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**Implementation of the European Neighbourhood Policy in Ukraine
Progress in 2011 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**

Delivering on a new European Neighbourhood Policy

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1. OVERALL ASSESSMENT AND RECOMMENDATIONS

This document reports on the progress made in implementing the EU-Ukraine Association Agenda between 1 January and 31 December 2011. 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 2011 Ukraine took positive steps to secure deeper long-term future relations with the EU by working intensively to finalise the negotiations of the Association Agreement. This Agreement establishes a comprehensive agenda for political association and economic integration on the basis of the sharing of European values, increased market access, approximation with the EU *acquis* and the overall modernization of Ukraine's institutions. It includes a Deep and Comprehensive Free Trade Area (DCFTA), and covers political and security co-operation, justice, liberty and security, financial co-operation and a comprehensive programme of approximation to the EU *acquis* across all sectors. Substantive negotiations on the Agreement were closed in December and the text was initialled on 30 March 2012.

In the area of democracy and human rights there was further deterioration. Several leading opposition figures, including former Prime Minister Tymoshenko, were subjected to selective justice, characterized by un-transparent judicial processes. This attracted substantial criticism both at home and abroad. 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, inter alia with regard to conclusion of the Association Agreement and its subsequent implementation. This would also provide a new momentum to a political dialogue which at present is dominated by discussions on stalled reforms and the rule of law. The adoption of a new Law on Public Associations in March 2012 was an important first step signalling a possible change from the existing trend.

Despite the adoption of new legislation, corruption perception remains high and Ukraine maintains a low position in relevant international indices. Conditions for business and investment have further deteriorated.

In November 2011, a new law on parliamentary elections was approved with an overwhelming cross party majority, although it failed to take fully into account all of the recommendations from the Venice Commission¹.

In the second part of the year Ukraine started a process of reviewing the Criminal Procedure Code which dates from the early 1960s (the Criminal Procedural Code was later adopted in April 2012). This revision was carried out in close consultation with experts from the Council of Europe and could represent an example for pursuing other reforms such as revision of the Criminal Code.

¹ Subsequent to the reporting period, in April 2012, the Constitutional Court of Ukraine ruled that some of the provisions of the new law on parliamentary elections were unconstitutional.

In 2011, Ukraine's economic recovery continued, with a strong growth performance and inflation largely under control. However, there are significant risks to the fiscal balance and the balance of payments. Moreover, the International Monetary Fund (IMF) programme is currently off-track, with an impact on access to international capital markets. Ukraine has resumed talks with the IMF in February.

Ukraine's progress in achieving important structural reforms and implementing the Association Agenda priorities remained below expectations. Public procurement legislation was brought closer to international standards but reforms in the field of public finance management were not adequately pursued. This had a negative impact on the delivery of EU financial assistance including budget support².

Ukraine made progress in the implementation of the first phase of the Action Plan for Visa Liberalisation.

On 1 February 2011, Ukraine acceded to the Energy Community Treaty committing in the process to implement a number of significant structural reforms including, for the gas sector, third party access and the separation of production, distribution and transport. Further efforts by Ukraine are necessary to fulfil these commitments.

Increased prices for imported gas negatively impacted on Ukraine's fiscal situation: securing a new arrangement with Russia remains a top priority for Ukrainian authorities. This needs to be linked to long-term energy reform including the restructuring of the state oil and gas monopolist Naftogaz and improving energy efficiency and the use of renewable energy. The EU will continue to offer to both Ukraine and Russia to participate in tripartite discussions on gas transit.

In a successful pledging conference in April 2011, EUR 550 million were pledged for the implementation of projects to complete the permanent shelter and related facilities at the Chernobyl site.

Ukraine continued to cooperate with the EU on regional and international issues. At the regional level, Ukraine's agreement with the Republic of Moldova on the demarcation of the borderline at the Odessa-Reni highway sector at Palanca gave a boost to bilateral relations. Cooperation with the EU on all questions related to the Transnistria settlement was very constructive.

On the basis of this year's report, and with the view of a sustained implementation of the Association Agenda in 2012, Ukraine is invited to:

- Ensure that constitutional reform process is carried out in an inclusive and transparent way and in close cooperation with the Council of Europe/Venice Commission.
- Effectively implement the Association Agenda priorities concerning the respect for the rule of law and democratic values.

² Subsequent to the reporting period, in April 2012, Ukraine reinvigorated the Department in the Cabinet of Ministers following up on the European agenda. It also took initial steps towards the adoption of a strategy on public finance management.

- Bring legislation on freedom of assembly and media freedom in line with European standards.
- Address the issue of politically-motivated selective justice, take steps, more broadly, to ensure the independence of the judiciary and pursue reform in all aspects of the judicial process: prosecution, trial, sentencing, detention and appeals.
- Further develop co-operation with Council of Europe (including on elections, the revision of the legislation on the Office of the Public Prosecutor and on the Bar, of the role of the High Council of Justice, of the Criminal Code and notably its articles 364 and 365 as well as amendments to the laws on the Judicial System and the Status of Judges in accordance with the recommendations made by the Venice Commission, effective implementation of the Law on Free Legal Aid and establishment of a National Preventive Mechanism to prevent ill-treatment and torture), building on the experience of preparing the new Criminal Procedure Code; address transparently the recommendations and advice received during consultations.
- Take effective action to tackle conflict of interest and corruption as well as specific obstacles to business and investment; address the trade and trade-related reforms laid down in the Association Agenda with a view to facilitate the implementation of the future DCFTA.
- Address in good time issues raised in the area of justice and home affairs, notably on combating trafficking in human beings taking into account a gender and human rights perspective.
- Prepare and conduct the 2012 parliamentary elections in line with the standards of the Organisation for Security and Cooperation in Europe - Office for Democratic Institutions and Human Rights (OSCE/ODIHR), including full co-operation with monitoring missions.
- Establish a macroeconomic framework, conducive to the resumption of IMF support addressing inter alia issues of fiscal sustainability in the energy sector.
- Address outstanding issues of transparency and accountability in public finance management, making use of EU technical assistance in this area. This is a condition for continued EU budget support and EU macro-financial assistance. Sustained improvements in public finance management are also essential for continued EU budget support.
- Bring the law on civil service of November 2011 in line with EU norms, which would allow an EU sector budget support programme of EUR 70 million to advance.
- Comply with the obligations of the Energy Community Treaty (as reflected in the Association Agreement and the Association Agenda) and pursue reforms in line with the commitments taken upon accession to this treaty.

- Coordinate better EU assistance and optimise its effectiveness by facilitating project and expert registration and integrating experts better in their respective working environment.

2. POLITICAL DIALOGUE AND REFORM

Towards Deep and Sustainable Democracy

Ukraine's **electoral legislation** was further revised taking into account a number of the recommendations from the Council of Europe Venice Commission or the OSCE/ODIHR. However the new law on Election of People's Deputies did not take into account those of the Venice Commission recommendations concerning the introduction of a mixed electoral system (majoritarian and proportional), the increase of the electoral threshold for parties to participate in distribution of mandates in the "nation-wide district" from 3% to 5%, the ban on electoral blocs and the proposed electoral limitations for convicted persons. The decision by the parliamentary majority of 81% to disregard these points and adopt the law was criticised by some civil society representatives. Civil Society also complained that, in its initial phase, the work on the new electoral legislation lacked transparency and inclusiveness³.

Improved legislation in the area of **freedom of association** would allow Ukraine's lively civil society to develop further. To this end, in May 2011, a new draft law on public associations, elaborated in close cooperation with civil society groups, passed its first reading in the parliament. Subsequent to the reporting period, the Parliament adopted the new law in March 2012. It was positively received by civil society representatives.

Authorities are increasingly hostile to public displays of discontent and on occasions tried to limit **freedom of assembly**. The number of court rulings prohibiting gatherings has grown compared to previous years. A further effort is needed to encourage courts to follow European Court of Human Rights case law, rather than resort to Soviet-era legal acts, when justifying their decisions. Law enforcement bodies resort to various means to deter demonstrations, in particular those against the current government. In November, while the authorities were removing a tented camp to fulfil a court ruling banning a rally in Donetsk, a 70-year-old protester died. The case is being investigated by the prosecutor.

The distribution of digital broadcasting licences to companies controlled by prominent members and associates of the current administration raises concerns about the future of **media freedom** and the pluralism of broadcast media. Journalists from the electronic media and the press report cases of censorship and harassment from law enforcement bodies. An interdepartmental working group has been established under the Presidential Administration to address the reports of violations of journalists' rights. An initiative welcomed by journalists which are, however, concerned by the lack of follow-up to the working group's meetings. The investigations on the disappearance of Editor Vasyl Klymentyev have not visibly progressed despite

³ Subsequent to the reporting period, in April 2012, the Constitutional Court of Ukraine ruled that some of the provisions of the new law on parliamentary elections were unconstitutional.

assurances from the Prosecutor General's Office in November that the case was being pursued. No effective steps were taken to establish a public service broadcaster in line with international standards. In June 2011, the Cabinet of Ministers finalised a draft law on public broadcasting which was submitted to the Council of Europe for assessment. The draft law was criticised by independent media experts. The issue of a lack of transparency in media ownership remains to be addressed.

Important concerns remain regarding respect for the **rule of law** and strengthening the **judiciary**. Trials against opposition leaders and members of the former government, which did not respect international standards on fair, transparent and independent legal processes, confirmed the perception that justice is being applied selectively through politically motivated prosecutions.

More than 20 high-level representatives of the former government are either under investigation or have been convicted, including former Prime Minister Yulia Tymoshenko. In October, Tymoshenko was sentenced to seven years in prison for abuse of office, in relation to the gas contracts she signed with Russia in January 2009. She is now serving her sentence in jail. Other high-profile cases concern former Minister of the Interior Yuriy Lutsenko and former Acting Defence Minister Valeriy Ivashchenko who were sentenced to prison subsequent to the reporting period. Apart from a high number of procedural deficiencies serious concerns have been voiced regarding the lack of proper medical treatment available to detainees. According to a number of reports the government has exerted inappropriate pressure on the chairman of the Supreme Court.

The National Commission for the Strengthening of Democracy and Rule of Law has worked on the preparation of amendments to the law on the Judiciary and on the Status of the Judges to address earlier recommendations by the Venice Commission. In July, the amendments were re-submitted to the Venice Commission. In its October opinion, the Venice Commission concluded that the draft amendments include a number of important improvements. It recommended, however, that the Constitution be amended to allow for reform of the appointments system and the removal of judges.

Regarding the **fight against corruption**, there was no significant progress in terms of results. In 2011, Ukraine lost 18 places in the Corruption Perceptions Index of Transparency International, being ranked 152nd out of 187 countries. In July 2011, the law on the Principles of Preventing and Combating Corruption, and the law amending several legislative acts concerning liability for corruption offences, entered into force. However, the legislation which has been adopted remains incomplete, and in some places ambiguous, and does not fully comply with the requirements of the relevant Council of Europe and UN instruments. There are important recommendations from the Council of Europe Group of States against Corruption (GRECO) to which proper follow-up has not yet been given.

In October, a National Anti-Corruption Strategy was adopted. The Strategy gives general directions for further action in a number of areas but does not tackle some of the key outstanding issues, such as the establishment of an independent anti-corruption body, the specialisation and clearer distribution of tasks among law enforcement agencies, the verification of asset declarations, and the conflict of interests. The corresponding action plan is still under preparation. The institutional

framework necessary to prevent and repress corruption, to monitor the implementation of anti-corruption policies, to enforce the law, and to prosecute violations, is not yet in place.

As in previous years, there was no significant progress on **constitutional reform**. In February 2011, an expert working group was established to prepare for the election of a Constitutional Assembly and the Venice Commission provided an opinion on the concept paper on the establishment and functioning of a Constitutional Assembly in March. The Constitutional Assembly had not been established by the end of 2011. In January 2012, the President issued a decree on formation and organisation of activities of a Constitutional Assembly. It is important that this reform is carried out through an inclusive process and that it aims to establish a coherent, lasting and democratic system of checks and balances in accordance with European standards.

Other Human rights and governance-related issues

The **Ombudsperson's Office** raised its profile by increasing the media coverage of its activities. An updated website allows the public to more easily access information on the Ombudsperson activities. Despite this positive development, government bodies failed to provide proper responses to a number of the Ombudsperson's requests.

The implementation of the judgements of the **European Court of Human Rights** continues to be of concern. The authorities in Kyiv have not yet taken measures to execute the "pilot judgment" in the Ivanov case, which concerns the obligation of Ukraine to set up an effective domestic remedy in cases of non-enforcement of domestic judicial decisions. The implementation of this pilot judgement is of particular relevance because of its effects on more than 1000 similar applications lodged with the Court.

International and domestic human rights organisations continue to report on an increasing number of complaints of **torture and ill-treatment** in penitentiary and detention facilities, and of failures to ensure appropriate medical care. There is an excessive use of pre-trial detention measures. The problem of overcrowding in detention facilities has been reported by both the Ombudsperson and independent human rights defenders. There is an urgent need to raise awareness among judges, prosecutors and other law-enforcement agents on combating torture and inhuman and degrading punishment. In November, Ukraine agreed to the publication of the report by the European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT) of the Council of Europe. In its report, the CPT notes some improvement in the material conditions of detention in law enforcement establishments, but expresses concern that little progress has been made in many other areas. The National Preventive Mechanism under the Optional Protocol to the Convention against Torture has not been established.

Cases of **discrimination** on the basis of nationality or ethnic origin continue to be reported. Roma and Crimean Tatar, as well as other minority groups, continue to be the object of discrimination and racism. Discrimination on the grounds of sexual orientation remains common and there is a need to raise social awareness and modify widespread attitudes in this respect. A comprehensive anti-discrimination legislation to ensure effective protection against discrimination, as recommended by UN and Council of Europe monitoring bodies is still missing. Ukraine should revise its

national legislation in the field of protection of persons belonging to national minorities to address the recommendations made by the European Commission against Racism and Intolerance and by the Council of Europe Committee of Ministers on the application of the European Charter for Regional or Minority Languages.

In the area of **gender equality**, the draft law on equal rights and voters lists remains to be adopted. Some further progress can be reported in the area of **children's rights**.

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 of certain nationalities, lack of protection of unaccompanied minors, widespread corruption in the asylum system, and denial of access to asylum seekers by representatives of the United Nations High Commissioner for Refugees (UNHCR). While the adoption of a Law on Asylum and Refugee Status is a positive development, problems remain with its implementation and the functioning of the new structures.

The functioning of **local and regional self-government** is affected by entrenched centralisation and excessive bureaucracy. Shortly after the reporting period, the Parliament adopted a law on the establishment of a State Fund for Regional Development. Together with the process of updating the National Regional Development Strategy, this represents a positive development.

Work continued on **public administration reform**. In November, the Parliament adopted a new law on the Civil Service which was subsequently endorsed by the President. The law did not take into account the core recommendations made by the EU funded SIGMA programme, putting at risk an EUR 70 million support programme for public administration reform⁴. The President submitted to the Parliament a draft law on administrative services, the adoption of which would help to define a legal framework for the relationship between state and citizens. It will need to be accompanied by a code of administrative procedures.

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

Ukraine continued to cooperate actively with the EU on regional and international issues although its alignment with EU Common Foreign and Security Policy declarations continued to decrease. In 2011 Ukraine aligned itself with 36 out of 82 declarations (44% against 89% in 2009). Ukraine cooperated very constructively with the EU on all questions related to the Transnistria settlement efforts and pro-actively engaged in the resumption of official 5+2 talks.

In June, Ukraine and the Republic of Moldova found a negotiated solution to almost all their disagreements over the demarcation of the northern and southern segments of their common border. Further efforts are needed to find solutions to the remaining border issues in particular as regards the Novodnistrovsc hydroelectric power station.

⁴ SIGMA is a joint initiative of the OECD and the European Union, principally financed by the EU. SIGMA supports European Union candidates, potential candidates and European Neighbourhood countries in their public administration reforms.

Ukraine continued to participate very 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 professional capacities, and to secure valuable inter-agency cooperation both within Ukraine and between Ukraine and the Republic of Moldova. EUBAM continued to support the demarcation of the central segment of the Ukrainian-Moldovan State border on the Ukrainian side and coordinated the successful “Akkerman” joint border control operation. In December, the Ukrainian government approved of the long-awaited decision to authorise joint patrolling of the border between Ukraine and the Republic of Moldova. EUBAM also facilitated talks to resume rail cargo traffic through the Transnistrian region. The EU continued to actively support the demarcation of the central (Transnistrian) segment of the border between Ukraine and the Republic of Moldova.

Ukraine indicated its interest in contributing to the EU-led naval operation ATALANTA, seconding staff and opening discussions on possible participation in future airborne reconnaissance activities.

Ukraine intensified cooperation with the countries from the region and the exchange of best practices with the EU through its participation in the EU Programme for Prevention of, Preparedness for, and Response to natural and man-made disasters (PPRD East).

3. ECONOMIC AND SOCIAL REFORM

Macroeconomic framework and functioning market economy

Ukraine's economy performed well in 2011, with real GDP growth reaching 5.2%, after 4.2% in 2010. It thus continued its recovery after the crisis in 2009, when output contracted by nearly 15%. Growth in 2010 and 2011 was initially export-led but increasingly fuelled by stronger domestic demand. Real growth is expected to slow down in 2012, with the World Bank and the IMF estimates ranging between 2.5% and 3.5-4% respectively.

After three years of double digit rates, year-on-year inflation in December 2010 came down to 4.6% (from 9.1% in December 2010) mainly due to falling food prices as international commodity prices dropped and the harvest was better than expected. Regarding fiscal policy, Ukraine broadly followed the consolidation course agreed with the IMF. However, the deficit of Naftogaz continues to represent a major risk for the budget. The gas tariff increases for households and utilities foreseen in the IMF programme have yet to be implemented and the programme is off-track. With Naftogaz' deficit reaching 1.6% of GDP, the overall government deficit is at 4.3% of GDP in 2011, which is above the 3.5% target agreed with the IMF.

The public debt ratio has increased significantly in recent years, to approximately 40% of GDP in 2011 from only 12% in 2007. Delays in the adjustment of gas prices and the expected slowdown in economic activity may threaten the fiscal consolidation path agreed under the IMF programme.

Following a period of stabilisation in 2010 (after the balance of payments crisis of 2008-2009), the current account deficit widened again in 2011, reaching an estimated USD 9.3 billion (EUR 7.2 billion), or 5.9% of GDP.

Currency reserves declined to USD 31.8 billion (EUR 24.6 billion) by end 2011. The EUR 610 million macro-financial assistance made available by the EU is currently on hold due to lack of progress in negotiations with the IMF and the slow pace of structural reforms in key sectors including energy, public finance management and fight against corruption.

The implementation of the ambitious Programme for Economic Reforms for 2010-2014 has been slow. Progress has been achieved in pension reform and, to a lesser extent, in improving budget legislation. Public administration and public finance management remain unreformed and non-transparent, weakened by red tape and prone to corruption.

Employment and social policy

The official unemployment rate is at 2.1%, (2.2% in 2010). While the ILO-measured rate stands at a substantially higher level, figures do not reflect the high number of unregistered low-paid jobs in the shadow economy.

Between January and August 2011, over 1.3 million of seekers were registered as unemployed, while around half a million found an occupation via the state employment services. The informal sector (including both undeclared jobs and undeclared wages) continues to represent a substantial share of employment, estimated at around 20%.

In September, Ukraine declared the improvement of skills matching a key priority and launched several initiatives in this area with donor support. An EU-funded project on skills matching and migration involving social partners started in April 2011.

In the area of **social protection**, a law on pension reform entered into force in October. The law increased from five to 15 years and from 25 to 35 years the minimum contribution requirements to qualify for a pension and to receive a full pension, respectively. Pension age for women and state civil servants increased to 60 and 62 years respectively. Specific services for disabled persons and veterans were established through Presidential decree in April 2011, as part of the overall administrative reform. The Ministry of Social Policy was given responsibility for the delivery of social allowances and services for youth and families. Social Service Centres are being reformed.

There was no progress towards the adoption of the amended Labour Code; several laws, notably concerning wages and collective bargaining, still have to be revised so as to ensure compliance with international **labour standards**. In February, the parliament ratified the 1981 ILO Convention concerning Occupational Safety and Health and the Working Environment, the 1993 ILO Convention on the Prevention of Major Industrial Accidents, and the 1995 ILO Convention on Safety and Health in Mines.

An occupational health and safety project including capacity-building of social partners, occupational security and health offices and labour inspectorates started in 2011, as part of an ILO global project.

4. TRADE-RELATED ISSUES, MARKET AND REGULATORY REFORM

Bilateral trade between the EU and Ukraine continued growing during 2011, consolidating the recovery started in 2010. EU imports from Ukraine increased by 30.6% and were dominated by iron and steel (29.5%), fuels and mining products (25.1%), as well as agricultural products (19.4%). EU exports to Ukraine experienced a growth of 22.2% and consisted mainly of machinery and transport equipment (36.6%) and chemicals (18.6%).

Economic operators were affected by a number of persistent trade irritants during 2011, notably difficulties with customs valuation and classification; growing value added tax (VAT) refund arrears despite the new automatic refund system; and perceived harassment by tax authorities.

In December, the EU and Ukraine completed the negotiations on a DCFTA as part of a future Association Agreement.

Ukraine acceded to the Revised Kyoto Convention on Harmonisation and Simplification of **Customs** Procedures, which should contribute to approximation with EU standards. The New Customs Code, which is still under preparation, should take into account the provisions of the Kyoto Convention and the DCFTA objectives. There is a need for a more structured approach for customs modernisation allowing to focus on strategic objectives. Despite of some progress made in specific areas, such as more streamlined coordination of border control and improved communication with business environment, the need for substantial reforms remains. Importers reported an increase from 2 to 8 days in the customs clearance time, as well as an increase in the rate of physical inspections (to 41%). Customs valuation remains a serious concern. Despite some positive steps taken, the situation after a short improvement deteriorated again in the fourth quarter of the year. An emerging problem area is classification control. Corruption remains a serious obstacle to trade and business operations. Ukraine participated in the "FIREBLADE" joint customs operation targeting trafficking of counterfeit goods at the EU Eastern border.

On **free movement of goods**, new laws on market surveillance and control of non-food products and on the safety of non-food products entered into force in July. Ukraine abolished the pre-market control of manufacturers. Implementing legislation made progress, with the adoption of nine by-laws in December, but there is still room for further development. The law on liability for the damage caused by defective products came into force in September.

In 2011, the Government submitted to the Parliament amendments to the metrology law, which preserve the existing (non-transparent) system burdened with conflicts of interest. Technical regulations based on EU Directives need to be revised in order to become fully compliant. The EU Budget Support Programme on Technical Barriers to Trade (EUR 45 million) experienced several delays due to the slow pace of

implementation of the administrative reform programme. As a result the second disbursement was postponed at the request of Ukraine.

The **business climate** deteriorated in 2011. Economic operators reported that they were facing an unpredictable regulatory environment where rules were unclear and inconsistently applied, which had the effect of hampering business development. Pressure and harassment of businesses by various authorities (tax, customs) and by law enforcement bodies (police, prosecutor general, security service), corruption and a general deficiency of rule of law enforcement were reported as the major obstacles to doing business. The ranking of the ease of doing business, produced in the annual World Bank's "Doing Business 2012" report showed that Ukraine's rating had worsened (to 152nd place in 2012, three places below its position last year).

Ukraine continued its gradual process of approximation with EU **sanitary and phyto-sanitary** (SPS) standards. It prepared the institutional reform plan required to obtain EU support under the Comprehensive Institution Building and an SPS roadmap. It started to consolidate the Veterinary and Phyto-sanitary Service, established in April 2011, and started training staff (with EU support). In November 2011, the Food and Veterinary Office (FVO) of the European Commission carried out an inspection mission on the implementation of feed safety requirements. The EU supported Ukraine, via a twinning project, in tightening up food safety checks. A new twinning on approximation of phyto-sanitary legislation and administration with EU standards was prepared.

In the area of **company law**, the law on Joint Stock Companies was amended in February 2011. The aim of the amendments is to further simplify the corporate governance framework. Hostile take-overs have been made more difficult. Due attention should be paid to minority shareholders' rights. The law introducing the International Financial Reporting Standards for banks, public limited companies, and insurance companies was approved in May.

There was progress in the area of **financial services** regulation. In February the amended regulation on Banking Activities defined certain disclosure requirements on the banks' ultimate/beneficial owners/controllers. It also included provisions on registration and external audit procedures for banks, on strengthened creditors' rights, and on investment activities. Internal financial rules have been defined with the aim of preventing money laundering activities. Reporting requirements in line with International Financial Reporting Standards were also established, and provisions on raising the capitalisation requirements for banks were put in place. However, the issue of the non-performing loans has not yet been substantively addressed. The legislator tightened up the information disclosure requirements on securities and stock market in October and the law on insider dealing in April.

A law introducing the methodology of consolidated supervision of financial institutions entered into force in December. It established the consolidated supervision responsibilities of the various bodies. The supervision work is now entirely financed by the industry via a specific fee. Amendments to the laws on mortgage bonds and on special-purpose bonds to improve the mechanisms for the emission and circulation of bonds and providing the market regulator with the powers for ensuring the protection of the legal rights of the investors were adopted in April and June 2011 respectively.

This process was supported by an EU funded twinning project in order to reinforce the monitoring policy.

There is no progress to report in the area of **free movement of capital**. The 2010 requirement that non-residents deposit a 20% reservation of funds in the form of credits or deposits with Ukraine's National Bank for a period up to six months was extended. The regulatory procedures for foreign exchange transactions were tightened in December 2011 to promote the use of the national currency in international operations and to restrict capital flight.

Other key areas

In the area of **agriculture**, the negotiations on geographical indications were finalised in September 2011 as part of the DCFTA negotiations.

The new **Tax Code** unifying all tax legislation into a single act entered into force in 2011. The absence of implementing legislation creates serious problems for businesses and control authorities. The State Tax Service reform, which is facing delays, has not yet reduced burden and costs for business operators. Business operators also report that tax controls are repressive and often accompanied by judicial intimidation. Despite efforts made by the authorities to tackle the long-lasting problem of VAT refunds, economic operators' increasingly complained about delays in VAT refunds and pressure to withdraw claims or pay corporate income tax in advance in order to receive any VAT refunds. The automatic refund system introduced in March offered only partial relief, as the criteria for such refunds lack transparency and few companies qualify. It is important that Ukraine adopts and implements without delay a comprehensive action plan with timeframes, bringing a sustainable solution to this problem.

Amendments made in July to the **competition** law and the law on the Anti-Monopoly Committee of Ukraine (AMCU) covered misleading advertising and increased fines for infringement. The AMCU proposed an increase in the value thresholds for merger notifications in line with international community recommendations. Budgetary constraints led to staff cuts of up to 20%. A number of AMCU practices fail to comply with EU standards (such as investigation of cartels based exclusively on price parallelism and assessment of vertical restraints). In the area of **state aid** EU assistance under the Comprehensive Institutional Building Programme was postponed pending the adoption of legislation in line with EU standards.

In 2011, the State Department of **Intellectual Property** was replaced by the State Intellectual Property Service of Ukraine (SIPSU). The SIPSU will be responsible for granting rights to intellectual property law objects, drafting legislation and providing information, products and services (including training) related to intellectual property issues. A twinning project was prepared to support this new institution.

An assessment of the national **statistical** system was carried out in 2011 which resulted in a number of recommendations for further improvement. While progress has been made to implement European standards in a number of statistical domains (business statistics, national accounts and others) future efforts should focus on guaranteeing the professional independence of the State Statistical Service of Ukraine, assure the confidentiality of individual data as stipulated in the European Code of

Practice and improve the coordination of the statistics system in Ukraine through the inclusion of all official statistics into the work programme and the statistical law.

Public finance management (PFM) progressed little. High levels of corruption and widespread conflicts of interest remained a major concern. The absence of a comprehensive PFM reform programme led to delays in the release of EU budget support payments; however, in December, the Government agreed to set up a working group to elaborate the programme. Concerning **public internal financial control** (PIFC) specific procedures for establishing internal audit units, their working procedures and a code of ethic were adopted in November. A draft law on public and publicly guaranteed debt was debated in Parliament and many of its provisions have been incorporated in the amendments to the Budget Code of July 2011. The focus should now be on streamlining the control systems for the budget.

The amendments to the **Public Procurement** law adopted in July 2011 introduced framework agreements and abolished prior approval for single source procurements by the Ministry of Economy. However the amendments did not address two key issues: namely the proper definition of the concept of contracting authorities or entities which are bound by the law (state enterprises, in particular, are excluded from the scope of the law) and the exclusions under the EU procurement *acquis*. Technical assistance from the EU has helped the government in improving the new legislation.

On **external audit**, the remit and technical capacity of the Supreme Audit Institution (the Accounting Chamber of Ukraine) remains insufficient to ensure an appropriate level of control over the budget. In particular, the Chamber has no right to audit government revenue, local government, extra-budgetary funds and state-owned enterprises.

The charter of the State Inspection of Ukraine for Consumer Rights Protection of April 2011 puts it in charge of **consumer protection** and the surveillance of compliance with standards.

5. COOPERATION ON JUSTICE, FREEDOM AND SECURITY

Intense cooperation on matters concerning justice, freedom and security took place between the EU and Ukraine in 2011, with a strong focus on **mobility**. Following presentation by the EU to Ukraine of the **Visa Liberalisation Action Plan** in November 2010, a first Progress Report on the implementation by Ukraine of Plan was issued in September 2011 and a second Progress Report in February 2012. Implementation of the EU-Ukraine **Visa Facilitation and Readmission Agreements** continued and was monitored at the Joint Committee meeting of May 2011. Ukraine and several EU Member States launched negotiations on implementing protocols under the **Readmission Agreement**, but no protocol was concluded. The negotiations on **amendments to the EU-Ukraine Visa Facilitation Agreement** were concluded in December. The text of the amending agreement was initialled in February 2012.

Ukraine achieved progress in the area of **migration and asylum**, but it now needs to adopt additional by-laws and to finalise the National Migration Management Strategy. A law on the legal status of foreigners and stateless persons was adopted in September. The State Migration Policy Strategy was approved in May 2011, together

with the accompanying Action Plan. An Action Plan covering the period until 2015 on the Integration of Migrants in Ukraine and the Reintegration of Ukrainian Migrants was approved in June. After the establishment of the State Migration Service (SMS) in December 2010, a regulation defining its basic tasks, functions and organisation was adopted in April 2011. A major EU project in support of the SMS was prepared as part of the Comprehensive Institution-Building Programme. Regarding asylum, the law on Refugees and Persons in Need of Subsidiary and Temporary Protection was adopted in July. Work on bylaws and other related legislation is ongoing. Human rights and international organisations reported a number of cases of violation of the **rights of refugees and asylum-seekers**, including instances of *refoulement* and denial of access to asylum seekers by UNHCR representatives.

Ukraine continued implementing the Concept for Integrated **Border Management** and the related Action Plan, approved in January 2011. A major EU project on Ukraine's border management sector policy was signed in October with the aim, *inter alia*, of contributing to Ukraine's border demarcation activities with the Republic of Moldova, Belarus, and the Russian Federation.

In October, Ukraine adopted a strategy on the **fight against organised crime**. The accompanying Action Plan remains to be adopted. The Third Protocol on the Illicit Manufacturing and Trafficking of Firearms, Their Parts, Components and Ammunition remained unsigned.

In September, Ukraine adopted a framework law on combating **trafficking in human beings**, articulated on three main pillars: prevention, prosecution and victim protection. The law introduces the function of National Coordinator on trafficking in human beings to be appointed by the Cabinet of Ministers, as well as a national mechanism for cooperation between all players involved in anti-trafficking actions. The accompanying Action Plan remains to be adopted. It is essential that the future Action Plan contains a timeframe, specific objectives, activities, results, performance indicators and sufficient human and financial resources.

The law amending certain legislative acts on the responsibility of carriers providing international passenger transportation so as to strengthen the responsibility of carriers was adopted by Parliament in December 2010 and entered into force in April 2011. It contains relevant measures on fighting trafficking in human beings, in line with the Council of Europe Convention on trafficking in human beings.

Progress was achieved on combating **money laundering** and the **financing of terrorism**. Three new laws entered into force in May. The Financial Action Task Force (FATF) plenary meeting of October decided to take out Ukraine from the list of states that have shortcomings of counteraction to money laundering systems and financing terrorism.

Concerning the **fight against drugs**, a new National Service for Drugs Control was established in April. Policy dialogue continued in September at the EU-Ukraine Drugs Dialogue meeting.

Major steps were taken in establishing an adequate legal framework for **data protection**. Ukraine ratified the 1981 Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data and

its 2011 Protocol. Ukraine's first law on data protection entered into force in January together with the Council of Europe Convention. Sanctions were introduced for the violation of data protection legislation, which entered into force in January 2012. Ukraine's data protection supervisory authority, established in April, became operational in July. Work started on assessing Ukraine's new legislation with a view to concluding cooperation agreements with EUROPOL and EUROJUST.

In the area of **judicial cooperation**, Ukraine ratified the Second Additional Protocol to the European Convention on Mutual Assistance in Criminal Matters in June.

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

Ukraine started in 2011 the implementation of the comprehensive **transport** strategy until 2020 by the development and elaboration of transport sub-sector programmes. This is supported by the EU through a sector policy support programme launched in January (EUR 65 million). There was satisfactory progress in road infrastructure development, good progress in the railways and aviation sectors and limited progress in inland water transport. A road safety strategy was adopted in May 2011. In rail, due to little progress in the implementation of the 2009 railway reform programme, a new law on railway reform was drafted in 2011; its adoption is still pending. The revised air code was finally adopted and entered into force in September 2011; its diligent implementation remains a challenge. The negotiations with the EU on a comprehensive air services agreement continued at a slow pace. The Law on Sea Ports which would enable partial privatisation of ports and allowed for the introduction of public-private partnerships has not yet been adopted. The Ukrainian flag remains on the black list of the Paris Memorandum of Understanding on Port State Control in the 'medium risk' category.

In February, Ukraine joined the **Energy** Community. More efforts are needed in order to implement its Community obligations. In December, the EU and Ukraine agreed the sixth progress report on the implementation of their Energy Memorandum of Understanding. Ukraine initiated the update of its energy strategy. In November, the National Commission on State Regulation in Energy was established, replacing the National Electricity Regulatory Commission. After an initial increase in gas prices for households and utilities (50% in August 2010) and electricity prices (30% in January 2011), Ukraine has not further increased the prices in 2011 towards cost recovery levels. This is an important obstacle to sustainability of the sector. In September, the President asked for the development of a restructuring plan for Naftogaz, but the plan was not finalised according to the established timetable. Restructuring should help to increase transparency in the gas sector and improve the financial viability of Naftogaz⁵. In April, Ukraine announced privatisation plans for the electricity sector. A masterplan for the restructuring of the coal mining industry until 2017 was developed as an output of an EU funded project. The reform process in the gas sector was facilitated through EU twinning assistance to the regulator. Ukraine had planned to join

⁵ Subsequent to the reporting period, a law including provisions which would permit unbundling was adopted. The follow up of this law will be closely monitored during 2012.

the Extractive Industry Transparency Initiative, but achieved little progress towards meeting its requirements. The Sector Budget Support programme for the energy sector was completed. The final tranche under the programme could however not yet be released, pending the elaboration of a mutually agreed comprehensive reform strategy and action plan.

Following-up the joint 2009 EU-Ukraine conference on the modernisation of the Ukrainian gas transit system, the EU financed feasibility study, and an environmental and social impact study progressed well. The study, together with progress to be made on restructuring Naftogaz, will be an important element for future loans from international financial institutions. In September, it initiated a feasibility study for a liquefied natural gas terminal on the Black Sea coast. Work towards a Euro-Asian Oil Transportation Corridor continued. The amendment of the law on Production Sharing Agreements in June constituted a first important step in improving the investment climate of Ukraine's upstream energy sector. Ukraine requested, together with the Republic of Moldova and Romania, EU financing for a feasibility study on synchronous interconnection of the power systems of the countries to the European Network of Transmission System Operators for Electricity (ENTSO-E), the continental European power system. Ukraine upgraded its electricity networks. Ukraine started implementing its energy efficiency programme 2010-2015; the draft law on energy efficiency has yet to be adopted.

In the framework of the sector policy support programme to the implementation of Ukraine's energy strategy in the area of energy efficiency and renewable sources of energy, the EU released a first tranche of EUR 31 million in September. In 2011, the EU also provided an additional contribution to the Eastern Europe Energy Efficiency and Environment Partnership Fund of EUR 15 million.

Ukraine continued the safety upgrading of its nuclear power plants. After the Fukushima nuclear accident, Ukraine initiated a comprehensive risk and safety assessment (nuclear stress test) of its plants, taking EU standards into account; and submitted a report to the Commission. In the context of the commemoration of the 25th anniversary of the Chernobyl accident, in April, donors raised additional funds to fill the financial gap for the completion of the major Chernobyl projects. Ukraine's Nuclear Regulatory Authority continued contributing towards restoring the Chernobyl site to an environmentally safer condition.

In the field of **climate change**, Ukraine took further steps to prepare legislation on emission trading, in line with its long-term objective to link with the EU emission trading system. 34 new Joint Implementation projects were registered at the UN level, bringing the number of registered projects to 82. In October, the United Nation Framework Convention on Climate Change (UNFCCC) Kyoto Protocol compliance committee suspended Ukraine from trading emissions units pending the resolution of questions relating in particular to transparency of emission data. Ukraine is encouraged to build capacity and engage in the new carbon market mechanism to be developed following the United Nation Framework Convention on Climate Change 17 Conference of the Parties (UNFCCC COP 17). Ukraine is also encouraged to fully implement the Cancun and Durban agreements and in particular devise a low carbon development strategy including update information on target or actions that it will implement. The EU launched two projects to study the potential implementation of low carbon technologies and carbon sequestrations with Ukrainian partners.

Ukraine adopted a national **environment** action plan for 2011-2015 to implement its environment strategy. A decree setting out the procedure for public participation with regard to decisions that can affect the environment was also approved. New legislation regulating urban development activities has raised concerns about the procedure of environmental assessments, including possibilities for public participation and will need to be reviewed. Ukraine adopted national targets under the Protocol on Water and Health to the Convention on protection and use of trans-boundary watercourses and international lakes of the United Nations Economic Commission for Europe (UNECE). Ukraine faced problems with implementing several agreements it has already ratified. In June and July respectively, the fifth Meeting of the Parties of the Espoo Convention and the fourth Meeting of the Parties of the Aarhus Convention issued cautions against Ukraine for non-compliance. The EU launched a sector policy support programme in the field of environment (EUR 35 million). A follow-up project to continue supporting Ukraine's implementation of Espoo and Aarhus Conventions was also launched.

In the field of **civil protection**, Ukraine intensified the cooperation with the countries from the region and the exchange of best practices with the EU in the field of disaster prevention, preparedness and response through its participation in the EU Programme for Prevention of, Preparedness for, and Response to natural and man-made disasters. The EU supported the clean up of the Gorlovka chemical plant (TNT, pesticides) through a contract with UNIDO.

In the **information society** sector, good progress was made as Parliament has adopted several important laws, notably those simplifying market entry procedures for some electronic communications services and strengthening the regulator's independence. In July, the law facilitating operators' access to the telecommunications market was approved. Accordingly legal entities who wish to provide services in the field of telecommunications shall apply to the National Commission for Communication Regulations (NCCR) to register as operators and providers of telecommunications. Another law strengthened the independence of NCCR (to be renamed into National Commission for Communication and Informatisation Regulations) and provided it with an additional mandate to regulate Informatisation. The approval of the Commission new statute and staff numbers is still pending. A twinning project for the NCCR was prepared.

In the area of **research and innovation**, the procedures for the prolongation of the EU-Ukraine Science and Technology Cooperation Agreement for an additional four years, to 2014 were completed in 2011. The first meeting of the Joint Committee established under the Agreement was held in Brussels on 23 November. Both sides shared information on priorities in health, ICT and nanotechnology/materials research, and it was agreed to enhance cooperation in areas of mutual interest through the Ukrainian funding programmes and the EU Framework Programmes. Ukraine continued to update and modernise the legal base and funding structure for research and innovation. Ukraine's participation in the 7th Framework Programme for Research and Technological Development (FP7) continued to be at a good level. Ukraine is the seventh most active international partner country participating in the programme. To date, 112 Ukrainian research organisations are involved in 150 FP7 projects, receiving an EU contribution of over EUR 14.1 million. Ukraine continued to strengthen the network of FP7 Contact Points, which should greatly assist increasing Ukrainian participation in the final calls to be launched under FP7.

Ukraine has made progress towards the setting up of a regional development policy and a regional development Fund. However, there are delays in adopting the Law on the State Regional Policy and the approval of the disbursement rules of the newly established Fund.

Recent analytical work shows discrepancies between allocations in the budget 2012 and the National Regional Development Strategy. Greater continuity and determination in the implementation of actions agreed in the regional policy dialogue with the EU will be essential to achieving results.

An identification mission took place in space cooperation in the context of the European Geostationary Navigation Overlay Service (EGNOS).

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

In the area of **education** reform, a revised **higher education** text was drafted following consultation of stakeholders, including universities, non-governmental organisations and students. Despite some improvements in approximating to EU legislation, the proposed law does not grant more autonomy to the universities, an element that remains a concern to civil society in Ukraine, as well to some university authorities. A lack of autonomy will also be an obstacle to setting up of multidisciplinary programmes, notably in the area of European studies.

Ukraine continued to benefit substantially from its increasing participation in higher education cooperation and exchanges with the EU. Nine new university cooperation projects were selected under the Tempus IV programme and at the end of 2011, Ukraine was involved in 38 projects; figures also show a constant increase in participation under the successive calls of the programme. Ukraine continued its active participation in the **Erasmus Mundus** (EM) programme in the academic year 2011-2012 with the award of a total of 354 scholarships and mobility grants. Seven new Ukrainian projects were selected under the **Jean Monnet** Programme in 2011, which fosters teaching and research in the field of EU integration studies.

At the end of 2011, among the Eastern Partnership Countries, Ukraine was the first country in terms of number of institutions (49) and individual researchers (62) currently participating in research collaboration actions under the **Marie Curie** scheme.

In the field of **vocational education and training** (VET), the European Training Foundation provided support to the Ministries of Education and Economy in developing a balance between the demand and supply of qualified workforce, on the basis of the National VET Development Programme 2011-2015, approved by the Ukrainian Government in April 2011. A major outcome of social partners' involvement is the proposal for a National Qualifications Framework which the inter-agency expert group finalised in October.

Preparations began for the participation of Ukraine in the eTwinning component of the **Comenius** programme, the EU programme for interconnecting schools, foreseen for 2012, with the selection of the partner support agency and an assessment of potential beneficiaries/schools.

Very positively, the number of young people and youth workers benefitting from exchange opportunities offered by the **Youth in Action** programme increased from 255 projects involving 818 participants in 2010 to 289 projects and 872 participants in 2011.

Ukraine developed a **health** reform concept and launched pilot decentralisation projects. It amended the law on health security and health care provision and established new institutions (for sanitary issues and epidemiology; quality control of medicines; and HIV/AIDS). In January 2011, the President signed the law on HIV/AIDS prevention and social protection, which also contributes to fight tuberculosis. Ukraine participated in the Commission's HIV/AIDS think tank. In September 2011, the parliament adopted a law prohibiting the advertising, sponsorship and promotion of sales of tobacco. In January, the Global Fund to fight AIDS, Tuberculosis and Malaria, to which the EU is one of the major contributors, awarded Ukraine a major grant of USD 305 million (EUR 228 Million) covering 2012-2016 to fight HIV/AIDS.