

INTEGRATION WITHIN ASSOCIATION: DYNAMICS OF THE EU - UKRAINE AGREEMENT IMPLEMENTATION

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The Ukrainian Side of the EU-Ukraine Civil Society Platform is part of the bilateral Civil Society Platform established in accordance with the Articles 469-470 of the EU-Ukraine Association Agreement. It is set to exchange views and make recommendations to the Association Council, Association Committee and Parliamentary Association Committee on how to attain the objectives of this Agreement. More: www.eu-ua-csp.org.ua/en

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POLICY PAPER

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INTEGRATION DYNAMICS OF THE ASSOCIATION AGREEMENT IMPLEMENTATION: CONCLUSIONS AND RECOMMENDATIONS

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CONTENTS OF THE ASSOCIATION AGREEMENT

The aims of the Association Agreement between EU and Ukraine (hereinafter - AA), as defined in Article 1, can be summarised as follows¹:

- promoting peace and stability;
- respect for common values (as they constitute essential elements of the AA)²;
- enhanced cooperation and Ukraine's association with EU policies in various areas³;
- **Ukraine's gradual integration in the EU Internal Market**, by setting up a Deep and Comprehensive Free Trade Area.

The main essence of the Deep and Comprehensive Free Trade Area (hereinafter - DCFTA) and the AA in general is a unilateral regulatory approximation in exchange for economic integration. According to the AA, Ukraine is obliged to adopt and implement the *acquis* - EU legislative norms, rules and technical standards. In return for this, Ukraine will gradually become part of the EU Internal Market.⁴ The extent to which this integration happens will depend on the ambition and capacity of Ukraine to achieve a reciprocal deep liberalisation through approximation with the EU *acquis*.⁵ In general, with the exception of the European Economic Area and candidate countries, the EU has never opened up the Internal Market to participation by a 3rd country to such a degree.⁶

¹ Given the complex structure and wording of Article 1 (and of the whole text of the AA), only the key content is presented here, in a somewhat simplified form, without undue details which may be of interest to professional lawyers.

² Article 2 defines that respect for democratic principles, human rights and fundamental freedoms, the principles of the rule of law, sovereignty and territorial integrity, inviolability of borders and independence, as well as countering the proliferation of weapons of mass destruction constitute essential elements of this Agreement. According to Article 478, in case of violation by a party of any of the essential elements of this Agreement, the other party may suspend the effect of the AA provisions on DCFTA.

³ The AA covers a lot of areas and topics, and the political dialogue between the parties on these issues can be very productive. For example, further progress on the visa dialogue and taking gradual steps towards a visa-free regime have been mentioned as commitments of both parties in Article 19 of the AA.

⁴ See the EU's explainer 'The EU-Ukraine Association Agreement and Deep and Comprehensive Free Trade Area: What's it all about?': http://eeas.europa.eu/archives/delegations/ukraine/documents/virtual_library/vademecum_en.pdf - p. 8 and 11.

⁵ *Ibid.*, p. 13.

⁶ *Ibid.*, p. 8.

The AA contains **three major types of arrangements** in various sectors of economic integration:

- Direct reciprocal market opening through the progressive removal of customs duties (asymmetric, privileged for Ukraine from the side of the EU)⁷;
- Conditional opening of the EU Internal Market for Ukraine in selected sectors in the future - on the condition of Ukraine's alignment with the EU norms and standards in these areas;
- Ensuring a fair competition between EU and Ukrainian firms by gradually bringing Ukraine in line with the EU rules and standards in consumer rights, intellectual property rights, labour rights, environmental protection, state aid and competition⁸.

Thus, the AA in its economic part will be fully implemented when customs duties are completely removed, regulatory environment in Ukraine aligned with that of the EU, and Ukraine becomes part of the EU Internal Market in a number of sectors. The specific areas, markets, the methods of the EU market opening foreseen in the AA as well as the timeframes for fulfilling the respective 'homework' are presented in **Table 1** (see p. 13). In total, these are 14 sectors or markets on which AA foresaw adoption of 15 decisions by the EU.

As the relevant AA provisions provide for the gradual opening of the EU Internal Market in the future, thus they lay down dynamics in the AA implementation. This dynamics, however, is not automatic: it depends on Ukraine's progress in its 'homework' of regulatory approximation.

The AA does not specify the timeframes when the EU should decide on the integration of Ukraine into its domestic market in a given sector but as a rule contains sufficiently clear timeframes when Ukraine has to fulfil its "homework" in a sector - after which it is logical to expect the EU decision to follow soon.

Thus, calculating from the **start of provisional application of DCFTA provisions on 1 January 2016**, in accordance with the timeframes foreseen in the AA, as of beginning of 2019 Ukraine should have implemented its commitments in at least four sectors. Thus, there must have been already created conditions for the EU decisions to integrate Ukraine into the Internal Market in these sectors, namely: conclusion of the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA); Ukraine's joining the two Conventions on customs; granting of the internal market treatment in postal and courier services; and partial opening of the public procurement market.

IMPLEMENTATION DYNAMICS - INTERIM RESULTS AND RECOMMENDATIONS

Analysis of the state of developments in selected sectors of economic integration as of January 2019 shows a very diverse dynamics of AA implementation depending on the area⁹:

In **technical barriers to trade**, AA foresees the perspective for concluding the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA). Initially, ACAA may cover one or several sectors, and later be gradually extended to all 27 sectors listed in the AA. Potentially, ACAA

⁷ In practice, it took place even before the provisional application of the AA, with unilateral introduction of the EU's autonomous trade preferences for Ukraine in 2014.

⁸ «EU-Ukraine Deep and Comprehensive Free Trade Area: Economic benefits and opportunities» - explainer of the European Commission: http://trade.ec.europa.eu/doclib/docs/2015/december/tradoc_154128.pdf

⁹ Here, only the main conclusions and recommendations for specific sectors are summarised. For more detail on each of them see relevant thematic chapters of this publication.

can cover up to up to a fifth of Ukrainian exports to the EU (primarily machine building products), facilitate trade and raise the image of the goods made in Ukraine on global markets. At the moment, progress made in Ukraine's homework implementation (harmonisation of legislation, national quality infrastructure and market surveillance with the EU *acquis*) does allow for concluding the ACAA at least in three sectors. However, the EU has not given any signals about actual prospects for it. In the absence of perspective for a quick conclusion of the ACAA, the harmonised procedures and requirements proved too burdensome, especially for importers.

Recommendation for the EU

- Carry out an official assessment of Ukraine's homework implementation, and in case of the positive results - make decision to conclude the ACAA with Ukraine.

In ***customs procedures***, there is no coherent policy in Ukraine, largely as a result of not having the Customs Service as a separate agency. This is an example of how an institutional issue not covered by the AA directly affects the pace of implementation of its provisions on regulatory approximation, in particular, complicates the passage of relevant laws in the Parliament. As a result, Ukraine has not yet fulfilled its "homework" in this area, and accordingly cannot use the prospects offered by the AA: recognition by the EU of authorised economic operators (AEO) and joining the EU Common Transit System (NCTS). In December 2018, the government decided to establish State Customs Service as a separate state body.

Recommendations for Ukraine

- Provide for systemic mechanisms for government and public oversight over the activities of the new agency - State Customs Service.
- Pass the Draft Law #7473 to amend the Customs Code to establish the institute of authorised economic operators (AEO) and simplify transit procedures.

Digital market covers AA provisions on e-commerce, telecommunications services, IT services, audio-visual media, copyright and related rights, and personal data protection. In recent years, Ukraine took steps to approximate its legislation and regulations, but it is not keeping up with the pace of updates to EU legislation in this area. Ukraine has a strong IT sector accounting for more than 3% of GDP, and in terms of exports it ranks third among all the sectors of the economy (the main export markets being the USA and the EU). However, Ukraine does not have a separate agency dealing with the digital economy and society. Implementation of the governmental Concept of the Development of the Digital Economy and Society is not funded. The government recently drafted a Strategy of Ukraine's Integration into the EU's Digital Single Market till 2023.

Recommendations for Ukraine

- Set up either a separate central executive body or a department within the Ministry of Economic Development and Trade in charge of the development of the digital economy and society, include expenditures in the State Budget to implement the action plan of the Concept of the Development of the Digital Economy and Society, and draft and adopt a law on the digital economy and society;
- Draft and adopt a law on electronic communications that reflects the new EU Electronic Communications Code;
- Amend the Law "On E-commerce" to harmonise it with EU legislation.

In ***financial services***, AA foresees a perspective for granting Ukraine the EU internal market treatment. The governmental Programme for Developing the Financial Sector till 2020 envisages implementation of all Ukraine's commitments in the sphere of financial services; and in recent years, there

has been noticeable progress with the implementation of EU norms. EU banks and insurance companies already have a significant presence on the Ukrainian market (EU banks prevail among privately-owned banks in Ukraine) and were able to enter the market without particular problems. Also, Ukrainian banks and insurance companies already may enter the EU market through subsidiaries and branches, but do not do it because of economic considerations. The latter would also limit the initial effect of the EU financial services market opening for Ukraine. Moreover, given that current EU legislation fundamentally changed the regulation of financial services in the EU, the prospects for an internal market treatment as anticipated in the AA became uncertain. This raises the question of rationale for implementing the AA in this area.

Recommendation for the EU

- Clarify the prospects for future financial services market integration, in effect choosing one of three possible options¹⁰.

In **public procurement**, AA foresees mutual gradual (in five phases) access to public procurement markets on the condition of Ukraine's fulfilment of its 'homework'. In 2016, the new Public Procurement Law was fully implemented and all public procurements started to be conducted on the basis of the ProZorro electronic system. Moreover, Ukraine has unilaterally asymmetrically opened its market for the EU: according to national legislation, companies from the EU member states already have full access to the Ukrainian public procurement market. Also, Ukraine has already gained access to the EU public procurement markets under the WTO Government Procurement Agreement (GPA) almost as much as foreseen by the AA. Unlike the AA, the GPA does not require Ukraine to fulfil 'homework'. Thus, as a matter of fact, both parties have already implemented most public procurement provisions of the AA.

Recommendations for Ukraine

- Amend the Law of Ukraine 'On Public Procurement' and some other legislative acts, the way it was envisaged by Draft Law No. 8265;
- Reject Draft Law No. 7206 'Buy Ukrainian'.

Recommendations for the EU

- Carry out a formal evaluation of Ukraine's progress in the implementation of its AA commitments in the area of public procurement;
- In accordance with the AA provisions, determine prospects for granting procurement market access below the thresholds set out in the GPA.

In the field of **energy**, being a member of the Energy Community, Ukraine is implementing the Third Energy Package. This is not explicitly envisaged by the AA which only contains commitments from the Second Energy Package. At the same time, the AA is missing a perspective for Ukraine's gaining the EU internal market treatment in the sectors of gas and electricity. In recent years, natural gas was imported to Ukraine exclusively from the EU. European companies are already using Ukraine's gas storage facilities conveniently located near the EU border. Ukraine's Energy Strategy envisages a build-up of the gas market on the principles of the EU Third Energy Package by 2020. Ukraine's laws are already approximated to the gas acquis: transposition of main requirements of the Third Energy Package has already taken place. Three key issues of their practical implementation remain unresolved: the unbundling of Naftogaz, the introduction of daily balancing, and the liberalisation of the retail supply.

¹⁰ See thematic chapter 'Integrating Ukraine into the EU financial services market' by Vitaliy Kravchuk.

Recommendations for Ukraine

- Immediately undertake the key steps to restructure Naftogaz in order to unbundle the independent transmission system operator;
- Ensure launch of daily balancing without delay;
- Revise the public service obligation (PSO) scheme on Ukraine's gas market.

Recommendations for the EU

- Offer the prospect of granting the EU's internal market treatment in gas and electricity sectors to Ukraine should it complete the 'homework', by updating the Annex XXVII of the AA following the results of the EU-Ukraine Association Council of 17 December 2018¹¹;
- Uphold a common position with Ukraine during negotiations with Russia regarding the transit of gas after 2019 based on EU rules and extend these requirements to all other routes for Russian gas to be delivered to the EU.

CONCLUSIONS

Achievements: As of January 2019, none of the AA deliverables in Ukraine's integration to the EU's Internal Market had been achieved - although by this time, according to the AA schedules, there must have been at least four. In fact, however, the opening of the public procurement market has taken place - but according to the GPA, i.e. beyond the AA framework.

Factors of success: it should be acknowledged that there are many successful areas of Ukraine's 'homework' implementation. These are: technical regulation, financial services, public procurement, and, to a large extent, energy. These achievements should be valued even more if due account of the specific context is taken: political fragmentation, weak institutions and influential vested interests which try to preserve the status quo. Behind these successes is the dedicated work of enthusiasts - 'agents of change' among civil servants, members of the Parliament, progressive business and civil society.

Roots of the problems: the necessary prerequisite for the successful accomplishment of the 'homework' is the availability of a developed public policy strategy and a competent agency in the relevant field. The absence of such responsible agencies is the main reason for lagging behind in implementing Ukraine's 'homework' in the customs and in digital market areas.

EU should: reward Ukraine for the successful implementation of the 'homework', as foreseen by the AA, by making decisions on Ukraine's integration into the relevant sectors of the EU's Internal Market. Indeed, many reforms are needed for Ukraine itself and without external encouragement, but at the same time, in many areas of regulatory approximation, new norms become more burdensome for the Ukrainian market players. In the absence of a market opening by the EU, the question may arise in Ukraine about necessity to take a more flexible approach to fulfilling its legislative harmonisation obligations.

In a number of areas, the scope of the Ukrainian 'homework' in the AA should be updated. Objectively, EU legislation has evolved significantly since the conclusion of the negotiations between Ukraine

¹¹ See the Joint press statement: <https://www.consilium.europa.eu/en/press/press-releases/2018/12/17/joint-press-statement-following-the-5th-association-council-meeting-between-the-european-union-and-ukraine/>

and the EU on the AA in 2011. The EU has started to build the Digital Single Market in 2015 and since then has made large-scale legislative changes in this area. In financial services, the radical change of regulation in the EU market has complicated (if not made impossible) the implementation of the prospect of the internal market treatment for Ukraine as provided by the AA. The ambitious goals of Ukraine within the Energy Community and its willingness to integrate into the EU gas market in the context of trilateral gas talks with Russia logically require the revision of the scope of the 'homework' in the energy sector (in particular, in the gas market).

«WHAT NEXT?»: PROPOSALS FOR THE EU – UKRAINE AGENDA

In 2019, the main priority ("new big thing") for EU-Ukraine relations should be the gas market integration. At the end of 2019, the current contract between Naftogaz and Gazprom for the transportation of gas from Russia to the EU through Ukraine expires. Ukraine's integration into the EU's internal gas market would be an ambitious but feasible goal which envisages full liberalisation of the Ukrainian market in practice and the change of the scheme for transportation of Russian gas to the EU through Ukraine. Since 2020, European companies should be able to buy gas from Gazprom at the Ukrainian-Russian border, avoiding affects of potential disputes over Ukrainian-Russian contracts. To achieve this goal, a concerted effort is required on both sides, both at a high political level and at a very technical level. Updating Annex XXVII to the AA, as agreed by the EU-Ukraine Association Council on 17 December 2018, should be regarded as the first step in this direction.

Given the forthcoming comprehensive review of the achievement of the AA objectives (within five years of its entry into force)¹², Kyiv and Brussels should define a list of priorities for Ukraine's integration into the EU's Internal Market within the framework of the DCFTA implementation by the end of 2020. This timeframe coincides with the implementation deadline for 20 Eastern Partnership deliverables and with the deadline for implementation of a number of sectoral strategies in Ukraine.

Based on the integration dynamics foreseen in the AA, presented in the **Table 1** (p. 13), it should be defined that **at least the following 9 deliverables in the market integration** (out of total 15 envisaged in the AA) should be achieved by the end of 2020:

- Recognition by the EU of Ukrainian authorised economic operators;
- Ukraine joining the EU common transit system (NCTS);
- Conclusion of the ACAA agreement and its extension to further sectors beyond the first three;
- Recognition of the equivalence in key sectors of agriculture;
- Internal market treatment for telecommunication services and significant progress in integration into the Digital Single Market in other segments;
- Signing, ratification and entry into force of the agreement on the Common Aviation Area;

¹² Article 481 stipulates that the AA is concluded for an unlimited period but the Parties shall provide for a comprehensive review of the achievement of objectives under this Agreement within five years of its entry into force, and at any other time by mutual consent of the Parties. According to Article 486 (5) of the AA, any reference in the AA text to the "date of entry into force of this Agreement" shall be understood to the "date from which this Agreement is provisionally applied". The provisional application of DCFTA provisions began on 1 January 2016, so it means that the comprehensive review of the DCFTA achievements should be provided by the end of 2020.

- Access to the public procurement market is defined by the decisions of the bilateral association bodies at the level not less than the completed phase 4;
- Full internal market treatment in the sectors of gas and electricity.

In addition, Ukraine and the EU should determine the ways of removing bottlenecks in the infrastructure of interconnections. The intensified bilateral movement of people and goods should be supported by the practical integration of Ukraine into **TEN-T transport networks** and the introduction of **integrated border management** (with the joint border controls and the opening of new border crossing points between Ukraine and the EU member states).

Such a package of priorities for integration into the Internal Market can be shaped in various ways, including in the form of a **new Association Agenda** - a bilateral document which was first approved in 2012, updated in 2015 and by now became obsolete. In order for this document to have a political weight – not just remaining a bureaucratic paper – it should be brief (the current version is more than 80 pages long) and define the key priorities of the AA implementation objectives. While the detailed steps for implementation of these agreed priorities may be included in the relevant sectoral 'road maps'.

In addition to the deliverables in economic integration, the list of priorities should also include deliverables in security cooperation and the development of institutions of democracy, rule of law and good governance. In the area of **security**, the agenda is obviously shaped by the Russian threat: priorities should include Ukraine's integration into the EU's Common Security and Defence Policy as well as law enforcement cooperation to ensure that sanctions against Russia are effectively implemented in practice.

In the **political part** of the joint agenda, the term '**political association**' should be specified: the text of the AA leaves it not clearly explained but at the same time one can understand that it is primarily about respect for common European values¹³. Here it is necessary to introduce an assessment by the EU, according to its internal methodology, of the practical observance of these common values in Ukraine. In particular, Ukrainian government could request the European Commission to assess the state of the fight against corruption in Ukraine in the format of the EU Anti-Corruption Report¹⁴. This would provide all parties with a much deeper and comprehensive understanding of the real situation and the needs¹⁵. Similarly, Ukraine can initiate an EU assessment of its judicial system in accordance with the EU Justice Scoreboard methodology¹⁶. The assessments carried out by the EU could effectively help in implementing these reforms in Ukraine which occupy a prominent place on the political agenda.

¹³ It is remarkable that the language of the relevant AA provisions (in particular, Articles 1 - 4, 6 and 14, as well as the preamble) is very similar to the wording of the first - political - Copenhagen criterion for EU membership ('Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities') that needs to be met before the start of accession negotiations.

¹⁴ https://ec.europa.eu/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report_en

¹⁵ The case and the proposal for the use of the EU Anti-Corruption Report assessment for the countries beyond the EU was made by the European Stability Initiative back in 2015: https://www.esiweb.org/index.php?lang=en&id=156&document_ID=162

¹⁶ https://ec.europa.eu/info/policies/justice-and-fundamental-rights/effective-justice/eu-justice-scoreboard_en

Table 1.**DYNAMICS OF THE CONDITIONAL INTEGRATION OF UKRAINE INTO THE EU'S INTERNAL MARKET ACCORDING TO THE PROVISIONS OF THE ASSOCIATION AGREEMENT**

Area	Market	Method of the EU market opening (or facilitation) foreseen in the AA after Ukraine's 'homework' implementation	Timeframe for implementing Ukraine's 'homework' as foreseen in the AA, from the date of entry into force of the AA*
Customs procedures	All goods	<ul style="list-style-type: none"> Ukraine's joining the Conventions on the simplification of formalities in trade in goods and on the Common Transit System; Recognition of authorised economic operators 	<ul style="list-style-type: none"> 1 year 3 years
Technical barriers to trade	Industrial goods	Conclusion of the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA)	2 years**
Sanitary and phytosanitary measures	Agricultural goods	Recognition of the equivalence in various sectors of agriculture commodities***	Not defined****
Communications			
	Telecommunication services	Granting internal market treatment	4 years
	Postal and courier services	Granting internal market treatment	2 years
Financial sector	Financial services	Granting internal market treatment	6 years
Transport			
	Road transport services	Possible conclusion of a special road transport agreement*****	7 years
	Rail transport services	Possible conclusion of a special rail transport agreement*****	8 years
	Inland waterways transport services	Possible conclusion of a special inland waterways transport agreement*****	5 years
	International maritime transport services	Granting internal market treatment	6 years
	Air transport services	EU-Ukraine Common Aviation Area Agreement	Not defined*****
Public procurement	Public procurement market	Granting market access in the scope defined by the AA provisions	Gradually, in five phases, in the period of 6 months - 8 years
Energy			
	Natural gas market	Not clearly defined in the AA*****	till 01.01.2012*****
	Electric energy market	Not clearly defined in the AA*****	till 01.01.2012*****

* According to the AA provisions (Art. 486 (5)), "date of entry into force of this Agreement" shall be understood as the "date from which this Agreement is provisionally applied". The provisional application of DCFTA provisions began on 1 January 2016.

** For fulfilling the "homework" in the scope sufficient for conclusion of the ACAA. For fulfilling it in the scope sufficient for extension of the ACAA coverage to all 27 sectors listed in the AA - 5 years

*** Also, the possibility is foreseen of certification of individual producers for export to the EU without waiting for decisions on the equivalence of the whole relevant sector. In practice, Ukrainian producers are actively using this opportunity

**** The AA determines the deadline for Ukraine's submission of a comprehensive strategy for the implementation of the AA chapter on sanitary and phytosanitary measures (Chapter 4 of the Title IV of the AA) - 3 months. At the same time, the AA does not regulate the period of this strategy implementation. In fact, in 2016 Ukrainian government approved a strategy which foresees the completion of all necessary implementation measures in 2021: <http://zakon.rada.gov.ua/laws/show/228-2016-%D1%80#n10>

***** The AA text does not specify whether implementation of a regulatory approximation 'homework' is a prerequisite for the conclusion of possible special road, rail and inland waterways transport agreements.

***** The EU-Ukraine Common Aviation Area (CAA) Agreement was initialled at the end of 2013 but has not yet been signed due to a dispute between UK and Spain about mentioning of the Gibraltar airport in the text of this agreement

***** According to the results of the Association Council meeting on 17 December 2018, the Parties agreed to update the Annex XXVII to the AA (on energy cooperation); but as of January 2019, the original version of this Annex remained valid.

ACAA: INTEGRATING INTO THE EU'S INDUSTRIAL PRODUCTS MARKET

Dmytro Lutsenko

THE BENEFITS OF THE ACAA

The Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) is a way to eliminate technical barriers to trade between Ukraine and the EU. In the sectors covered by this Agreement, Ukrainian exporters will be entitled to affix CE markings on their products and freely sell them on EU markets without additional certification in the EU itself. The ACAA could potentially cover up to 20% of Ukrainian exports to the EU,¹ predominantly machinery.

Apart from saving exporters the time and costs of undergoing certification, an ACAA with the EU should help promote the image of products made in Ukraine, facilitate access to other global markets for Ukraine, and make Ukraine more attractive as a location for production facilities.

ACAA will facilitate trade in industrial goods and will help promote the image of products made in Ukraine

In addition, it will be possible to freely import and sell in Ukraine any products manufactured anywhere that are marked with EU CE conformity marking. This should make life easier for Ukrainian importers and should contribute to a reduction in customs fraud.

The ACAA between the EU and Ukraine has quite a long history. As far back as December 2005, Ukraine and the EU signed an Action Plan to prepare for ACAA accession, long before the start of the negotiations on the Association Agreement. In the text of the latter, the ACAA comes up in Art. 57. According to this article and Annex III to the Association Agreement, the ACAA will cover 27 categories of industrial, non-food products. Initially, the ACAA could cover one or more of those sectors and later be extended to others. Once the ACAA covers all the sectors listed in Annex III, Ukraine and the EU will consider the possibility of extending its scope to cover industrial sectors that were not listed.

For conclusion of the ACAA, a positive EU assessment of Ukraine's homework implementation is required.

Procedurally, the ACAA will be concluded as a Protocol to the Association Agreement, based on a decision by Ukraine-EU Association bodies, such as the Association Committee for Trade and the Association Council. This decision must be preceded by a positive assessment of Ukraine's implementation of its "homework."

¹ Based on calculations by experts at the Institute for Economic Research and Policy Consulting (IER).

UKRAINE'S HOMEWORK

The Association Agreement requires Ukraine to complete four key steps in order to sign the ACAA:

- bring its legislation, both horizontal (framework) and vertical (sectoral), completely in line with EU law;
- adopt European harmonised standards for related product categories as national standards of Ukraine;
- bring its national quality infrastructure - national standards body, national accreditation body, metrology institutes, and conformity assessment bodies - as well as its market surveillance infrastructure - market surveillance authorities and procedures - in line with EU requirements;
- eliminate all regulatory regimes, most of which exist from the soviet and post-soviet times, that contradict, duplicate or overlap with European requirements for the given product categories. This is especially important for sanitary norms and rules and workplace safety documents that include requirements for product design, manufacture and pre-market control.

CURRENT PUBLIC POLICY

The fundamental documents that lay down public policy in technical regulation are the Strategy and Action Plan for Reforming the System of Technical Regulation till 2020.² These documents require that technical regulations and other legal acts be drafted in full compliance with related EU directives and regulations.

The institutional centre for reforming the system of technical regulation and preparing for ACAA is the Ministry of Economic Development and Trade. MEDT is responsible for public policy in this area and for regulatory and coordinatory functions in horizontal (framework) legislation – technical regulations, conformity assessments, standardisation, metrology, and market surveillance. It is also one of the regulators in vertical (sectoral) legislation, and is responsible for developing technical regulations in individual sectors. Other central executive bodies (CEBs) regulate, inspect and oversee individual sectors.

Established in 2002, the National Accreditation Agency of Ukraine (NAAU) is a signatory of the Bilateral Agreement (BLA) with the European Cooperation for Accreditation (EA), which ensures the mutual recognition of accreditation of conformity assessment bodies.

The Ukrainian Scientific, Research and Training Centre for Standardisation, Certification and Quality, a state-owned enterprise, is Ukraine's national standards body and is a companion body to European standardisation organisations like CEN and CENELEC, as well as a member of the International Organisation for Standardisation (ISO) and the International Electrotechnical Commission (IEC).

On 23 May 2018, the Verkhovna Rada passed the law on Ukraine's accession to the Metre Convention and Ukraine became a full Member State of the International Bureau of Weights and Measures (BIPM) on 7 August 2018, having been an Associate State of the General Conference on Weights and Measures since 2002. This opens the way for full membership in the International Organisation of Legal Metrology (OIML), where Ukraine is currently a corresponding member. These developments provide

² Approved by Cabinet Executive Order #844-R dated 19 August 2015.

new opportunities for Ukraine for comparing measurement standards and strengthening its national quality infrastructure, the foundation of which is metrology.

The situation with conformity assessment bodies varies. All bodies that assess conformity to technical regulation requirements are accredited by the NAAU. Some Ukrainian bodies have cooperation or recognition agreements with conformity assessment bodies from other countries, including the EU. But there are still some problems with the practices of issuing of certificates by certain bodies.

IMPLEMENTATION DYNAMICS

Although the first breakthroughs in legislation happened as far back as in 2010 with the adoption of the laws on market surveillance and on general non-food product safety, the pace of drafting and adopting the necessary legislation has significantly improved since the Revolution of Dignity.

Commitments regarding the adoption of **horizontal (framework) legislation** have been fulfilled by Ukraine in the form of a series of laws and by-laws, adopted over 2010-2016: the Laws "On general non-food product safety" dated 2 December 2010; "On the accreditation of conformity assessment bodies" dated 17 May 2001, amended on 22 December 2011, and 15 January 2015; "On state market surveillance and control of non-food products" dated 2 December 2010; "On technical regulations and conformity assessment" dated 15 January 2015; "On metrology and metrological activity" dated 5 June 2014; and "On liability for damage caused by defects in a product" dated 19 May 2011. In addition, Ukraine passed the Law "On standardisation" on 5 June 2014, in order to align its infrastructure with European requirements.

Because all these legislative acts have been drafted based on related EU legislation, they generally comply with the EU acquis. In some places, Ukrainian lawyers have interfered with the contents during the drafting process and deviations or discrepancies can be seen. Some amendments of a technical nature also need to be made as a result of the legal application of these acts. Some horizontal legislation has been preliminarily analyzed by European experts and some acts are in the process of being amended. This relates specifically to Draft Laws #6235 amending certain legislative acts with regard to technical regulations and conformity assessment, which has passed first reading, and #7123, which amends a number of Ukraine's laws to bring them in line with the fundamental principle of voluntary application of standards, as laid down by the Law "On standardisation."

The legislation on market surveillance also needs amendment, although only a few of the changes are related to aligning with EU legislation. Most of them are needed to solve problems with legal application in Ukraine. Unfortunately, Draft Law #5450-1, which amends the Law "On state market surveillance and control of non-food products," is likely to create more problems rather than leading to full alignment between domestic market surveillance legislation and EU law, and so a new draft has been prepared that incorporates the right changes to legislation on market surveillance and consumer rights protection. As of January 2019, this draft was waiting for official registration in the Verkhovna Rada.

Over 2014-2017, state market surveillance faced a moratorium on inspections. However, starting in 2018, inspections have been actively carried out. Despite the need to introduce certain corrections to legislation and practices, it is possible to assert that, on the whole, the state of national quality infrastructure and market surveillance is acceptable to conclude the ACAA.

The four priority sectors for adapting **vertical (sectoral) legislation** were identified back in the 2005 Action Plan: low voltage equipment, electromagnetic compatibility, machinery, and simple pressure vessels. In 2012, the Cabinet of Ministers adopted technical regulations on low voltage equipment and electromagnetic compatibility. In 2013, the technical regulation on machinery appeared. In 2015, new technical regulations on low voltage equipment and electromagnetic compatibility were developed and adopted that are based on new EU directives from 2014. In July 2018, these three technical regulations were amended based on recommendations from European experts. Thus, the first three sectors where the ACAA can be concluded are low voltage equipment, electromagnetic compatibility and machinery.

State of horizontal legislation, national quality infrastructure and market surveillance is acceptable to conclude the ACAA

State of vertical legislation is acceptable to conclude the ACAA in three sectors: low voltage equipment, electromagnetic compatibility and machinery.

As of January 2019, technical regulations based on new EU directives were adopted in several other sectors: simple pressure vessels, transportable pressure equipment, appliances burning gaseous fuels, lifts, toys, non-automatic weighing instruments, measuring instruments, equipment designed for work in explosive atmospheres, civil explosives, pressure equipment, and requirements for energy efficiency and energy consumption labeling for certain household appliances. This means that these 11 technical regulations may well be subject to a review of their compliance with EU directives and regulations in the process of preparing those sectors for the ACAA.

household appliances. This means that these 11 technical regulations may well be subject to a review of their compliance with EU directives and regulations in the process of preparing those sectors for the ACAA.

In 2016, Ukraine and the EU launched **a high-level industrial and regulatory dialogue**. Two meetings have taken place so far: in Brussels in March 2017 and in Kyiv in March 2018. At least 5 working groups are actively facilitating this dialogue encompassing the system of technical regulation and national quality infrastructure, with one of them dealing with the issues of technical barriers to trade.

Paradoxically, with the start of the application of the Association Agreement, EU technical assistance for developing legislation and preparing quality infrastructure and market surveillance authorities in Ukraine has decreased.

UNCERTAIN PERSPECTIVE FOR CONCLUDING THE ACAA

Thus, progress in developing public policy, institutions, quality infrastructure and market surveillance, and the alignment of horizontal (framework) and vertical (sectoral) legislation in several sectors does allow for the process of concluding the ACAA to begin.

However, the EU has not given any signals about actual prospects, such as in its official reports on Ukraine. The first report on the implementation of the Association Agreement (2016) made no mention of the ACAA.³ In the first report on the implementation of the DCFTA for 2016, which was published in autumn 2017, the ACAA was designated as a long-term objective, while the Regulatory Dia-

³ Association Implementation Report on Ukraine, SWD (2016) 446 final, Brussels, 9 December 2016.

Progress made in Ukraine's homework implementation does allow for concluding the ACAA. However, the EU has not given any signals about actual prospects for it

log on technical barriers to trade that had been launched was designated the appropriate technical cooperation forum for carrying out a detailed assessment of Ukraine's system for the compliance of legislation, enforcement and institutional capacity with EU rules and standards. Only a positive assessment will lead to the start of negotiations on the ACAA.⁴ In a further report on the implementation of the Association Agreement (2017), the ACAA was mentioned as an issue of the future, without specifying how distant.⁵ In yet another report on the implementation of the DCFTA for 2017, published in autumn 2018, the ACAA was not mentioned at all.⁶ In a third report on the implementation of the Association Agreement (2018), the ACAA was mentioned, once again, only as an issue of the future, without specifying how distant.⁷

Nor is the EU position clear as to how the ACAA might be concluded. Will a separate EU evaluation mission be necessary to assess the "homework" done, as the Ukrainian government has requested? Or can this assessment be done by EU experts already involved in the EU-Ukraine industrial and regulatory dialog? Such uncertainty on the part of the EU offers little assurance that the ACAA will be signed in the foreseeable future, despite Ukraine's progress in doing it "homework." Nor does it increase confidence in the irreversibility of reforms or stimulate the further development of quality infrastructure and market surveillance.

Meanwhile, another issue has arisen: in anticipation of a quick conclusion of the ACAA, Ukraine has implemented the requirements of EU directives and regulations immediately rather than gradually, which has already led to problems in some sectors. For instance, certain conformity assessment procedures and marking requirements have proved too strict or burdensome, especially for importers. This, in turn, could lead to higher prices for consumers, a smaller range of products on the market, and even the emergence of monopolist importers. Consequently, there has been pressure to simplify procedures or soften requirements. This runs contrary to Ukraine's obligations under the Association Agreement, but is an inevitable outcome in the absence of at least approximate timeframes for how long the wait for the ACAA will be.

In the absence of perspective for a quick conclusion of the ACAA, the harmonised procedures and requirements proved too burdensome, especially for importers

⁴ "Having in mind that due to the relevant reforms, the ACAA is a long-term objective, both Parties have launched in July 2016 the TBT Regulatory Dialogue (as provided by Article 55 of AA) as the appropriate technical cooperation forum for carrying out the detailed assessment of the Ukrainian system in order to verify its compliance (in terms of legislation, its enforcement, and institutional capacity) with the EU rules and standards. Only positive results of that assessment will allow for a start of negotiations on the ACAA." Annual report on the implementation of the Deep and Comprehensive Free Trade Area (DCFTA) between the EU and Ukraine, 1 January 2016 - 31 December, 2016, SWD (2017) 364 final, Brussels, 9 November 2017.

⁵ Association Implementation Report on Ukraine, SWD (2017) 376 final, Brussels, 14 November 2017.

⁶ Annual report on the implementation of the Deep and Comprehensive Free Trade area (DCFTA) between the EU and Ukraine, 1 January 2017 - 31 December 2017, SWD (2018) 454 final, Brussels, 31 October 2018.

⁷ Association Implementation Report on Ukraine, SWD (2018) 462 final, Brussels, 7 November 2018.

RECOMMENDATIONS

For Ukraine

- Adopt Draft Laws #6235 and #7123 as well as Draft Law on amending the market surveillance law, which formal registration in the Parliament is still pending;
- Concentrate the functions of legal concurrence of draft regulations, including technical ones, aimed at implementing the Association Agreement and preparing for the ACAA in a single institution, staffed with specialised personnel with the proper knowledge of the EU legislation and languages;
- Make the process of accreditation, the supervision of accredited conformity assessment bodies, and the process of designating and monitoring conformity assessment bodies stricter, in order to ensure the proper level of technical competence and to prevent fraudulent and unfair practices;
- Particularly focus on building capacity of market surveillance authorities;
- Raise awareness among economic operators and strengthen the role of business associations in the raising of their awareness.

For the EU

- Clarify the process and prospects for concluding the ACAA with Ukraine;
- If the EU is politically ready to move forward with the ACAA, make an official assessment of Ukraine's homework implementation;
- If the prospect of concluding the ACAA is indeed distant, define the stages of this process and agree to temporarily simplifying procedures and requirements that may be too strict or burdensome for economic operators;
- Provide Ukraine with effective technical assistance in drafting legislation and ensuring the proper functioning of quality infrastructure and market surveillance authorities.

STREAMLINING EU-UKRAINE CUSTOMS PROCEDURES

Andrii Butin

THE BENEFITS OF THE ASSOCIATION AGREEMENT

Implementing the customs-related provisions of the Association Agreement between Ukraine and the European Union (AA) will play a major role in integrating Ukraine economically into the EU's internal market. The result should be considerable streamlining of customs procedures, reduced costs for companies engaged in international trade, and a gradual increase in trade turnover between Ukraine and the EU.

According to the Agreement, the EU offers Ukraine recognition of authorised economic operators (AEOs) and joining the common transit system (NCTS) that would considerably streamline customs procedures

Among others, the AA provides for:

- establishing the institution of "authorised economic operators" in Ukraine (AEOs) and their recognition by the EU (Art. 76,1 (k) and Art. 80 (i) AA);
- establishing the single administrative document (SAD) in Ukraine and its recognition by the EU, and Ukraine's joining the EU's common transit system NCTS (Art. 76, 1 (c), Art. 76, 4 (b) and Annex XV to the AA).

Establishing the AEO will help reduce the number of customs procedures and the time for going through customs clearance for reliable companies, which will increase the competitiveness of Ukrainian businesses on foreign markets. One of the key advantages will be the recognition by both Ukraine and the EU of companies that have the status of AEOs. For the private sector, this means, first of all, savings in time, money and organisational resources, the transparency and predictability of procedures, and better potential business opportunities.

Establishing the SAD means instituting customs declarations in line with EU declarations and can be used for any import or export clearance procedure as well as for the procedure of the common tran-

sit for trade in goods between Ukraine and all other signatories of the **Convention on the Common Transit System**¹ and the **Convention on the simplification of formalities in trade in goods**² regardless of the type and source of such goods.

Ukraine's participation in the EU common transit system (NCTS) will bring a series of advantages, principal among which will be a significant acceleration and reduction in the cost of the movement of goods for all participants—exporters, transporters and importers, — and the removal of the requirement to declare export goods at the EU border: for exports, this will be done in Ukraine.

UKRAINE'S HOMEWORK

AA provisions on customs cooperation in Annex XV commit Ukraine to:

- introduce best practice from EU customs legislation to Ukrainian law, including the EU Customs Code, and establish the prerequisites for mutual recognition of AEOs within three years of the AA coming into effect;
- implement the provisions of the Conventions within a year of the AA coming into effect.

AEO status, which is granted to enterprises, offers a specific list of benefits and procedural shortcuts when going through customs clearance. This is the highest level of trust on the part of Customs towards a company. To gain this status, a company needs to meet specific criteria.

Nominally, AEO status was introduced in the Customs Code of Ukraine in 2012. But it doesn't work under the current rules and is significantly out of sync with international practice. Specifically, the criteria for gaining AEO status and the streamlining that comes with the relevant certificate do not match the actual types of certificates; AEO certificates cannot be issued to some businesses, such as brokers, expeditors and freighters; there are no provisions for monitoring AEO activities either, and more. In short, in order for Ukraine to establish the institute of AEOs, it needs to adopt legislation to amend the current Customs Code.

For Ukraine to join the EU common transit system and institute the SAD, legislation needs to be passed to establish different types of customs declarations that match those used in the EU for common transit procedures. The necessary information and telecommunication system needs to also be developed and launched, based on European technology.

¹ <https://eur-lex.europa.eu/eli/convention/1987/415/2017-12-05>

² <https://eur-lex.europa.eu/eli/convention/1987/267/oj>

CURRENT PUBLIC POLICY

There is no unified customs policy in Ukraine today, both in terms of a comprehensive vision of the role and position of the Customs Service within the system of government agencies, and in terms of a systematic view of the top priority steps that are needed to simplify procedures in Ukraine.

There is no unified customs policy in Ukraine today, largely as a result of not having the Customs Service as a separate government agency

Provisions in the AA and WTO treaty on simplifying trade procedures³ list fairly clear steps that are needed to improve customs procedures. Unfortunately, Ukraine's Government and legislature tend to operate in a chaotic and unsystematic fashion. The number of legal documents that are not aligned with each other is considerable and negatively affects how these norms are perceived and understood by those who are supposed to apply them. Draft amendments to current regulatory and normative acts are often not harmonised with each other or duplicate each other. This artificially causes delays in the making of important and much-needed decisions.

draft amendments to current regulatory and normative acts are often not harmonised with each other or duplicate each other. This artificially causes delays in the making of important and much-needed decisions.

Much of this is the result of, in effect, not having a government agency that is responsible for implementing customs policy. Right now, the Finance Ministry is responsible for coming up with customs policy, while implementation is delegated to the State Fiscal Service. The one good thing is that the regulatory and executive functions are separated. But because the SFS combines both the tax and customs components, customs issues have been diluted into fiscal ones. A significant part of the functions of Customs is simply not being carried out, and effectively there is no one to carry out customs-related tasks. This has been going on since 2013, when the Ministry of Revenues and Fees was established on the basis of the State Tax Service and the State Customs Service, and was then reorganised into the State Fiscal Service in 2014.

STAKEHOLDER ANALYSIS

Overall, the streamlining of customs procedures will have a positive impact on everyone involved in foreign trade, as bringing down the costs of the process has a knock-on effect on the entire delivery cycle, starting with the seller and ending with the buyer. According to the Ministry of Economic Development and Trade, more than 14,000 companies exported goods to EU markets in 2017.⁴ Comparatively more benefits should materialise from the general simplifications and reduction of costs of moving goods across the border, including thanks to the institution of the SAD and joining the EU Common Transit System, for small businesses, as their costs are much higher relative to volumes.

SMEs will benefit more from joining the NCTS, and in time will be also able to take advantage of AEO status

³ Ukraine joined the treaty in 2015. http://zakon.rada.gov.ua/laws/show/981_053

⁴ <https://ukr.segodnya.ua/economics/enews/ukraina-serezno-rasshirila-assortiment-svoih-tovarov-v-es-1117702.html>

From the institution of AEOs, however, more benefits will be felt by relatively larger, older companies who can meet the criteria for being granted AEO status and gain the advantages that this status brings. In time, of course, SMEs will also be able to take advantage of AEO status once they have a track record of regular, uniform trade operations.

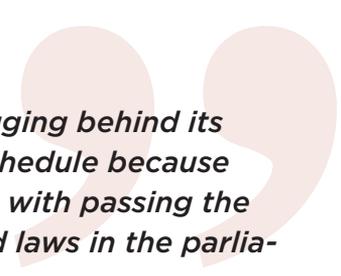
IMPLEMENTATION DYNAMICS

In order to establish AEOs, in 2016, the Government submitted Draft Law #4777⁵ to the Verkhovna Rada. It was prepared with the participation of profile NGOs and experts, and was presented at a broad range of public hearings for public debate. Meanwhile, the Rada soundly criticised it and in March 2018 returned the draft to the authors for further work. Most likely, it was returned because there was controversy around the criteria for granting AEO status that was aggravated by specific players who have been lobbying the interests of those who will potentially be receiving this status.

For Ukraine to join the EU Common Transit System, the Cabinet of Ministers submitted Draft Law #5627⁶ to the Verkhovna Rada back at the end of December 2016. After languishing 18 months in the legislature, it failed to get the necessary votes to pass in May 2018, for inexplicable reasons.

Even before Draft Law #4777 was officially returned and Draft Law #5627 voted down, a new Government draft, #7473, was registered in the Rada in December 2017, to amend the Customs Code.⁷ This Draft Law was intended to both establish the institute of authorised economic operator (AEO) and streamline transit procedures in Ukraine. In effect, it replaced the two ill-fated earlier drafts. Draft Law #7473 is now waiting to be considered in the Verkhovna Rada.

Relative to the previous two draft laws, the content of most of the rules in Draft Law #7473 had changed little. The most visible change is the new terminology introduced for AEO: the Slavic term for “authorised” has been replaced by a Latinised one. This doesn’t change the essence at all. The transitional provisions of the new draft law do shorten the maximum number of AEO certificates that may be issued in the first three years after the law comes into effect — a restriction that was absent in the previous draft. The new draft also proposes that, for these same first three years, applications for a certificate “to streamline customs procedures” only be considered from companies that both manufacture and export/import the goods involved — a restriction that was also absent in the previous draft law. In addition to this, compared to the previous draft, the number of special short-cuts for bearers of certificates on reliability and security was reduced.



Ukraine is lagging behind its homework schedule because of difficulties with passing the much-needed laws in the parliament

⁵ Draft Law #4777 “On amending the Customs Code of Ukraine regarding authorised economic operators and streamlining customs formalities,” dated June 3, 2016. http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=59320

⁶ http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=60887

⁷ Draft Law #7473 “On amending the Customs Code of Ukraine (regarding several issues of execution in Sec. IV, Ch. 5 of the Association Agreement between Ukraine, on the one side, and the European Union, the European Atomic Energy Community and their member countries, on the other side)” dated 29 December 2017. <http://w1.c1.rada.gov.ua/pls/zweb2/webproc4>:

Given the difficulty with passing the much-needed laws, individual changes to establish SADs in Ukraine were added to a completely different draft law, intended to improve the functioning of the “single-window” mechanism at Customs. The Rada adopted this law on 6 September 2018.⁸ These changes⁹ make it possible for Ukraine to use customs declarations that are in line with the Convention on the common transit system before the Convention itself comes into effect for Ukraine. At the same time, the practical implementation of the necessary information and telecommunication system and the actual use of these kinds of customs declarations remain up in the air.

In short, over the last three years, there has been little to no progress with implementing provisions regarding AEOs, the single administrative document, or joining Ukraine to the Common Transit System. Much of this stalling is because of the lack of a common vision in the Cabinet and the Rada, of what the role and position of a customs service within the system of state agencies should be. The AA itself does not require an independent customs agency in Ukraine, while EU practice varies. This is an example how an institutional issue that is not covered by the AA directly affects how quickly the implementation of its provisions on regulatory harmonisation takes place.

This stalling was caused largely by the lack of the customs service as a separate agency. The issue is not covered by the AA but directly affects its implementation

Finally, in December 2018, the government decided to create a separate State Customs Service. Now the main question is to provide efficient institutional mechanisms for government and civic control over the activities of the new agency.

On 18 December 2018, the Cabinet of Ministers of Ukraine adopted a decision on the reorganisation of the State Fiscal Service of Ukraine and the creation of the State Tax Service and the State Customs Service.¹⁰ These services are formed as separate central executive agencies, whose activities will be directed and coordinated by the Cabinet of Ministers through the Minister of Finance of Ukraine. The competitive selection of directors of these services is to be held within three months after the adoption of this resolution. The Government also decided to establish an inter-agency working group on reforming the system of bodies implementing the state tax and customs policy.

⁸ Law of Ukraine #2530 "On amending the Customs Code of Ukraine and other legislation to institute the mechanism of a "one-stop shop" and streamlining control procedures while moving goods across the customs border of Ukraine, dated 6 September 2018. <http://zakon.rada.gov.ua/laws/show/2530-19>

⁹ New Point 73 of the concluding and transitional provisions of the Customs Code of Ukraine, introduced by Point 40 of Law №2530.

¹⁰ Resolution of the Cabinet of Ministers of Ukraine dated 18.12.2018 No. 1200 'On the Establishment of the State Tax Service of Ukraine and the State Customs Service of Ukraine' <https://www.kmu.gov.ua/ua/npas/pro-utvorennya-derzhavnogo-podatkovoyi-sluzhbi-ukrayini-ta-derzhavnogo-mitnoyi-sluzhbi-ukrayini>

RECOMMENDATIONS

For Ukraine

1. Amend the Customs Code to establish the institute of authorised economic operators (AEOs) and streamline transit procedures in Ukraine by passing Draft Law #7473, which is currently under consideration in the Verkhovna Rada.

2. Systematise efforts aimed at implementing the customs-related provisions of the Association Agreement and simplifying trade procedures. Such efforts, moreover, should be joined with civil society institutions such as business associations that can really assist in making changes happen.

3. Provide for systemic mechanisms for government and public oversight over the activities of the new agency - State Customs Service.

For the EU

1. Activate the provision of technical, organisational and methodological support in reforming customs service and customs procedures in Ukraine.

2. Provide political impulse of readiness for connecting Ukraine into the EU's Common Transit System and recognizing AEOs once Ukraine's procedures match EU rules and regulations.

INTEGRATING UKRAINE INTO THE EU'S DIGITAL SINGLE MARKET

Volodymyr Nochvai, Lilia Oleksiuk, Oksana Prykhodko

DIGITAL SINGLE MARKET AND THE ASSOCIATION AGREEMENT

Given that the digital revolution is evolving at much faster pace than the industrial revolution once did, digitalizing the economy will determine a country's competitive positions for the upcoming years. Understanding this, the EU began to carry out its Digital Single Market (DSM) Strategy in 2015.¹

In a Joint Statement at the Eastern Partnership Summit in November 2017, the participants agreed to cooperate in harmonizing digital markets to extend the benefits of the EU DSM to the partner countries.² The related deliverable, #7, was listed among the 20 deliverables of the EaP by 2020.³

The structure of the Association Agreement covers the subject of a digital market in a number of places:

- Title IV, Chapter 6, Section 5, Sub-section 3: liberalizing commerce in computer services;
- Title IV, Chapter 6, Section 5, Sub-section 5 and Annex XVII: integrating Ukraine into the EU's internal market of telecommunications services;
- Title IV, Chapter 6, Section 6: cooperation in developing e-commerce;
- Title V, Chapter 14: cooperation in the information society and access to information and communication technologies (ICT);
- Title V, Chapter 15 and Annex XXXVII: approximating policy in the audio-visual sector.

In the telecommunications services sector, the AA offers the prospect of a mutual internal market treatment. According to Art. 4 (3) of Annex XVII of the Agreement, this kind of treatment means that there should be no restrictions on the freedom of a Ukrainian legal entity to provide services on the territory of the EU and vice-versa. This will be possible provided that the EU evaluates Ukraine's fulfilment of its "homework" with regard to approximating Ukrainian legislation and regulations to EU law.

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0192>

² <https://www.consilium.europa.eu/media/31758/final-statement-st14821en17.pdf>

³ https://cdn3-eeas.fpfis.tech.ec.europa.eu/cdn/farfuture/dLJ9RdBalFgQqx34IgPlwagsNlUjB6cjzDeeiRR0RdQ/mtime:1497363650/sites/eeas/files/swd_2017_300_f1_joint_staff_working_paper_en_v5_p1_940530.pdf

Integrating Ukraine into the DSM is in line with AA provisions and EaP priorities. The AA also offers prospects for an internal market treatment in the telecoms services sector

In this way, Ukraine's integration into the EU's DSM is a logical objective that flows out of AA provisions and EaP priorities. For Ukraine, the DSM will effectively mean access to the online markets and e-services of EU countries, simplified legal and administrative barriers, enjoying common rules for free cross-border dissemination of online services and content, online payments, simplified procedures for digital contracts, licensing, taxation and

copyright registration. As a consequence of integrating into the DSM, investments should grow, together with commerce and employment.

UKRAINE'S DIGITAL MARKET

In 2016, Ukraine's telecommunications market was assessed at nearly UAH 57 billion or a little less € 2 billion, meaning less than 1% of the EU market, which was worth €220bn that same year. The most important market players in telecom are the operators of mobile, satellite and cable networks, and internet service providers. In Ukraine, the biggest of these segments in terms of revenues is the mobile telecoms market.

In 2016, the volume of e-commerce in Ukraine reached \$ 5.65 billion or about 1% of e-commerce in the EU that same year — € 530 billion. On the other hand, Ukraine was in first place among all European countries for growth of e-commerce, which was 30-35% in 2016, and hit 44% in the first half of 2017, compared to 15% growth in EU e-commerce for 2016.⁴ According to various sources, about 25-33% of Ukrainians regularly buy online and pay for their orders with bank cards directly on the site. Both international and Ukrainian e-platforms such as eBay, Taobao, Amazon, Rozetka etc. have grown in popularity. This has also raised a slew of problematic issues that need to be legislated properly, especially when it comes to consumer protection and personal data security in the face of illegal use for the purposes of advertising, and marketing and selling data.

Today, Ukraine's IT sector produces more than 3% of GDP. The industry's total income for 2017 was US \$3.6bn, which places it in third place after agriculture and metallurgy for export volumes.⁵ The domestic IT sector is largely oriented towards export markets: 80-90% of IT services are provided to foreign markets. The sector's main customers for computer and information services are traditionally in the US and the EU.⁶

IT sector products currently form more than 3% of Ukraine's GDP. In terms of exports and incomes, the IT sector is now in third place, behind agriculture and metallurgy

⁴ https://www.civic-synergy.org.ua/wp-content/uploads/2018/04/web_E-commerce__civic_synergy_ua_2018.pdf

⁵ <https://www.kmu.gov.ua/ua/news/sekto-it-mozhe-stati-dodatkovim-lokomotivom-ekonomichnogo-zrostantnya-glava-uryadu>, <https://economics.unian.ua/finance/2349038-eksport-it-poslug-z-ukrajini-za-rik-zris-do-36-milyarda-infografika.html>

⁶ <https://eba.com.ua/industriya-narostyla-eksport-poslug-na-17-5/>

UKRAINE'S HOMEWORK

In signing the AA, Ukraine committed itself to gradually bringing its existing and future legislation governing the telecommunications sector in line with the EU acquis, commitments that are spelled out in Annex XVII. However, since the AA was concluded, the EU has begun to radically revise its legislation in this sphere as part of setting up the DSM. Thus, the DSM Strategy for Europe requires:⁷

- Removing barriers to cross-border trade in goods and services through the internet by simplifying contractual obligations, e-commerce, reforming copyright rules, avoiding unwarranted geoblocking, protecting consumer rights, unifying taxation, reviewing the rules for providing cable and satellite communications and courier services;
- Harmonizing with the regulations governing digital networks and services in EU countries by revising legislation governing the dissemination of content, telecommunications, audio-visual services, the protection of personal data, the development of public-private partnerships in cyber security, ensuring that information and communication technologies are broadly accessible;
- Taking maximum advantage of potential growth in the EU digital economy by investing in infrastructure and technologies such as cloud computing and big data, and in research and innovations aimed at increasing industrial competitiveness, improving public services, and developing digital skills among ordinary citizens.

Substantive changes to EU legislation mean that AA provisions defining Ukraine's DSM 'homework' need to be updated

As of September 2018, the European Commission had presented 30 legislative propositions related to DSM as part of the implementation of the Strategy, 19 of which were passed by the Council of the EU and the European Parliament.⁸ Taking into account such considerable changes since the conclusion of the AA with Ukraine, now Annexes XVII and XXXVII⁹ both need to be updated to identify the exact extent of Ukraine's 'homework'.

Common tasks for Ukraine and the EU include achieving 20 EaP deliverables till 2020. The EaP deliverable #7 targets on harmonisation of digital markets somewhat duplicate, supplement, elaborate on or are additional to the AA provisions. Most of the defined targets relate to Title V Chapter 14 (Information society), and also to some other AA articles regarding telecommunications services, database protection, cross-border digital communications services, and regulations governing e-commerce.¹⁰

⁷ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0192>

⁸ <https://ec.europa.eu/digital-single-market/en/news/creating-digital-single-market-european-commission-actions-2015>

⁹ Annex XXXVII deals with approximating Ukraine's legislation to that of the EU in audiovisual matters and envisages the introduction of provisions from the Audiovisual Media Services Directive #2010/13/EU. However, while Ukraine was still debating the need to amend the law on radio and television broadcasting (<https://detector.media/rinok/article/132891/2017-12-14-syumar-zarestruvava-zakonoproekt-pro-audiovizualni-poslugi>), the EU passed a revised Audiovisual Media Services Directive, #2018/1808 (<https://ec.europa.eu/digital-single-market/en/revision-audiovisual-media-services-directive-avmsd>, <https://eur-lex.europa.eu/eli/dir/2018/1808/oj>). This new directive reflects changes in the market itself, where the consumers more and more choose content for themselves and get it online rather than through radio or television broadcasts.

¹⁰ https://www.civic-synergy.org.ua/wp-content/uploads/2018/04/Web_ua_AAEap-deliverables_civic_synergy_ua_2018.pdf pp 6, 13-14.

CURRENT PUBLIC POLICY

Ukraine still lacks a separate central executive body to deal with the development of a digital economy and society. The Ministry of Economic Development and Trade (MEDT) set up a Department of e-Economy in 2015, but it was shut down in 2016. Public policy for the development of information society is partly handled by the State Agency for E-Governance of Ukraine.

Ukraine does not have a separate agency dealing with the digital economy and society

The national regulator for electronic communications in Ukraine is the National Commission for the State Regulation of Communications and Informatisation (NCCIR). The State Service of Special Communication and Information Protection regulates special communications and the protection of state information and telecommunications systems and resources.

The national regulator is not an independent agency and cannot carry out its proper functions

There is no clear and understood division of powers in state administration and regulation of electronic communications, while NCCIR lacks the authority to function properly as an independent regulator in line with EU standards. A poll of stakeholders¹¹ showed that they see a need to reinforce the independence and administrative capacity of the national communications regulator. De jure, NCCIR is not an independent agency as it is subordinated to the President of Ukraine and de facto it does not function as a regulator.

On 17 January 2018, the Cabinet approved the Concept of the development of the digital economy and society of Ukraine for 2018-2020¹² and confirmed an Action Plan for implementing it. Prior to concluding this document, the MEDT spent considerable efforts drafting the foundation document - 'The Digital Agenda for Ukraine - 2020'¹³, - together with leading IT experts and civil society, which was coordinated by the Hi-Tech Office Ukraine.¹⁴ The Concept establishes the key policies, priority areas, initiatives and projects for the digitalisation of Ukraine till 2020.

In the autumn of 2018, the Government drafted a Strategy of Ukraine's Integration into the EU's Digital Single Market (Roadmap), and an action plan for implementing it over 2018-2023 that took into account new EU legislation. At the moment the draft Strategy is being agreed with stakeholders and the EU.

¹¹ https://www.civic-synergy.org.ua/wp-content/uploads/2018/04/Report_USPGS_2017_ukr_final.pdf pp 39-47.

¹² <https://www.kmu.gov.ua/ua/news/uryad-shvaliv-konceptiyu-rozvitku-cifrovoyi-ekonomiki-ta-suspilstva-ukrayini-na-2018-2020>

¹³ <https://goo.gl/BUui46>

¹⁴ Hi Tech Office Ukraine is an association of enterprises involved in high technology (<http://www.ht-office.org>) whose purpose is to help establish positive conditions for innovative business and the digital economy to develop in Ukraine. The National Council of Hi Tech Office Ukraine includes representatives from the Ministry of Economic Development and Trade, the Verkhovna Rada and the Presidential Administration, which ensures effective interactions between the private and public sectors.

IMPLEMENTATION DYNAMICS

In the last few years, Ukraine managed to take a series of steps to approximate legislation and regulation. For instance, in 2015, a law on e-commerce was adopted that nevertheless did not regulate a slew of issues regarding harmonisation with EU legal norms.¹⁵ In November 2018, the law on electronic trust services came into effect, which updated legislation governing electronic identification such as digital signatures in line with the eIDAS Regulation.

In recent years, Ukraine took steps to approximate its legislation and regulations, but it is not keeping up with the pace of updates to EU legislation

At the same time, Ukraine still lacks a strategy to ensure access to high-speed internet (broadband access). New legislation on electronic communications and radio spectrum has still not been passed. The draft laws on electronic communications that are currently registered in the Rada do not meet EU norms¹⁶ and new EU Electronic Communications Code.¹⁷

In early 2016, a Cyber Security Strategy was approved and in May 2018 the law on the basic principles of ensuring the cyber security of Ukraine came into effect. A legislative proposal on critical information infrastructure is in the process of being drafted. However, both the legislation and the Cyber Security Strategy action plan need to be amended to meet the requirements of NIS Directive on network and information system security¹⁸ and the new Cybersecurity Act currently being approved in the EU that, in particular, will introduce the new approach to cyber security certification.¹⁹

Meanwhile, Ukraine has not completely ratified the Council of Europe's Convention on Cybercrime, having not yet agreed to apply the section of the Convention on digital evidence.²⁰ Because of this, law enforcement agencies often seize computers as material evidence (e.g. in investigations of piracy), claiming that existing legislation does not provide for the use of copies. This worsens conditions for IT business. In spring 2017, the law on government support for cinematography was adopted, instituting new mechanisms for protecting copyright and other rights on the internet. However, this did not resolve the problem with the dissemination of illegal content on pirate sites that are generally not hosted in Ukraine.

In 2018, the Government's action plan for implementing the Concept of the development of the digital economy and society was not backed by public financial and organisational resources. Coordinating and organising the fulfilment of the action plan is the job of the Coordination Council for development of the digital economy and society,²¹ chaired by the First Deputy Prime Minister - Minister of Economic Development and Trade. The

The Government approved a Concept of the Development of the Digital Economy and Society that was drafted with input from the IT industry and the civil society, but failed to fund its implementation in 2018

¹⁵ For more on the problems with public policy in e-commerce in Ukraine, see: https://www.civic-synergy.org.ua/wp-content/uploads/2018/04/web_E-commerce_civic_synergy_ua_2018.pdf

¹⁶ http://osf.org.ua/data/blog_dwnl/BE_brief5_UKR.pdf

¹⁷ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3A0J.L_2018.321.01.0036.01.ENG

¹⁸ <https://ec.europa.eu/digital-single-market/en/network-and-information-security-nis-directive>

¹⁹ http://europa.eu/rapid/press-release_IP-18-6759_en.htm

²⁰ <http://zakon.rada.gov.ua/laws/show/2824-15>, <https://inau.ua/news/inau-proponuye-implementuvaty-yevropeysku-konvenciyu-pro-kiberzlochynnist-na-osnovi-napracyuvan>

²¹ <https://www.kmu.gov.ua/ua/news/v-ukrayini-rozpochala-robotu-koordinacijna-rada-z-rozvitku-cifrovoyi-ekonomiki>

functions of the secretariat and coordination of activities of the working groups are carried out by Hi Tech Office Ukraine.²²

RECOMMENDATIONS

For Ukraine

- Set up either a separate central executive body or a department within the Ministry of Economic Development and Trade in charge of the development of the digital economy and society;
- Include expenditures in the State Budget to carry out the action plan of the Concept for developing a digital economy and society in Ukraine for 2018-2020 and have the Government decide to launch a Digital Transformation Fund;
- Draft and adopt a law on the digital economy and society that reflects the provisions of EU law, EaP objectives, and national data security priorities;
- Draft a coherent strategy for fostering broadband access to the internet;
- Draft and adopt a law on electronic communications that reflects the new EU Electronic Communications Code;
- Reinforce the independence and regulatory capacities of the national communications regulator;
- Ratify the Council of Europe's Convention on Cybercrime in its entirety. Amend domestic legislation and the cyber security strategy action plan in line with the NIS Directive and other new EU legislation;
- Amend the Law "On e-commerce" to harmonise it with EU legislation.

For the EU

- Provide political, technical and expert support for Ukraine to integrate into the Digital Single Market;
- Provide funding for priority projects implementing the Concept of the development of the digital economy and society in Ukraine.

²² <https://goo.gl/oTE6EH>

INTEGRATING UKRAINE INTO THE EU FINANCIAL SERVICES MARKET

Vitaliy Kravchuk

THE BENEFITS OF THE ASSOCIATION AGREEMENT

Annex XVII of the Association Agreement envisages a possibility of full internal market treatment for trade in financial services. This means offering equal conditions for the operation of Ukrainian companies and companies from EU member states on the EU and Ukrainian market, and complete freedom for Ukrainian companies to provide services on the EU market and for EU companies to provide them on the Ukrainian market. For financial institutions, this should mean expanding the “passport” regime, which allows banks, insurance companies and other financial services providers governed by a regulator in one of the EU countries to operate in all EU countries, to include Ukraine. In other words, Ukrainian companies would be able to work in all EU countries and EU companies in Ukraine.

The Agreement contains the perspective for full internal market treatment for trade in financial services, but the changes in EU regulations have made this prospect uncertain.

Annex XVII anticipates internal market treatment to be granted after the EU had carried out a comprehensive assessment of regulation in the sector in Ukraine and concluded that the prerequisites established by the AA have been met.

Annex XVII anticipates internal market treatment to be granted after the EU had carried out a comprehensive assessment of regulation in the sector in Ukraine and concluded that the prerequisites established by the AA have been met.

Before internal market treatment is granted, the rules for trading in services between Ukraine and the EU do not significantly differ from the rules governing trade with third countries: trade is free with certain exceptions that are provided for in Annex XVI. These exceptions are not very different from similar exceptions written into the GATT under the WTO.

However, the European Commission’s report on the implementation of the DCFTA with Ukraine for 2016¹ notes that Ukraine will not be able to completely institute EU legislation in financial services. The reason why is that the EU itself is gradually moving towards more centralised supervision of banks and other providers of financial services. Newly established EU-level financial services regulators such as the European Banking Authority have no legal authority to operate outside the EU. So, a major shift in the approach to regulating financial services within the EU has made the prospects for granting internal market treatment to Ukraine written into the AA uncertain.

¹ p. 44. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017SC0364>

UKRAINE'S HOMEWORK

In order to get internal market treatment, Ukraine's legislation needs to be approximated to EU legislation governing financial services and ensure the necessary level of capacity for oversight bodies and mechanisms to work. The list of EU financial services legal acts that Ukraine has committed to instituting in its own legislation is specified in Annex XVII-2 of the AA. The commitment is considerable: Ukraine must institute the basic EU legislation that regulates the operation of banks, insurance companies and capital markets operators; the circulation of securities, current payment settlements, prevention of money-laundering, and the free movement of capital.

Though the content of Ukraine's obligations under the AA has not been updated, Ukrainian implementation plans do include approximation to the new EU legislative acts

As a result of reforms to the regulation of financial services in the EU, a considerable portion of EU legislation mentioned in the AA has been dropped and replaced by new legislation that in many cases increases the regulatory burden on market players. In this situation, Art. 3 of Annex XVII provides for consultations between the EU and Ukraine about how to update this annex. So far, the text of Annex XVII remains unchanged, but Ukraine has already added new EU legislative acts to its AA implementation action plan, at least the ones that replace eliminated legislation.

Both Ukraine and the EU are implementing recommendations from the Basel Committee on Banking Supervision.² So far both have introduced the principles of banking supervision and basic capital requirements for banks known as Basel I. However, the EU has already instituted the latest standards for banking regulation, known as Basel III, which were adopted in response to the global financial crisis of 2007-2009, whereas Ukraine is still just in the process of instituting them.

The operation of insurance companies in Ukraine is regulated by the Law on insurance adopted in 2001. At that time, the regulation of the insurance sector in Ukraine was not significantly different from EU rules. However, since 2016, insurance companies in the EU have been working according to new rules, established in Directive 2009/138/EU known as Solvency II. Among others, the list of permissible assets for investment was dropped, new capital requirements were introduced, along with new requirements for the way insurance companies manage risks, and transparency in the supervision of insurance companies was increased. These changes have not yet been reflected in Ukrainian legislation.

EU legislation governing capital markets corresponds to the more developed capital markets in member-states economies, compared to Ukraine, and has also been substantially updated in recent years. The MiFID II Directive and MiFIR Regulation contained the most substantial changes regarding financial instruments markets. They increased the requirements for the protection of retail customers, expanded transparency requirements among market participants, in particular the disclosure of OTC transactions, and updated requirements for regulated markets.

² Includes the central banks and bank regulators of 28 (mostly developed) countries and territories. For more information, see: <https://www.bis.org/bcbs/index.htm?m=3%7C14>

CURRENT PUBLIC POLICY

The Programme for Developing the Financial Sector till 2020 envisages implementation of all Ukraine's commitments in the sphere of financial services

In 2015, the National Bank of Ukraine (NBU), the National Financial Services Commission (NFSC),³ and the National Commission for Securities and Stock Markets (NCSSM) jointly approved the Comprehensive Programme for Developing the Financial Sector till 2020. The programme establishes the priorities for reform of financial services and, among others, provides measures for implementing all of Ukraine's commitments in this sphere under the Association Agreement. In early 2017 and in May 2018, the programme was revised⁴. During this process, new EU legislation to replace the laws that were dropped

was added to the programme, and the timeframes for instituting various EU norms were extended to more realistic ones. The NBU's strategic documents, such as the Concept for Improving Capital Requirements⁵ and the draft New Currency Regulation,⁶ also provide for the implementation of commitments under the AA.

The regulators have already introduced some of the programme's measures, although most of the EU legislation requires changes not only to regulatory acts but also in basic related laws. The distribution of functions between regulators and the related spheres of responsibilities for implementing the AA remains undefined. Back in 2015, plans were announced, including in the programme, to shut down the NFSC and divide its functions between the NBU and the NCSSM, but the related Draft Law #2413a has languished in the Verkhovna Rada ever since it passed first reading in 2016. In autumn 2018, the draft law was added to the Rada agenda and the text was prepared for second reading.

MARKET ANALYSIS

The role of the financial sector in Ukraine's economy declined during the 2014-2015 crisis when half the country's banks were shut down and the number of financial institutions sharply cut. As a result, the gross value added (GVA) share of financial services shrank from 5.2% in 2013 to 3.2% in 2017, when the GVA of financial services was worth UAH 81 billion or around € 2.29 billion. This is comparable to the financial services GVA of the three Baltic countries (€2.5 billion) or Cyprus (€1.9 billion). Budget revenues from banks, insurance companies and other financial institutions are relatively small. Financial services generally are not subject to VAT, while revenues from profits are limited by losses that accumulated during the crisis.

Banks and insurance companies are Ukraine's biggest components of the financial sector. In 2016, commercial banks and the NBU formed 61% of the sector's added value, insurers formed 28%, and other capital market participants only 10%.⁷

At the moment, state-owned banks—Privatbank, OshchadBank, UkrExImBank and Ukrgazbank—dominate

At the moment, state-owned banks dominate Ukraine's banking sector. Among privately-owned banks, the EU banks prevail

³ Full name: National Commission Regulating Financial Services Markets.

⁴ <https://bank.gov.ua/doccatalog/document?id=43401314>

⁵ <https://bank.gov.ua/doccatalog/document?id=62251340>

⁶ <https://bank.gov.ua/doccatalog/document?id=77863567>

⁷ Rounding results in a total of 99%.

Ukraine's banking sector, constituting more than 50% of market value. Among privately-owned banks, the larger share is foreign owned and most of the owners are EU banks. Only one privately owned Ukrainian bank is among the Top 10 largest banks by asset value—and it's in 8th place.

Privatbank was the largest privately owned bank in Ukraine until the end of 2016, owned by Ihor Kolomoyskiy and Ghennadiy Boholiubov.⁸ According to the NBU, Privatbank was using the money it took from depositors mainly to issue credits to related parties that were part of Kolomoyskiy's Privat Group. These loans were often issued against over-valued, illiquid or even completely non-existent collateral.

When negotiations of NBU and Ministry of Finance with Privatbank's owners about restoring the bank to financial health reached a dead end, the owners appealed to the government to nationalise the bank.⁹ The Personal Deposit Guarantee Fund declared Privatbank insolvent on 18 December 2016, and sold the bank to the state on 21 December for a single hryvnia.¹⁰ The former owners promised to restructure the loans the bank had issued by 1 July 2017, but never did.¹¹ In order to protect the interests of Privatbank's 20 million depositors and maintain overall financial stability, over 2016-2017 the government spent more than UAH 155 billion or about €5 billion, equal to 5% of Ukraine's GDP, to cover the bank's losses.

Today, the NBU and now state-owned Privatbank have suits pending against the bank's former owners in Ukrainian, Swiss and English courts to compensate the losses the government has suffered.¹²

Among the biggest insurance companies in Ukraine, there are also several subsidiaries of EU insurers such as AXA¹³, UNIQA and PZU, but the share of Ukrainian-owned insurers is higher. Other financial institutions are also predominantly Ukrainian-owned.

As of today, Annex XVI of the AA allows Ukrainian banks and insurance companies to enter the EU market through subsidiaries and branches, but they may not provide services across borders, with a few exceptions: insuring sea and air transport, and goods in transit. In order to open a subsidiary or a branch, Ukrainian companies must undergo a prudential review of the parent company, just like any other investors. So far, only Ukraine's Privatbank owns a 47% stake in AS Privatbank in Latvia and has a branch in Cyprus. In 2017, plans were announced for the sale of the Latvian subsidiary of Privatbank. Other Ukrainian banks have no branches or subsidiaries in the EU.

Should Ukraine's access to the EU financial services market be expanded, the initial effect is likely to be limited, given that Ukrainian financial firms are not very actively taking advantage of available options for entering the EU market. Barriers to entry for providers of standard banking and insurance services will also not change much: the EU market is dominated by major players, the cost of real

Ukrainian banks and insurance companies already may enter the EU market through subsidiaries and branches, but do not do it because of economic considerations. Respectively, the initial effect of the EU financial services market opening for Ukraine will be limited

⁸ <https://bank.gov.ua/doccatalog/document?id=62483489>

⁹ <https://www.minfin.gov.ua/uploads/redactor/UBOs%20Letter%20UKR.jpg>

¹⁰ <http://www.fg.gov.ua/not-paying/banks-sold-to-state/188-pat-kb-pryvatbank>

¹¹ <https://www.minfin.gov.ua/news/view/povidomlennia-ministerstva-finansiv-shchodo-statusu-restrukturyzatsii-kredytnoho-portfeliiu-pryvatbanku-kolyshnimy-vlasnykamy?category=novini-ta-media>

¹² https://bank.gov.ua/control/uk/publish/article?art_id=71475865&cat_id=55838, https://bank.gov.ua/control/uk/publish/article?art_id=60908601&cat_id=55838

¹³ Axa is in process of selling its Ukrainian subsidiary to Canada-based Fairfax Holdings.

estate and labour is high, and capital is relatively expensive. Still, in a longer perspective, relatively inexpensive and professional labour force could offer a competitive advantage for start-ups in financial technology on the EU market. Ukrainian banks could put up a good fight to serve the subsidiaries of Ukrainian business groups abroad and Ukrainian migrants.

Expanded access to Ukraine's financial services market could also have a limited impact on EU companies. EU banks and insurance companies already have a significant presence on the Ukrainian market and were able to enter the market without particular problems. Financial sector companies with Ukrainian owners have been competing with foreign market participants for quite some time. However, lowering barriers to entry for new players could increase competition on the market and reduce the shares of the biggest players.



EU banks and insurance companies already have a significant presence on the Ukrainian market and were able to enter the market without particular problems

IMPLEMENTATION DYNAMICS

Among financial services regulators, the NBU has more freedom to act in regulating banks. As a result, the NBU can implement most EU banking norms without amending the relevant laws. For instance, in 2015, the NBU required banks to establish buffer capital as of 2020,¹⁴ while in 2018 the central bank instituted the liquidity coverage ratio or LCR.¹⁵ The adoption of the new Law on currency and currency operations, which comes into effect in February 2019, will allow the National Bank to implement AA commitments to liberalise the movement of capital. Overall, AA implementation in the banking sector is on schedule.

Establishing EU norms in the insurance market requires that the related law¹⁶ be amended, as the basic requirements for solvency among insurance companies are set at the legislative level. Draft Law #1797-1,¹⁷ which institutes provisions of the Solvency II Directive regarding solvency for insurance carriers, passed first reading in 2016 but remained without further review until recently. In September 2018, the draft law was placed on the Verkhovna Rada's agenda.

With capital markets, changes¹⁸ were made to the related law on securities and the stock market,¹⁹ and to other laws, to implement some of Ukraine's AA commitments, at the end of 2017. To implement the revised legislation, the NCSSM amended its regulations in 2018.²⁰ In July 2018, the Verkhovna Rada rejected Draft Law #7055,²¹ which had been submitted in 2017 and proposed adopting a new law on capital markets and organised commodity markets. The draft law contained provisions to introduce the norms of EU legislation, including the profile MiFID II/MiFIR directive/regulation regarding financial instruments markets. In October 2018, the Verkhovna Rada's committee supported first reading of Draft Law #9035,²² which largely repeats the provisions of the Draft Law #7055 and introduces those same norms of EU legislation.

¹⁴ <http://zakon.rada.gov.ua/go/v0312500-15>

¹⁵ <http://zakon.rada.gov.ua/go/v0013500-18>

¹⁶ Law "On insurance" #85/96-VR dated 7 March 1996. <http://zakon.rada.gov.ua/go/85/96-%D0%B2%D1%80>

¹⁷ http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=53904

¹⁸ Law "On amending certain legislative acts of Ukraine to simplify doing business and attracting investments for issuers of securities." #2210-VIII, dated 16 November 2017. <http://zakon.rada.gov.ua/go/2210-19>

¹⁹ Law #3480-IV dated 23 February 2006. <http://zakon.rada.gov.ua/go/3480-15>

²⁰ <https://www.nssmc.gov.ua/2018/02/20/zakon-v2210-viii-regulyuvannya-otsnyuvatchiv/>

²¹ http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=62443

²² http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=64532

There has been noticeable progress with the implementation of EU norms in financial services in recent years, although the Parliament is slow in reviewing the necessary draft laws

Overall there has been noticeable progress with the implementation of EU norms in financial services in recent years, although it is hampered by the slow work of the Verkhovna Rada in reviewing the necessary draft laws. The Rada has also not managed to decide to either adopt or reject the proposition to redistribute the powers of financial services market regulators – which is not required under the AA, but this has slowed down the development of regulators’ institutional capacity to implement the AA.

The prospects for internal market treatment as anticipated in the AA remain unclear, given that current EU legislation does not provide for EU financial services oversight agencies and regulators to operate beyond the borders of the EU.

The prospects for internal market treatment as anticipated in the AA became unclear, given that current EU legislation fundamentally changed the regulation of financial services

RECOMMENDATION

The EU and Ukraine need to clarify the prospects for future integration between their financial services markets, in effect choosing one of three possible options:

- 1) Offer Ukraine the same kind of ***mechanism as has been offered to the countries of the European Free Trade Association (EFTA)***²³, which involves introducing EU legislation within the framework of the European economic space. Formally, the function of European supervisory bodies was delegated to the EFTA supervisory body, while the regulators themselves participate in reviews and draft decisions for the EFTA supervisory body.
- 2) ***Look for a compromise*** that would expand the integration of financial services markets and reduce the regulatory burden tied to full implementation of EU legislation. For instance, Ukraine could institute all EU norms, except the ones that are the most complicated for market participants to implement, in return for simplified procedures for Ukrainian companies to enter the EU market.
- 3) Reject the goal of having a single financial market. That would make the establishment of EU rules in this sector non-binding for Ukraine, and so more attention would have to be paid to possibly increasing the regulatory burden on market participants while offering more flexibility in the implementation of EU norms, which will simply become non-binding sources of best regulatory practice.

²³ <http://www.efta.int/EEA/news/EEA-adaptations-EU-financial-supervisory-system-128596>

RECIPROCAL OPENING OF EU AND UKRAINIAN PUBLIC PROCUREMENT MARKETS

Oleksandra Betliy

BENEFITS OF THE ASSOCIATION AGREEMENT

Under its Title IV, Chapter 8, the EU-Ukraine Association Agreement (AA) envisages 'mutual access to public procurement markets on the basis of the principle of national treatment at national, regional and local level for public contracts and concessions in the traditional sector as well as in the utilities sector.'¹

This implies benefits for Ukrainian companies, which gain access to the public procurement market of the EU equal to about 14% of GDP, or over EUR 1.9 trillion.² On the other hand, the increased competition on the public procurement market in Ukraine resulting from the participation of EU companies will make public spending more efficient and urge Ukrainian companies to become more competitive.

Unlike the commodity markets, for which the AA envisages the asymmetric opening by the EU, in the case of public procurement, the agreement provides for symmetric reciprocal access to the markets of both parties after Ukraine completes its 'homework' on bringing its legislation in line with EU norms.

Annex XXI to the AA provides an Indicative Time Schedule for Institutional Reform, Legislative Approximation and Market Access, which sets up five phases of legislative amendments and the reciprocal opening of market access from 1 Jan. 2016 to the year 2024. The implementation of each phase is subject to evaluation by an Association Committee meeting in Trade configuration (Trade Committee). A positive assessment by the Trade Committee will mean the opening of a certain public procurement segment in the EU and Ukraine for contracts that exceed the value thresholds set out in that Annex.



The AA envisages mutual access to public procurement markets, provided that Ukraine fulfils its "homework", in five phases

¹ https://trade.ec.europa.eu/doclib/docs/2016/november/tradoc_155103.pdf

² These figures do not include procurements by public utility companies. If the latter are included, the aggregate public procurements in the EU can be estimated at 19% of the GDP or €2.3 trillion. For details see European Semester Thematic Factsheet: Public Procurement <https://goo.gl/DfQsvP>

According to Article 154(4) of the AA, after all the phases of the Indicative Time Schedule are implemented, Ukraine and the EU will examine the possibility to mutually grant even deeper market access to their procurement markets.

UKRAINE'S HOMEWORK

The Association Agreement explicitly ties up access to the EU public procurement market with Ukraine's successes in approximating its legislation to public procurement rules of the EU.

Particularly, Ukraine has to designate a central executive body that will be responsible for its public procurement policy as well as a separate, impartial and independent, body of appeal for reviewing decisions taken by contracting authorities or entities in the procurement process. It has to ensure that the principles of non-discrimination, equal treatment, transparency, and proportionality are observed in the award of contracts. Ukraine also has to approximate its legislation to the EU Directives that regulate public procurement, although it is not required to implement these Directives fully or instantly. Annexes XXI-B to XXI-N break down these Directives into elements of several types: 'basic,' 'mandatory,' 'non-mandatory' (i.e., provisions that are not mandatory but recommended for the approximation), and 'outside the scope of the process of legislative approximation.'

In the first phase, for which Ukraine was given six months after the entry into force of the AA, the focus was on the implementation of basic principles of EU legislation and the designation of a central executive body responsible for public procurement policy and an independent supervisory authority in this area.

In May 2018, the Trade Committee updated Annex XXI³ to take into account the new EU Directives on public procurement that had been adopted in 2014.⁴ They also somewhat increased the value thresholds for the application of public procurement rules (Table 1).

Table 1
VALUE THRESHOLDS FOR THE APPLICATION OF PUBLIC PROCUREMENT RULES⁵

<i>Contract types</i>	<i>Value threshold</i>	<i>Updated value threshold</i>
Public supply and service contracts awarded by central government authorities and design contests awarded by such authorities	EUR 133 000	EUR 135 000
Public supply and public service contracts not covered by the point above	EUR 206 000	EUR 209 000
Public works contracts and concessions	EUR 5 150 000	EUR 5 225 000
Works contracts in the utilities sector	EUR 5 150 000	EUR 5 225 000
Supply and service contracts in the utilities sector	EUR 412 000	EUR 418 000
Public service contracts for social and other specific services	—	EUR 750 000
Service contracts for social and other specific services in the utilities sector	—	EUR 1 000 000

³ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22018D0972&rid=9>

⁴ Directive 2014/23/EU on the award of concession contracts; Directive 2014/24/EU on public procurement and repealing Directive 2004/18/EC; and Directive 2014/25/EU on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC.

⁵ The current updated thresholds are set out in accordance with the Trade Committee decision of 14 May 2018. They would have to be in line with the effective provisions of the corresponding EU Directives. However, since January 2018, the thresholds in the EU Directives have already become somewhat higher for their harmonisation with the WTO Government Procurement Agreement (GPA). Thus, a further insignificant upward adjustment in the thresholds of AA Annex XXI can be predicted – see: https://ec.europa.eu/growth/single-market/public-procurement/rules-implementation/thresholds_en, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32017R2365>

CURRENT PUBLIC POLICY

The government launched the public procurement reform to overcome corruption in this area, as well as within the framework of fiscal consolidation, yet before the entry into force of AA Chapter 8. Moreover, before the signing of the AA, Ukrainian legislation did not limit the participation of foreign companies in public procurement, and the announcements of large-scale tenders were accompanied by the translation of their documentation into English. In April 2014, Parliament passed a new Law 'On Government Procurement',⁶ the main provisions of which were harmonised with EU norms.⁷ Still, the higher transparency and broader competition opportunities resulting from the implementation of the new Law were not sufficient to overcome corruption anyway.

In 2016 the new law on public procurement was fully implemented, and all public procurements started to be conducted on the basis of the ProZorro electronic system

Therefore, in 2015, an e-procurement pilot project was launched and a new Law 'On Public Procurement'⁸ was adopted. As soon as in 2016, the Public Procurement Law was fully implemented. Accordingly, all publicly owned and publicly funded companies began procuring based on the ProZorro electronic system for contracts above a certain amount (UAH 200,000 for procurement of goods and services and UAH 1.5 million for procurement of works).

The Law designated the Ministry of Economic Development and Trade as the authorised body in the area of public procurement and the Antimonopoly Committee of Ukraine as the body of appeal for reviewing complaints against violations of public procurement legislation.

MARKET ANALYSIS

The adoption of the new public procurement legislation helped to increase competition and transparency and reduce fraud and corruption. In particular, according to the data of the Centre of Excellence in Procurement (Kyiv School of Economics), the number of single-supplier procurements has dropped, whereas the number of suppliers has grown.⁹ What is important, access of small to medium enterprises to the public procurement market was simplified, and as a result, their participation in procurement increased. During 2017, according to the data of the electronic procurement system, about 27,000 contracting entities announced over one million procurement procedures at an expected value of more than UAH 777.7 billion.¹⁰

Companies from the EU member states already have full access to the Ukrainian public procurement market

Ukraine does not limit access to its public procurement market for companies from the EU since it provides non-discriminatory access to all companies. The translation of documentation into English

⁶ Law No. 1197-VII of 10 Apr. 2014, <http://zakon.rada.gov.ua/laws/show/1197-18>

⁷ An analysis of the Law's compliance with the EU norms is presented in: S. Yaremenko and O. Shatkovsky, 'Comments to Ukrainian Public Procurement Legislation', EU Project 'Harmonisation of Public Procurement System of Ukraine with EU Standards', 5 Nov. 2014 (<http://eupublicprocurement.org.ua/wp-content/uploads/2014/12/Commentary-to-Ukrainian-PP-legislation-ENG-031220141.pdf>).

⁸ Law No. 922-VIII of 25 Dec. 2015, <http://zakon.rada.gov.ua/laws/show/922-19>

⁹ http://cep.kse.org.ua/assets/img/articles/Prozorro_report_ua.pdf

¹⁰ <https://www.kmu.gov.ua/ua/news/minekonomrozvitku-zvituye-pro-publichni-zakupivli-u-2017-roci>

is required for all tenders at a value above €133,000 for goods and services and above €5.15 million for works. However, the share of companies from the EU is still low (0.1% of all tenders and 1.0% of their total value in 2017). This may be due to various technical difficulties of providing documents for entering into agreement with a Ukrainian party. Therefore, smaller European companies still incline to participate in public procurement in Ukraine through their Ukrainian subsidiaries or partners.

IMPLEMENTATION DYNAMICS

Most of the provisions of the Public Procurement Law are in line with relevant EU Directives. To adapt other provisions, in 2016, the Cabinet of Ministers approved a Public Procurement Reform Strategy,¹¹ which is a 'roadmap' for implementing changes in public procurement.¹² The provisions of the Law and the roadmap approval are sufficient for Ukraine to pass the first phase of the Indicative Time Schedule for Institutional Reform. According to the governmental Report on the Implementation of the EU-Ukraine Association Agreement in 2017,¹³ the first phase was already complete in 2016.

The roadmap provides for further changes in the public procurement regulation. It was earlier expected that the Verkhovna Rada would pass Draft Law No. 8265 of 13 Apr. 2018 'On Amending the Law of Ukraine "On Public Procurement" and Some Other Legislative Acts of Ukraine'¹⁴ before the end of 2018. It was planned that the new law would regulate below-threshold procurement, improve the bidding appeal procedure, allow businesses to correct technical errors in documentation, implement e-catalogues, and broaden the list of punishable actions by contracting entities. Having it adopted would generally allow Ukraine to pass the second phase of the Indicative Time Schedule. However, on the 'budgetary night' of 23 Nov. 2018 (when the Verkhovna Rada was approving the State Budget for 2019), this draft law failed to win enough votes of MPs and thus was rejected in compliance with the parliamentary rule of procedure. Now, a similar draft will be probably introduced again.

Meanwhile, the European Commission's report on the implementation of DCFTA with Ukraine in 2016,¹⁵ published in November 2017, pointed out that Ukraine was lagging behind with the first phase completion. It was only in May 2018 that the Trade Committee issued its positive opinion¹⁶ of the roadmap approved in 2016. However, the Committee's decision does not mention the passage of the first phase by Ukraine and the corresponding reciprocal opening of markets.



Ukrainian government believes that it has already completed the first phase of the Indicative Time Schedule, but the EU does not share this assessment

It looks like Ukraine did not initiate the EU's formal evaluation of the first phase implementation. A possible reason could be its intention to obtain a positive assessment on passing several phases of the Indicative Time Schedule at once. However, the most probable main reason is that Ukraine has

¹¹ Ordinance of the Cabinet of Ministers of Ukraine No. 175-r of 24 Feb. 2016 'Public Procurement Reform Strategy (Roadmap)'; <http://zakon.rada.gov.ua/laws/show/175-2016-%D1%80#n11>

¹² A comprehensive roadmap for public procurement reform is required by AA Chapter 8 Art. 152.

¹³ Report on the Implementation of the EU-Ukraine Association Agreement in 2017, <https://www.kmu.gov.ua/storage/app/media/uploaded-files/pro-vikonannya-ugodi-pro-asotsiatsiyu-mizh-ukrainoyu-ta-evropeyskim-soyuzom-za-2017-rik.pdf>

¹⁴ http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=63852

¹⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017SC0364>, p. 44.

¹⁶ <https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX:22018D0972>

already gained access to the EU public procurement markets under the WTO Government Procurement Agreement (GPA).

On 18 May 2016, Ukraine acquired the status of a full-fledged party to the GPA.¹⁷ Within the framework of this agreement, the EU defined for access to its market the same thresholds for application of public procurement rules¹⁸ as those currently in effect according to the updated Annex XXI to the AA. The data of the 'GPA in Ukraine'¹⁹ project shows that Ukrainian companies have already begun entering the public procurement markets in the EU.

Ukraine has already gained access to the EU public procurement markets under the GPA agreement. The GPA does not require Ukraine to fulfil 'homework'

Mutual access to procurement markets under the GPA does not require any additional changes in procurement rules on either side. This is what makes the GPA essentially different from the AA, which requires that Ukraine would gradually be doing its homework on the harmonisation of its public procurement legislation and foresees phased granting of procurement market access to Ukraine only after a favourable assessment issued of the homework completion.

It is worth mentioning, however, that the EU does not grant access to all types of public procurement under the GPA – in contrast to what the AA provides for after going through all phases of the Indicative Time Schedule. In particular, the matter is procurement in the public utility sector, procurement of certain types of goods and services, and concessions.

As a matter of fact, both parties have already implemented most public procurement provisions of the AA

Thus, as a matter of fact, both parties have already implemented most public procurement provisions of the AA. In view of access to the EU market gained within the GPA framework, Ukraine has not that many external stimuli to fully carry out its legislation harmonisation commitments under the AA as it was expected at the moment of the AA signing. Nevertheless, Ukraine has gone to the even deeper, asymmetric opening of its market to the EU. According to its national legislation, companies from the EU member

states have already got full access to the Ukrainian public procurement market (although its practical use involves various technical complications, because of which businesses from the EU might still find it more convenient to participate in procurement through their Ukrainian subsidiaries).

At the same time, it is important to ensure that these achievements would not be destroyed. For example, dangerous discussions are going on in Ukraine as to taking protectionist measures on the public procurement market. In December 2017, Parliament passed in the first reading a 'Buy Ukrainian' draft law, initiated by a group of MPs, which provides for amending the Public Procurement Law to grant preferences to goods produced in Ukraine.²⁰ This draft contradicts both the AA and the GPA.

¹⁷ Parties' commitments are available at <https://e-gpa.wto.org/en/Agreement/Latest>

¹⁸ The thresholds are primarily set in a special drawing rights (SDR) equivalent but the WTO site also provides these values in Euros and other currencies: <https://e-gpa.wto.org/en/ThresholdNotification?PartyId=557>

¹⁹ <https://www.facebook.com/gpainua/>

²⁰ Draft Law No. 7206 of 17 Oct. 2017: http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=62736

RECOMMENDATIONS

For Ukraine and the EU

- Find a technical solution to ensure interconnection between the Ukrainian e-procurement system, ProZorro, and the European information system for public procurement, TED.

For Ukraine

- Reject Draft Law No.7206 'Buy Ukrainian';
- Amend Law of Ukraine 'On Public Procurement' and some other legislative acts, the way it was foreseen by Draft Law No. 8265, and continue the implementation of the 'Public Procurement Reform Strategy (Roadmap)' to eliminate those practical barriers that still exist on the procurement market to companies from the EU member states.

For the EU

- Carry out a formal evaluation of Ukraine's progress in the implementation of its commitments under Title IV, Chapter 8, of the Association Agreement;
- In accordance with AA Art. 154(4), determine prospects for granting procurement market access below the thresholds set out in the GPA – similarly to the single procurement market within the framework of the European Economic Area (EEA).

ANNEX XXI-A TO CHAPTER 8 ON PUBLIC PROCUREMENT²¹

INDICATIVE TIME SCHEDULE FOR INSTITUTIONAL REFORM, LEGISLATIVE APPROXIMATION AND MARKET ACCESS

Phase		Indicative time schedule	Market access granted to the EU by Ukraine	Market access granted to Ukraine by the EU	
1.	Implementation of Articles 150(2) and 151 of this Agreement	6 місяців з дати набрання чинності Угодою	Контракти на поставку товарів для центральних органів влади	Контракти на поставку товарів для центральних органів влади	
2.	Approximation and implementation of basic elements of Directive 2014/24/EU and of Directive 89/665/EEC	3 years after the entry into force of this Agreement	Supplies for state, regional and local authorities and bodies governed by public law	Supplies for state, regional and local authorities and bodies governed by public law	Annexes XXI-B and XXI-C
3.	Approximation and implementation of basic elements of Directive 2014/25/EU and of Directive 92/13/EEC	4 years after the entry into force of this Agreement	Supplies for all contracting entities in the utilities sector	Supplies for all contracting entities	Annexes XXI-D and XXI-E
4.	Approximation and implementation of other elements of Directive 2014/24/EU. Approximation and implementation of Directive 2014/23/EU	6 years after the entry into force of this Agreement	Service and works contracts and concessions for all contracting authorities	Service and works contracts and concessions for all contracting authorities	Annexes XXI-F, XXI-G, and XXI-H
5.	Approximation and implementation of other elements of Directive 2014/25/EU	8 years after the entry into force of this Agreement	Service and works contracts for all contracting entities in the utilities sector	Service and works contracts for all contracting entities in the utilities sector	Annexes XXI-I and XXI-J

²¹ As updated by Decision No 1/2018 of the EU-Ukraine Association Committee in Trade Configuration of 14 May 2018: <https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX:22018D0972>

INTEGRATING UKRAINE INTO THE EU GAS MARKET

DiXi Group

THE BENEFITS OF THE ASSOCIATION AGREEMENT

Ukraine already took its first steps towards integrating in the EU energy market before the Association Agreement was signed, having become a member of the Energy Community back in 2011. This international organisation brings together the EU and neighbouring countries for the purpose of establishing an integrated pan-European energy market by expanding EU energy legislation beyond EU borders.¹



Ukraine is implementing the Third Energy Package without clear prospects for internal market treatment by the EU

In joining the Energy Community, Ukraine committed itself to implement the provisions of the EU's Third Energy Package.² This is a deeper level than the commitments Ukraine has made under the Association Agreement, where Annex XXVII contains a list of legislation from the Second Energy Package. However, according to Article 278 of the AA, the provisions of the Treaty Establishing the Energy Community take precedence over the provisions of the AA.

However, even if Ukraine completely harmonises its energy legislation with EU laws, it still has no set prospects for gaining internal market treatment in the energy sector from the EU even if it completes this 'homework' assignment. The necessary provision is missing in Annex XXVII, in contrast to Annex XVII, which clearly provides such a prospect for certain service markets. At the meeting of the EU-Ukraine Association Council in December 2018, the Parties agreed to update Annex XXVII to reflect changes in EU acquis.³

Today, the most important part of the Ukrainian market that needs to move to EU rules is transportation of gas from Russia to EU countries. The current contract between Ukraine's Naftogaz and

¹ <https://www.energy-community.org/aboutus/whoweare.html>

² As well as a number of others, such as for security of supply, projects of common interest, and rules of competition in the EU's internal market. The list of legislation is contained in the Annexes of the Treaty Establishing the Energy Community. This list may periodically be updated by decision of the Ministerial Council of the Energy Community to reflect changes in EU energy legislation.

³ Joint press statement following the 5th Association Council meeting between the EU and Ukraine: <https://www.consilium.europa.eu/en/press/press-releases/2018/12/17/joint-press-statement-following-the-5th-association-council-meeting-between-the-european-union-and-ukraine>

Gas is transported from Russia to the EU via Ukraine under a contract between Naftogaz and Gazprom that expires at the end of 2019

Russia's Gazprom expires at the end of 2019. In 2018, the EU, Ukraine and Russia began negotiating the terms for transportation of Russian gas to Europe starting in 2020. Ukraine and the EU share their position regarding the extension of EU rules to the delivery of Russian gas to the EU via Ukraine.⁴ Kyiv knows from experience that special political deals with Moscow are dangerous. The only path to protecting itself against any unpredictable aggressive behaviour on the part of Gazprom is to force the Russian

state giant to work in line with EU rules. This will be possible to properly ensure if the EU grants internal market treatment to Ukraine, so that EU norms fully apply to the points of entry into the Ukrainian gas transmission system (GTS) at the border with Russia.

With this treatment granted, EU legislative acts in the gas market referring to "EU member states" will read as "EU member states and Ukraine." This will give Ukraine the same rights and obligations on the gas market as EU members. This will mean that European institutions like the European Commission and the Court of Justice of the EU will have additional powers in Ukraine, but Ukraine will also have additional rights in relation to these institutions and to EU member states.

This kind of integration establishes a stable legal framework and offers investors additional guarantees. It also significantly simplifies the operations of EU companies on the Ukrainian market, which will have positive consequences in the form of increased supplies for delivery, rising FDI, and growing domestic production. It will also open prospects for Ukrainian companies to enter various segments of the EU market.

The internal market treatment offers more powers to EU institutions, better guarantees to investors, and streamlining to EU companies

European companies will be able to buy gas from Gazprom at the Ukrainian-Russian border, avoiding potential disputes over Ukrainian-Russian contracts

In terms of the transportation of Russian gas, this will mean that the common EU-Ukraine market will begin at the Ukrainian-Russian border. Rules governing the cross-border gas transmission as designated in harmonised European network codes will directly apply in Ukraine. Based on this, European companies will be able to buy gas from Gazprom at the Ukrainian-Russian border. The shipment of this gas through Ukraine will be subject to contracts between such European companies and the Ukrainian transmission system operator

(TSO), the managing partner of which could well be an EU operator. In this way, the potential for disputes related to direct Ukrainian-Russian contracts can be avoided, which will preserve the stable supply of Russian gas to EU countries through Ukraine.

⁴ <https://www.euointegration.com.ua/articles/2018/07/18/7084538/>

UKRAINE'S HOMEWORK

In the context of the AA and Energy Community, Ukraine has committed itself to implementing all the key requirements of EU legislation governing the gas market, including:

- opening its market to competition and offering all consumers the right to choose their supplier;
- separating the functions of transportation, storing and distributing gas, which means unbundling the transmission and storage systems operators, as well as the distribution systems operators;
- providing free and non-discriminatory third party access to networks;
- instituting a security of supply policy with regular monitoring;
- monitoring the activities of gas market players for upholding quality standards and a competitive environment;
- offering targeted social protection to vulnerable consumers;
- issuing permits for hydrocarbon exploration and extraction in a transparent, non-discriminatory manner;
- establishing an independent national regulator.

CURRENT PUBLIC POLICY

In recent years, public policy regarding the gas market has been adjusted in line with Ukraine's international commitments. And so instituting the principles of the Third Energy Package now underpins an entire series of public policy documents.⁵ Approved in 2017, Ukraine's Energy Strategy foresees a build-up of the gas market on these principles by 2020 by properly implementing EU legislative acts governing energy, reforming vertically-integrated companies, and establishing the necessary conditions for Ukraine to integrate into the EU energy system.

The main institutions governing this sphere are the Government of Ukraine and, directly, the Ministry of Energy and the Coal Industry, the National Energy and Utilities Regulatory Commission (NEURC) as the independent regulator and the Anti-Monopoly Committee (AMC) as the agency that ensures that competition is maintained, including on the energy market. The law on NEURC passed in 2016 contains provisions ensuring the Commission's independence. Although its activities were quite problematic⁶ for a long while, they did finally improve in June 2018 with the replacement of some members of the Commission. However, restoring trust in the regulator among market participants is a work in progress.

⁵ Ukraine's Energy Strategy till 2035, the Medium-Term Priority Action Plan of the Government till 2020, the Government's Priority Action Plan for the current year, the separate Action Plan for implementing the Association Agreement, and the Roadmap of priority draft laws to legislatively underpin the implementation of the AA, which was jointly developed by the Verkhovna Rada and the Cabinet of Ministers.

⁶ According to a study of NEURC operations and independence, undertaken by the Energy Community Secretariat and published in March 2018, there are significant problems with ensuring the genuine independence of the regulator and maintaining the trust of market participants. The National Energy Regulatory Authority of Ukraine Governance and Independence, Energy Community Secretariat Review, March 2018, pp 33-36. https://www.energy-community.org/dam/jcr:6eb10b22-ca6a-4c43-8c9f-f3614dab3c91/ECS_NEURC_reg_report_032018.pdf

The rapid development of gas hubs¹⁶ in the EU offers additional opportunities for Ukrainian companies to establish a presence. Its strong infrastructure, including gas storage facilities near the EU border allows Ukraine to consider setting up its own hub to serve European customers, among others.¹⁷ Moreover, the introduction of customs warehousing¹⁸ has led a number of European suppliers to enter the gas storage market.¹⁹

IMPLEMENTATION DYNAMICS

The adoption of the Gas Market Law in 2015 and related bylaws, such as Cabinet and NEURC resolutions effected the transposition of the requirements of Directive 2009/73/EC, Regulation (EC) 715/2009, and Directive 2004/67/EC. In addition, a number of amendments were made to the GTS Code, the Gas Distribution Systems Code, the Gas Storage Code, and to the Security of Supply Rules over 2017-2018, in particular, with the purpose of preventing discrimination in network access and to introduce daily balancing on the market. Another series of adjustments, part of which have already been approved, was prepared in regard to the methodology for calculating tariffs for gas storage and transmission.

Ukraine's laws are already approximated to the gas acquis: transposition of main requirements of the EU's Third Energy Package has already taken place

Other steps were taken to streamline the approval process for exploration, development and processing of hydrocarbons in line with the Directive 94/22/EC by amending the Subsoil Code and other legislation and regulations.²⁰ In autumn 2018, the Law "On Ensuring Transparency in Extractive Industries" was adopted.

In this way, despite delays in the transposition of individual legal acts, such as Regulation (EC) 347/2013, which covers projects of joint interest, Ukraine's laws no longer have any serious differences with the EU gas acquis: the transposition of the main requirements of the EU's Third Energy Package regarding national legislation has already taken place. The Energy Community Secretariat, which noted the conclusion of the transposition process²¹ in his annual implementation report, and representatives of Ukraine's expert community agree.²²

Three key issues of their practical implementation remain unresolved: the unbundling of Naftogaz, the introduction of daily balancing, and the liberalisation of the retail supply to households and district heating companies, which is about 60% of the market.

The key unresolved issues: the unbundling of Naftogaz, daily balancing, and the liberalisation of the retail supply

¹⁶ A gas hub is where sales of gas take place, both physical and virtual, based on the intersection of a significant number of gas pipelines.

¹⁷ DiXi Group, Policy Paper, A Ukrainian Gas Hub: A chance for Europe, 2016. http://dixigroup.org/storage/files/2016-12-19/web_ukrainian_gas_hub_2016_ua_1.pdf

¹⁸ The option for TSO customers to store gas for up to three years without paying taxes or customs duties, for further sale to EU markets or in Ukraine. In the second case, all necessary taxes and duties have to be paid first.

¹⁹ Business Recorder, Ukraine boosts injections of gas into storage, 3 May 2018. <https://www.brecorder.com/2018/05/03/415825/ukraine-boosts-injections-of-gas-into-storage/>

²⁰ Law of Ukraine #2314-VIII "On amending certain legislation of Ukraine regarding the deregulation of the oil and gas sector" dated 1 March 2018, and others.

²¹ Annual Implementation Report, Energy Community Secretariat, 1 September 2018, p. 182: https://www.energy-community.org/dam/jcr:05c644e0-3909-4c26-84f5-e1c6b63e1af4/ECS_IR2018.pdf

²² Energy Reforms: Monitoring report on Ukraine's progress with implementing the Association Agreement with the EU in the energy and environment, June 2018. Gas Benchmarks, p.12, 58: http://enref.org/wp-content/uploads/2018/09/Monthly-June-2018_rs.pdf

The Government approved a plan to restructure Naftogaz back in summer of 2016,²³ but the key element of this plan, transferring the assets to the new TSO, Mahistralni Gazoprovody Ukrainy (MGU) kept being delayed in anticipation of the results of the Stockholm arbitration of a dispute between Naftogaz and Gazprom. After a positive decision was handed down in early 2018, Naftogaz' position is that, as long as the transit gas contract between the company and Gazprom is in effect, i.e. until the end of 2019, the right to execute the contract cannot be transferred to a third party (like the new, independent TSO) without Gazprom's approval.²⁴

But the position of the Government of Ukraine and the European Commission is that unbundling must take place to certify the new operator by 1 January 2020. According to the Commission,²⁵ a joint action plan was agreed in late November 2018 in trilateral talks between Naftogaz, Ukrtransgaz and MGU that includes the drafting of contracts to transfer assets.

At the end of 2018, steps were agreed to unbundle the Naftogaz - in particular, transfer of assets to the new TSO by 1 January 2020

According to amendments made to the GTS Code in December 2017, the transition from monthly to daily balancing²⁶ was supposed to start on 1 January 2018, but the NEURC was forced to move the deadline back three times, ultimately to 1 March 2019.²⁷ These delays are the result of disagreements between the TSO, the distribution system operators (DSOs), and the regulator. To get this process moving again, the conflict between Ukrtransgaz and DSOs needs to be resolved, among others to establish consumers' data format and interoperability protocols, while the information platform used by the TSO for balancing purposes needs to be tested properly.

In its current form, the public service obligation (PSO) scheme does not comply with the EU standards and impedes liberalisation of the retail supply

The main obstacle to liberalising the retail supply for households and ensuring choice of supplier is the excessive regulatory imposition of public service obligation (PSO) on participants in the gas market in order to cover social needs. Under European legislation, the PSO scheme can be generally applied to protect vulnerable consumers, but it should not get in the way of competition. In its current form, the PSO scheme both restricts the rights of consumers to choose a supplier and quality services, and

the rights of market participants through the discriminatory way that the duty to supply is imposed on specific companies, mainly those connected to RGC for households, and Naftogaz for district heating companies.

These problems led the Energy Community Secretariat to open an infringement case against Ukraine.²⁸ Despite long discussions on this very issue, the Government of Ukraine did not manage to resolve them and was unable to meet the requirements of the Energy Community when updating its resolution on PSO in November 2018.

²³ <http://zakon.rada.gov.ua/laws/show/496-2016-%D0%BF>

²⁴ Gotev G., EU and Ukraine in tug-of-war over Naftogaz unbundling, EURACTIV.com, July 19, 2018. <https://www.euractiv.com/section/energy/news/eu-and-ukraine-in-tug-of-war-over-naftogaz-unbundling/>

²⁵ https://ec.europa.eu/commission/commissioners/2014-2019/sefcovic/announcements/statement-following-meeting-between-vice-president-sefcovic-and-ukraines-foreign-affairs-minister_en

²⁶ Balancing is a service provided by the TSO to regulate supply and demand, that is, to balance the volumes of gas entering the pipelines from suppliers and exiting to consumers. At the moment, Ukraine balances on a monthly basis, while European practice is to do it every day and even in the middle of a day.

²⁷ <http://www.nerc.gov.ua/?news=8386>

²⁸ Energy Community, Case ECS 02/17: Ukraine/Gas: <https://energy-community.org/legal/cases/2017/case0217UE.html>

RECOMMENDATIONS

For Ukraine

- Immediately undertake the key steps to restructure Naftogaz in order to unbundle the independent transmission system operator (TSO), including by approving and implementing the necessary contracts to transfer assets;
- Ensure that the TSO and others using the information platform properly test daily balancing and launch it without delay;
- Revise the public service obligation (PSO) scheme on Ukraine's gas market in order to make it compliant with the requirements of the Energy Community and EU standards;
- Accelerate efforts to implement EU legislation such as the Regulation (EU) 347/2013 regarding projects of joint interest, Regulation (EU) 1227/2011 on a transparent wholesale market, and the harmonised European network codes.

For the EU

- Following the results of the EU-Ukraine Association Council of 17 December 2018, update Annex XXVII of the AA: add the provisions of the Third Energy Package and the harmonised European network codes to Ukraine's 'homework', while also offering the prospect of granting the EU's internal market treatment to Ukraine should it implement these assignments;
- Uphold a common position with Ukraine during negotiations with Russia regarding the transit of gas after 2019 based on EU rules and extend these requirements to all other routes for Russian gas to be delivered to the EU, by implementing the amendments to Directive 2009/73/EC proposed by the European Commission;
- Support the establishment of an open, competitive gas market infrastructure in Ukraine, including by introducing daily balancing, developing gas trading on the spot market, forming a hub, and unblocking all cross-border interconnections between Ukraine and EU countries for the free flow of gas in both directions.

