommendations contained in last year's European Neighbourhood Progress (ENP) progress report. However, it did take steps toward legal and judicial reform, with the entry into force of a new Criminal Procedure Code and other important legislation. It also adopted a law on Asylum and Refugee Status, though implementation is flawed. Progress is needed on the other key recommendations. On the basis of this year's report, and with a view to the sustained implementation of the Association Agenda in 2013, Ukraine is invited to:

- Take early steps to establish a reliable electoral system based on an Election Code and clear rules for balanced media access for candidates; fully implement the OSCE-ODIHR's other recommendations on the conduct of the October 2012 parliamentary elections, and address the shortcomings, in line with the public commitments made by the Prime Minister of Ukraine in an inclusive dialogue with the opposition.

- Address the cases of politically motivated convictions without further delay; take further steps to reform the judiciary to prevent any recurrence, including an early implementation of all judgments of the European Court of Human Rights and of the recommendations by the Council of Europe related to detention conditions and medical assistance for persons in detention; review in close consultation with the Council of Europe/Venice Commission the law on the functioning of the Prosecutor's Office, the Criminal Code, the role of the High Council of Justice, the laws on the Judicial System and the Status of Judges, and reform of the Police.
- Step up fight against conflict of interest and corruption, including in the judiciary system and in relation to improving the business climate.
- Reverse the backsliding which occurred in 2012 on public procurement and budget transparency; develop and start to implement a public finance management strategy; broaden the remit of the Accounting Chamber and amend the law on the civil service of November 2011 in line with EU norms.
- Ensure that the constitutional reform process is carried out in an inclusive and transparent way in line with all constitutional norms and in close cooperation with the Council of Europe/Venice Commission.
- Make greater efforts to meet the benchmarks set out in the Action Plan on Visa Liberalisation.
- Comply with its obligations under international refugee and human rights law, in particular the principle of *non-refoulement*.
- Establish a macroeconomic framework conducive to the resumption of IMF support, addressing such issues as fiscal sustainability in the energy sector.
- Refrain from introducing protectionist measures, such as recycling fees on vehicles, which are potentially in breach of its WTO commitments, and withdraw the notification for renegotiating its WTO commitments.
- Comply with its obligations under the Energy Community Treaty (as reflected in the Association Agreement and the Association Agenda).

2. POLITICAL DIALOGUE AND REFORM

Towards deep and sustainable democracy

The conduct of the 28 October 2012 parliamentary **elections** presented a mixed picture. The voters had a genuine choice between distinct parties; candidate registration was inclusive; the centralised voter registration system appeared to be functioning well; and the campaign was visible and active and was competitive in most parts of the country. But the lack of a level playing field, caused primarily by the abuse of administrative

resources, cases of candidates and electoral staff being intimidated, lack of transparency of campaign and party financing, lack of balanced media coverage, and the irregularities and delays in the vote count and tabulation constituted a step backwards compared with recent national elections. The Prime Minister made a public commitment to follow-up on electoral complaints. It proved impossible to establish the election results in five single mandate electoral districts. Electoral legislation still needs to be brought into line with OSCE and Council of Europe standards. Trials which did not comply with international standards prevented some opposition representatives from standing in the elections.

The new law on civic organizations, which entered into force on 1 January 2013, represented an important step forward in the area of **freedom of association**. If correctly implemented, it will address such problems as territorial restrictions on the activities of NGOs and administrative obstacles to their registration.

Freedom of assembly has been undermined by the lack of modern legislation. Steps have been taken to prepare new legislation, though this has still to be adopted.

Media freedom did not improve in 2012. Reports of physical attacks on journalists have become more frequent, and the law-enforcement agencies have failed to investigate alleged cases properly. The information space has been dominated by pro-governmental media. The pressure on media which are critical of the government has increased. Journalists and media experts have criticised the Inter-Agency Working Group under the Presidential Administration for failing to address the situation effectively. A draft law on defamation was passed by the Parliament at first reading but withdrawn following strong criticism from civil society and the international community. There was no progress in adopting legislation on public broadcasting and on the transparency of media ownership.

Confidence in Ukraine's **judiciary** was undermined by trials which did not meet international standards as regards fair, transparent and independent legal processes and which indicated a selective use of justice vis-à-vis leaders of the opposition and members of the former government. Ukrainian judges are subject to interference from the executive branch.

In August 2012, the adoption of new legislation on the Bar was a positive step. In November, the entry into force of a new Criminal Procedure Code, formulated elaborated in close consultations with the Council of Europe, was a further major step, if implemented correctly, the Code will play its part in ensuring fair trials, and equality of status between prosecution and defence, and in preventing ill-treatment and torture.

The Prosecutor General's Office remains largely unreformed, resists any restrictions of its current prerogatives and interferes with law-enforcement investigations. Despite a law adopted in September, Ukraine needs a comprehensive reform of how the Prosecutor's Office operates. A law on the Police and a revision of the Criminal Code are yet to be pursued.

Despite the National Anti-Corruption Strategy approved in October 2011, **corruption** perception remains high: Transparency International rated Ukraine 144th out of 176

countries in the 2012 Corruption Perception Index. Conditions for business and investment have deteriorated further. In September, the government approved a Concept Paper on reform of public financial management (PFM), and initiated work on an Action Plan. Progress in PFM is a condition for EU budget support and EU macro-financial assistance.

There were some steps to prepare for a **constitutional reform**. In May, the President adopted a decree appointing the members of a Constitutional Assembly, which acts as an auxiliary body advising the President. The Assembly has met three times, but its working methodology has not yet been approved. Draft constitutional amendments prepared by the Assembly are to be sent to the President who intends to submit them to Parliament. Reform of the local self-government and judicial systems have been announced as a priority issue. The Assembly includes some members of independent civil society organisations, but opposition parties have declined to take part. It will be of crucial importance that the constitutional reform process be transparent and inclusive.

Other human rights and governance-related issues

In spring, the election of a new **Ombudsperson** proved to be a divisive issue in a very polarised Parliament. The aim of electing an Ombudsperson outside of the domestic political struggle was not achieved. Subsequently, the Ombudsperson's office has undergone a number of positive changes. Further steps will be needed to create a climate of confidence and to prove that the Ombudsperson's office is genuinely free of interference.

The establishment of a National Preventive Mechanism against torture is a substantial step forward, in line with Ukraine's obligations under the Optional Protocol to the Convention against Torture, which it ratified in 2006. Together with the new Criminal Procedure Code, it should significantly reduce **cases of torture and ill-treatment**. The Criminal Procedure Code provides for the establishment of an Independent Bureau of Investigation, i.e. an independent body with authority to investigate cases of torture and ill-treatment. Detention conditions and overcrowding in prisons remain matters of concern.

The situation regarding **freedom of religion** in Ukraine is generally satisfactory. The authorities engage in dialogue with most religious denominations. There were some cases of display of religious hatred and disputes over property during the reporting period.

The promotion of **gender equality** by Ukraine government entities was affected by a significant slow-down in cooperation with civil society, as well as some regression from the standards previously achieved.

Progress has been made in terms of **children's rights**. In June, Parliament ratified the Council of Europe's Convention on the protection of children against sexual exploitation and sexual abuse. The Government approved the concept and subsequently the National Strategy to Prevent Social Orphanhood. Despite improved legislation, though, societal and cultural factors are still leading to violence against children.

Despite the adoption of anti-discrimination provisions related to disability, Ukrainian legislation lacks comprehensive provisions regarding the **rights of disabled persons** and the need for their integration in society and in the workplace.

Regarding **labour rights**, no progress can be reported regarding the adoption of the long-awaited amended Labour Code. Concerns were expressed by the ILO on the non-conformity of certain provisions with its basic standards.

Ukraine adopted a Law on **Countering Discrimination**. The new legislation represents a step in the right direction but lacks clear and complete definitions, broader scope including an explicit reference to sexual orientation and institutional provisions to ensure its effectiveness. The LGBT community continues to face discrimination and is often victim of hate speech. Their freedom of peaceful assembly during the Kyiv Pride 2012 was effectively prevented by anti-LGBT protesters. In October, the adoption at first reading of a draft law banning homosexual promotion raised important concerns. Crimean Tatars and Roma minorities as well as smaller groups such as refugees, foreign students and illegal migrants face different forms of discrimination and, occasionally, acts of violence. The representation of the Crimean Tatars in the local administration has decreased and the adoption of the draft Law on Deported People has been postponed. The proposal of the Mejlis of Crimean Tatars to hold an International Forum on the Restoration of Crimea Tatars' and others' rights as deported people, supported by the OSCE High Commissioner for Minorities, did not materialize. Tensions and clashes over land property and other contentious issues were reported recurrently, with turmoil erupting in December 2012 when a group of unidentified persons tried to organize a pogrom in a rural Crimean Tatars settlement.

A new law that allows regional and local bodies to grant regional status to minority languages spoken by at least 10% of the population has mostly consolidated the use of Russian in the official sphere in Eastern and Southern regions and has had some positive impact on people's right too use other minority languages. The law triggered a wave of protests by opposition parties and citizens who felt that the Ukrainian language was being threatened by the wider use of Russian.

Human rights and international organisations reported a number of cases of violation of the **rights of refugees and asylum-seekers**, including instances of forced deportation, systematic lack of protection for certain nationalities, lack of protection for unaccompanied minors, widespread corruption in the asylum system, and denial of access to asylum seekers for representatives of the UNHCR. The adoption of a Law on Asylum and Refugee Status was a positive development, but there are practical challenges in getting it implemented and in running the new structures effective.

Ukraine remains one of the most centralised states in Europe, something which impacts on local and regional **self-government**. Reform efforts, closely coordinated with the Council of Europe, have yet to yield practical results. The press and NGOs have reported increasing pressure on elected mayors who are not members of the central ruling party. In several cases elected mayors have been dismissed by local deputies and replaced by 'Heads of Administration' appointed by the central authorities.

Although the EU continued to support **Public Administration Reform** through a SIGMA initiative, the law on the civil service passed at the beginning of 2012 was assessed by the OECD/SIGMA and the Council of Europe as not in line with the European standards. The November 2012 amendments to the law merely deferred the entry into force of the law that SIGMA has already flagged as being not in line with European principles. The main reason for the law entering into force a year later (now 1 January 2014) appears to be budgetary, while the current legislative framework continues to allow the civil service in Ukraine to be politicised and subject to arbitrariness. It therefore did not provide a sufficient basis for the EU sectoral budget support programme in this area. Consequently the EUR 70 million initiative agreed between Ukraine and the EU to support public administration reform was cancelled. There was at least some progress with the adoption of the law on administrative services.

Cooperation on foreign and security policy, regional and international issues, conflict prevention and crisis management

In 2012 Ukraine aligned with 23 out of 62 EU CFSP declarations it has been invited to support (36 out of 82 in 2011). The rate of alignment has been decreasing over the last three years. On the other hand, good progress was achieved as regards cooperation on the Transnistrian issue. Five official meetings of the ‘5+2’ forum showed the resilience of the reinstated negotiating process. In the course of 2012 the ‘5+2’ reached agreement on two important documents: ‘Principles and Procedures for the Conduct of Negotiations’ and a comprehensive agenda for the negotiating process. Ukraine took a pro-active part in the resumed 5+2 talks. Ukrainian diplomacy has become more active, particularly with a view to its chairmanship-in-office of the OSCE in 2013. Kyiv has reiterated that Transnistria will be a central issue on the OSCE agenda in 2013.

Ukraine continued to participate constructively in the work of the **EU Border Assistance Mission to the Republic of Moldova and Ukraine** (EUBAM). With EUBAM support, the Ukrainian customs and border guard services continued to enhance their capacities and to secure inter-agency cooperation both within Ukraine and between Ukraine and the Republic of Moldova. EUBAM continued to support the demarcation of the state border with the Republic of Moldova, as well as the joint pilot project launched with the Republic of Moldova in February 2012, establishing joint control on Ukraine’s territory of the “Briceni-Rososhany” border section.

Ukraine contributed one Officer to the ATALANTA with Operational Headquarters. Discussions on deploying Ukrainian maritime patrol and reconnaissance aircraft as well as Vessel Protection Detachments have continued, as have discussions on signing the Administrative Arrangement on Strategic Air Transport. Ukraine plans to contribute to the Greek-led HELBROC battle group in 2014 by offering strategic airlift capabilities, a marine company and ten staff officers. The Ukraine-Poland-Lithuania Brigade should become fully operational in 2013 and available for future CSDP missions.

3. ECONOMIC AND SOCIAL REFORM

Macroeconomic framework and functioning market economy²

Ukraine's economy was increasingly affected by the negative global environment in 2012. Following strong expansion of 4.2% in 2010 and 5.2% in 2011, **GDP growth** slowed to 0.2% in 2012, as a consequence of declining industrial production, weaker agricultural output and tight credit conditions. In the absence of a strong global economic recovery, real growth in 2013 is expected to remain sluggish.

Low food prices helped keep **inflation** under control. Headline inflation reached a record low of -0.2% at year end, after 9.1% and 4.6% in December 2010 and 2011³. Ukraine's **fiscal deficit** exceeded the target agreed with the IMF in 2012. IMF expects the deficit to increase to 5.3% of GDP (up from 4.2% of GDP in 2011), mainly as a result of the authorities' refusal to increase gas tariffs for households and utilities to cost-recovery levels, and due to increased government spending before the October 2012 Parliamentary elections. After a marked rise following the 2008-09 crisis public debt stabilised at around 36-40% of GDP in 2011-2012.

The **current account** deficit, already high, grew further in 2012, reaching an estimated 8.3% of GDP (up from 6.2% in 2011). Foreign currency reserves declined to USD 25.3 billion (EUR 18.6 billion) at the end of 2012. Ukraine received no disbursements under the IMF standby arrangement in 2012, as the authorities had reached no agreement with the Fund on gas tariffs and the budget parameters. Macro-financial assistance from the European Union to the value of EUR 610 million presupposes IMF disbursements.

Progress in implementing structural reforms to boost competitiveness has been slow, and Foreign Direct Investment remains very weak in regional comparison. Public administration reform was not pursued in line with European practice, and technical advice from SIGMA was not taken adequately into account in formulating the new Civil Service law. The law was not amended despite repeated requests from the EU side. Initial steps were, however, taken to prepare a public financial management reform through the adoption of a Concept in September and the formulation of an Action Plan.

Social situation and employment

The economic crisis continued to impact negatively on the **employment** and social situation. According to ILO, the activity rate for the working age population was at 73.0% (first half of 2012), the employment rate at 66.9%. While the unemployment rate stood at 7.9% in 2011 (8.8 for men, 6.8 for women and 18.6 for young people), unemployment is expected to be at 7.5% for 2012.

² Figures on GDP, inflation, trade and employment are generally from Eurostat based on data supplied by the national statistical offices; or IMF or Commission Staff estimates, as indicated in the Statistical Annex. When other data sources are used these are then indicated.

³ All figures as per Ukrainian statistical office

The National Tripartite Agreement on Employment and Jobs signed in June was seen as a response to the ILO's Global Jobs Pact and was aligned on the ILO's Decent Work Agenda. This could be a move towards a more comprehensive approach to employment and social challenges and a step in fostering social dialogue. The agreement set specific targets for the employment rate and the training/retraining of employees to be met by 2017.

Social payments and wages were, in theory, increased in an attempt to mitigate the impact of the crisis, but the payments were not actually made. New legislation entered into force, with the aim of encouraging employment among vulnerable groups (e.g. young people, parents with children under six, disabled persons, orphans and persons over 50); for one year, employers will be able to reclaim social taxes paid for employing persons falling under these categories.

No progress can be reported towards the adoption of the long-awaited, amended Labour Code.

In June, the Parliament adopted the law on "Amendments to the Administrative and Criminal Code to strengthen the responsibility of actions in line the legislation on occupational health and safety". These amendments aim to reverse the current situation whereby entrepreneurs are willing to pay a small fine rather than bear the expense of creating safe conditions for work. A more comprehensive approach and more capacity building and training would be needed to create the conditions for a real improvement of in health and safety at work. An EU supported project on health and safety, run by ILO, ended in September 2012. The improvements need to be sustained.

4. TRADE-RELATED ISSUES, MARKET AND REGULATORY REFORM

The EU is Ukraine's second largest trading partner accounting for about 27% of its trade volume in 2011⁴. **Bilateral trade** flows increased and during the first eleven months of 2012 amounted to EUR 35.2 billion. EU exports to Ukraine consisted mainly of manufactures of machinery and vehicles, other manufactured goods and chemicals. EU imports from Ukraine consisted mainly of other manufactured goods (mostly iron and steel), raw materials (mineral fuels, ores) and food and drinks (cereals, oilseeds).

In a move that raises both commercial and systemic concerns, including about the impact of such action on the global trading system, Ukraine notified the WTO in September of its intention to modify import tariffs for a large number of agricultural and industrial products. Another worrying development took place in November, when a new Law on Customs Tariff was adopted by Parliament, raising customs tariffs on some 100 tariff lines to the highest levels allowed under Ukraine's WTO-bound tariffs.

The entry into force of a new **Customs** Code in June had a significant and positive impact in a number of areas. The new Code enhanced the rights of operators by allowing them to choose customs entry points and reversed the burden of proof regarding customs

⁴ Data for 2012 was not available at the time of writing.

valuation. Operators acquired the right to make electronic declarations and to modify their customs declarations within three years of the release of the goods. The new Code also facilitated customs flows by reducing the number of documents required for customs declarations, limiting customs clearance time to four hours and introducing the concepts of preliminary customs declaration and authorised economic operator. Valuation control has improved, with fewer complaints from trade operators, but classification control remains an area of concern as customs authorities tend to change the classification of imported goods to a higher duty category. The improvements may be helpful in the fight against corruption, which remains a serious concern.

In the area of **free movement of goods**, Ukraine prepared a draft Law on Standardisation which envisages a separate standardisation body for the construction industry. This is not consistent with EU practice and needs reconsideration. A new Law on Metrology was under preparation. Ukraine has adopted 40 technical regulations, loosely based on EU directives, and about 20 more were being drafted. The process of revising existing technical regulations started, with the aim of achieving closer correspondence to the relevant EU directives. Ukraine established a legal basis for market surveillance and set work in motion.

On **sanitary and phyto-sanitary (SPS)** issues, Ukraine approved an Institutional Reform Plan in June in preparation for the DCFTA; a detailed Action Plan is being drafted, with EU support.. Ukraine is preparing a food safety strategy and a list of SPS legislation to be approximated with EU standards. Laws on food safety, official controls, veterinary checks, novel food, hygienic production and animal feed are in preparation. Ukraine approved an Order on microbiological criteria. It continued to train SPS staff with some TAIEX support, on areas such as animal welfare, African swine fever and auditing of food processing enterprises. Greater efforts are needed on training at regional level too.

The **business climate** remained poor in 2012. The main causes are the lack of rule of law and widespread corruption. The new Customs Code and the progress made with the automated VAT refund system are the positive elements. The poor business climate affects SMEs in particular: the contribution of SMEs to the Ukrainian economy is falling, with employment in medium-sized enterprises falling by some 10 % per year between 2007 and 2010. Ukraine maintains a low position in the World Bank's Ease of Doing Business Index: it moved up to 137th place in 2012 (out of 185 countries) due to some improvement on starting business, registering property and paying taxes. Transparency International has rated Ukraine 144th out of 176 countries in the 2012 Corruption Perception Index. The ranking reflects the lack of activity on the part of the National Anti-corruption Committee under the President, and amendments to the public procurement legislation.

In the course of 2012, the Government submitted to the Parliament draft laws introducing amendments to the Joint Stock **Company Law** on simplification of the procedures for reorganising joint stock companies into companies with different forms of ownership, and on reducing the quorum for general shareholders' meetings. Neither law has been yet passed by Parliament. International Standards for Financial Reporting were introduced for all publicly listed companies.

In the area of **financial services**, in September Ukraine adopted a law on the depository system raising businesses' concerns over the potential establishment of a Central Depository under the National Bank's control. Ukraine introduced legislative changes to the functioning of **payment systems** and non-cash payments which provide for the creation of a National clearing centre for electronic payment under the oversight of the National Bank. The potential monopolisation of the sector is a matter of concern for market operators. The newly established National Commissions for Securities and Stock Market, and for Regulation of Financial Services Markets were subordinated to the President of Ukraine and not to the Cabinet of Ministers. Both non-bank regulators were fully dependent on state funding, which is not compliant with the best international practices. The major weaknesses in the financial services market in Ukraine remained a lack of sector consolidation and too many weakly capitalised, non-viable financial institutions. Ukraine needs to make progress on capital adequacy in the banking and securities sectors, on investor protection and on protecting the rights of financial services' consumers.

In the area of **movement of capital**, the National Bank of Ukraine (NBU) introduced obligatory sales of F/X proceeds from exports and mandated conversion into local currency of any individual transfers from abroad exceeding UAH 150 000. The NBU also reduced the maximum term for the repatriation of profits from 180 to 90 days, as from 19 November, and set a requirement to sell 50% of exporters' profits received in foreign currencies. The measures will be in effect for the next six months. Also on 19 November, the NBU set up a Committee to prevent fraudulent operations in the foreign exchange market.

Other key areas

Amendments to the **Tax** Code changed the rules for the administration of taxes, and introduced new tax rates and tax benefits in Ukraine. Ukraine's further efforts to reform the tax system could benefit from greater involvement on the part of experts and the business sector. The long-standing issue of VAT refunds saw some progress with the improved automatic VAT refund system; approximately 50% of refunds were processed automatically. The total amounts of VAT refunds have increased. The automated system functions best for larger taxpayers, while many smaller businesses were unable to access the system because of its strict criteria. Economic operators complained about pressure to pay corporate income tax in advance in order to receive VAT refunds or to refrain from submitting VAT refund applications. On **fighting fraud**, Ukraine replaced criminal penalties for goods smuggling with fines, to be determined by the authorities taking into consideration the gravity of the act. This raises concerns about the possible negative impact on investigations and sanctioning of cases of smuggling of excisable goods, especially cigarettes. Given the high profit margins, fines might not always ensure the adequate level of deterrence. Ukraine is expected to provide further information on the impact of these changes. The EU will continue to follow this matter closely.

In 2012 the Antimonopoly Committee adopted a regulation on leniency for cartel participants. In August a draft **State Aid** Law, seeking to approximate with EU rules, was submitted to the Parliament. It proposes to designate the Antimonopoly Committee as the

State aid authority and to give the Cabinet of Ministers an important role on exemptions from notifications. In September, the Cabinet of Ministers approved a concept for the draft law on **Competitive Strategy**.

In 2012, **intellectual property rights** (IPR) protection and enforcement in Ukraine deteriorated in some areas. The situation regarding copyright protection and related rights raised particular concerns: piracy and counterfeiting were widespread, and the enforcement authorities did not coordinate their work. The institutional and administrative weakness of the State Intellectual Property Service is also a concern. Ukrainian legislation did not provide for adequate and effective enforcement of IPR rights, especially in the digital environment. Existing criminal sanctions did not prove to be a sufficient deterrent and the rules concerning the destruction of IPR-infringing goods and of equipment used for their production were applied inconsistently. 2012 saw some worrying developments regarding the system of collective management organisations (CMOs), especially in terms of CMO accreditation. The establishment of a collective management system in accordance with EU standards would help to ensure the remuneration of royalties, paving the way for proper implementation of the DCFTA.

In the area of **enterprise policy**, in April the President signed the Law on the 'Development of and State Support for Small and Medium Business in Ukraine'. The Law's definition of an SME aims to approximate with the EU acquis. The Law sets the goals and the tasks of the new SME Agency which, under the supervision of the Cabinet of Ministers, will be responsible for drafting and implementing SME policy and policy instruments.

Public procurement policy still lacks a coherent strategic approach to legislative approximation with EU rules and standards. A series of amendments to the public procurement law were passed during 2012, restricting the scope of competitive procurement by either excluding certain operations or by increasing the scope of the single source procedure. A law on procurement by utilities was adopted in May, but the key concept of 'utilities' is not fully compliant with EU rules due to a different definition of the entities concerned and, in some cases, to higher threshold values for the law to apply.

From January onwards, **internal audit** units were being established and audits conducted in the ministries, other central executive authorities, their territorial offices and budget institutions. However, further evidence is needed to demonstrate that the audits meet international standards. Their effectiveness might be limited in the absence of a comprehensive Internal Control strategy based on the applicable international framework (COSO-ERM) and of strategic reflection on the interaction between Internal Control, Internal Audit and Financial Inspection.

In June, Ukraine adopted the amendment of the Regulation on the State **Statistics** Service and re-instated the professional independence of the statistical office to accord with European standards. The multi-annual statistical work programme has been developed for the period 2013–2017, taking into account the recommendations of the 2011 global assessment and EU best practice.

Ukraine prepared a draft Concept for State Policy on **consumer protection**. The point is to gradually shift the emphasis from the State to progressive inclusion of consumers NGOs in consumer protection activities. It also addresses consumer information, education and counseling; access to justice; consumer collective actions; and out-of-court resolution of disputes. The Concept has still to be adopted. There was no progress on adopting the legislation on protection of rights of financial services' consumers.

5. COOPERATION ON JUSTICE, FREEDOM AND SECURITY

Progress in the area of migration and asylum slowed. There is a Migration Policy Strategy and Action Plan in place, but the State Migration Service (SMS, established in 2010) was not fully and effectively functional. A major EU project in support of the SMS was finalised as part of the Comprehensive Institution-Building Programme (CIB), and relevant preparatory measures were launched.

The Second EU Report on the implementation by Ukraine of the **Visa Liberalisation Action Plan** was issued in February. Implementation of the EU-Ukraine **Visa Facilitation and Readmission Agreements** continued, and was monitored at the Joint Committee meeting of July. The amended EU-Ukraine Visa Facilitation Agreement was signed in July. Negotiations with several EU Member States continued on implementation of the Protocols under the Readmission Agreement.

Regarding **asylum**, in July Ukraine adopted the Law on Refugees and Persons in Need of Subsidiary and Temporary Protection. Work on bylaws and other related legislation was launched. Human rights and international organisations reported a few cases of violation of the **rights of refugees** and asylum-seekers, including instances of *refoulement*, lack of protection of certain nationalities, lack of protection of unaccompanied minors, widespread corruption in the asylum system and denial of access for UNHCR representatives to asylum-seekers.

Ukraine started to implement the 2011 Integrated **Border Management** Strategy and Action Plan. A EUR 66-million sector budget support programme was launched to help implement the Action Plan.

Ukraine adopted an Action Plan in January to give effect to its strategy on the **fight against organised crime**. The Third Protocol on the Illicit Manufacturing and Trafficking of Firearms, their Parts, Components and Ammunition remained unsigned.

The administrative reform process almost paralysed criminal investigations of **human trafficking** in 2011, leading to a significantly lower number of prosecutions and of identified victims in 2012. Administrative capacity on counter-trafficking (CT) was weakened, partly because of the reorganisation at the Ministry of Interior. According to the Minister of Interior, combating trafficking was not among the priorities. Local counter-trafficking units were subordinated to the local criminal investigation departments, and suffered of a high staff turnover and a lack of financial resources.

Good progress was achieved on combating **money laundering** and terrorism financing. Ukraine significantly enhanced its legislation by adopting the Law on Prevention and Counteraction to Legalisation of the Proceeds of Crime, on Terrorist Financing and three laws that concern money laundering and the freezing of terrorist assets. The Financial Action Task Force (FATF) removed Ukraine from the list of states with shortcomings and Ukraine is no longer subject to FATF's monitoring process.

Concerning the fight against illegal **drugs**, Ukraine continued to implement the National Strategic Programme and Action Plan including by incorporating the institutional activities into the National Service for Drugs Control created in 2011. Also in April, an EU Dialogue on Drugs with Azerbaijan, Georgia, the Republic of Moldova and Ukraine was held in Brussels. Cooperation with the European Monitoring Centre for Drugs and Drug Addiction (EMCDDA), based on a 2010 Memorandum of Understanding, continued. Ukraine attended the EMCDDA first European Information Network on Drugs and Drug Addiction (Reitox) week in Lisbon in May. The Ukrainian Medical and Monitoring Centre on Drugs and Alcohol (UMMCDA), reporting to the Ministry of Health, sent its annual report following EMCDDA guidelines at the end of June 2012.

Ukraine adopted amendments to the **Data Protection** Law. However, the law is not in full compliance with European and international standards. Remaining concerns, *inter alia* insufficient guarantees on freedom of expression, and independence of the Supervisory Authority, are expected to be addressed by further amendments to the law.

No progress was made following the initialing of a draft agreement between Ukraine and Eurojust (in December 2011). Further steps will depend on full alignment of data protection legislation with European standards.

Regarding **judicial cooperation**, the Second Additional Protocol to the European Convention on Mutual Assistance in Criminal Matters entered into force on 1 January 2012.

6. TRANSPORT, ENERGY, ENVIRONMENT, THE INFORMATION SOCIETY, RESEARCH AND INNOVATION

Ukraine's 2010 national **transport** strategy envisaged the development of transport sub-sector programmes. Despite their approval being a condition for the disbursement of transport sector budget support tranches for 2012, none of the draft programmes was approved. Following the approval in May 2011 of a strategy for improving road safety by 2015, the action plan was approved by the Cabinet of Ministers in March 2012. Regarding maritime transport, Ukraine remains on the blacklist of the Paris Memorandum of Understanding (MoU) on Port State Control. In order to address deficiencies in maritime safety, Ukraine established a new State Inspection body; further efforts in this area are needed. In June, Ukraine approved a Law on Sea Ports. It regulates the administration and governance of ports, monitoring of shipping safety, and the supervision and monitoring of sea port operations. On inland waterways, Ukraine has yet to apply EU standards regarding technical requirements for inland waterway vessels. The

negotiations between the EU and Ukraine on the Common Aviation Area Agreement were resumed in September 2012, following the tentative technical resolution of the issue of aircraft certification. The EU and Ukraine will keep their own certification methods and work towards a revised MoU on the convergence of certification systems.

Ukraine made progress in implementing some of its Energy Community Treaty (EnCT) commitments. In particular, the regulator approved rules on certifying eligible customers of natural gas and on third party access to the gas transportation system though they need further work to bring the rules fully into line with the EU acquis. *As Ukraine progressively implements its EnCT commitments, the investment climate is improving and it has been able to further diversify energy supplies. Since November 2012, Ukraine received gas from the West. The EU is closely working with Ukraine in developing additional routes of bidirectional gas supplies.* In June, a law on natural monopolies was adopted; it is a first step towards incentive-based regulation in the sector. A draft law on the principles of electricity market operation was submitted to the Parliament. Legislation on state regulation in the energy sector and legislation aiming to approximate with EnCT rules on energy performance in buildings and the energy services directive are in preparation. Ukraine is encouraged to swiftly agree with the EnCT Secretariat on an Action Plan and a Roadmap for implementing its EnCT obligations and to make progress on implementation. No progress was noted in bringing energy prices to cost recovery levels. This continues to be an obstacle to sustainability of the sector. The continued low rates of energy bill collection (households approximately 85%, heating utilities approximately 40%) remain a concern.

Ukraine continued to implement the 2009 Joint Declaration on the modernisation of Ukraine's gas transit system. It made progress on the unbundling of Naftogaz, with the amendment of the pipeline transport law in April and a regulation allowing for the corporatisation of two key subsidiaries of Naftogaz, Ukrtransgaz and Ukgazproduction. This was expected to be completed by the end of 2012. The EU-World Bank Trust Fund on restructuring Naftogaz was signed in December. Implementation of this fund will be important to pave the way for future lending by international financial institutions.

Ukraine has yet to finalise the revision of its Energy Strategy to 2030. The strategy should incorporate Ukraine's EnCT commitments and reflect the International Energy Agency's recommendations from its in-depth review of the country's energy sector policy, which was co-funded by the EU, as well as the joint comments from the EU, US and the World Bank.

In April, Ukraine announced its plan to implement the Extractive Industries Transparency Initiative. A multi-stakeholder group, created in October, started drafting an implementation action plan. The 'Master Plan for the Development of the Ukrainian Coal Industry' – the main output from the EU supported coal support programme – is gradually being implemented, albeit with some delay due to the lack of financial resources. In April, Ukraine adopted a law on the privatisation of coal mining enterprises.

In November, Ukraine amended its renewable energy law. The country needs to vigorously step up its efforts on energy efficiency and the use of renewable energy sources. It also needs to adopt, among other things, its draft Energy Efficiency Action

Plan up to 2020 and, in line with Energy Community commitments, the draft law on the efficient use of energy resources.

The EU's energy/energy efficiency related assistance continued through two sector budget support programmes (EUR 157 million), technical assistance, twinning, the Neighbourhood Investment Facility and a contribution to the Eastern Europe Energy Efficiency and Environment Partnership Fund.

The EU Instrument for Nuclear Safety Cooperation focuses on the consequences of the Chernobyl accident (shelter fund, nuclear safety account) and on the management of radioactive waste and safety improvements to currently operational nuclear power plants. Energoatom designed an "upgrade package" for its nuclear power plants to the value of EUR 1.2 billion. The EU (EURATOM) and EBRD are considering a loan to help implement this package. In September 2012, Parliament approved the construction of two new 1000 MW nuclear units at the Khmelnytskyi site without waiting for the results of the impact assessment required under the Espoo Convention.

Regarding **climate change**, in June the Government launched a national platform on green economy/sustainable development under the auspices of the Ministry of Economy. The suspension imposed on Ukraine from trading emissions units under the Kyoto Protocol of the United Nations Framework Convention on Climate Change (UNFCCC) was lifted. The EBRD will provide expertise to Ukraine for the possible development of a national greenhouse gas emissions trading system. Ukraine participated in preparations for the forthcoming regional EU Climate East project (EUR 18 million) that will be implemented in the period 2013-2016. Ukraine is encouraged to build capacity and engage in the new carbon market mechanism to be developed following the 17th and 18th sessions of the UNFCCC Conference of the Parties. Ukraine is also encouraged to make additional efforts to fully implement the Cancun and Durban agreements and in particular devise a low-carbon development strategy. The country is also encouraged to ratify the Doha agreement on the second commitment period of the Kyoto Protocol.

Work continued on implementing the National **Environmental** Strategy (NES) and Action Plan. In December, the Ministry of Ecology and Natural Resources published a report on the civil society assessment of NES implementation in 2011. In May, Ukraine adopted a water management programme for the period up to 2021. The Minister of Environment approved an approximation plan for the environmental *acquis*. Past pollution from industrial dumps remained a concern. In April, the Ministry of Ecology and Natural Resources organised a forum, 'Environment for Ukraine', to raise awareness of environment issues. In May, Ukraine submitted an implementation report to the Secretariat of the Aarhus Convention, following the decision by the Meeting of the Parties (MOP) to the Convention in July 2011 to issue a caution to Ukraine for non-compliance with its obligations under the Convention. The report indicates that a law is under preparation but, based on the evaluation process established by the MOP, gives no evidence of full implementation of the measures requested by the 2011 MOP. Following the caution for non-compliance with the Espoo Convention in May 2011, Ukraine informed the Espoo Convention Compliance Committee in June that the relevant draft law on environmental impact assessment in a trans-boundary context had been submitted

to the Parliament. However, the draft law did not pass its first reading before Parliament was dissolved following the elections in October. Ukraine is encouraged to strengthen its environmental legislation and administrative capacity, to apply develop procedures for environmental impact assessment consistently and to pay particular attention to public participation. The EU provides environment sector budget support of EUR 35 million.

In November 2012, Ukraine signed the Charter of the **Regional Environmental Centre** for Central and Eastern Europe (REC-CEE) enabling a branch of REC-CEE to be opened in Ukraine.

In the field of **civil protection**, Ukraine continued to participate in the EaP flagship programme on prevention, preparedness and response to natural and man-made disasters (PPRD East). As a part of the programme Ukraine is contributing to the development of Electronic Regional Risk Atlas. Ukraine is encouraged to take advantage of the guiding document on Risk Assessment Policy for the EaP region produced under the PPRD East programme. In December 2012 the Ministry of Emergencies became an agency under the Ministry of Defence.

Ukraine is among the 168 governments that adopted the "Hyogo Framework for Action: Building the Resilience of Nations and Communities to Disasters", but work on Disaster Risk Reduction is still only at the beginning and it will require considerable further effort to develop capacities and processes.

In terms of the **information society**, Ukraine defined the competencies of the regulatory authority, eliminated duplications of price-setting controls and extended the powers of the regulator to identify telecommunications operators with significant market power. The regulator established unified requirements for the routing of voice telephony traffic by telecommunications operators in public telecommunications networks (in force since July).

Despite Ukraine's ratification of the European Convention on Transfrontier Television (ECTT) in 2008, only minor changes has been made to legislation on the **audiovisual media** up to 2012. This was partially caused by the standstill in the revision of the Convention. Two draft laws on setting up the public broadcasting system were tabled in Parliament in mid-December 2012. However, neither of these drafts meets European standards and both need substantial improvement.

In the field of **research and innovation**, Ukraine's participation in the Seventh Framework Programme for Research and Technological Development (FP7) continued at a good level. Ukraine was the seventh most active international partner country in the programme. There are 125 public and private Ukrainian institutions participating in 123 projects under FP7. The total EU contribution to these projects amounts to EUR 390 million, of which EUR 18 million went to the Ukrainian partners. They have been most active in collaborative research projects in the fields of the environment, health, agriculture and international cooperation activities.

7. PEOPLE-TO-PEOPLE CONTACTS, EDUCATION AND HEALTH

Education reform progressed in Ukraine, notably in the area of **higher education**, which moved decisively towards the implementation of the Bologna principles. Ukraine made progress in areas like organising the first two cycles of tertiary education, and implementing quality assurance measures and the European Credit Transfer and Accumulation System (ECTS). Further efforts (methodical support and legislative amendments) are needed in areas such as the reform of the third cycle, the application of learning outcomes, and the development of internal and external mechanisms for quality assurance. In this context, the government proposed recasting the existing legislation on higher education. The proposed amendments include the key points under the Bologna Process: introducing a three-cycle system; granting greater autonomy to universities; granting more rights to students' self-governance; supporting companies which employ graduates; improving the legal basis for independent external assessments. In December the Government decided to use a draft law prepared by a working group headed by the Rector of the Kyiv Polytechnic University as a basis for further work by the Ministry of Finance and the Ministry of Education, Science, Youth and Sports.

With regard to **vocational education and training**, Ukraine adopted an inter-ministerial decree in April to implement the National Qualification Framework (NQF). An inter-agency working group began drafting an NQF implementation strategy. The involvement of the social partners and particularly employers in education and training policy development was endorsed through two laws adopted in January and June respectively (the Law on Professional Development of Employees, and the new Law on Employers' Organisations). In spite of these positive developments and growing awareness, Ukraine has only limited technical competence and capacity to reform its vocational education and training with a view to addressing the mismatch between supply and demand of skills on the labour market. The upcoming EU-funded Twinning project will assist the Ministry of Education and Science in this field.

Ukraine continued to benefit substantially from its active participation in **Tempus**, with the selection of 23 new projects. There is a steady increase in Ukrainian participation and a clear willingness on the part of Ukrainian higher education institutions to act as project coordinators. The Tempus programme has done a lot to internationalise Ukrainian universities, help to establish long-term partnerships with European counterparts, contribute to new initiatives and exchange programmes, promoted competitiveness in higher education and introduce a culture of quality assurance, establishing new curricula and introducing new forms of governance and evaluation. Ukraine continued its active participation in the **Erasmus Mundus** programme, with the award of 52 scholarships for Erasmus Mundus joint Masters programmes, two scholarships for Erasmus Mundus Joint Doctoral programmes, and a further 391 grants for short-term mobility organized within a university consortium. Five new Ukrainian projects were selected under the **Jean Monnet** Programme in 2012. Among the Eastern Partnership (EaP) countries, Ukraine ranks first in terms of the number of institutions (63 institutes) and individual researchers (107 individual researchers) participating in **Marie Curie Actions** supporting researchers' training, mobility and career development.

Ukrainian young people and youth organisations continued to benefit from the **Youth in Action** programme. For 2012 and 2013, the ENPI is providing additional funding for the Youth in Action Programme to increase cooperation among young people, youth workers and youth organisations from the European Union and the Eastern Partnership (EaP) countries. The setting up of the EaP Youth Window within the Youth in Action Programme enables significantly more young Ukrainians to participate in the programme. In 2012, 1976 young Ukrainians and Ukrainian youth workers were involved in 512 projects.

Ukraine was fully involved in the EaP **Culture** Programme. Of the fifteen regional projects selected, eleven involve Ukrainian partners and four projects are led by a Ukrainian partner. The priority field for the period 2012-2013 is to get more Ukrainian cultural players involved in cultural cooperation programmes, with special reference to launching the new Creative Europe programme as of 2014.

In the area of **health**, Ukraine continued to implement its reform concept, inter alia, through pilot decentralisation projects. The EU and Ukraine strengthened health cooperation. Following a risk assessment by the European Centre for Disease prevention and Control (ECDC) in the wake of the outbreak, in early 2012, of measles in Western Ukraine, the EU provided health security support during the EURO-2012 football championship. In the run-up to this tournament, Ukraine adopted, with TAIEX support, the law on the emergency system operation under “112” calls. In March the Ukrainian President signed a law banning any advertising, promotion or sponsorship by the tobacco industry. In October, Ukraine adopted a programme to fight non-communicable diseases. To fight maternal and infant mortality, Ukraine started implementation of its "New life" programme aiming to establish, by 2014, twenty seven prenatal centres throughout the country. It continued to address the problem of HIV/AIDS and tuberculosis. In 2012, despite being invited, Ukraine did not participate in the Commission's HIV/AIDS think tank. Through the thematic programme "Investing in people", the EU supports Ukrainian civil society organisations in developing a network of legal support in the field of HIV/AIDS. A programme to combat tuberculosis is before Parliament for adoption. As major contributor to the Global Fund to Fight AIDS, Tuberculosis and Malaria, the EU supports Ukraine through this fund.