Reforming state aid in Ukraine

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Executive Summary

The ineffectiveness of budget spending has historically been one of the main flaws in Ukraine’s budgetary system, especially due to the lack of clear rules about providing state aid to commercial entities. Different estimates put the cost of such assistance at between 4-5% of GDP. Ukraine also currently lacks an oversight over the provision of state aid. This is the crucial reason for ineffectiveness of spending on state aid to various branches of the economy and individual enterprises. Moreover, the impact of state aid on the country’s economy, in particular on competition, is not analyzed. The losses incurred from this nontransparent and inefficient state aid run to the billions of hryvnias, while the resulting distortion of competition has a very negative impact on the investment climate. The latest casualty of all this was the EU Budget Support program, which was terminated in February 2012.

Ukraine committed to approve rules for the state aid. It is one of the priorities of the Association Agenda with the EU in the sphere of competitiveness. Still, the framework law on state aid has not been approved, although several versions of a bill have already been drafted. Lack of political will and disagreement in the Government about the principles of regulation is the main reason for the delay.

To make the system more effective, a number of steps need to be taken to carry out the Concept for Reforming State Aid that has already been given a green light by the Cabinet: approving the framework law on state aid, inventorying such aid as is already being provided, and establishing which government bodies are authorized to oversee and monitor the provision of such assistance. Moreover, this framework legislation should be based on such principles of public administration as non-interference and the independence of institutions, transparency and delimited timeframes. If these conditions are met, state aid to commercial entities might actually begin to foster economic growth with a minimum of negative impact on competitiveness.
Contents

1. Introduction .................................................................................................................................................3
2. Definition of state aid and its impact on competition ..............................................................3
3. State aid in Ukraine .................................................................................................................................4
   3.1. The rules for state aid ....................................................................................................................4
   3.2. A tentative estimate of state aid spending ................................................................................5
   3.3. Ukraine’s commitments regarding state aid and reform initiatives ........................................8
4. WTO and EU rules on state aid ...........................................................................................................8
   4.1. The WTO rules ...........................................................................................................................8
   4.2. The EU rules .............................................................................................................................9
   4.3. Some conclusions for Ukraine .................................................................................................9
5. How to reform state aid in Ukraine .....................................................................................................10
6. In lieu of conclusions ............................................................................................................................12
1. Introduction

The ineffectiveness of public spending has historically been one of the main flaws in Ukraine’s budgetary system. The first reason for this is the lack of medium-term planning. The second reason is the constantly large number of budget programs with funding not tied to clearly-established performance criteria. This makes it impossible to have effective control over spending. Last but not least is the widespread corruption that fosters the misappropriation of public spending and prevents positive outcomes.

Every single Ukrainian Government has promised to improve the effectiveness of budget expenditures and free up tens of billions of hryvnia, but few measures have ever actually contributed to achieving this goal. So, year after year, the State Budget loses large sums due to the ineffectiveness of public spending. Just the officially reported misappropriations of public funds discovered by the Accounting chamber and state financial audit institutions add up to tens of billions of hryvnia.\(^1\) The latest display of all this was another suspension of EU Budget Support program, in February 2012.\(^2\)

Right now, the problem is not how (and if) Ukraine has spent the money it received from the EU under various energy efficiency projects, but the fact that Ukraine lacks clear rules about the provision of state aid to commercial entities. State aide constitutes, according to various estimates, 4-6% of GDP. Moreover, there is no appropriate oversight of state assistance. This is the key factor leading to ineffectiveness of subsidies to various sectors of the economy and individual enterprises. If there were clear rules that met international standards, it would become harder to embezzle public funds.

Moreover, the state does not analyze the impact of this assistance on the economy. State aid may be provided to use economic resources more efficiently by addressing market failure or to redistribute available resources to reach certain policy goals. At the same time, state aid distorts the market mechanism by providing advantages to some competitors over others. This makes state aid controls necessary to limit negative impact on the economy and to ensure that state aid is truly in line with public policy goals.

In this paper, the authors attempted to analyze the current situation with state aid in Ukraine\(^3\) (Section 3) and to evaluate the country’s commitments related to its membership in the WTO and its intentions to integrate into the European Union (Section 4). This analysis is then used to propose certain principles for reforming the system of state aid and to suggest the provisions that should be contained within the Law “On state aid to commercial entities” (Section 5).

2. Definition of state aid and its impact on competition

State aid is defined as state interference in the economic activity of agents, sectors or regions that provides these with advantages.\(^4\) Moreover, this interference often involves the expenditure of state funds or their loss. Since state aid can distort competition, state aid policy is an important component of competition policy. The main purpose of competition policy is to provide a level

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2. [http://www.kommersant.ua/doc/1868231](http://www.kommersant.ua/doc/1868231)
3. This paper primarily considers state aid as state interference in the economic activities of commercial entities. Social assistance to individuals is not under consideration here.
playing field for all companies on a market. While EU rules generally focus more on competition on domestic markets, WTO rules are geared more towards competition on the world market.

Proper state aid can foster economic development by overcoming market failures. In addition, it can serve the social goal, which would justify the welfare losses of a less efficient economy. For this reason, most countries regulate the provision of state aid to specific sectors of their economies while emphasizing the need to uphold competition. Rules of fair competition are gaining significance in Ukraine, given the country’s international commitments.

State subsidies can be divided into direct and indirect subsidies by form. Direct subsidies are direct transfers of economic benefits to the beneficiary.\(^5\) Usually, there is a clear accounting of direct subsidies, making them more transparent and readily subject to analysis. Indirect subsidies include tax benefits, deferred payments on obligation, cheap loans, subsidized prices for inputs, guaranteed loans, and so on. They sometimes also include discounted prices for state products and services or discounted leases on state property. As a rule, indirect subsidies are accounted for less clearly, making it much more difficult to control their use.

Aid can also be divided into regional, sectoral and horizontal depending on principle of distribution. Regional aid is intended to help development in depressed regions and can include setting up special economic zones (SEZs) and transfers from the central to local budgets. At the same time, sectoral aid comes generally as subsidies and grants to specific sectors of the economy during a crisis or shifts in economic structure. Horizontal aid is granted without regard to sector or region and intended to resolve such issues as easing unemployment, improving environmental quality, supporting SMEs, or stimulating innovation. Governments can thus promote development in depressed regions or in specific sectors of the economy through effective and appropriate policy measures regarding state aid. Experience of developed countries suggests that regional and horizontal aid is more effective in fostering economic development in a country. At the same time, sectoral aid dampens competition the most.

Sectoral aid often gets in the way of the restructuring of a given sector and results in the inefficient allocation of resources. Moreover, government creates moral hazard risks by providing aid as it protects companies from the negative consequences of their actions. State aid can also spur rent-seeking behavior that is primarily aimed at gaining more aid, rather than at improving economic and commercial efficiency. When state aid is provided as part of political process, it is also likely to be given to beneficiaries who have serious political clout.

State aid needs to be properly regulated because of the limited nature of public resources, a fact that makes it impossible to help all economic agents. Moreover, such aid can and does distort competition because the given benefits may be offered to a few enterprises—and not necessarily on objective, justifiable grounds. This, in turn, hurts the country’s investment climate because potential investors can see different rules of play for various commercial entities.

3. State aid in Ukraine

3.1. The rules for state aid

So far, Ukraine has not approved a law on state aid to the economy, although the first attempts to draft and adopt such a law were made more than a decade ago. Meanwhile, there are a number of pieces of legislation that partly regulate the provision of state aid to commercial entities: the Commercial, Budget and Tax Codes, the Laws “On protecting economic competition”\(^6\) and “On

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\(^5\) Oleksandra Betliy, Reforming state aid in Ukraine.

\(^6\) The Law “On protecting economic competition” specifically prohibits any attempts to stifle competition, including “providing discounts or other advantages...to individual commercial entities that place them in a privileged position in relation to their competitors and that result or could result in preventing, eliminating, restricting or distorting
stimulating regional development," and numerous concepts on development of particular industries or individual sectors of the economy. Often state aid is provided under sectoral laws that are adopted individually every time a decision is made to aid one sector or other. These provisions later influence the drafting of the State Budget, but the laws themselves lack any clear definition of state aid and how it is supposed to be given.

Benefits or subsidies are also provided for in other legislation. For instance, when the newly adopted Tax Code granted tax breaks to a number of industrial sectors, such as shipbuilding, the light industry and the hospitality industry (hotels and restaurants). Enterprises in these industries were relieved of paying enterprise profit tax for the following 10 years. At the same time, it remained unclear how these industries were chose and the rationale behind such breaks is questionable at best.

In 2011, the Government once again confirmed the priority of supporting the energy sector. In particular, the Tax Code\(^7\) was amended to allow power companies to include capital outlays in their overall expenses, which considerably reduced their taxable profits.

Ukraine still lacks a clear, transparent procedure for providing state aid to commercial entities. Nor has it established an entity responsible for controlling this process. The main state authority that makes decisions on state aid is the Ministry of Finance. It decides the volume of state aid, which is included into the draft State Budget, and it analyzes the budgetary impact of all the bills proposed by the Cabinet and most of the ones submitted by other state bodies. The Anti-Monopoly Committee (AMC) is responsible to ensure equal opportunities for all companies and protect competition on the market. Practice shows that cooperation between these two agencies is quite ineffective, given the differences in their functions. While the Ministry of Finance, along with a number of other ministries, sees state aid as an instrument for stimulating economic activity and as simply another area of public spending, the AMC looks at the impact of state aid on competition and considers state aid unnecessary. Typically, however, the Anti-Monopoly Committee only gets involved in state aid cases when such aid significantly distorts competition on a particular market, and not to regulate and analyze the overall impact of state aid. Moreover, the powers of the AMC extend mostly to local government bodies.\(^8\) As a result, no one is carrying out impact analysis of state aid measures on competition in Ukraine. According to current legislation, oversight can only be exercised after the fact, when such aid was given to commercial entities.

The problems with state aid are merely one component of the larger problem with ineffective control over all public spending in Ukraine. Lack of medium-term planning and clear performance criteria in budgeted programs means that budget funds are ineffectively used, including those for state aid. In the absence of monitoring and oversight, in turn, the system remains opaque and the risks that corruption will occur and spread remain high.

Currently, Ukraine does not conduct oversight over state aid. Impact assessments of state aid on competition and international trade are not carried out. Nor is there any monitoring of the effectiveness of the aid that is provided. As a result, the state aid system remains extremely untransparent.

### 3.2. A tentative estimate of state aid spending

The rules for providing state aid, whether as subsidies or as tax breaks and exemptions, are not especially understandable or clearly set out. There is a list of tax breaks, but nothing is published

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\(^7\) Law of Ukraine № 2755-VI dated December 2, 2010.

\(^8\) Although the powers of the AMC extend to ministries and other CEBs, decisions at the central level regarding state aid are generally the remit of the Verkhovna Rada or the Cabinet of Ministers.
about the State Budget funds allocated to these purposes, let alone a list of the beneficiaries of such aid. In short, establishing the volume of state aid to commercial entities is no trivial matter. This section presents some estimates of the possible volume of state aid.

A look at consolidated fiscal expenditures shows that state aid is mostly provided to a number of “fat” sectors of the economy: coal mining and the agro-industrial complex (AIC) (see Table 1). Direct subsidies to these sectors amounted to around 2.5-3% of GDP over these years. Thus, lack of political will was the main reason why state aid reforms did not move ahead. Moreover, a major share of this aid is being provided in discretionary manner. The principles of aid for the coal industry have remained largely unchanged,9 while aid to the farm sector transformed since Ukraine joined the WTO.

Table 1: State aid of commercial entities in Ukraine

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consolidated Budget spending on economic activity, bn UAH</strong></td>
<td>29.7</td>
<td>38.7</td>
<td>33.2</td>
<td>47.1</td>
<td>57.1</td>
</tr>
<tr>
<td><strong>Consolidated Budget spending on economic activity, % GDP</strong></td>
<td>4.1</td>
<td>4.1</td>
<td>3.6</td>
<td>4.6</td>
<td>4.3</td>
</tr>
<tr>
<td><strong>Total Consolidated Budget losses from discounts and exemptions on taxes and fees, bn UAH</strong></td>
<td>13.5</td>
<td>17.9</td>
<td>22.6</td>
<td>29.5*</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Total Consolidated Budget losses from discounts and exemptions on taxes and fees, % GDP</strong></td>
<td>1.9</td>
<td>1.9</td>
<td>2.5</td>
<td>2.7*</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Total aid for AIC, % GDP</strong></td>
<td>2.1</td>
<td>2.2</td>
<td>1.9</td>
<td>1.7</td>
<td>…</td>
</tr>
<tr>
<td>Budget spending on AIC, % GDP**</td>
<td>1.4</td>
<td>1.4</td>
<td>1.0</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td>Tax expenditures, % GDP</td>
<td>0.7</td>
<td>0.8</td>
<td>0.9</td>
<td>0.9</td>
<td>N/A</td>
</tr>
<tr>
<td>Manufacturing subsidies (Yellow Box), % of cash aid**</td>
<td>45.8</td>
<td>40.9</td>
<td>21.8</td>
<td>26.8</td>
<td>19.9</td>
</tr>
<tr>
<td><strong>Coal sector aid, % GDP</strong></td>
<td>0.8</td>
<td>0.8</td>
<td>1.1</td>
<td>1.0</td>
<td>0.8</td>
</tr>
</tbody>
</table>

*Finance Ministry estimates

** State spending on the farm sector is grouped according to how they affect processing and trade: spending that distorts or does not distort the market or those that stimulate or hamper development. This grouping matches WTO classifications of state aid called Yellow Boxes, that is aid programs that retard development, and Green Boxes, measures that stimulate development.

Source: Author calculations based on reports from the State Treasury and data from Derzhkomstat, the state statistics agency.10

Over the last few years, Consolidated Budget expenditures under the heading “Economic activity” have averaged nearly 4.0% of GDP. These expenditures generally constitute the cash value of direct state aid for specific branches of the economy.

Meanwhile, indirect subsidies constitute a large share of state aid. According to the State Tax Administration (STA)’s estimates, lost fiscal revenues from tax breaks in 2010 reached UAH 29.5bn or

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9 Aid to the sector has actually grown due to lack of restructuring and a powerful industrial lobby.
10 A. Kuznetsova and O. Niviyevskiy, Assessment of state aid to the farm sector: A review of agricultural policy: State expenditure on farm aid and rural development programs, № 1/2012 (February 2012), German-Ukrainian Agricultural Dialog.
close to 2.7% of GDP. This means that the total state aid was likely more than 6% of GDP in 2010: even though tax breaks in the farm sector went down, new tax breaks were instituted for power utilities, aircraft manufacturing and the hospitality industry. The World Bank assessed this kind of aid as ineffective and claimed that it distorts competition on the market as some companies have wider access to the aid than others.

Thus, in Ukraine state aid is more than 4% of GDP, whereas in EU countries, such aid, as a rule, rarely amounts to more than 1% of GDP and is provided on the basis of clearly defined rules and principles. The main principle lies in minimizing the market distortions and negative impact on competition (see Section 4). During the recent crisis, aid grew to 2% of GDP because of supplementary anti-crisis stimulus programs for individual sectors of the economy and companies.

One more component of state aid is guaranteed loans to individual companies. By the end of 2011, the Ukrainian state was guaranteeing debt worth UAH 116bn but most of these guarantees were provided within public sector. Traditionally, the Cabinet of Ministers has broad powers to offer guarantees.

The large volume of quasi-fiscal operations (QFOs) in Ukraine contributes to the lack of transparency in state aid. The largest QFOs involve discounted utility tariffs. In particular, low heating tariff led to a steep rise of debt of heating companies before the ‘Naftogaz Ukrainy’. By January 2011, this debt had risen to UAH 12.3bn and had still been not paid off by June, so the Verkhovna Rada decided to write off the debts of local heating plants and natural gas distribution companies known as oblgasenergos. Another law was passed to write off tax debts accumulated by the Naftogaz, heating generating companies and oblgases — nearly UAH 20bn by January 1, 2011. Debt of “Gas of Ukraine”, subsidiary of Naftogaz to parent company, was also written off. Below-cost natural gas rates for residential customers and heating generating companies have reduced the Naftogaz’s liquidity and forced the government to recapitalize the Naftogaz through extra-budgetary government bond issues. This large volume of quasi-fiscal operations in the energy sector has cost the State Budget considerably in indirect subsidies.

Moreover, QFOs are also handled by state banks that, among others, provide loans to state companies, foremost among them Naftogaz Ukrainy, and are also often the buyers of T-bills that are part of the authorized capital of Naftogaz.

Although the volume of aid provided by the Ukrainian government is considerable, there is no separate report prepared regarding state aid that has been provided to various commercial entities. As a result, there is little transparency in this regard and the effectiveness of the aid is highly questionable. Meanwhile, the share of indirect subsidies remains high and, being by its nature even less transparent, it also constitutes ineffective assistance and distorts competition on the market. Horizontal aid is nearly nonexistent, while regional aid is largely in the form of equalizing transfers from the State Budget to local budgets.

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11 Explanatory brief to the Bill on the 2010 State Budget, April 2010.
14 According to the IMF, quasi-fiscal operations (QFOs) can be defined as those operations that are handled by financial and non-financial state institutions, and sometimes by the private sector, at the request of the Government, and which are fiscal in nature. In other words, these are operations that could be duplicated by special fiscal means, such as through taxes, subsidies or direct spending, although their value is very hard to estimate in individual cases. (Source: IMF, Code of Good Practices on Fiscal Transparency, 2007, p. 11.)
15 Regional aid was cut back in 2005 when free economic zones (FEZs) were shut down.
3.3. Ukraine’s commitments regarding state aid and reform initiatives

In its international agreements, Ukraine has committed to reform its competition policy. As a member of the WTO, Ukraine is supposed to carry out the provisions of the Agreement on Subsidies and Countervailing Measures. Otherwise, other countries may apply countervailing measures against Ukraine.

Moreover, in its Partnership and Cooperation Agreement (PCA) with the EU, Ukraine has committed to maintain a free market. In the Ukraine-EU Association Agenda, the two sides agreed that the country would work towards more effective state aid system with controls and monitoring systems in order to improve competition on the domestic market. The agreed text of the Association Agreement also contains commitments on the part of Ukraine in this sphere. Still, the country did not take sufficient steps in this direction so far.

To begin the adaptation of Ukraine’s legislation to EU rules in regard to state aid, at the beginning of 2010 the Cabinet of Ministers approved the Concept of Reforming the System of State Aid to Commercial Entities. As part of this Concept, the plan was to draft and pass a law on state aid, to inventory existing state aid, and to set up a single registry of data on state aid. In response to this, the Anti-Monopoly Committee prepared draft law “On state aid for commercial entities” and submitted it to the Cabinet of Ministers for approval in November 2011. So far, the bill was not approved. The implementation of other measures called for in the Concept is also in doubt.

4. WTO and EU rules on state aid

4.1. The WTO rules

WTO member countries committed under the Agreement on Subsidies and Countervailing Measures (SCM) not to apply export or import subsidies (state aid). Indeed, other forms of subsidies are also prohibited, if providing them caused noticeable harm to the industries of other member countries and if they are provided on specific basis, rather than to all enterprises that meet certain objective criteria. Under Article XVI of the GATT, countries are required to notify the WTO about any subsidies that restrict imports or increase exports.

Art. 1 of the SCM Agreement sets out the main features of a subsidy:

− financial contribution from the Government through budgetary spending, loss of revenues or state supply of goods;
− advantage granted to an enterprise;
− specificity of the subsidy.

Enforcement of these provisions takes place post factum that is, after the state has provided aid, and only in the event that other member countries are concerned about the impact of the subsidy on their own economies. Enforcement may be undertaken within the WTO or national procedures on countervailing measures.

From an economic point of view, this kind of oversight is justified by the need to establish a level playing field for global competition and to prevent a counterproductive race which country gives its businesses the most aid.

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16 Agreement on Subsidies and Countervailing Measures, Uruguay Round, WTO.
17 The Ukraine-EU Association Agenda for preparing and aiding the implementation of the Association Agreement.
18 The Resolution of the Cabinet of Ministers, No.81-r dated January 13, 2010.
19 Draft regulation: Bill of Ukraine “On state aid of commercial entities.”
4.2. The EU rules

EU countries are among the few WTO members who have a system of before-the-fact oversight over the provision of state aid to branches of the economy. The EU presumes that any form of state aid distorts competition and, thus, is prohibited under the Treaty on the Functioning of the European Union. Nevertheless, EU legislation contains several exceptions to this general principle. EU rules for state aid impose control over various forms of aid granted to commercial entities by their governments. The purpose of this oversight is to prevent any harmful impact on competition in the common market, to restrict creation of “economic rents,” and to prevent the ineffective use of public money in a “subsidies race.”

In the EU, the provision of state aid takes place only with prior approval from the European Commission, which determines whether the proposed aid falls within the established exceptions to the general prohibition. For instance, a several forms of horizontal aid, including aid to R&D and SMEs — was declared serving common European interests. Other forms of aid, such as funding to restructure an enterprise, have to meet certain criteria to be permissible. In exceptional cases, decisions may be made based directly on the Agreement on the Functioning of the European Union.

The EU imposed strict regulation over state aid primarily to establish a level playing field for all players on the common market. Also state aid must be in line with the common interests of all EU members. This shifts the focus to state aid that is intended to address market failures. Redistributive state aid is reduced to the lowest common denominator among EU countries.

Box 1: Defining state aid in the EU

A state policy measure is defined as state aid if it meets four main criteria:

− there has been an intervention by the State or through State resources which can take a variety of forms (e.g. grants, interest and tax relieves, guarantees, government holdings of all or part of a company, or the provision of goods and services on preferential terms, etc.);
− the intervention confers an advantage to the recipient on a selective basis, for example to specific companies or sectors of the industry, or to companies located in specific regions;
− competition has been or may be distorted;
− the intervention is likely to affect trade between Member States.

By contrast, general measures are not regarded as State aid because they are not selective and apply to all companies regardless of their size, location or sector. Examples include general taxation measures or employment legislation.

Source: [http://ec.europa.eu/competition/state_aid/overview/what_is_state_aid.html](http://ec.europa.eu/competition/state_aid/overview/what_is_state_aid.html)

It should be pointed out, that EU definition of state aid is very similar to WTO rules, but not identical. For instance, a given program is considered state aid under EU rules if there is a net loss of state resources, whereas a program is a subsidy in accordance to the WTO rules if any financial contribution from the state is involved. Moreover, the European Commission does not review the impact of state aid on external markets when determining its acceptability. This means that state aid that is granted under EU rules could be in conflict with WTO rules, as was seen in the case of state aid for Airbus production.21

4.3. Some conclusions for Ukraine

In short, EU experience can help Ukraine determine which forms of state aid are least likely to distort the market mechanism, while using EU oversight mechanisms could aid Ukraine in fulfilling its

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21 [http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds316_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds316_e.htm), [http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds353_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds353_e.htm)
international commitments. At the same time, it is important to understand that certain forms of state assistance that the EU might accept in the common European interest might not be in Ukraine’s best interest. And the opposite is true as well, that Ukraine, with its transition economy might find it appropriate to provide certain forms of state aid that would be prohibited in the EU.

Since Ukraine has not yet joined the common market with the EU, the country can operate more flexibly in providing state assistance than EU members. Similarly, in applying EU practice, it is important to understand that criteria designed for the EU regarding the adequacy of certain types of state aid need to be adapted to conditions in Ukraine. On the other hand, in Ukraine, the likelihood of the government failure is higher than in EU countries, which reduces the ultimate effectiveness of state aid. It means that greater caution needs to be exercised than in the EU when providing state aid.

The draft law proposed by the AMC replicates the basic provisions of the EU legislation and makes the AMC position similar to this of the European Commission regarding state aid. However, EU legislation does not reflect conditions in Ukraine. For instance, the AMC is not a supranational body, but operates as a part of national process of forming state policy. This means the procedures in the law need to be adapted to conditions in Ukraine, for example by distributing powers among competent government bodies.

5. How to reform state aid in Ukraine

The principles on which state aid is based should be reformed along with changes to the legislative base for all types of public spending. Among others, it would be useful to institute principles in Ukraine’s legislation that allow for public money to be spent only for the purpose of reaching public objectives. For such provisions to work, there needs to be a clear system of objectives and clear procedures for expenditures. The performance criteria for each type of spending also need to be clearly spelled out.

Box 2: Essential points in state aid reform:

- The framework law on state aid should be adopted.
- This law should follow generally-accepted principles of public administration, including non-interference, independence of institutions, accountability, transparency, and limitations as to timeframes and spheres of influence.
- This law should include elements of prior control so that propositions regarding new forms of state aid and changes to existing mechanisms of state aid are first checked by a competent body.

It is critical that special legislation governing state aid be adopted. Such a law should follow international principles for providing state aid that are reflected in the legislation of the European Union:

- **Minimizing interventions:** Any form of state interventions affects the market mechanism limiting competition. Thus, if state support is inevitable its negative impact on competition has to be minimized.

- **Independent institutions:** Regulation and oversight of state aid need to be handled by an independent agency following clear and transparent procedures. Moreover, control over the allocation and provision of state aid needs to be in the center of attention to define clear rules and stages of this control. Proper oversight should help improve the effectiveness of state aid and reduce the cost of providing it in the first place.

- **Evaluation:** Evaluations of the actual need for state aid, its likely effectiveness, and its impact on the public good and competition is critically important.
− **Transparency:** Public access to information about state aid and its application should be guaranteed.

− **Limitations on time and scope:** The scope of state aid, its duration and coverage should be limited. The principle of gradual diminishment of aid should always apply.

− **Sector-based assistance:** Vulnerable sectors and special forms of assistance should be clearly defined to prevent the further emergence of state aid schemes with a special treatment.

This law should contain elements of prior control so that propositions regarding new forms of state aid and changes to existing mechanisms of state aid are first checked by a competent body. Moreover, the law on state aid should also indicate that such aid can only be provided if certain conditions have been met:

− In cases where an investment is being made to generate new jobs, state aid can only complement funding allocated by the company.

− The amount, duration and coverage of assistance should be proportional to the seriousness of the problem being addressed.

− The social profits, i.e., the cost of providing aid, should be greater than what would have been achieved had no state aid been provided.

− State aid is provided to projects during a necessary, but fixed time period within limits and on a scale sufficient to achieve the purpose for which it has been provided.

− The provision of aid must be transparent, which makes oversight easier.

Ukraine clearly stands to gain if it limits sector-based state aid and switches to horizontal and regional forms of aid instead. Horizontal aid can include fostering the development of small business, protecting the environment, research and innovation. It will be necessary to establish economic policy priorities and develop a clear set of instruments to support them — instruments that may not necessarily include state aid.

Experience in regulating and monitoring state aid in different countries shows that there is really no single approach to appointing the main agency to carry out these responsibilities. In the EU countries often the agency responsible for competitiveness policy also controls and monitors state aid. However, the AMC is not likely to have technical capacities to effectively control and monitor state aid. In particular, this relates to compulsory ex-ante impact assessment of state aid on competitiveness at a particular market. Besides, according to the Accounting Chamber’s audits the AMC does not efficiently fulfill its major obligations. Today the proper system of its influence on economic competitiveness and monopoly is not established. Besides, independence of the AMC, which is a necessary requirement to such authorized bodies in the EU, is under a question.

Given the realities in Ukraine today, it makes sense to consider introduction of a transition model at first. In particular, during several years it would be required to appoint two bodies that would be responsible for different aspects of state aid. Because of the logical mesh between state aid and the regulation of competition, the Anti-Monopoly Committee could be the right candidate to conduct assessment of the impact of state aid on competition both within the country and beyond its borders, along with other control and oversight functions.\(^2\) Given that reporting on state aid should be a component of fiscal accountability, the Ministry of Finance is likely to be a most appropriate authority for monitoring and inventory state aid, especially since organizing the reporting system

\(^2\) The point is that oversight criteria for state aid should be in line with international requirements, especially with WTO membership and the draft FTA with the EU. Of course, this should normally not get in the way of consultations between the AMC and the Ministry of Trade and Economic Development (MTED) on issues related to meeting WTO commitments.
requires the participation of entities that are subordinate to the Ministry of Finance. For such a model to work effectively, there need to be clear rules for providing state aid and effective cooperation between the two agencies. If one of these components is missing, the system is unlikely to work properly.

In the longer run, after reaching actual independence and required capacities the AMC could become a single authorized body responsible for state aid regulation.

Having clear rules for providing, overseeing and monitoring state aid will encourage greater efficiency in budgetary spending, improve the investment climate, and increase institutional capacity of government bodies.

The transition model should be applied. The Anti-Monopoly Committee could be the right candidate to conduct assessment of the impact of state aid, along with other control and oversight functions, while the Ministry of Finance is likely to be a most appropriate authority for monitoring and inventory state aid.

6. In lieu of conclusions

This analysis shows that the rules for providing state aid are neither clear nor transparent in Ukraine right now. Nor is there any legislation that might establish the conditions for approving such assistance and the agencies that would be responsible for inventorying and overseeing the provision of such aid. Today, state aid is completely discretionary in Ukraine. Apart from budgetary reporting, there is no accountability for providing state aid, which is in contradiction to the principle of open public finances. Moreover, the ineffectiveness of state aid leads to considerable public cost and the lack of oversight allows it to distort competition. This, in turn, creates a poor investment climate.

Today, the Government has plans for reforming the state aid system. In particular, the Concept for Reforming State Aid envisages such steps as approval of the Law on State aid, inventory of state aid being provided, clear definition of responsibilities of authorities to conduct an oversight and monitoring. All these steps should help make the system more effective. And this means that state aid to commercial entities could eventually stimulate economic growth with a minimum of negative impact on competition.
MISSION
Presenting an alternative point of view on key problems of social and economic development of Ukraine.

GOALS
Providing top quality expertise in the field of economy and economic policy-making.
Acting as real leader of public opinion through organisation of open public dialog.
Contributing to the development of economic and political sciences as well as promoting development of Ukrainian research community.

PUBLICATIONS

Monthly Economic Monitor Ukraine (MEMU)
The MEMU contains a monthly review and brief analysis of the key economic policy measures and data that come public during the previous month. The MEMU supplement presents extended analysis of one key event in the Ukrainian economy. There are 12 issues per year disturbed among subscribers.

Macroeconomic Forecast of Ukraine (MEFU)
The MEFU includes forecast of the GDP and its components, fiscal indicators, balance of payments, inflation, exchange rate for current and next years. There are 12 issues per year – 4 quarterly issues and 8 updates with short comments – disturbed among subscribers.

Infrastructure Monitoring of Ukraine (IMU)
The IMU is an annual report that presents information on the restructuring of six key infrastructure sectors of the Ukrainian economy in a standardized manner, which allows for cross-industry comparisons. Monitored indicators are qualitative and fall into three broad categories: (1) commercialisation, (2) tariff reform, and (3) regulatory and institutional development. Twenty-one indicators allow for economic and policy-making analysis at different aggregation levels. It is distributed free of change.

Economic Summary for Ukraine
Economic summary is a review and brief analysis of the key economic indicators and policy measures of the year. It is published in January using the available statistics and annual estimates and updated in May when the most of previous year data becomes publicly available. The product is distributed among subscribers.

Business Tendencies Survey
Business Tendency Surveys are comprised of two surveys. The first one – Industries – is prepared on the basis of quarterly surveys of industrial enterprises managers. The second – Banking – is based on the survey of banks managers. There are four publications for each of the component of the Business Tendencies available to participants of the surveys and to subscribers.

Policy papers
The policy papers are the joint product of the German Advisory Group for Economic Reforms in Ukraine and the IER aimed at providing economic policy recommendations to Ukraine’s policy makers. The recommendations are based on the careful analysis of Ukraine’s situation, state-of-the-art economic theory, and best international practices. The papers are available for policy makers and – with some time lag – for general public.
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