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ON STRENGTHENING THE EUROPEAN NEIGHBOURHOOD POLICY

**ENP Progress Report
Ukraine**

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Background and overall assessment

The EU-Ukraine Action Plan was adopted on 21 February 2005 for a period of three years. Since then, implementation has been guided and monitored on the basis of annual implementation tools, which set out comprehensive sets of priorities and timelines for 2005 and 2006, based on the political priorities agreed jointly by the EU and Ukraine. Overall evaluations were carried out in November 2005 and March 2006. In addition, intense institutional co-operation through the EU-Ukraine Cooperation Council, the EU-Ukraine cooperation committee, and seven sub-committees, has enabled both sides to progress with the implementation of the Action Plan.

This document reports on overall progress made on the implementation of the EU – Ukraine Action Plan. As such, it concentrates primarily on the development of EU-Ukraine bilateral relations and on issues involved in implementing the Action Plan. Reports on progress made on the implementation of Action Plan priorities addressed in 2005 and 2006 respectively were drafted and shared with the Ukrainian side in November 2005 and March 2006. The present report is not a general review of the political and economic situation in Ukraine, which was last set out by the Commission in the Country Report for Ukraine published in May 2004.

With the preparation and conduct of overall free and fair parliamentary elections in March 2006, Ukraine consolidated the breakthrough in conducting a democratic election process that began with the Orange Revolution and which is also a key element of the Action Plan.

There has been good cooperation between the EU and Ukraine on foreign policy, with Ukraine aligning with EU positions on issues of regional and international relevance and allowing more intensive cooperation on regional issues (Moldova and Belarus). In particular, enhanced co-operation regarding the settlement of the Transnistria issue and the launch and successful work of the EU Border Assistance Mission have provided positive momentum.

Considerable steps have been taken towards consolidating respect for human rights and the rule of law (e.g. removing pressure on the media and civil society, reform of the customs service) and a wide range of legislative reforms has been introduced. But progress is being hindered by endemic corruption, which is the main challenge to the development and economic growth of Ukraine, and by the lack of a truly independent judiciary.

Progress has been made in various trade and trade-related areas, e.g. the WTO accession process has advanced considerably with the last legislative steps scheduled to be taken before the end of 2006, discrimination in the automobile sector was abolished and talks were launched for an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA). However, at this stage a clear-cut economic policy is still lacking, and there are particular concerns about loose monetary and fiscal policies. Significant further steps need to be taken to improve the business climate, including

administrative and legislative reform, improving tax regulation and administration and further fighting corruption. Attention should also be paid to inconsistencies between legislation e.g. the civil and commercial codes.

Substantial progress has been achieved on energy cooperation, through the signing and implementation of a Memorandum of Understanding on energy, with tangible results after one year of implementation. Overall, some progress has been made in the nuclear safety sector, but further progress needs to be made notably as regards the implementation of the modernisation programme for the K2R4 nuclear reactors and the “upgrade package” for the other reactors. While good progress has been made on the stabilisation of the Chernobyl shelter, Ukraine must take the necessary steps to expedite the implementation of the new safe confinement project as a matter of the highest urgency. On transport, a horizontal aviation agreement was signed and agreements concluded on Ukrainian participation in the Galileo and Egnos programmes. On justice, freedom and security, agreements on visa facilitation and readmission have been successfully negotiated and initialled. Good progress has also been made in the environment, research and innovation sectors. The two sides have launched a structured dialogue on agricultural issues.

Overall, while good progress has been made since 2005, implementation of reform strategies has lagged behind since the beginning of 2006, mostly due to long pre- and post-election periods of political instability. It is vital for Ukraine’s reform agenda that the country find increased political stability.

Political dialogue and reform

Political dialogue

Since the adoption of the EU-Ukraine Action Plan, wide-ranging political dialogue between the EU and Ukraine has been further intensified. Dialogue ranged from high-level meetings - the yearly EU-Ukraine Summit (December 2005, October 2006) and twice-yearly Foreign Minister Troika meetings (March and September 2005, March 2006) - to regular consultations at the level of political directors and working groups (EU Political and Security Committee, Council working groups). A regular exchange of views took place on internal developments in Ukraine and the EU, the reform process in Ukraine, foreign policy and security issues and on the state of EU-Ukraine relations.

Democracy and the rule of law

The March 2006 parliamentary **elections** in Ukraine were observed by an International Observer Mission under the leadership of the OSCE/ODIHR, which included observers from the European Parliament. The International Observer Mission concluded that the elections were conducted “largely” in line with OSCE and Council of Europe commitments and other international standards for democratic elections. Overall, fundamental civil and political rights, such as freedom of expression and assembly, were respected. Inclusive candidate registration and a vibrant media environment provided for genuine competition which enabled voters to make informed choices and to freely and

fairly express their will. Prior to the elections, the legislative framework had been revised, through the July 2005 Law on the Election of People's Deputies addressing recommendations made by the OSCE Observer Mission following the 2004 presidential elections and through the establishment of voters' lists. The International Observer Mission also noted shortcomings, which included the delayed setting-up of a number of polling stations, a number exceeding the legal maximum of registered voters at certain polling stations and drawbacks in the legal requirements regarding campaign financing. A central, electronic voters' register has still to be set up.

As regards constitutional reform, amendments to the 1996 **Constitution** entered into force in January 2006 (having been adopted in December 2004), concerning the roles of the President and the Government and strengthening the powers of the *Verkhovna Rada*. In its June 2005 Opinion on the constitutional amendments, the Council of Europe's Venice Commission strongly recommended the withdrawal of the constitutional provision concerning the imperative parliamentary mandate and noted that the principles governing mutual relations between the President, the *Verkhovna Rada* and the Government should be fully consistent. In its June 2006 Opinion, the Venice Commission further highlighted the issue of the absence of a functioning Constitutional court and made recommendations with a view to closing legislative and constitutional gaps in the appointment procedure. The *Verkhovna Rada* re-established the full quorum of judges in August 2006, after nine months of inactivity, but the recommendations of the Venice Commission remain to be addressed.

The Venice Commission opinion on the 2004 constitutional amendments also recommended reforming and limiting the powers of the prosecution service. This is still outstanding, as the draft law on prosecution reform has not yet been adopted by the *Verkhovna Rada* and further constitutional amendments are necessary. Set up in July 2005, the National commission for strengthening democracy and rule of law adopted a Concept on the improvement of the judiciary and on ensuring justice in line with European standards in May 2006. This Commission also established an Action plan for the honouring by Ukraine of its obligation and commitments to the Council of Europe, which as a first step led to the adoption of the Law on enforcement of judgements of the European Court of Human Rights, which is a precedent within the Council of Europe. Pending execution problems persist, however. The Code on administrative justice and the new civil procedure Code entered into force in September 2005. Training for judges and human rights experts, was provided through joint co-operation programmes between the EC and the Council of Europe.

A step in the fight against **corruption** was taken with Ukraine's membership in the Council of Europe's group of states against corruption (GRECO), as a result of the entry into force in January 2006 of the Civil law convention on corruption. The revised national anti-corruption strategy and the draft law on the civil service in executive bodies, aimed at promoting the transparency and accountability of the administration, were adopted in September 2006.

Human rights and fundamental freedoms

In terms of legislation, Protocols 12 and 14 of the Convention for the Protection of Human Rights and Fundamental Freedoms were ratified in July 2006. Legislation to allow for the ratification of the European Convention on the Compensation of Victims of Violent Crimes, signed in April 2005, has not yet been adopted. A step towards setting up of public service broadcasting was taken when, in January, the Parliament adopted the Law on television and radio broadcast, although not much measurable progress has been made, while a National commission for strengthening freedom of speech and development of the information sphere began work in June 2006. Important steps towards effective respect of the freedom of the media were the abolition of the practice of issuing “*temniki*” i.e. instructions given by the authorities to the media on what to report and how and, in particular, the free debate which took place in the media on the electoral campaign for the March 2006 parliamentary elections and formation of the new Government. There was also progress as regards respect for the rights of persons belonging to national minorities, with the entry into force in January 2006 of the European Charter for Regional or Minority Languages. The issue of ill-treatment and torture was addressed through legislative changes, notably ratification of the optional Protocol to the UN Convention against Torture and other cruel, inhuman or degrading treatment or punishment, and the amendment of the Criminal Code so as to make torture by law enforcement officers a criminal offence. The Parliamentary ombudsperson in Ukraine nevertheless notes that ill-treatment by the police is still widespread. The expulsion from Ukraine of 10 Uzbek refugees in February 2006 raised serious questions about the authorities’ compliance with its international obligation of “non-refoulement” under the 1951 Geneva Convention on Refugees. In other areas, progress includes parliamentary approval, in September 2005, for the law on equal rights of women and men. Although Ukraine signed the Rome Statute of the International Criminal Court on 20 January 2000, it has not yet been ratified as constitutional amendments are required.

Regarding the fulfilment of core ILO obligations, the authorities have increased their efforts in the area of **trade union** rights and core labour standards, notably setting up an Economic and Social Council, facilitating new trade union registration and expanding programme of policy dialogue and technical assistance, with the ILO through the 2006-2007 Decent work country programme.

CFSP and security issues

Co-operation and dialogue on CFSP matters was significantly increased. As of July 2006, Ukraine had aligned itself with 549 out of 589 CFSP declarations. On sanctions, Ukraine did not align itself with the measures imposed by the EU on Belarus following the presidential elections in that country. Foreign policy planning consultations were introduced (May 2005, November 2006). Ukraine continued to take part in the EU Police Mission in Bosnia-Herzegovina (EUPM), following its participation in the EU police mission in FYROM (PROXIMA) which ended in 2005. Co-operation was underpinned by the signing in June 2005 of the Agreement establishing a framework for participation in EU crisis management operations and the Agreement on security procedures for classified information, although Ukraine has not yet ratified either of these.

As regards **non-proliferation**, Ukraine joined the Australia Group in April 2005. In December 2005, it ratified the Ottawa Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and Their Destruction. This then formed the basis for EC assistance to Ukraine for the elimination of landmines and old ammunition.

Supported by the EU Border Assistance Mission to Moldova and Ukraine (EUBAM), Ukraine has made important progress in developing co-operation with Moldova on border questions, covering the entire Ukraine-Moldova border, including effective information exchange on the flow of goods and people across their common border.

EU Border Assistance Mission to Moldova and Ukraine (EUBAM)

Following a request from President Yushchenko and Moldovan President Voronin, the EU established an EU Border Assistance Mission (EUBAM) on the border between Ukraine and Moldova, including on the Transnistrian segment. The purpose of this mission is to enhance the capacities of the Ukrainian and Moldovan services on this border and thereby provide a valuable contribution to the settlement of the Transnistria conflict. Ukraine is working closely with the mission. During the second Advisory and Monitoring Board meeting of the EUBAM in May 2006, the EUBAM presented to Ukraine and Moldova a list of concrete recommendations for strengthening the Ukrainian and Moldovan customs and border guard services, for increasing cooperation among them and for improving customs control and border management between the two countries.

As of July 2006, in full agreement with Moldova and Ukraine, the EU has further reinforced the EUBAM bringing the total number of EU experts to 101, reinforcing EUBAM's risk analysis capacity and opening two additional field offices in Odessa and Chisinau.

The Ukrainian and Moldovan Prime Ministers issued a Joint Declaration on customs issues at the end of December 2005. For its part, Ukraine committed to allowing the transit of Moldovan goods through the Ukrainian border only if accompanied by official Moldovan customs stamps while Moldova, for its part, committed to facilitating registration and access to official Moldovan customs stamps for Transnistrian companies. Ukraine began implementing the agreement in March 2006. Moldova introduced changes to its legislation before March. The EUBAM has been active in monitoring the situation.

Economic and social reform and development

Macro-economic outlook and developments

The Ukrainian economy remains highly vulnerable to external shocks. The considerable surplus in the current account (10.5% of GDP in 2004), boosted by buoyant steel exports, turned into a deficit in 2006 as import prices of energy increased while the world market for steel tightened. With this negative term-of-trade shock, combined with sluggish investment demand in an uncertain policy environment, Ukraine experienced a hard

landing in 2005. Real GDP growth declined sharply to 2.6% against 12.1% in 2004. In 2006, however, the economic situation is improving, with growth forecasts now in the range of 6%.

The monetary policy framework is based on maintaining a *de facto* pegged nominal exchange rate for the *hryvnia* against the US dollar. In mid-2006, consumer price inflation came back to single digits (after an average of 13.5% in 2005) but the outlook remains uncertain. The National Bank of Ukraine (NBU) does not have a clear operational mandate to pursue price stability and provisions ensuring its independence still need to be strengthened. A broad understanding on moving towards inflation-targeting in the medium-term is emerging and a Memorandum of Understanding between the NBU and the Government, setting out respective roles and responsibilities, is under discussion.

After pre-election fiscal loosening in 2004, fiscal conservatism has returned, keeping the general government deficit at no more 3% of GDP. This has been achieved by rapidly increasing tax revenues, which have risen from 29% of GDP in 2004 to a projected 36% in 2006. Public investment was largely neglected at the expense of higher social spending during the election period. The new Government has yet to put in place a medium-term fiscal framework which is consistent with macroeconomic stability and creates fiscal space for growth-enhancing policies, including investments in infrastructure. Some steps are being taken e.g. in the 2007 draft budget which provides for a more moderate increase in social expenditure (of approximately 8%) and a focus on investment. A new tax code is under consideration.

Ukraine's pension system encompasses several problems which threaten fiscal sustainability as the population is ageing. It is estimated that by 2055 there will be 1 worker for every 1.42 pensioners. Driven by electoral promises, pension outlays soared to 15.3% of GDP in 2005 (against an average of 8.4% in the EU25). The Government started to address these problems, in a December 2005 strategy paper.

Social outlook and developments

Ukraine's population continues to decline (at an average rate of -0.8% over recent years) and reached 47 million at end-2005, of which the urban population accounts for 68% and the rural population for 32%. Since 2001, there has been a manifest reduction in the incidence of poverty from about 30% to 19% of the population (2003). Poverty has become an increasingly rural phenomenon as agricultural restructuring has not been accompanied by an increase in other employment opportunities in rural areas, where the population is also ageing rapidly. Agriculture represents about 25% of total employment (14% of GDP). The land market has stalled as a moratorium on agricultural land sales has been imposed until 2007 and there is strong lobbying in the country against lifting the ban after the date.

In 2005, the minimum pension was adjusted in line with the living wage. Assistance for disabled persons and child birth assistance increased 12-fold, assistance for single mothers increased 4.1-fold, for disabled children 4.5-fold and for orphans 5.2-fold. The

average monthly wage is 1.8 times higher than the living wage and grew by 36.7% in 2005 as compared with 2004. Given the fragility of Ukraine's economy and, with it, fiscal revenues, it remains questionable whether this increase in social spending is sustainable. This will depend on the Government's success in putting Ukraine on a long-term path of economic growth of 5% or higher.

Structural reforms and progress towards a functioning and competitive market economy

While the Ukrainian authorities have introduced structural reforms in recent years, the corresponding reform of institutional systems and the adoption and implementation of new laws lags behind. In 2006, the World Bank ranked Ukraine in 128th place in its Doing Business Database covering 175 countries. With this result, Ukraine lags clearly behind all other European countries and even the majority of NIS countries. The main obstacles to business development in Ukraine remain uncertainty over investors' rights, red tape and heavy tax pressure.

The Ukrainian administrative system is still in transition towards a market-oriented model. Current government structures are based on previously-existing structures and approaches, including cumbersome decision-making, excessive bureaucracy and in several cases a lack of clarity about the division of labour and responsibilities between government agencies.

However, these challenges have been largely recognised by the Ukrainian authorities and reforms have been initiated. For example, the fight against corruption and public administration reform were important priorities for the authorities in 2005, who started by tackling reform of the customs administration. The constitutional changes which became effective in January 2006 strengthened the authority of the accounting chamber regarding external audits, paving the way for modernising its audit practices in line with international standards. There is also growing interest in fiscal decentralisation and, together with possible changes in the tax systems, more effective formula-based transfers to local governments will need to be developed.

If, under the new Government, reform policies are upheld and reinforced, this will speed up the implementation of other reforms, make the public sector less prone to corruption and red-tape and improve the country's image, thereby putting Ukraine on an accelerated course to attract investment and thus faster development and growth. In this context, finalisation of the WTO accession process, currently expected in late 2006 / early 2007, will be an important step, giving fresh impetus to investment and economic growth.

In 2006, the Ministries of environmental protection and of the economy were entrusted with the joint task of drafting a framework strategy for **sustainable development** by the end of 2006, to be submitted to the Cabinet of Ministers and the Parliament for approval. The key challenge is to finish drafting this new strategy and activate inter-ministerial structures in order to ensure a true cross-sectoral approach to sustainable development issues.

Trade, market and regulatory reform

Trade policies

While total trade with Ukraine has increased in recent years, growth in imports has far exceeded growth in exports. In 2005, the merchandise trade balance turned negative (-USD 1.1 billion) and the current account surplus narrowed from 10.5% in 2004 to 3% of GDP in 2005. Exports of goods increased by 5% (41% in 2004), and imports by 25% (26% in 2004).

Regarding Ukraine's participation in the multilateral trade framework, in the last two years the Government has been committed to accelerating its accession to the WTO, which should enable Ukraine to join the WTO still in 2006. Bilateral protocols have been signed with all members of the WTO Working Group, except Kyrgyzstan. There has been progress on key issues related to WTO accession such as decreasing import duties in March and in June 2005; undertaking to comply with sanitary and phyto-sanitary standards upon WTO accession and adopt several SPS-framework laws, adopting key legislation on the protection of IPRs, streamlining the technical barriers to trade (TBT) regulatory framework and reducing export duties (sunflower seeds). At this stage, however, Ukraine still has outstanding matters to settle, in particular Parliament has yet to adopt the remaining WTO-related laws. This should include, for example, permits for foreign banks to open branches in Ukraine and a significant reduction of export restrictions on ferrous and non-ferrous metal scrap and hides/skins.

Regarding the future of Ukraine's trade relations with the EU, both sides are preparing for the start of negotiations of a Free Trade Area as part of a new Enhanced Agreement. Ukraine and EU agree that the negotiations on a Free Trade Area are conditional on Ukraine's WTO accession. Exploratory talks concerning the format and scope of the negotiations have taken place since May 2006.

On **customs**, steps have been taken to facilitate and speed up customs procedures, including implementation of the concept of a "single window" at the borders. A Customs disciplinary statute together with other anti-corruption measures was adopted. Customs valuation rules were harmonised with WTO standards and the computerisation of the customs service is proceeding, with the introduction of electronic customs declarations. Work on risk-based customs control started with the setting up of a Department on risk analysis and audit in the State customs committee. In order to foster dialogue with operators and to provide vetted operators with simplified procedures, the concept of a 'white list of economic operators' was introduced. The EUBAM has proven instrumental in providing training and support to Ukraine's customs officials, which has led to considerable improvements in customs procedures along the sensitive border with Moldova. In terms of remaining challenges, Ukraine will need to adopt appropriate legislative and administrative measures (including implementing legislation and introducing and developing modern techniques and procedures in line with international standards) in a number of crucial areas, such as risk analysis, simplified procedures,

customs valuation, control of counterfeited goods and application of the Harmonised System and single window, and combating corruption.

On the **free movement of goods and technical regulations**, Ukraine has confirmed its commitment to negotiate an Agreement of Conformity Assessment and Acceptance of Industrial Products (ACAA) and has selected the priority sectors to be included. Good progress is being made in implementing the “ACAA Action Plan” agreed in 2005. Several laws on standards, technical regulations and conformity assessment procedures and on consumer protection were adopted in 2006. Building up of the administrative, legal and technical capacity to manage and enforce legislation properly remains a challenge.

On **sanitary and phyto-sanitary** issues, progress was made in preparing for WTO accession, *inter alia* by enacting framework laws in the veterinary, phytosanitary and food safety areas and adopting a plan for compliance with WTO rules. Ukraine is a member of the Codex Alimentarius, the World organisation for animal health (OIE) and joined the International plant protection convention (IPPC) in 2006. Intensified cooperation with the EU included a general assessment of controls of feed and food safety, animal health, animal welfare and plant health, realized by the Commission's Food and Veterinary Office, whose preliminary conclusions were overall encouraging. An FVO inspection mission on fishery products took place in June 2005, and Ukraine has satisfactorily addressed the identified deficiencies. Therefore, Ukraine will be added to the list of countries authorized to export fishery products to the EU. Further planned cooperation will contribute to supporting Ukraine's efforts to improve food safety and to fulfil requirements for future exports to the EU e.g. eggs, milk products and meat will be considered for next step. Ukraine acted swiftly after the 2005/2006 avian influenza outbreak including by adopting a national contingency plan.

Recognising the need for reform, the Ukrainian Government has, in recent years, improved consultation with the business community. First steps in eliminating barriers to the **establishment** of companies were taken through the September 2005 law on the licensing system. This law simplified the legislation and sharply reduced the time and number of permissions required to start a business. The new legislation on automobiles eliminated local content requirements and special tax breaks for local production. However, there has been much less progress on of company law, notably as regards the adoption of a new Law on the joint stock company, the development of a framework of corporate governance and the modernisation of accounting.

Regarding **competition policy**, a new law “On protection of economic competition” was adopted in 2005. The Action Plan calls *inter alia* for assessment of the adequacy of the current legislative framework and ensuring the powers and independence of the Anti-monopoly committee of Ukraine. To evaluate its progress in this area in a neutral way, Ukraine has agreed to submit itself to an OECD "peer review" of its competition policy in the OECD's Global Forum on Competition, which will take place in October 2007, on the basis of an independent report available shortly before that.

On state aids, a draft state aid law, closely modelled on the *acquis*, was rejected by the *Verkhovna Rada* in 2004. The Anti-monopoly committee of Ukraine intends shortly to submit to the Government a draft law amending the law on protection of economic competition, in order to introduce elements of state aid control.

In 2005 Ukraine attracted large foreign direct **investment** (FDI) in the financial sector and steel industry. As a result, FDI reached a record total of USD 7.3 billion in 2005, though much of this was a single large transaction (Krivorishstal). FDI in the first half of 2006 stood at USD 1.7 billion.

In the absence of a substantial improvement in the investment climate, however, this steep increase in FDI inflows may prove to be a once-off phenomenon. Policy measures are required, for example, in areas such as the fight against corruption, a more transparent plan for further privatisation consistent with the rule of law, the adoption of the Joint stock company law, incompatibilities between the civil and commercial codes and court systems, the overall improvement of transparency and predictability and further reduction of the burden of licensing and inspection regimes.

Ukraine has reviewed its legislation on **services** in the framework of the WTO accession negotiation process. Concerning **financial services**, the National Bank of Ukraine has passed various resolutions with the aim of improving audit and supervision in the banking sector. A draft law on banking activities, concerning the conditions for the setting up of credit institutions and minimum capital requirements, was adopted in September 2006. Progress has also been made with the adoption, in 2005, of legislation concerning the regulation of securities markets, which enhances the powers of the State Commission for Securities, and on the licensing of professional activity in the securities market.

There has been no progress in the area of freedom of **capital movements**. The national bank of Ukraine introduced new regulations which still contain restrictions on the purchase by non-residents of short-term government securities, cumbersome requirements for foreign payments and reserve requirements on foreign currency loans from non-residents.

Movement of persons including movement of workers

Ukraine has not yet ratified the European Convention on the legal status of migrant workers. In June 2005, the Ukrainian authorities and the Council of Europe secretariat held a round table to discuss ratification of this Convention.

Other key areas

Sector-specific tax privileges and provisions on special economic zones, which were incompatible with WTO provisions and the EU Code of conduct on business taxation, have been ended. Ukraine will however need to make sure that new tax exemptions in the special economic zones are compatible with these provisions. The discrimination in the use of promissory notes was removed and VAT reimbursement was partially reformed,

including in terms of audit procedure and the creation of computer registers of tax invoices and a related automated system. Although the backlog was reportedly reduced, in August 2006 the reimbursement of VAT refunds was temporarily stopped, allegedly to fight fraud and identify fictitious reimbursement schemes. Major actions still need to be taken to strengthen the administrative capacity of the tax administration in line with EU standards.

A new law on protection of economic competition was adopted in 2005 but contains inconsistencies with the commercial code.

On **intellectual property rights**, progress has been made in upgrading relevant legislation (notably in the area of laser-readable disks and raising criminal sanctions) and, partly, its enforcement. Effective implementation and progress on issues such as geographical indications (GIs), data protection and copyright obligations is required.

As regards **public procurement**, the many changes that have been introduced into the legislative and administrative set-up have reduced transparency and some key changes are not in accordance with international and EU best practices. Information on public procurement has become more difficult to obtain while the division of responsibilities between public and private bodies is now unclear. It has, however, been agreed to collaborate on improving this legal and institutional situation.

Regarding **statistics**, statistical discrepancies are the subject of discussions under enhanced cooperation between EUROSTAT and the Ukrainian State statistics committee and customs services. This dialogue focuses on tackling methodological differences, data exchange, amendment of Ukrainian legislation to simplify procedures for updating national classifications and joint detailed analysis of external trade data (“mirror statistics”). The administrative capacity of the State statistics committee is being improved, with the assistance of the EC and other donors. This is reflected in higher quality data.

There has been good progress in the area of **public internal control**, notably incorporating some extra-budgetary funds in the budget, extending of internal and external audits to state-owned enterprises and implementing of a strategy on the development of internal control and audit systems, which is being discussed with Commission experts. The external audit institution has been given the mandate to audit revenues. Internal audit units in spending ministries are being strengthened. Managerial accountability and performance audits need, however, to be developed.

Discussions with Commission experts are taking place with a view to the possible adoption and implementation of the European Charter for **Small Enterprises**. An Euro-info Centre was opened in Ukraine at the end of 2005.

Co-operation on justice, freedom and security

Revision of the JLS Action Plan

A review of the 2001 EU-Ukraine JHA Action Plan was launched at the end of 2005. The review is based on two major EU JLS expert missions deployed to Ukraine in December 2005 and February 2006. The Action Plan was streamlined and specific actions were updated in the context of the range of priority areas already defined in the 2001 plan.

Readmission and visa facilitation

Twelve rounds of readmission negotiations and four rounds of visa facilitation negotiations took place before the simultaneous initialling of the EC-Ukraine readmission and visa facilitation agreement at the October 2006 EU-Ukraine Summit. The visa facilitation agreement specifies conditions for facilitated access of Ukrainian citizens to EU visas, including the waiving of visa and visa fee requirements for certain categories, as well as conditions for obtaining long-term visas and documents required to justify the purpose of travel.

For its part, Ukraine is, in addition, a signatory to bilateral readmission agreements with twelve countries. The signature of a readmission agreement between Ukraine and Russia is outstanding, while a readmission agreement with Belarus is under preparation. Concerning **visa facilitation**, Ukraine abolished visa requirements for EU citizens in July 2005.

Other aspects of the implementation of the JLS Action Plan

In the area of border management, reform of the State Border Guard Service (SBGS) is still underway and a concept and programme for the development of the SBGS was approved by the Government in April 2006. Co-operation agreements between the Ukrainian and Slovakian, Belarusian and Moldovan border guard services were signed in 2005. The demarcation of Ukraine's borders with Russia, Belarus and the central/southern border with Moldova has not yet been achieved.

Concerning asylum and migration, an overall long-term strategy on asylum has yet to be drafted, and a Ukrainian migration service has yet to be set up as one single state authority dealing with immigration and asylum issues (five different state structures are still in charge of various aspects). In May 2005, the Law on refugees was amended to comply with the wording of the 1951 Geneva Refugee Convention with regard to certain aspects of asylum procedure. The conditions in certain centres for refugees and illegal migrants need urgent improvement.

In the fight against trafficking of human beings, Ukraine signed the Council of Europe Convention on Action against Trafficking in Human Beings in November 2005 but has not yet ratified it. In January 2006, the Criminal Code was amended as to include criminal liability for human trafficking and crimes related to prostitution. The 2006 Action Plan for 2006 on the Prevention of and Counteracting Legalisation (Laundering) of Proceeds Obtained and Terrorism Financing was approved by the Government in April 2006. Ukraine also signed the Council of Europe Convention on the Prevention of Terrorism in May 2005.

Co-operation agreements between Ukraine and EUROPOL and EUROJUST are being negotiated. In August 2005, Ukraine signed the Council of Europe Convention on Protection of Personal Data.

Transport, energy, the information society and the environment

Ukraine continues to implement its **transport** policy, in particular as regards infrastructure development, land transport and aviation. Standards for road transport have been raised, in particular as regards roadworthiness of vehicles, licensing of transport operators and introduction of rules on driving times and rest periods applied internationally. As regards passenger transport, Ukraine intends to adhere to the Interbus Agreement. In the rail sector, Ukraine has actively participated in the development of the common consignment note and work on intermodality and interoperability. In the aviation sector, progress has been made regarding the adoption of European rules but Ukraine has still to make efforts to improve safety standards and to become a full JAA member. EC carriers still face problems in doing business. In the maritime sector, there are safety concerns about an ageing fleet and control deficits, although the situation is somewhat better in the inland waterways sector. The restructuring of the state-owned port sector (separating operational and commercial functions) is progressing very slowly. The EU has reached an agreement with Ukraine on its participation in the Galileo programme, a joint initiative of the European Commission and the European Space Agency (ESA) to provide Europe with its own independent global civilian controlled satellite navigation system.

Ukraine contributes, as a key transit country, to the EU's **energy** security, notably as regards transit of Russian gas and oil supplies. EU-Ukraine energy relations have been considerably stepped up by means of a 2005 Memorandum of Understanding on energy cooperation, the implementation of which has begun. Following a dispute on gas prices with Gazprom, the move towards market-related prices accelerated. Ukraine wishes to ensure its supply security, increase its transit role and integrate into the EU's internal energy market. Steps in this regard include the adoption of a new energy strategy-2030, the commitment to use the Odessa-Brody oil pipeline in the South-North direction and participation in the ongoing study to extend it to Plock (Poland), the start of preparations to establish security oil stocks and active involvement in the "Baku" process on regional energy cooperation in the Caspian/Black Sea area. Ukraine obtained observer status in the Energy Community Treaty, and its aim is full membership. In addition, Ukraine submitted (jointly with Moldova) an application for parallel operation with the interconnected electricity networks of continental Europe (UCTE). A debt law was adopted, energy tariffs were revised but are still not at commercially-sustainable levels and a second stage of developing the wholesale electricity market is being implemented. Ukraine further reduced network losses, including through enhanced surveillance and the adoption of a law criminalising electricity theft. The installation of border gas meters, key to ensuring transparency in the gas business, advanced including through the signature, in September 2006, by Ukraine and the European Commission, of an *aide memoire* on energy investments. Ukraine further implemented its coal sector restructuring programme and improved mine safety *inter alia* through the new "Programme to increase labour

safety in mines 2006-2010". The promotion of energy efficiency and the use of renewable energy sources were enhanced by the new Energy Policy-2030, the establishment of a new agency, the amendment of the energy saving law, the adoption of a co-generation law and a bio-fuels decree and by plans for the EBRD to provide financing of up to €100 million for investment in energy efficiency in Ukraine.

Following signature in 2005, the EURATOM-Ukraine Cooperation Agreement on the peaceful uses of nuclear energy entered into force in September 2006. Ukraine addressed certain nuclear safety issues regarding the K2R4 nuclear reactors and fulfilled the conditions for effectiveness of the EURATOM and EBRD loans required for further improvements. Nuclear safety of the other operational reactors continued to be improved through the implementation of a 2005 Programme of modernisation and increase of security of nuclear power plant reactors. The 2005 Concept for improving the safety of operational nuclear power units until 2010 has been approved and its implementation begun. Some progress has been achieved on the projects at the Chernobyl site, particularly on stabilising the existing shelter which is at an advanced stage of completion, but the contract for the New safe confinement is yet to be concluded. Ukraine has been urged by Chernobyl shelter fund donors to take the necessary actions to expedite the implementation of this project. Ukraine must do so as a matter of the highest urgency. Ukraine further strengthened its nuclear regulator, and established a state inspection service for nuclear and radiation safety. It began to set up the establishment of a decommissioning fund for its existing nuclear power plants.

Key **environment** issues relate to air quality, water quality, waste management, nature protection and radiation contamination in the north-east of Ukraine. It has made important progress on climate change, as national structures have been set up, joint implementation guidelines adopted, an inventory of greenhouse gases carried out and several joint implementation projects prepared. The 1998-2008 National Environment Strategy is being reviewed. Framework legislation and sectoral legislation is in place in most areas, but require further development, in particular implementing legislation. Recent legislation includes a law on environmental audits, amendments to the water code and an order to inform the public about polluting installations. New laws on waste, integrated permits and integration of environment into other sectors are under consideration. The latest strategic programmes include a 2006-2020 programme on drinking water and a draft national strategy on water resources protection. Ukraine has not published state-of-the environment reports since 2003, but has nevertheless made progress in improving public access and involvement in environment matters.

The Ministry of environmental protection was restructured at the end of 2005, but a major challenge is to strengthen administrative implementation capacity at national, regional and local level, including coordination between authorities. Ukraine has ratified relevant international and regional conventions and protocols, with a couple of exceptions. Ukraine participates actively in the Danube – Black Sea Task Force and the International Commission for the Protection of the Danube River. Ukraine also benefits from activities undertaken under the EU Water Initiative. Work is underway to establish a Regional Environmental Centre. In the wake of the "Bystroe channel project", Ukraine

signed up to the joint "Vision for the conservation and sustainable development of the Danube Delta". The European Commission and Ukraine have enhanced co-operation on climate change, environmental governance, waste management and water quality.

As regards the **information society**, the National commission for communications regulation (NCCR) was created in April 2005. The first stage of tariff reforms based on cost orientation was implemented in July 2006 with a second stage planned for November 2006. There is a need to strengthen the NCCR's administrative capacity and independence and to implement the National concept of telecommunications development until 2010, adopted by the Government in June 2006. The incumbent operator UKR Telekom holds the monopoly for the fixed telephony market. Regarding **audiovisual** policy, the Council of Europe convention on trans-frontier television has still not been ratified, although sector legislation has been adopted.

In the area of research and innovation, Ukraine is currently reviewing its policy in order to enhance its research capacities to better exploit its high human potential and research tradition. An increase in the low level of investment in research is planned. Participation by Ukrainian scientists in FP6 has been encouraging in the fields of life sciences, materials science, nuclear safety and environmental protection as well as in aeronautics research and the use of space. In order to achieve to the fullest possible extent the overall objective of the EU-Ukraine Action Plan of reinforcing cooperation with a view to integrate the Ukrainian scientific community in the European Research Area, a coherent approach to joint decision-shaping and policy implementation processes is being more fully developed through mechanisms and actions aimed at creating progressively common research agendas combined with closer and co-ordinated implementation tools.

People-to-people contacts

Ukraine has made progress with reform, particularly in higher **education**, since 2005, realising that reforms are necessary to ensure quality and relevance and to retain a high level of human resource development. The country joined the Bologna Process in May 2005 and has set up an inter-ministerial group to ensure implementation. A Government resolution for new accreditation and licensing procedures is under consultation with stakeholders. A Presidential Decree has established a framework for social dialogue, aimed particularly at education and **training**.

Policy dialogue has intensified between Ukraine and the European Commission on education and training issues. Ukraine makes good use of Tempus to support reforms in higher education and capacity-building. Steps have been taken to increase participation in the Tempus programme, the number of Ukrainians participating in Erasmus Mundus has been steadily increasing and four Jean Monnet projects are under implementation. Education will be a focus area for EC cooperation with Ukraine from 2007-2010. Moreover, Ukraine participates actively in the **Youth** programme, with 74 multilateral youth projects in 2005.

The process of ratification of the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions is ongoing. Ideas for enhanced cultural cooperation are under discussion.

Public health reforms continued and need to be further pursued to ensure, in particular, improvement in quality and more efficient functioning of this sector, including as regards the use of available financial means. In order to combat the rapid spread of HIV/AIDS, a national programme 2004-2008 is being implemented and various institutions were established across the country. Both the President and Deputy PM were involved in public information campaigns. Ukraine has begun to participate in the Commission's HIV/AIDS think tank.

Assistance

Over the last two years, EC assistance to Ukraine has been increasingly geared towards supporting the achievement of key policy objectives as outlined in the EU-Ukraine Action Plan. The training of judges and human rights experts under the joint programmes with the Council of Europe, the successful launch and implementation of the EU Border Assistance Mission (EUBAM) and the assistance provided to help Ukraine eliminate landmines and old ammunition are just some illustrative examples. The introduction of new cooperation instruments such as twinning and TAIEX strengthens the EC's ability to provide expert advice and to support technical cooperation in regulatory areas. The first twinning projects are being launched in important areas such as electricity regulation, competition policy and norms and standards.

EC financial assistance to Ukraine has increased substantially in recent years from €50 million in 2003 to €100 million in 2006. With the entry into force of the new European Neighbourhood and Partnership Instrument (ENPI) in 2007, financial allocations will increase further as will the strategic, policy-driven character of EC assistance programmes to Ukraine. Future EC assistance to Ukraine will therefore focus on strengthening good governance and democratic development, regulatory reforms and infrastructure development. Infrastructure development will particularly focus on the energy sector, in close collaboration with the EIB, EBRD and other international financial institutions.